Opening address to the 2015 Australia-Hong Kong RMB Trade and Investment Dialogue

9 July, Sofitel Sydney Wentworth, 9.05 - 9.20am

Introduction

Thank you for your kind introduction.

It's a pleasure to be here with you today. On behalf of the Australian Government, I'd like to welcome you all to the third Australia-Hong Kong RMB Trade and Investment Dialogue.

I would like to recognise our co-facilitators, the Hong Kong Monetary Authority and the Reserve Bank of Australia. I would also like to thank our event sponsors, speakers and panellists — particularly those that have travelled from Hong Kong.

The RMB dialogue will consider the opportunities that will emerge as the RMB becomes an increasingly important international trade and investment currency. By deepening our understanding and expertise through forums such as this, Australia will be well positioned to benefit from these opportunities.

The RMB's increasing importance as a trade and investment currency

China is actively seeking to internationalise the RMB. This audience will be aware of the RMB's increasing importance as an international trade currency.

Around one quarter of China's merchandise trade is now settled in RMB, up from 3 per cent in 2010. The RMB is now the world's fifth most used payments currency.[1]

RMB trade settlement has the potential to benefit both sides of the transaction with Chinese firms benefiting from settlement in their own currency while foreign firms are in some cases offered discounts to settle in RMB.

China has expanded the offshore RMB clearing architecture with official clearing banks launched across Asia, the Middle East, Europe, the Americas and Australia. By the end of the year China is also expected to introduce the China International Payments System which promises increased efficiency and lower technical barriers for financial institutions that deal in RMB.

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[1] SWIFT international payments.

The liberalisation of China's capital account

In addition to their efforts to internationalise the RMB, China is also advancing a programme of financial sector reforms.

A range of quota-based schemes are facilitating increasing amounts of both inbound and outbound portfolio investment.

This includes the RMB Qualified Foreign Institutional Investor scheme under which Australia was last year granted a RMB50 billion allocation. Australian-domiciled financial institutions are now eligible to apply for a quota to invest in Chinese portfolio assets under the scheme.

Portfolio flows are also being facilitated by new trading platforms such as Shanghai–Hong Kong Stock Connect which was launched last year. A Shenzhen link into the platform is in the pipeline.

China is also expected to launch the Qualified Domestic Individual Investor scheme, which will allow Chinese individuals to purchase overseas financial and real estate assets.

While China is moving quickly, portfolio flows are expanding from a very low base.

Quota-based schemes facilitating inbound and outbound portfolio investment are relatively small with a total capacity of around 1.3 per cent of GDP for outbound2 investment and 2.7 per cent of GDP for inbound3 investment. By comparison, the external portfolio assets and liabilities of the United States are around 55 per cent and 97 per cent of GDP respectively.

Looking ahead, China is expected to continue to open up channels for cross-border investment and is advocating for the RMB to be included in the IMF's Special Drawing Rights or SDR currency basket.

To be included in the SDR basket, the RMB must be determined a 'freely usable' currency. While not synonymous with an open capital account, it requires the RMB to be widely used to make international payments and widely traded in the principal foreign exchange markets.

To this end, we understand that China will pursue what it has described as 'managed convertibility', which means that China will retain policy levers to manage risks that might otherwise be associated with a sudden and dramatic increase in cross-border investment.

An optimistic person might call it 'capital account liberalisation with Chinese characteristics'. This strategy will likely include further quota expansions and the relaxation of supervisory mechanisms that administer investment transactions.

While China is by no means moving hastily, we shouldn't underestimate the impact that these gradual steps can have, particularly in driving continued reform.

Importantly, we see China as working to resolve distortions in financial intermediation with the launch of deposit insurance and tradable certificates of deposits for individuals and corporates.

[2] Combined capacity of QDII and Stock Connect.
[3] Combined capacity of QFII, RQFII and Stock Connect.

These are both important precursor steps towards the liberalisation of deposit interest rates. Deposit interest rates are expected to be liberalised by the year's end.

While financial sector development is crucial to improving the efficient allocation of capital across the economy, it poses transition risks to the financial sector – a taste of which we've seen in the volatility of China's stock markets in recent months. Appropriately targeted reforms will be important to ensuring the underlying financial stability and investor confidence in China's financial sector.

Implications and opportunities

But what does all of this mean for the rest of the world including Australia? For a start it will precipitate the accumulation of China's external assets and liabilities.

Chinese assets will become an increasingly important feature of a diversified portfolio.

Last month MSCI announced that it expects to include China A-Shares in its global benchmarks pending the resolution of a number of market access issues. Once included, institutional investors are expected to increase their Chinese exposures, a significant development given that more than US$9.5 trillion in assets are estimated to be benchmarked against MSCI indexes worldwide.

Equally, Chinese households will seek to diversify their portfolios by acquiring overseas financial assets. This will inevitably mean more investment into countries like Australia.

A more open capital account will also provide scope for Australia to extend our exports of financial services as Australian providers' access to the market is improved. China is relaxing its rules on foreign ownership of private funds management companies with some reports suggesting that 100 per cent foreign ownership will be possible as early as the end of this year.

In my former life, we established a joint venture in funds management in China but were limited to 49 per cent ownership. A move by China to provide access on a fully reciprocal basis for foreign investment would be welcome.

In that regard, only around 3 per cent of the Australian managed funds pool is foreign sourced. This shows the tremendous scope that exists for that industry to share its expertise more widely with the region.

Other initiatives are also underway to ensure that Australia's fund management industry is able to actively market their services globally. Consistent with the approach taken in a number of other jurisdictions, the Australian Government has recently implemented the investment manager regime. The regime seeks to remove tax disincentives to foreign investors engaging an Australian fund manager, in relation to investment into Australia and also overseas.

As an open, well regulated and stable economy in the region, Australia is well placed to capitalise on these advantages and to benefit from the considerable opportunities associated with regional financial integration. Australia will have keen eyes on the implementation of the Mainland-Hong Kong mutual recognition agreement which will allow eligible Mainland and Hong Kong funds to be distributed in each other's market.

Concluding remarks

Now I will leave you in the hands of an impressive list of experts who will share their insights into the array of issues I have touched on this morning.

Thank you once again for your continued support and I hope you enjoy the day’s festivities.