Darryl Chan: Sustaining financial stability amid uncertainty, fragmentation and rapid innovation

Opening remarks by Mr Darryl Chan, Deputy Chief Executive of the Hong Kong Monetary Authority, at the joint conference on "Sustaining financial stability amid uncertainty, fragmentation and rapid innovation", organised by the Hong Kong Institute for Monetary and Financial Research (HKIMR), the International Monetary Fund (IMF), and the Bank for International Settlements (BIS), Hong Kong, 14 July 2025.

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Hyun (*Hyun Song Shin, Economic Adviser and Head of the Monetary and Economic Department, BIS*),
Jason (*Jason Wu, Assistant Director, Monetary and Capital Markets Department, IMF*),
distinguished guests, ladies and gentlemen, good morning.

It gives me great pleasure to welcome you to today's conference, jointly organised by the Hong Kong Institute for Monetary and Financial Research (HKIMR), the International Monetary Fund (IMF), and the Bank for International Settlements (BIS).

The theme of this conference aptly summarises the complex and unsettling global economic and financial landscape. The world today faces a confluence of challenges, chief of which are uncertainty and fragmentation. Innovation greatly improves efficiency and promotes growth. But the disruption it brings, and the speed with which it advances, also poses tremendous challenges to the way we used to monitor and manage risks and vulnerabilities. Putting together all these known and unknown risks, it makes the task of sustaining financial stability all the more challenging.

We have a strong line-up of speakers for this two-day conference. For sure there will be plenty of insightful sharing and exchange regarding these important topics. If I may, by way of raising the curtain, share some initial thoughts and observations.

Let me start with fragmentation in global trade. In recent years reshoring or friend-shoring has been widely discussed and, to some degree, being put into action. Yet, wholesale relocation of supply chains has proven difficult and uneconomical due to the entrenched integration of global supply chain with local production ecosystems and end markets. The result is therefore a web of more diversified supply chains, with connector economies playing a more significant role. However, with the recent wide-spread tariff measures, some of which may highlight the significance of local value added content, it seems the end game is far from settled.

Already, recent data indicates a decline in new export orders across many economies, signalling a slowdown in global trade. Over time, this could lead to more persistent dislocation of supply chains and increased fragmentation in a global trading system that aimed to optimise economic efficiency. The uncertainties are slowing down investments as people take a wait-and-see approach, pending more clarity on the future of global trades.

The twists and turns on the trade front have brought volatility to financial markets, unsettled by the potential supply shock brought by much elevated tariff levels, and its implications on US inflation outlook and future interest rate path. This has added new complexities to the global financial system that already had to grapple with a multitude of vulnerabilities including elevated asset valuations, rising debt levels, and increased leverage among non-bank financial institutions (NBFIs).

At one point, the markets seemed to be casting doubts on what used to be regarded as safe haven assets. The effect was immediately felt in this region with the abrupt unwinding of long-USD positions and the widespread appreciation of Asian currencies. The episode also exposed the degree of unhedged forex positions by some exporters and financial institutions in the region. That said, recent market movements amid continued uncertainties seemed to suggest that risk-on exuberance is back. There could be multiple reasons behind the swing in market sentiments. The question is whether excessive complacency is being built up that may come back and haunt us.

Let me turn to innovation. The advancement of artificial intelligence (AI) has drawn much discussion about its potential to revolutionise various aspects of finance, from risk management to customer service, as well as the potential risks of AI models and algorithms to the financial system.

In the world of finance, the equally exciting, and perhaps more imminent, issue is the emergence of tokenisation. In its latest annual economic report, the BIS devotes a full chapter to the discussion of the next-generation monetary and financial system, including the very hot topic of stablecoins. The intellectual rigour behind the study, in particular the very concept of a "unified ledger", presents us with an excellent framework to get a glimpse of what the future of finance may hold in the form of tokenisation.

I hope Hyun would be kind enough to share some of the thoughts with us. Suffice it to say, at this point, that Hong Kong is bringing stablecoins under regulation, and that we are at various stages of putting together the building blocks of the unified ledger. It would be interesting to look back, hopefully in the not too distant future, how things have evolved in this space.

Ladies and gentlemen, we are living in a world of uncertainty. Policymakers should adopt an agile approach that is capable of responding to a wide range of scenarios, while ensuring effective communication of their policy reaction functions. Let me highlight a few things that central banks and regulators should do to address emerging risks and safeguard financial stability.

First, we need to continuously enhance our surveillance frameworks for risk monitoring. I mentioned non-banks in my earlier discussion. As an example, the HKMA has developed a holistic surveillance framework to help us better monitor systemic risks in the financial system. The framework uses granular data sets, including trade repository data on over-the-counter derivatives and transaction-level data on bank loans, to reconstruct NBFIs' portfolios and risk exposures. Together with textual analysis and conventional indicators, the framework gives us a fuller picture of NBFIs' market positions and potential vulnerabilities, as well as early warning indicators for closer monitoring and follow-up actions.

We have also been experimenting with AI tools to enhance financial stability monitoring, leveraging its ability to distil insights from large pools of data, particularly document-based data such as research reports and news articles. This capability is particularly valuable in identifying emerging risks that may not be captured by traditional indicators.

Second, the rapid pace of financial innovation calls for timely regulatory preparedness. We seek to encourage a culture of responsible innovation. Again, using AI as an example, we aim to reap its benefits while effectively managing its risks. To this end, the HKMA has launched a Generative AI sandbox which provides a risk-controlled environment for banks to develop and test innovative solutions. The sandbox enables us to understand how banks intend to use AI, gauge the potential risks, and assess the need for supervisory guidance.

Last but not least, multilateral collaboration is crucial. Despite the threat of economic fragmentation, the global financial system is highly interconnected. It makes perfect sense that central banks, regulators, and international organisations like the IMF and the BIS continue to collaborate closely and safeguard the resilience and stability of the financial system. Only by delivering on this goal, we can continue to have the trust of the people that we serve.

With that, it remains for me to thank all speakers and participants for joining us at this conference, which I am sure will be a great occasion for fruitful and insightful exchange. Thank you.