Changes in financial markets and payment systems

Jaap Koning

The subject of this CPSS conference has been well chosen indeed. For a number of reasons the G-10 central banks' attention has increasingly focused over the last decade on the safety and reliability of payment systems, a concern that has been reflected in a large number of CPSS reports on payment systems and related subjects that as a rule have been made public. The presence of a large number of central bank representatives from all over the world at this conference shows, moreover, that this interest is not confined to the G-10 central banks alone.

One motive for central bank interest in payment systems is, as you are all aware, the crucial role of these systems in the implementation of monetary policy operations, as these require an instrument through which liquidity can be efficiently provided to, or withdrawn from, the markets. For this reason, central banks often operate a payment system of their own, usually based on real-time gross settlement. In addition, however, central banks have a more general interest in the well-being of payment and settlement systems. This is not only because major disturbances in such systems might influence the functioning of financial markets as such, but also because payment systems are the vehicle through which transactions in the real economy are effected, and hence the smooth functioning of such systems is of the utmost importance for day-to-day life.

There are a number of fundamental changes in the financial markets which have an impact on payment and settlement systems. The above-mentioned increased awareness of the risks involved in payment systems has triggered a number of modifications to these systems.

Another important factor is the high speed of technological progress. The immense advances in information technology over the past decades, notably in terms of greater computer power, declining processing costs and innovative network developments, have made it possible to realise the tremendous growth in national and international payments.

A further fundamental change in financial markets concerns the internationalisation of financial flows. In my view, a main factor that has contributed to this heightened interdependence is the liberalisation of financial markets, in combination with the introduction of innovative products such as options and futures, to name but two. This has greatly increased the financial flows that have to be processed each day. To facilitate this, an interconnection of financial centres has been realised, allowing trades to be conducted on a 24-hour basis worldwide.

From a central bank standpoint, these developments, although in principle to be welcomed because of their contribution to the efficient allocation of financial resources, require close attention, as the interrelationships between worldwide financial markets could also give rise to a propagation of risks. After all, if a major participant in one market should fail to honour its obligations, the impact might no longer be restricted to an isolated market segment, but could have much broader repercussions. In recent studies this phenomenon is usually referred to as the domino effect. For this reason, and also because the extremely high investments needed for worldwide operations might drastically limit the number of financial institutions operating on a truly global basis, the financial soundness of the major participants in the financial markets, and the robustness of the infrastructures in which they operate, are of the utmost importance.

Having said this about the more general trends which may give rise to changes in the traditional patterns in the area of payment and settlement systems, I do recognise, of course, that in each individual country the national environment will be different. In addition to these general trends, therefore, changes in national circumstances may equally cause changes in payment operations and infrastructures.

In Western Europe countries will have to adapt their payment systems to meet the demands of increasing cooperation. Here I am referring in particular, of course, to the integration process in Europe, i.e. the creation of economic and monetary union, or EMU, to which most members of the European Union have committed themselves. For those countries that meet the admission criteria, and have not decided to opt out for the time being, EMU will start on 1st January 1999 with the introduction of the euro as the single currency. On that same date, the European Central Bank (ECB) will commence its operations as the independent central bank for the Union, and the national central banks will become part of the European System of Central Banks (ESCB).

This integration process will have consequences in a great many areas, one of which will be the way in which the payment systems in the European Union are organised. The exact form of the changes in procedures and infrastructures of private sector credit institutions is still unclear, but one may be sure that the disappearance of a large number of the present currencies, which will be replaced by the euro, will lead to increased competition, especially in the money and capital markets, to which market participants will be bound to respond.

For the national central banks of the participating countries, the outlook is more clear. As from 1st January 1999, they will use the euro in their administrative and payment systems, although some of them may offer conversion facilities for a limited period of time to those of their customers who still use the national currency. Furthermore, in order to facilitate the monetary policy of the ECB, the RTGS systems of the national central banks will be linked, to form an EU-wide payment infrastructure, called TARGET. Although TARGET will primarily serve as an instrument for the ECB to perform monetary policy operations, the system will also be available for private sector institutions as a mechanism for making cross-border payments. As such, it will be a competitor to other payment infrastructures, like the clearing organised by the EBA or traditional correspondent relationships.

Another group of countries which are affected strongly by institutional changes are those which are moving from a centrally planned economy to a market economy. For these countries the modernisation of payment and settlement systems is even more complicated, as they usually have to move at the same time from a centralised system to a more decentralised one. Therefore, in addition to responding to the changes brought on by worldwide developments, they have to evaluate to what extent a continuation of (part of) the previous payments infrastructure is still feasible and desirable. As I see it, other central banks and international organisations like the IMF and the World Bank can provide invaluable expertise in this area.

I have tried to identify some of the elements that in my view are important when discussing developments in payment systems in the years to come. As I indicated, however, national situations may differ considerably and we may all benefit by learning from each other.