# Philip Lowe: Australia's RMB policies and future direction

Introductory Remarks by Mr Philip Lowe, Deputy Governor of the Reserve Bank of Australia at the RMB Internationalisation Roundtable, Sydney, 23 July 2014.

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*I would like to thank Michelle Wright for assistance in the preparation of these remarks.*

I would like to thank David Olsson and the RMB Working Group for organising today's Roundtable. It is very encouraging to see the ongoing interest in the topic of RMB internationalisation from both government and business leaders. The Reserve Bank is a strong supporter of the work that is going on and I am very pleased to be able to participate.

For anyone interested in international trade or global finance, understanding the issues we are talking about this morning should be very high on their agenda. As I have said before, the internationalisation of the Renminbi (RMB) and the accompanying process of capital account liberalisation in China could well turn out to be one of the seismic events in global capital markets over the coming years.[1] Ultimately, this process could see Chinese citizens be able to hold internationally diversified portfolios, just as the citizens of many other countries are already able to do. It could also see citizens from other countries able to buy and sell Chinese financial and other assets with far fewer restrictions than are currently in place. And it could see the Chinese currency become one of the world's most actively traded. If these things do come to pass, then they would reshape the nature of global capital flows and the international financial system, just as China's entry into the global trading system reshaped global trade and production.

As Australians, we have more than a passing interest in all of this. China is our largest trading partner and our financial linkages with China, while still relatively small, are growing. And by virtue of being a small open economy with an already liberalised capital account, our markets will be affected by changes in global capital flows. So understanding what is going on here is important. This is true not just for those involved directly in the financial sector, but for our society more broadly.

I have had the privilege of participating in the first two Australia-Hong Kong RMB Dialogues, the first in Sydney last year and the second in Hong Kong quite recently. From participating in these dialogues my sense is that we are making progress and David Gruen in his remarks has outlined some of the examples. More businesses are genuinely interested in exploring the advantages of having trade invoiced in RMB. The financial infrastructure that supports this trading is gradually being put in place. And some of the stumbling blocks and misperceptions are being eroded.

There is, though, much further to travel on this journey. Currently, less than 1 per cent of Australia's merchandise trade with China is invoiced in RMB. For China, around 12 per cent of total merchandise trade in 2013 was invoiced in RMB, although we estimate the number was around 3 to 5 per cent if trade with Hong Kong is excluded. These figures suggest that there remains significant potential for growth in RMB trade invoicing, not only by Australian firms, but by firms in other countries as well.

Australia's own experience with liberalisation is that the growth of trade makes financial liberalisation easier. As financial markets develop to support trade relationships, those same markets can, in time, support deeper financial relationships. Trade helps deepen financial markets, and deeper financial markets make it easier to liberalise. In the end, though, how

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[1] Lowe P (2014), "Some Implications of the Internationalisation of the Renminbi", Opening Remarks to the Centre for International Finance and Regulation Conference on the Internationalisation of the Renminbi, Sydney, 26 March.

long this whole journey takes in China is largely dependent upon the pace of reform by the Chinese authorities.

It is, of course, also dependent upon the speed with which the financial sector is able to respond to any new opportunities. In part, the development of the appropriate markets depends on commercial decisions made by financial institutions. The Reserve Bank is seeking to play a positive role in this area, partly through helping create a constructive environment in which these decisions can be made. Given this, I would like to spend a few minutes outlining the various elements of our work in this area.

First, we have sought simply to ***better understand*** how the RMB markets operate. In particular we have sought to understand: the nature of the existing arrangements and products; any impediments to the development of an RMB market in Australia; and how the RMB market sits within the broader financial system. Our representative office in Beijing has been helpful here as have the frequent trips by RBA staff to China. We have also worked closely with the financial sector in Australia, including with the RMB Working Group and have been involved in two separate surveys of corporates' attitudes toward the use of RMB.[2] These efforts have helped us develop a deeper understanding of the issues, as well as understanding in the broader financial community. The joint work has also assisted in providing a forum to support and to coordinate industry-led discussions and initiatives.

Second, the RBA has invested some of its ***foreign currency reserves in RMB***. First and foremost, this portfolio shift reflects the growing importance of China in the global economy and the broadening financial relationship between Australia and China. But it has also allowed us to deepen our own understanding of developments in Chinese financial markets and the RMB. Currently, around 3 per cent of our net foreign reserves are invested in RMB.

Third, is ***the bilateral local currency swap agreement*** between the RBA and the People's Bank of China (PBC). This swap, which was signed in 2012, allows the two central banks to exchange their local currencies for mutually agreed purposes. The key benefit of the swap agreement is to provide confidence to the Australian market that RMB liquidity will be available through a "backstop" channel in the event of some disruption to the market for RMB. The swap is not meant to provide a "cheap" source of RMB funding to the Australian market in normal times. Its existence, though, should be helpful for market development, as it provides market participants with greater confidence that RMB will be available in Australia during times of dislocation. Since the swap agreement was signed there has not been a need to activate it, although it could be used should it be required.

Fourth, the RBA is currently working with the PBC on future RMB clearing and settlement arrangements, in particular the establishment of an "***official RMB clearing bank"*** in Australia. In keeping with the process that has recently been followed in a number of other jurisdictions – including London, Frankfurt, Paris, Luxembourg and Seoul – this would involve the signing of a Memorandum of Understanding between the RBA and the PBC, and the designation of an official clearing bank in Australia. It is important to note that the RBA would not expect to play a significant role in choosing which particular bank would be designated – this is, quite rightly, largely a matter for the Chinese authorities. In terms of timing, we are hopeful that an official RMB clearing bank could be designated over the coming months.

The concept of an official RMB clearing bank is one that is sometimes open to some misunderstanding, so I would like to spend a few moments setting out how these institutions

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[2] The survey in 2013 was coordinated by the RBA, while the 2014 survey was coordinated by the Centre for International Finance and Regulation. The 2013 survey results are summarised in Ballantyne A, M Garner and M Wright (2013) "Developments in Renminbi Internationalisation", RBA *Bulletin*, June, pp 65–74. The 2014 survey results are summarised in Centre for International Finance and Regulation (2014), "Internationalisation of the Renminbi: Pathways, Implications and Opportunities", Research Report, March.

operate. In essence, their key function is to facilitate cross-border payments and receipts of RMB for trade-related purposes on behalf of other financial institutions in the local market.

Of course, Australian importers and exporters are *already* able to make and receive cross-border RMB payments through a number of existing channels. For example, Australian-based banks can facilitate cross-border RMB trade transactions through correspondent banking relationships with banks in mainland China, or through RMB clearing "services" that are offered by Australian-based Chinese banks via their mainland Chinese Head Offices. Similarly, these transactions can also be effected through other offshore RMB centres, such as Hong Kong.

In fact, the differences between an official RMB clearing bank and the channels that are already available are quite subtle, though still important. In essence, official RMB clearing banks are afforded more *direct* access to China's onshore RMB and foreign exchange markets than other offshore institutions. More specifically, official clearing banks have direct access to China's interbank RMB payments system and receive a quota to transact in China's onshore foreign exchange market. These changes also entail more direct access to RMB liquidity from the PBC.

While an official RMB clearing bank would not *directly* increase the range or type of RMB transactions that are permitted to take place between Chinese and Australian entities, it would improve the efficiency of cross-border RMB transactions, for example by potentially reducing payment delays and/or reducing transaction costs. And, over time, the presence of an official clearing bank could encourage local financial institutions to offer a broader range of RMB products to the local market than is currently available.

Given the way in which the Chinese authorities have chosen to liberalise trading in the RMB, these clearing banks are playing an important practical and symbolic role. Indeed, the establishment of a clearing bank in Australia would help ensure that we are well positioned to participate in the next stages in the process of RMB internationalisation. Ultimately, though, if China does follow the general path travelled by a number of other countries, these clearing banks are likely to become less significant. In other currencies, alternative arrangements exist for the clearing of cross-border flows, with financial institutions managing the liquidity and risk issues without access to an official clearing bank. If this eventually turns out to be the case for the Chinese currency as well, then there is likely to be a reduced need for these official clearing banks. In the meantime, they are an important stepping stone on the path to a more internationally integrated Chinese currency.

Finally, a fifth step that we hope to take soon is to obtain a quota for Australian-based financial institutions to invest in mainland China under the Renminbi Qualified Foreign Institutional Investors (or RQFII) scheme. Following the granting of a RQFII quota to a specific jurisdiction, financial institutions operating within that jurisdiction can apply to the Chinese authorities to obtain an individual investment quota. Approved institutions can then invest their own quota in selected mainland Chinese bonds and equities using RMB obtained in the offshore market. In this way, the RQFII scheme can be thought of as representing both a partial relaxation of controls on inward portfolio investment to mainland China and as a means of developing the offshore RMB market.[3] An RQFII quota would therefore represent an important next step in facilitating cross-border RMB-denominated investment transactions

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3 The RQFII scheme exists alongside two other schemes that allow approved institutions to invest foreign currency in selected mainland Chinese securities: namely, the Qualified Foreign Institutional Investors (or QFII) scheme and a scheme that is commonly referred to as the China Interbank Bond Market (or CIBM) scheme. A number of Australian-domiciled institutions have already received quotas under the QFII scheme, while the RBA's acquisition of RMB reserves was facilitated under the CIBM scheme. The QFII and CIBM programs differ in a number of respects, including: the types of mainland securities that can be purchased; the types of investors that are eligible to apply; and the mechanisms that are available to convert foreign currency into RMB.

between our two economies. And, as Australia has a relatively large and sophisticated private funds management sector, there is significant potential for growth in this area.

So, in summary, a lot has been happening, both in the public sector and the private sector. I regard it as very much in our collective interest to continue this work. The changes that could occur in the Chinese financial system over the coming years have the potential to be felt around the world. To benefit from these changes, we need to understand them and be prepared for them.

Much of the work that we have been doing has been aimed at identifying and reducing potential *impediments* to the development of RMB business here in Australia. But once those impediments have been removed – and we are moving closer to that point – the development of the market is very much up to the private sector. Ultimately, in order for the RMB market in Australia to flourish, Australian corporates must be able to identify a clear business case for paying, receiving, lending, borrowing and investing in RMB. Over time, I think this will happen, but there is more work to be done.

Thank you.