

Central banking in the digital economy

2023-04-08

DOING DIGITAL FORUM

APRIL 5, 2023,

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Central banking in the digital economy/society.

Ladies and Gentlemen,

I welcome you to the Doing Digital forum, and look forward to inspiring and thought-provoking conversations.

In 2023, we celebrate the 30th anniversary of the Armenian Dram.

It is, therefore, a great occasion to take stock of the past, and talk about the future.

The history of the Armenian Dram and the establishment of the Central Bank of Armenia tell a cautionary yet empowering story of conservative innovation and research-driven institutional development.

Let me step back and provide you with a bit of a context.

The mission of the Central bank of Armenia is to be a reliable partner in a rapidly changing world, contribute to national prosperity by preserving price and financial stability. In other words, our purpose is to preserve stability in the world of uncertainty.

The hard question is—how to achieve this? We laid this out in our vision stating that the way for us to deal with the uncertainty and instability is through cutting-edge research and innovative solutions.

Today's central topic is the rapid digitization and the associated challenges and opportunities. So, here again, we ask the same question—how do we cherish the opportunities and cope with challenges?

I will walk you through the story of the Central bank of Armenia and then tell you how we see our role in the context of future developments.

In 1993 Armenia was going through a radical change. The collapse of the Soviet Union had severed most of the economic ties, and the GDP plunged by 70% from its height in 1987.

The introduction of the Armenian Dram in 1993 was one of the cornerstones of the economic policy for the country. The following years of hard-fought price stability provided stability to our economy and paved the way for economic growth.

The Dram was born into a crisis, in the environment of skepticism about the future of the currency and the country. We had very little knowledge about the institutions and the policies of a market-based economy, and had to learn on the run.

Yet, the introduction of the Dram and the establishment of the Central bank with a research-driven reform mindset proved to be a game changer in the transformation to a free market economy. It was, and still is, a clear example of institutional innovation with a widespread economic impact.

My main message is that the times of extraordinary challenges were, in fact, the times where we learned the most and built the most.

As we celebrate the 30th anniversary of the Armenian Dram, we reflect on the challenges ahead, and build the foundations for the next stage of sustainable economic development. In a rapidly changing global economy, which goes digital at an ever accelerating speed, we must continue to adapt and innovate to stay competitive. We must also aim to ensure that all our citizens share the benefits of a more digital and robust economy.

I will state that the mindset, knowledge and skills, forged in the process of the Dram introduction and the Central Bank establishment and maturity, are ever more relevant and applicable to sustainable growth of the digital economy and the digital society transformation in Armenia.

Of course, nowadays challenges are different. Indeed, the digital economy is changing the way we live, work, and do business. But the pattern of growth and institutional development has not changed.

We, as many others, watch the fast pace of technological advance with hope and caution. The hope is that rapid technological breakthroughs will enable our societies to be more productive and prosperous. The caution, however, is not that it might take over the jobs of humans, and eventually take over the world. The key danger stems from the possibility of the overreliance of humans on the output of complicated tools without proper sanity check, and the consequences of mechanical decisions. If not well handled, this will also

have dire distributional consequences, as only few will be able gain from the technological advancement--the digital divide is widening, leaving many behind, and the markets are unable to handle this problem.

As the father of modern cybernetics Norbert Wiener stated, the world of the future will be an even more demanding struggle against the limitations of our intelligence, not a comfortable hammock in which we can lie down to be waited upon by our robot slaves.

The key point is that a major source of technological uncertainty is actually our inability to handle it.

The rapid advance of the digital economy with instant spread of information, and faster and larger transactions add another complexity layer to many dimensions of change. It touches all aspects of our life. For example, the collapse of the Silicon Valley Bank was driven by the record amount of deposit outflows in a short time span—42bln dollars in a day- all because of instant speed of mobile applications!!! This shows that technology can accelerate both good and bad, when sound fundamentals or vulnerabilities are in place.

Having said this, we believe that the core functions of the Central Bank, the price and financial stability, are as much relevant in the digital economy as in the traditional economy.

It is, however, very easy to lose focus during all these rapid changes. The three key focal points for the Central bank of Armenia are:

Collaboration with private sector with balanced risk sharing between private and public and emphasis on private sector's ability to handle uncertainty;

Underlying infrastructure enabling households and firms to be more productive;

Data. The future of financial services and business models rely on data, so we need to make sure that we have leveled playing field and consumer-centric system.

These points are reflected in all our flagship initiatives.

First, we have embarked on a journey to revise our monetary policy framework to build a robust risk-based monetary policy framework based on the acceptance of uncertainties, and proactive risk management ahead of the curve. This represents a major mindset shift from trying to predict the future to envision the possible scenarios and manage the risks. We should not be alone in this journey, and we engaged private sector companies to think about and build robust risk management capabilities.

Second, on infrastructure, together with the Government and the newly created Information Systems Agency, instead of having industry-only effort of banking ID we co-

lead the work on the national electronic ID system with an aim to design a coherent eID infrastructure both for public and private use. Today, our colleagues will expand on this topic further.

Third, in parallel to eID efforts, we are investing in our cybersecurity capacity both in terms of systems and processes, and in terms of human capacity. We are mobilizing the private and the public sector to build a resilient cybersecurity layer.

Fourth, we initiated a review of the state of our payment infrastructure. Here, our goal is to future-proof our payment system, make it more robust, more resilient and more integrated to meet the needs of all the citizens of Armenia.

At the same time, as the speed and size of the transactions in the digital economy continue to grow, this may represent a threat to financial stability. With this review, we also aim to build better tools to monitor in real time and to respond to the possible financial stability threats in an instant manner. Moreover, we discuss with the payment service providers to take on a more active role in managing payment-related risks.

Technology has also penetrated into the traditional turf of monetary science, the money itself. The proliferation of crypto assets, and unlicensed banks, posing as exchanges, and the possible consequences for the public and financial stability remain on our radar screens.

The idea of the digital Dram is very close to the heart of our technologically minded fellow citizens, yet its introduction may bring more questions, while not solving any essential need not already addressed by other means. We watch the global developments in this space, and will be building capacity in this area.

To conclude, while we will defend the need for the Central Bank to be the conservative risk manager for the monetary and financial system, we have also provided ample support to institutional innovation in Armenia, and continue taking part in nationwide digital projects. But, we will always ask difficult questions, because there is no substitute for sound thinking!

Thank you.