ASIAN FINANCIAL TRANSFORMATION: DEVELOPING AN RMB ZONE & REDBACK MARKET

Asian Finance Forum
Seoul, 27 May 2013

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Agenda

- ✓ Changing Global Economic and Financial Geography
- ✓ Some Lessons from the Great Financial Crisis & the Imperative of Developing Asian Banking & Financial Markets
- ✓ An RMB Zone and Redback Market as an anchor for Asian Financial Markets
- ✓ Takeaways

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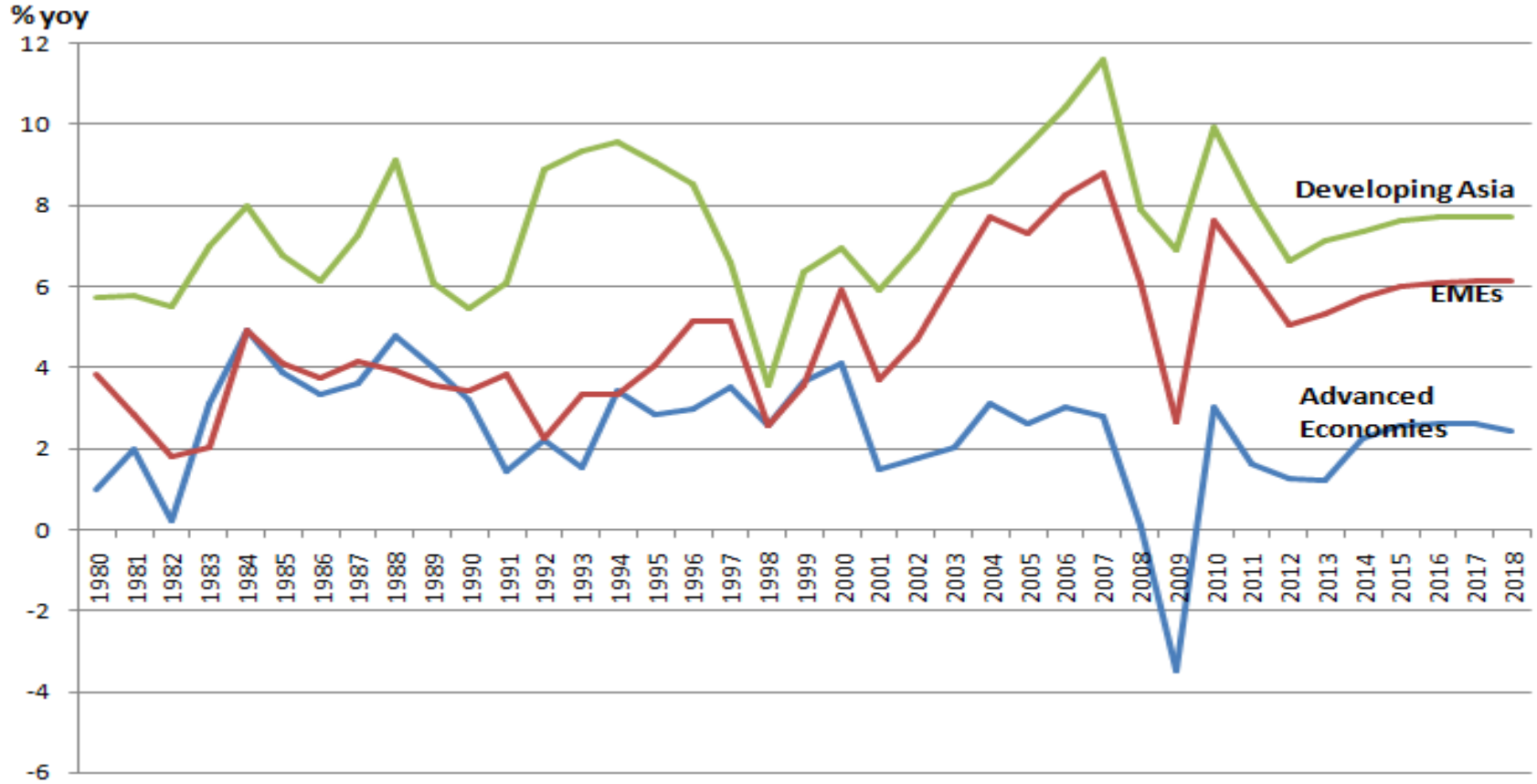
Global Growth: Dominated by EMEs & Developing Asia



	1990-1994	1995-1999	2000-2004	2005-2009	2010-12	2010-2014
Advanced nations	2.4	3.1	2.5	1.0	2.0	1.9
Emerging markets	3.2	4.1	5.7	6.6	6.3	6.0
Developing Asia	7.9	6.8	7.3	9.3	8.2	7.8

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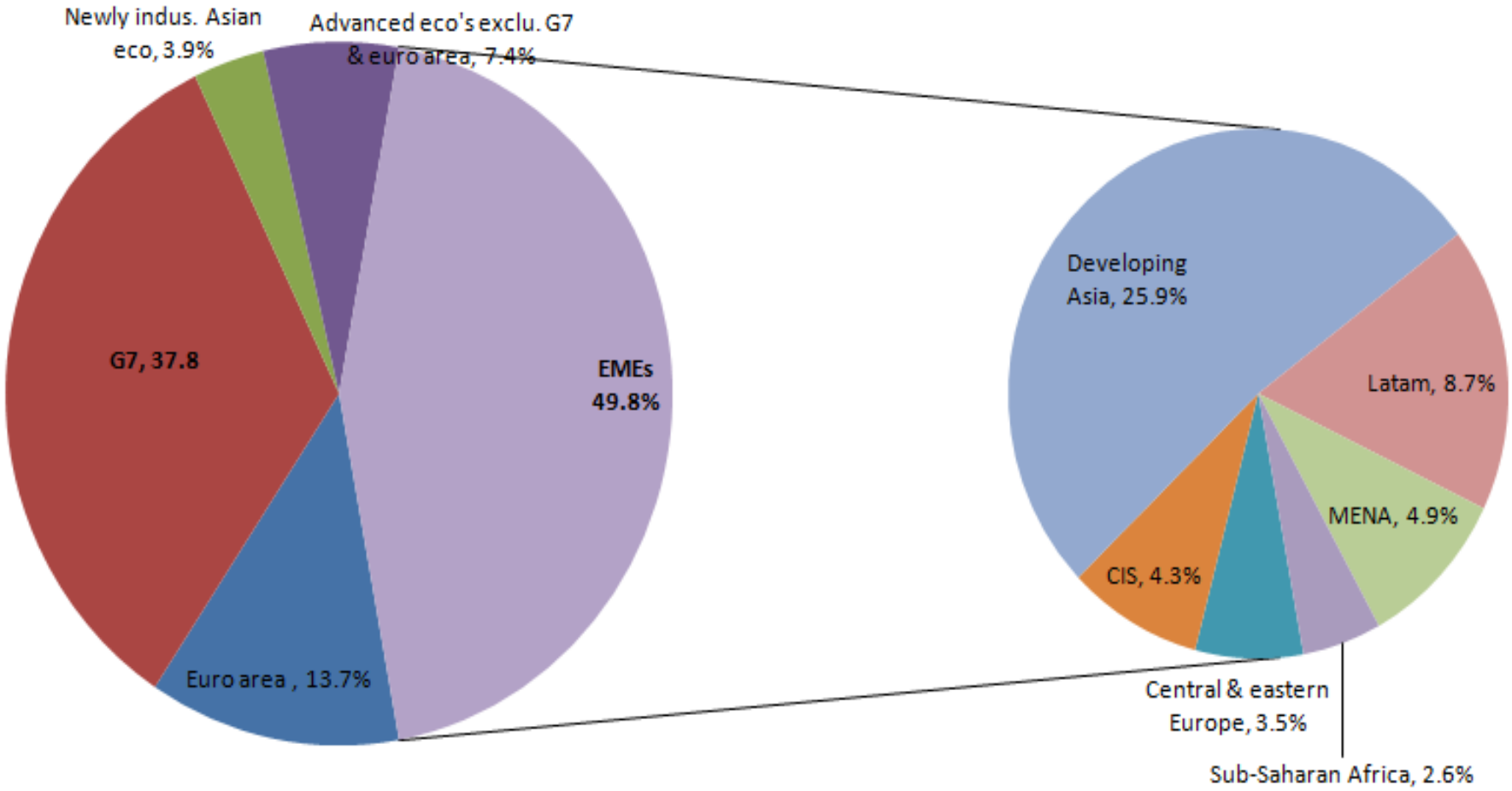
Shifting Economic Geography: EMEs Account for ~50% of Global Output

Growing Share of World Output – GDP 2012



Source: IMF World Economic Outlook, 2013.

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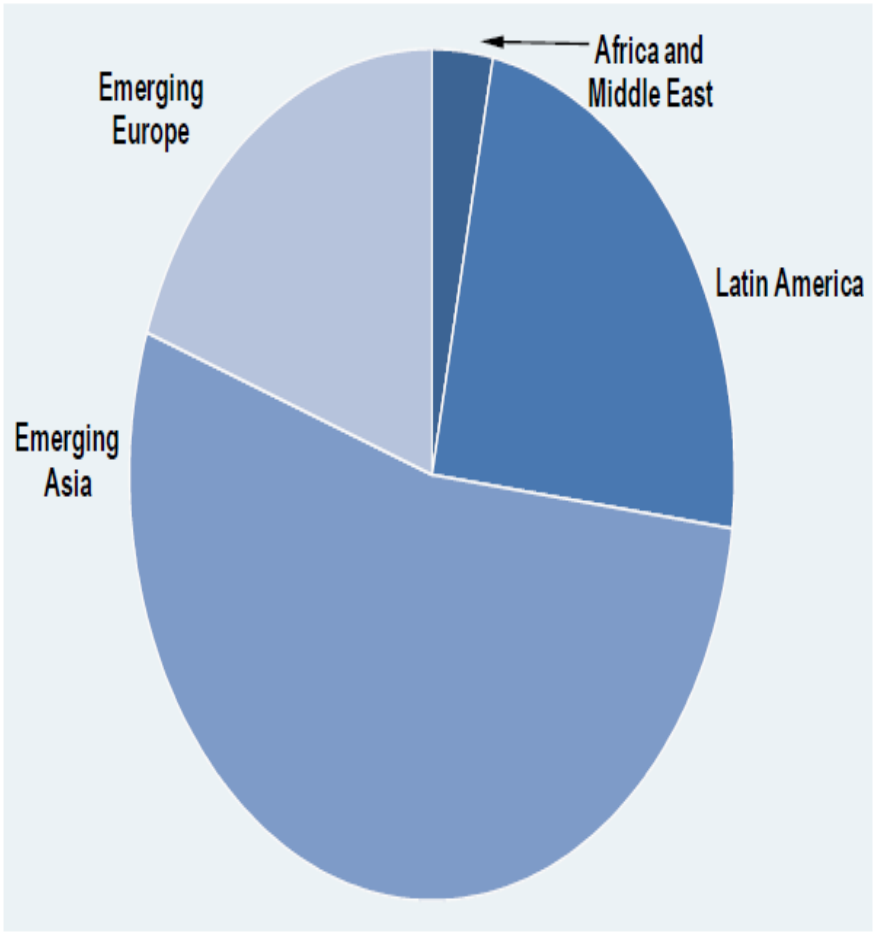
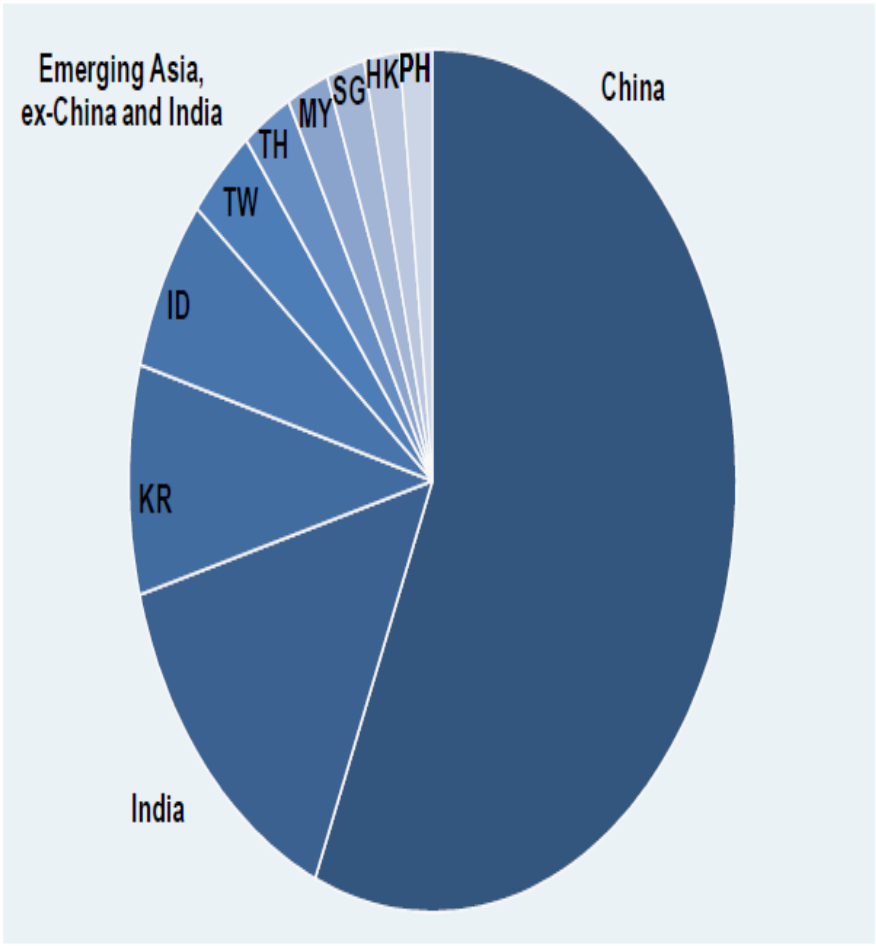
Within EMEs, Asia dominates and China dominates within Asia

Global GDP (Emerging Markets)



EM Asia GDP



Source: J.P.Morgan

Shift Towards Emerging Market Economies: Equity Markets

Growing Share of World Equity Market Wealth

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
World Market Cap	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
United States	46%	47%	50%	47%	45%	43%	39%	36%	31%	34%	32%	31%	33%	35%
Rest of Developed	46%	45%	41%	42%	44%	44%	44%	44%	41%	42%	39%	41%	41%	40%
Emerging Markets	8%	8%	9%	11%	12%	13%	16%	20%	28%	24%	29%	28%	25%	25%
BRIC	2%	3%	3%	3%	4%	4%	6%	9%	17%	13%	17%	16%	14%	13%
Rest of Emerging	6%	5%	6%	7%	7%	9%	11%	10%	11%	11%	12%	12%	12%	11%
of which MENA	0.5%	0.5%	0.6%	0.8%	1.2%	1.8%	3.0%	1.7%	2.2%	2.3%	1.9%	1.9%	2.1%	2.0%

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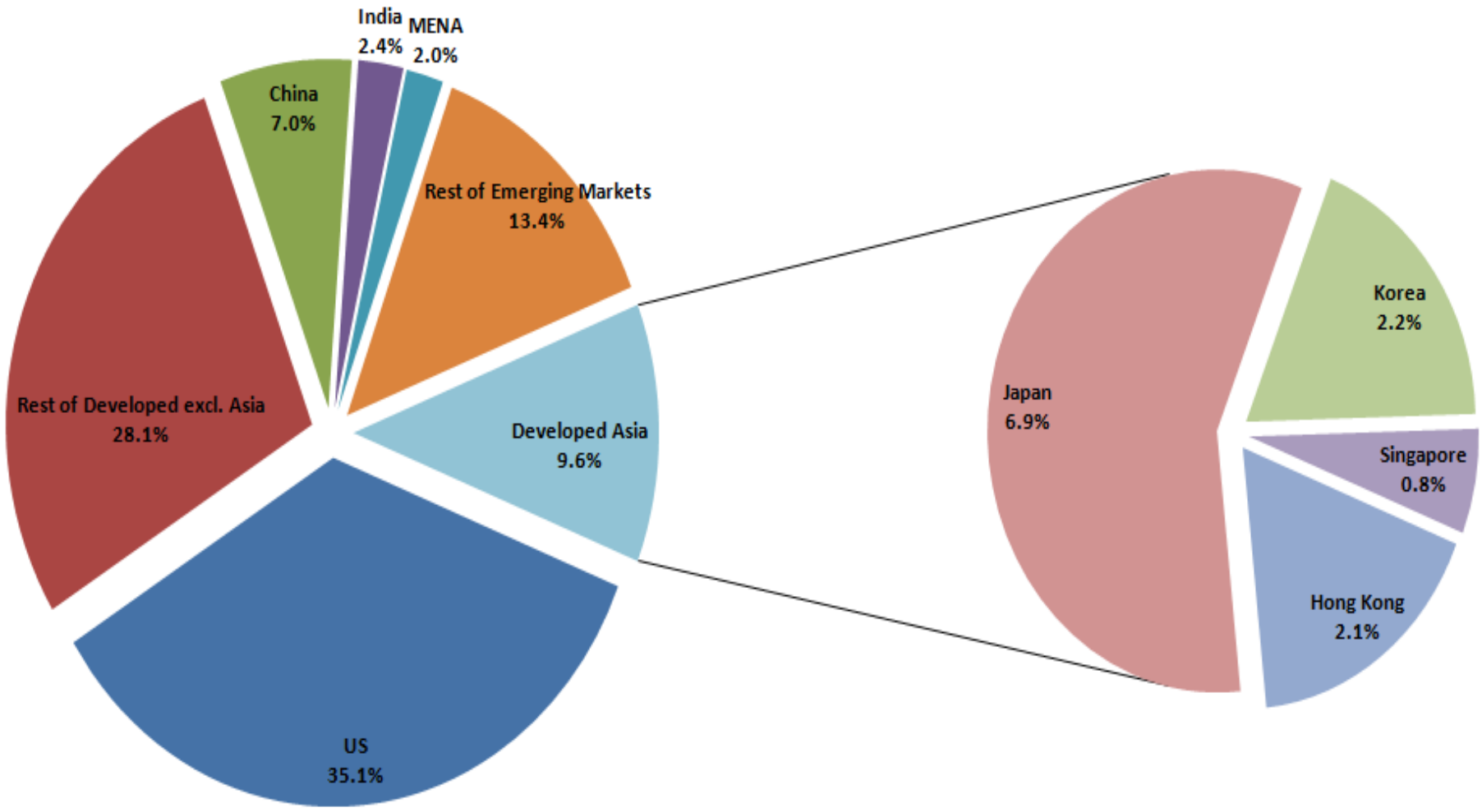
Source: Standard & Poors, March 2012.

Shift Towards Emerging Market Economies: Equity Markets



Source: Standard & Poors, Dec 2012.

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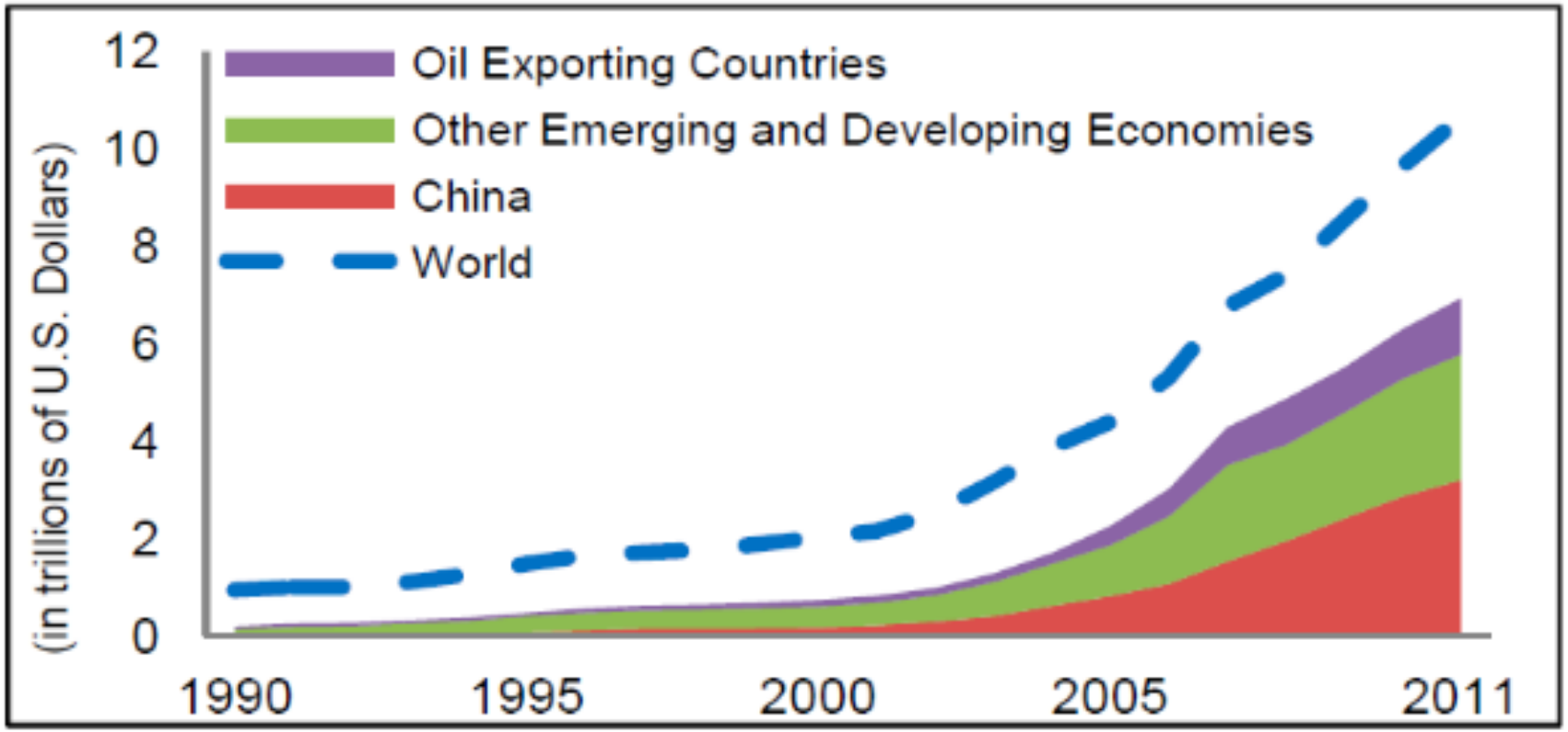
EMEs Own a Growing Share of International Reserves



Source: IMF *International Financial Statistics*.

[1]Total reserves minus gold.

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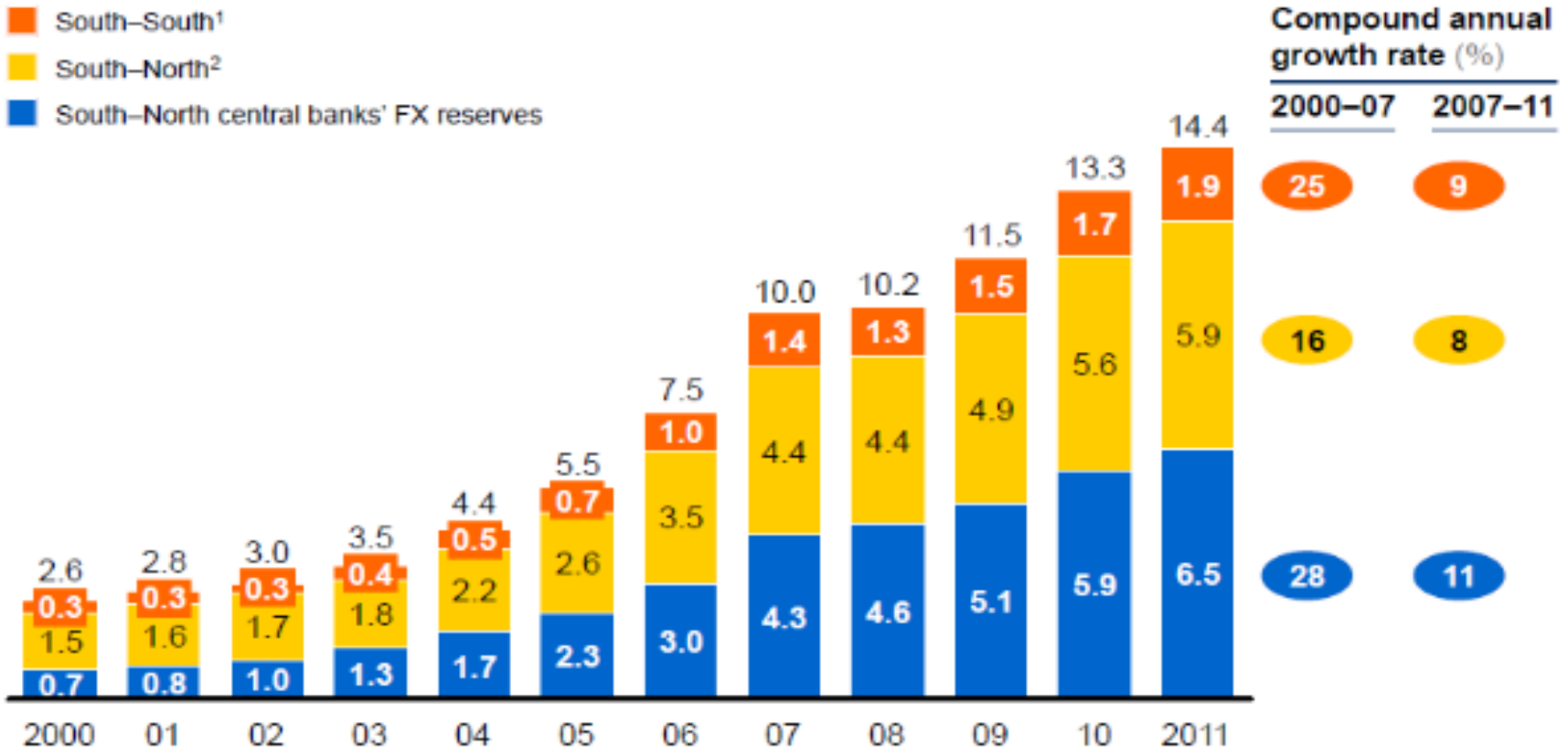
Foreign Investment Assets of EMEs mainly invested in Advanced Economies



1 Foreign investment assets of developing countries in other developing countries.
2 Foreign investment assets of developing countries in advanced economies.

SOURCE: McKinsey Global Institute Bilateral Foreign Investment database; McKinsey Global Institute analysis

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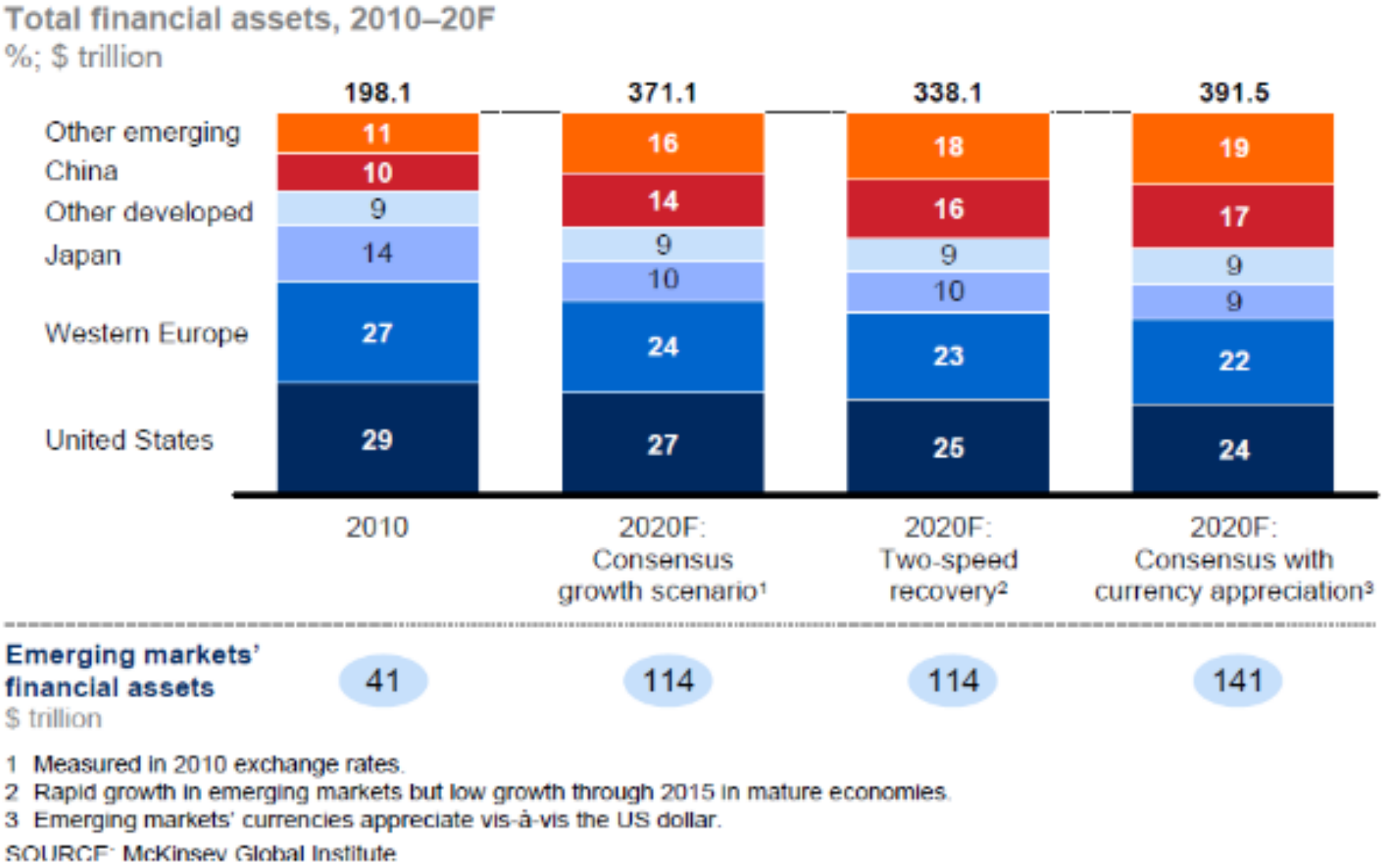
Growing Share of Global Financial Assets Held in EMEs in All Economic Scenarios



1 Measured in 2010 exchange rates.
2 Rapid growth in emerging markets but low growth through 2015 in mature economies.
3 Emerging markets' currencies appreciate vis-à-vis the US dollar.

SOURCE: McKinsey Global Institute

7 SWFs from Asia are among Top 20 Ranked by Total Assets

Rank	Country	Sovereign Wealth Fund Name	Assets $Billion	Inception
1	Norway	Government Pension Fund – Global	715.9	1990
2	UAE – Abu Dhabi	Abu Dhabi Investment Authority	627.0	1976
3	China	SAFE Investment Company	567.9	1997
4	Saudi Arabia	SAMA Foreign Holdings	532.8	n/a
5	China	China Investment Corporation	482.0	2007
6	Kuwait	Kuwait Investment Authority	342.0	1953
7	China – Hong Kong	Hong Kong Monetary Authority Investment Portfolio	298.7	1993
8	Singapore	Government of Singapore Investment Corporation	247.5	1981
9	Russia	National Welfare Fund	175.5	2008
10	China	National Social Security Fund	160.6	2000
11	Singapore	Temasek Holdings	157.5	1974
12	Qatar	Qatar Investment Authority	115.0	2005
13	Australia	Australian Future Fund	88.7	2006
14	Algeria	Revenue Regulation Fund	77.2	2000
15	UAE – Dubai	Investment Corporation of Dubai	70.0	2006
16	UAE – Abu Dhabi	International Petroleum Investment Company	65.3	1984
17	Libya	Libyan Investment Authority	65.0	2006
18	Kazakhstan	Kazakhstan National Fund	61.8	2000
19	South Korea	Korea Investment Corporation	56.6	2005
20	UAE – Abu Dhabi	Mubadala Development Company	53.1	2002

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- ✓ Takeaways

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Major Lessons from the GFC for EMEs

1. Avoid Growth in Financial Sector Unrelated to Real Economy
2. Establish safeguards & buffers against spillover & contagion channels & risks; Financial Safety Nets
3. Ensure good Governance of Banking & Financial Sector & its Regulators
4. Control Systemic Risk Arising from Too Big To Fail &Too Interconnected to Fail
5. Develop Local Currency Financial Markets

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A Time For Transformation & “Change”

- Traditional financial centres (NY, London) have become TBTF and TITF posing systemic risk for global international financial system
- Governments and regulators in traditional centres have supported their TBTF and TITF institutions but the latter cannot serve the EMEs and Asia.
- National Capital Markets face growing Globalisation, Decentralisation and Networking
- Imperative to build **Regional Financial Centres** (RFCs) to serve new multi-polar economic geography

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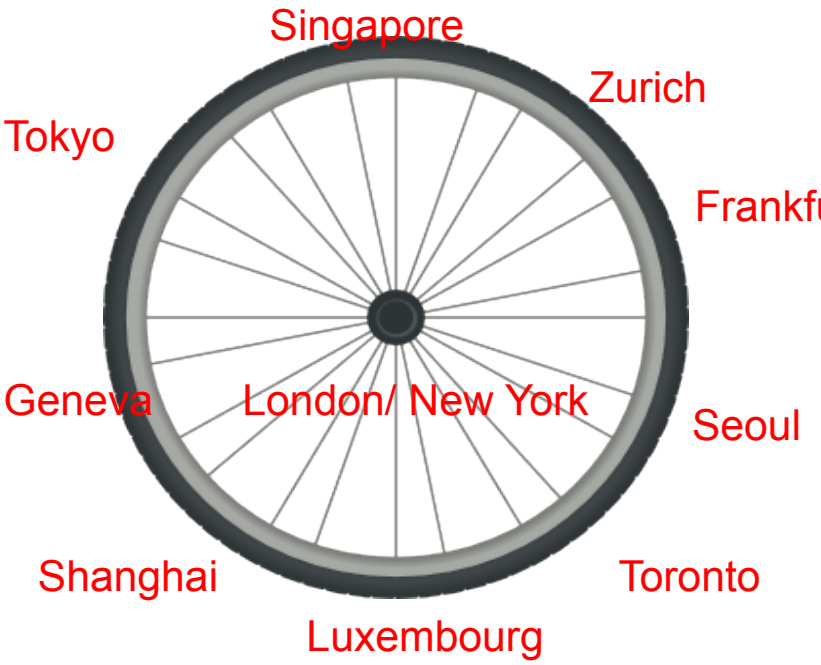
A New Decentralised Global Financial Architecture is Emerging

Moving away from a hub-spoke model



to a spider-web model

Source: Global Financial Centres Index, March 2013

Global Financial Centre Index 2013: Growing Importance of EME Centres

Centre	GFCI 13 Rank	GFCI 13 Rating	GFCI 12 Rank	GFCI 12 Rating	CHANGES Rank	CHANGES Rating
London	1	807	1	785	-	▲ 22
New York	2	787	2	765	-	▲ 22
Hong Kong	3	761	3	733	-	▲ 28
Singapore	4	759	4	725	-	▲ 34
Zurich	5	723	5	691	-	▲ 32
Tokyo	6	718	7	684	▲ 1	▲ 34
Geneva	7	712	9	682	▲ 2	▲ 30
Boston	8	711	11	680	▲ 3	▲ 31
Seoul	9	710	6	685	? -3	▲ 25
Frankfurt	10	703	13	677	▲ 3	▲ 26
Chicago	11	698	8	683	? -3	▲ 15
Toronto	12	696	10	681	? -2	▲ 15
San Francisco	13	695	12	678	? -1	▲ 17
Washington D.C.	14	692	14	672	-	▲ 20
Vancouver	15	690	16	668	▲ 1	▲ 22
Montreal	16	689	17	667	▲ 1	▲ 22
Calgary	17	688	23	647	▲ 6	▲ 41
Luxembourg	18	687	24	646	▲ 6	▲ 41
Sydney	19	686	15	670	? -4	▲ 16
Vienna	20	685	36	633	▲ 16	▲ 52

Centres likely to become more significant	Number of mentions
Singapore	99
Shanghai	85
Hong Kong	68
Seoul	66
Toronto	45
Sao Paulo	32
Luxembourg	31
Istanbul	30
Beijing	27
Moscow	19

Source: Global Financial Centres Index, March 2013

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Imperative to Develop Asia's Banking & Financial Markets

- Manage and Control region's rapidly growing financial wealth
- Protect & secure national financial wealth & investments
- Finance Economic Development & Infrastructure
- Support privatisation and PPP in infrastructure
- Enable & support economic and financial reforms
- Invest & Deploy financial wealth regionally & internationally
- Support Regional Economic Integration

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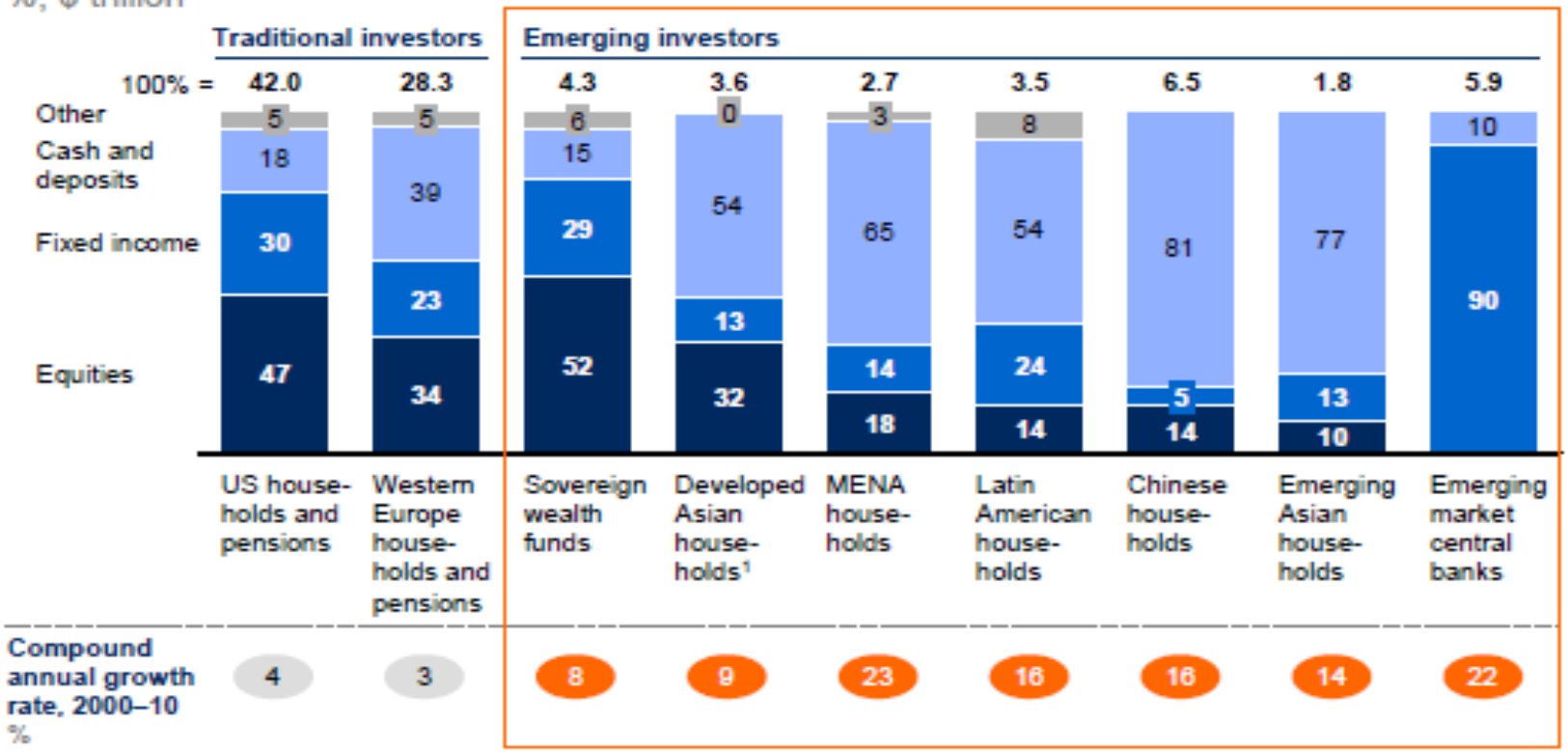
Asia Needs to Develop its Equity & Debt Markets to Intermediate Saving-Investment

Today, most investors in emerging markets have very low allocations to equities

Asset allocation by investor, 2010
%; $ trillion



1 Includes Singapore, Hong Kong, Korea, and Taiwan. Excludes Japan, where households allocate 10% of their portfolio to equities.

SOURCE: National sources; McKinsey Global Institute

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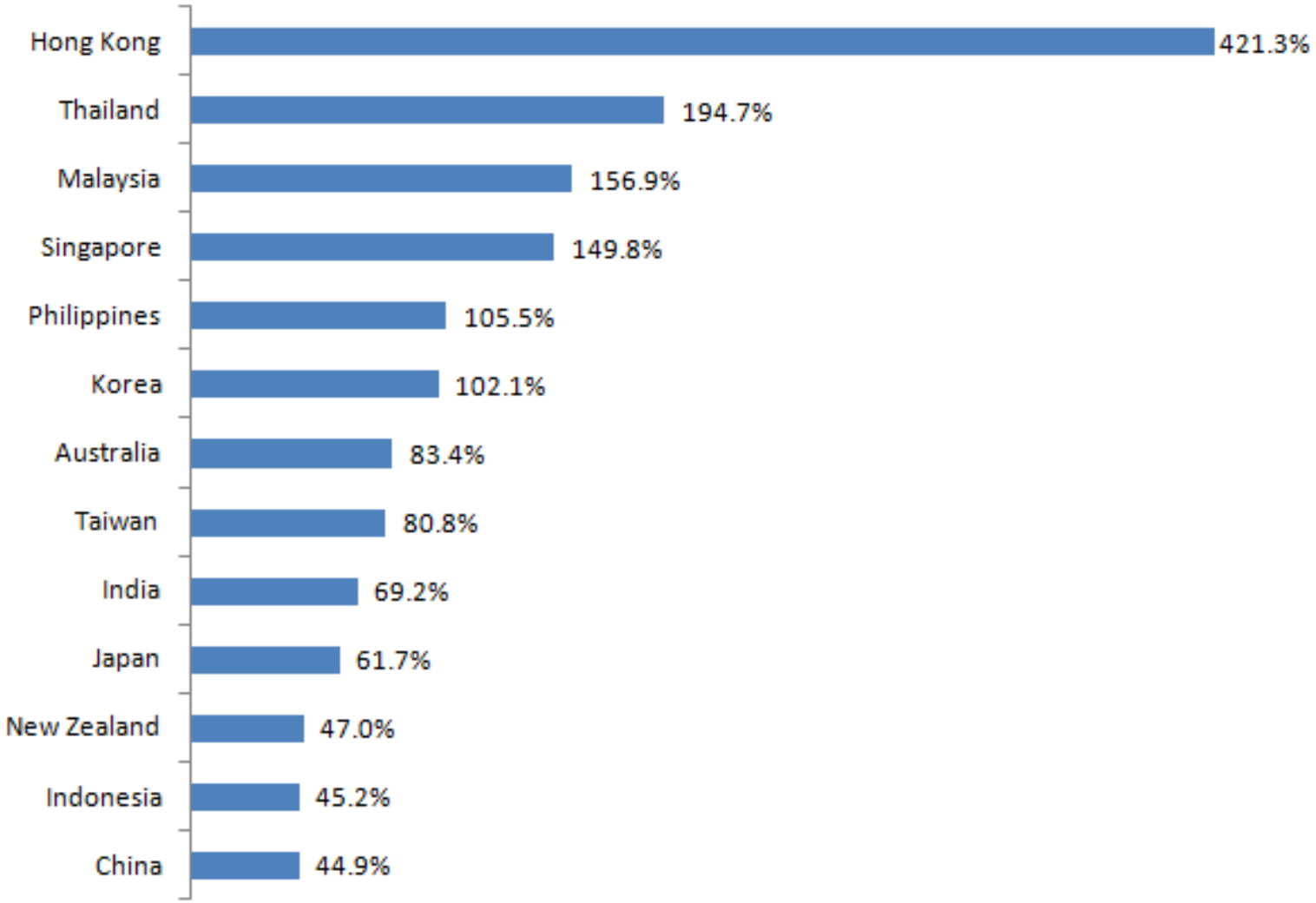
Asian Equity Capitalisation % of GDP



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Asian Regional Financial Market requirements

- Maintain Macroeconomic Stability
- Build Depth, Breadth & Liquidity
- Gradual liberalisation of entry barriers for non-resident investors
- Enhance & Integrate Financial & Payments Infrastructure & payments linkages
- Improve corporate governance, disclosure and transparency
- Harmonisation & standardisation of legal & regulatory frameworks

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Four Building Blocks for Asian Markets

1. **Focus on financing infrastructure & housing** as building blocks for capital markets and Asian Bond Market.
   - ADB: US$8.3 trillion in overall infrastructure investment between 2010 and 2020, with an average of US$750 billion in annual infrastructure spending. Half of total needed for regional transport and logistics, while the rest covers cross-border infrastructure
   - Housing Finance should form basis of mortgage market
2. **Chiang Mai Agreement** to be extended and used as platform
3. Focus on developing **Domestic Capital Markets** with regional cooperation
4. Use **Local Currencies and Bilateral Swap Agreements**

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RMB is emerging as 3rd global currency; included in IMF SDR by 2015

IMF has laid out two requirements for a currency to become internationally "accepted" and become a constituent of its Special Drawing Rights (SDR):

(1) Large value of exports of goods and services over 5-year period

(2) Freely usable currency: "(i)Widely used to make payments for international transactions and (ii) Widely traded in principal exchange markets."

- Free usability of a currency "concerns the actual international use and trading of currencies, and is distinct from whether a currency is either floating or fully convertible".
- Full convertibility is not a requirement for a currency to be considered "international".

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Imperatives for RMB Internationalisation

RMB Internationalisation requires China to:

1. Maintain Macroeconomic Stability
2. Build more Liquid Onshore Financial Markets
3. Liberalise Interest Rates
4. Transit to a more Open Capital Account
5. Improve Governance of Economic Policy, Rule of Law, Protection of Investors

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RMB Internationalisation: Policy Reforms

Policy Deregulation to support offshore RMB business

2009	RMB trade settlement pilot scheme kicks off in five mainland cities
2010	Offshore RMB products platform launched in Hong Kong
2010	RMB trade settlement rolled out globally
2011	RMB ODI and FDI started
2011	Official launch of R-QFII scheme
2012	PBoC widened the daily USD-CNY band from +/-0.5% to +/-1%
2012	HKMA loosens NOP & liquidity risk management rule; RMB lending facility introduced
2012	R-QFII, QFII schemes expanded significantly
2012	PBoC approved cross-border RMB loan business
2013	RMB business started in Taiwan
2013	ICBC nominated as the RMB clearance bank for Singapore
2013	BoE and PBoC agreed to sign bilateral FX swap

PBoC's bilateral swap agreements

Expiry	Date entered	Country / Region	Period	Amount (RMBbn)
10-Mar-12	11-Mar-09	Belarus	3 years	20
22-Mar-12	23-Mar-09	Indonesia	3 years	100
1-Apr-12	2-Apr-09	Argentina	3 years	70
9-Jun-13	10-Jun-10	Iceland	3 years	3.5
17-Apr-14	18-Apr-11	New Zealand	3 years	25
18-Apr-14	19-Apr-11	Uzbekistan	3 years	0.7
12-Jun-14	13-Jun-11	Kazakhstan	3 years	7
22-Jun-14	23-Jun-11	Russia	3 years	20
25-Oct-14	26-Oct-11	South Korea	3 years	360
21-Nov-14	22-Nov-11	Hong Kong	3 years	400
21-Dec-14	22-Dec-11	Thailand	3 years	70
22-Dec-14	23-Dec-11	Pakistan	3 years	10
16-Jan-15	17-Jan-12	UAE	3 years	35
7-Feb-15	8-Feb-12	Malaysia	3 years	180
20-Feb-15	21-Feb-12	Turkey	3 years	10
21-Mar-15	21-Mar-12	Mongolia	3 years	10
22-Mar-15	22-Mar-12	Australia	3 years	200
26-Jun-15	26-Jun-12	Ukraine	3 years	15
22-Jun-15	22-Jun-12	Brazil	3 years	190
6-Mar-15	7-Mar-13	Singapore	3 years	300

Source: HSBC, various reports

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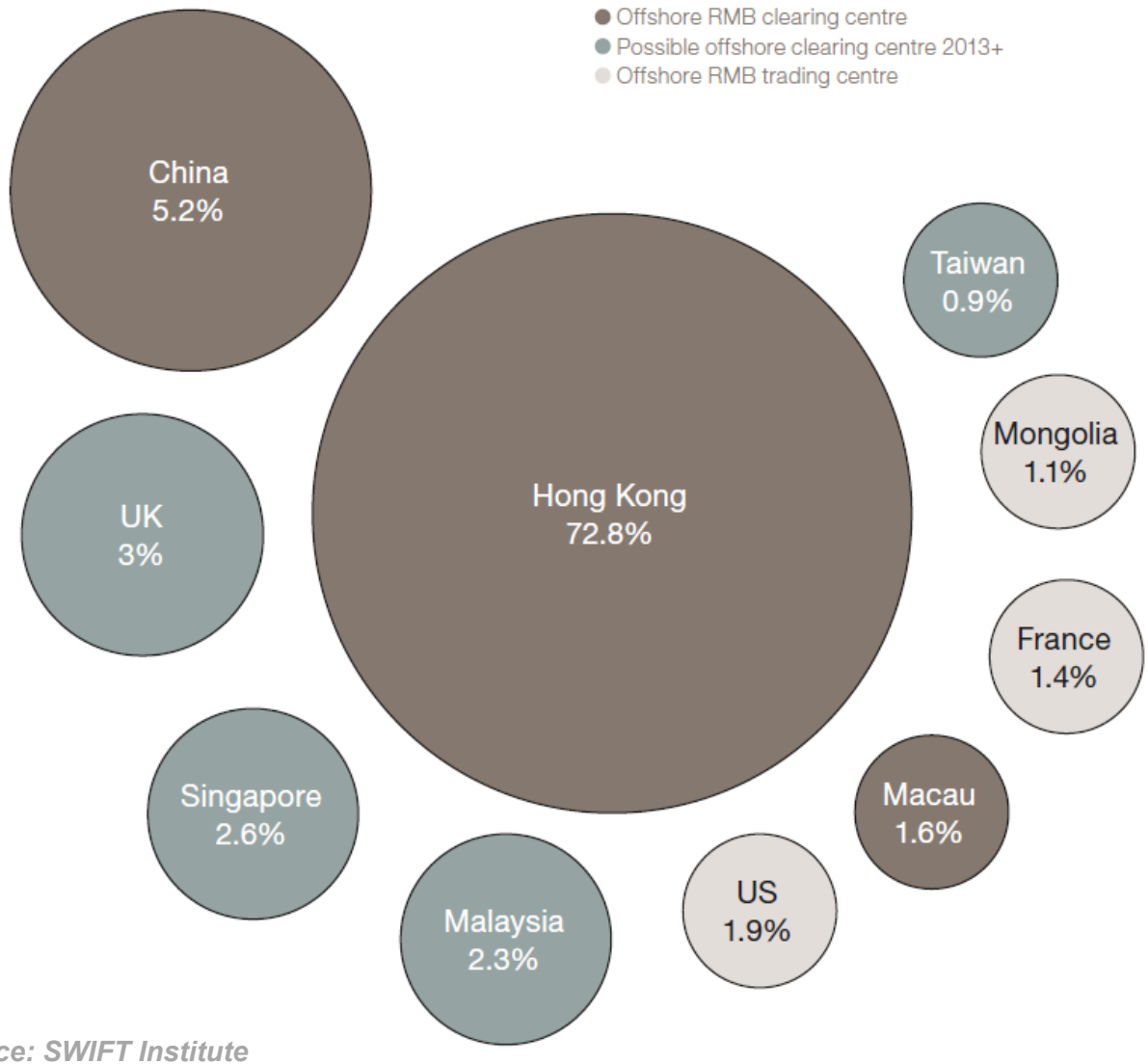
Top 10 Offshore RMB centres and market share of payment volumes; Korea?



Source: SWIFT Institute

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Chiang Mai Agreement should be amended to create an "RMB Zone"

- Chiang Mai Initiative Multilateralisation (CMIM) in effect since March 2010.
- CMIM objective is to provide financial support through currency swap transactions among participants in times of liquidity need
- **Expand CMIM to create an RMB Zone: (a) Use RMB for currency swap agreement; (b) Include Non-ASEAN + ME + Africa**

	Financial contribution per Country		Purchasing Multiple
	USD (billion)	(%)	
China	38.4 *China (Ex Hong Kong) 34.2* *Hong Kong 4.2*	32 *28.5* *3.5*	0.5 2.5
Japan	38.4	32	0.5
Korea	19.2	16	1
Plus 3	**96**	**80**	-
Indonesia	4.77	3.97	2.5
Thailand	4.77	3.97	2.5
Malaysia	4.77	3.97	2.5
Singapore	4.77	3.97	2.5
Philippines	3.68	3.07	2.5
Vietnam	1	0.83	5
Cambodia	0.12	0.1	5
Myanmar	0.06	0.05	5
Brunei	0.03	0.02	5
Lao PDR	0.03	0.02	5
ASEAN	**24**	**20**	-
Total	**120**	**100**	-

Total currency swap agreement $120bn; with China & Japan main contributors

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What would RMB Zone look like in 2015?

Criteria	Latest	2015 est.
Total trade settled in RMB	12% of China's total trade in 2012 (RMB 2.9 trn or US$ 0.5 trillion)	US$ 1.8 to 3trn (30-50% of total trade)
Redback Bond Market	RMB 405bn outstanding as of end-Jan 2013 (US$ 66bn)	US$ 4.4-6.6trn (40-60% of GDP)
CD market	RMB 720bn outstanding as of 2012 (US$ 117.4bn)	US$ 1.1-2.3trn (25-35% of GDP)
Redback equity market	US$ 3.69trn (total market cap as of end-2012)	US$ 11-16.5trn (100-150% of GDP)
FDI investment in RMB	2% of total FDI (~ US$ 2.4bn)	US$ 41bn (20% of total FDI)
Outward direct investment in RMB	4% of total outflows (~ US$ 2.7bn)	US$ 26.5bn (30% of total outflows)
RMB as foreign exchange	n.a (likely to be less than 1% of allocated reserves, as tracked by IMF)	US$ 760bn – US$ 1.14 trn (~10-15% of total allocated reserves)
FX Daily Turnover	US$ 8bn (end-2012, HSBC)	US$ 948bn

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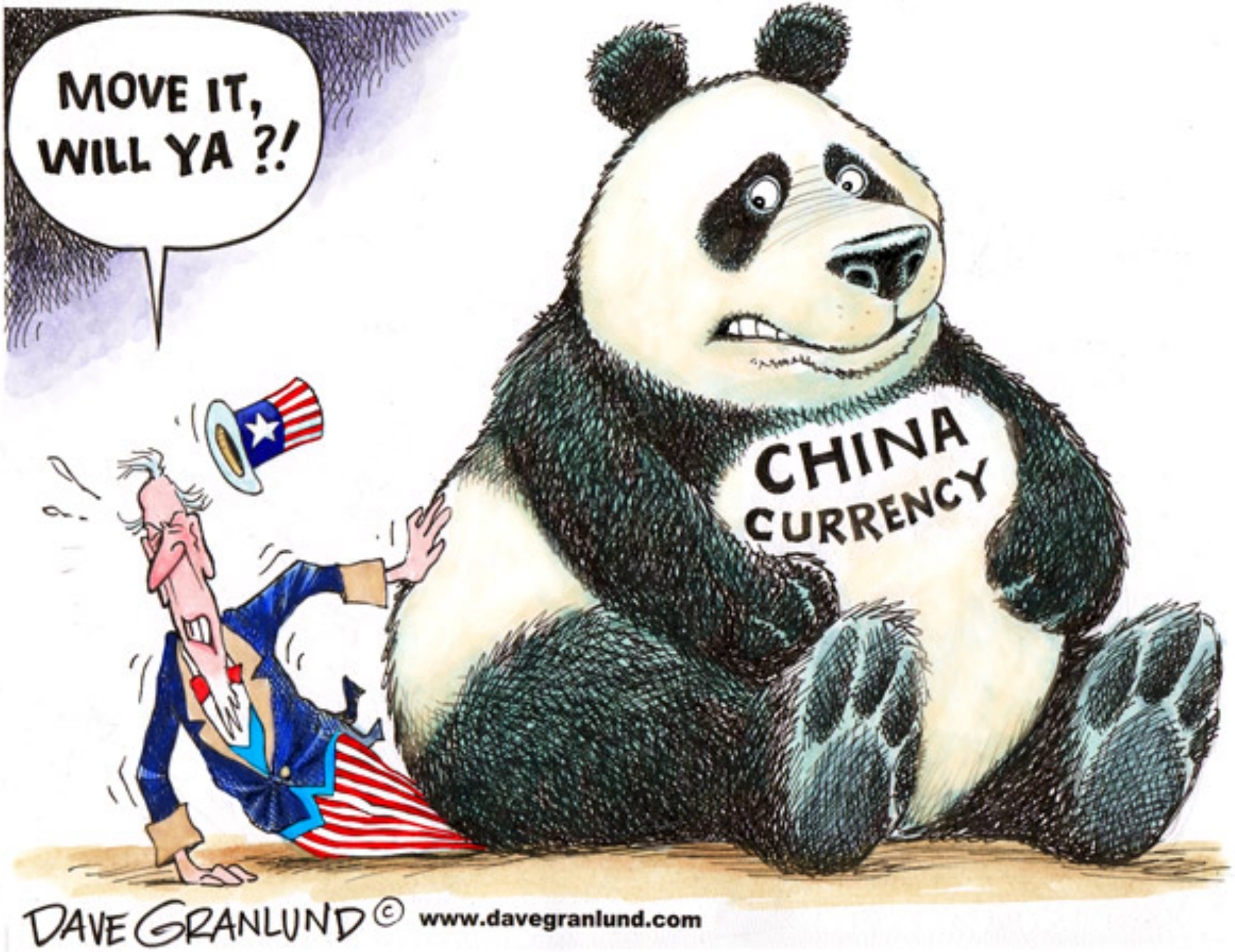
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Takeaways

- **Global Economic Geography has shifted towards EMEs and Asia**
- **A New Global Financial Architecture is required to serve a multi-polar world with several Regional Financial Centres**
- **It is imperative that Asia develop its banking & financial markets to finance its economic development & infrastructure investments; manage, protect, deploy & control its financial wealth**
- **The RMB is emerging as a 3rd global currency alongside the US$ and Euro. China & ASEAN should develop an RMB Zone**
- **An emerging RMB Zone and 'Redback' Market can form the anchor of an Asian Bond & Money Market**

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ASIAN FINANCIAL TRANSFORMATION; DEVELOPING AN RMB ZONE & REDBACK MARKET

Thank you

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