Roong Mallikamas: Keynote speech - Central Banking Asia Summit

Keynote speech by Ms Roong Mallikamas, Deputy Governor of the Bank of Thailand, at the Central Banking Asia Summit, Bangkok, 24 July 2024.

* * *

Distinguished guests, ladies and gentlemen,

A very good morning to you all. First, let me thank Central Banking for inviting me to deliver the keynote address at this year's Asia Summit. This event offers a good opportunity for us central bankers to share our views on the trends and innovations that shape our economies.
But beyond this two-day seminar, I hope the networks we build here will help foster ongoing dialogues on regional collaboration, especially in addressing the challenges facing emerging market economies, and in exploring digital currency developments, cross-border payments and future trends.

Today, I will share with you my thoughts about the changing global context we are navigating through, from more fragile global economies to geopolitics and the advancement in digital technologies. I will then touch on how this has created challenges for us small open economy central banks – both in delivering on traditional mandate and in meeting expectation in emerging areas. And finally end on a positive note – how we can overcome these challenges by leveraging on innovation and collaboration at many levels.

Part I – Global context

On the context, the global economy is in a fragile condition – having gone through the pandemic and crisis after crisis. Most legacies of the pandemic are still with us til this day – more debts, less policy buffers, lower potential growth, and high inflation.

Let me start with inflation.

- After a long-dormant phase during the Great Moderation of the 1990s and low inflation post-GFC, inflation has risen and gained the attention of central bankers worldwide. Inflation in advanced economics (AEs) had average around 1.5% for the past decade but shot up to around 7% in 2022. Then came the synchronized tightening monetary policy around the world that gradually brought inflation down.
- While emerging market economies (EMEs) faced similar inflation developments as AEs, with inflation nearly doubled from 5% in 2010s to nearly 10% in 2022, there are vast differences in inflation dynamics and disinflation process across region. In ASEAN-5, inflation averaged around 5% in 2022 and is expected to come down to around 2.5% this year, while in emerging market Europe, Latin America and Africa, inflation averaged more than 15% in 2022 and will remain elevated this year before slowly coming down in 2025.

On the fiscal front, the buffer is increasingly eroded.

- Governments were called upon to provide assistance during COVID-19, resulting in fiscal deficits nearly tripled from 3.6% in 2019 to 9.5% in 2020. Although some countries started the consolidation process during 2021 and 2022, more crises unfortunately erupted – starting with the war in Ukraine and the accompanied cost of living crisis, then conflicts in Gaza – and both AEs and EMEs once again dipped into the government's purse. With one crisis after another, fiscal support cannot be withdrawn even with the pandemic being five years behind us. As a result, we only see a slow pace of fiscal consolidation – with deficit globally remaining above pre-pandemic level at 5.5% in 2023 and is expected to be more than 4% each year until the end of this decade[1].
- Consequently, total government debts worldwide are on an ever-increasing trend, from 84% of GDP pre-COVID to 94% in 2024 and almost 100% of GDP by 2029. On a longer horizon of 30 years, the IMF expects the gross debt to GDP of the US and China – the two biggest economies in the world – to double to 240% and 163% of GDP, respectively.

Pandemic and war-induced shocks further complicate existing structural challenges that have not been addressed – but we are now left with even less policy space to deal with them. Potential growth worldwide has been revised downward due to lower productivity, with one of the underlying causes being "aging society". Major economies face a demographic transition, with declining fertility rates and a shrinking share of working-age population. These demographic shifts have a direct bearing on global labor supply. By 2030, the IMF projects global labor supply growth to be only 0.3% – a fraction of its pre-pandemic average. While these trends were evident before 2019, the pandemic exacerbated the drop in labor participation, especially in emerging markets. Some countries, such as Thailand, also emerged from the pandemic with a deteriorated household balance sheet. This can have strong implications when interest rates are raised to temper inflation but income growth is harder to come by because of lower productivity and cannot act as a tailwind. Overall, there is less room to maneuver, but in hard times, there is often higher expectation from the public for governments and central banks to shore up the economy, not to mention to deal with other structural issues and climate change.

The second context is the return of politics and geopolitics to the forefront of policymaking. Risks of further geoeconomic fragmentation and domestic political tensions make it even harder to collaborate both at home and abroad.

- In the short term, we already see trade restrictions around the globe tripled from around 1,000 measures pre-COVID to around 3,000 in 2023, according to the IMF. One of the consequences is that the two biggest economies slow down trade with each other [4.2% growth in 2016–2018 to 1.9% growth in 2019–2023] and shift to trade more with the rest of the world. This trend is also likely to continue into the future as foreign direct investment into ASEAN grew by 40% since 2017, leading by the US and China.
- In the medium term, increasing tariff and reshoring could further challenge the objective of low and sustainable inflation, while ongoing reconfiguration of investment and supply chain could make economies more prone to disruption.

The third is rapid advancement in digital technologies that support payment innovation, new business model for financial services, and advances in AI that could be incorporated in many dimensions of banking. Such advancement leads to opportunities and unprecedented level of cross-country collaborations, as reflected in digital currency projects and cross 98 border digital payments linkages, but they have also exposed us to risks such as faster and more sophisticated fraud, as well as digital divide.

Part 2: Challenges of Small Open Economies/EMEs' central banks and what we do to overcome the challenges and be 'future ready'

All of these backdrops amplify old challenges and create new ones. I think there are primarily 3 challenges which this context presents to us. The first is that our task in ensuring macro-stability is much harder given limited policy space but higher expectation. The second challenge is to ensure the financial sector serves its purpose in allocating resources efficiently – with a pursuit to build a financial landscape that embraces innovation to help address legacy problems rather than worsening them. The last challenge is to reap benefits of technologies and innovations in building resiliency of the economy and addressing the risk of geopolitical fragmentation.

[Challenge 1: Macro stability] First, the changing context makes the job of ensuring both macroeconomic and financial stability harder.

- Lower growth and limited policy space leave smaller room for maneuver. Nature of inflation dynamic itself is also changing with inflation increasingly driven by supply-side factors outside of the central bank's control, such as geopolitical tension and supply chain reconfiguration. For example, in Thailand, oil and food price movements account for approximately 65% of overall price changes during the past 2-3 years. And we will continue to face persistent supply-side price pressures going forward as countries form stimulus strategies around concerns regarding geopolitical tension and supply chain reconfiguration. Secular trends such as digitalization and technological advancements and green transition will likely lead to large-scale adjustments in relative prices as well. This comes at the time when the public has higher expectation, not just to deliver on traditional issues but also new emerging ones, while the tools that central banks can use are quite limited and constrained.

[Solution 1] To deal with this challenge, we need to first ensure robust policy framework and to ramp up our efforts in policy coordination at many levels. Both missions are of first order importance if we are to maintain credibility and public trust that allows us to work on other very challenging emerging areas.

Let me lay this out in a three-step approach:

Step 1: Monetary policy needs to prioritize domestic conditions while policy mix needs to be tailored to country-specific contexts. Moreover, policy decisions should be made with a risk management mindset, to preserve policy optionality. Monetary policy must look through the noise and, as suggested in this year BIS Annual Economic Review, the focus should be on robustness to broad range of scenarios, awareness of any longer-term costs or side effects, and sufficient safety margins or room for maneuver.

Step 2: Macro-financial policy coordination is a critical step in ensuring that we use our limited policy space in an effective manner. In the case of Thailand, higher legacy household debt post-pandemic requires good coordination of monetary policy with other complementary tools such as targeted financial policies to address heavy debt burden in specific segments and other macroprudential measures to ensure better new lending practice. We should be mindful that trust in the central bank applies to all domain of central banking. Any gaps or pain points on the banking side, such as a rise in fraud cases or even IT outage that disrupts financial services, will have repercussions on central bank credibility and trust and ultimately on the effectiveness of monetary tools necessary in fulfilling our core mandate.

Step 3: Since public policy requires public trust, it is important to ensure coordination across public policymakers, particularly the government and the central bank, and to ensure transparency and accountability.

At a fundamental level, this starts with the central bank having established transparent communication with the government to ensure accountability. For the Bank of Thailand, our accountability mechanism involves issuing the Open Letter addressing the rationale to the Ministry of Finance in case inflation falls outside the target range[2].

In the era of rapid information dissemination and easy access to social media, misinformation or misinterpretation could spread easily and wider than before. Effective communication therefore does not just mean publishing press releases or doing surveys of business sentiment. It also involves preemptive steps, such as the use of social listening to identify issues that are top-of-mind concerns of the public and could evolve and undermine the trust of the central bank. Then plan out scenarios and appropriate engagement strategy before the problem morphs into something more damaging. In a broader sense, effective communication does not just aim to correct the misinformation, but also to set healthy expectation for the public regarding the work and the mandate of the central bank.

[Challenges 2: Financial landscape] Second challenge is how to adapt financial landscape to address underlying problems in our financial system as well as capture opportunities from innovation to support new business model and financial services.

The real challenge lies in improving financial inclusion for the underserved groups, while at the same time not fueling further indebtedness for the structurally weak ones. In the case of Thailand, SMEs usually face much higher cost of financing, part of the reasons being that financial institutions lack data to appropriately assess their underlying risks. We believe more efficient financial solutions have the potential to bring their cost of financing down.

[Solution 2 3O's, AI/Fraud] Resolving this will require new thinking on regulations, allowing new players with different business models to come into market and better utilize data – while ensuring a level playing field.

So what can central bank do to reap benefits of new technologies and both address legacy issues and future ready our financial landscape? – again to maintain trust in the central bank and the financial system.

While we understand that each country is different and what is suitable for Thailand may not be suitable for others, let me share with you our thinking at the Bank of Thailand on how we as a policymaker and regulator can shape financial landscape of the future. BOT has issued the Financial Landscape Consultation Paper outlining crucial steps to reposition the financial sector, supporting a sustainable digital economy. The cornerstone of this strategy revolves around the "3-Open" principles - Open Data, Open Infrastructure, and Open Competition - to foster innovation and enhance financial services.

(1) Open Data facilitates easier data exchange such as promoting mechanisms in which consumers can transfer their own data from one service provider to another more conveniently. This will enable new financial services and address the problem of SMEs' access to finance due to data scarcity. By leveraging micro-level data, including behavioral insights from transactions, Open Data promotes analytical advancements and innovative service development.

(2) Open Infrastructure aims to allow service providers to access financial infrastructure at reasonable costs. In Thailand where the financial sector has been predominantly bank-based and incumbent banks already made significant resource contributions in the early stage of key infrastructure development, opening up access to nonbanks requires some public intervention, for example in fee negotiation and the governance structure of the infrastructure. Nonetheless, this is necessary to foster competition that benefits both the public and diverse business sectors.

(3) Open Competition promotes a level playing field, encouraging incumbents and new entrants to innovate and meet consumer demands effectively. This principle aims to cultivate a balanced ecosystem where competition among players with similar as well as different risk appetites drives continuous improvement in financial services.

- One of the key policies is the introduction of Virtual Banks as new players into the financial landscape. The objective is to allow applicants who possess the expertise in technology, digital services, and data analytics to offer financial services efficiently through the digital channel and better serve the needs of each customer segment, particularly the unserved and underserved segments of retail and SMEs customers. Working toward this objective is a challenge as we want to see Virtual Banks truly bringing new value proposition with lower operating costs, optimized processes, and enhanced user experiences.
- Looking ahead, optimizing data flows is critical. Finding ways for banks, Virtual Banks, and nonbanks to better utilize data is essential for improving financial services extensively and intensively. However, navigating the regulatory landscape, which currently lacks robust legal frameworks, demands creative execution to achieve these goals effectively.

Another group of issues, namely AI and fraud, are new developments that could pose risks to our financial system. While fraud maybe as old as time, the emergence of social media, fast payment and AI has super-charged them to the new prevalence and speed with scam easier to commit. Fraud is also increasingly borderless; it could be committed by someone in one jurisdiction while money moves through accounts in others including through crypto.

- Solving this complex issue will surely require work on financial literacy and domestic regulation and supervision at a fundamental level. We need to also work on addressing the entire life cycle of fraud in a holistic manner, so there is no leakage or bottleneck that would erode effectiveness. Moreover, given its complexity and potential to attract public criticism, we must focus on efficiency, tackling the spot with bigger return to effort, for example, how to prevent money from getting into a mule account in the first place for that would be more effective and easier to unwind than to stop money from being drawn out of a mule account once already in. Given most of the fraud cases are now committed online, working with relevant authorities and social media/e-commerce platform to make it harder for fraudsters to advertise and scam people will be an extra critical step as well.
- But working on domestic fronts is not enough given its borderless nature; this is the challenge we cannot walk alone. To cope with digital crime, we would need greater collaboration among countries at regional and global levels to identify risks, find solutions, and come up with a rulebook or international guidelines that facilitate data sharing or collaboration. Without this cooperation, differing standards of domestic fraud will create the weakest link and make dealing with cross-border fraud much harder.

[Challenge 3: Geopolitics and how to create resiliency] The last challenge concerns how to make economy more resilient and robust to risk scenarios as geopolitical tension increases and technology advances.

Apart from addressing gaps in our current financial system above, what most central banks have learned from global economic uncertainty is to explore alternative infrastructure as a volatility mitigation or risk mitigation option. Like many EME central banks, the Bank of Thailand has been exploring and using technology to enhance both the efficiency and resiliency of our financial system. There are two main areas that our region already has partnerships, namely cross-border payments and local currency usage.

1. Cross-border payment linkages

Given our regional economic linkages, it makes sense for the central banks to develop cross-border payment linkages that facilitate real economic activities and welfare. Central banks play a role in ensuring that such infrastructure is open and inclusive enough – to help address rather than worsen financial inclusion at a national level, and to avoid creating further fragmentation at an international level. In the case of Thailand, we started linking our payment system with Japan in 2018 and currently has bilateral linkages with 8 countries. Apart from bilateral linkages, Bank of Thailand, along with 4 ASEAN peers, initiated Project Nexus to showcase the potential of fast payment system (FPS) technology, in delivering faster, cheaper, and more transparent services. Our goal is to create a standardized payment platform that potentially serves as a global infrastructure, not just a closed-loop regional platform. This year we also have India joining and look forward to others participating in this initiative as well.

Likewise, we participate in Project mBridge to explore the potential of distributed ledger technology (DLT) in enabling instant cross-border payments and settlement, with an aim to solve some of the key inefficiencies in cross-border payments, including high costs, low speed and operational complexities.

2. Local Currency

On the rationale of local currency initiatives, it simply aims to provide the flexibility in terms of trade settlement. 60% of Thailand's cross-border trading activities occur within our region, with 8 out of 10 top trading partners being Asian countries. Therefore, it is our job to facilitate those activities both in normal times and in uncertain times.

We are aware that the volatility of major currencies can have significant impact on local players. Therefore, the Bank of Thailand promotes the use of local currency as one of the foreign exchange hedging mechanisms, acting as an alternative settlement or payment option for local businesses under circumstances of USD volatility. I am pleased that today my colleague, Mr. Sakkapop will share our local currency journey in the afternoon session.

Distinguished guests, ladies and gentlemen,

This brings me to the end of my remark. As we draw this session to a close, I want to share with you one final thought. As a regulator of the financial sector and a guardian of financial stability, we have the duty to continuously learn and adapt ourselves to embrace the emerging trends and innovations. While each of us may spend most of the time coping with challenges at home, we must not lose sight of the potential collaboration we could build, to help us navigate through the complexity of these contexts. I hope the insights and connections we have forged here will plant the seed for future collaboration as well.

Thank you for your attention, and I wish you all a thought-provoking and fruitful seminar

---

[1] Figures from IMF Fiscal Monitor and World Economic Outlook April 2024.

[2] Among the central banks in the world, Bank of England and the Bank of Thailand are the only two central banks that issue the Open Letter, while other central banks use press release or input such information in Monetary Policy Report.