

Guy Debelle: Remarks at the Funding Australia's Future Forum – a look at Australia's financial system

Remarks by Mr Guy Debelle, Assistant Governor (Financial Markets) of the Reserve Bank of Australia, at the Funding Australia's Future Forum, Sydney, 7 August 2013.

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As I said at the launch of these papers a few weeks back¹, the Australian Centre for Financial Studies (ACFS)² has put together a very interesting and timely body of work on an important topic.

I will make two points, the first about global financial regulation, the second about the way forward for this project.

At the launch I talked about the need for a holistic review of global financial regulation. I think this *does* need to be done at a global level. There is a vast global regulatory reform agenda which is complex and interacting in a number of different ways. We need a better understanding of how some of these interactions occur. As I said before, each of these regulatory changes may well make sense in their own right, and when looked at in terms of their impact on their own particular market segment. I just don't get the sense that we have a good idea on how they will all interact and affect market functioning.

One good example of this is in the demand for collateral. Quite a number of the global reforms require banks, as well as others, to hold more high quality collateral than they did in the past. The shift to central clearing is one such reform. In a number of cases, margin has always been posted, but depending on how the shift to central clearing actually occurs, we may or may not get all the benefit of netting which would mean a greater demand for collateral. Then there are some transactions on which margin has not previously been required. The sort of collateral which can actually be posted is also changing. The liquidity reforms under Basel III also imply a material increase in demand for High Quality Liquid Assets (HQLA). I'll have some more to say on that in the Australian context next week.

The bottom line is that demand for HQLA is going up. As it so happens, this is occurring at a time where the supply is also going up quite a bit, given the fiscal situation around the globe.

So how is that greater demand for collateral going to play out? What are the implications? Is it just an issue of price working to clear the market or will there be impacts on market functioning?

The BIS Committee on Global Financial Stability³, on which I sit, has published some work on that recently, but there is more to be done. This is just one example where we don't really know the full implications of the many interacting reforms underway.

That said, what I am *not* saying is that we should delay implementing some of these reforms in Australia, or pick and choose the ones the financial sector likes. I do not agree with that. We do not have that luxury.

As the papers we are discussing today highlight, the Australian system is part of the global financial system. The capital inflows are sourced from the global financial system. Given that, we don't have the option to opt out when we feel like it.

¹ Remarks at the Launch of Funding Australia's Future – 10 July 2011.

² <http://www.australiancentre.com.au/>.

³ <http://www.bis.org/publ/cgfs49.htm>.

The second point I'd like to make gets right to the heart of the ACFS' agenda: Funding Australia's Future. It's a good question to ask. But I suppose I'm not sure how much further we can go with it.

The Australian financial system has undergone a severe stress test over the past five or six years.

And it has come through that pretty well.

Are there some things that can be done to make it function better and be more resilient?

Yes, and some of them have already been put in train over the past few years, so that the system now is more resilient than it was in 2007. Some of them are the reforms that are being done at the global level.

The fact that the problems didn't happen here is also not a good argument for not implementing them. The reforms have been developed with the aim of increasing the resiliency of the financial system, which would seem to make them worthwhile in their own right. I don't see the logic in not learning from what happened elsewhere rather than waiting to learn the lesson painfully ourselves. Learning from others' mistakes is a lot less painful approach to life.

As the past few years show, the financial system is just that, a system, as Rod Maddock and Peter Munckton's paper highlights. It is also a set of markets where there is demand and supply and a market-clearing price. As the system evolves and is stressed in different parts, other parts of the system adjust. As supply and demand changes, the price adjusts.

Does this always happen seamlessly or painlessly?

No. But broadly speaking, the stress test of the past few years shows that it does happen. There were a lot of people worrying throughout that period about where the funding would come from. But in the event, the system broadly speaking coped. The system here didn't fail, and that is an important point to keep in mind in this whole exercise.

Prices did adjust. The exchange rate in 2008 was one of them. Deposit pricing was another.

Do markets always get this right? No they don't, but it's not clear what the better alternative is.

Regulation is motivated at least in part to address some of those deficiencies of markets.

Is regulation always going to get it right? Clearly not.

So that's why we need to keep on questioning the appropriateness of the structure of financial markets and their regulation. It's good to be asking the question in an environment when the system hasn't failed rather than when it has, as is the case in other countries. And that I see as the value of the work the ACFS is doing, namely asking the question, is the system working as well as it can? In particular, talking about the system, as Rod and Peter do. In terms of the way forward, Kevin Davis had a slide in his presentation which basically mapped the path out. What are the broad structural forces shaping the financial system in the years ahead. Do we want those structural forces to play out? Are they well founded or are they the result of some distortion in the system? So in a nutshell: think about the system, think about the broad structural forces.