

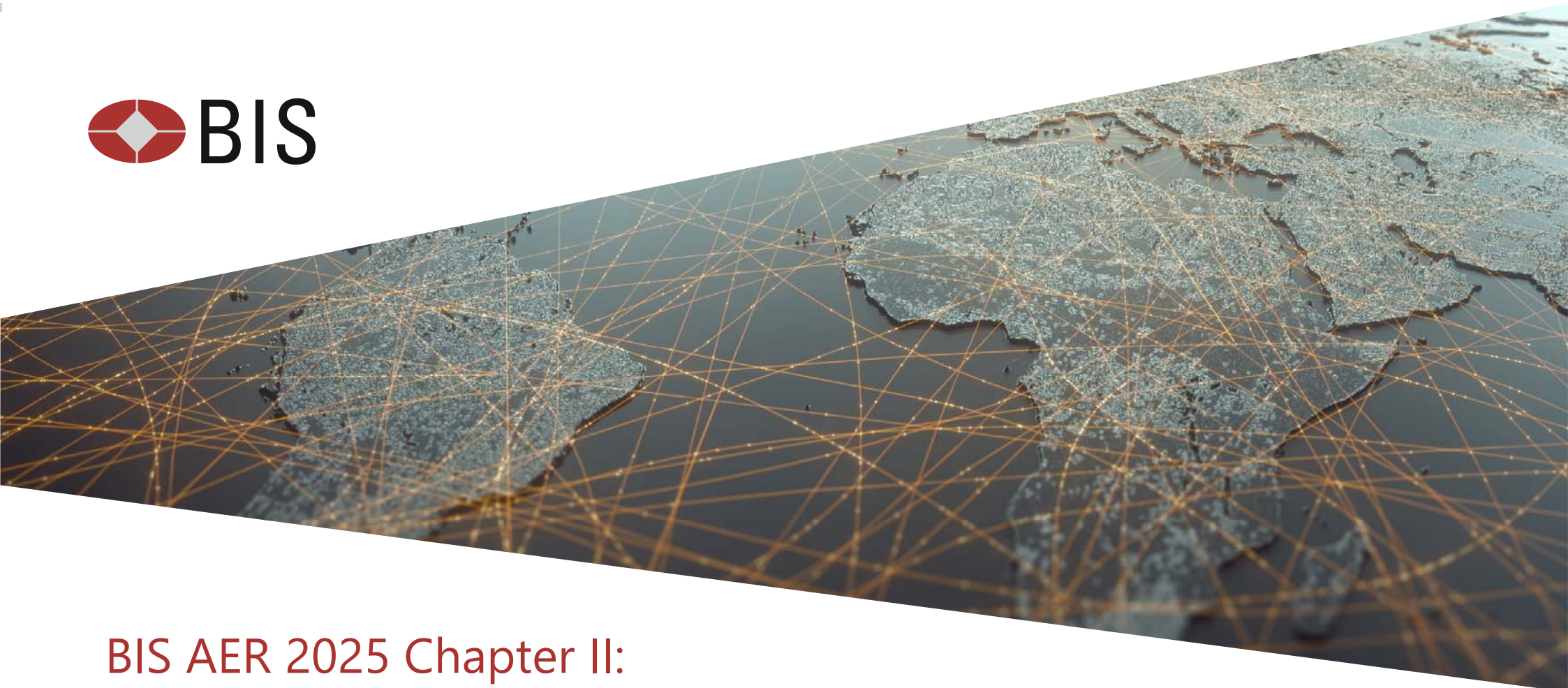


Securing the foundations for tomorrow in a changing global financial system

Hyun Song Shin

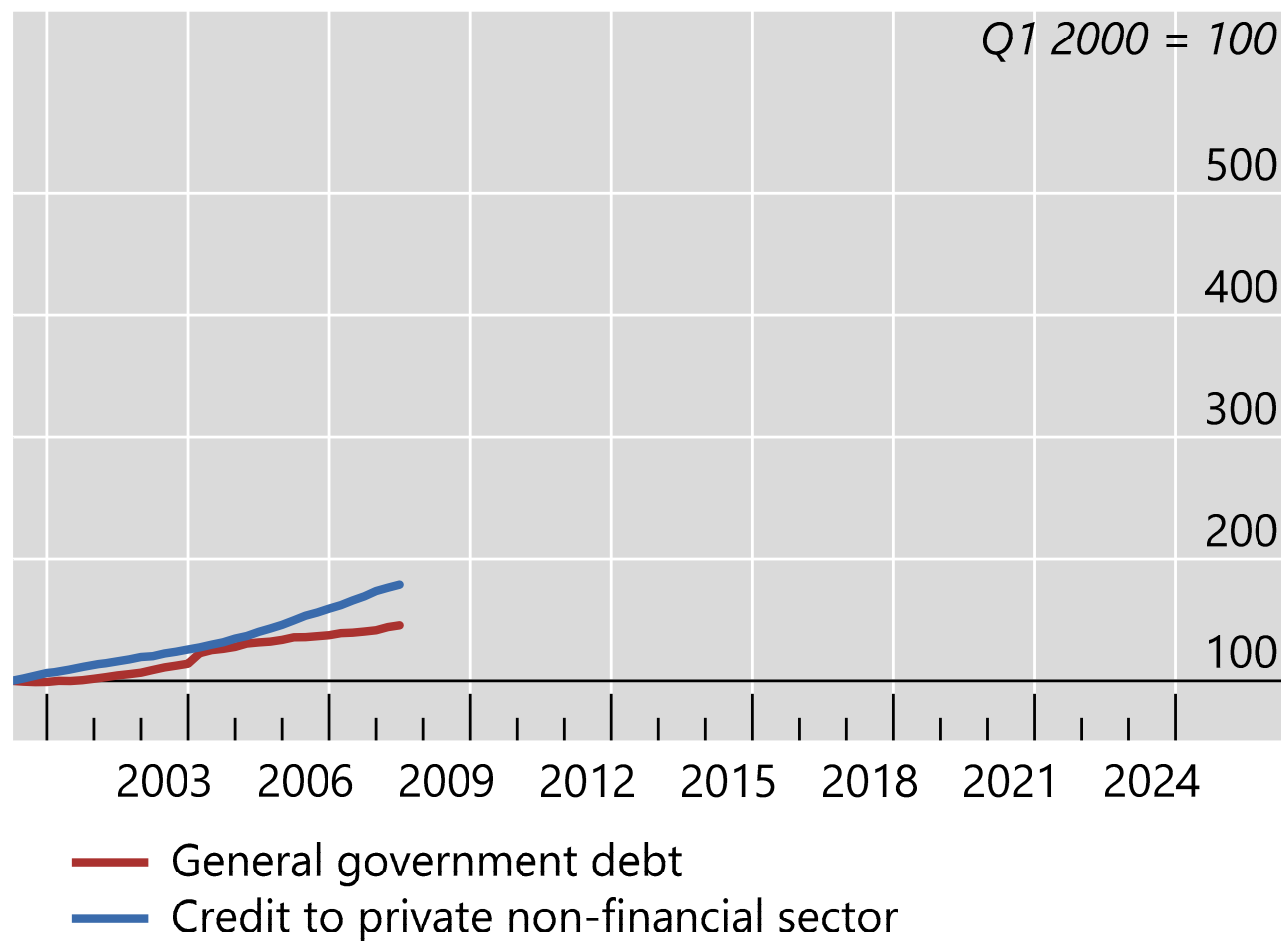
Economic Adviser and Head of the Monetary and Economic Department

Basel, Switzerland, 29 June 2025

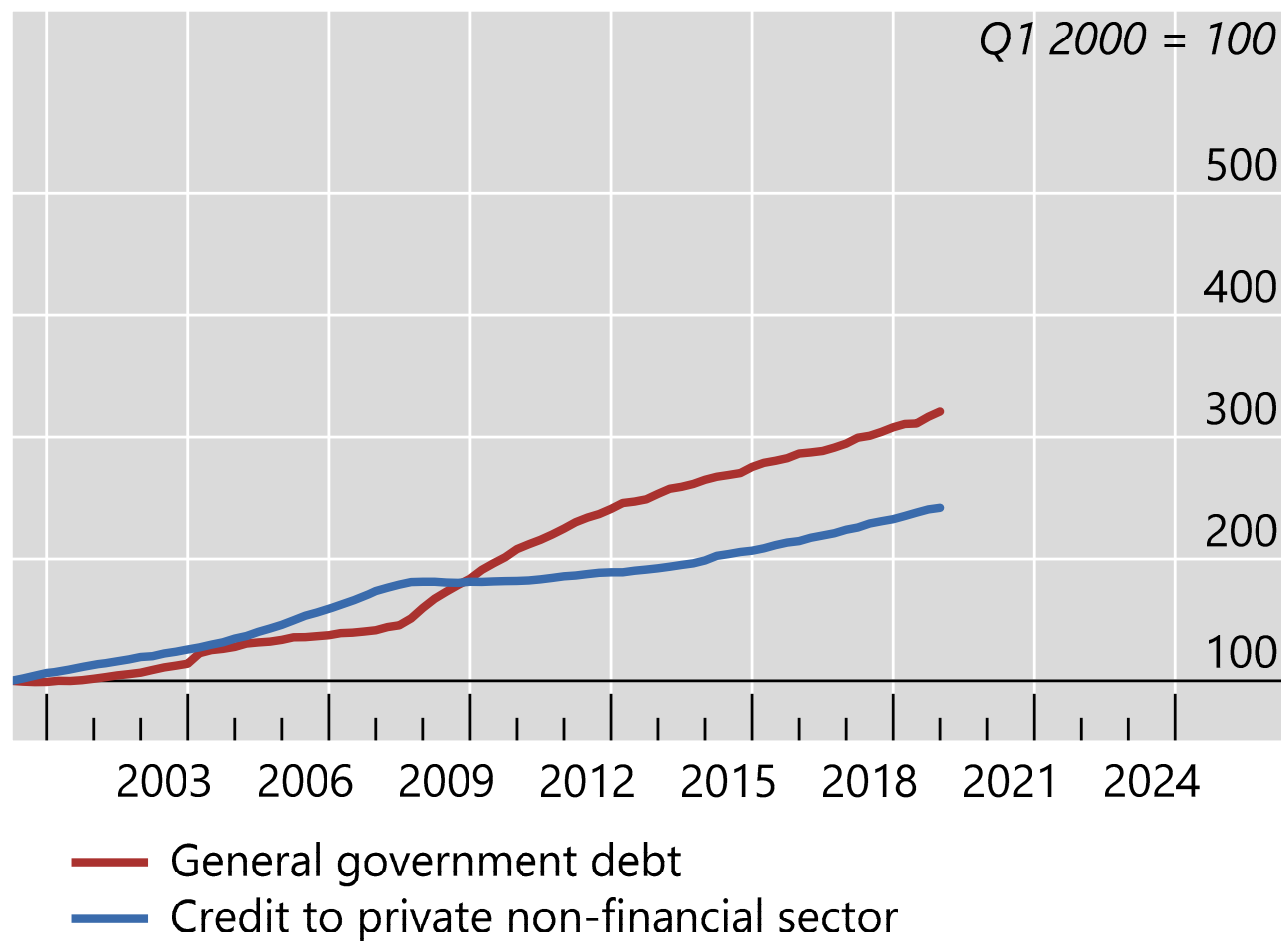


BIS AER 2025 Chapter II:
Financial conditions in a changing global
financial system

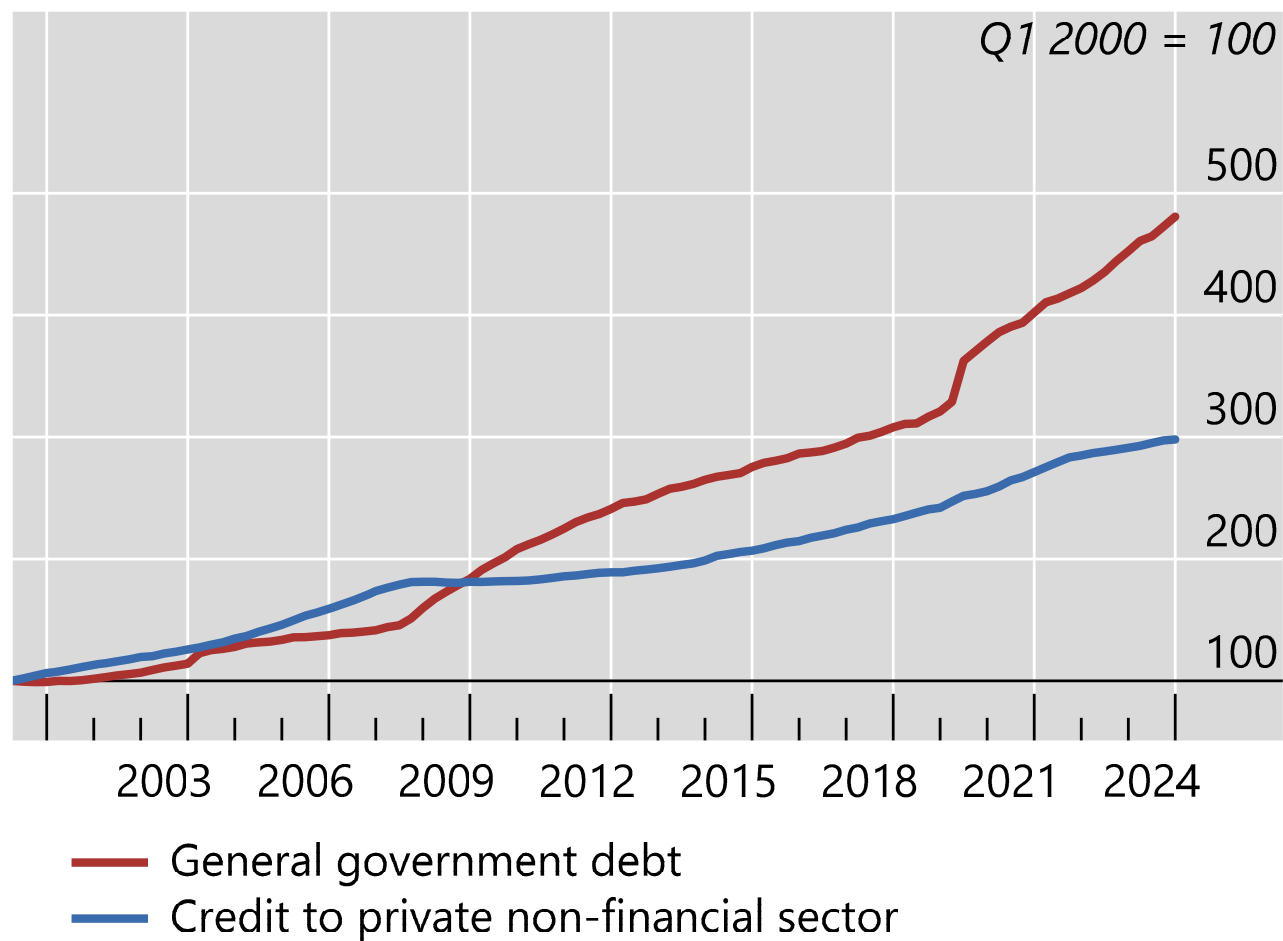
Before the GFC, credit to the private sector grew faster than credit to government



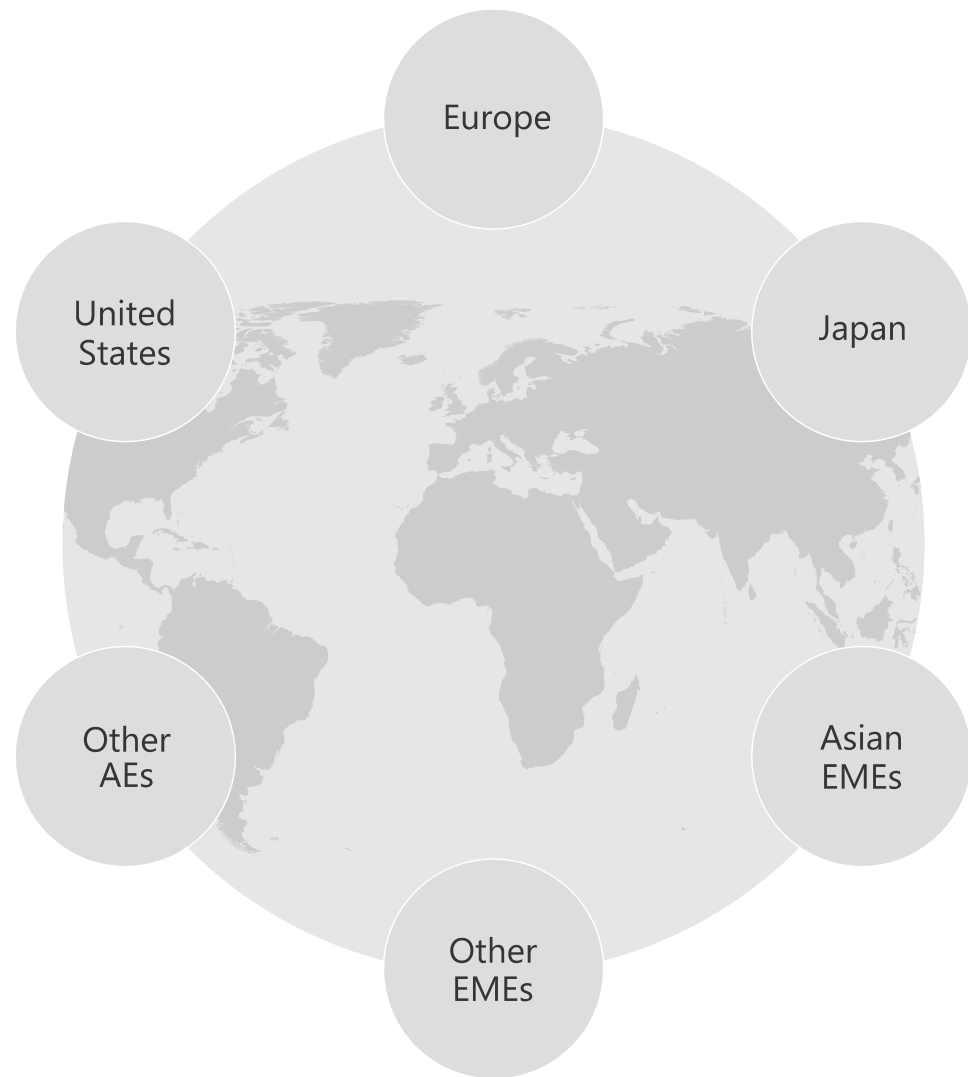
Credit to government has outpaced credit to the private sector after the GFC



Policy response to Covid gave this trend a further upward boost

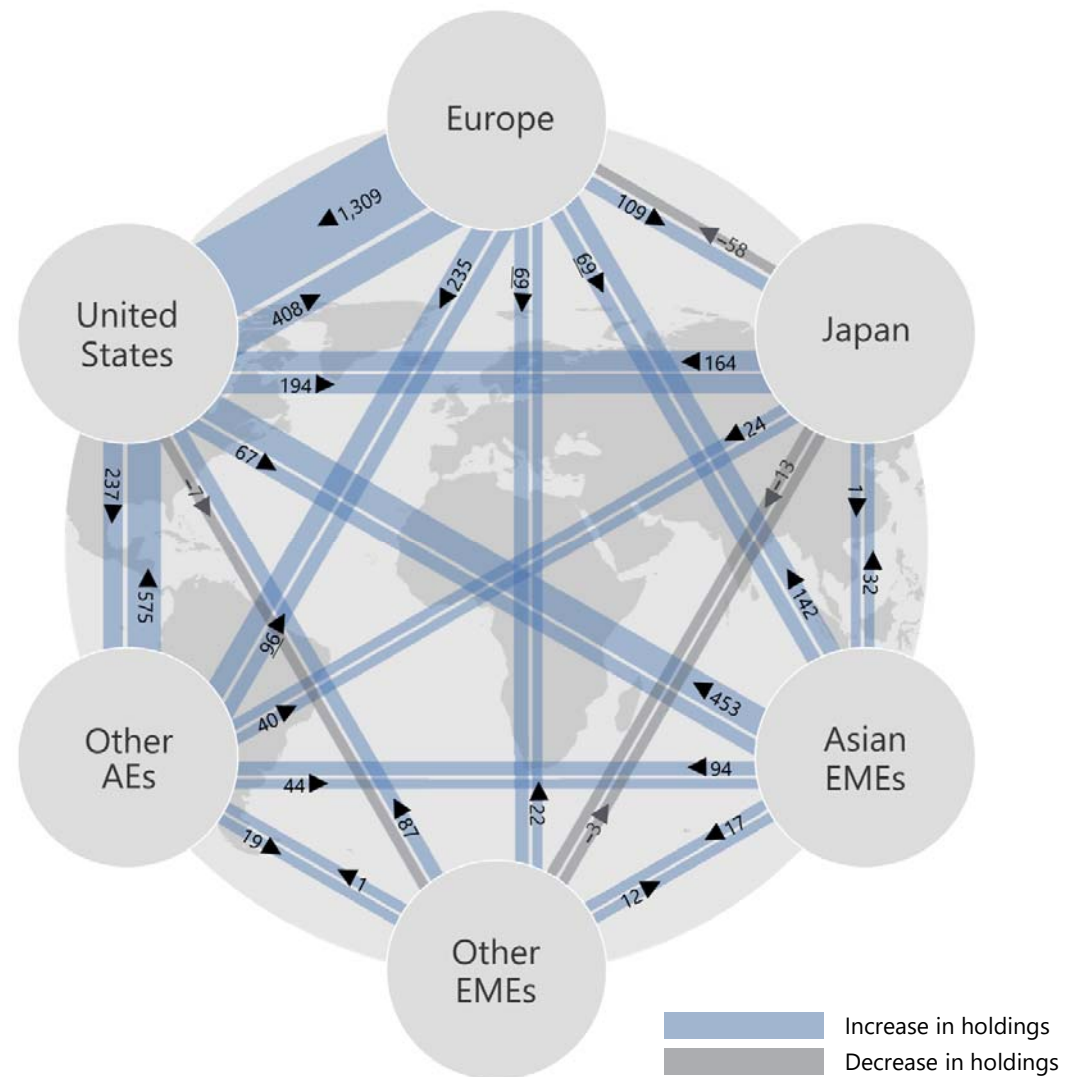


Portfolio flows are
now centre stage
as a key driver of
financial conditions



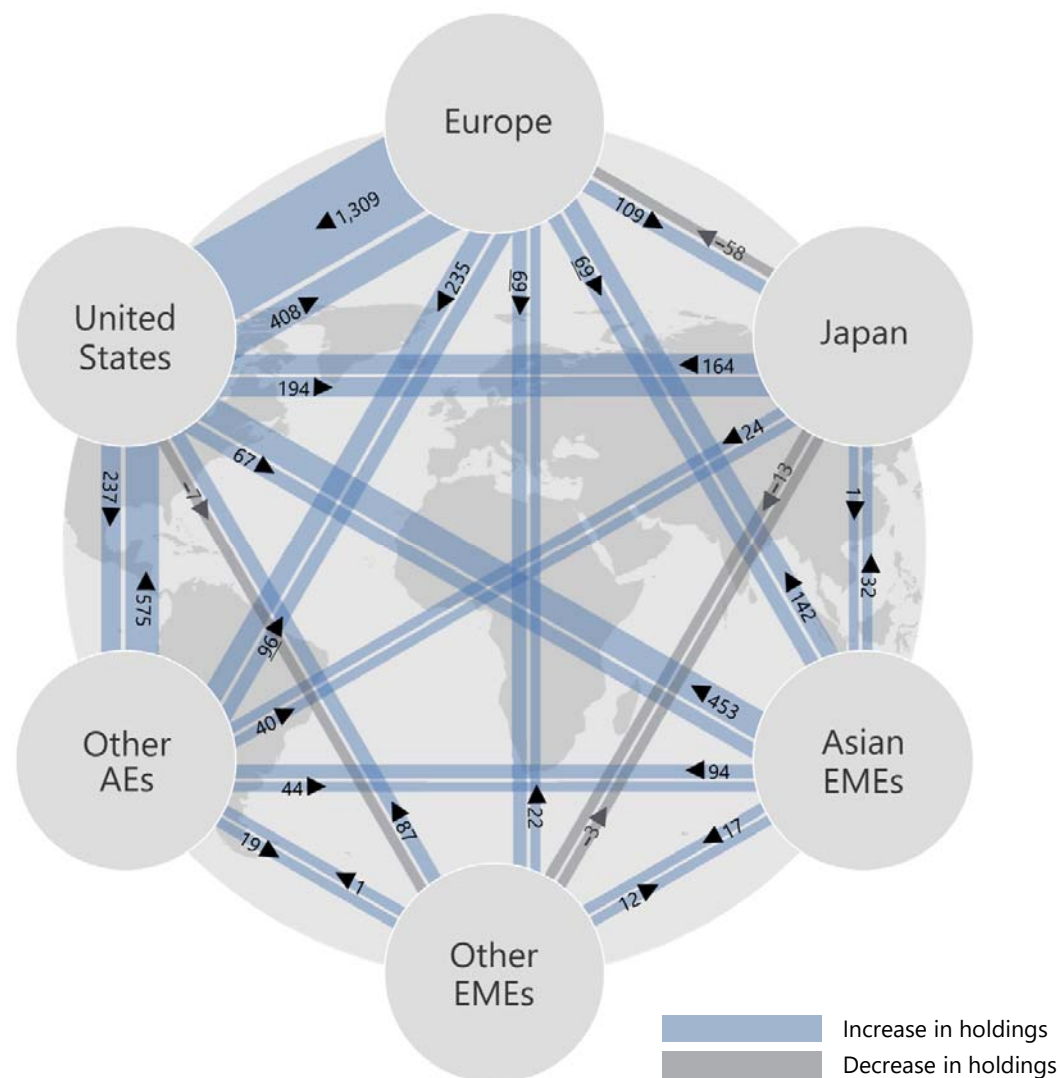
Portfolio flows are
now centre stage
as a key driver of
financial conditions

*Changes in stocks over 2015–23,
in USD bn*

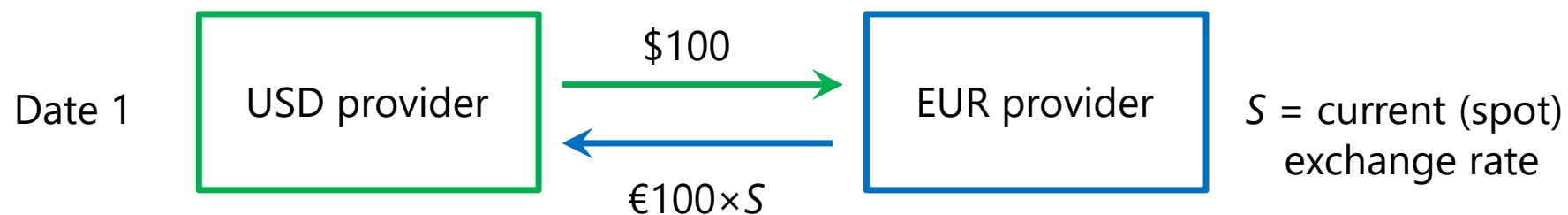


Global nature of sovereign bond markets means that currency choice is an integral part of the story

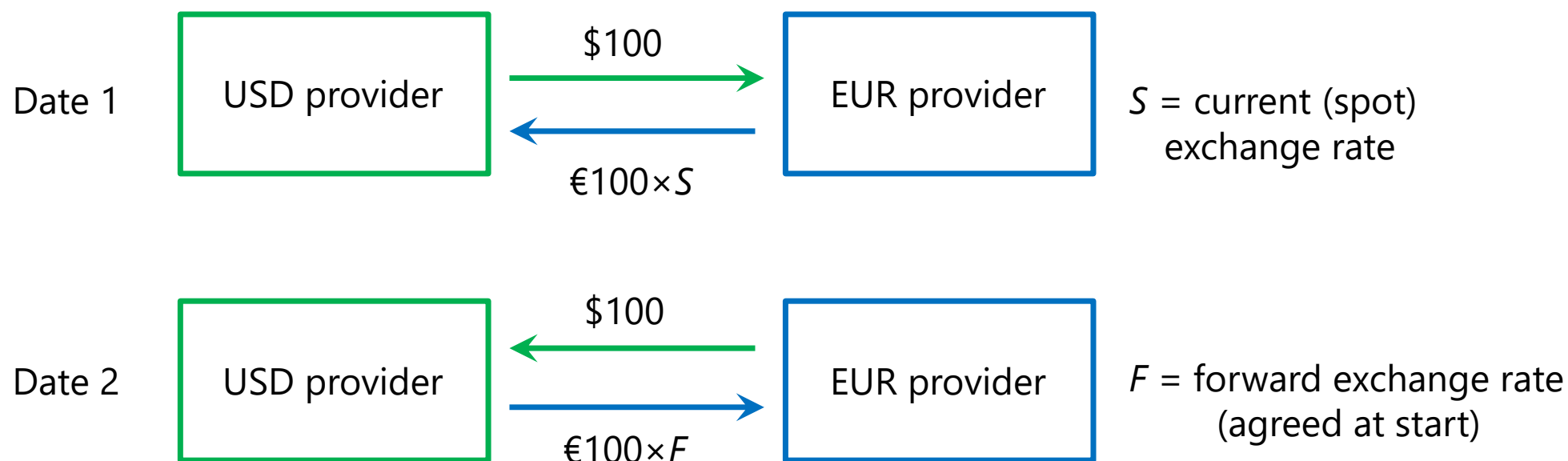
*Changes in stocks over 2015–23,
in USD bn*



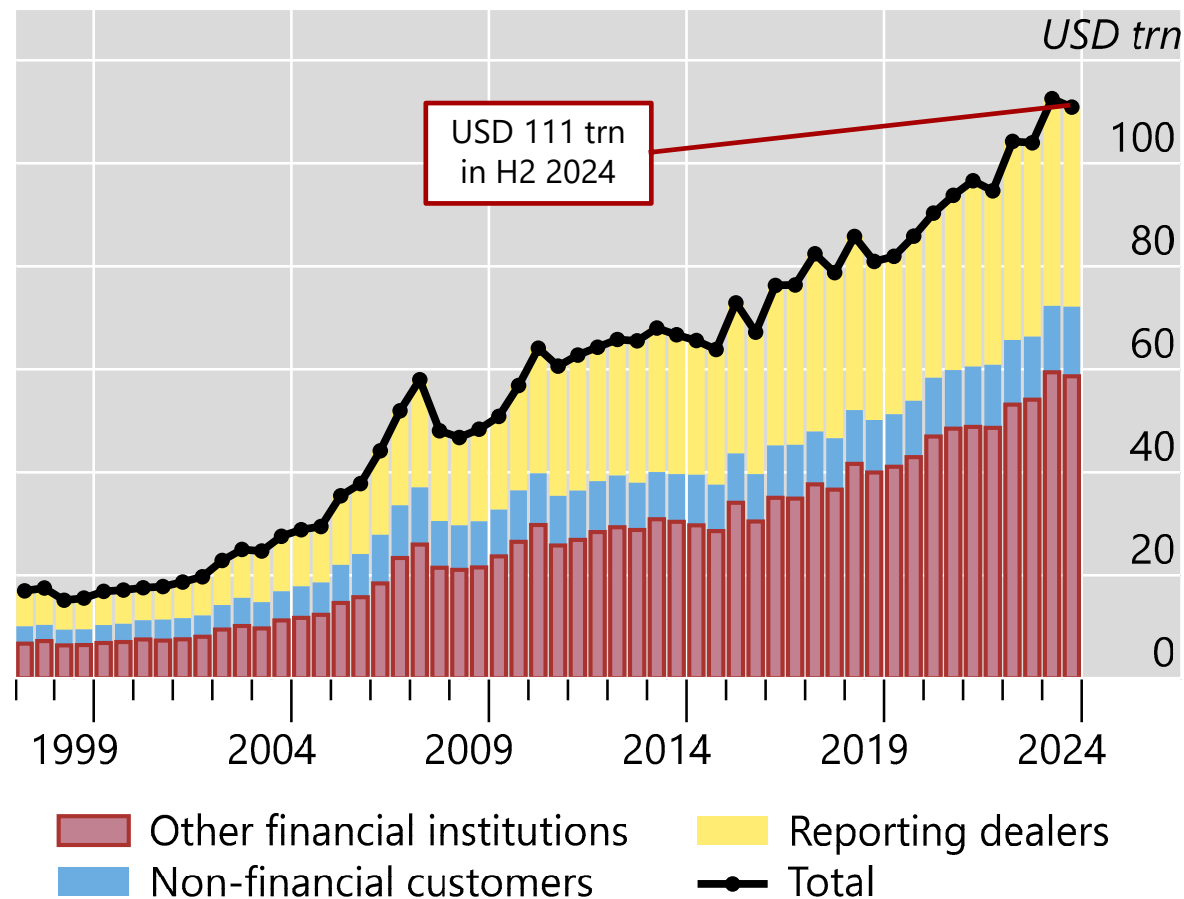
FX swaps are collateralised borrowing operations which make money fungible across currencies



FX swaps are collateralised borrowing operations which make money fungible across currencies

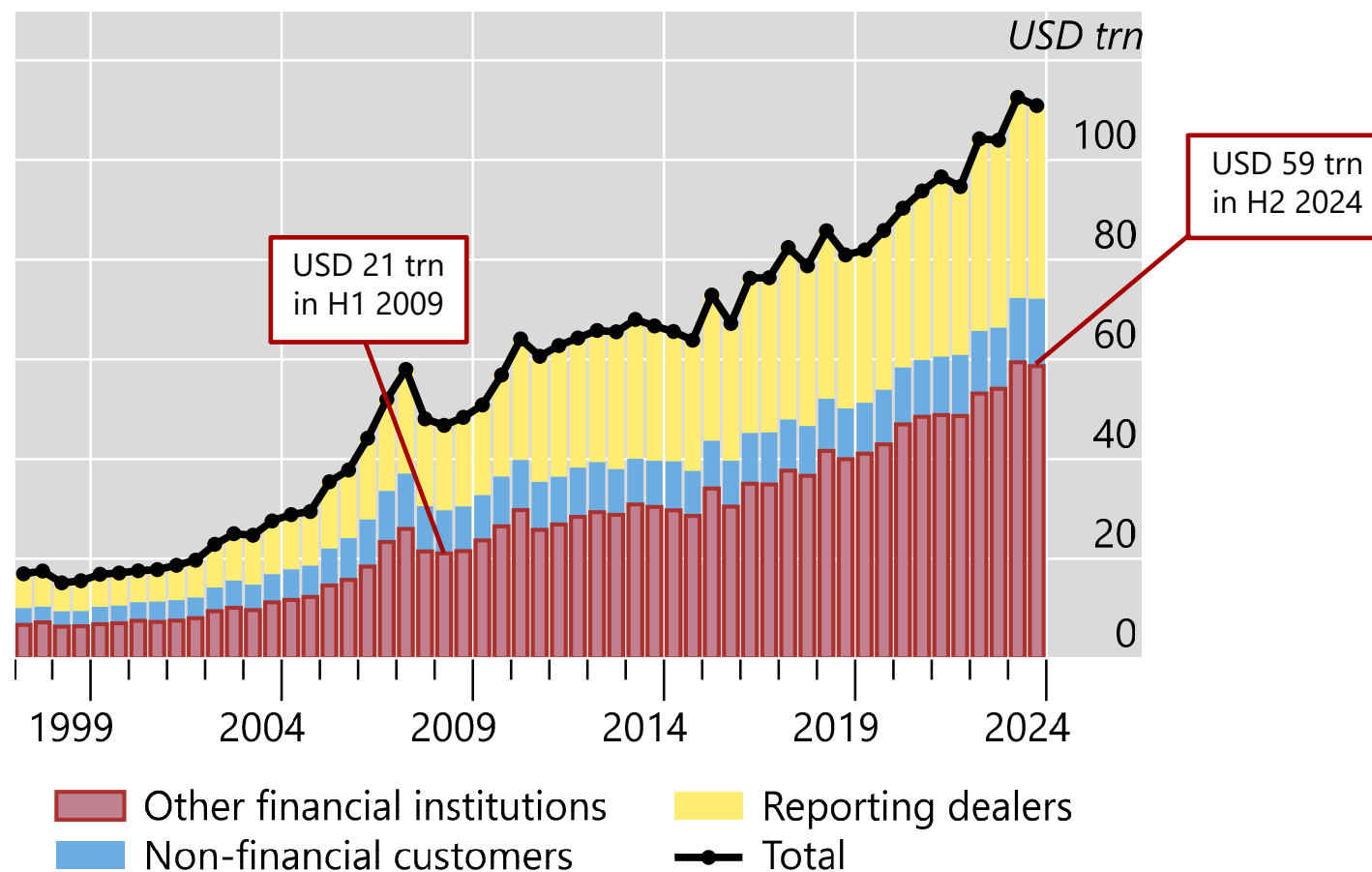


FX swap market grew rapidly after the GFC, reaching \$111 trillion in 2024



Notional amounts outstanding; including FX swaps, outright forwards and currency swaps.

Largest and fastest growing segment is for financial use; it has tripled since 2009



Notional amounts outstanding; including FX swaps, outright forwards and currency swaps.

Balance sheet mechanics of FX swap-enabled bond investment:

Euro-based investor has euros...

Assets	Liabilities
EUR cash	EUR obligations
Other EUR assets	

Balance sheet mechanics of FX swap-enabled bond investment:

...borrows dollars by pledging euros; has future obligation to repay dollars...

Assets	Liabilities
EUR cash	EUR obligations
Other EUR assets	

Assets	Liabilities
USD cash	EUR obligations
Other EUR assets	
Forward EUR receipt	Forward USD obligation

Balance sheet mechanics of FX swap-enabled bond investment:

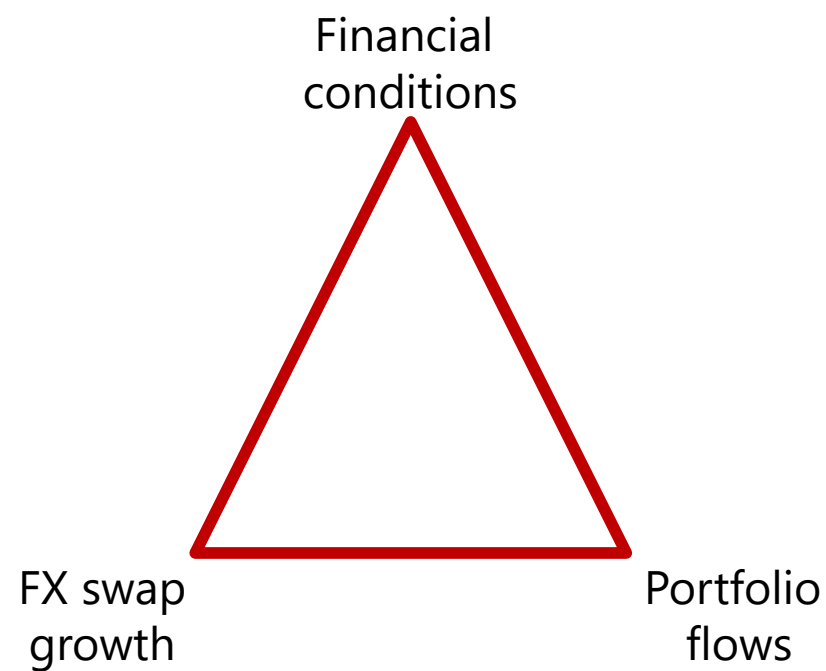
...buys USD securities; currency exposure is hedged

Assets	Liabilities
EUR cash	EUR obligations
Other EUR assets	

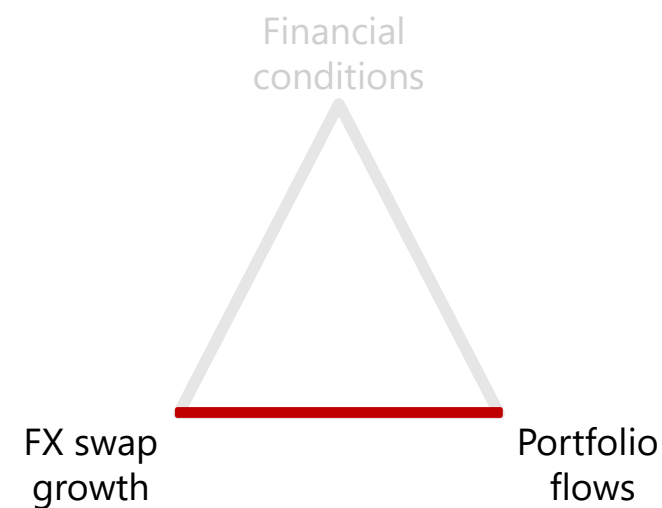
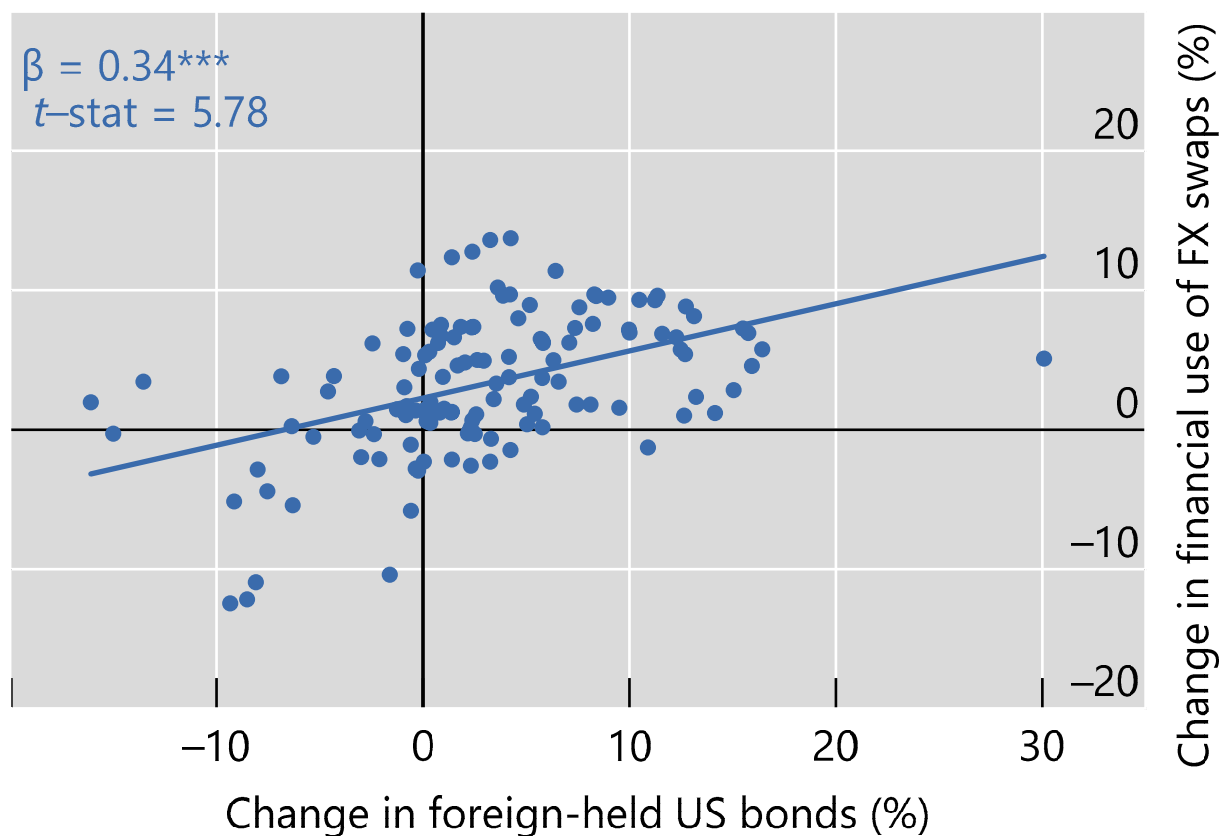
Assets	Liabilities
USD cash	EUR obligations
Other EUR assets	
Forward EUR receipt	Forward USD obligation

Assets	Liabilities
USD security	EUR obligations
Other EUR assets	
Forward EUR receipt	Forward USD obligation

Triangle between FX swap growth, portfolio flows and financial conditions

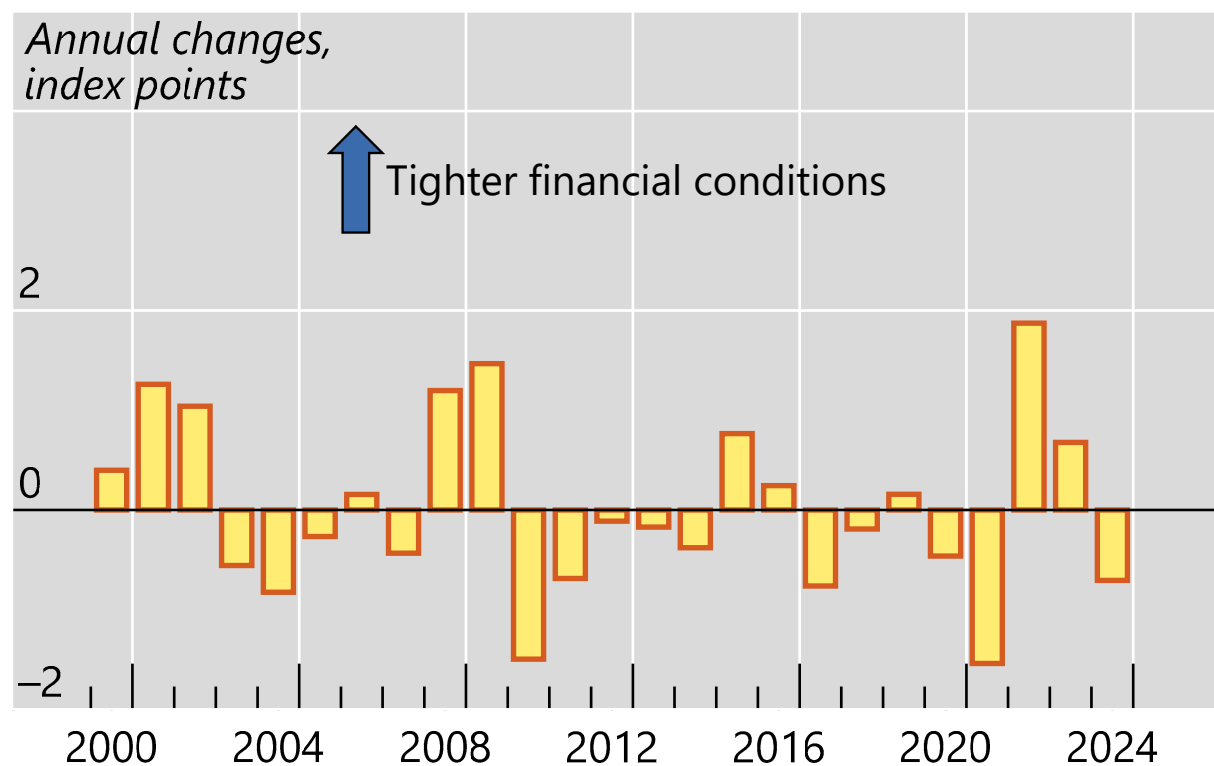


Financial use of FX swaps tracks portfolio inflows into US debt securities



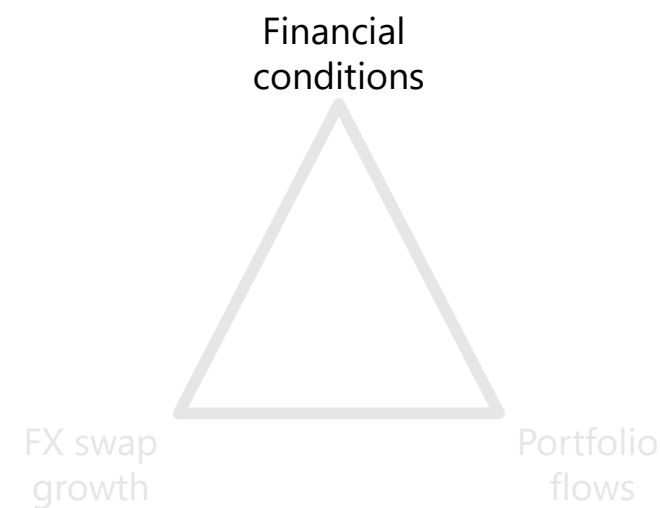
Source: T Nenova, A Schrimpf and H S Shin (2025): "Global portfolio investments and FX derivatives", *BIS Working Papers*, no 1273, June.

Financial conditions as the tip of the triangle

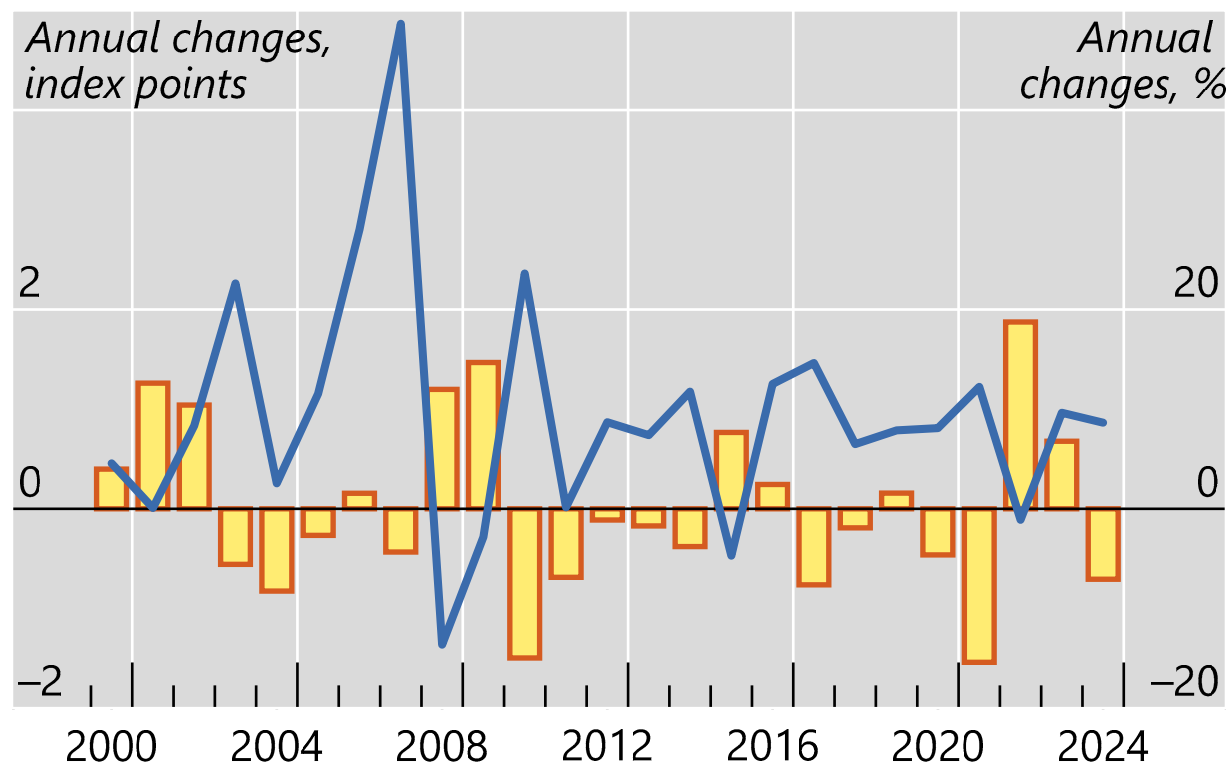


Lhs:

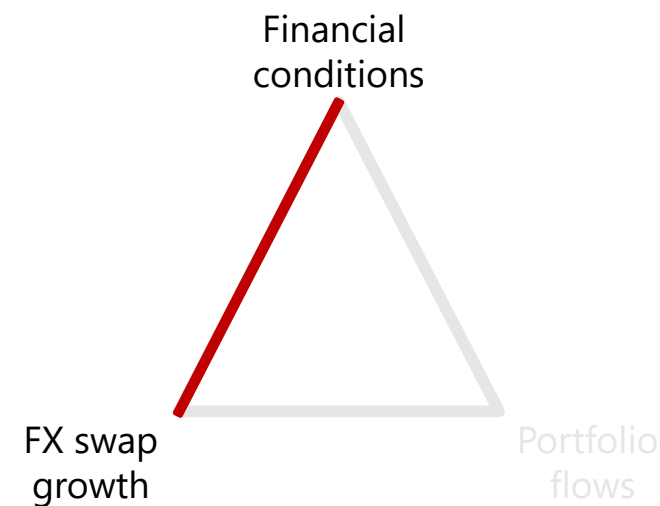
Goldman Sachs US FCI



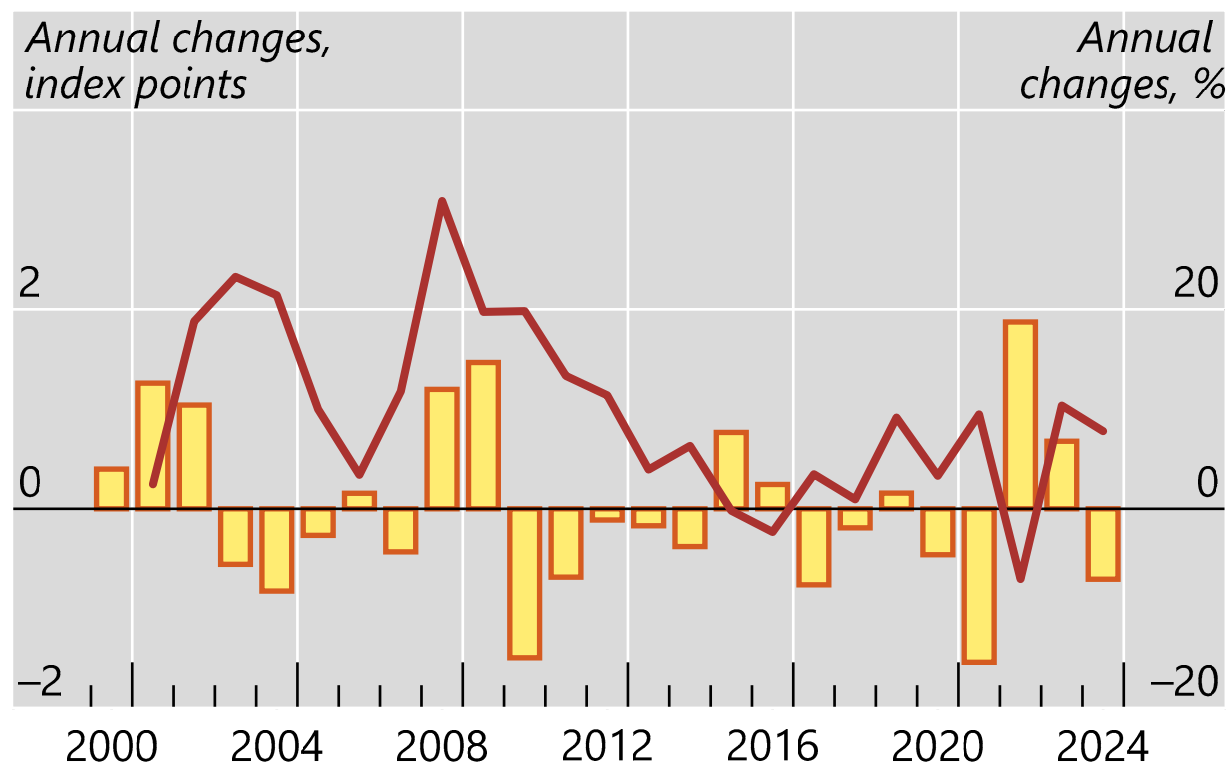
As financial conditions tighten...
...outstanding FX swaps volumes decline...



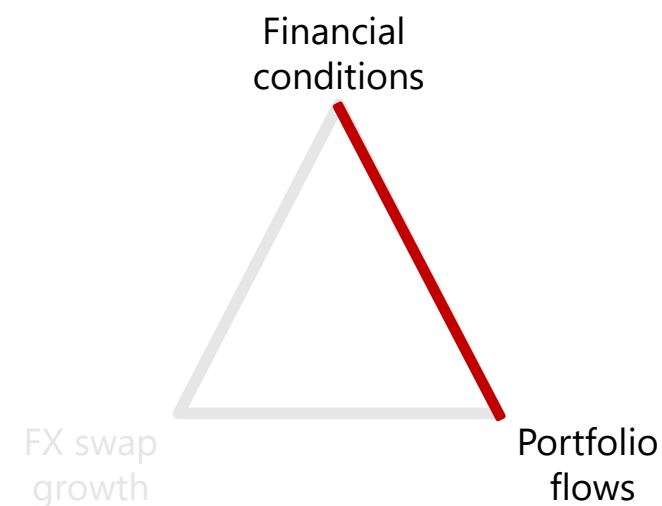
Lhs: Rhs:
■ GS US FCI — OFIs' FX swaps & outright forwards



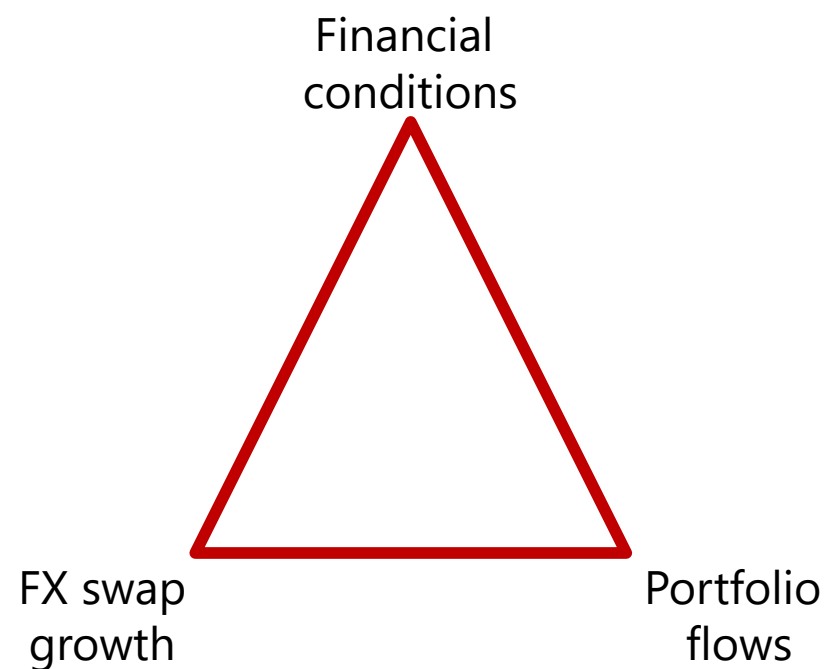
As financial conditions tighten...
...investment in US bonds falls



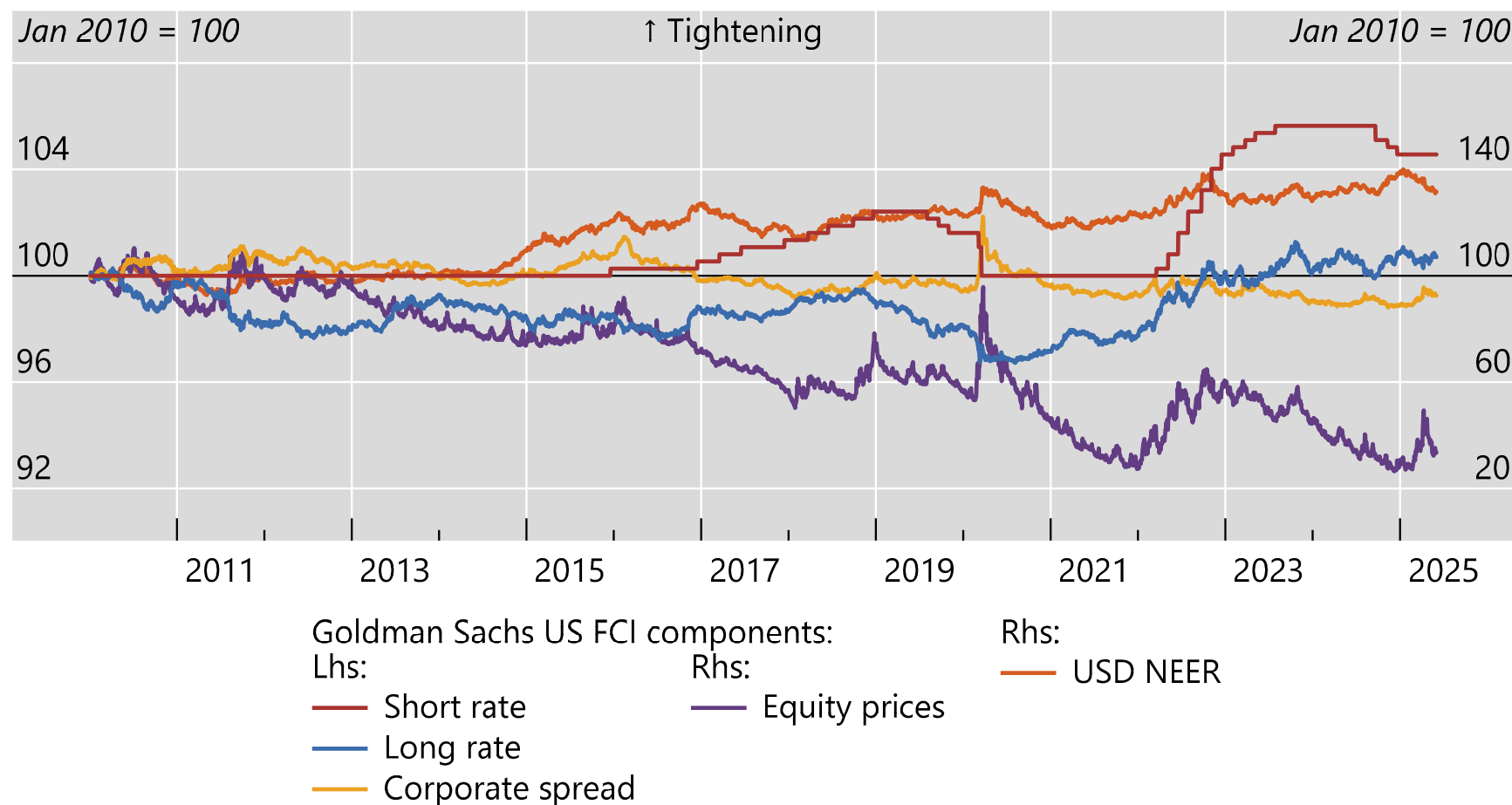
Lhs: Rhs:
■ GS US FCI — TIC foreign holdings of US debt securities



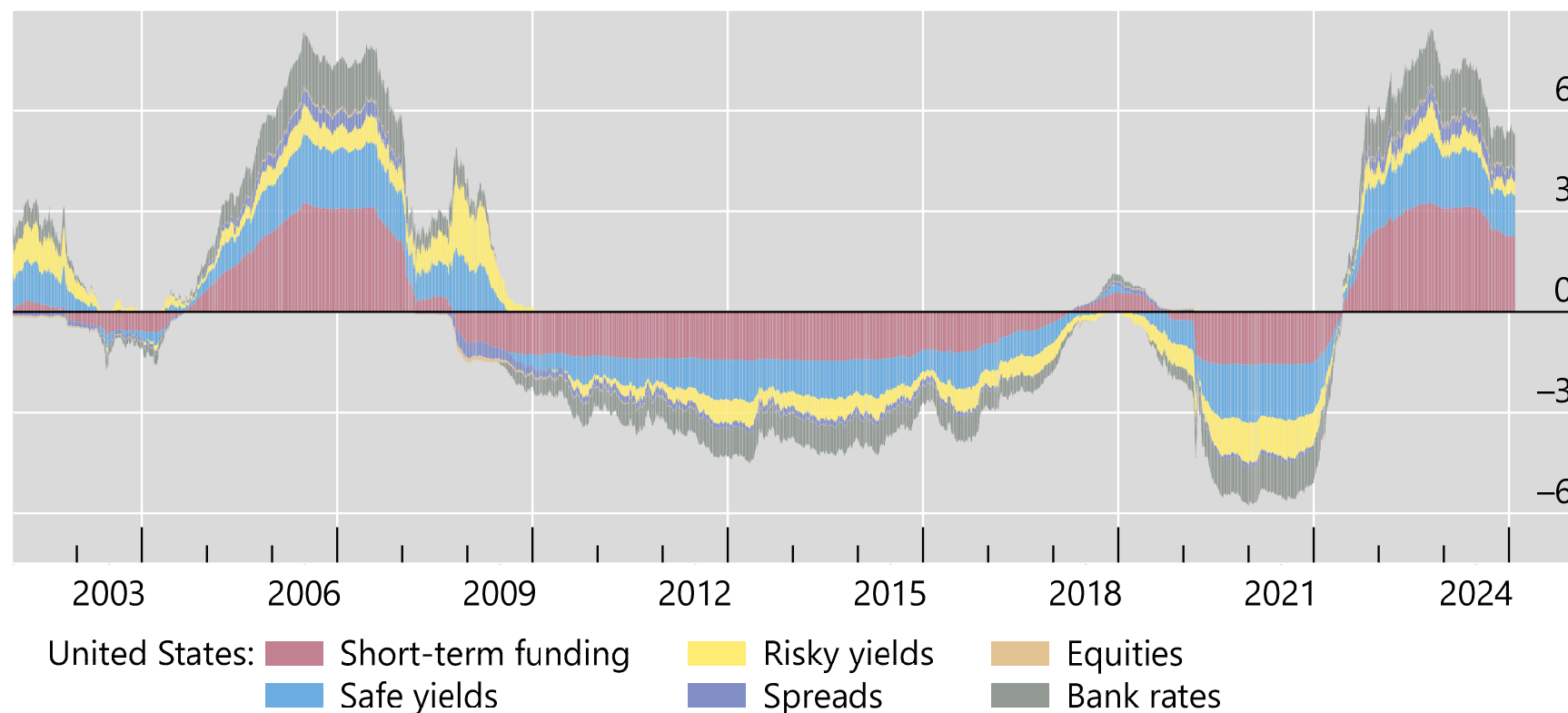
Triangle between FX swaps growth, portfolio flows and financial conditions



Composite measures of financial conditions need careful interpretation

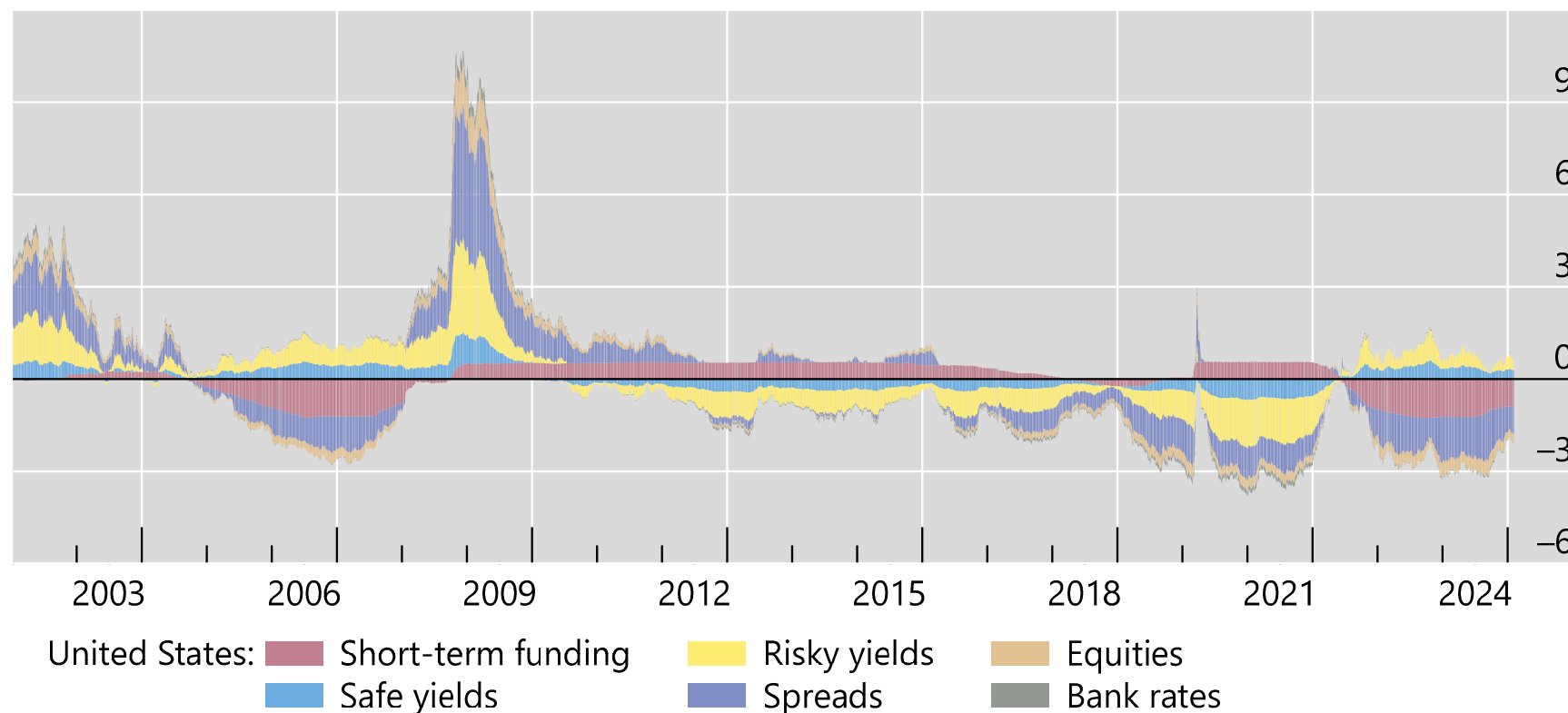


The **level factor** follows the cycle of policy rates and has tightened since Covid



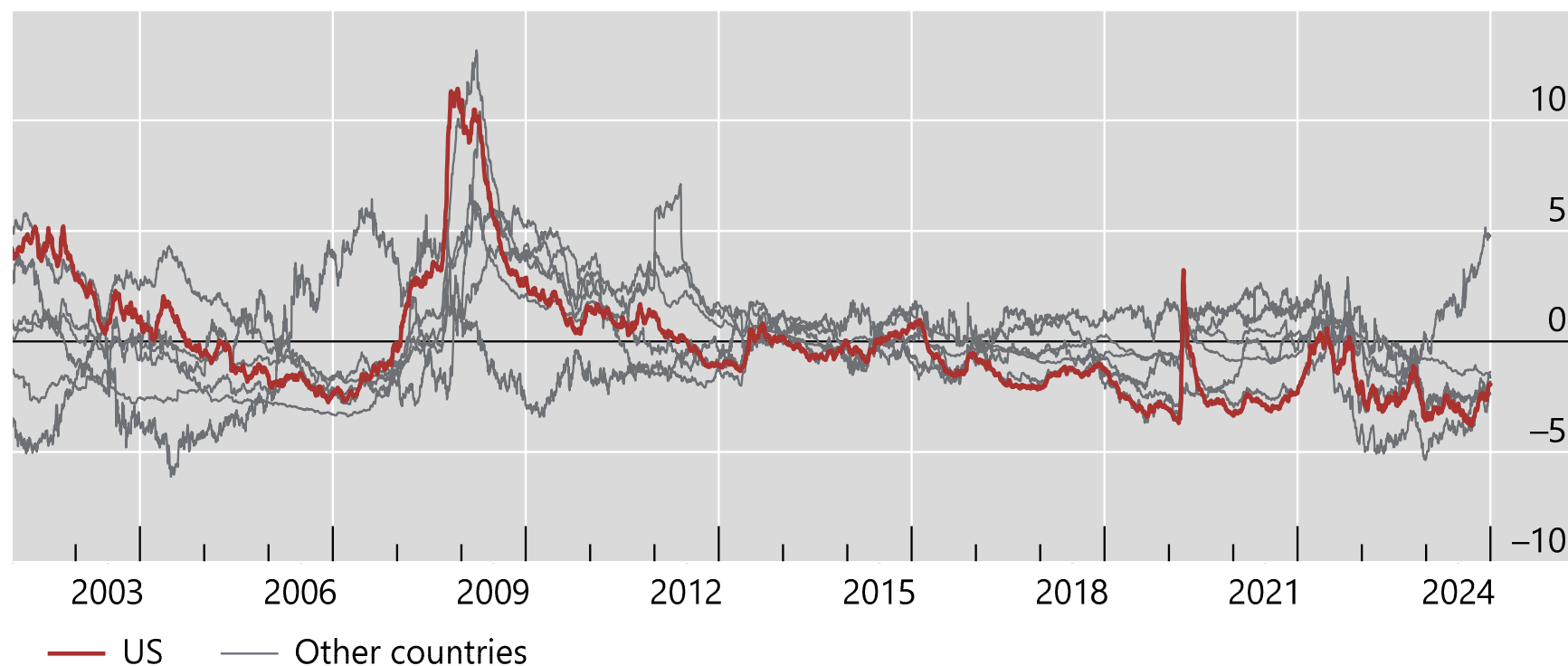
Source: M Lombardi, C Manea and A Schrimpf (2025): "Financial conditions and the macroeconomy: a two-factor view", *BIS Working Papers*, no 1272, June.

The **risk factor** reflects risk appetite; correlated with tight spreads and strong stock markets



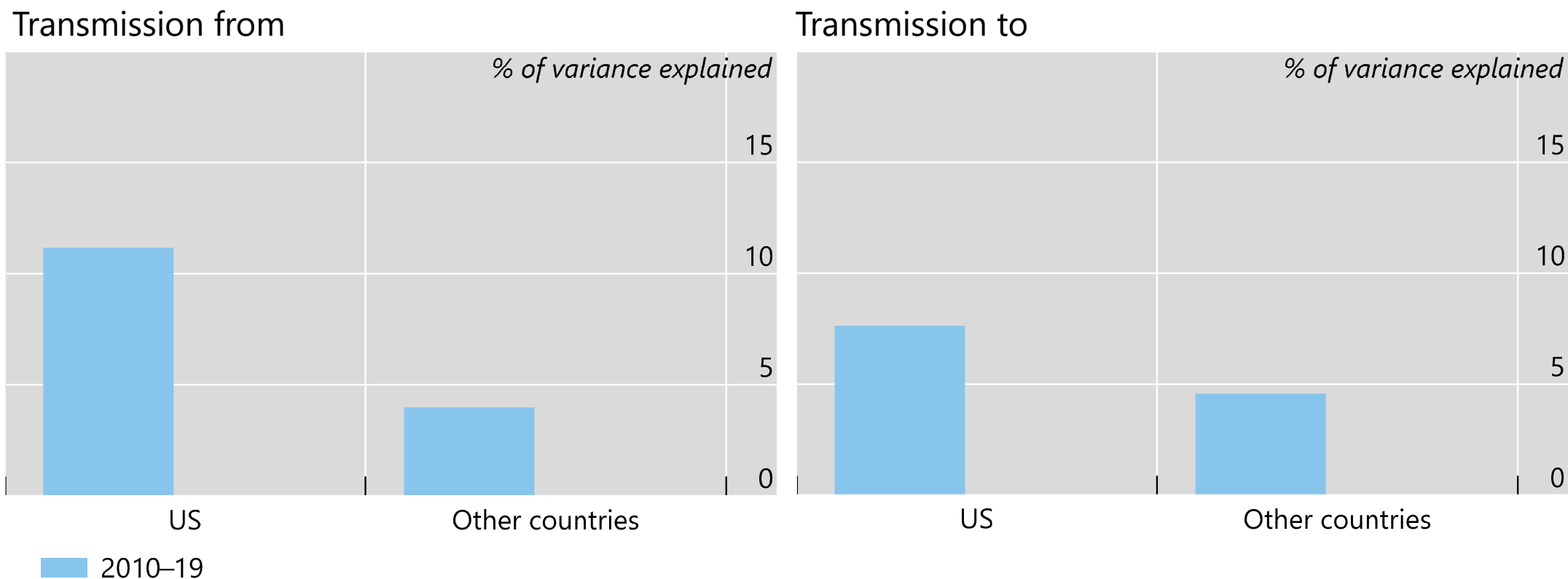
Source: M Lombardi, C Manea and A Schrimpf (2025): "Financial conditions and the macroeconomy: a two-factor view", *BIS Working Papers*, no 1272, June.

Time profile of the risk factor for the United States and six other economies

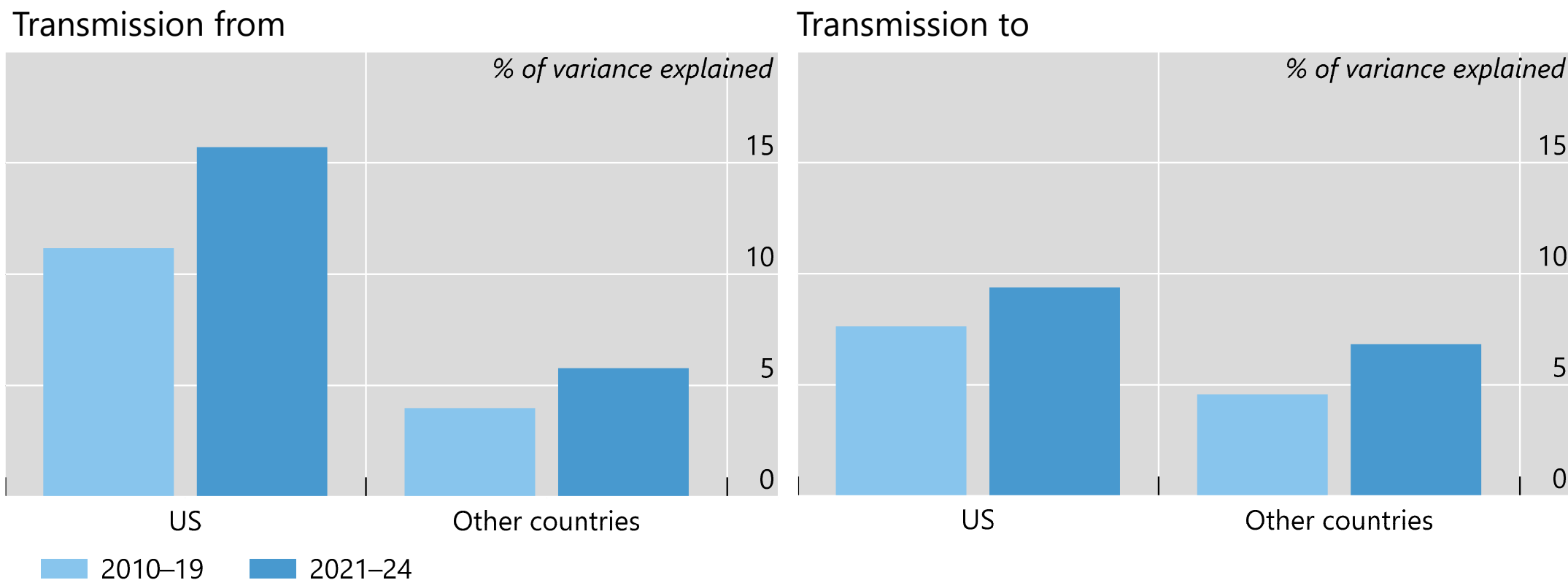


Source: M Lombardi, C Manea and A Schrimpf (2025): "Financial conditions and the macroeconomy: a two-factor view", *BIS Working Papers*, no 1272, June.

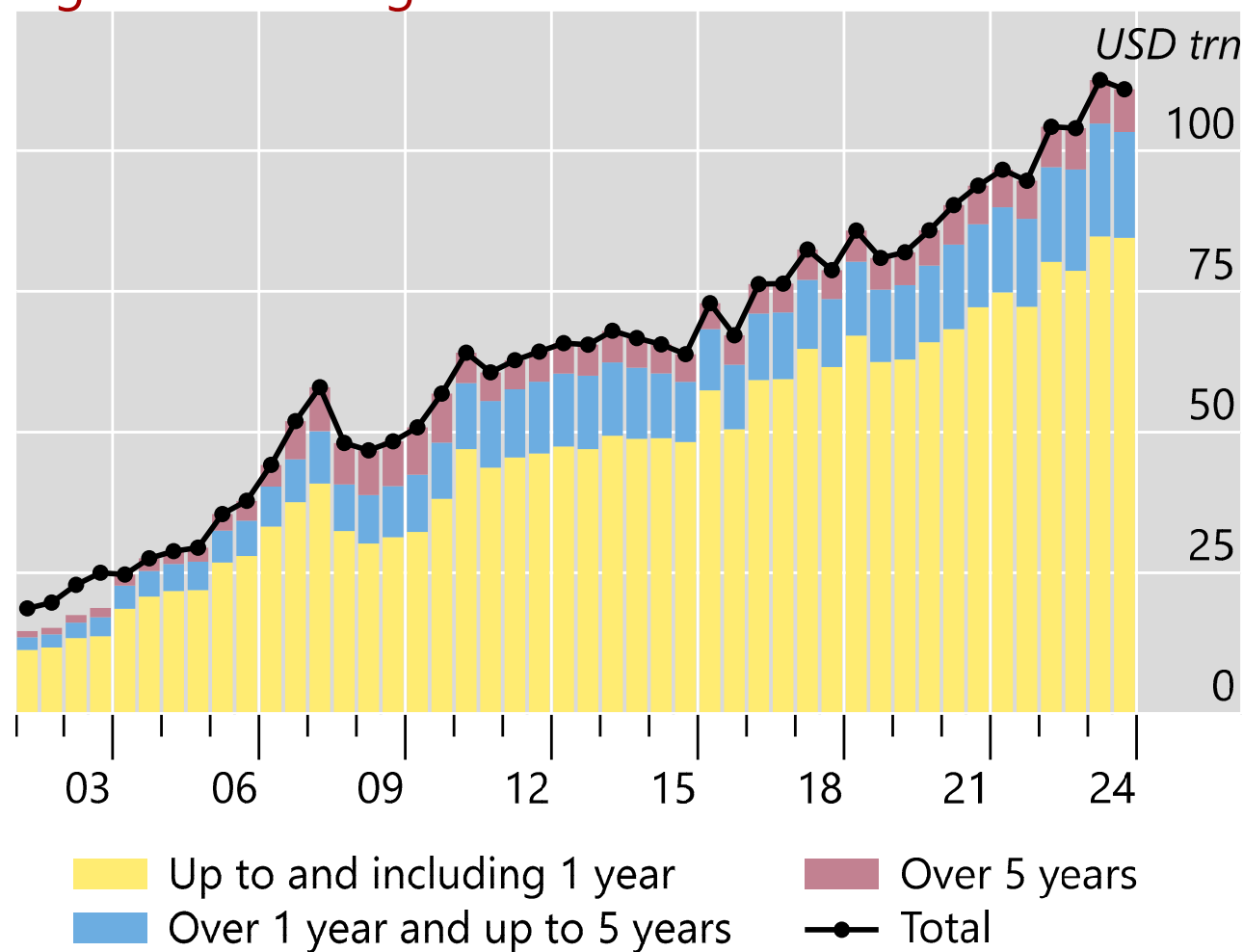
Connectedness in the risk factor is multi-directional...



Connectedness is multi-directional...but has strengthened substantially after Covid



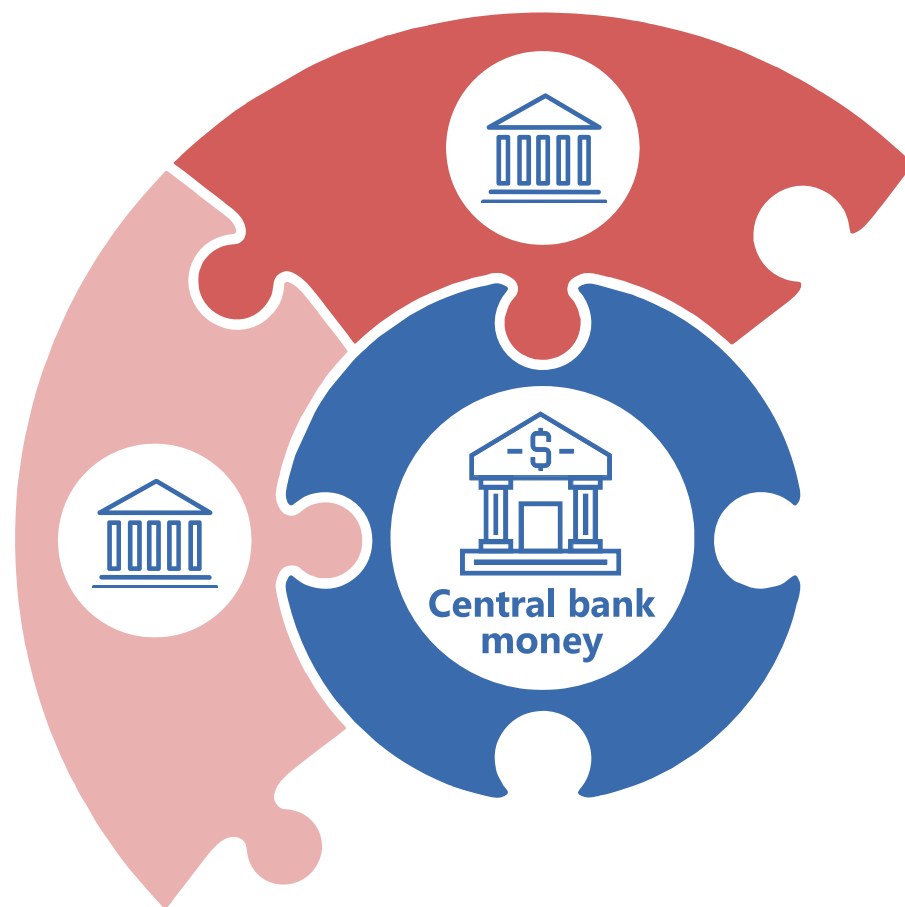
FX swaps are mainly short-term instruments; there are financial stability implications through the banking sector

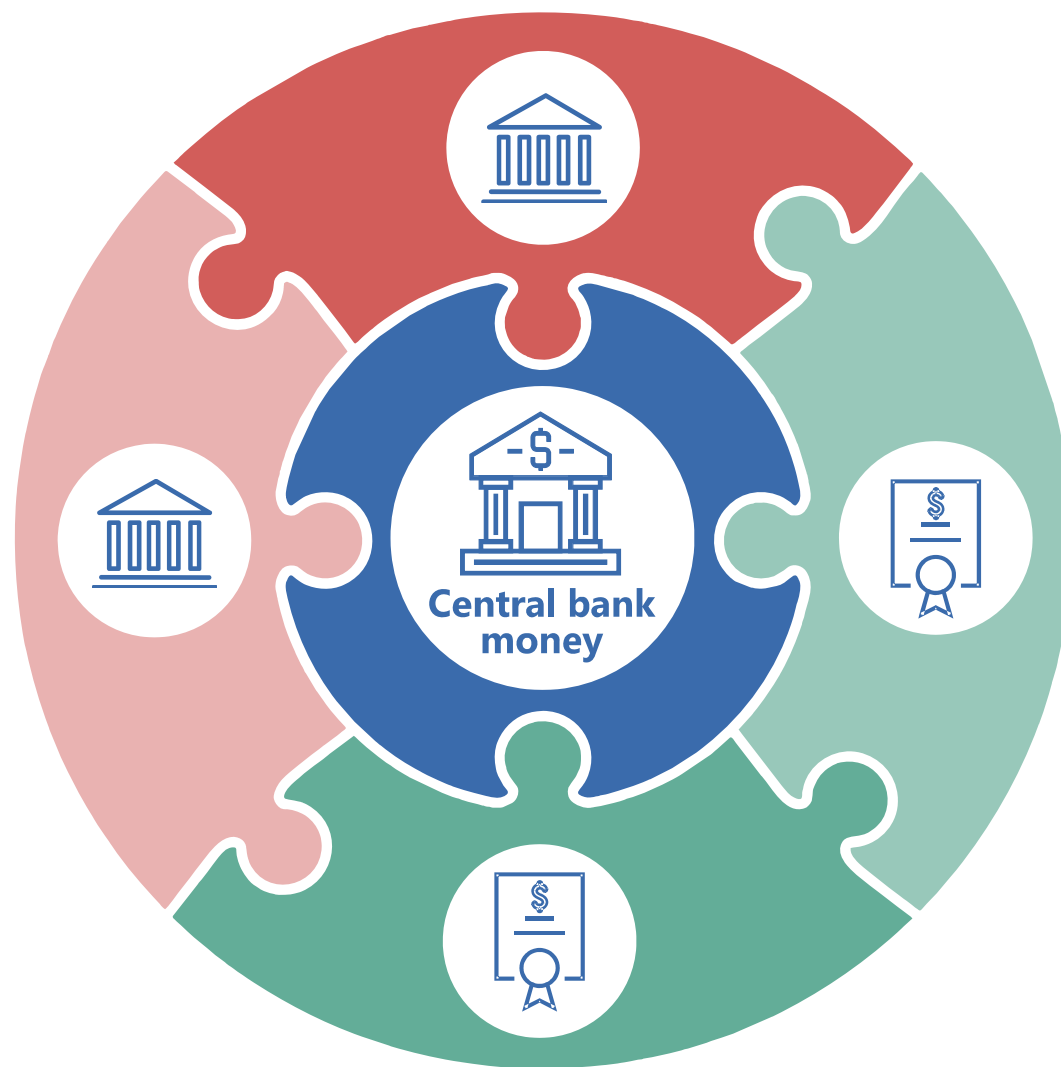




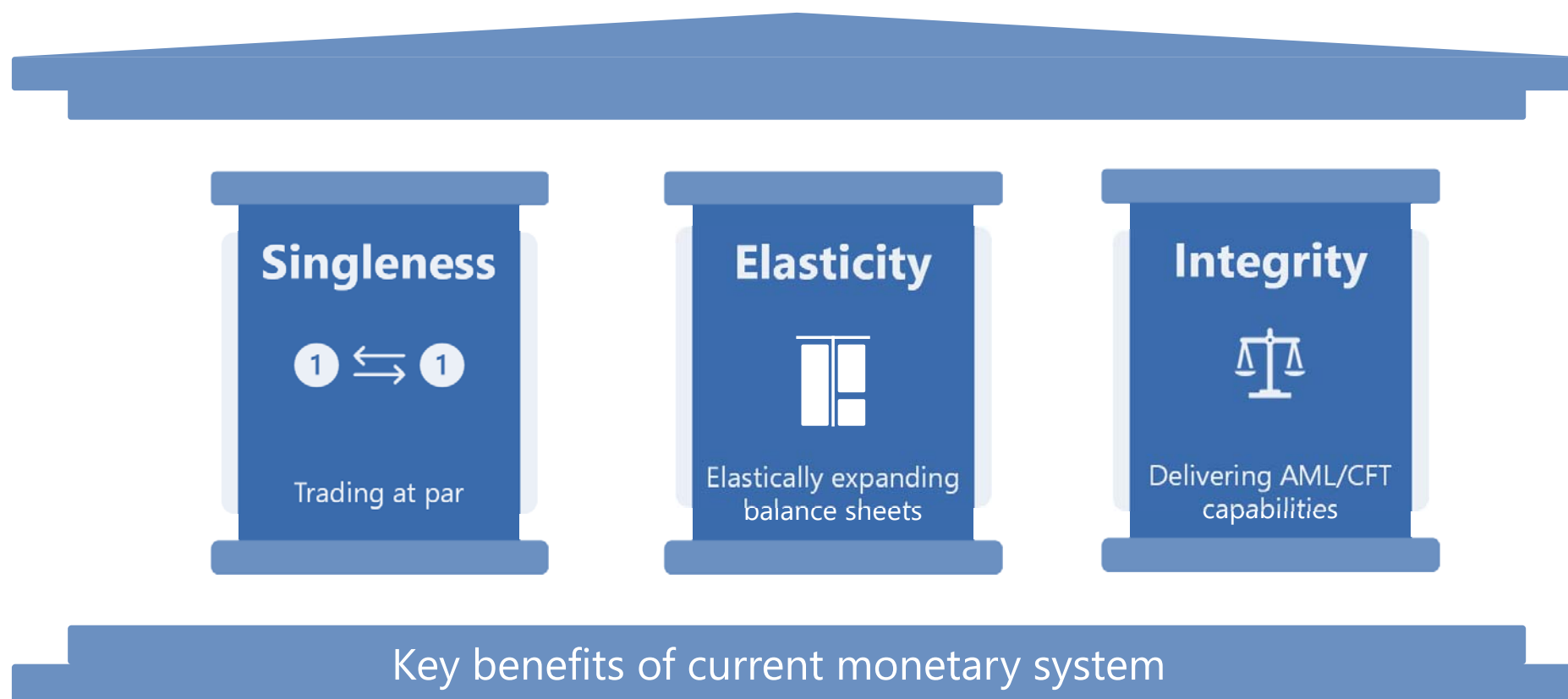
BIS AER 2025 Chapter III: The next-generation monetary and financial system



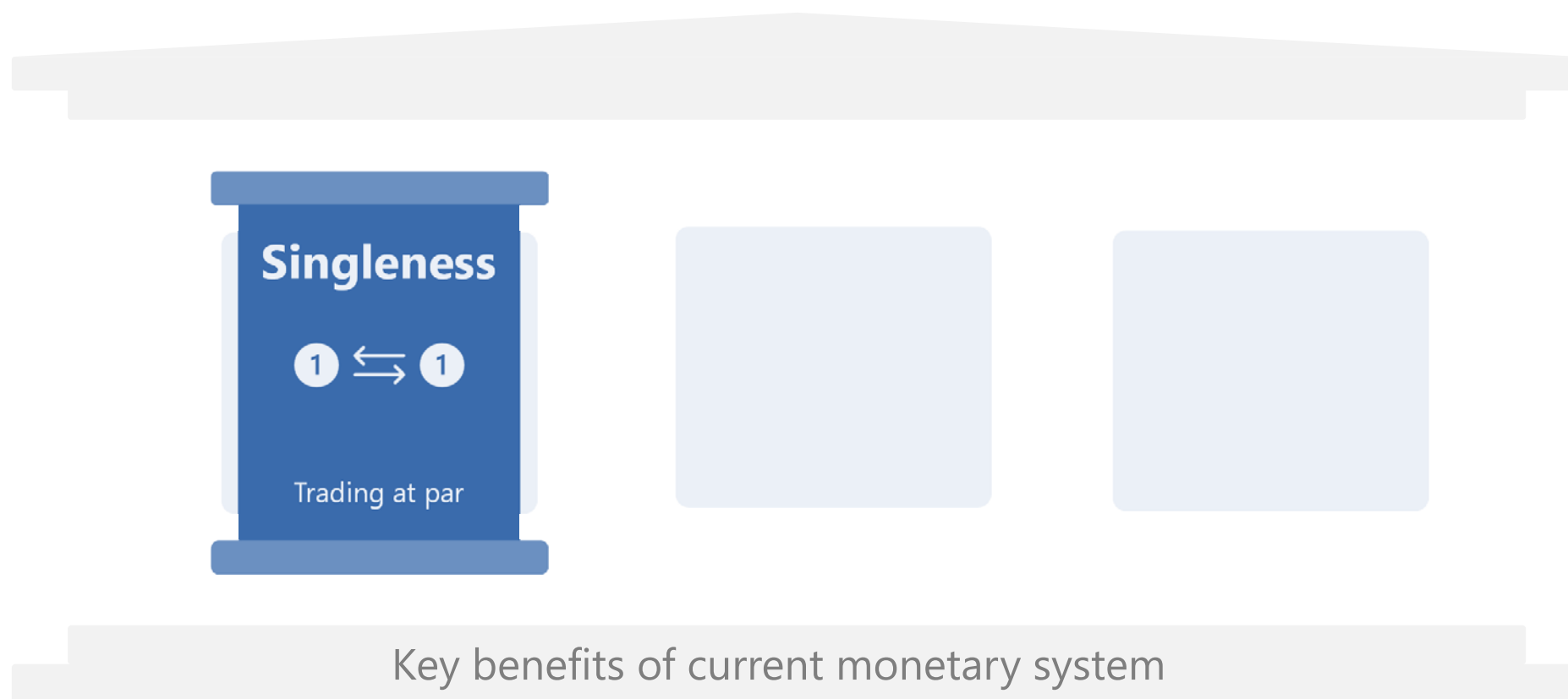




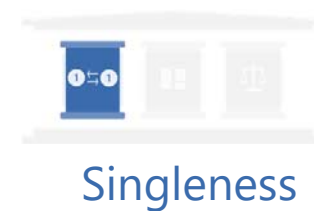
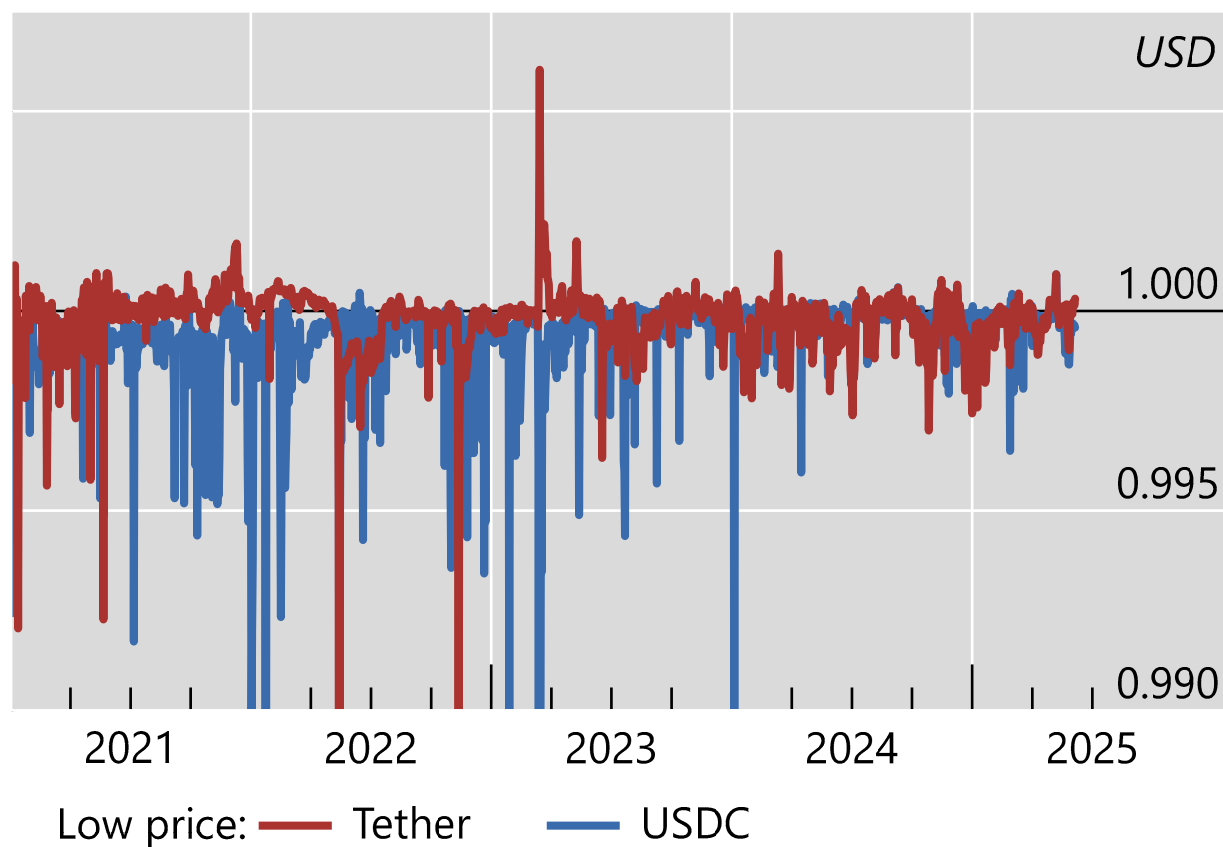
Two-tier monetary system built on central bank money has three key attributes



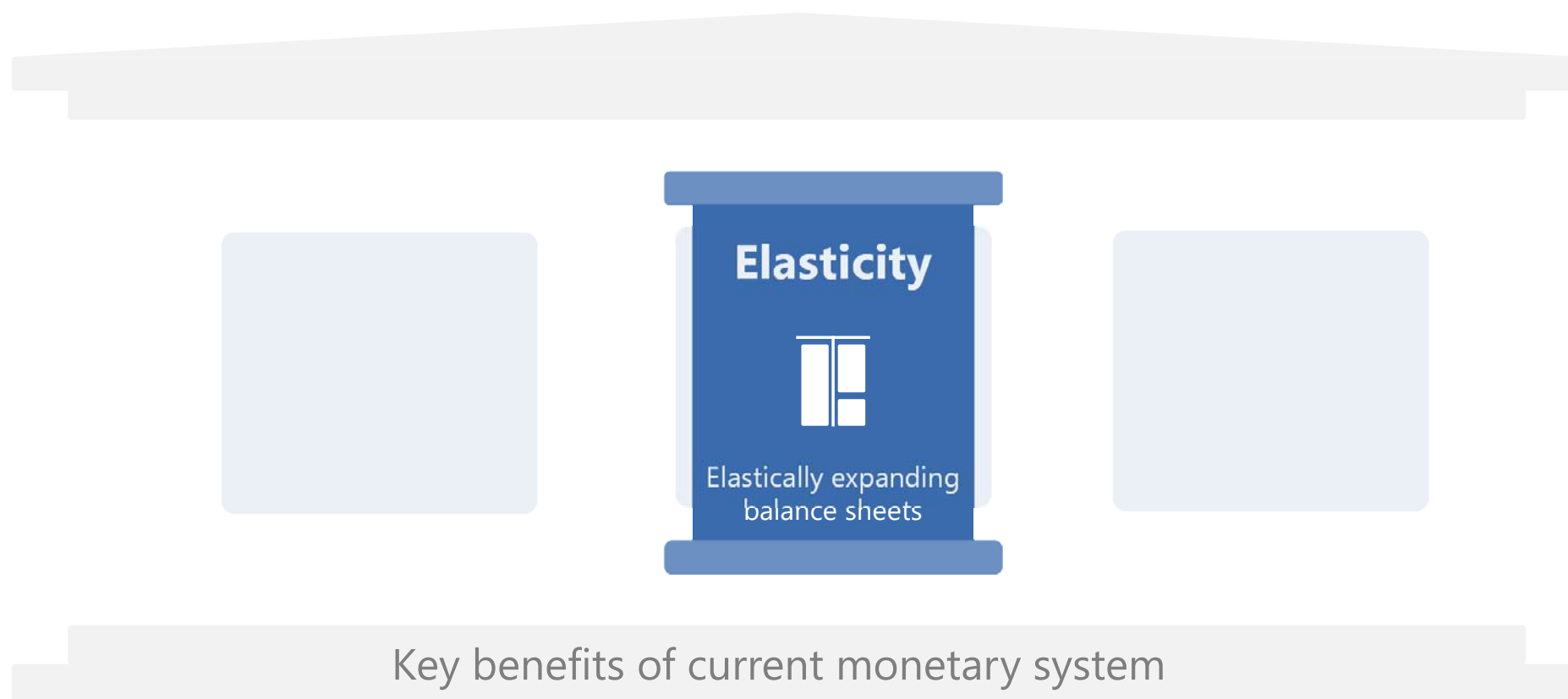
Singleness of money ensures acceptance at par, whatever form money takes



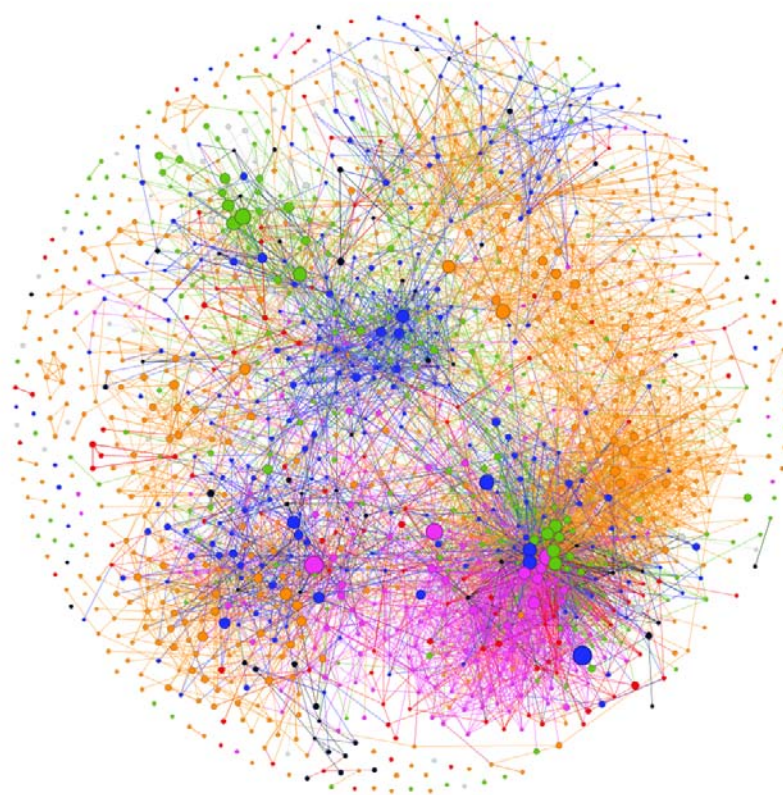
Stablecoins fare poorly on the singleness test



Elasticity allows money creation at the discretion of the payer through overdrafts to meet payment obligations without waiting for incoming payments



Elasticity ensures working capital is available in a world with cash flow shocks



Elasticity

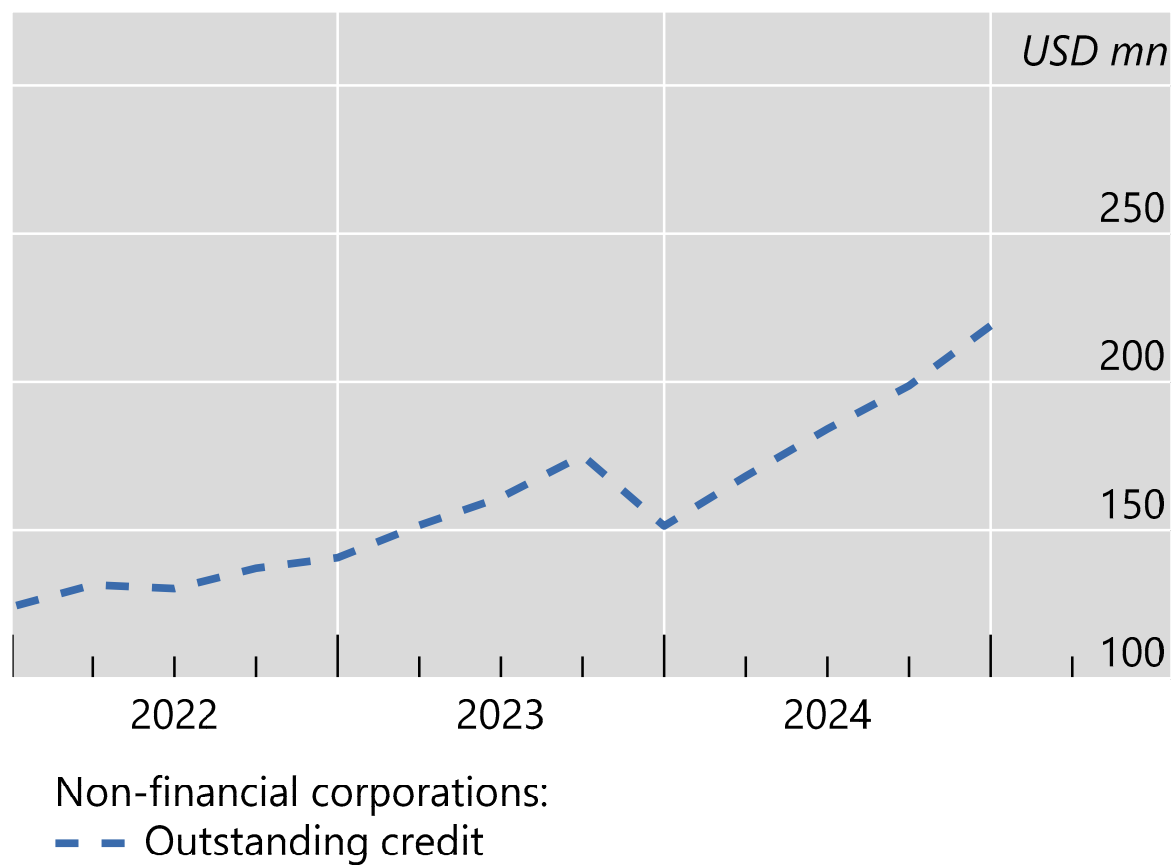
— CN
— Europe

— Japan and Korea
— US

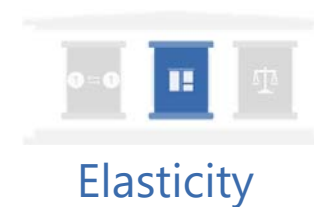
— North America ex US
— Rest of Asia-Pacific

— Other

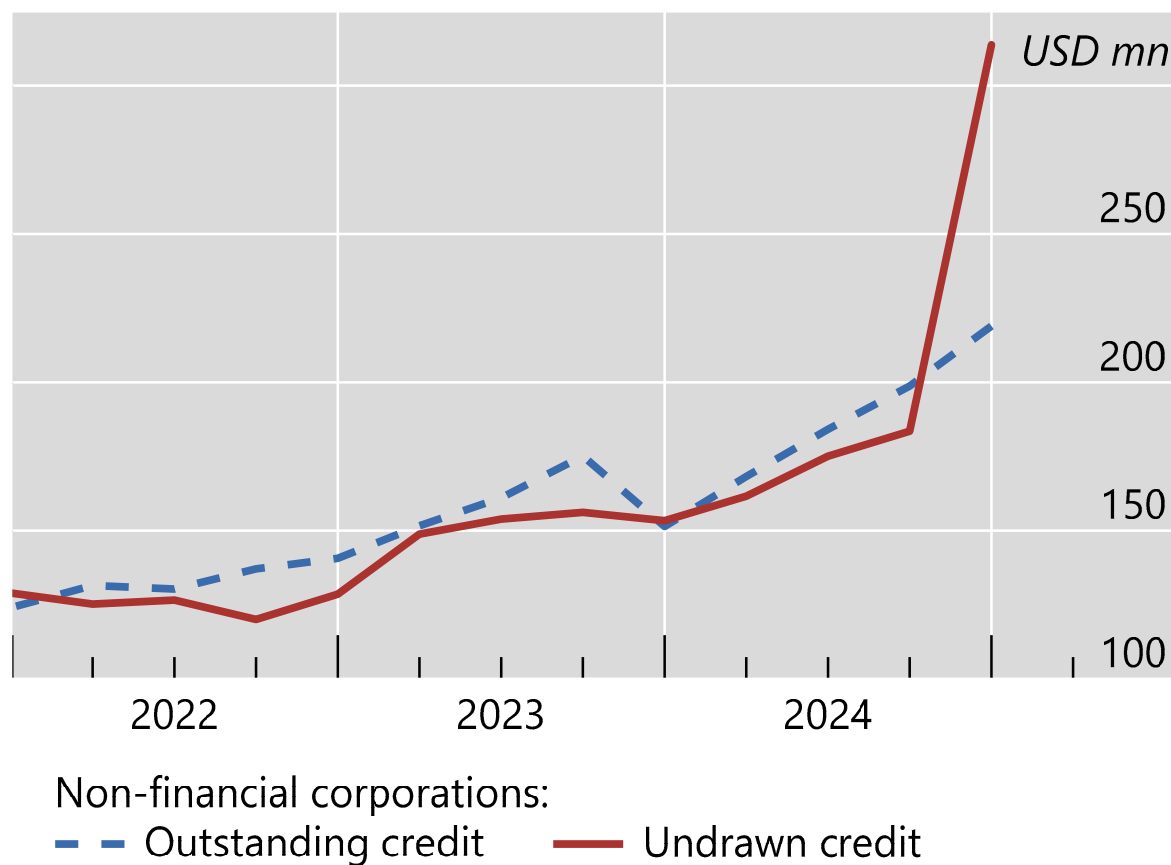
Recent months illustrate this well. Even as outstanding credit has increased...



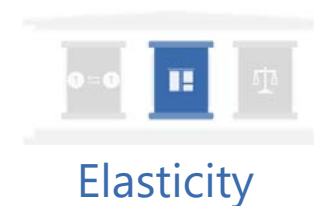
Seasonally adjusted medians. Outstanding credit includes commercial paper, revolving credit and term loans.



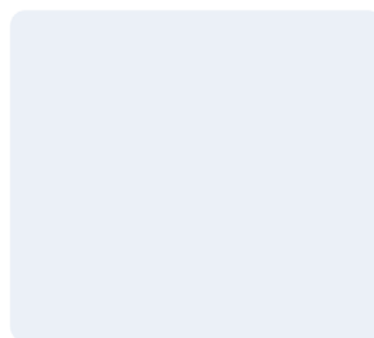
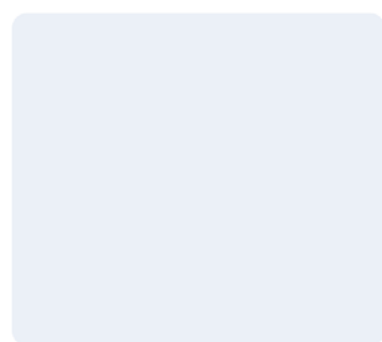
...undrawn credit lines surged much more, as firms sought resilience of working capital; stablecoins are subject to a “cash-in-advance” constraint and lack elasticity



Seasonally adjusted medians. Outstanding credit includes commercial paper, revolving credit and term loans.

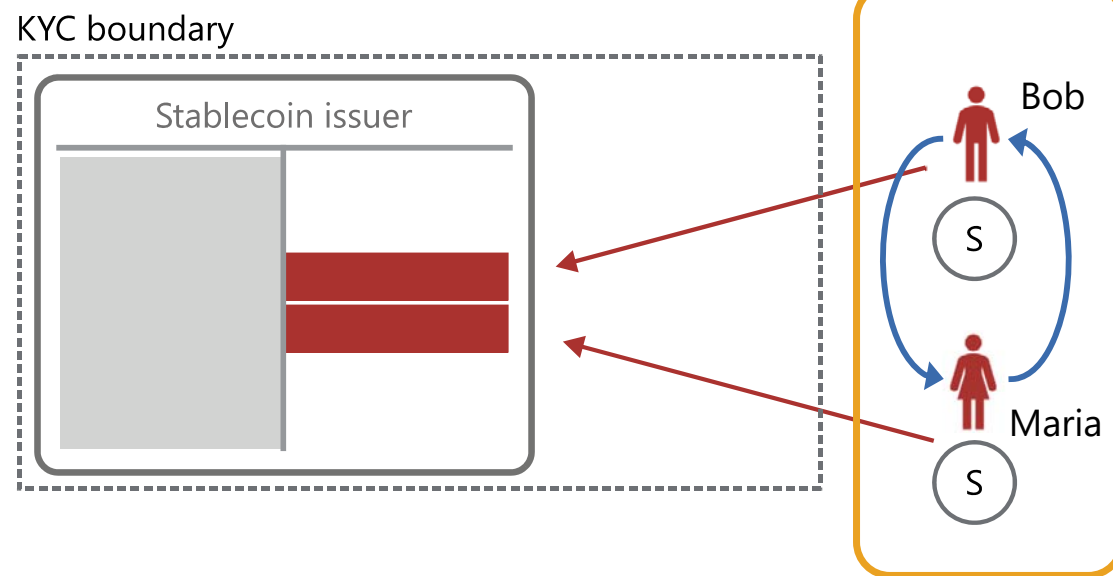
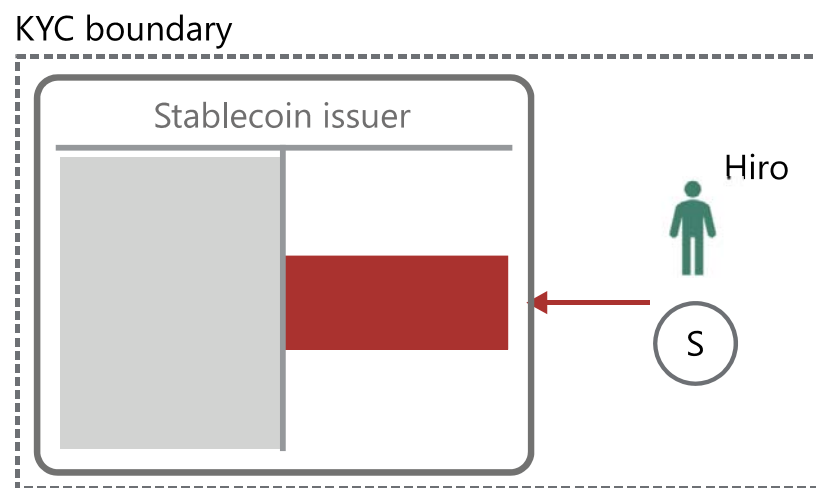


Integrity against financial crime and other illicit activity is critical for trust to be maintained in the monetary system

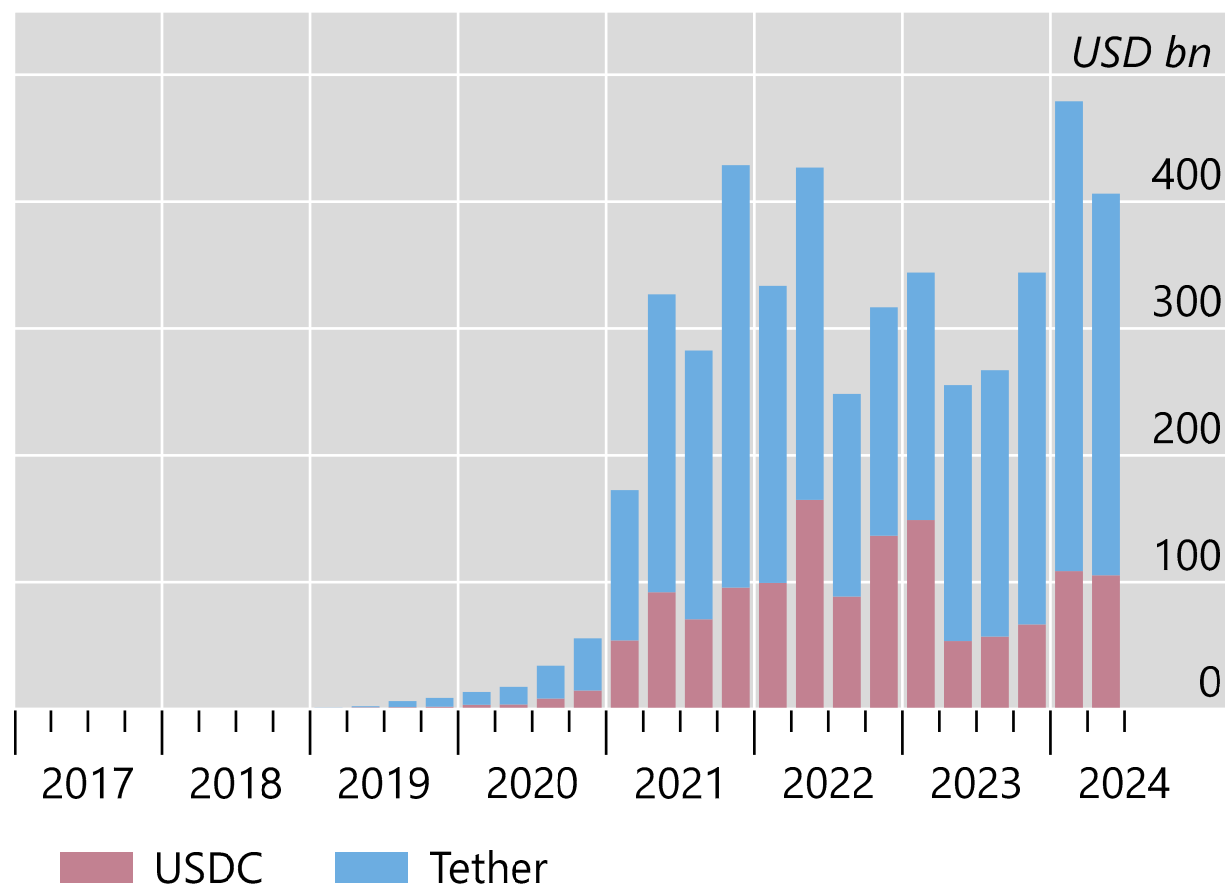


Key benefits of current monetary system

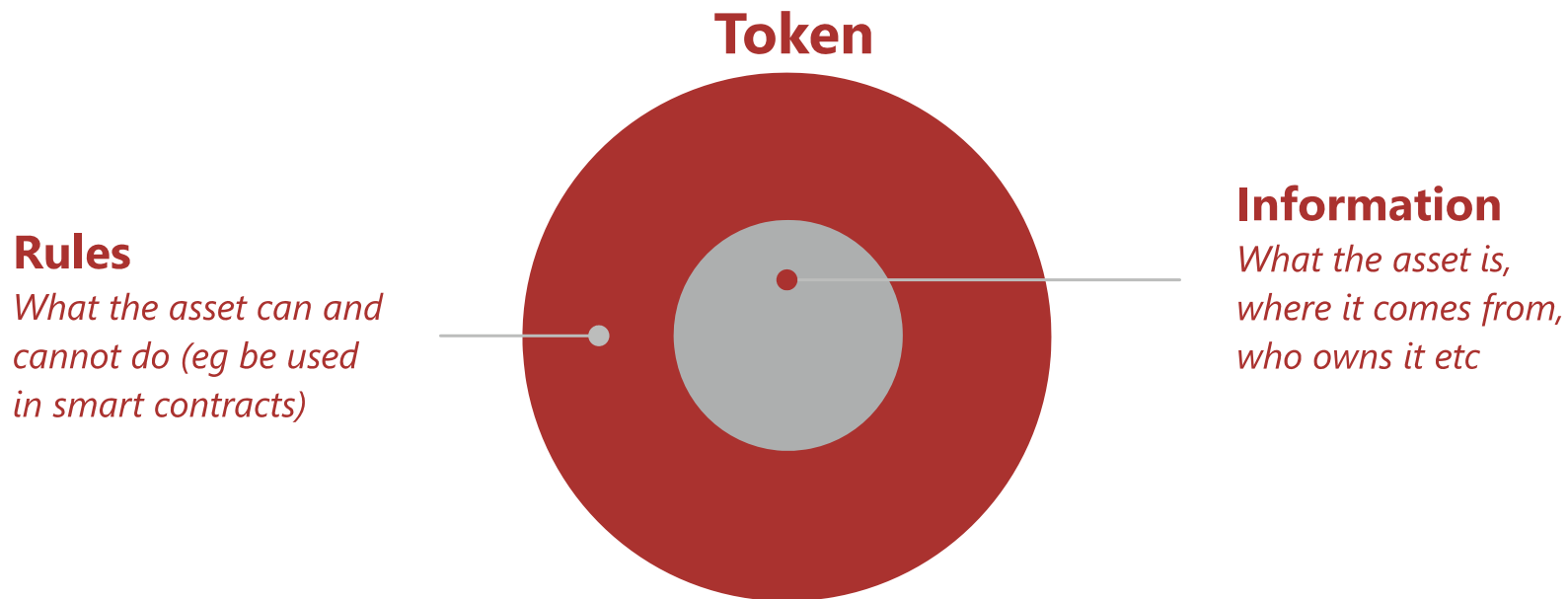
Stablecoins as bearer instruments fare poorly on integrity compared with the system that relies on account updates by trusted intermediaries



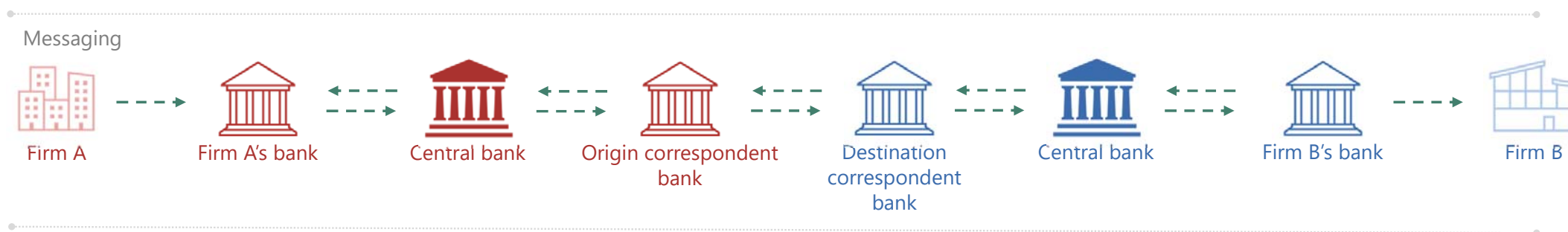
Cross-border stablecoin flows have surged, posing new policy challenges



Tokenisation integrates records in a traditional database with the rules and logic governing transfers; it enables the *contingent performance of actions* and programming capabilities of digital platforms

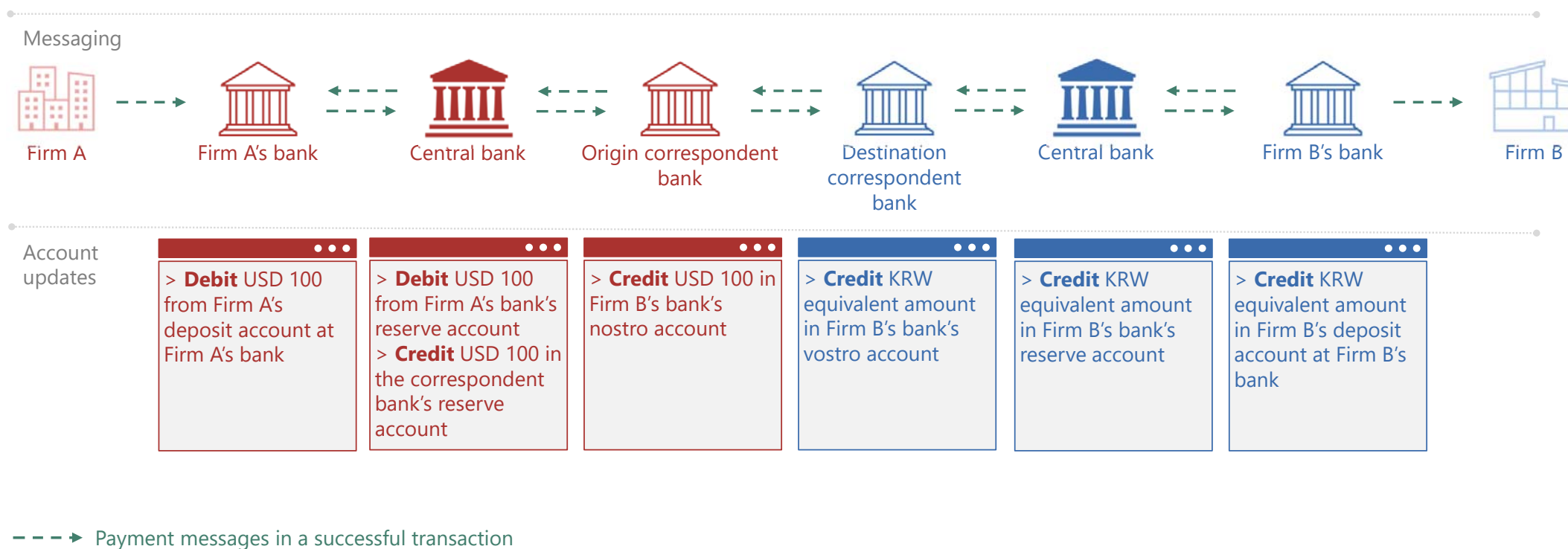


Correspondent banking is the backbone of today's commercial payment system, but it has well known weaknesses

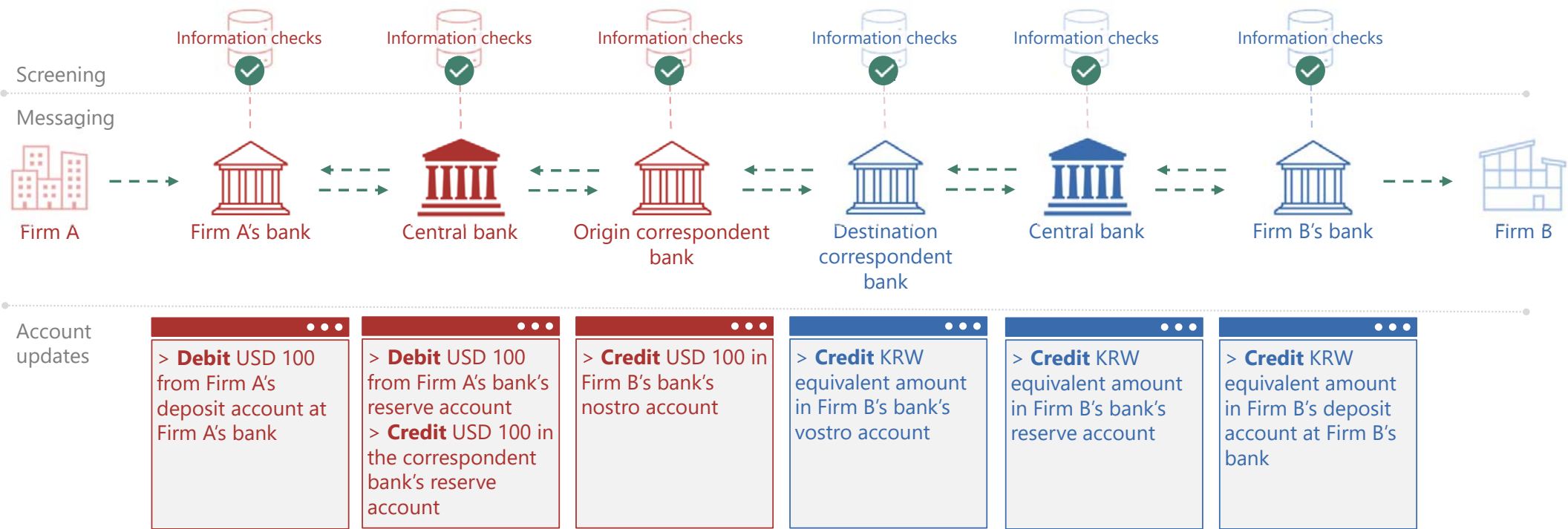


--- ➤ Payment messages in a successful transaction

Separation of messaging and account updates, and the sequential nature of account updates, give rise to delays and operational risks

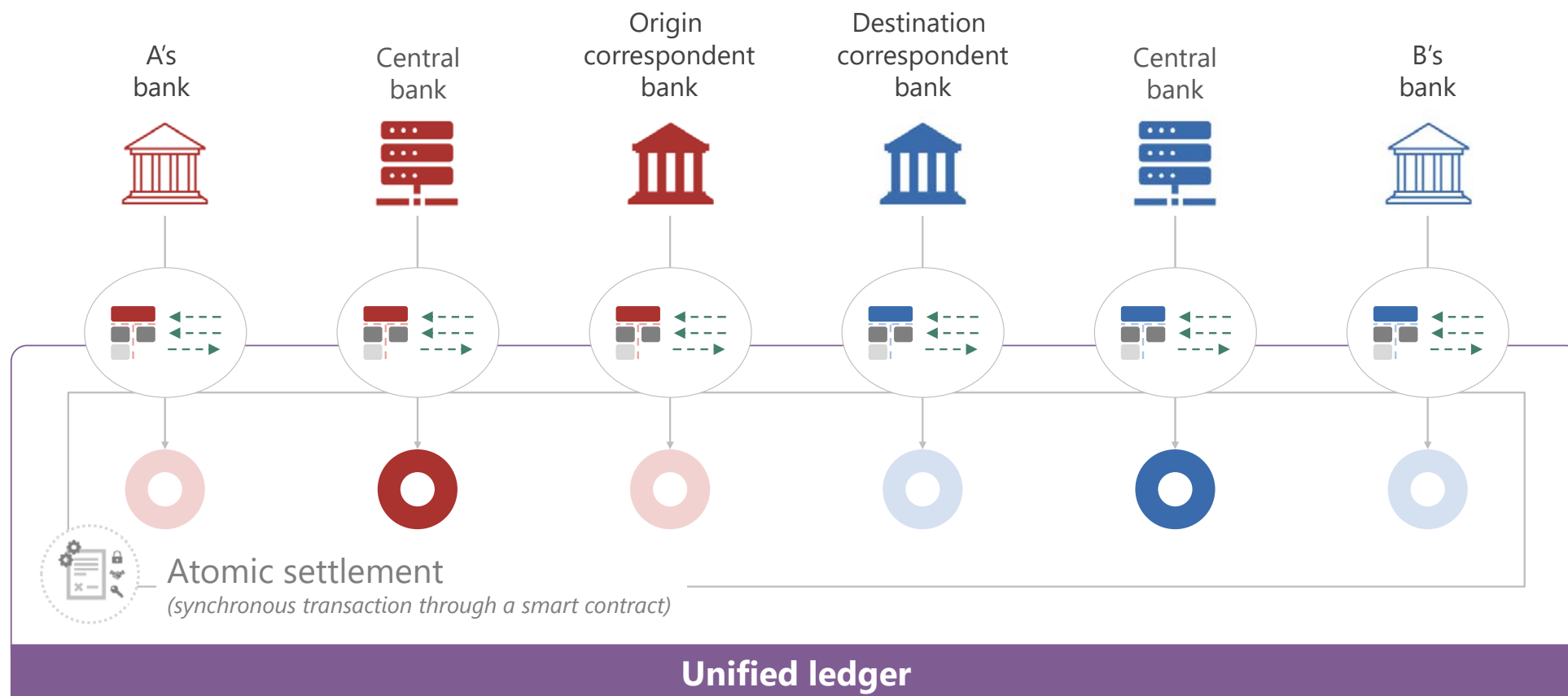


Know-your-customer (KYC) and anti-money laundering (AML) checks give rise to duplication of effort along the chain

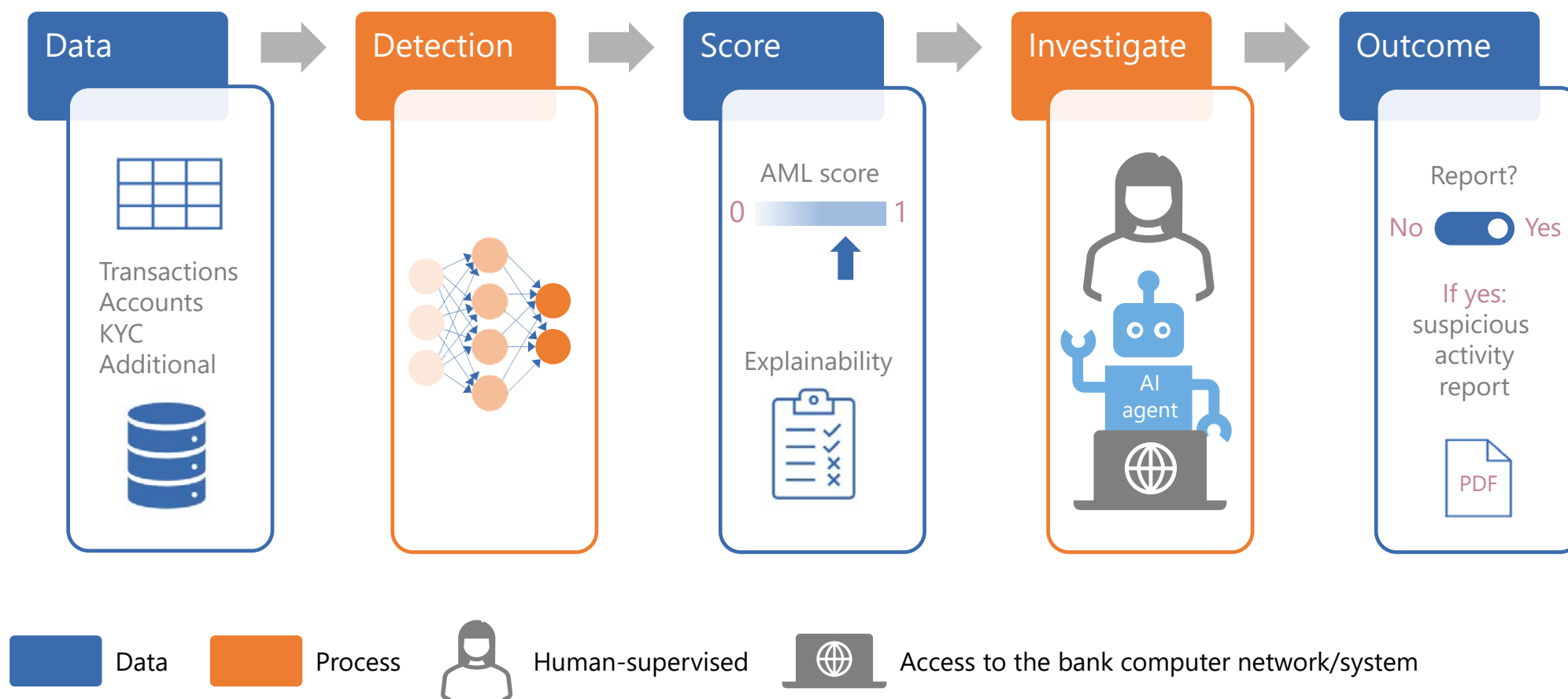


--- ➔ Payment messages in a successful transaction

The next-generation correspondent banking envisaged in Project Agorá uses tokenisation to combine messaging and settlement into one atomic transaction...



...and platform resources can be utilised for KYC/AML compliance



Trilogy of tokenised
central bank money,
tokenised deposits and
tokenised government
bonds will be the
backbone of the
next-generation
monetary and financial
system

