

Peter Pang: Promoting and maintaining financial stability in Asia through cross-border co-operation

Remarks by Mr Peter Pang, Deputy Chief Executive of the Hong Kong Monetary Authority, at the Hong Kong Monetary Authority – Bank of Thailand Joint Press Conference on the launch of US dollar – Thai Baht PvP link, Hong Kong, 15 July 2013.

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Deputy Governor, ladies and gentlemen,

I would like to thank the Bank of Thailand for co-hosting this press conference with the Hong Kong Monetary Authority (HKMA). It is my great pleasure to join Deputy Governor Mr. Krirk Vanikkul to announce the implementation of the payment-versus-payment (PvP) link between the Thai Baht Real Time Gross Settlement (RTGS) system in Thailand and the US dollar RTGS system in Hong Kong.

This PvP link sets another excellent example of central bank cooperation to provide solutions to enhance regional financial stability and to meet market needs. In particular, it will make a significant contribution to addressing the current principal risk in the USD-Thai Baht foreign exchange (FX) transactions that arises from buyers of USD paying Thai Baht in Asian time ahead of receiving US dollar in US time the next day. For technical people in the payment field, this is often referred to as the “Herstatt” risk which brought down the Herstatt Bank in Germany in 1974. The new PvP link will eliminate this principal risk by enabling the Thai Baht delivered in Thailand and the US dollar delivered in Hong Kong to be done at the same time in a coordinated manner within the Asian time zone.

The linkage of the two RTGS systems will enhance integration of the financial markets in Thailand and Hong Kong, and provide a win-win solution that will bring significant benefits to the banks on both sides. For the banks in Thailand, the USD RTGS system in Hong Kong, with its low cost and operating hours that are fully synchronized with its Thai counterpart, will provide a highly flexible and cost-effective solution for them to manage the settlement risk of their US dollar FX transactions. There are more than 90 participating banks in the USD RTGS system in Hong Kong, of which 18 have significant presence in Thailand. This extensive network will provide ample USD liquidity and easily accessible correspondent banking service to the Thai banks for the PvP service. For banks in Hong Kong, the link will provide them with new correspondent banking opportunities of serving Thai banks in settling their US dollar FX transactions in Hong Kong. Over time, this new relationship will also create opportunities for commercial cooperation on other fronts.

The implementation of this PvP link comes at an opportune time in view of the need to better manage the increased settlement risk due to the rapid growth in FX transactions and to assist financial institutions, in particular banks, to comply with the standards recommended by the international standard setting bodies.

Driving the rapid growth in FX activities of the regional currencies has been Asia’s expanding share in global trade and investment flows. In the past decade, trade between Asia and the rest of the world had grown tremendously. Asian economies’ export of goods and services, as a percentage of the world total, increased significantly from 29% in 2002 to 38% in 2012, amounting to US\$8.5 trillion. Asian economies’ total imports also increased significantly in the same period from 32% to 47%. Meanwhile, the investment flows between Asia and other regions have also intensified. Supported by the robust trade performance and increasing capital flows, activities in the regional FX market have increased significantly. According to the latest triennial survey on global FX market activity of the Bank for International Settlements (BIS), the average daily turnover in FX transactions involving Asian currencies increased by 172% from US\$354 billion equivalent in 2001 to US\$962 billion equivalent in 2010.

Against this backdrop of rapid growth in global FX activities, the Basel Committee on Banking Supervision issued an updated guidance on management of FX risk in February 2013. The Committee cautioned that many banks underestimate their principal risk by not taking into account the duration of exposure between trade execution and final settlement, which may create significant concerns during times of market stress. A key recommendation of the Committee is that banks should reduce its principal risk as much as practicable by settling FX transactions through the use of financial market infrastructures that provide PvP arrangements. Banking supervisors worldwide are incorporating the updated guidance into their supervisory requirements. For example, banking supervisors in Hong Kong are now bringing their supervisory manuals in line with the guidance, and have reminded banks to take actions to address any gaps and deficiencies. The decision of the Bank of Thailand to implement the PvP link will certainly facilitate banks in Thailand to meet the Basel Committee's recommended standards in good time.

The new PvP link will be the third cross-border PvP link for Hong Kong's USD RTGS system. The successful experience of the established links with Malaysia and Indonesia clearly indicates that the arrangement can be fully integrated into the operation of the partner RTGS systems, tailored to meet local requirements and made easily accessible by local users. Since 2010 when both links have been in operation, the combined average daily turnover has almost doubled, equivalent to an annual growth rate of close to 20%. Last month, the daily turnover generated by the two existing PvP links reached a new record of US\$4.1 billion. Given the proven track record of the two existing links, I am confident that the new link with the Thai Baht RTGS system will similarly be able to deliver reliable service to the banks in Thailand.

As always, the HKMA stands ready to explore with our Asian neighbours opportunities for further collaboration in the area of financial infrastructure to promote regional financial integration and to help our markets cope with the challenges posed by the rapidly changing landscape of the global financial system. The implementation of this new PvP link demonstrates that both the Bank of Thailand and the HKMA fully recognise the merits and importance of cross-border co-operation to the promotion and maintenance of financial stability in the region. I believe that the solid partnership developed out of this project will open up new horizons for further cooperation between the Bank of Thailand and the HKMA in the future.

Thank you.