FINANCIAL INTEGRATION IN THE ASIA-PACIFIC

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What can we do together?
Framework for considering financial opening + integration

Financial connectedness ➔ Financial integration

Mechanisms for financial integration
• Trade in financial services
• Cross border investment (capital account)

Measurement of financial integration
• De Jure – Comparison of legal or regulatory restrictions
• Qualitative – Size of Flows
• Quantitative – Law of One Price
Financial services have been undersized in Asia but are growing faster than the economy

Financial services as % of national economic output

Source: UN Department of Economics and Social Affairs; US BEA; ACFS calculations
On *de jure* measures, major Asian economies have lowest degree of integration in the OECD.
On qualitative measures, rising flows but still low integration for some

External Stock* (Assets + Liabilities) as % of GDP
* includes Direct Investment, Portfolio Investment and Cross-Border Banking Claims

Source: IMF, BIS, Datastream, ACFS calculations
A cautious stance on opening is warranted given volatility of flows...

External Flows* (Inward + Outward) as % of GDP
* includes Direct Investment, Portfolio Investment and Cross-Border Banking Claims

Source: IMF, BIS, Datastream, ACFS calculations
Particularly in economies where households hold less wealth (on average)

External Flows* (Inward + Outward) as % of GDP Per Capita
* includes Direct Investment, Portfolio Investment and Cross-Border Banking Claims

Source: IMF, BIS, Datastream, ACFS calculations
First glimpse of Chinese portfolio investment by destination

Outbound portfolio investment from China, Q2 2015, gross amount

<table>
<thead>
<tr>
<th>Destination</th>
<th>Amount (US$ bn)</th>
<th>Share of total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 United States</td>
<td>116.7</td>
<td>40.6</td>
</tr>
<tr>
<td>2 Hong Kong</td>
<td>49.5</td>
<td>17.2</td>
</tr>
<tr>
<td>3 Cayman Islands</td>
<td>16.3</td>
<td>5.7</td>
</tr>
<tr>
<td>4 Great Britain</td>
<td>13.0</td>
<td>4.5</td>
</tr>
<tr>
<td>5 Japan</td>
<td>12.4</td>
<td>4.3</td>
</tr>
<tr>
<td>6 Virgin Islands</td>
<td>11.3</td>
<td>3.9</td>
</tr>
<tr>
<td>7 Australia</td>
<td>6.5</td>
<td>2.3</td>
</tr>
<tr>
<td>8 France</td>
<td>5.0</td>
<td>1.8</td>
</tr>
<tr>
<td>9 Germany</td>
<td>4.8</td>
<td>1.7</td>
</tr>
<tr>
<td>10 Canada</td>
<td>4.5</td>
<td>1.6</td>
</tr>
</tbody>
</table>

Source: SAFE (China)
Can deeper trade in financial services help Asia to keep more of its portfolio investment in the region?

**Sources of FDI**

**Sources of portfolio investment***

*Corrected for financial centre intermediaries
Source: Pongsaparn, R and Unteroberdoerster, O (2011)
And help the large market in China smooth its transition...

**Domestic credit as % of total Asia-Pacific credit**

- Australia
- Hong Kong SAR
- India
- Indonesia
- Malaysia
- Taiwan
- Thailand
- China (RHS)
- South Korea
- Japan (RHS)

Source: CEIC data; ACFS calculations
…While Australia re-orient its focus?

### Destination of Australian financial services exports by mode of supply, 2009-10

![Graph showing destination of Australian financial services exports by mode of supply, 2009-10.](image)

**Gross foreign investment into and out of Australia by counterpart country**

<table>
<thead>
<tr>
<th>Partner country</th>
<th>Value (A$ bn)</th>
<th>Outbound</th>
<th>Share of total (%)</th>
<th>Value (A$ bn)</th>
<th>Inbound</th>
<th>Share of total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>471.7</td>
<td>29</td>
<td></td>
<td>657.9</td>
<td>27</td>
<td></td>
</tr>
<tr>
<td>United Kingdom</td>
<td>255.7</td>
<td>16</td>
<td></td>
<td>562.9</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>New Zealand</td>
<td>81.1</td>
<td>5</td>
<td></td>
<td>n/a</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>50.2</td>
<td>3</td>
<td></td>
<td>131.0</td>
<td>5</td>
<td></td>
</tr>
</tbody>
</table>

*Source: ABS*
THINK BIG