

Mr David Hawker MP
Chairman
Standing Committee on Economics
Finance and Public Administration
House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Mr Hawker

**INQUIRY INTO THE INTERNATIONAL FINANCIAL MARKET EFFECTS ON
GOVERNMENT POLICY**

Thank you for your letter of 3 June 1999 inviting the ABS to make a submission to the inquiry.

2 In our view, the terms of reference for the inquiry relate more to policy and regulatory issues than statistical ones. However there are some statistical matters that the committee may wish to be aware of, and the attached submission addresses these issues. The submission makes reference to the ABS quarterly publication *Financial Accounts* (Cat. no. 5422.0). A copy of the latest quarter's publication is attached for your information.

3 For further information, please contact Ivan King, Assistant Statistician, International and Financial Accounts Branch, phone 6252 6038, fax 62531051, email ivan.king@abs.gov.au.

Yours sincerely

W. McLennan

July 1999

**SUBMISSION TO HOUSE OF REPRESENTATIVES STANDING COMMITTEE ON
ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION**

**INQUIRY INTO THE INTERNATIONAL FINANCIAL MARKET EFFECTS ON
GOVERNMENT POLICY**

FROM: AUSTRALIAN BUREAU OF STATISTICS

Introduction

The terms of reference for the inquiry do not touch significantly on statistical issues that warrant a detailed submission from the ABS. The terms of reference relate primarily to the policy implications of the globalisation of international financial markets, and to disclosure by market participants, areas appropriate for the relevant policy and regulatory agencies to make submissions. Accordingly, this submission is limited to some comments on the production of statistics relating to hedge funds, and an overview of the availability of ABS statistics generally about the financial systems.

2 There is also a reference to the information requirements for stable and efficient international financial market operation which includes the provision of information by governments. However, the ABS has interpreted this inquiry to be looking at issues which go beyond the Prime Minister's Task Force on International Financial Reform and the March 1999 Treasury report "Making Transparency Transparent: An Australian Assessment". That report dealt with, among others, the issue of the transparency of macroeconomic and financial data for efficient market operation and assessed Australia's performance in that regard. The ABS has assumed that the information provision by governments in this reference relates to information about government policy, access (market entry), investment guidelines, governance, supervision and other issues not related to economic statistics.

Statistics of Hedge Funds

3 One area of information relevant to the inquiry relates to the operation of international hedge funds and similar institutions. Much of the information collected by the ABS in regard to cross-border financial transactions and positions identifies the particular resident (ie, Australian) participant in the transaction, the country with which they are transacting, and sometimes the broad nature of the foreign institution with which they are dealing. However, the precise identification of the foreign institution is rarely possible from our enquires.

4 The ABS does not believe it would be possible for us to collect information about the activities of foreign hedge funds. Anecdotal evidence from several significant

resident institutions is that they do not deal directly with hedge funds, and do not have cross-border exposures to them. If the exposure is through another foreign institution that takes a position with an Australian institution on behalf of, or as an offset to a position they have taken with a hedge fund, then the hedge fund activity will impact Australian financial markets but not be directly measurable from statistical surveys of the Australian participants. Foreign banks may sell the Australian dollar because they are buying from hedge funds, but the Australian institution will see (ie, book) the transaction as buying from a foreign bank, not from a hedge fund, even if the market place knows generally who is driving the selling of the Australian dollar.

5 We also consider that information on short term position-taking by hedge funds, of use to inform the market and policy and regulatory agencies, is not something that could be readily identified in statistical collections. Even if their positions were held directly with residents, without another intermediary in the process and without the use of nominees and other ways of avoiding obvious disclosure of their position, the lags in collecting and disseminating the quarterly macroeconomic statistical information from which this aspect of activity could be extracted, would often mean the position had been unwound before it was reported publicly.

Availability of Statistics about the Financial System

6 The wealth of information collected in Australia for supervision of the financial system and for other regulatory purposes has been converted to a very wide range of industry and activity statistics. ABS surveys of the finance sector have sought to fill the gaps in the available administrative and regulatory data.

7 The thrust of ABS efforts in recent years has largely been to deal with the overlap in information requests made to the finance sector, and to coordinate and, to the extent possible, harmonise the resultant statistics to improve their utility for analytical purposes. This thrust has mirrored overseas efforts in this direction.

The Financial Corporations Sector

8 International, and Australian, statistical standards recognise a Financial Corporations Sector. It comprises all resident corporations and quasi-corporations mainly engaged in financial intermediation and provision of auxiliary financial services.

9 The Financial Corporations Sector comprises:

- 2 Financial corporations
 - 2.1 Central bank
 - 2.1.1 Reserve Bank of Australia
 - 2.1.2 Other central bank institutions (i.e. APRA)
 - 2.2 Depository corporations

2.2.1 Banks

2.2.2 Other depository corporations (Other institutions included in RBA's definition of broad money: e.g. cash management trusts, building societies, credit cooperatives, finance companies ...)

- 2.3 Insurance corporations and pension funds
 - 2.3.1 Life insurance
 - 2.3.2 Pension funds (i.e. superannuation funds)
 - 2.3.3 Other insurance corporations (e.g. general, fire, accident, health, export insurance)

- 2.4 Other financial institutions
 - 2.4.1 Central borrowing authorities
 - 2.4.2 Financial intermediaries n.e.c. (e.g. development corps, common funds, mortgage and equity unit trusts, issuers of asset backed securities ...)
 - 2.4.3 Financial auxiliaries (i.e. monthly financial services rather than financial intermediation e.g. fund managers, stock brokers, insurance brokers, arrangers of hedging instruments)

This sectorisation can be concurred to the Australian and New Zealand Standard Industry Classification (mainly ANZSIC Division K Finance and Insurance).

Statistics on the Financial Sector

10 Most statistical information about this sector relates to the operation of the financial system, in its support of the efficient functioning of payments, investment and saving.

11 The contribution of the financial sector in the national economy is described in

- National accounts (quarterly Cat. no. 5206.0 and annual Cat. no. 5204.0) - e.g. gross value added of Finance and Insurance, Division K, of ANZSIC compared with other industry divisions (finance and insurance contributes 6.3% of gross value added in the economy). The average annual growth rate of the finance and insurance division during 1992-93 to 1997-98 was 5.0%, compared with 4.2% for the whole economy. A major source used for these national accounts estimates is the annual ABS Economic Activity Survey (EAS), which provides further detail on the operations of the Finance and Insurance Division, see Summaries of Industry Performance 1991-92 to 1996-97 (Cat. no. 8140.0.40.002). A publication which provides business averages and ratios for industries, including Division K, was released on 31 March 1999-Business Operations and Industry Performance 1996-97, (Cat. no. 8140.0)

- Labour force statistics (Cat. no. 6203.0 - e.g. persons employed in Division K (302,400 in May 1999), with some limited breakdown by characteristics. Other labour-related publications, such as average weekly earnings and job vacancies and overtime contain an industry dissection, including for Division K. The Population Census has extensive cross-tabulations of persons in the industry.

12 The best summary of financial flows in the economy is shown in Diagram 26.1 of the 1999 Year Book (Cat. no. 1301.0). This shows a succinct view of the financial system through the net flows of funds between sectors during the year, and describes the pivotal role of the financial sector in financial intermediation. The same diagram is provided quarterly in Financial Accounts (Cat. no. 5232.0). A similar diagram of the level of indebtedness of one sector to another is also shown in 5232.0. The Financial Accounts are a component of the National Accounts and bring the accounts of the "real" economy and the financial economy together in a conceptually consistent framework.

13 More detailed information on the assets, liabilities and operation of particular types of institutions is contained in publications from ABS, the Reserve Bank (RBA), the Australian Prudential Regulation Authority (APRA), eg:

- * RBA reports of its own operations and reserve assets;
- * APRA weekly reports of bank assets (by broad type of loans provided) and liabilities (by source of funds);
- * RBA and APRA monthly bulletins covering information on money supply, and more detailed information on the assets and liabilities of institutions regulated (deposit taking corporations; insurance; superannuation; other categories of Financial Corporations Act institutions) and those within the definition of broad money;
- * APRA publications on the assets, liabilities and operations of the State-based institutions formerly supervised by AFIC;
- * ABS Managed Funds publication (Cat. no. 5655.0) covering the source and disposition of funds under management by different types of institutions;
- * ABS Housing Finance for Owner Occupation (Cat. no. 5609.0) and Lending Finance (Cat. no. 5671.0) monthly publications show lending for housing, personal finance, commercial finance and leasing by the major financial institutions undertaking these forms of investment;
- * ABS special data service publications on cash management trusts, unit trusts, common funds and Financial Corporation Act institutions;
- * the Financial Accounts (Cat. no. 5232.0) incorporate financial activity not facilitated by financial institutions, most particularly the issuance and trading in securities, supplementary data from securities markets regulators and key non-financial sector participants in those markets;

- * ABS Directory of Superannuation-related Statistics (Cat. no. 1131.0).

More detail is usually available for release than is shown in the printed publications.

14 Information on the Australian market for different financial instruments is shown in detail in Financial Accounts (Cat. no. 5232.0) for the instruments listed below. This information is classified by subsector of both the borrower and lender.

Currency and deposits (currency on issue and deposits at deposit taking institutions, mainly banks);

Bills of exchange (short term securities, usually bank-endorsed);

One name paper (short term securities eg. Treasury Notes; bank certificates of deposit);

Bonds market (long term securities eg. Treasury bonds, inscribed stock from central borrowing authorities and government corporations, mortgage backed bonds etc);

Loans and placements (borrowings not covered by tradeable debt securities; account balances with other than deposit taking institutions);

Listed shares and other equity;

Unlisted shares and other equity

More detailed information on many of the financial instruments is contained in the range of APRA, RBA and ABS publications referred to above.

15 There are a large number of private sector analysts of financial market segments, some readily accessible such as ratings agencies. Others are available, sometimes for significant subscription fees.

16 The annual Australian Financial Markets Report (by the Australian Financial Markets Association) provides a statistical review of exchange-traded and over-the-counter financial markets, sourced from the Australian Stock Exchange, Sydney Futures Exchange, RBA, ABS and their own surveys of market participants.

International Relationship

17 The impact of the Overseas (or Rest of World) Sector on Australia's financial affairs is shown through the Balance of Payments and International Investment Position (Cat. no. 5302.0), and the Financial Accounts (Cat. no. 5232.0). These data include international trade in services, and identify, for the depository corporations sector, all the cross-border financial assets and liabilities (by significant instrument), the transactions in and income earned on those instruments, and the price and exchange rate effects on their valuation. For example:

- International trade in financial services:

Total exports of financial services (including insurance services) in 1998 were \$1.6 billion (up 5 fold on a decade earlier). Total imports of financial services (including insurance services) in 1998 were \$1.5 billion (slightly more than double the amount a decade earlier).

Financial services exports are earned by Australian financial corporations from: foreign exchange commissions levied on overseas clients; providing insurance services directly to overseas clients and by reinsuring overseas risk; by making a margin on deposits taken from abroad and in lending abroad; and in a range of fee for service business provided to foreign clients. Trade in financial services data are also available annually by main trading partner countries.

- Foreign debt of financial corporations

The net foreign debt of financial corporations at December 1998 was \$145 billion, of which 93% was attributable to the private sector. For comparison, Australia's net foreign debt (all sectors) was \$239 billion.

The net foreign debt of Australian private financial corporations has increased 5 fold in the past decade as the increasingly globalised sector has funded domestic borrowing requirements. Over that same period, the net foreign debt of private non-financial corporations has grown by only 15%.

- Market capitalisation

The Australian financial sector equity market capitalisation was in excess of \$250 billion at December 1998, or 25% of the total equity market in Australia. At 31 December 1998, 22% of the equity in the Australian financial corporations sector was owned by non-residents.

- Asset portfolio held overseas

Australia's financial sector is a significant participator in world financial markets. At June 1995 Australian financial corporations (excluding the Reserve Bank) held assets abroad worth \$84 billion which represented 10% of their financial asset portfolio. By December 1998 assets held abroad had grown to \$150 billion, which represented 13% of their financial asset portfolio. During the same period, the percentage of investment in Australian financial corporations by the rest of the world ranged from 22 to 25% of their total liabilities and equity.

18 APRA provides further information on the overseas assets and liabilities of the institutions it regulates, in its monthly bulletin.

Gaps in the Statistics on the Financial Sector

19 The current thrust towards increased transparency in global financial arrangements is already being felt in the way that data are analysed and the way that they may be required to be reported in future. Much of the "new" information (such as greater cross classification of international indebtedness by sector, country of debtor, residual maturity of debt, global portion by country of residence of the global enterprise, debt servicing and guarantees) being sought by governments, international organisations and creditor institutions forms a core element of institutional and system supervision and regulation requirements of economies, and goes beyond what would be appropriate to collect purely for statistical purposes. In these areas the ABS expects to use what may be collected, rather than being the initiator for the collection. That is, the ABS is working closely with APRA in the coordination of statistical enquires, including the development of protocols and agreements for obtaining data collected by APRA for ABS statistical analysis. ABS legislation, precludes such unit record data, if collected by the ABS, being provided to others or utilised for supervision purposes.

20 In other areas of statistics, however, gaps do exist that might be addressed by the ABS if sufficient user demand were identified. Analytic presentations of existing information is an obvious area of value adding that the ABS might undertake for finance sector statistics. Others might be the collection of specific globalisation indicators, such as the offshore business of Australian owned financial institutions abroad. This is currently an area of joint investigation between ABS and APRA, in the first instance to support the "nationality" dimension of reporting banking statistics to the Bank for International Settlements (BIS). BIS requirements cover not only the residency dimension that underlies much of macroeconomic statistical collection, but also the nationality dimension which looks at the country of incorporation of the parent bank. These data, when developed, would therefore capture the offshore financial activity of Australian owned banks.

21 From a Financial Accounts perspective, three improvement projects are being pursued: information on the assets/liabilities profiles of "excluded" super funds; additional data to provide insight into small and medium trading enterprises finances; and revision to Financial Corporations Act collections to reduce burden and provide more relevant data. There are other more difficult improvements not yet actioned directed at improving our insights into Australian saving, particularly in respect of household savings.

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