The Relevance of SEACEN in a Turbulent World[1]

Honourable Governors, Deputy Governors, Managing Directors, delegations from SEACEN central banks, distinguished experts, and panellists, Dr. Mangal Goswami and the SEACEN team, and my colleagues from the Reserve Bank of India.

I join previous speakers in expressing my gratitude to you all for your participation in the rousing discussions that took place today. As this conference draws to a close, I note with great satisfaction the richness and depth of the insights provided in keynote and special addresses, and in the panel discussions about the global economic outlook; the lessons learnt from the fight against the recent worldwide surge in inflation; the financial stability implications of monetary policy actions; and financial inclusion and the role of digital public infrastructure. We live in challenging times, with divergent pathways characterising our jurisdictions, but our common commitment to macroeconomic and financial stability will shine light on the way ahead.

There is broad consensus that the centre of gravity of the global economic order is moving eastwards to Asia. The January 2024 update of the IMF's World Economic Outlook upgrades the outlook for Asia's growth relative to its October 2023 projections, rendering it the fastest growing region of the world[2]. This growth performance is expected to be underpinned by the resilience of domestic drivers. Overall, Asia will likely contribute about two-thirds of global growth in 2024, a carryover of its blockbuster performance in 2023. Another noteworthy development is that disinflation is expected

[2] https://www.imf.org/en/Publications/WEO/Issues/2024/01/30/world-economic-outlook-update-january-2024

to remain on track in Asia and convergence with central bank targets is being sighted. Thus, the outlook for Asia in a stormy and unsettled global environment is one of sustained growth with stability.

Within Asia, the group of nations served by SEACEN will likely be its main engine of progress. This presents exciting opportunities as well as trials and tribulations. According to a recent Suara SEACEN blog, the challenges that our central banking community has flagged are changing workforce demographics, the rise of financial products and services beyond the conventional definition of banking, digitalisation, climate change, talent shortages and persistent supply shocks, apart from the pandemic and the recent inflation experience[3]. It is in this context that SEACEN assumes importance as a supra-national public good committed to building capacity and fostering networking and collaboration in our region. Emboldened by its contributions, I would like to focus on the economic transformation of the economies that have constituted the SEACEN as the theme of my address.

Some Stylised Facts

The countries comprising the membership of SEACEN are home to 45 per cent of the world's population. The share of SEACEN economies in the world economy – measured by the ratio of their combined gross domestic product (GDP) to global output - has risen from 9 per cent at the turn of the century to 27 per cent in 2023. In terms of purchasing power parity (PPP), SEACEN members account for more than a third of global GDP. In terms of per capita GDP at current prices, member countries range from lower-middle income to high income categories, but a common characteristic is that they are high saving economies barring a few

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[3] Future Proofing Central banks through Leadership Practices, posted on December 14, 2023 by Donna Lumbo.

outliers[4]. On a PPP-weighted basis, the average saving rate of SEACEN economies is estimated at 37 per cent of combined GDP, and the weighted average investment rate is estimated at 36 per cent. While bearing out the existence of the Feldstein–Horioka puzzle[5], this is also indicative of the predominant role of domestic resources in driving investment and growth in the region[6].

The SEACEN group of countries is also a power house of international trade. It accounted for 31 per cent of world exports of merchandise in 2022 according to the World Trade Organisation (WTO), attesting to its international competitiveness and its central position in global supply chains. The SEACEN group also absorbs 28 per cent of world imports of merchandise, thereby underscoring the vital role it plays in boosting net global demand.

According to the United Nations, the SEACEN group region is expanding its footprint in the frontline area of digital trade, estimated at US$ 3.9 trillion globally in 2022. Although information on digital trade for each of the member countries of the SEACEN is not uniformly available, it is noteworthy that the Asia-Pacific region exported digitally deliverable services valued at US$ 958 billion, representing 52 per cent of the region's total services exports[7]. In fact, the digital landscape in each of our economies has swelled in recent years, encompassing an array of innovations from manufacturing automation to e-commerce platforms, all the way to digital payments. Asia has led the installation of industrial robots in recent years, spearheaded by members of the SEACEN.

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[4] Cambodia; Papua New Guinea.
[5] Feldstein, Martin; Horioka, Charles (1980), "Domestic Saving and International Capital Flows", *Economic Journal*, 90 (358): 314–329.
[6] Data are drawn from the IMF's World Economic Outlook Database, October 2023.
[7] "Unleashing Digital Trade and Investment for Sustainable Development", *Asia-Pacific Trade and Investment Report 2023/24*, December 2023.

There are notable differences among the SEACEN member economies too. Illustratively, gross general government debt to GDP ratios range widely between 2 and 168 per cent, pointing to high variations in fiscal stances, although the median ratio at 58 per cent compares favourably with that of advanced (112.7 per cent) as well as emerging market and middle-income economies (68.6 per cent)[8]. Similarly, external current account balances range widely from deficits of above 10 per cent of GDP to surpluses of close to 17 per cent[9].

The region is also a preferred habitat for international financial flows to which I shall come back shortly. Positive growth differentials *vis-à-vis* the rest of the world, deep and vibrant financial markets and reasonable stability in financial asset prices contribute to the relative attractiveness of these economies in drawing capital flows. On the other hand, global spillovers from geopolitical developments, geoeconomic fragmentation and the tightening of financial conditions as a result of the aggressive and synchronised monetary policy tightening worldwide have imposed downward pressures on currencies in the region, resulting in widening of risk spreads and reversals of portfolio equity and debt flows.

These stylised aspects of economic performance reflect the growing economic heft of the SEACEN configuration and the locomotive of global growth it is shaping up to become in the medium-term. Against this backdrop, I will now turn to a few areas that have engaged policy attention among SEACEN central banks in the recent period as seen through the lens of valuable research undertaken at the SEACEN centre.

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[8] https://www.imf.org/external/datamapper/GGXWDG_NGDP@WEO/OEMDC/ADVEC/WEOWORLD
[9] IMF's WEO Database, October 2023.

Managing Capital Flows

Right from the establishment of the centre, SEACEN member central banks have expressed an abiding interest in the management of volatile capital flows, especially in mitigating risks to price and financial stability. SEACEN central banks' successes in addressing these challenges are now helping to forge a new consensus on appropriate risk analyses, policy instruments and frameworks as well as proactive policy responses.

A recent book publication by the SEACEN Centre reveals interesting insights into this experience[10]. Capital inflows to SEACEN member economies have more than doubled from an average of around US$400 billion in 2000-2010 to over US$900 billion in 2011-2021. Multinational enterprises (MNEs) have been prime movers in the form of within-company credits reflected in FDI debt flows, trade credits and cross-border bank deposits. The banking sector, the second largest recipient of capital flows, is facing rising competition from non-bank financial institutions (NBFIs) in cross border financial intermediation. The period 2011 to 2021 also witnessed the significant rise of non-resident bond issuances mostly by the public sector, marking a move towards market-based finance. The volatility of capital inflows into SEACEN economies declined between 2000-2010 and 2011-2021; however, the variability of portfolio equity and trade credit and advances flows rose.

These evolving patterns highlight shifts in drivers and sectors and hence the need for varied responses. Generally, SEACEN economies have loosened capital flow measures (CFMs) while macroprudential measures (MPMs) were mostly tightened.

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[10] "*Challenges and Options in Managing Capital Flows for Small, Open, and Financially Integrated Economies*" (2023), The South East Asian Central Banks (SEACEN) Research and Training Centre.

Monetary Policy and the Cost of Disinflation

The conduct of monetary policy has been a subject of animated interest in the SEACEN Centre and its membership, igniting a proliferation of work on the theme. In 2022, the interest rate cycle turned after several years of global accommodation and aggressive rate increases occurred in response to the sharp and persistent rise in headline inflation. The aim was also to prevent potential second round effects – most notably the wage-price spiral - and from a SEACEN members' perspective, to stem possible capital outflows due to the unparalleled increase in US interest rates. During 2022 and 2023, most Asian economies reported higher than envisaged inflation rates. A February 2023 Bangko Sentral ng Pilipinas survey indicated that private households expected inflation to edge up towards the upper limit of its inflation target[11]. In response, practically all central banks in the region raised main refinancing rates, leading to tighter financial conditions. Estimates at that time pointed to subdued GDP growth forecasts, down from 5.5 per cent in 2022 to 4. 7 per cent in 2023[12]. A working paper from the SEACEN centre provides estimates of the sacrifice ratio – the loss of output to achieve a reduction in inflation by one percentage point – for select SEACEN member countries[13]. For the region as a whole, it estimates with several caveats that the cost of a one percentage point reduction in headline inflation is between zero and 0.5 per cent of GDP. The extent of contraction in output was found to diverge widely across the membership. A factor potentially affecting monetary policies of member central banks was identified as the stance of US monetary policy.

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[11] Bangko Sentral ng Pilipinas. (2023). Business Expectations Survey. 2nd Quarter 2023.
[12] Asian Development Bank. (2022). Asian Development Outlook Supplement. December.
[13] Dierks., L. H. (2023): "Inflation, Monetary Policy and the Sacrifice Ratio: The Case of Southeast Asia", *SEACEN Working Paper 01/2023.*

Central Bank Digital Currencies

The growing interest in digital forms of payments worldwide has led SEACEN central banks to explore the possibilities of central bank digital currency (CBDC). Although still in various stages of experimentation in different member countries, the central tendency seems to be a CBDC design under a two-tier hierarchical structure implemented by using public-key cryptography, with the central bank as the root certificate authority for generating digital signatures, and other financial institutions as intermediate certificate authorities. An important design feature is the capability to create secure point-to-point online payments through the use of authorised hardware. The overarching goal for developing CBDC as digital cash among the SEACEN central banks appears to be to create a resilient payment system for consumers and businesses to transact in any situation.

SEACEN central banks are actively coordinating their efforts to develop CBDCs, with near real time exchanges of information on progress. Bank Indonesia is pushing ahead with trials of the digital Rupiah for wholesale interbank settlement. The BIS led Project Dunbar involving the Central Bank of Malaysia and the Monetary Authority of Singapore, has developed two prototypes for a shared platform that could enable international settlements using digital currencies issued by multiple central banks. Bangko Sentral ng Pilipinas (BSP) announced in September 2023 that it will use the Hyperledger Fabric blockchain for its first wholesale CBDC trials under Project Agila. Singapore has started Project Ubin which is aimed at solving challenges faced by the financial industry and the blockchain ecosystem. In Sri Lanka, the central bank is working on a proof of concept for its board before proceeding to a pilot. Thailand's Project Inthanon aims to explore the potential of CBDC for interbank settlements.

South Korea will start a pilot for a CBDC involving 100,000 citizens in 2024. Cambodia launched Project Bakong, a blockchain-powered retail payments system that allows interoperability among the different players in the country's payments landscape by using a tokenized deposit system. Hong Kong's pilot, which involves 16 banks and payment companies, tested six potential uses of the e-HKD. India is conducting pilots in both retail and wholesale segments. Myanmar, Lao PDR, Nepal and Vietnam are in various stages of research.

Big Data Applications

To quote Dr. Mangal Goswami in his eloquent foreword to the survey on *Big Data Applications in Monetary Policy and Financial Stability for SEACEN Member Economies: The Case of Indonesia*[14] as part of the SEACEN centre's research project, the use of big data and the associated data analytical techniques is inexorably moving forward in central banking, including in many SEACEN member central banks and monetary authorities. Asian central banks, he pointed out, are some of the most enthusiastic adopters of big data and the associated analytical toolkit such as natural language processing, nowcasting/monitoring exercises and applications to extract economy insights as well as suptech/regtech solutions.

Machine learning has also been used extensively in Asia for research purposes to inform monetary policy decisions, facilitate data management and support regulatory supervision. Dr. Goswami does well to cite the challenges that come along with the analytical opportunities of big data, namely, data management and governance, high upfront costs, legal

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[14] Bank Indonesia. (2023): "*Big Data Applications in Monetary Policy and Financial Stability for SEACEN Member Economies: The Case of Bank Indonesia*", SEACEN, July.

issues around privacy, the adequacy of the IT infrastructure and most importantly, the necessary human capital. Moreover, big data creation has migrated from the public sector to the private sector, bring in issues relating to data sharing and communication challenges.

According to the 2020 Irving Fisher Committee on Central Bank Statistics survey[15,16] to which most of SEACEN members contribute, the share of central banks and supervisory authorities adopting big data and machine learning has risen to 86 per cent in Asia, involving nowcasting exercises, applications to granular financial data, and suptech/regtech applications. The survey cites the computation of the economic policy uncertainty (EPU) indices in India. Other applications in Asian central banks include using text analysis to: i) evaluate monetary policy credibility; ii) ensure consistency in central banks' communication of supervisory issues to financial institutions; iii) improve efficiency in the compilation of statistics; iv) assess the state of the labor market or of trade conditions; v) extract information on tourism activities; and vi) capture firms' sentiment or evaluate employees' feedback. Another important area relates to fraud detection - one third of surveyed Asian central banks deploy big data algorithms for anti-money laundering/combating the financing of terrorism (AML/CFT) purposes.

Climate Change

Climate change poses a common and potentially overwhelming macro-financial risk for all SEACEN member countries. The alarming rise in the incidence and intensity of extreme weather events in our region in recent

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[15] Bank for International Settlement (2021). Irving Fischer Committee on Central Bank Statistics: 2020 IFC Annual Report. January.
[16] Cornelli, G; Doerr, S; Gambacorta, L & Tissot, B (2022): "*Big Data in Asian Central Banks*". Bank for International Settlements. IFC Working Papers. No 21. February.

years relative to the historical record is causing large agricultural losses, threats to transport infrastructure, risks to manufacturing supply chains, tourism and exports and translating into credit risks for banks as well as tightening of financial conditions.

For instance, the results of a structural vector autoregression panel analysis conducted in 2022 at a SEACEN Centre-National Bank of Cambodia-IMF STI seminar[17] estimates that risk premium on account of climate vulnerability in sovereign bond yields in the south East Asian region is as much as 155 basis points as compared with 113 basis points for other EMEs (other than high risk ones). Impulse responses show that bond yields rise in response to a climate shock and the shock becomes permanent after 12 quarters.

Conclusion

56 years ago, Gunnar Myrdal, winner of the Nobel prize for economics in 1974, made a Malthusian prophecy of stunted economic growth in Asia in his *magnum opus* **Asian Drama: An Inquiry into the Poverty of Nations**. In his words: "…countries are in constant danger of not being able to lift themselves out of stagnation or even of losing ground as far as average income levels are concerned."[18]

The preface of the Asian drama starts with the words *habent sua fata libelli* - books have their own destiny; but as Asia has shown, economic development too has a life and rhythm of its own. Over the last three decades and looking ahead, the dramatic rise of Asia has proved Asian Drama wrong. Macroeconomic performance of the region is standing out

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[17] Details of the seminar are accessible at:
https://www.imf.org/en/News/Seminars/Conferences/2022/12/01/120522-seacen-imf-sti-high-level-seminar-on-policy-challenges-and-peer-learning-event-on-climate
[18] Myrdal, Gunnar (1968). *Asian Drama: An Inquiry into the Poverty of Nations''*. New York: Twentieth Century Fund Study, Pantheon.

in a world that is expected to experience its slowest growth in three decades, according to the World Bank. The membership of SEACEN is at the forefront of this transformation and their central banks are leading the way forward.

Thank you for your patience.