SEACEN CAPITAL FLOWS MONITOR 2025 *UPDATE*

July 2025

The South East Asian Central Banks (SEACEN)
Research and Training Centre 198201000672

The SEACEN Centre

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The SEACEN Capital Flows Monitor 2025 *Update* should not be reported as representing the views of SEACEN member central banks/monetary authorities. The views expressed in this report are those of The SEACEN Centre and do not necessarily represent those of its member central banks/monetary authorities.

Notes:

The SEACEN Centre recognises "China" as the People's Republic of China," "Hong Kong, China" as the Hong Kong SAR, China, and "Korea" as the Republic of Korea.

USD or US$ refers to the U.S. dollar.

IMF and national source data were accessed through the CEIC Database and Haver Analytics. The data cut-off is 30 June 2025.

Asian economies include the nineteen economies of the SEACEN member central banks and monetary authorities with available data. It includes Brunei Darussalam; Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Lao PDR; Malaysia; Mongolia; Myanmar; Nepal; Papua New Guinea; Philippines; Singapore; Sri Lanka; Chinese Taipei; Thailand and Vietnam. This report also discusses subregional groupings. Advanced Asian Economies include Hong Kong, China, Korea, Singapore, and Chinese Taipei. ASEAN5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Asian Emerging and Developing Market Economies (EDMEs) include Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Myanmar, Nepal, Papua New Guinea, and Sri Lanka, whenever data are available.

This report has been approved by Dr. Cyn-Young Park (Executive Director). Dr. Ole Rummel (Director of Macroeconomic and Monetary Policy Division—MMPM) also edited and reviewed the report. Dr. Rogelio Mercado (Senior Economist, MMPM) authored Sections 1 to 2 and supervised the production of the report. Dr. Rogelio Mercado and David Nefzi of Banque de France co-authored section 3. Mr. Ahmad Aizudeen provided research assistance. Ms. Yun Yee Seow edited the draft sections, and Mr. Aizul Fazli Zulkifli of Swift Cursor Studio designed, typeset, and layout the report.

CONTENTS

ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
BoP	Balance of Payments
BPM6	Balance of Payments Manual 6
IMF	International Monetary Fund
IIF	Institute of International Finance
IIP	International Investment Position
SEACEN	South East Asian Central Banks (SEACEN) Research and Training Centre
SEG	SEACEN Expert Group on Capital Flows

CONCEPTS

Net IIP or NFA	Net International Investment Position or Net Foreign Assets are computed as total foreign (international) investment assets minus total foreign (international) investment liabilities.
Resident capital flows	Net purchases of foreign assets by residents are commonly referred to as "gross capital outflows." The data refers to the Financial Account Assets of the Balance of Payments Financial Account Balance.
Nonresident capital flows	Net purchases of domestic assets by nonresidents are commonly referred to as "gross capital inflows." The data refers to the Financial Account Liabilities of the Balance of Payments Financial Account Balance.
Net resident capital flows	Computed as resident capital flows minus nonresident capital flows. Positive values may suggest that domestic residents are purchasing more foreign assets than nonresidents purchasing domestic assets.

FOREWORD

In the midst of growing uncertainty around global trade policies, vigilant macroeconomic monitoring becomes ever more essential for anticipating emerging risks and shaping effective policy responses. This edition of the SEACEN Capital Flows Monitor supports these efforts by shedding light on the latest regional trends and underlying forces influencing cross-border capital movements throughout Asia-Pacific.

Designed as a key reference for the SEACEN Expert Group (SEG) on Capital Flows—which brings together nineteen central banks and monetary authorities from across the region—this monitor offers timely regional perspectives on the evolving dynamics of international financial transactions and investments.

This bi-annual report is organized into three main sections. The first section offers an overview of recent global and regional developments affecting capital flows in Asia, with a particular focus on the first half of 2025. The second section examines the composition, trends, and patterns of capital flows and international investment positions among SEACEN member economies for the full year 2024. The third section is dedicated to an in-depth analysis of a key policy topic related to capital flows and international investment positions. In this edition, the spotlight is on the impact of foreign direct investment (FDI) on productivity and long-term economic growth. It reviews both theoretical models and empirical evidence, aiming to provide relevant policy insights. This analytical section serves as a foundation for further empirical exploration of the relationship between FDI and productivity growth.

The relationship between foreign direct investment and productivity growth remains especially important amid today's uncertainties in global trade policies. By enabling the freer movement of capital, both sending and receiving countries can better allocate resources toward more productive activities. Foreign investment has been a driving force behind growth and industrialization in emerging and developing economies, creating jobs and expanding economic opportunities. Moreover, cross-border trade and investment encourage risk-sharing and the exchange of knowledge, benefiting investors looking to diversify portfolios, enter new markets, or leverage the unique strengths of different economies.

We hope the insights presented in this report help guide decision-makers navigate the increasingly challenging and complex financial landscape amid heightened economic and policy uncertainty. Our aim is for this edition to serve as a valuable resource for understanding the significance of cross-border investments, the role of foreign exchange, and the impact of geopolitical factors on investment decisions. The perspectives offered are the product of input from our expert contributors and partners, whose ongoing support is essential to our mission of promoting sustainable growth and financial stability across the region.

Thank you for your continued support and commitment to the SEACEN Centre as we explore how global macroeconomic and financial conditions affect capital flows to the region and impact monetary and financial stability.

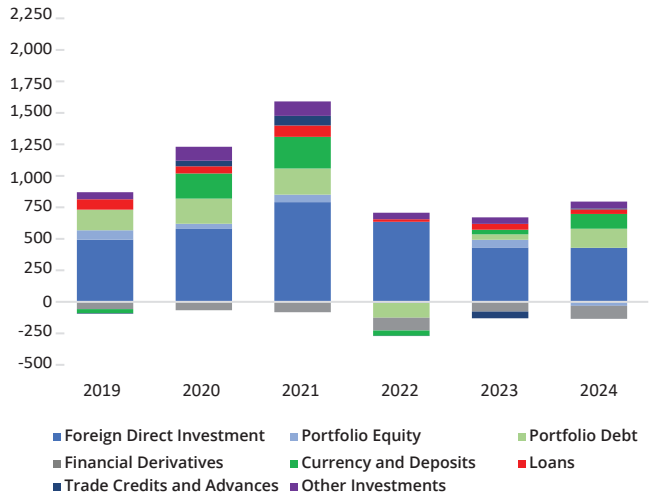
Cyn-Young Park
Executive Director
The SEACEN Centre

July 2025

SEACEN Capital Flows Monitor July 2025: Highlights

- *The announcement of higher U.S. reciprocal tariffs in April 2025 has heightened uncertainty on global trade and dampened the growth outlook across the region and elsewhere.*
- *Financial conditions in the region have held up relatively well despite ongoing U.S. trade policy uncertainty. As inflationary pressures remain benign, policymakers have space to implement supportive measures.*
- *Moving forward, the region's economic growth forecast is expected to remain steady in 2025, and inflation to remain moderate. However, the risks to the region's economic outlook for the year are tilted to the downside.*
- *Asian economies, as a whole, witnessed a marked increase in cross-border resident and nonresident capital flows in 2024, following two years of significantly lower cross-border capital flows in 2022 and 2023.*
- *The region's aggregate net foreign asset position remained positive, although some economies remained a net borrower in 2024.*
- *Theoretical models show that FDI brings new knowledge, promotes specialisation, and stimulates innovation, which contribute positively to the long-run growth rate. However, this outcome hinges on technology diffusion, linkages, competition, and the ability of host economies to harness them.*
- *Empirical studies indicate that (i) FDI generates productivity spillovers conditional on the levels of human capital, trade openness, and financial development of recipient economies; (ii) horizontal spillovers have ambiguous effects as competition can crowd out or boost the productivity of local producers; (iii) backward vertical linkages provide the strongest productivity spillovers; (iv) knowledge can be transferred locally via labour mobility and innovation-induced competition; and (v) the type of FDI matters.*
- *These theoretical models and empirical evidence suggest that the impact of FDI flows on economic outcomes is conditional rather than systematic. Consequently, a sequenced policy roadmap must be considered to fully capture the long-term benefits of FDI.*

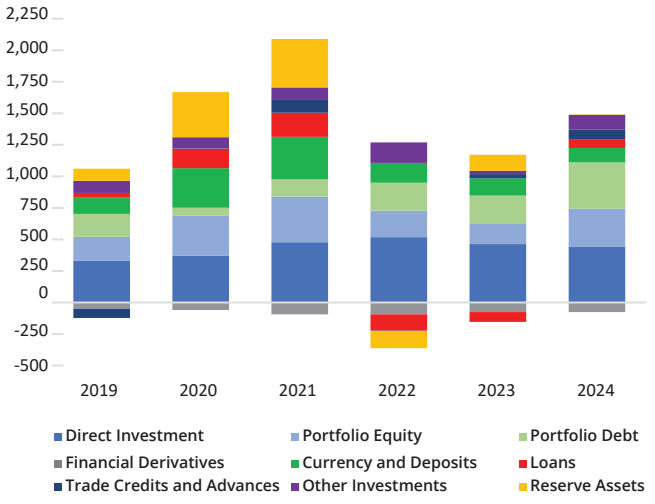
Figure H.1: Nonresident Capital Flows, Asia, by Category *(US$ billion)*



Notes: Asia includes Brunei Darussalam; Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Lao PDR; Malaysia; Mongolia; Nepal; Philippines; Singapore; Sri Lanka; Chinese Taipei; Thailand; and Vietnam. Other investments include other payables, other equity, insurance and pension, and SDRs liabilities.

Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

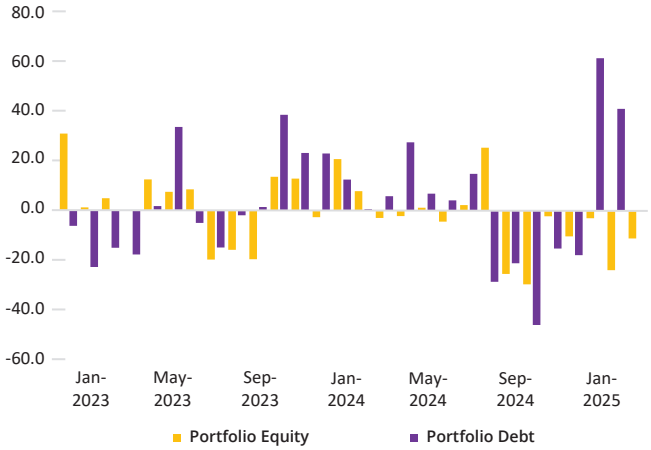
Figure H.2: International Investment Assets, by Category *(US$ billion)*



Notes: Asia includes Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Malaysia; Mongolia; Nepal; Philippines; Singapore; Chinese Taipei; and Thailand. Other investments include other receivables; other equity; and insurance and pension.

Source: SEACEN staff calculations using data from IMF's International Investment Position accessed through CEIC Database (downloaded June 2025).

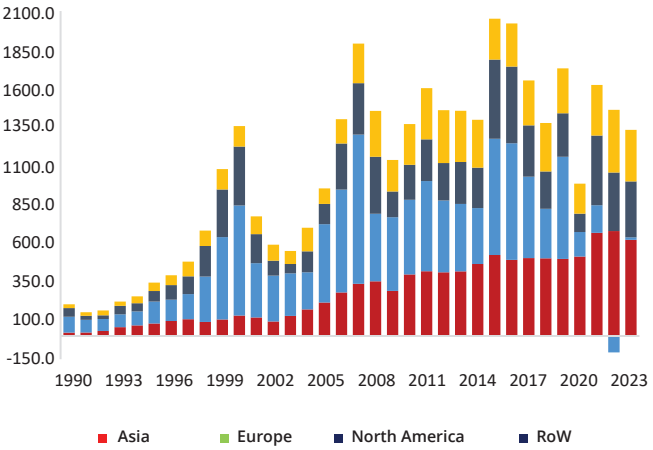
Figure H.3: Nonresident Portfolio Flows,
Selected Asian Economies *(US$ billion)*



Notes: The sample for nonresident portfolio equity flows includes China, India, Indonesia, Korea, Malaysia, Mongolia, Philippines, Sri Lanka, Chinese Taipei, Thailand, and Vietnam. The sample for nonresident portfolio debt flows includes China, India, Indonesia, Korea, Malaysia, Mongolia, and Thailand.

Source: SEACEN staff calculations using data from the Institute of International Finance.

Figure H.4: Inward FDI,
by Region *(US$ billion)*



Notes: RoW = rest of the world

Source: United Nations Trade and Development (UNCTAD) Database.

SECTION I: RECENT GLOBAL AND REGIONAL ECONOMIC AND FINANCIAL TRENDS AND DEVELOPMENTS

This section reviews the global and regional economic and financial trends that impacted capital flows to Asia in the first half of 2025. It highlights several key developments:

- *The announcement of higher U.S. reciprocal tariffs in April 2025 has heightened uncertainty on global trade and dampened the growth outlook across the region and elsewhere.*
- *Financial conditions in the region have held up relatively well despite ongoing U.S. trade policy uncertainty. As inflationary pressures remain benign, policymakers have space to implement supportive measures.*
- *Moving forward, the region's economic growth will remain steady in 2025, and inflation will remain moderate. However, the risks to the region's economic outlook for the year are tilted to the downside.*

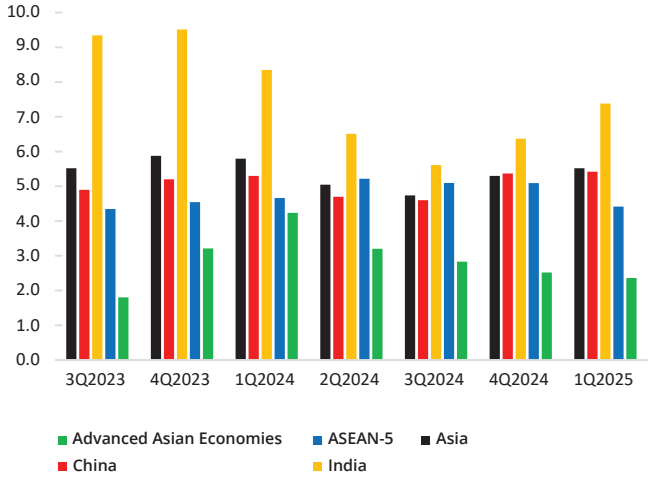
Economic growth in Asia is expected to slow in 2025 as trade and geopolitical uncertainties could weigh down trade, investment, and domestic demand. Economic growth in the region remained steady in the first quarter of 2025 as it grew by 5.5% year-on-year, which is slightly higher than the 5.3% growth posted in the final quarter of 2024, but lower than the 5.8% growth in the first quarter of 2024 **(Figure 1.1).**[1] India's economy grew strongly in the January to March 2025 period as it expanded by 7.4% year-on-year. China's economic growth in the first quarter of 2025 exceeded expectations as it grew by 5.4% year-on-year due to strong exports and recovery in domestic demand. In contrast, economic growth of Advanced Asian Economies (Hong Kong, China; Korea; Singapore; and Chinese Taipei) and ASEAN5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam) dipped slightly during the review period as both economic groups grew by 2.4% and 4.4% year-on-year, respectively, down from 2.5% and 5.1% in the final quarter of 2024.

The announcement of higher U.S. reciprocal tariffs in April 2025 has heightened uncertainty on global trade and dampened the growth outlook across advanced, emerging and developing economies in the region and elsewhere. The U.S. reciprocal tariffs are designed to address America's trade imbalances and protect its industries by imposing tariffs on imports from economies that are deemed to have non-reciprocal trade practices with the U.S.[2] This current U.S. trade policy is part of a broader strategy to renegotiate trade deals and assure that American exporters have commensurate access to foreign markets. The reciprocal tariffs are set to take effect on 1st August 2025, with some countries having revised rates from previously announced rates in April based on their trade negotiations with the U.S. As of July 2025, Asian economies face an average U.S. tariff of around 27%, which is almost double that of the global average of 15%. Consequently, Asian and other economies face greater economic uncertainties and challenges due to current U.S. trade policy **(Figure 1.2).** The ongoing economic and trade policy uncertainty could eventually weaken cross-border trade and delay consumption and investment, thereby dampening the region's growth prospects for the year.

So far, financial conditions in the region have held up relatively well despite ongoing U.S. trade policy uncertainty. Equity markets in the region ended mostly in positive territories in the first half of 2025. Benchmark stock price indices of Korea; Hong Kong, China; and Vietnam increased by more than 10% on a year-to-date basis, with Korea and Vietnam reversing the previous year's losses, while Chinese Taipei sustained gains from last year **(Figure 1.3).** Similarly, the benchmark stock price indices of the Philippines, India, China, and Singapore grew by 3% to 9% on a year-to-date basis, while those of Malaysia, Indonesia, and Chinese Taipei decreased by less than 10% in the first half of 2025. The benchmark stock price index of Thailand reported the biggest drop on a year-to-date basis by around 17%. As the U.S. dollar weakens due to ongoing policy uncertainty, Asia's currencies have appreciated in the first half of 2025. The NT dollar, Korean won, Singaporean dollar, Malaysian ringgit, and Thai baht appreciated by

1. Aggregate GDP growth rates and inflation were computed using GDP at Purchasing Power Parity (PPP) in U.S. dollars sourced from IMF's World Economic Outlook Database (April 2025) as weights.
2. The reciprocal tariffs will make imported goods more expensive in the U.S., thereby encouraging consumers to buy domestically produced products, instead of imported products. However, tariffs lead to higher prices and potential retaliatory tariffs from trade partners.

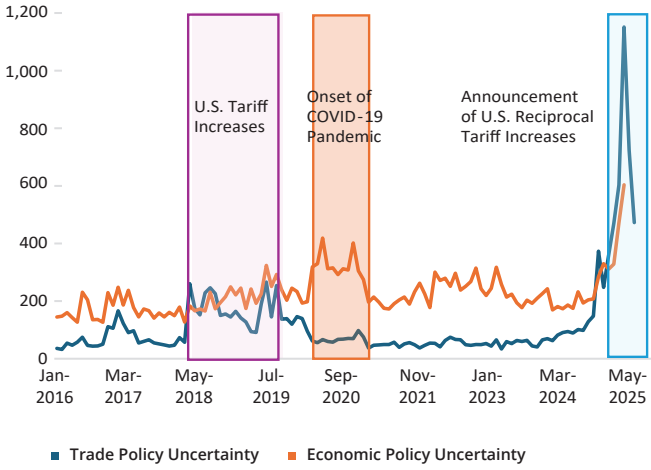
Figure 1.1: Quarterly GDP Growth, Selected Asian Economies *(% change, year-on-year)*



Notes: Regional growth rates are weighted averages of individual growth rates, using GDP in PPP as weights. Asia Economies include China, India, Mongolia, ASEAN-5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam), and Advanced Asian Economies (Hong Kong, China; Korea; Singapore; and Chinese Taipei).

Source: SEACEN staff calculations using data from national sources accessed through the CEIC Database.

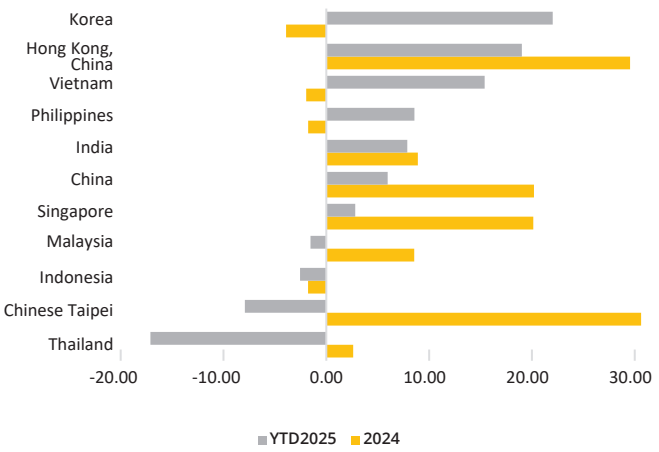
Figure 1.2: Economic and Trade Policy Uncertainty Indices



Notes: Economic policy uncertainty index refers to global uncertainty. Trade policy uncertainty computed following Caldara, Iacoviello, Molligo, Prestipino and Raffo (online). Higher values mean higher uncertainty.

Source: Economic Policy Uncertainty (https://www.policyuncertainty.com/trade_cimpr.html).

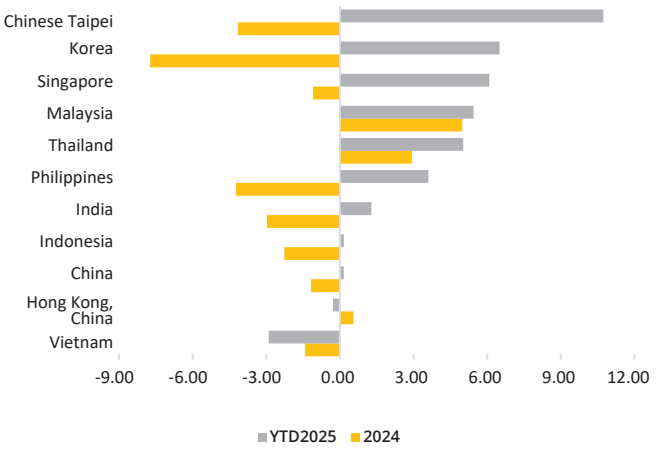
Figure 1.3: Changes in Benchmark Stock Price Indices, Selected Asian Economies *(% change, year-to-date)*



Notes: Year-to-date values are computed as the monthly difference between the first and last data points within a year.

Source: SEACEN staff calculations using data accessed through the CEIC Database.

Figure 1.4: Exchange Rate Changes, Selected Asian Economies *(% change, year-to-date)*



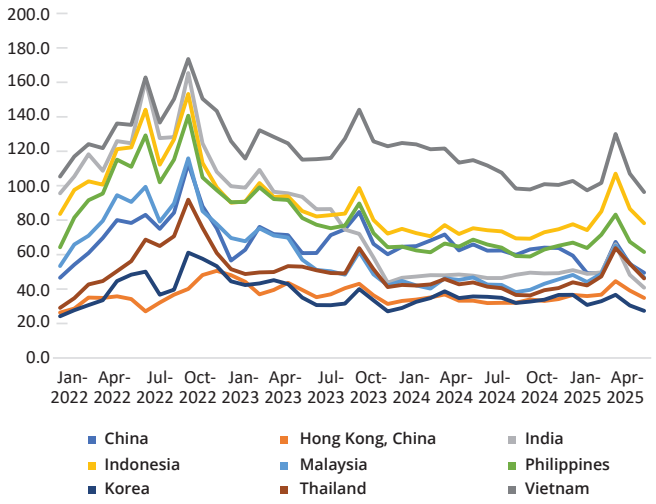
Notes: Year-to-date values are computed as the monthly difference between the first and last data points within a year. Positive changes refer to an appreciation of the local currency versus the U.S. dollar, and negative changes refer to depreciation.

Source: SEACEN staff calculations using data accessed through the CEIC Database.

over 5% year-to-date, while the Philippine peso and Indian rupee appreciated by around 3.6% and 1.3%, respectively **(Figure 1.4).** In contrast, the Vietnamese dong depreciated by around 3% during the review period. The Chinese renminbi, Indonesian rupiah, and Hong Kong dollar barely moved.

The risk premiums of selected Asian economies, measured by year-to-date changes in sovereign credit default swap (CDS) spreads, continued to narrow in the first half of 2025 by a simple average of 4.6 basis points (bps) **(Figure 1.5).** This follows a narrowing of risk premiums by a simple average of about 1.6 bps the previous year. Nonetheless, CDS spreads trended higher in April, following the announcement of higher U.S. reciprocal tariffs, before heading downwards in May and June. Meanwhile, 5-year sovereign bond yields of most Asian economies declined on a year-to-date basis in the first half of the year as bond price rose **(Figure 1.6).** Foreign investors seeking to diversify

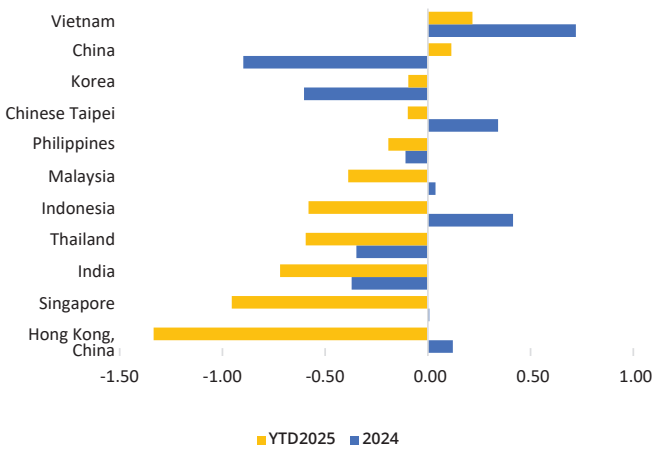
Figure 1.5: 5-Year Sovereign Credit Default Swap, Selected Asian Economies, *(basis points)*



Notes: 5-Year USD Credit Default Swap par mid-rate in basis points.

Source: CMA Datavision and Haver Analytics downloaded from Haver Analytics.

Figure 1.6: Changes in Sovereign Bond Yields, Selected Asian Economies *(% change, year-to-date)*



Notes: Year-to-date values are computed as the monthly difference between the first and last data points within a year.

Source: SEACEN staff calculations using data accessed from Haver Analytics.

their portfolios sought assets with stable and high yields along appreciating currencies, such as those of Indonesia, Malaysia, Chinese Taipei, Thailand, and others in the region. Sovereign bond yields of Korea; Chinese Taipei; Philippines; Malaysia; Indonesia; Thailand; India; and Singapore dropped by less than 1.0%, while that of Hong Kong, China dipped by 1.3%. Bond yields of Vietnam and China, however, increased slightly on a year-to-date basis by around 0.2% and 0.1%, respectively.

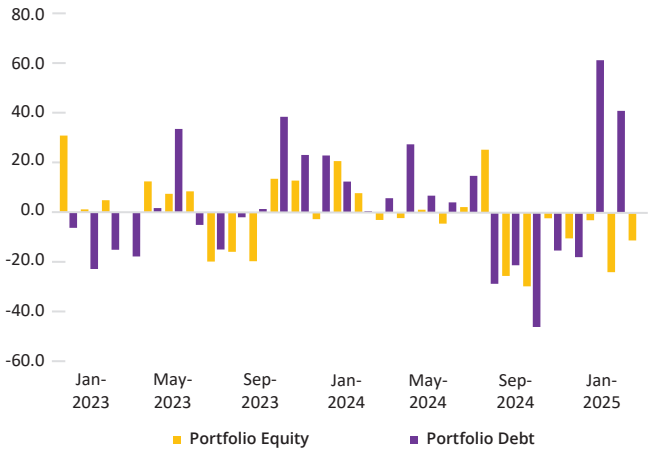
Consequently, nonresident portfolio debt flows in the region reported cumulative inflows of around US$105.6 billion in the first four months of 2025, a significant turnaround from nonresident portfolio debt outflows of around US$91.9 billion in the second half of the previous year **(Figure 1.7).**[3] However, nonresident portfolio equity flows to selected Asian economies registered a cumulative outflow of around US$48.3 billion in the first four months of 2025, larger than the cumulative equity outflow of around US$34.1 billion reported in the second half of 2024.

Despite U.S. trade policy uncertainty, global investor risk aversion remained muted, and Asia's financial markets showed no signs of stress in the first half of 2025. The Chicago Board of Exchange Volatility Index (VIX) stayed below the index level of 20 at the start of 2025 but then peaked in April at an index level of 32, before falling back to below 20 in May **(Figure 1.8).** In other words, although global risk aversion spiked in April with the announcement of higher U.S. reciprocal tariffs, risk aversion returned to normal levels thereafter. In addition, Asia's financial market stress indices from January to May 2025 suggest no signs of financial sector distress **(Figure 1.9).** Taken together, these two measures indicate that there were no visible signs of global investor risk aversion and financial market distress in the region during the review period.

As inflationary pressures remain benign, policymakers have space to implement supportive measures. Inflation continued to ease across Asian economies in the first five months of 2025, with most economies having inflation rates below target or forecast rates. For most economies in the region, the inflation downtrend continued into the first five months of the year, while for the rest, inflation edged up slightly, albeit still within or below the target range of central banks or monetary authorities for the year **(Figure 1.10a and 1.10b).** In China, consumer inflation decelerated, on average, by 0.60% year-on-year from February to May 2025, while in Thailand, it decelerated, on average, by 0.40% year-on-year in April and May 2025. In India, consumer inflation trended downwards in the first five months of the year, compared to the previous

3. Monthly nonresident portfolio debt and equity flows data were sourced from the Institute for International Finance. For portfolio equity flows, the sample includes China, India, Indonesia, Korea, Malaysia, Mongolia, the Philippines, Sri Lanka, Chinese Taipei, Thailand, and Vietnam. The sample for portfolio debt flows include China, India, Indonesia, Korea, Malaysia, Mongolia, and Thailand.

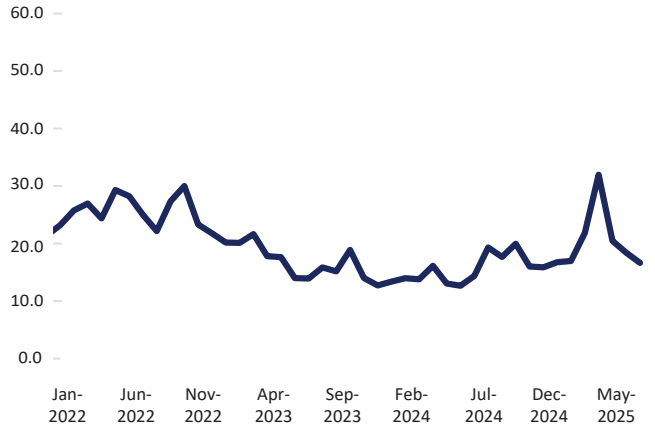
Figure 1.7: Nonresident Portfolio Flows,
Selected Asian Economies *(US$ billion)*



Notes: The sample for nonresident portfolio equity flows includes China, India, Indonesia, Korea, Malaysia, Mongolia, Philippines, Sri Lanka, Chinese Taipei, Thailand, and Vietnam. The sample for nonresident portfolio debt flows includes China, India, Indonesia, Korea, Malaysia, Mongolia, and Thailand.

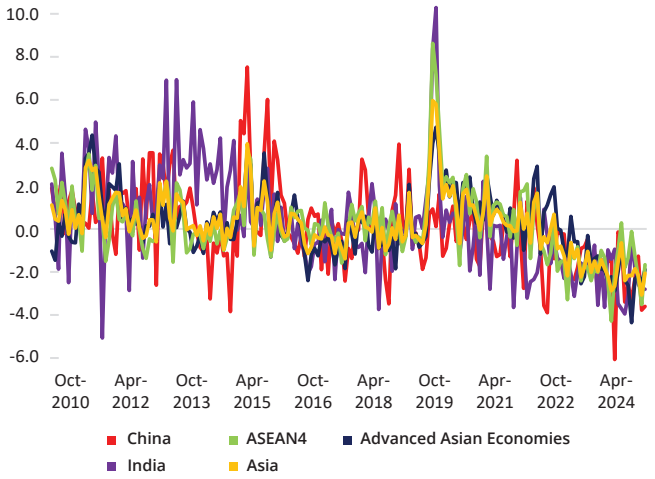
Source: SEACEN staff calculations using data from the Institute of International Finance.

Figure 1.8: Volatility Index
(VIX)



Source: Chicago Board of Exchange.

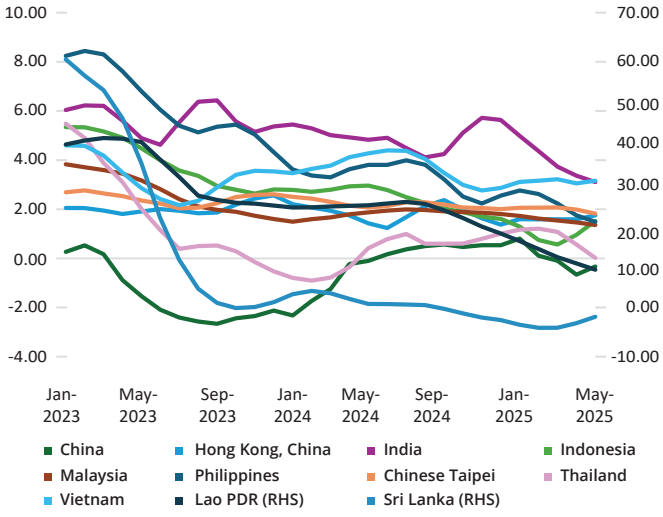
Figure 1.9: Financial Stress Indices,
Selected Asian Economies



Notes: Advanced Asian Economies include Hong Kong, China; Korea; Singapore; and Chinese Taipei. ASEAN4 includes Indonesia, Malaysia, Philippines, and Thailand. Financial stress indices for Advanced Asian Economies and ASEAN4 are computed as a simple average of individual country financial stress indices. Individual country financial stress indices are calculated following the methodology of Park and Mercado (2014) but use financial sector beta instead of banking sector beta. Financial market stress indices are computed starting in 2010.

Source: SEACEN staff calculations using data accessed through CEIC Database and Haver Analytics.

Figure 1.10a: Monthly Inflation,
Selected Asian Economies *(% change, year-on-year)*



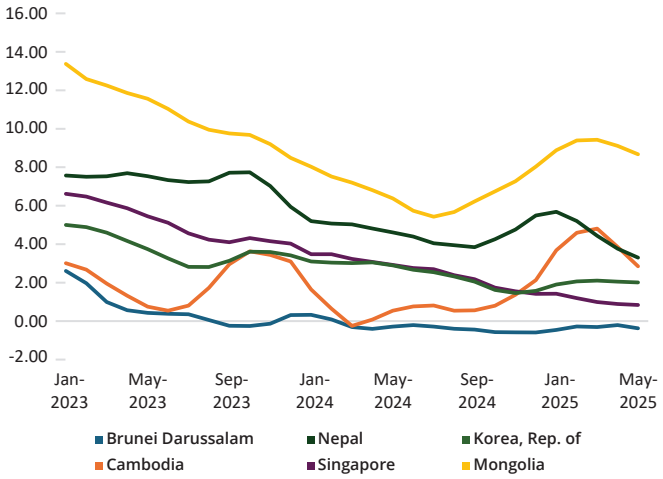
Notes: RHS = right-hand scale. Values are three-month moving averages of year-on-year monthly changes in the consumer price index.

Source: SEACEN staff calculations using data from national sources accessed through the CEIC Database.

year. Inflation in the Lao PDR has returned to single digit at 8.4% in May 2025, after 36 months of double-digit inflation. In contrast, consumer inflation slightly accelerated in Korea, Mongolia, and Vietnam in the first five months of 2025, compared to the second half of 2024.

Most central banks in the region either cut or kept policy rates on hold in the first half of 2025. Korea, Indonesia, Philippines, and Thailand have lowered their policy rates twice since the start of the year up to the end of June 2025. India cut its interest rate thrice since January up to end June 2025, while Sri Lanka cut it only once **(Figure 1.11a and 1.11b).** Malaysia, Nepal, and Chinese Taipei maintained their policy rates on hold from the start

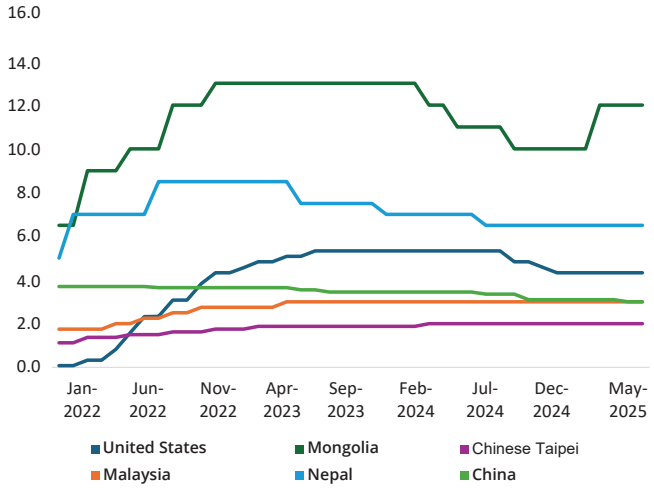
Figure 1.10b: Monthly Inflation, Selected Asian Economies *(% change, year-on-year)*



Notes: Values are three-month moving averages of year-on-year monthly changes in the consumer price index.

Source: SEACEN staff calculations using data from national sources accessed through the CEIC Database.

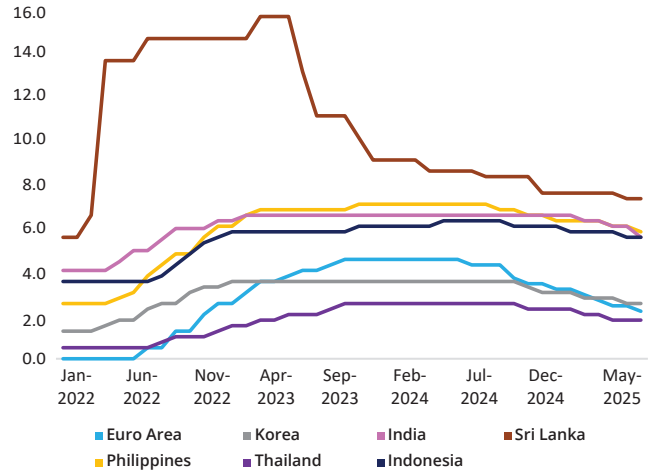
Figure 1.11b: Policy Rates in Selected Asian Economies *(% per annum)*



Notes: The policy rate for the United States refers to the effective Fed Funds rate. Data for China pertains to the one-year loan prime rate sourced from the Bank for International Settlements (BIS) Data Portal.

Source: Data taken from national sources accessed through CEIC Database and BIS Data Portal.

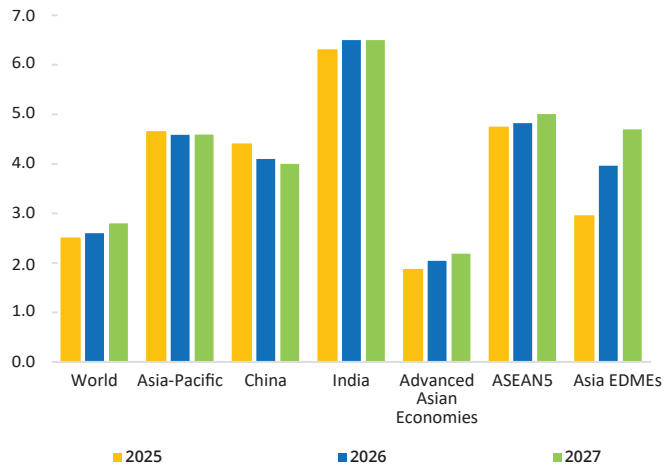
Figure 1.11a: Policy Rates in Selected Advanced and Asian Economies *(% per annum)*



Notes: The policy rate for the Euro Area is the main refinancing fixed rate of the European Central Bank.

Source: Data from national sources accessed through the CEIC Database.

Figure 1.12a: GDP Growth Outlook *(% change, year-on-year)*



Notes: Values for regional growth rates and inflation are weighted averages of individual growth rates, using GDP in PPP current international dollars ($) as weights. Asia economies include China, India, Advanced Asian Economies (Hong Kong, China; Korea; Singapore; and Chinese Taipei), ASEAN5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam), and Asian EDMEs (Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Myanmar, and Sri Lanka).

Source: SEACEN staff calculations using data from Focus Economics consensus forecasts accessed through Haver Analytics in June 2025.

of the year to the end of June 2025. Mongolia has raised its policy rate from 10% per annum to 12% per annum in March 2025 to control accelerating inflation. Elsewhere, the U.S. Federal Reserve (Fed) kept the Federal funds target rate on hold since last year, while the European Central Bank (ECB) cut its policy rates four times since the start of the year, amounting to a cumulative 100 bps cut.

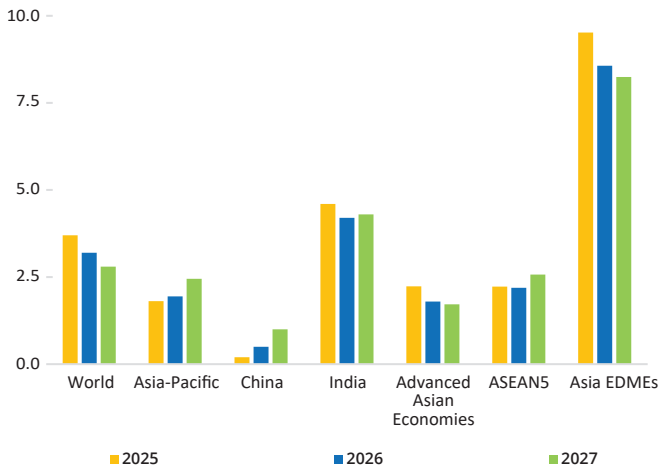
Moving forward, the region's economic growth is forecast to remain steady in 2025, and inflation will remain moderate. Asian economies are expected to grow, as a group, in 2025 at the same pace as in 2024 at 4.6% year-on-year **(Figure 1.12a).**[4] India is expected to maintain a strong growth momentum in 2025 at 6.3% year-on-year, while China is expected to grow by 4.4%. ASEAN5

4. The GDP growth and inflation forecasts for 2024 and 2025 are sourced from Focus Economics consensus forecasts accessed through Haver Analytics in June 2025.

economies will expand by around 4.7% with Vietnam and the Philippines growing by more than 5% this year. Asian EDMEs is expected to grow by 2.9% in 2025. The Advanced Asian Economies group is projected to expand by only 1.9% in 2025, as Korea experiences sluggish domestic consumption and a slowdown in export momentum. The region's inflation will likely remain moderate in 2025, increasing by 1.8% year-on-year from the previous year **(Figure 1.12b)**. Consumer inflation is expected to increase by 4.6% year-on-year in India and around 2.2% for Advanced Asian Economies and ASEAN5 in 2025. China's consumer inflation will remain weak while those of Asian EDMEs will be in single digits.

Risks to the region's economic outlook in 2025 are tilted on the downside. First, U.S. trade policy uncertainty can delay consumption and investment decisions and weaken global trade. Second, higher tariffs in the U.S. may lead to higher prices, halting further U.S. Fed policy rate cuts. Third, geopolitical risks, coupled with severe weather disturbances, can cause supply disruptions and increase food and fuel prices. These risks could stoke inflationary pressures in the region and elsewhere. Fourth, continued property sector woes and weaker demand in China can further soften its growth prospects and strengthen deflationary pressures.

Figure 1.12b: Inflation Outlook
(% change, year-on-year)



Notes: Values for regional growth rates and inflation are weighted averages of individual inflation, using GDP in PPP current international dollars ($) as weights. Asia economies include China, India, Advanced Asian Economies (Hong Kong, China; Korea; Singapore; and Chinese Taipei), ASEAN5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam), and Asian EDMEs (Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Myanmar, and Sri Lanka).

Source: SEACEN staff calculations using data from Focus Economics consensus forecasts accessed through Haver Analytics in June 2025.

Although improved policy frameworks have made the region more resilient in the face of short- to medium-term domestic and external challenges in recent past, the ongoing U.S. trade policy uncertainty underscores the importance of deepening regional integration and cooperation. Central banks and monetary authorities in the region have successfully addressed recent external challenges, particularly the inflation surge of 2021-2023. Improved monetary policy and financial stability frameworks have made the region resilient in the face of common challenges and kept regional economies dynamic and agile. Indeed, the region's resiliency can be attributed to its improved policy frameworks and central bank independence (Adrian, Natalucci, and Wu, 2024). For instance, central banks and monetary authorities in the region and elsewhere have successfully curbed intense inflationary pressures post-COVID-19 pandemic through policy rate hikes. Some have eased monetary policy ahead of the U.S. Federal Reserve rate cut in September 2024 as domestic inflationary pressures subsided, and as local economic conditions permitted. With the ongoing U.S. trade policy uncertainty, harnessing the full potential and benefits of regional integration and cooperation is an important component in managing challenges associated with global trade. Policy dialogue will help identify common impacts and challenges of higher U.S. reciprocal tariffs as well as potential solutions. Moreover, deepening and broadening the integration of regional markets can provide new business and investment opportunities, which can fillip domestic growth and development, for years to come.

SECTION II: RECENT TRENDS IN CAPITAL FLOWS AND EXTERNAL POSITIONS

This section reviews the trends and compositions of capital flows and international investment positions of Asian economies over the full year 2024.[1]

- *Asian economies, as a whole, witnessed a marked increase in cross-border resident and nonresident capital flows in 2024, following two years of significantly lower cross-border capital flows in 2022 and 2023.*

- *The region's aggregate net foreign asset position remained positive, although some economies remained a net borrower in 2024.*

A. Trends in Capital Flows and International Investment Positions

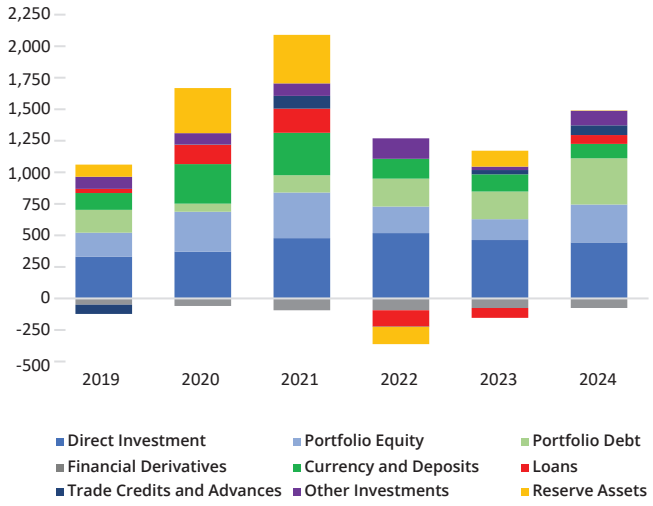
Net resident capital flows of Asian economies, as a group, amounted to US$754 billion in 2024.[2] Net acquisition of foreign assets by residents (Financial Account Assets) reached US$1,415 billion, while net incurrence of liabilities to non-residents (Financial Account Liabilities) amounted to US$661 billion, bringing net resident capital outflows to around US$754 billion. Resident capital outflows grew by almost 39% in 2024, compared to 2023. The bulk of resident net acquisitions of foreign assets were direct investments abroad, followed by portfolio debt and then portfolio equity resident outflows. In addition, residents resumed providing loans overseas in 2024, after two years of resident overseas loan retrenchment **(Figure 2.1a).** The region's resident investment abroad was mainly driven by Advanced Asian Economies (Hong Kong, China; Korea; Singapore; and Chinese Taipei) and China, whose resident capital outflows grew by around 55% from the previous year. Net incurrence of liabilities to non-residents, likewise, also grew in 2024, by around 22% from 2023. Nonresident inflows were mostly in the form of foreign direct investment (FDI), followed by portfolio debt liabilities, and currency and deposits **(Figure 2.1b)[3].** The largest recipient of FDI in 2024 were Advanced Asian Economies, followed by India and then ASEAN5 (Indonesia, Malaysia, Philippines, Thailand, and Vietnam). In the case of China, it registered a nonresident capital flow reversal of US$12 billion in 2024 due to reversals on nonresident currency and deposits and loans.

Across economies and subregions, Advanced Asian Economies and China reported the largest resident outflows in 2024, followed by India, ASEAN5 and Asian Emerging and Developing Market Economies (EDMEs), which include Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Nepal, and Sri Lanka **(Figure 2.2a).** For nonresident capital inflows, Advanced Asian Economies received the largest nonresident capital flows, followed by India **(Figure 2.2b).** Nonresident capital inflows to ASEAN5 grew by around 64% in 2024, compared to the previous year, while Asian EDMEs registered a 2% drop in foreign capital inflows in the same period. China used to be the largest recipient of nonresident capital inflows to the region until 2021, but it witnessed foreign capital flow reversals since then, particularly in 2022 and 2024.

The region's current account surplus widened in 2024 to around US$775 billion, which was almost 50% higher than the surplus of US$521 billion reported the previous year. The region's trade in goods balance grew significantly in 2024, primarily due to China, Korea, and Singapore **(Figure 2.3).** But India's trade in goods deficit increased to US$279 billion in 2024, compared to a deficit of US$245 billion in 2023. In contrast, the region's trade in services registered another deficit during the period of US$45 billion due to larger deficits from China. Excluding China, the region's trade in services would have been a surplus of US$184 billion. Meanwhile, Asia's primary income deficit (which includes investment income) continued to improve from a deficit of around US$274 billion in 2023 to a deficit of around

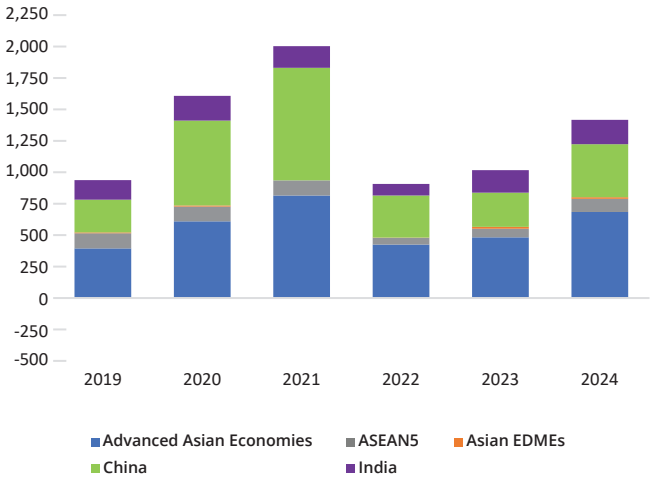
1. Asian economies in this monitor include Brunei Darussalam; Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Lao PDR; Malaysia; Mongolia; Nepal; Philippines; Singapore; Sri Lanka; Chinese Taipei; Thailand; and Vietnam with available data (whenever possible). These economies are also SEACEN member economies. The primary source of Balance of Payments (BoP) and International Investment Position (IIP) data is the International Monetary Fund (IMF) accessed through CEIC. Data from the IMF are consistently classified and standardised series in U.S. dollars across economies. All figures and data in this section exclude Myanmar and Papua New Guinea due to unavailable 2024 data.
2. The value of US$755 billion net capital flows refers to net acquisition of foreign assets by residents minus net incurrence of liabilities to non-residents.
3. Currency and deposits, loans, and trade credits and advances are treated as separate items in this report, while other investments include other receivables (payables), other equity, insurance and pension, and SDRs (for liabilities).

Figure 2.1a: Resident Capital Flows, Asia, by Category *(US$ billion)*



Notes: Asia includes Brunei Darussalam; Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Lao PDR; Malaysia; Mongolia; Nepal; Philippines; Singapore; Sri Lanka; Chinese Taipei; Thailand; and Vietnam. Other investments include other receivables; other equity; and insurance and pension.

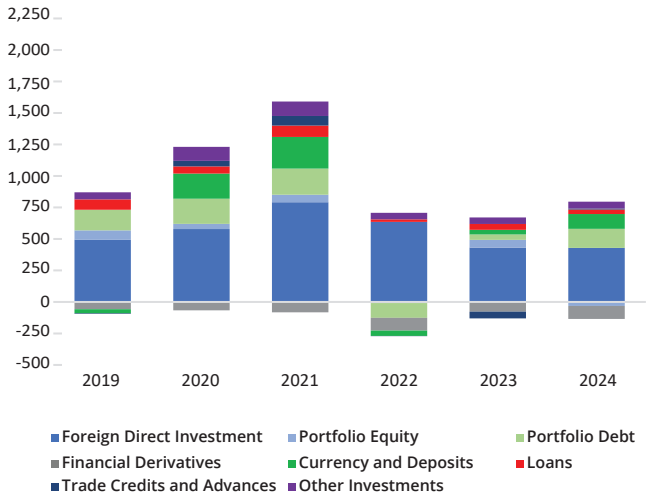
Figure 2.2a: Resident Capital Flows, Asia, by Sub-region *(US$ billion)*



Notes: Advanced Asian Economies include Hong Kong, China; Korea; Singapore; and Chinese Taipei. ASEAN5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Asian Emerging and Developing Market Economies (EDMEs) include Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Nepal, and Sri Lanka.

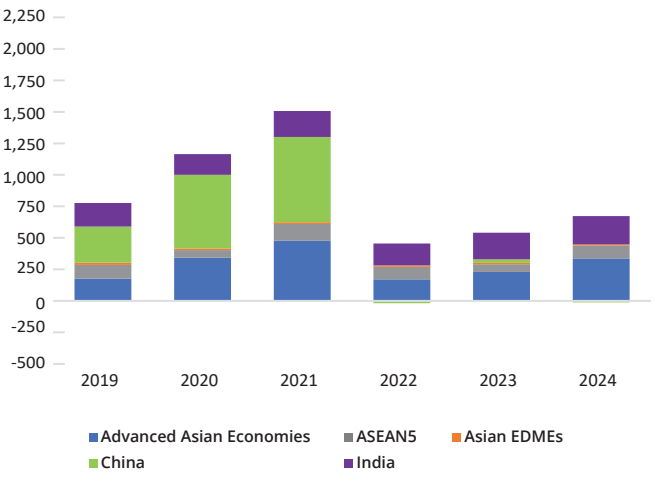
Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

Figure 2.1b: Nonresident Capital Flows, Asia, by Category *(US$ billion)*



Notes: Asia includes Brunei Darussalam; Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Lao PDR; Malaysia; Mongolia; Nepal; Philippines; Singapore; Sri Lanka; Chinese Taipei; Thailand; and Vietnam. Other investments include other payables, other equity, insurance and pension, and SDRs liabilities.

Figure 2.2b: Nonresident Capital Flows, Asia, by Sub-region *(US$ billion)*



Notes: Advanced Asian Economies include Hong Kong, China; Korea; Singapore; and Chinese Taipei. ASEAN5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Asian Emerging and Developing Market Economies (EDMEs) include Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Nepal, and Sri Lanka.

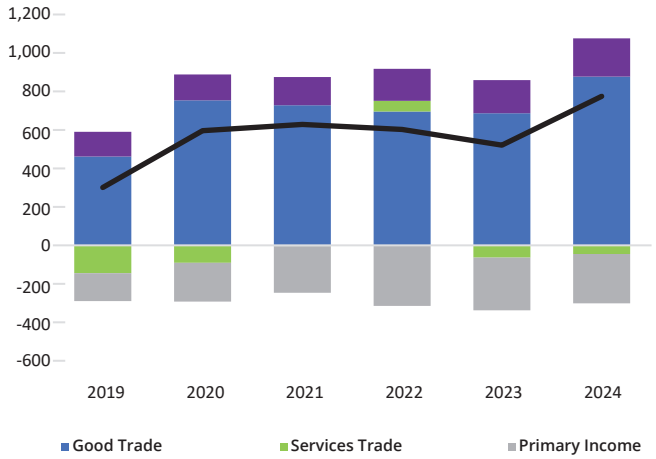
Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

US$256 billion in 2024, whereas the secondary income balance (which includes remittances) remained in surplus at US$199 billion, driven by surpluses from India and the Philippines. Across regional economies, the current account balances of India, Indonesia, Mongolia, and the Philippines were in deficit during the period, while the rest posted current account surpluses. But the current account surpluses of most Asian economies (including China) widened in 2024, except for Cambodia and Sri Lanka, whose current account surpluses narrowed during the review period.

Figures 2.1a-2.2b clearly show a marked recovery in cross-border resident and non-resident capital flows in 2024, compared to 2022 and 2023. The recovery in cross-border capital flows was mostly in portfolio debt and trade credits and advances. The observed improvement in the region's cross-border capital flows last year occurred during the period when global and regional policy rates were being recalibrated amidst subsiding global and regional inflationary pressures.

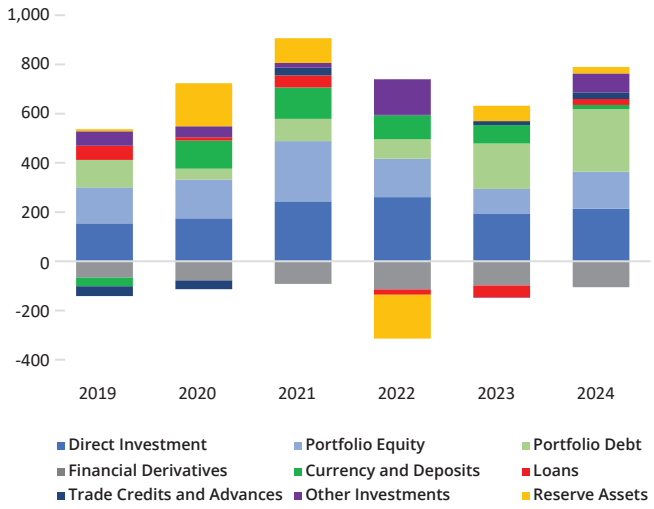
The resident capital outflows of most Asian economies increased in 2024, compared to 2023, due to larger resident overseas portfolio equity and debt flows as well as trade credits and advances; however, resident capital outflows dipped slightly in Asian EDMEs. China's resident capital outflows increased to around US$422 billion in 2024 compared to 2023, due to greater portfolio debt and equity flows and larger other investments abroad including trade credits and advances **(Figure 2.4a).** China also experienced foreign reserve decumulation in 2024, amounting to around US$62 billion. Meanwhile, resident capital outflows of Advanced Asian Economies, ASEAN5, and India, likewise, increased during the period, while those of Asian EDMEs declined. Advanced Asian Economies' resident capital outflows grew by 42% in 2024 to US$685 billion, from US$483 billion in 2023, because of larger resident outward investments in portfolio equity and debt flows, as well as trade credits and advances **(Figure 2.4b).** Similarly, ASEAN5's resident investments abroad rose to US$105 billion in 2024, from US$69 billion in 2023, due to larger resident overseas investments in

Figure 2.3: Current Account Balance, Asia
(US$ billion)



Notes: Asia includes Brunei Darussalam; Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Lao PDR; Malaysia; Mongolia; Nepal; Philippines; Singapore; Sri Lanka; Chinese Taipei; Thailand, and Vietnam.

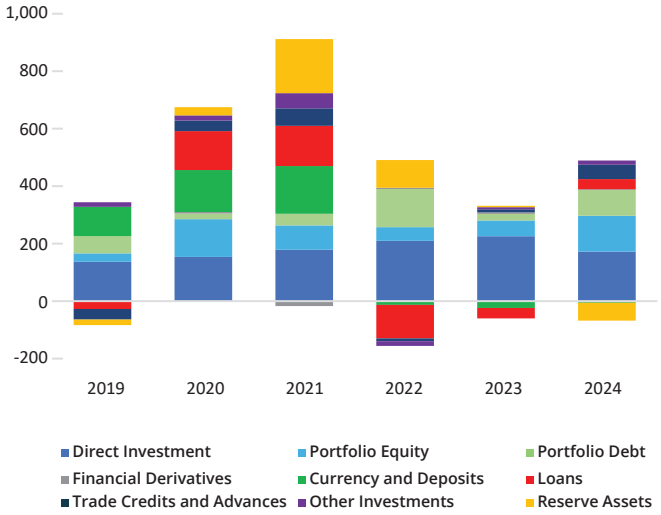
Figure 2.4b: Resident Capital Flows, Advanced Asian Economies *(US$ billion)*



Notes: Advanced Asian Economies include Hong Kong, China; Korea; Singapore; and Chinese Taipei. Other investments include other receivables; other equity; and insurance and pension.

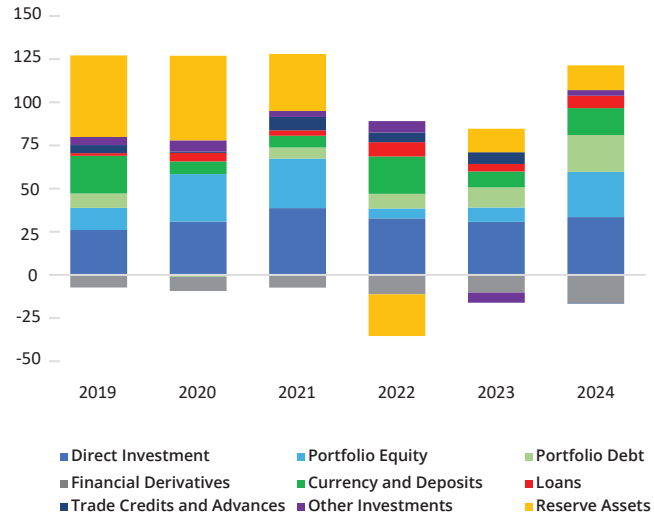
Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

Figure 2.4a: Resident Capital Flows, China,
(US$ billion)



Notes: Other investments include other receivables; other equity; and insurance and pension.

Figure 2.4c: Resident Capital Flows, ASEAN5
(US$ billion)



Notes: ASEAN5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Other investments include other receivables; other equity; and insurance and pension.

Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

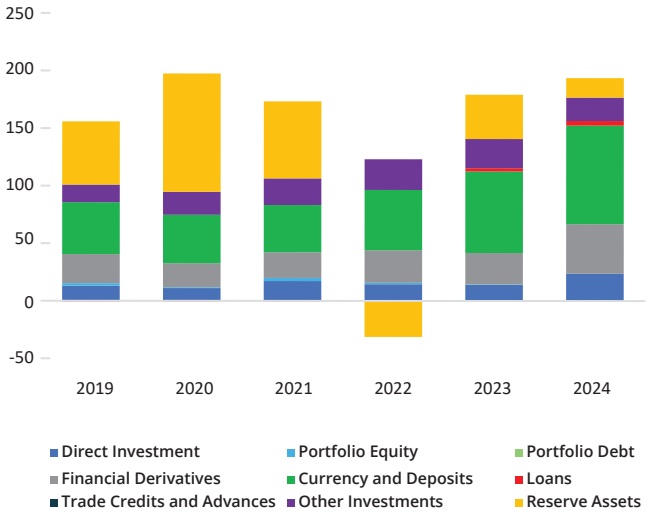
portfolio equity, portfolio debt, currency and deposits, as well as trade credits and advances **(Figure 2.4c).** India's resident investment abroad increased by around 8% from US$179 billion in 2023 to US$194 billion in 2024 because of the continued increase in resident direct investment abroad and financial derivatives **(Figure 2.4d).** In contrast, Asian EDMEs witnessed a slight drop in resident capital outflows, from US$14 billion in 2023 to US$13 billion in 2024, due to lower resident outflows of currency and deposits; trade credits and advances; and other investments **(Figure 2.4e).**

Nonresident capital inflows to the region saw a divide between economies which received larger and smaller inflows in 2024 compared to a year ago. Nonresident capital inflows to Advanced Asian Economies, ASEAN5, and India increased during the review period due to recovery in portfolio debt, currency and deposits, and trade credits and advances, compared to 2023. Nonresident capital inflows to Advanced Asian Economies grew from US$230 billion in 2023 to US$337 billion in 2024 due to higher cross-border foreign portfolio debt and loans **(Figure 2.5a).** ASEAN5 also reported higher nonresident capital inflows from US$62 billion in 2023 to US$101 billion in 2024 as the subgroup experienced strong improvement in foreign portfolio debt and currency and deposit inflows **(Figure 2.5b).** India also registered a significant increase in nonresident capital inflows of around US$225 billion in 2024, from US$211 billion in 2023, driven by foreign portfolio debt inflows **(Figure 2.5c).** In contrast, China reported a reversal of nonresident capital flows in 2024, amounting to US$12 billion, a turnaround from nonresident capital inflows of US$28 billion in 2023, driven by reversals in foreign portfolio equity, nonresident currency and deposits, and foreign loans **(Figure 2.5d).** Meanwhile, Asian EDMEs registered a slight decline in nonresident capital flows, albeit still inflows, in 2024 **(Figure 2.5e).**

The increase in the region's cross-border investments is, likewise, noticeable relative to regional GDP. Asia's resident and nonresident capital flows increased to around 4.8% and 2.2% of GDP, respectively, in 2024. This is a marked improvement from 2022, when the region reported lower resident and nonresident capital flows, of around 3.2% and 1.5% of GDP, respectively, due to then rising global and domestic policy rates. This suggests that the region's total cross-border investments have recovered in 2024 from their recent lows in 2022.

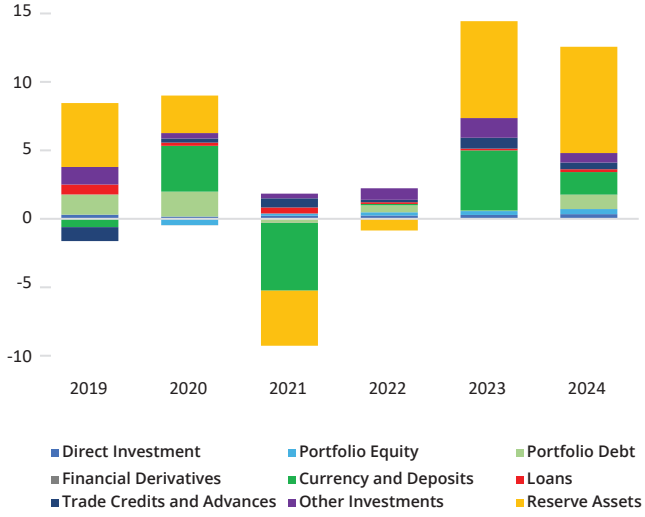
Total international investment liabilities of Asian economies increased by 5.3% to US$23.5 trillion as of end-2024, up from US$22.3 trillion at end-2023. Among Asian economies, Advanced Asian Economies, as a subgroup, held the largest international financial assets amounting to US$18.2 trillion, followed by China (US$10.2 trillion), ASEAN4 (US$2.0 trillion), India (US$1.1 trillion), and Asian EDMEs (US$64 billion), respectively. The international investment asset holdings of Advanced Asian Economies and China alone comprised around 90% of the region's total international investments

Figure 2.4d: Resident Capital Flows, India, *(US$ billion)*



Notes: Other investments include other receivables; other equity; and insurance and pension.

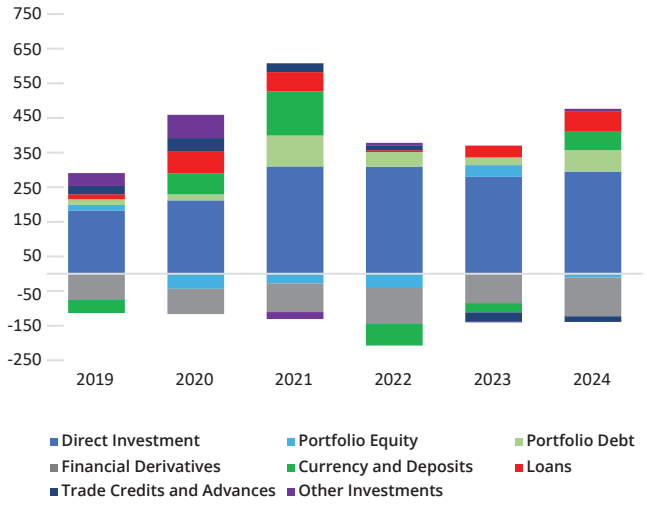
Figure 2.4e: Resident Capital Flows, Asian Emerging and Developing Market Economies *(US$ billion)*



Notes: Asian Emerging and Developing Market Economies (EDMEs) include Brunei Darussalam, Cambodia, Lao PDR, Mongolia, Nepal, and Sri Lanka. Other investments include other receivables; other equity; and insurance and pension.

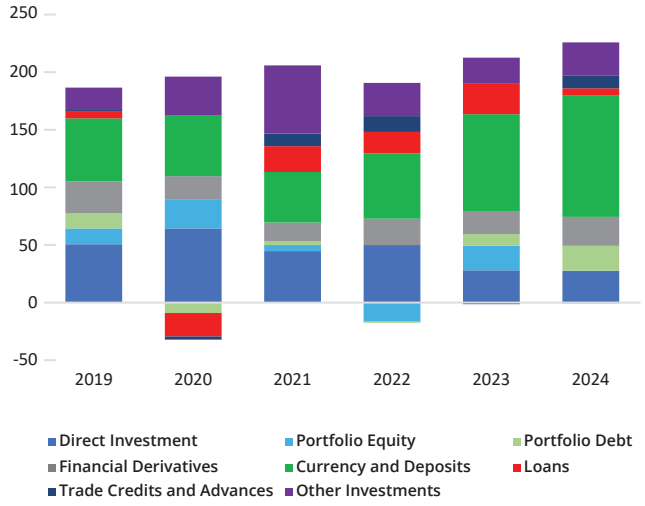
Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

Figure 2.5a: Nonresident Capital Flows, Advanced Asian Economies *(US$ billion)*



Notes: Advanced Asian economies include Hong Kong, China; Korea; Singapore; and Chinese Taipei. Other investments include other payables, other equity, insurance and pension, and SDR liabilities.

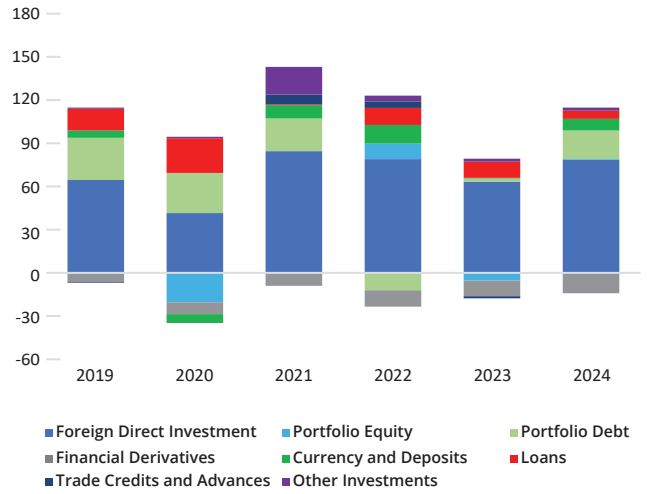
Figure 2.5c: Nonresident Capital Flows, India, (*US$ billion)*



Notes: Other investments include other payables, other equity, insurance and pension, and SDR liabilities.

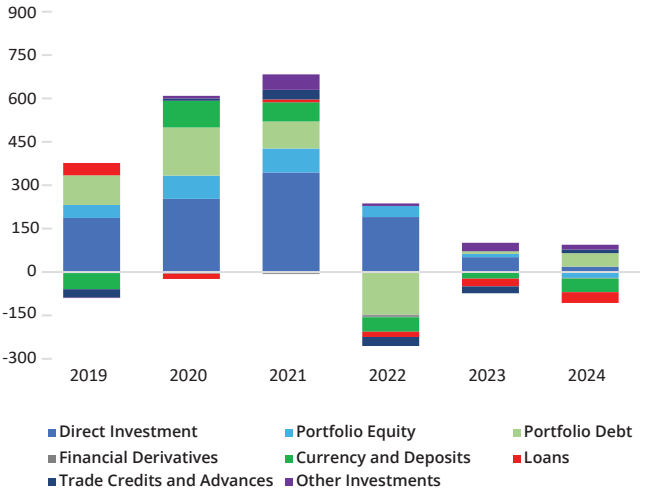
Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

Figure 2.5b: Nonresident Capital Flows, ASEAN5 *(US$ billion)*



Notes: ASEAN5 includes Indonesia, Malaysia, Philippines, Thailand, and Vietnam. Other investments include other payables, other equity, insurance and pension, and SDR liabilities.

Figure 2.5d: Nonresident Capital Flows, China, *(US$ billion)*



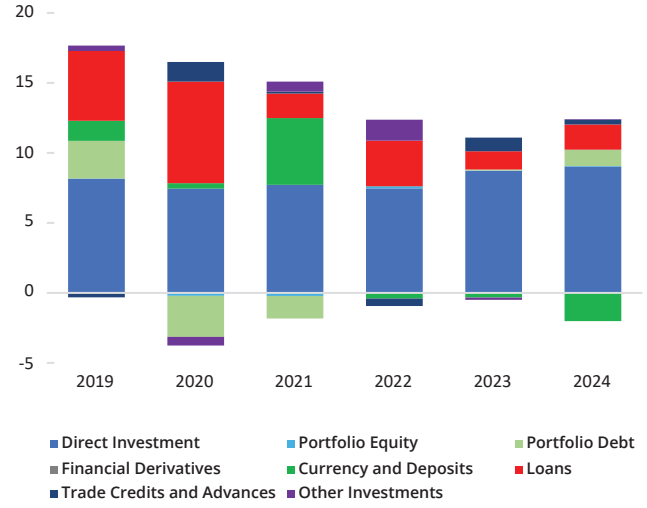
Notes: Other investments include other payables, other equity, insurance and pension, and SDR liabilities.

Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

(Figure 2.6a). Across asset categories, direct investment abroad (US$9.6 trillion) and official reserve assets (US$6.5 trillion) comprised the bulk of the region's foreign asset holdings in 2024, followed by portfolio equity (US$4.7 trillion), portfolio debt (US$3.7 trillion), and currency and deposits (US$ 3.1 trillion). The region's portfolio investment assets are more tilted towards portfolio equities rather than portfolio debt in 2024 **(Figure 2.6b)**. Excluding financial derivatives, the debt-equity asset ratio stood at 1.18 as of end 2024, which was slightly lower than 1.25 as of end-2023.[4] Compared to 2019-20 when the debt-equity asset ratio stood at 1.35, the continued decline of the debt-equity ratio for international assets suggests a growing preference for equity-type investments which could offer higher returns.

4. Debt investments include portfolio debt, currency and deposits, loans, trade credits and advances, other investments, and official reserve assets.

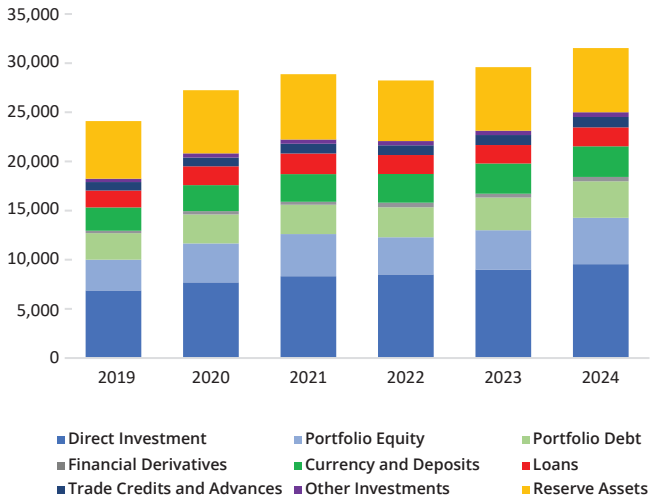
Figure 2.5e: Nonresident Capital Flows, Asian Emerging and Developing Market Economies *(US$ billion)*



Notes: Asian Emerging and Developing Market Economies (EDMEs) include Brunei Darussalam; Cambodia, Lao PDR, Mongolia, Nepal, and Sri Lanka. Other investments include other payables, other equity, insurance and pension, and SDR liabilities.

Source: SEACEN staff calculations using data from IMF's Balance of Payments Statistics accessed through CEIC Database (downloaded June 2025).

Figure 2.6b: International Investment Assets, by Category, (*US$ billion)*



Notes: Asia includes Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Malaysia; Mongolia; Nepal; Philippines; Singapore; Chinese Taipei; and Thailand. Other investments include other receivables; other equity; and insurance and pension.

Source: SEACEN staff calculations using data from IMF's International Investment Position accessed through CEIC Database (downloaded June 2025).

Figure 2.6a: International Investment Assets, by Sub-region *(US$ billion)*

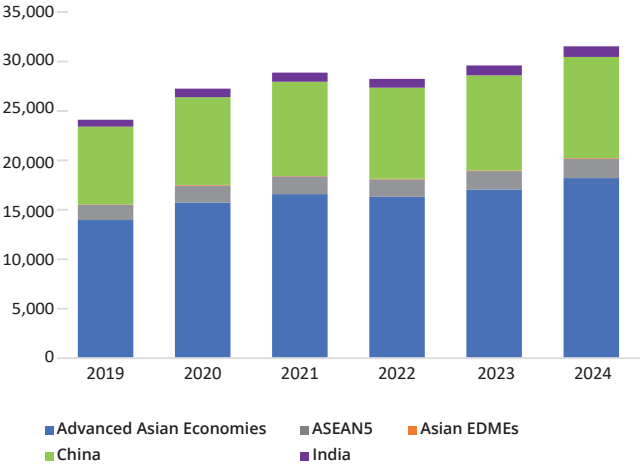
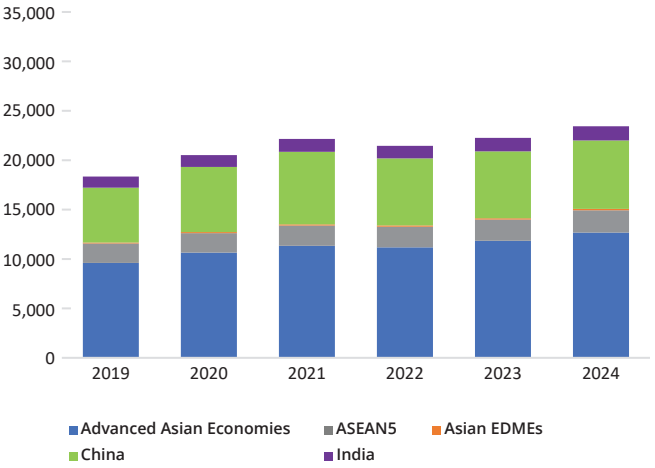


Figure 2.7a: International Investment Liabilities, by Sub-region *(US$ billion)*

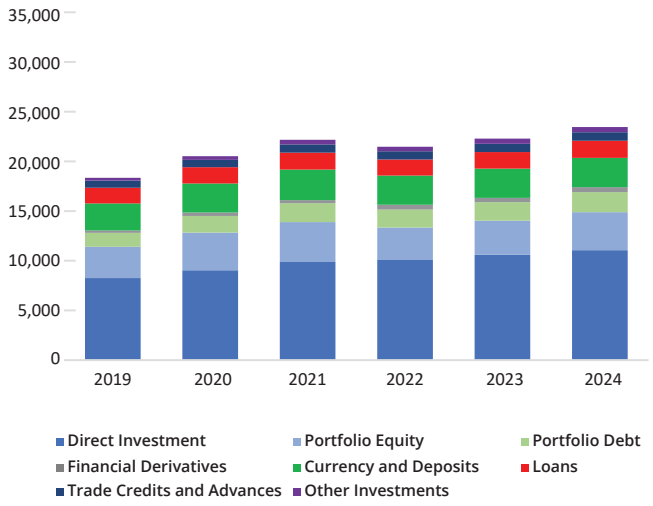


Notes: Advanced Asian Economies include Hong Kong, China; Korea; Singapore; and Chinese Taipei. ASEAN4 includes Indonesia, Malaysia, Philippines, and Thailand. Asian Emerging and Developing Market Economies (EDMEs) include Cambodia, Mongolia, and Nepal.

Source: SEACEN staff calculations using data from IMF's International Investment Position accessed through CEIC Database (downloaded June 2025).

Total international investment liabilities of Asian economies increased by 5.3% to US$23.5 trillion as of end-2024, up from US$22.3 trillion at end-2023. Among Asian economies, Advanced Asian Economies had the highest international financial liabilities amounting to US$12.7 trillion in 2024, again followed by China at US$6.9 trillion and ASEAN4 at US$2.3 trillion, respectively **(Figure 2.7a).** Meanwhile, the external financial liabilities of India and Asian EDMEs grew slightly by 5.5% and 4.4% in 2024 to US$1.4 trillion and US$141 billion, respectively, from the previous year. Across investment types, the region incurred foreign direct investment liabilities amounting to US$11.1 trillion, followed by portfolio equity investment at US$3.8 trillion and currency and deposits at US$3.0 trillion, respectively. **(Figure 2.7b).** Excluding financial derivative liabilities, the

Figure 2.7b: International Investment Liabilities, by Category, (*US$ billion)*



Notes: Asia includes Cambodia; China; Hong Kong, China; India; Indonesia; Korea; Malaysia; Mongolia; Nepal; Philippines; Singapore; Chinese Taipei; and Thailand. Other investments include other receivables; other equity; and insurance and pension.

Source: SEACEN staff calculations using data from IMF's International Investment Position accessed through CEIC Database (downloaded June 2025).

debt-equity liabilities ratio stood at 0.54 as of end-2024, slightly lower than 0.56 at end-2023, reflecting a continued tilt towards equity liabilities.

Asian economies, as a group, remained a net capital exporter in 2024 as their positive net foreign asset position stood at US$8.1 trillion, higher than the US$7.3 trillion at end-2023. However, within Asian economies, there was a clear divide between net capital exporters and net capital importers. China; Hong Kong, China; Korea; Nepal; Singapore; Chinese Taipei; and Thailand were net capital exporters as they have positive net foreign asset position at end-2024. In contrast, Cambodia, India, Indonesia, Malaysia, Mongolia, and the Philippines have negative net foreign asset position, indicating they were net capital borrowers. Across subregions, the net negative position of ASEAN4 economies remained the same in 2023 and 2024 at US$275 billion, whereas the net negative position of India and Asian EDMEs slightly improved in 2024 compared to 2023.

B. Outlook on Capital Flows and International Investment Positions

As a group, Asian economies will most likely sustain its positive net resident capital outflows and net foreign asset position in 2025, but at slightly lower levels compared to 2024. The region's net resident capital outflows, as a group, will most likely remain positive in 2025, buoyed by the region's current account balance which is expected to remain positive according to the latest IMF World Economic Outlook 2025 (IMF, 2025). However, compared to 2024, net resident capital outflows in Asia will most likely decrease in line with the region's narrower projected current account surplus for 2025. Moreover, trade policy uncertainty and geopolitical risks might weigh down the region's growth prospects and cross-border investment flows. Meanwhile, given the expected current account surpluses in 2025, the region will likely maintain its positive net foreign asset position, although divergence between economies with positive and negative positions will persist due to varying current account balances, exchange rate movements, and capital gains in 2025.

SECTION III: FDI, PRODUCTIVITY, AND ECONOMIC GROWTH: THE LITERATURE AND IMPLICATIONS[1]

This analytical section reviews the theoretical and empirical literature that considers the impact of foreign direct investment (FDI) on productivity and economic growth, before providing some policy considerations. The key takeaways are as follows:

- *Theoretical models show that FDI brings new knowledge, promotes specialisation, and stimulates innovation, which contribute positively to the long-run growth rate. However, this outcome hinges on technology diffusion, linkages, competition, and the ability of host economies to harness them.*

- *Empirical studies indicate that (i) FDI generates productivity spillovers conditional on the levels of human capital, trade openness, and financial development of recipient economies; (ii) horizontal spillovers have ambiguous effects as competition can crowd out or boost the productivity of local producers; (iii) backward vertical linkages provide the strongest productivity spillovers; (iv) knowledge can be transferred locally via labour mobility and innovation-induced competition; and (v) the type of FDI matters.*

- *These theoretical models and empirical evidence suggest that the impact of FDI flows on economic outcomes is conditional rather than systematic. Consequently, a sequenced policy roadmap consisting of three mutually reinforcing phases must be considered to fully capture the long-term benefits of FDI.*

A. Trends in Foreign Direct Investments

Worldwide inward foreign direct investment (FDI) expanded tenfold between 1990 and the mid-2010s annually, peaking at roughly US$2 trillion before sliding to about US$1.3 trillion in 2022. Over this period, a profound geographical reconfiguration of FDI flows has taken place **(Figure 3.1).** Europe accounted for the bulk of inflows at the turn of the millennium, but its share has since dwindled, even turning negative in 2022. While FDI flows to North America have fluctuated around US$300-350 billion per annum, Asia has emerged as the preferred destination for FDI flows, capturing close to one-half of global inflows (over US$600 billion) by the early 2020s. The rest of the world (Latin America, Africa, and the Middle East) continues to experience highly volatile, pro-cyclical swings in FDI flows.

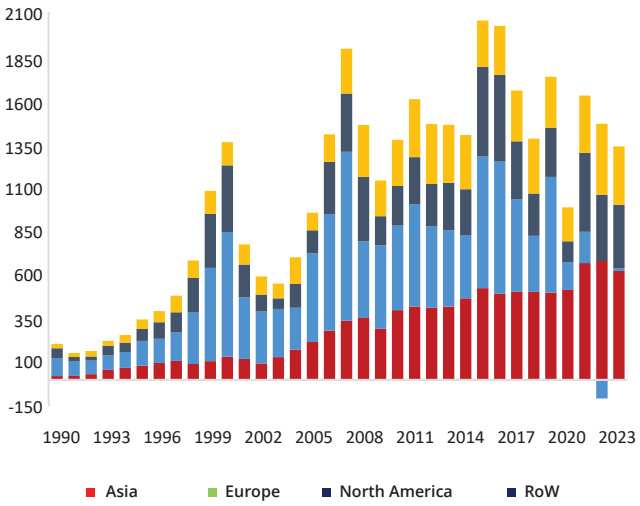
Examining cumulative net inflows since 1990 shows an even starker contrast in the shifts taking place in FDI flows across global regions **(Figure 3.2).** Asia's FDI index exceeds 3000 in the late 2010s—triple the world benchmark—while Europe falls below zero after 2021, illustrating outright net divestment. The magnitude of post-crisis boom-bust cycles has also increased, with the pandemic shock producing the sharpest contraction on record and only a partial rebound thereafter. These stylised facts signal that the global FDI landscape is becoming both more concentrated and more volatile.

This section examines a large body of theoretical and empirical literature that investigates how international capital mobility affects long-run growth and productivity in recipient economies. From a policy perspective, it is important to understand what the implications of capital flows are for macroeconomic outcomes. This is particularly relevant against the backdrop of the current geopolitical environment that raises the prospect of structural reversals of capital flows as well as greater volatility of these flows. This section distils important economic features that can harness the benefits of FDI, in terms of contributing to sustained economic growth and development.

In a nutshell, this section highlights how theoretical models map out the potential transmission channels through which FDI flows can raise total factor productivity (TFP). Empirical studies test whether these channels operate uniformly across host countries. The consensus that has gradually formed is one of marked heterogeneity: inflows of FDI are a necessary, but far from sufficient, condition for technology transfer and productivity gains to happen in host economies. The impact of FDI flows on technology transfer and productivity gains depends critically on host-country fundamentals such as human-capital endowments, market structure, and institutional frameworks.

1. This section draws on preliminary work of David Nefzi (2025) of the Banque de France entitled: "How do FDI flows impact macroeconomic outcomes? A literature review and policy implications". The SEACEN Centre will continue to work in this area by assessing the link between FDI and productivity through further empirical analysis.

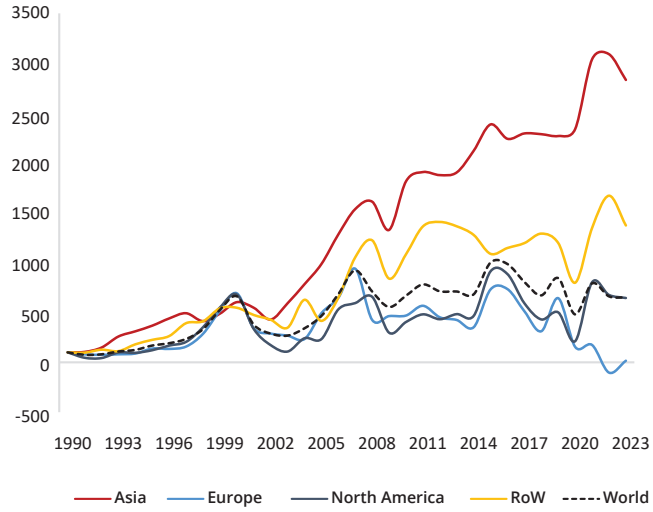
Figure 3.1: Inward FDI Flows,
by Region *(US$ billion)*



Notes: RoW = rest of the world

Source: United Nations Trade and Development (UNCTAD) Database.

Figure 3.2: Inward FDI Flows,
by Region *(Index 100 = 1990)*



Notes: RoW = rest of the world

Source: United Nations Trade and Development (UNCTAD) Database.

These insights lead to the following implications. First, reduced and more cyclical FDI inflows may negatively affect investments in frontier technologies—especially digital and green—as they need both large size and stability of FDI flows. Second, heightened policy uncertainty and tighter national-security screening can discourage the horizontal FDI flows that are channelled through multinational enterprises (MNEs). As horizontal FDI flows tend to foster knowledge spillovers through competition, labour mobility, and supplier linkages, these transmission channels will be negatively affected. On the other hand, economies that have already entrenched themselves in global production networks may be able to retain privileged access to both capital and knowledge, reinforcing existing productivity differentials.

B. Theoretical Models Linking Foreign Direct Investments and Productivity and Growth

Economic growth models have emphasised the importance of technological progress and knowledge accumulation as key drivers of continuous economic growth. In particular, the endogenous growth models of Romer (1990) and Aghion and Howitt (1992) demonstrate that economic growth is driven by ideas, innovation, and knowledge accumulation, which are often generated using capital and labour in research and development (R&D). For instance, capital encompasses human capital, in addition to machines, while labour can also be utilised to generate new knowledge, aside from producing goods and services. Consequently, in endogenous growth theory, capital and labour contribute directly to technological progress, thereby making growth sustainable over time. In an open economy setting, FDI is considered not only a source of capital accumulation but also an instrument of technological change which fosters productivity and, ultimately, growth (Grossman and Helpman, 1991; Rivera-Batiz and Romer, 1991).

The theoretical link between FDI and productivity growth can be categorised into types of models. First, horizontal diffusion models explain how foreign MNEs help local firms grow by sharing technology, either directly or indirectly. These spillovers happen through employees switching jobs, local firms following innovations, or simply observing how foreign firms operate. How fast a country can catch up depends on how large the technology gap is--such that it ought to be large enough to learn from but not too big that it becomes unmanageable (Findlay, 1978; Wang and Blomström, 1992). Studies show that the benefits of FDI are strongest when domestic workers are skilled enough to absorb new knowledge (Borensztein et al., 1998). Others suggest that imitation becomes easier once modern technologies are already being used locally (Glass and Saggi, 1998 and 2002). Benhabib and Spiegel (2005) highlight that even countries with lower education levels can grow if they reach the minimum

level needed for knowledge to spread. Additional models examine how companies safeguard their innovations when investing abroad, striking a balance between the cost of exporting and the risk of losing their intellectual property (Ethier and Markusen, 1996). These models explain why FDI often flows between developed countries and how it shapes wages, innovation, and industrial specialisation.

Second, vertical linkage models focus on how foreign MNEs interact with local suppliers and customers, creating positive ripple effects throughout the economy. When foreign MNEs purchase specialised domestic goods and services, they increase demand and encourage new local firms to enter the market, thereby enhancing productivity through the greater variety and higher quality of inputs. However, the extent to which this helps depends on factors such as communication costs, input intensity, and the host's existing supplier base. In some cases, foreign firms may isolate themselves (enclaves), while others can form transformative clusters (Rodríguez-Clare, 1996). These effects also apply to services like finance; information and technology; and logistics, where foreign demand helps local providers grow, specialise, and improve (Francois, 1990a, 1990b). As manufacturing expands, services become cheaper and more diverse, creating a cycle that boosts overall productivity. Ultimately, these models suggest that the growth impact of foreign investment comes not just from capital deepening per se, but in the domestic input interlinkages it activates.

Third, Schumpeterian competition models view FDI as a significant source of innovation that can fuel continuous innovation. When a foreign MNE enters a country with a better product or process, it can push local firms to innovate faster by raising the bar for productivity (Walz, 1997). This kind of competition can boost R&D and lead to more frequent innovations, known as "escape-competition" effect (Aghion et al., 2005). In the best-case scenario, FDI increases not just productivity levels but also the long-term growth rate. However, the benefits depend on whether local firms have the skills and resources to respond. If they do not, foreign firms may simply dominate the market without sharing knowledge (Aitken and Harrison, 1999). In such cases, FDI might actually harm local productivity by forcing smaller firms out of business. Ultimately, whether FDI helps or hurts depends on the local economy's readiness to compete and innovate.

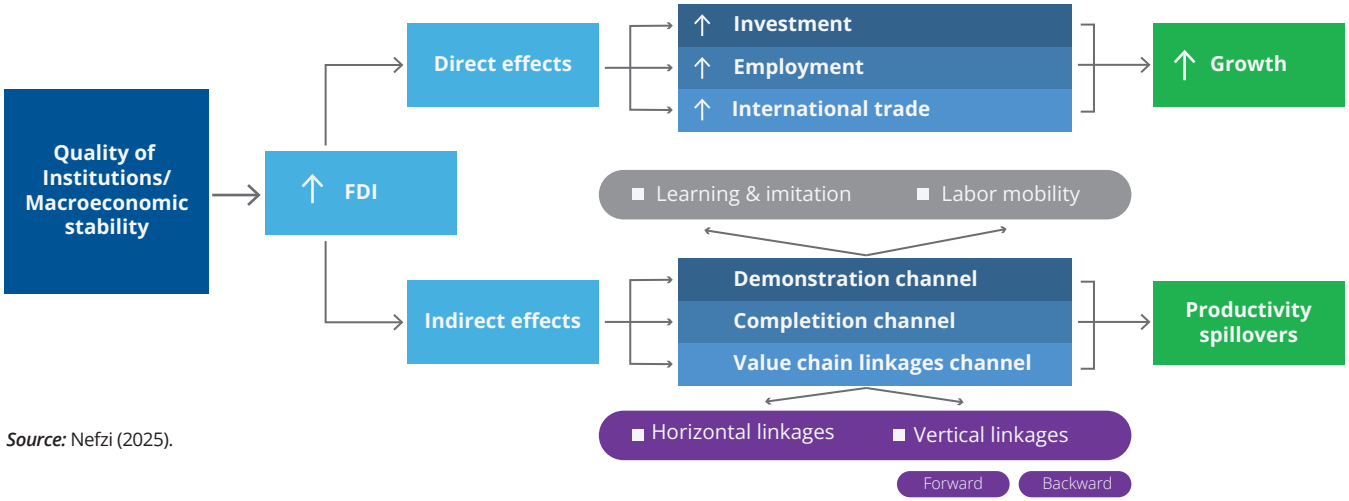
Across all model classes, absorptive capacity—encompassing education, managerial competence, infrastructure, and institutional quality—emerges as the pivotal condition for dynamic productivity gains. In diffusion models, absorptive capacity determines the speed at which ideas are decoded. In linkage models, absorptive capacity shapes supplier sophistication, while in Schumpeterian models, it governs incumbents' ability to respond to rivalry. The interaction between absorptive capacity and the technology gap is explicitly non-linear, such that productivity spillovers peak when the gap is neither too low nor too wide. Moreover, varying FDI objectives may lead to heterogeneous outcomes. Horizontal, market-seeking projects generate strong demonstration and competition effects, whereas vertical, efficiency-seeking plants embedded in global value chains tend to cultivate supplier networks. R&D-intensive or service-oriented investment diffuses general-purpose knowledge more widely than assembly operations. Consequently, the same host-country reform—say, a corporate-tax cut—can yield radically different growth outcomes depending on the sectoral composition of the ensuing FDI inflows.

Figure 3.3 summarises in a stylised manner the transmission channels of FDI on host economies' productivity and growth. The figure illustrates that FDI has the potential to serve as an engine of endogenous growth through productivity spillovers. It can introduce new knowledge, promote specialisation, and stimulate innovation in host economies, thereby affecting not only the level of output but also the long-run growth rate. The outcome, however, hinges on the mechanisms at play—technology diffusion, linkages, competition—and the host country's ability to harness them. The models underscore that FDI's growth impact is not automatic but mediated by economic conditions. This aligns with the mixed findings in empirical research, where positive spillovers are observed in some contexts but not others.

C. Empirical Evidence on the Impact of Foreign Direct Investments on Productivity and Growth

Over the past few decades, numerous empirical studies have assessed the impact of FDI on the productivity and growth of host economies. FDI is widely viewed as a conduit for technology transfer and productivity spillovers from MNEs to host economies. The critical question is whether FDI generates lasting productivity gains and higher

Figure 3.3: Transmission Channels of FDI on Growth and Productivity



Source: Nefzi (2025).

economic growth in recipient economies, and under what conditions these spillovers occur. The empirical literature offers five key findings.

First, FDI generates productivity spillovers only conditional on the levels of human capital, trade openness, and financial development of recipient economies. Blomström et al. (1994) found that very low-income FDI recipient economies lacked the absorptive capacity needed to transform foreign technology into productivity gains, leading to threshold models. Borensztein et al. (1998) corroborated the said threshold narrative. The authors embedded FDI in an augmented Solow framework that interacted inflows with human-capital endowment. The results indicate that the marginal product of foreign capital exceeded that of domestic capital only where the average schooling is above the sample median. In relation to trade openness, Balasubramanyam et al. (1996) examined how trade policy influences the impact of FDI spillovers. They found that FDI has a strong positive effect in export-oriented economies but little impact under import-substitution regimes. The study supports the view that trade openness reduces rent-seeking and enhances the effectiveness of foreign investment, while cautioning that FDI alone may not improve productivity in distorted economies. In the context of domestic financial development, Hermes and Lensink (2003) and Alfaro et al. (2004) showed positive FDI effects only in countries with deep financial systems. Strong financial intermediaries help allocate resources effectively, enabling domestic firms to absorb FDI spillovers more broadly.

The abovementioned macro-level studies relied on cross-country regressions that associate larger inflows with faster growth. Yet such macro-level evidence masks the mechanisms by which MNEs might affect domestic productivity. Micro-econometric studies looked inside the "black box" of productivity spillovers by examining industry and/or firm-level data. These studies revealed how foreign presence translates into productivity gains for local firms and highlighted distinctions between horizontal spillovers (within the same industry) and vertical spillovers (between multinationals and their local suppliers or customers in different industries).[2]

Second, horizontal spillovers have ambiguous effects as competition can either crowd out or boost the productivity of local producers. The net effect depends on the technological gap and the market structure. Haddad and Harrison (1993) used manufacturing data and found that although a foreign presence lowers the dispersion of productivity within industries, it did not raise the average productivity of domestic plants. Aitken and Harrison (1999) showed that an increase in foreign equity lowered the growth of domestic-plant productivity, mainly through the market-stealing effect. Similarly, Konings (2001) uncovered negative horizontal effects in Bulgaria and Romania, while Kokko (1994) argued that large technology gaps and protected product niches create MNE enclaves that insulate affiliates from local interaction. Meanwhile, Hale and Long (2011) addressed a bias in previous studies on China by instrumenting county-industry FDI with political variables. Once selection bias is accounted for, horizontal spillovers disappear, suggesting that earlier positive coefficients were driven by composition and endogeneity effects.

2. See Jordaan et al. (2020) for a comprehensive review of the empirical literature.

Third, the empirical literature suggests that backward vertical linkages provide the strongest productivity spillovers, although they are also conditional on the capabilities of local suppliers. Using factory-level data, Javorcik (2004) showed that domestic suppliers selling to foreign MNEs experienced a TFP boost within five years, but no benefits arose within the same industry. Using meta-analysis techniques, Havranek and Irsova (2011) reported robust evidence demonstrating knowledge transfer from foreign investors to domestic firms in supplier sectors (backward spillovers), but only a small effect on firms in customer sectors (forward spillovers) and no effect on firms in the same sector (horizontal spillovers). These results indicate that supply-chain ties, not competition, constitute the principal channel of foreign technology impact in many developing contexts. On forward vertical linkages, Blalock and Gertler (2008) showed that the main productivity spillovers from FDI accrue to domestic firms that supply foreign entrants. Foreign MNE buyers transmit technology and managerial expertise to their local suppliers, which lowers input costs and raises quality, which in turn boosts suppliers' TFP, sharpens competition, and reduces prices. These improvements propagate downstream to other purchasing sectors, creating a positive externality for firms that never transact directly with MNEs.

Fourth, knowledge can be transferred locally via labour mobility and through innovation-induced competition, but both channels depend on the characteristics of labour markets and intellectual property regimes. A complementary channel of spillover operates through labour mobility as tacit knowledge is embedded in workers. Görg and Strobl (2005) showed that entrepreneurs previously employed by foreign MNEs in the same industry founded start-ups with higher productivity, whereas experience in other industries showed no effect, indicating industry-specific knowledge. Balsvik (2011) used matched employer–employee records to calculate the share of workers recently employed by MNEs for each plant. The estimates show a positive and significant correlation between this share and plant productivity, such that the plant-level effect exceeded the private wage premium, signalling a genuine externality. Beyond productivity levels, the interaction between FDI and domestic innovation is contested. Applying a difference-in-differences strategy around China's 2002 revision of the foreign-investment catalogue, Chen et al. (2022) combined firm balance sheets with patent citations and found that encouraged industries registered significant rises in patent quantity and quality. They traced the mechanism to the escape-competition effect formalised by Aghion et al. (2005), such that intensified rivalry pushes incumbents to innovate in order to retain market share.

Lastly, the type of FDI matters; greenfield direct investments and collaborative joint ventures transmit substantially more technology than acquisition-led expansion. In the Czech Republic, a rigorous "meet-the-buyer" screening process is complemented by results-based matching grants that cover up to 60% of certification and testing costs. Participating SMEs doubled their value-added relative to matched non-participants, and two-fifths of MNEs reported measurable delivery-performance gains from Czech vendors (Smarzynska and Spatareanu, 2014). Focusing on cluster programmes, empirical evidence from the United Kingdom shows that productivity spillovers from inward FDI materialise only when MNEs locate inside well-established industrial clusters (De Propris and Driffield, 2006). TFP gains accrue both to domestic firms and to the foreign affiliates themselves, which appear to source local knowledge and appropriate the returns to domestic investment. By contrast, when the same foreign investors enter regions without dense agglomeration, the competitive pressure they introduce merely crowds out local output, without raising compensating spillovers. The key distinction, therefore, is not between foreign and domestic ownership per se, but between cluster and non-cluster locations.

D. Summary and Policy Considerations

The findings from the literature survey on how FDI flows impact economic outcomes can be summarised in two parts: those based on theoretical models and the other based on empirical studies. Studies employing theoretical models suggest that FDI flows have the potential to be an engine of endogenous growth through productivity spillovers. FDI flows can bring new knowledge, promote specialisation, and stimulate innovation in host economies, which in turn contribute positively to the long-run growth rate (not just the level of output). This outcome, however, hinges on the mechanisms at play—technology diffusion from MNEs, linkages, and competition—and the host country's ability to harness them. The models underscore that FDI's growth spillover is not automatic but will be determined by economic conditions in the FDI recipient country.

The key takeaways from the survey of empirical literature reveal five stylised facts. First, FDI generates productivity spillovers conditional on the levels of human capital, trade openness, and financial development in the recipient economies. Second, horizontal spillovers have ambiguous effects: competition can crowd out or boost the productivity of local producers, and the effect depends on the technological gap and market structure. Third, backward vertical linkages provide the strongest productivity spillovers. Fourth, knowledge can be transferred locally via labour mobility and through innovation-induced competition, but both channels depend on the characteristics of labour markets and intellectual property regimes. Fifth, the type of FDI matters: greenfield plants and collaborative joint ventures tend to transmit substantially more technology than acquisition-led footprint expansion.

To sum up, the collective evidence on how FDI flows impact macroeconomic outcomes is conditional rather than systematic. Generous tax exemptions, accelerated depreciation allowances, and unrestricted profit repatriation can certainly attract some FDI inflows, yet they do not generate on a regular basis the iterative learning, imitation, and supplier upgrading that translate FDI flows into lasting productivity improvements. What ultimately matters is the manner in which foreign projects are embedded within domestic production networks and the extent to which local firms can absorb the external knowledge that MNEs bring. Policies that focus exclusively on inflows risk leaving the productive structure of the economy unchanged. Rather, it is important to first consolidate sectoral clusters and then lure investors committed to knowledge transfer. This could be followed by giving subsidies to suppliers for technology upgrading on a results-driven basis. Such an approach stands the best chance of converting external capital from a balance-of-payments entry into a durable engine of productivity growth.

Consequently, the following may be considered in prioritising a sequenced policy roadmap consisting of three mutually reinforcing phases. First, authorities must deepen existing industrial clusters by formulating an ex-ante strategy that identifies value chains located at a moderate technological distance from the global frontier. Second, policymakers must attract foreign projects selectively, favouring investors whose capabilities complement the targeted clusters and who are prepared to formalise long-term commitments to local sourcing and knowledge transfer. Third, authorities need to implement a targeted supplier-linkage programme that increases the potential for spillovers through contractual arrangements and continued joint upgrading of the programme. Each phase is a prerequisite for the success of the subsequent one.

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SEACEN Capital Flows Monitor 2025 *Update*

The SEACEN Capital Flows Monitor is a bi-annual report on cross-border capital flows and net foreign asset positions of SEACEN member economies, which are members of the SEACEN Expert Group (SEG) on Capital Flows. The report discusses financial market developments in the region, recent trends, and the outlook on capital flows and international investment positions. A separate section provides a thematic analysis of topical issues, such as foreign direct investment and productivity growth.

The SEACEN Centre

The South East Asian Central Banks (SEACEN) Research and Training Centre was first established as a legal entity in 1982 with eight member central banks/monetary authorities which has since grown to nineteen members. The SEACEN Centre has established its unique regional position in serving its membership of central banks in the Asia-Pacific region through its learning programmes, research work, and networking and collaboration platforms for capability building in central banking knowledge.

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