Representative Office
for Asia and the Pacific

Navigating uncertainty in the global economy: central bank challenges in an era of change

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Introduction

Distinguished guests, colleagues, and friends, good morning. It is a privilege to address you today with my presentation **"Navigating Uncertainty in the Global Economy: Central Bank Challenges in an Era of Change."**

I am especially delighted to be here at the 41st Nomura Central Bankers Seminar in Kyoto – a city rich in history and culture – as we gather to discuss the most pressing monetary and economic challenges of our time.

Today's discussion comes at a moment when the global economic environment is fraught with uncertainties and rapid change. We face headwinds from escalating tariffs, increasing market volatility and structural challenges such as ageing populations, mounting debt and climate change.

At the same time, we are witnessing the transformative potential of artificial intelligence – a technological force that promises to reshape our economies and central banking practices.

Setting the stage

My remarks today will cover global growth outcomes, inflation dynamics and Asia's performance. I will then address the pressing challenges central banks face, and finally, explore how artificial intelligence is beginning to influence our work. Each of these topics is interconnected, forming the backdrop against which central banks' monetary policy decisions must be made.

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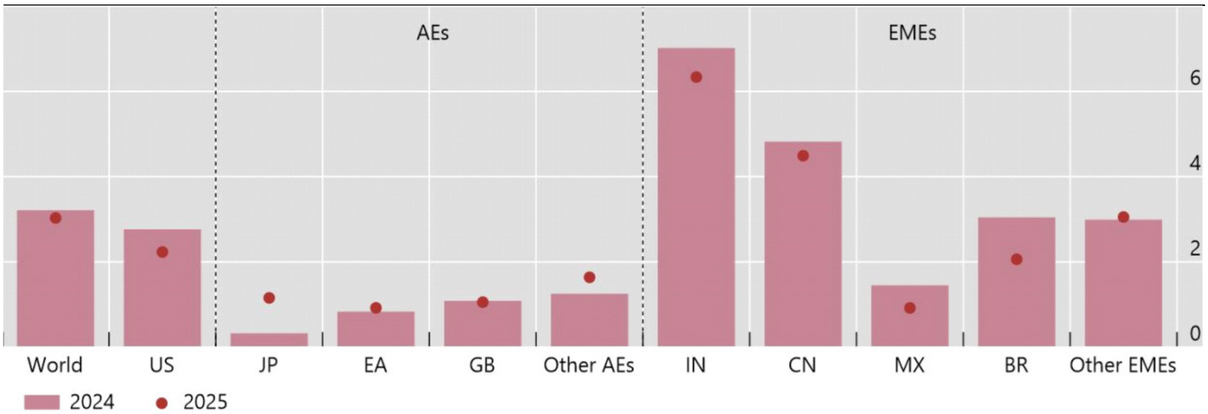
Global growth (Graph 1)

Despite heightened policy uncertainty, the soft-landing scenario is still intact[1]

In per cent Graph 1



[1] The bars represent the IMF *World Economic Outlook* forecasted values for 2024, while the dots show the forecasted GDP growth for 2025 in February 2025.

Sources: IMF; Consensus Economics; BIS.

The year 2024 was generally favourable when a soft-landing scenario appeared intact. However, within the first quarter of 2025, the global economic outlook has grown more unstable – characterised by increasing market volatility against a general backdrop of uncertainty, particularly regarding tariffs (Graph 1).

We at the BIS do not produce forecasts, but according to the latest IMF forecasts, global real GDP growth is projected at 3.3% both in 2025 and 2026, below the historical (2000–19) average of 3.7%.

However, growth remains highly uneven across economies.

Specifically, outside Asia-Pacific (about which I will give more details later). After a resilient 2024 for the US economy, consumer spending fell in January, its first drop in almost two years. Additionally, the United States faces strong headwinds from policy uncertainty and trade tensions, which has resulted in elevated market volatility in recent weeks.

In the euro area, growth has been subdued, largely reflecting continued weakness in manufacturing and goods exports even as consumption picked up in line with the recovery in real incomes. More recently, Germany's approval of fiscal spending has generated optimism through significant investments in infrastructure and defense. That said, looking ahead, concerns about Europe's long-standing structural weaknesses and trade policy uncertainty continue to weigh on growth.

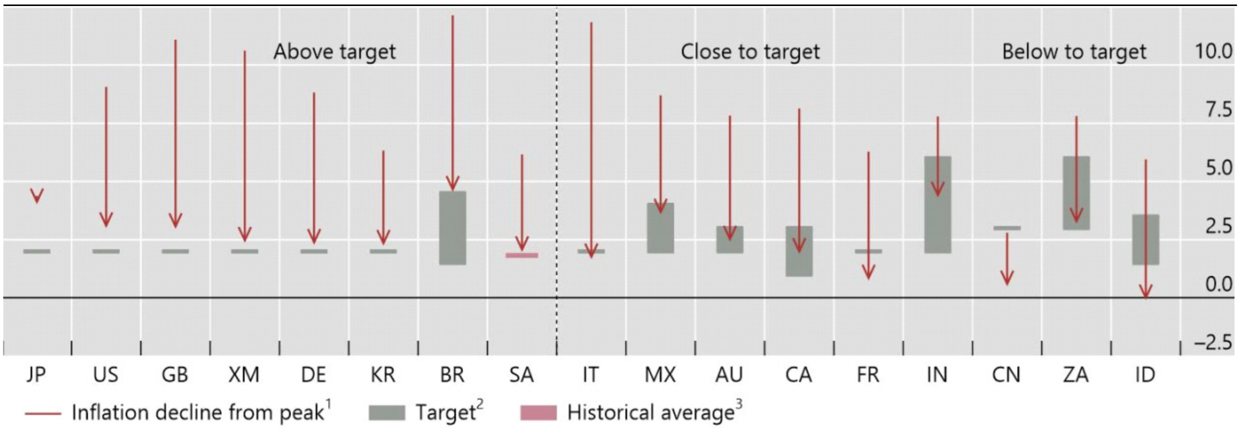
In Latin America, many countries have been severely affected by heightened uncertainties. In some, these uncertainties have started to affect business investment and consumer confidence. More specifically, Brazil's economic activity showed signs of easing, especially in the services sector, while Mexico's activity remained subdued.

Global inflation dynamics (Graph 2)

Inflation is forecast to converge gradually to central bank targets in most jurisdictions

Year-on-year changes, in per cent

Graph 2



[1] Headline CPI is used for cross-country comparability and may not correspond to the central banks preferred measure. Peak since 2021. Countries are sorted by distance of the latest value of headline inflation relative to the target (midpoint for those with an interval). [2] Inflation targets are official point targets, target bands, tolerance ranges or unofficial objectives announced by authorities. [3] Monthly headline inflation average for 1990–2019.

Sources: OECD; LSEG Datastream; national data; BIS.

Turning to inflation, while it is expected to continue to gradually return to central bank targets (Graph 2), the process remains uneven across economies.

In the United States, inflation declined further towards its 2% target. However, longer-term inflation expectations have started to pick up, perhaps reflecting the expected effects of rising tariffs. In the euro area, inflation decreased slightly in February, edging closer to the ECB's target of 2%, reflecting a drop in energy price inflation. Elsewhere, while many economies have seen inflation moving closer to central bank targets, some continue to experience sticky inflation due to higher commodity prices, supply chain disruptions and geopolitical risks.

This brings us to a critical point: monetary policy responses have become increasingly divergent. The Federal Reserve held its policy rate steady and signalled that it was "not in a hurry" to adjust policy any further. By contrast, many central banks eased policy in their first meeting of the year, including 25 basis point cuts by the ECB in late January, the Bank of England in February and the Bank of Canada in March. The Central Bank of Brazil raised its policy rate by 100 basis points on 29 January and affirmed guidance for an increase of the same magnitude at its next meeting.

This divergence in monetary policy has reinforced yield differentials and heightened financial volatility.

Turning to financial markets, volatility and uncertainty have been dominant themes, with escalating trade tensions and recession fears spurring significant fluctuations across various asset classes. US stock indices have experienced notable declines. For instance, the S&P 500 has fallen by almost 9% from its mid-February peak as of 18 March, reflecting investor apprehension about a potential economic slowdown. Meanwhile, European stock markets have recently seen notable gains, outpacing their US counterparts, reflecting optimism amidst increased German fiscal spending. Bond markets have also reacted, with US Treasury yields fluctuating as investors seek diversification from the United States amid equity market turbulence. There has been notable volatility in currency markets due to heightened concerns about geopolitics and tariffs, monetary and fiscal policy changes, and economic data releases.

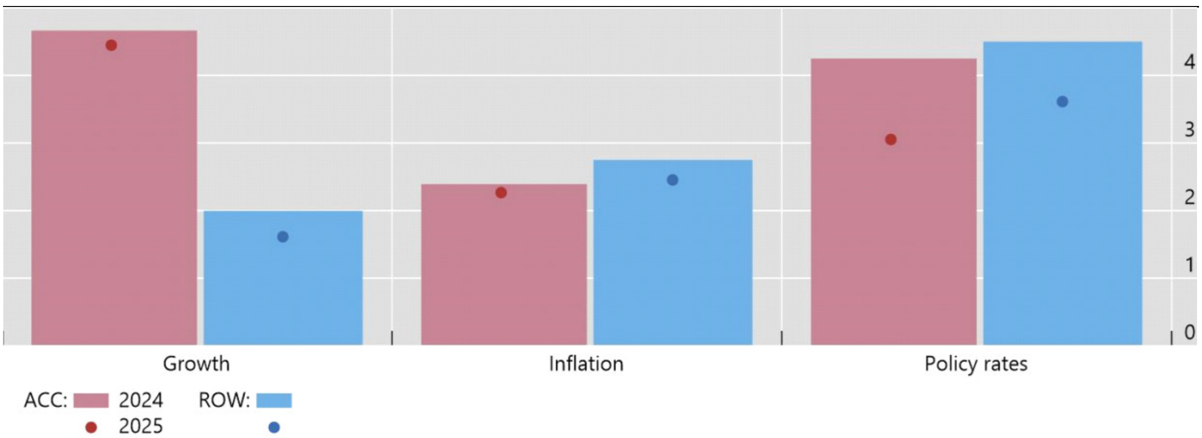
These developments underscore the interconnectedness of our global economy and the challenges we face in navigating such uncertain times.

Asia's performance and monetary policy stances (Graph 3)

Asia is generally more resilient than the rest of the world[1]

In per cent

Graph 3



ACC = Asian Consultative Council; ROW = rest of world.

[1] A PPP-weighted average is used to measure GDP growth across countries, while the median is employed to measure inflation and policy rates. The sample coverage extends to BIS shareholder countries with the exception of Argentina, Turkey and Russia, and is subject to data availability. GDP growth for 2024 is estimated by using previous values for the missing quarters. Forecasts for 2025 of GDP and headline inflation are collected from Consensus Economics and represent the latest observation available, while policy rates are derived from market-implied rates. ACC countries include Australia, China, Hong Kong SAR, India, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand and Vietnam.

Sources: Consensus Economics; LSEG Workspace; Macrobond; BIS.

Turning to Asia-Pacific, like the rest of the world recent developments have been dominated by the general environment of uncertainty, particularly regarding tariffs.

While growth in some regional economies had softened, domestic demand is proving resilient and the region continues to be a key driver of global growth, standing out as a stronger performer relative to the rest of the world (Graph 3).

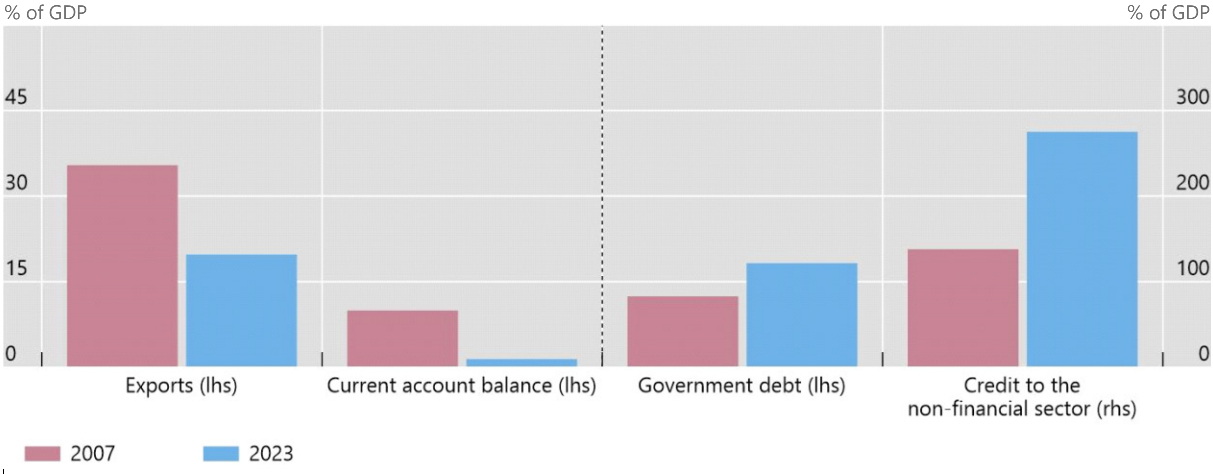
With inflation either declining or remaining near target, central banks in the region have started to ease to support growth. However, in a few cases they have paused further rate cuts due to worries about market volatility, considering the high degree of uncertainty as central banks strive to balance inflation control with currency stability and economic growth.

More specifically, Japan has continued to tighten in response to strong wage growth, which has been supporting consumption. While food prices have pushed headline inflation above the 2% target, services inflation remains subdued. Nevertheless, the Bank of Japan still considers that its policy stance remains accommodative. The Reserve Bank of India also reduced its policy rate by 25 basis points in early February and announced a range of measures to boost banking system liquidity. The growth outlook for economies in Southeast Asia has been solid, underpinned by robust domestic demand and export activities. However, escalating trade tensions pose potential challenges to this outlook.

China's economic transition and rebalancing (Graph 4)

China: transitioning and rebalancing

Graph 4



Sources: Macrobond; BIS.

Turning to China, the world's second largest economy has demonstrated resilience amid global challenges – recording around 5% growth in 2024, which is also the government's growth target for 2025.

Renewed optimism in the artificial intelligence (AI) sector, which I will elaborate on later, has been a catalyst for market enthusiasm. Consequently, Chinese equities have experienced significant inflows, with foreign investors adding $11.2 billion to Chinese stocks in February – the highest monthly inflow since September 2024 – amid growing recognition of China's advances in AI and electric vehicles.

However, recent data indicate persistently low inflation, with the consumer price index falling by 0.7% year on year in February, marking the first drop in over a year. This decline is attributed to diminished seasonal demand and cautious consumer spending due to job and income concerns. Furthermore, imports have unexpectedly declined, reflecting subdued domestic demand and escalating trade tensions.

To counter these challenges, the People's Bank of China (PBOC) has pledged to implement a "moderately loose" monetary policy, utilising tools such as interest rate and reserve requirement ratio adjustments to maintain ample liquidity and support economic growth. The PBOC has also conducted reverse repo operations totalling RMB 175.4 billion to ensure sufficient liquidity in the banking system.

Going forward, China needs to contend with several pain spots, including issues in the real estate sector, weak domestic consumption, concerns about local government financing vehicles and mounting overall government debt, as well as an ageing population.

At the macroeconomic level, the transition and rebalancing of the Chinese economy are entering a new phase. Indeed, after China's current account surplus peaked at approximately 10% of GDP in 2007, it decreased to about 2.2% of GDP in 2024, though remaining still large in absolute terms. At the same time, general government debt has surged, and in terms of the GDP ratio increased from a range of 45–55% in 2007 to 76 -110% by 2023. Total credit to the non-financial sector increased to more than 270% of GDP in 2023 from 145% of GDP in 2007 (Graph 4).

Will the internal imbalance continue while progress in reducing external imbalance is maintained? The challenge in the transition is for the Chinese economy to become more sustainable and balanced as domestic demand has remained weaker than expected and external pressure has mounted.

Challenges to monetary policy

Let me now turn to some of the key challenges that will shape the conduct of monetary policy in the years to come.

The first is the high level of policy uncertainty and unpredictability. Trade policy has now become a central issue, but uncertainty also extends to fiscal policy, regulatory frameworks and immigration policy, all of which remain unresolved in many jurisdictions. On top of this, the geopolitical environment remains fluid, further complicating the economic outlook.

Such an environment of uncertainty and unpredictability has significant implications for central banks. It weighs on economic activity by making businesses more hesitant to invest and households more reluctant to make major purchases. This, in turn, can dampen growth and exert downward pressure on inflation.

Additionally, policy uncertainty fosters volatility, particularly in financial markets. In recent weeks, we have witnessed large swings in asset prices, including sharp movements in stock markets and exchange rates, as investors struggle to gauge the direction of future policies. Some of these price fluctuations, particularly currency depreciation, may also contribute to inflationary pressures.

The second major challenge is persistently high levels of public debt. In some economies, fiscal positions have reached unsustainable levels. Even before the pandemic, public debt was elevated in many countries. Since then, it has expanded further, as the large deficits accumulated at the onset of the Covid-19 crisis have not yet been fully reversed.

An accommodative fiscal stance poses several complications for central banks, particularly when interest rates remain high. By boosting aggregate demand, it can increase inflationary pressures, making the task of returning to price stability more difficult. Furthermore, uncertainty surrounding fiscal sustainability may push up risk premia on interest rates and cause currency depreciation, further aggravating inflation while also weighing on growth. In more extreme cases, a sharp repricing of sovereign debt could create risks for financial stability, particularly in countries where financial institutions hold significant amounts of government bonds. While these risks are well known, the challenge for central banks will be to navigate the consequences effectively.

A third challenge stems from increasing divergence among economies. The pandemic was an extraordinary shock that prompted a highly coordinated response from central banks around the world. Most policymakers moved swiftly to loosen monetary policy in response to the crisis. Then, as inflation surged, central banks shifted towards tightening, although emerging market economies were generally ahead of their advanced economy counterparts in taking action.

Going forward, economic conditions and appropriate policy responses are likely to diverge even further. The US economy, for instance, outperformed much of the rest of the world in recent years. If this trend continues, it would probably lead to greater disparities in policy settings, with consequences for capital flows, exchange rates and global financial conditions.

A fourth, and closely related, challenge is prolonged weakness in productivity growth. Low productivity growth presents central banks with difficult choices. It increases pressure to maintain accommodative policy settings in an effort to support economic growth, even when underlying fundamentals remain weak. However, as many here will appreciate, monetary policy lacks efficacy when it comes to addressing structural weaknesses.

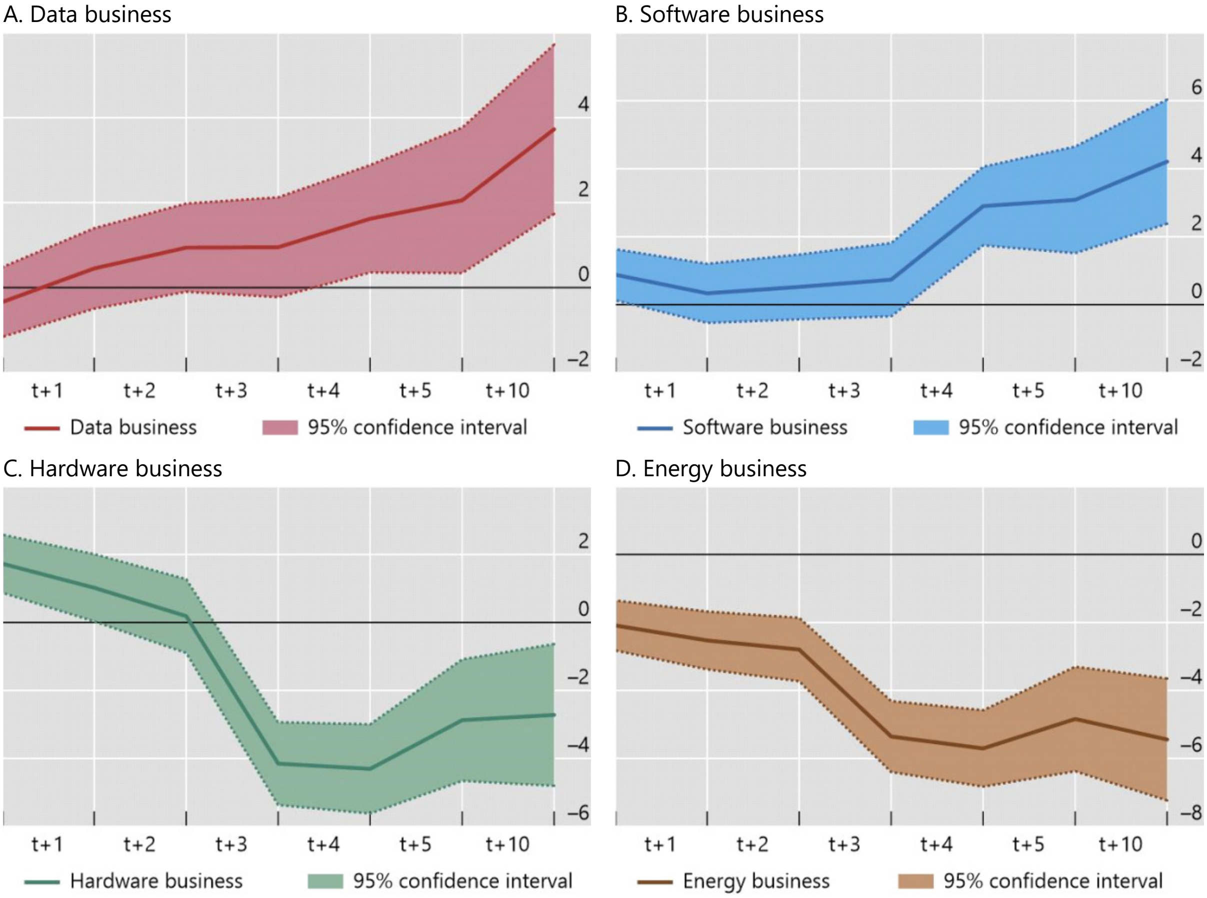
The persistence of weak productivity growth presents a fundamental challenge for economic policymakers. In an era where structural inefficiencies, sluggish investment and trade fragmentation continue to weigh on output, it is imperative to explore avenues that could drive a new wave of productivity gains.

Artificial intelligence: a new frontier for central banking and economic analysis (Graph 5)

Impact of sales exposure on cumulative raw returns[1]

In per cent

Graph 5



[1] This graph shows cumulative raw returns in response to a one-unit increase in a firm's sales exposure to energy, hardware, data and software businesses. Cumulative raw returns are the sum of daily returns over specific time windows around the DeepSeek announcement on 20 January 2025. Exposure is measured by the proportion of revenue from each business relative to total revenue, as recorded in the FactSet Revere database.

Sources: Bloomberg; FactSet; authors' calculations.

The discussion of productivity cannot be complete without elaborating on technology development. This now leads to my remarks on AI.

AI has the potential to improve productivity by automating routine tasks, optimising resource allocation and enhancing decision-making across industries. It offers both opportunities and challenges, making it imperative that we understand its implications within financial and economic policymaking. For example, issues including data governance and security remain key concerns going forward.

For central banks, understanding AI's implications is no longer optional – it is essential. AI-driven innovation could reshape labour markets, influence inflation dynamics and even redefine financial stability risks.

Recent advancements in AI, particularly generative AI models like ChatGPT, Llama, Claude and the latest, DeepSeek, have attracted global attention and stimulated policy discussions. These developments offer a more innovative approach to balancing computational efficiency and performance, in addition to the traditional "scaling laws", which focus on the size of models, data and computing power.

The Asia-Pacific region hosts numerous small-scale businesses that focus on AI applications. These businesses could significantly benefit from the inclusive advancement of AI. Such progress would offer the region unique opportunities to transform its economies and create more jobs.

More importantly, the widespread and easy adoption and application of AI may drive long-term productivity growth through the emergence of new business activities. Consequently, the increased marginal productivity of both capital and labour, potentially affecting investment-saving balances, could affect the determination of the equilibrium real interest rate (r*), the benchmark against which real interest rates are compared to assess the monetary policy stance.

Before I finish my remarks on AI, let me share recent analysis by my BIS colleagues on advancements in AI innovation, which offers some insights on its potential economic implications.

As Graph 5 illustrates, the stock market has responded positively about the increased use of data and software, while anticipating savings in hardware and energy deployment. Stock market reactions have underscored the potential of recent AI advancements and heightened expectations for the development of AI innovations and widespread applications. For example, the market value of the main components – data, software, hardware and energy – of AI business models has responded markedly.

Conclusion: navigating uncertainty, embracing innovation and the way forward

To conclude, the global economic landscape is evolving rapidly, with new challenges and opportunities emerging at an unprecedented pace. The task ahead for central banks is to remain agile, adaptive and forward-looking. Conventional policy tools like interest rates are essential. The broader arsenal of macroprudential tools and foreign exchange intervention can also play a role.

The ability to balance inflation control, financial stability and economic growth will determine economies' resilience in the years to come. In these days of uncertainty and unpredictability, central banks should remain committed to their mandates in safeguarding monetary and financial stability.

Central banks need to be realistic about what they can deliver and communicate that clearly to the public. As we navigate this uncertain and unpredictable landscape, we must recognise that the wide-ranging economic challenges we face today go well beyond the domain of an individual central bank. Collaboration among central banks, governments and market participants will be needed more than ever.

Thank you for your attention. I look forward to our discussions on how we can navigate these economic challenges together.