

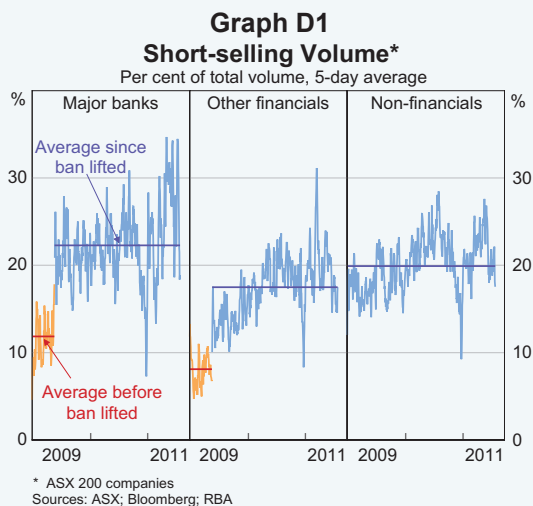
Box D

Recent Trends in Short Selling

Short selling is the practice of selling a security that has been borrowed and purchasing the security at a later stage to repay the lender.¹ An investor will make a profit if the share price declines in the intervening period and a loss if the price increases. Short selling allows investors to profit from price decreases without needing to own the underlying shares and can contribute to market liquidity and efficiency.

The proportion of share turnover that is reported as short selling has averaged around 20 per cent for ASX 200 companies since the partial short-selling ban for financial shares was lifted in May 2009.² For the shares of the major banks, this proportion has averaged around 22 per cent, which is marginally higher than the 20 per cent proportion for non-financial companies (Graph D1).

While 20 per cent of turnover is accounted for by short selling, outstanding short positions at the end of each trading day are only around 1 per cent of total shares on issue for ASX 200 companies. The difference in the two metrics reflects two main factors. First, only a small proportion (around 0.5 per cent) of ASX 200 companies' outstanding shares are actually traded each day. That is, the denominator of the first measure (turnover) is much smaller than for the second measure (market



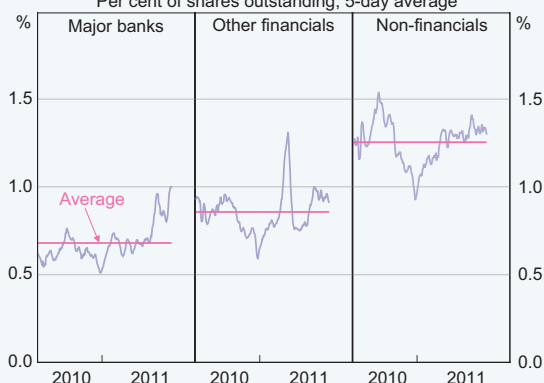
capitalisation). Second, short positions are typically held for only a brief period – about 12 days on average – before being closed out, with some being closed out on the same day they are entered into. Therefore, on average, only those short positions that have been recently established will still be outstanding.

The decline in share prices since the previous *Statement* has been accompanied by a pick-up in short-selling activity, particularly in the shares of the major Australian banks where the proportion of short turnover increased to over 30 per cent. Although the limited history of the data makes it difficult to assess how significant this pick-up has been, a number of factors may have contributed. These include concerns over the European sovereign debt situation, which has been associated with weakness in global banking stocks, Moody's decision to lower the major Australian banks' credit ratings by one notch to Aa2 and subdued growth in domestic housing and business credit.

1 A covered short sale is where the security has been borrowed before being sold (or the seller has arranged for it to be borrowed). This is generally the only type of short sale subject to reporting requirements. Naked short selling is where the borrower has not yet arranged to borrow the underlying security.

2 The Australian short-selling ban took effect on 22 September 2008 in response to severe market turmoil. The initial ban restricted covered and naked short sales of both financial and non-financial listed stocks, with limited exceptions relating to arbitrage transactions, market making, hedging of certain positions, and exchange-traded options. The ban on covered short sales was lifted for non-financial stocks on 19 November 2008 and for financial stocks on 25 May 2009. The ban on naked short sales remains in place, subject to limited exceptions.

Graph D2
Short Positions Outstanding*
Per cent of shares outstanding, 5-day average



* ASX 200 companies
Sources: ASIC; Bloomberg; RBA

The proportion of outstanding short positions has typically been smaller for financials than for other sectors of the market (Graph D2). This reflects the fact that short positions for financials typically have a duration of around 10 days, compared with 14 days for non-financials (Table D1). The difference in duration across the different sectors can be partly explained by the higher level of share price volatility for financials, as higher volatility means there is a greater chance that short sellers will need to cover their positions. The pick-up in short-selling volume in the major banks' shares over the past few months has seen the average duration of short positions fall to around 8 days, indicating that there may have been an increase in trading activity by market participants with shorter investment horizons. ↘

Table D1: Average Duration of Short Positions in ASX 200 Companies
By sector, number of days^(a)

	Since previous Statement	June 2010–April 2011
Financials	9.0	9.8
– Major banks	8.2	10.0
– Other financials	10.7	9.5
Non-financials	12.9	13.6
– Resources	10.9	11.7
– Other non-financials	15.7	16.8
ASX 200	11.6	12.4

(a) Outstanding short positions divided by short turnover
Sources: ASIC; ASX; Bloomberg; RBA