



Conference 2014
*Asian financial system,
Australian financial services*

Presented with our media partner:



*The internationalisation of the Asian financial system:
Prospects and challenges*

Mr Warren Hogan, ANZ
Mr John Garnaut, Fairfax Media
Mr Geoff Weir, Financial Sector Services

Presented with our media partner:

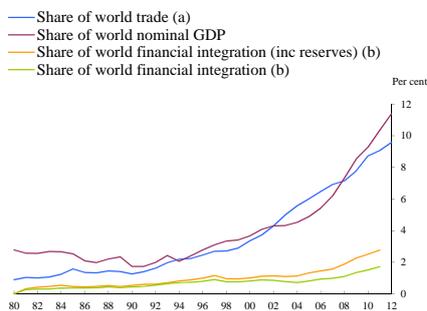


The Opening Up of China's Capital Account: Opportunities and Challenges for Australia

Presentation by Geoff Weir
 ABE Annual Conference
 November 2014

The Outlook: "Finance Follows Trade"

Chart 1: China's International Integration in GDP, Trade and Finance



Source: Hooley (2013).

How Quickly Will Finance Follow Trade?

- Reforms necessary for successful RMBI:
 - Remove capital controls
 - Remove interest rate ceiling on bank deposits
 - Float exchange rate
 - Improve corporate governance
- ***“In the absence of some major setback, substantial progress will have been made in internationalising the RMB within 10 years, with capital controls largely or completely lifted, borrowing and lending rates market determined, the exchange rate market determined and the RMB having become a significant international reserve asset”***
- Reasons include:
 - Domestic policy imperatives
 - Government and central bank commitment to RMBI: c.f. Third Plenum
 - Recent pace of reform, including the Shanghai FTZ experiment and Shanghai/Hong Kong Stock Connect scheme
- Risks: more political than economic?

5

Size Matters: Financial Flow Projections

(a) Inflows

Hong Kong Monetary Institute:

- The stock of inward portfolio investment could increase from around USD 220 billion in the base year to around USD 6 trillion in 10 years time; and
- The stock of inward direct investment in China could rise from around USD 1.5 trillion in the base year to around USD 7 trillion in a decade.

(b) Outflows

Hong Kong Monetary Institute:

- The stock of outward direct investment could rise from around USD 300 billion to USD 5.1 trillion;
- The stock of outward portfolio investment could rise from around USD 250 billion to around USD 5.5 trillion

6

How is Australia Positioned? Financial Architecture

- Australia's policy framework already incorporates important features that should be conducive to developing closer financial relations with China:
 - Swap facility: RMB 200 billion, the fifth largest;
 - Direct trading AUD/CNY
 - Official local clearing and settlement bank: why is it important?
 - Bank of China/ASX Austraclear linkup
 - RQFII Quota
 - Free Trade Agreement and MFN clause

7

Opportunities: Trade-Related Banking Business

- Why is so little of Australia's trade with China invoiced and settled in RMB?
 - Dominance of commodities in our exports
 - Some other impediments: **CIFR survey key results**
- What are the prospects for greater RMB commodity pricing?
 - China wants it and has a lot of market power;
 - Given potential price advantage that more than offsets hedging costs, one large producer "breaking ranks" could see a snowball effect;
 - It is already happening with some commodities, including some Australian wool exports; and
 - Some Australian mining companies would appear to be actively preparing for it

8

Opportunities: Capital Markets

- **China's Needs**
 - As capital controls are removed and China's capital markets develop, more companies will look to diversify funding away from overreliance on domestic banks, including into offshore debt and equity raisings.
 - Australia has deep and liquid equity and derivatives exchanges, but more work to do on our domestic bond market
 - When combined with the ability of Austraclear to clear RMB denominated products, we have the capacity going forward to become a hub for the issuance and trading of debt, equity and derivatives products denominated in RMB.

9

Opportunities: Funds Management

- **Inflows into China**
 - China's financial assets will become very large and core components of global benchmark indices
 - RQFII quota and Hong Kong/Shanghai Stock Connect scheme substantially increase capacity to invest in mainland China's debt and equity markets
- **Outflows from China**
 - Australia has a very efficient and competitive funds management sector:
 - China has massive pools of domestic savings, and a growing need to diversify into offshore assets

10

Challenges: Removing Obstacles

- In Australia
 - Increasing customer awareness of possibilities for transacting in RMB
 - Inward looking focus of our funds management sector
 - Removing tax obstacles to greater cross-border financial flows
 - Developing our corporate bond market
- In China
 - Opening up its capital markets smoothly and efficiently
 - Improving corporate governance
 - Increasing awareness amongst SME's of scope for RMB trade settlement
 - Removing other obstacles to greater RMB trade settlement

11

Concluding Comments

- *“The opening up of China’s capital account is likely to be one of the major factors influencing the type, volume, currency denomination and location of financial flows and financial market activity globally over coming decades”*
- Associated with these developments, there is considerable scope for much broader and deeper financial relations between Australia and China.
- But this won’t happen as a matter of course. We need to ensure amongst other things that:
 - companies and individuals in Australia are fully aware of the rapidly expanding opportunities arising from RMB internationalisation; and
 - our tax system does not discourage cross-border financial flows.

12