3. Domestic Financial Conditions

Australian financial conditions have tightened a little further in recent months. The Reserve Bank has increased the cash rate target and the rate on Exchange Settlement (ES) balances by a further 50 basis points since the previous *Statement* to 3.85 per cent and 3.75 per cent, respectively. Market pricing currently suggests that financial market participants assign some chance to a further increase in the cash rate.

Money market rates have risen alongside increases in the cash rate target this year. Australian Government Securities (AGS) yields are lower and have continued to trade in a relatively wide range, in line with moves in US Treasury yields. AGS yields rose in February as market expectations for the cash rate were revised higher following the February Reserve Bank Board meeting and because stronger-than-expected US data led to higher yields globally. Yields subsequently declined and trading conditions in bond markets deteriorated following the collapse of Silicon Valley Bank (SVB) in the United States in March and the resulting concerns around other banks offshore. Yields subsequently moved higher again, including for a time after the cash rate target was increased at the May Board meeting.

Banks' funding costs continued to increase in the March quarter of 2023, as the cash rate and bank bill swap rates (BBSW) rose. Banks increased both lending and deposit rates, although both have risen by less than the cash rate. Scheduled mortgage repayments have increased further and will continue to rise largely because more fixed-rate loans will roll off onto higher mortgage rates over the next year. Extra payments into offset and redraw accounts had been declining as scheduled payments picked up, but extra payments picked up somewhat in the March quarter. Commitments for new housing loans have declined sharply over the past year and housing credit growth has continued to ease; there are signs, however, that housing market activity has stabilised in recent months. Business credit growth has continued to slow from earlier rapid rates.

The Australian dollar has depreciated over recent months alongside a decline in the prices of Australia's key commodity exports, while the yield differential between AGS and those of the major advanced economies is little changed from its levels in early February, having increased of late. Despite the recent depreciation, the Australian dollar is around its levels in early 2022 on a trade-weighted (TWI) basis.

AGS yields have declined

Yields on AGS have traded in a wide 70 basis point range and are around 30 basis points lower since the previous *Statement* (Graph 3.1).

Yields had moved higher following the Bank's communication about the February Board decision – as market participants revised up their expectations for the future path of monetary policy – and US economic data was stronger than expected. However, in March there was a sharp move lower in AGS yields in line with the decline in global bond yields that occurred following the collapse of SVB. Yields have subsequently stabilised but remain near the bottom of their recent range, with concerns

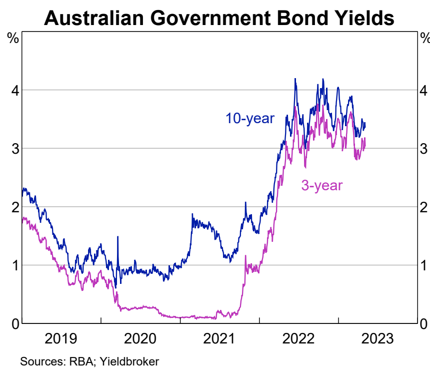
about some banks in the United States continuing to linger. There was little lasting impact on yields following the May Board decision to increase the cash rate target by 25 basis points.

The differential between yields on 10-year AGS and US Treasuries has declined a little since the last *Statement* and currently sits around zero (Graph 3.2). Short-term yield differentials have become less negative, although yields on Australian securities remain notably lower than yields on equivalent US securities. This is consistent with the higher expected level of the US Federal Funds rate compared with the Reserve Bank cash rate.

Movements in longer term AGS yields continue to be largely driven by movements in real yields, reflecting changes in expectations for policy rates over the near term (Graph 3.3). By contrast, break-even inflation rates have remained relatively stable and well anchored. This implies that market participants expect monetary policy tightening to be sufficient to keep inflation around the target range over the medium term.

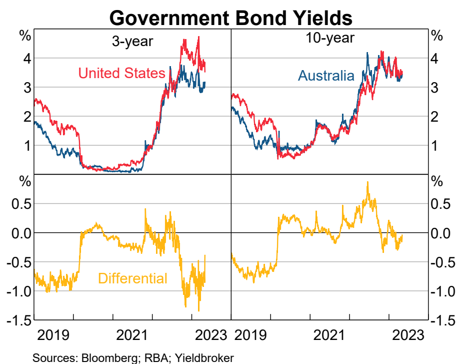
Yields on semi-government securities (semis) have moved in line with AGS yields, and so their spreads to AGS are little changed since the last *Statement* (Graph 3.4). The spread between yields on semis and AGS rose in March, largely reflecting a rise in risk premia and a widening of swap spreads that occurred due to the increase in concerns about banks offshore. However, these spreads subsequently narrowed as the volatility in bond yields abated.

Graph 3.1



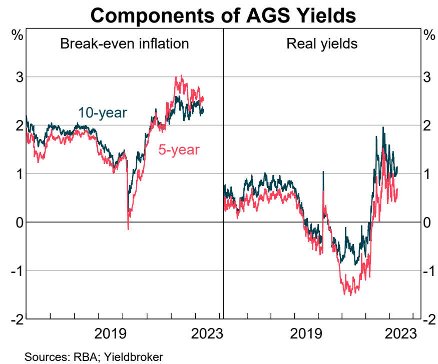
Sources: RBA; Yieldbroker

Graph 3.2



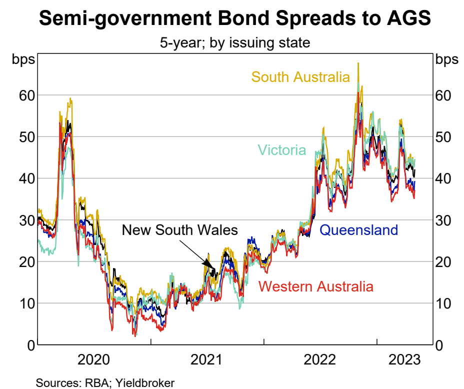
Sources: Bloomberg; RBA; Yieldbroker

Graph 3.3



Sources: RBA; Yieldbroker

Graph 3.4



Sources: RBA; Yieldbroker

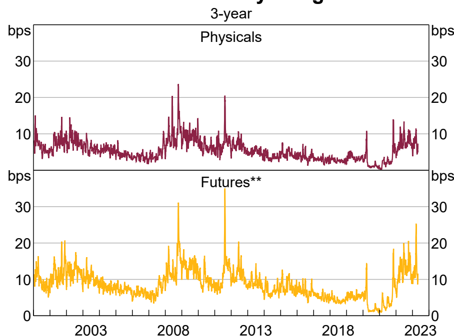
Bond market conditions deteriorated for a time as concerns rose about offshore banks

Conditions in bond markets temporarily deteriorated alongside the collapse of SVB. Bond volatility rose around this time and bid-offer spreads on AGS and semis widened, although these moves were not as severe as those observed around the onset of the pandemic in March 2020. Trading conditions normalised relatively quickly with volatility and bid-offer spreads returning to the relatively low levels observed earlier in the year (Graph 3.5).

Demand to borrow AGS from the Bank has declined in recent months, with an average of around $4 billion of bonds per day borrowed from the Bank's stock by market participants since the previous *Statement*. Demand remains focused on bonds with residual maturities of one to three years, particularly those where the stock available in private markets is more limited because of the Bank's earlier purchases (Graph 3.6). Bond dealers borrow these bonds to help settle their own transactions and the transactions of their clients. By lending these bonds back into the market for short periods, the Bank supports the functioning of government bond markets.

Graph 3.5

Bonds Intraday Range*



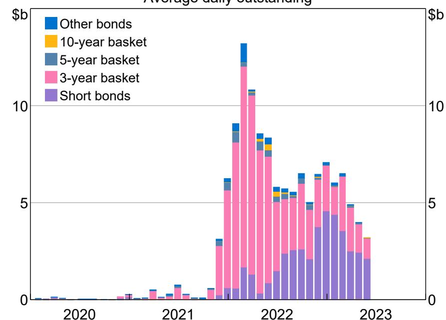
* Ten-day moving average.
** Includes overnight session.
Sources: Bloomberg; RBA

The size and pace of government bond issuance by the Australian Office of Financial Management (AOFM) in 2023 has so far been well below issuance in recent years (Graph 3.7). In January the AOFM lowered its 2022/23 fiscal year issuance guidance to around $85 billion (from around $95 billion previously). Of this, around $74 billion has already been completed. Semis issuance has remained strong in 2023, with issuance to date higher than observed in recent years. This continued to be the case in March and April despite volatility in financial markets following the collapse of SVB.

Graph 3.6

RBA and AOFM Securities Lending*

Average daily outstanding

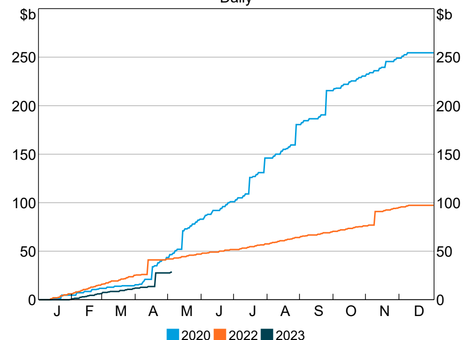


* Face value; last bar indicates month-to-date.
Source: RBA

Graph 3.7

Cumulative AGS Issuance*

Daily



* Cumulative value for each year.
Sources: AOFM; RBA

The cash rate has increased and market pricing implies participants see some chance of a further increase

The Reserve Bank has increased the cash rate target and the rate on ES balances by a further 50 basis points since the previous *Statement* to 3.85 per cent and 3.75 per cent, respectively. Market pricing implies that expectations for the peak in the cash rate have declined since the time of the last *Statement*; prices for overnight indexed swap (OIS) contracts currently imply that the cash rate is close to its expected peak of around 3.85 per cent compared with over 4 per cent last quarter, with some chance for one additional rise in coming months. Since March, uncertainty over the stability of some US banks has reduced market expectations of policy rate increases in a number of countries, including in Australia. Some market economists now expect an additional increase in the cash rate target later this year, but the median expectation is for no further increase (Graph 3.8).

Transaction volumes in the cash market have picked up a little in recent months, with the cash rate determined by market transactions on most days. The cash rate has remained at a modest margin below the cash rate target, currently 3 basis points.

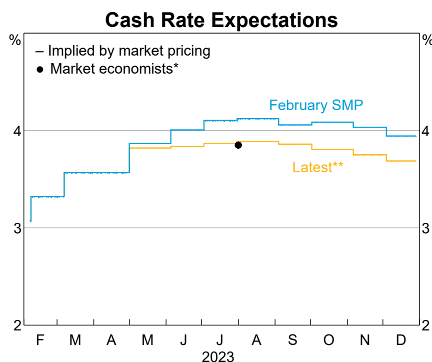
Money market rates have continued to rise

Short-term money market rates have continued to increase, including BBSW, consistent with the rise in the cash rate (Graph 3.9). While the spread between BBSW and OIS widened for a time following the collapse of SVB, this largely reflected a decline in OIS rates rather than credit concerns surrounding Australian banks (which would have seen BBSW rates move materially higher). The cost of Australian dollar funding from offshore short-term issuance (via the foreign exchange swap market) has also increased since the previous *Statement*, about in line with moves higher in domestic money market rates.

Repurchase agreement (repo) rates at the Bank's regular open market liquidity operations (OMO) have also increased further, with the OMO hurdle rate continuing to be set at term-matched OIS plus a modest spread. This rate was 3.88 per cent at the OMO immediately following the May Reserve Bank Board meeting. Demand for short-term Australian dollar liquidity obtained at OMO remains modest. Although volumes increased a little around the time of the SVB collapse, demand was not unusually high over this period.

Graph 3.8

Cash Rate Expectations



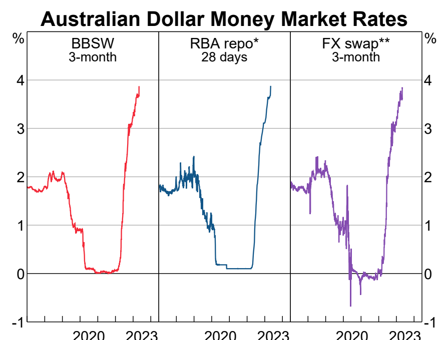
* Median peak rate called by market economists at both February SMP and April 2023; peak rate timing ranges mostly from March quarter 2023 to September quarter 2023.

** Latest projections as at May 2023.

Sources: Bloomberg; RBA

Graph 3.9

Australian Dollar Money Market Rates



* Weighted average rate for morning open market operation repos.

** Implied AUD rate based on covered interest parity.

Sources: ASX; Bloomberg; RBA; Tullet Prebon; US Federal Reserve

The Term Funding Facility has started to unwind

Funding obtained by banks under the Term Funding Facility (TFF) has started to mature, with $3 billion having matured in April. The Bank established the TFF in March 2020 to support the economy by offering low-cost fixed-rate funding for three years to banks operating in Australia. To repay the TFF, banks will use some of the balances held in their ES accounts. ES balances will therefore decline by $84 billion in 2023 and a further $104 billion in 2024, with TFF maturities concentrated in the September 2023 and June 2024 quarters (Graph 3.10). Nonetheless, even after all loans from the TFF are repaid, aggregate ES balances will remain abundant by pre-pandemic standards.

ES balances qualify as high-quality liquid assets (HQLA) for the purpose of banks' regulatory liquidity ratios. On the other hand, around 90 per cent of the collateral that secured banks' TFF loans was self-securitised assets, which do not qualify as HQLA. Consequently, as the banking sector runs down its ES balances to repay the TFF, it will need to obtain other HQLA in order to maintain liquid asset ratios, which are currently well above regulatory requirements. Bank bond issuance has been very strong over recent months, with some of this funding likely to be used to purchase HQLA securities.

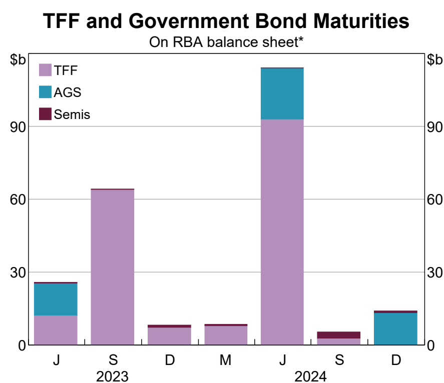
TFF loan maturities will add to bank funding costs, although the effect is expected to be small relative to the cumulative change in the cash rate. This reflects the fact that TFF loans account for around 5 per cent of banks' funding and that banks have hedged some of this borrowing (and hence funding costs) back to floating rates, which have already increased.

The Bank's balance sheet remains large but will decline noticeably over the course of this year

The Bank's balance sheet remains large by historical standards reflecting the monetary policy measures introduced in response to the COVID-19 pandemic (Graph 3.11). Since the previous *Statement*, the size of the balance sheet has decreased slightly to around $620 billion. The decline was primarily driven by the maturity of $13 billion of the April 2023 AGS held by the Bank. Separately, the outstanding size of the TFF has declined by around $3 billion following the first scheduled TFF maturities in April. On the liabilities side, government deposits rose alongside the syndication of a new December 2034 AGS, although this was partly offset by the April 2023 AGS maturity (Graph 3.12). The increase in government deposits and TFF maturities led to a decline in ES balances. The Bank's balance sheet will decline noticeably over the next few years as funding provided to banks under the TFF is repaid and the Bank's government bond holdings mature.

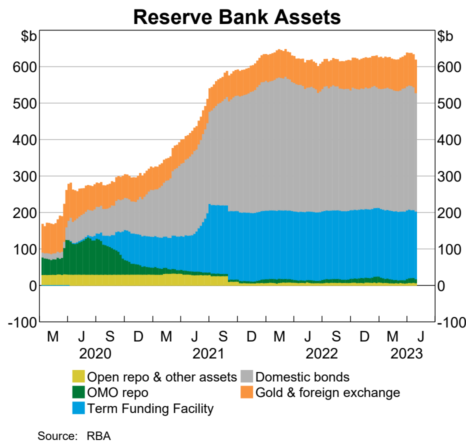
Bank bond spreads are little changed

Bank bond yields remain at about their levels of three months ago, with yields on three-year bonds now at around 4 per cent (Graph 3.13).

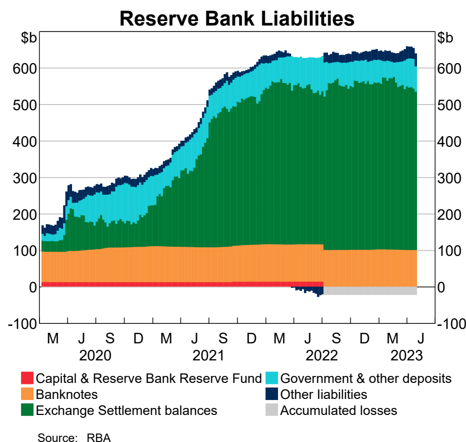


While the spread to the swap rate (a reference rate for the pricing of fixed-income securities) widened a little following the failure of SVB in the United States, it has recently narrowed. The spread remains around the average of the past year for major banks, and a little wider for smaller banks. Banks generally swap fixed-rate payments on newly issued bonds into floating-rate payments to match their floating-rate loan assets, and so it is the spread to swap that matters most for funding costs.

Graph 3.11



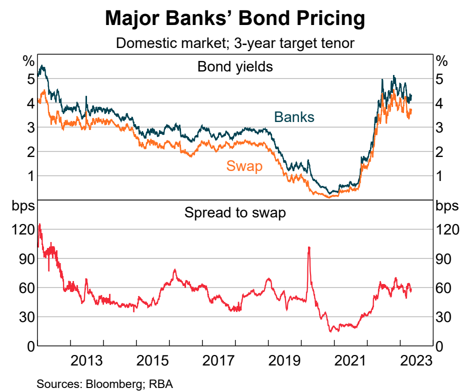
Graph 3.12



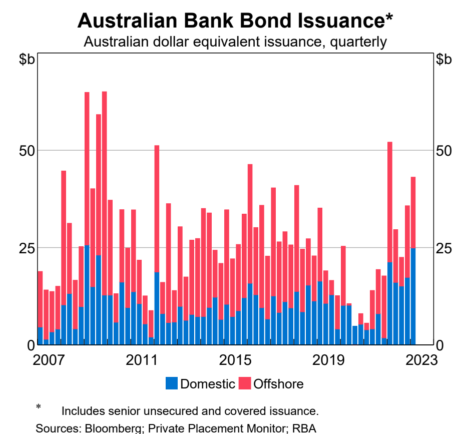
Bank bond issuance was high in the March quarter

Bank bond issuance was high in early 2023 (Graph 3.14). Banks raised $43 billion in bond markets over the March quarter, of which $25 billion was raised in the domestic market – the highest amount in over a decade. Covered bond issuance was around $9 billion. Much of this was issued in late March, which may have reflected a preference among some investors for secured rather than unsecured debt during a time of somewhat heightened financial market volatility. More recently, issuance has been slower, partly reflecting the fact that banks are ahead of their funding plans.

Graph 3.13



Graph 3.14



Banks issued $9 billion of Tier 2 hybrid securities in the March quarter – the highest level in over a decade (Graph 3.15). Most Tier 2 hybrids were issued by the major banks. Hybrid securities have both equity and debt features and can be used to fulfil a part of regulatory capital requirements. The Australian Prudential Regulation Authority has introduced new capital rules, coming into effect from 1 January 2026, which will substantially increase the major banks' loss-absorbing capital requirements; banks had been issuing hybrids in anticipation of this.

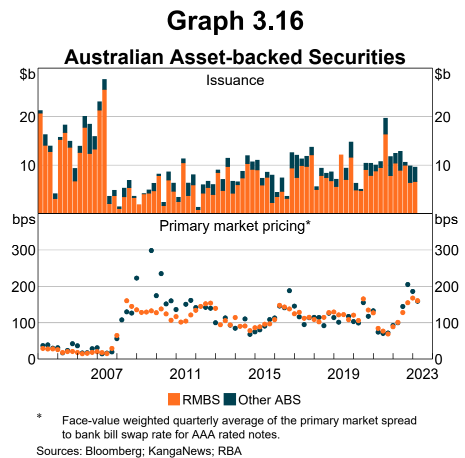
Issuance of asset-backed securities remained robust in the March quarter

Issuance of asset backed securities (ABS) remained strong in the March quarter and continued to be driven primarily by non-banks (Graph 3.16). Non-bank lenders, which are more dependent on wholesale funding than banks, accounted for $9 billion of the $10 billion issued. While issuance slowed during mid-March, following the failure of SVB, it has since resumed with several deals being completed recently. Spreads on both residential mortgage-backed securities (RMBS) and other ABS remain at the wider end of the pre-pandemic range. Market liaison suggests that wider spreads in RMBS markets make RMBS issuance less appealing for banks compared with senior unsecured and covered bond issuance.

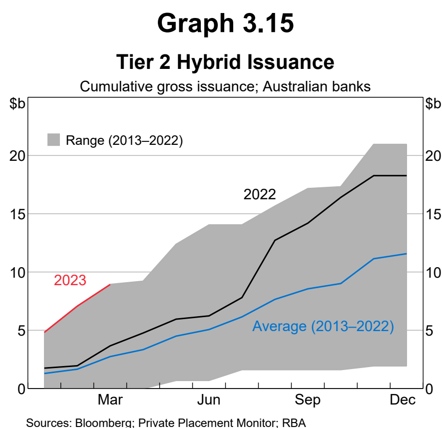
Growth in deposit funding has slowed and shifted towards term deposits

The total stock of deposits has grown more slowly in the last six months than during the pandemic – in part because credit growth has slowed, which means fewer deposits are created (Graph 3.17). Depositors have continued to shift from at-call deposits into term deposits, which offer significantly higher returns (see below).

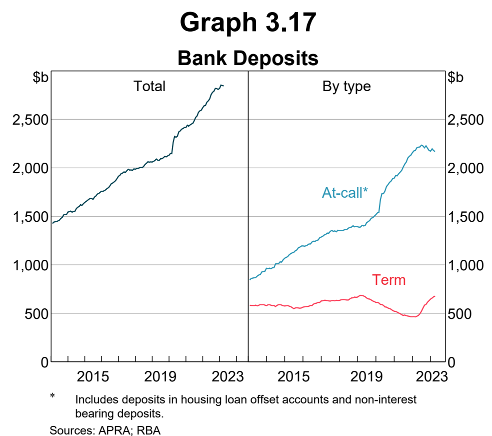
Graph 3.16



Graph 3.15



Graph 3.17



Banks' funding costs continued to increase

Banks' overall funding costs rose in the March quarter of 2023, underpinned by higher BBSW rates (Graph 3.18). BBSW rates have increased due to both actual and expected changes in the cash rate. Much of banks' wholesale debt and deposit costs are linked to BBSW rates either directly or through banks' hedging. This includes banks swapping foreign-currency denominated and fixed-rate liabilities into floating-rate exposures that reference BBSW.

There has been little impact on Australian banks' overall funding costs following the failure of SVB in March. As discussed above, bank bond issuance has also remained elevated recently as banks prepare for TFF maturities.

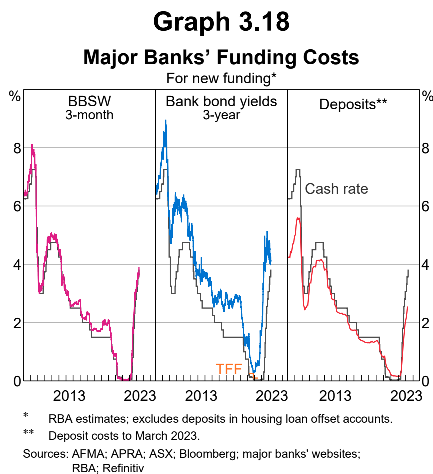
Deposit and lending rates have increased by less than the cash rate

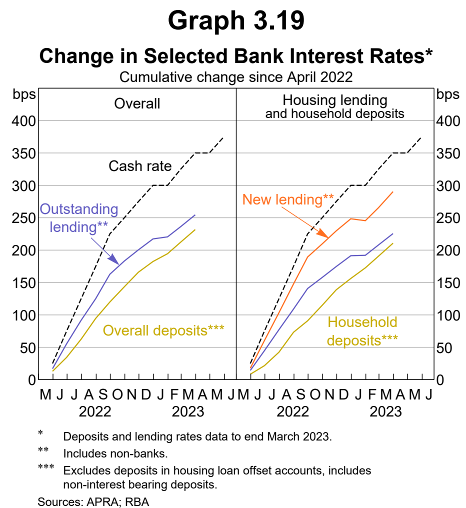
As the cash rate has risen, banks have increased both lending and deposit rates, although both have increased by less than the cash rate (Graph 3.19). The average rate charged on all outstanding loans to households and businesses has increased by around 100 basis points less than the cash rate increases to March (the latest available data). Housing loans (which make up around two-thirds of total credit) account for much of this difference, due to the material share of fixed-rate loans outstanding and strong competition among banks for new and existing customers. The average rate on outstanding business loans has moved more closely in line with the cash rate. The average rate on outstanding deposits has increased by around 120 basis points less than the cash rate, due to lower pass-through to some at-call deposit accounts. Given that lending rates have risen by more than deposit rates, banks' net interest margins have ticked up a little, although they remain lower than before the pandemic.[1]

In February, the Treasurer directed the Australian Competition and Consumer Commission to conduct an inquiry into the market for retail deposits, including on the interest rates paid on deposits and the nature and extent of competition in the supply of retail deposits.[2] The inquiry report is due in December this year.

Deposit rates have risen more on some products than others

The average rate on outstanding at-call deposits, which comprise around three-quarters of total deposits, increased 210 basis points in the 12 months to March (Graph 3.20). This includes around 15 per cent of at-call balances on which





banks pay no interest to depositors, although banks often hedge such deposits so their effective cost to banks increases with BBSW rates. By contrast, banks have increased advertised rates on 'bonus savers' (where depositors must meet certain conditions to receive a higher interest rate) more than they have on standard at-call savings accounts.

Average rates on new term deposits increased by more than the cash rate, in line with larger movements in BBSW and swap rates, which are the key benchmarks used to price these products. Rising term deposit rates also partly reflect banks' interest in growing term deposits given their favourable treatment in liquidity ratios, compared with at-call deposits, as they prepare for TFF maturities.

Banks have continued to pass on larger rate increases to wholesale depositors than households, in part because wholesale depositors have a wider range of market-based alternatives in which to place cash.

Housing loan interest rates have risen further

Housing lenders have passed on cash rate increases up to March in full to their reference rates for variable-rate loans (Graph 3.21). At the time this *Statement* was finalised, some housing lenders had announced they would also pass through the May increase in the cash rate in full to their housing reference rates.

Very few borrowers pay the reference rate, however, and instead are charged a rate discounted relative to these reference rates.[3] These discounts have increased over the past year, as competition for mortgage holders has been elevated amongst banks. As a result, the average rate on outstanding variable-rate loans has increased by around 50 basis points less than the cumulative increase in standard variable reference rates (and the cash rate) up to March (the latest available data) (Table 3.1). Reserve Bank estimates suggest that just under half of this difference reflects borrowers renegotiating a lower rate on their home loan with their current lender. Borrowers are also refinancing their loans with another lender to secure lower new variable rates; the average new variable rate is around 45 basis points lower than the average outstanding variable rate. Recent changes in advertised rates suggest that competition for housing loans may be easing – since the end of February, major banks and some of their subsidiary brands have started to reduce discounts on new variable-rate loans.

The average interest rate on outstanding fixed-rate loans has increased marginally in recent months (Table 3.1). This reflects the gradual roll-off of existing fixed-rate loans originated at low rates during the pandemic and relatively few borrowers taking out new fixed-rate loans at higher rates. Currently, around 30 per cent of total housing credit is on a fixed interest rate. Over the coming year, around half of all fixed-rate loans outstanding will reach the end of their terms and many of these loans will reprice at significantly higher interest rates.[4] Importantly, the repricing of these loans will occur gradually in aggregate because borrowers will reach the end of their terms at different times (Graph 3.22).

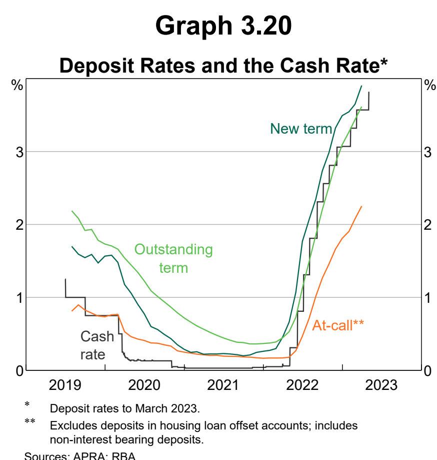


Table 3.1: Average Outstanding Housing Rates

March 2023

	Interest rate March 2023 Per cent	Change since Apr 2022 Basis points	Change since Feb 2020 Basis points
Cash rate	3.60	350	285
Variable-rate loans			
– Owner-occupier	5.85	298	227
– Investor	6.19	298	222
– All variable-rate loans	5.96	298	225
Fixed-rate loans			
– Owner-occupier	2.63	40	–110
– Investor	2.92	33	–109
– All fixed-rate loans	2.72	37	–113
Loans by repayment type[(a)]			
– Principal-and-interest	4.92	224	130
– Interest-only	5.59	235	137

(a) Weighted average across variable- and fixed-rate loans.

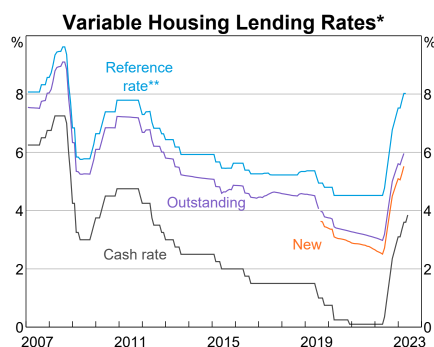
Sources: APRA; RBA

Scheduled housing loan payments have increased further

Scheduled mortgage payments – interest plus scheduled principal – increased further over the March quarter to around 8.9 per cent of household disposable income (Graph 3.23). Scheduled payments are now around 1¾ percentage points of household disposable income higher than in the March quarter of 2022 as increases in the cash rate have passed through to banks' lending rates and borrowers' mortgage payments.

Scheduled payments will increase further over coming months, as borrowers with fixed-rate loans continue to roll off onto higher rates. Additionally, recent cash rate increases will continue to flow through to payments as lenders typically take a few months to adjust

Graph 3.21

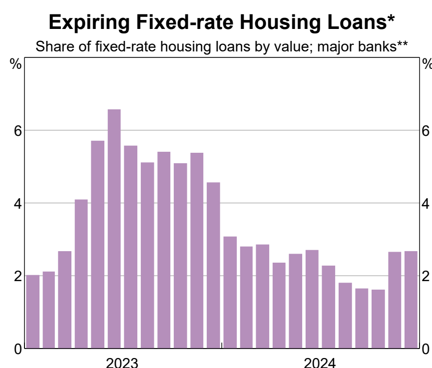


* Reference rates to end April 2023; new and outstanding rates to end March 2023. Series break for new and outstanding loans in July 2019.

** Major banks' standard reference rates for variable-rate owner-occupier loans.

Sources: APRA; banks' websites; CANSTAR; Perpetual; RBA; Securitisation System

Graph 3.22



* Loans expiring beyond 2024 not available monthly.

** Value of fixed-rate housing loans outstanding as at end December 2022.

Sources: Major banks; RBA

Table 3.2: Growth in Financial Aggregates

Percentage change[(a)]

	Three-month annualised		Six-month annualised	
	Dec 22	Mar 23	Sep 22	Mar 23
Total credit	5.0	4.3	9.0	4.6
– Household	4.3	3.7	6.3	4.0
– Housing	4.7	4.0	6.6	4.4
– Owner-occupier	5.4	4.6	7.0	5.0
– Investor	3.4	2.8	5.9	3.1
– Personal	–1.0	–0.7	0.9	–0.9
– Business[(b)]	6.7	6.4	14.9	6.5
Broad money	8.7	6.0	6.2	7.3

(a) Figures are break-adjusted and seasonally adjusted.

(b) Lending to non-financial businesses.

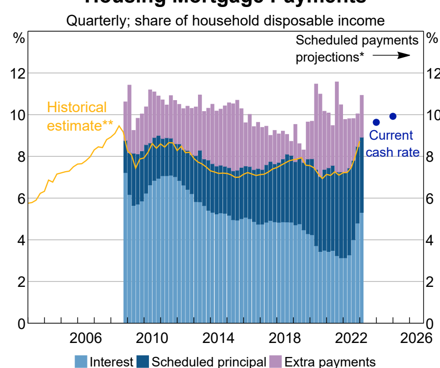
Sources: ABS; APRA; RBA

borrowers' mortgage payments. Scheduled mortgage payments are projected to reach around 9.6 per cent of household disposable income by the end of the year, and around 9.9 per cent by the end of 2024, based on cash rate increases to date.

Graph 3.23

Housing Mortgage Payments

Quarterly; share of household disposable income



* Projections incorporate fixed-rate roll off to variable rates and the observed gap between cash rate increases and increases to variable loan rates. The current cash rate is 3.85 per cent.

** Estimated scheduled payments using credit foncier model.

Sources: ABS; APRA; RBA

Extra payments into offset and redraw accounts increased over the March quarter

Extra payments into offset and redraw accounts increased over the March quarter but remain well below the highs seen during the pandemic following a period of declines (Graph 3.24). Borrowers have accumulated significant mortgage payment buffers over the past three years; this is true for borrowers across the income distribution.[5] Although the total value of these funds continues to increase, the share of borrowers who are drawing down on their mortgage payment buffers has increased compared with the 2019–2021 period.[6]

Growth in total credit has continued to slow

Total credit growth has continued to slow in recent months (Graph 3.25; Table 3.2).[7] Business credit growth fell further from its September 2022 peak and housing credit growth continued to ease up to March. Growth in personal credit contracted a little, and personal credit outstanding remains well below pre-pandemic levels.

Demand for new housing loans declined sharply over the past year but refinancing activity remains very high

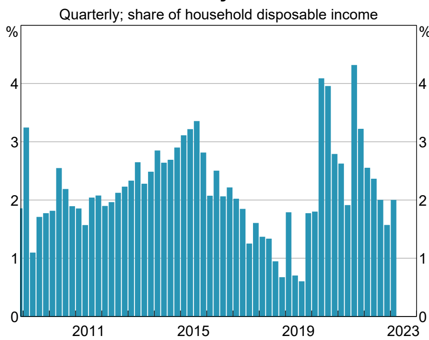
Housing credit growth declined in March to 4.4 per cent on a six-month-ended annualised basis. New housing loan commitments have declined by around one-third since the January 2022 peak (Graph 3.26). The large fall in commitments over the year to March is consistent with higher interest rates, lower housing turnover and the decline in housing prices. However, housing prices have stabilised of late, which could provide some support for housing lending over the coming months.

Commitments for external refinancing (switching to a new lender) remain at very high levels. A large share of borrowers with variable-rate loans have sought a better deal on their mortgage as interest rates and the cost of living have increased. At the same time, fixed-rate loans taken out during the pandemic have continued to expire and roll onto variable rates, which has prompted some borrowers to shop around.

Graph 3.24

Extra Payments*

Quarterly; share of household disposable income

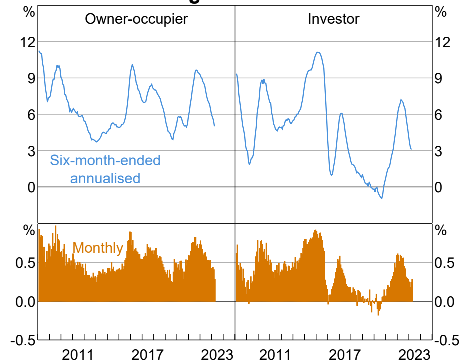


* Payments into offset and redraw accounts. Data are break-adjusted and seasonally adjusted.

Sources: ABS; APRA; RBA

Graph 3.26

Housing Credit Growth*



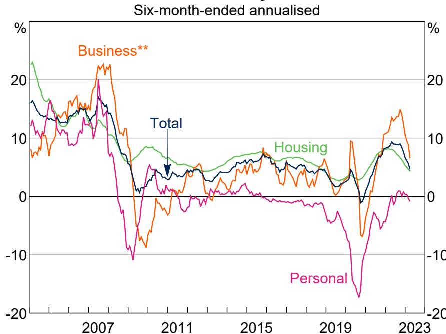
* Seasonally adjusted and break-adjusted.

Sources: APRA; RBA

Graph 3.25

Credit Growth by Sector*

Six-month-ended annualised



* Seasonally adjusted and break-adjusted; including securitisation.

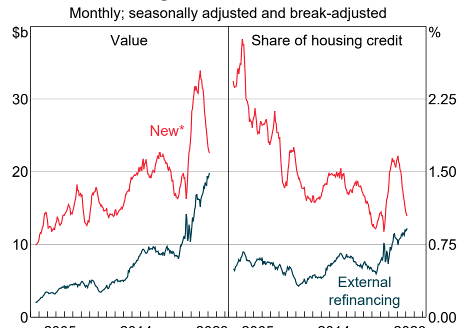
** Lending to non-financial businesses.

Sources: ABS; APRA; RBA

Graph 3.27

Housing Loan Commitments

Monthly; seasonally adjusted and break-adjusted



* Excludes refinancing.

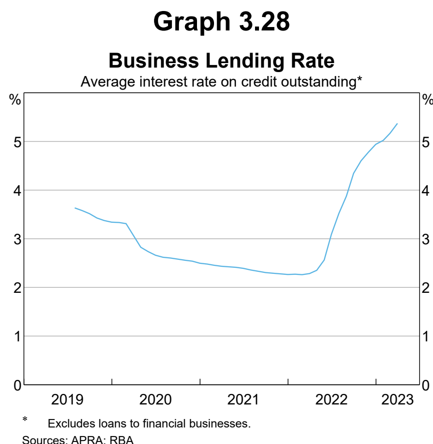
Sources: ABS; APRA; RBA.

Interest rates on business loans have risen, and business credit growth has slowed

Interest rates on business loans have risen in recent months, reflecting increases in the cash rate and BBSW rates (BBSW rates are the standard benchmark rates used to price loans to medium and large businesses) (Graph 3.28).

Growth in non-financial business credit has continued to decline over recent months (Graph 3.29). The slowdown in business credit growth has been broadly based across industries. Growth in lending to the property services industry has slowed, consistent with the decline in commercial property transactions. To manage disrupted supply chains, some businesses in goods-related industries had earlier increased their use of revolving credit facilities; now that those disruptions are easing, businesses are winding this back. Commitments for new business loans have decreased in recent months, which suggests the growth of business credit is likely to decline further.

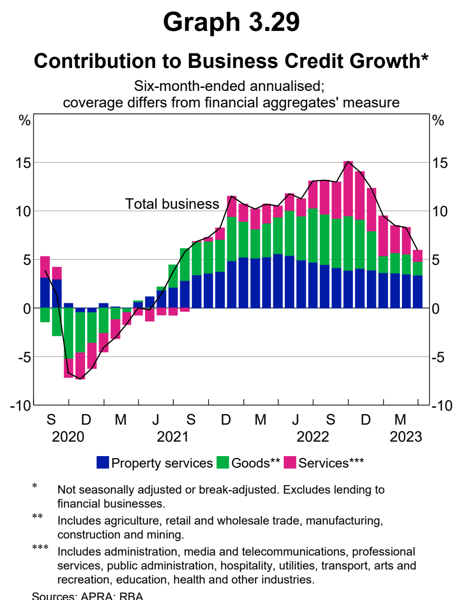
Another factor weighing on business demand for credit is that the attractiveness of its pricing, relative to bond issuance, has diminished recently. Accordingly, bond issuance by non-financial corporations picked up in the March quarter to $10 billion. Most issuance was in offshore markets and around half was issuance from resource-related corporations.



Australian equity prices have fallen a little

The ASX 200 index is about 3 per cent below its recent peak in early February on a total return basis (Graph 3.30). Equity prices fell sharply following the failure of SVB, and again after concerns about Credit Suisse emerged; however, they mostly recovered as broader concerns over financial stability eased from late March. During this period of market stress, banks' share prices declined by less than those in some other markets. More recently, banks' share prices have again experienced some volatility following pressures on some US banks.

Since the start of 2023, the ASX 200 has underperformed overseas equity markets. This partly reflects the composition of the Australian market, which has a larger resources sector and a smaller IT sector compared with many other markets. Energy stocks have decreased, reflecting lower commodity prices due to concerns about the outlook for the global



economy (Graph 3.31). By contrast, prices of stocks in the interest-rate-sensitive IT and consumer discretionary sectors have risen as bond yields have fallen over this period.

Profits and dividends of listed companies fell in the second half of 2022

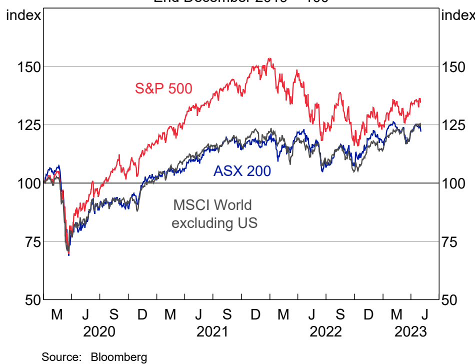
Aggregate underlying profits of ASX 200 companies were 12 per cent lower in the second half of 2022 compared with the same period a year earlier (Graph 3.32). Due to moderating iron ore prices, lower earnings by mining companies were the main contributor, though earnings in other sectors also decreased. Around one-half of ASX 200 companies reported lower earnings relative to the second half of 2021. Cost pressures still remain an issue for most companies and many have raised prices to preserve margins (see Box B: Have Business Profits Contributed to Inflation?). Some companies reported an easing in consumer demand in early 2023.

Dividends announced in the first half of 2023 fell in comparison to those paid in the first and second halves of 2022 (Graph 3.33). The decline was driven by a large decrease in dividends from the major miners. That said, most sectors reported higher dividends compared with a year ago, with the largest increase in the energy sector due to elevated oil and gas prices. As aggregate dividends fell by less than underlying earnings, the dividend payout ratio increased compared with the same period a year earlier.

Graph 3.30

Total Return Indices

End December 2019 = 100

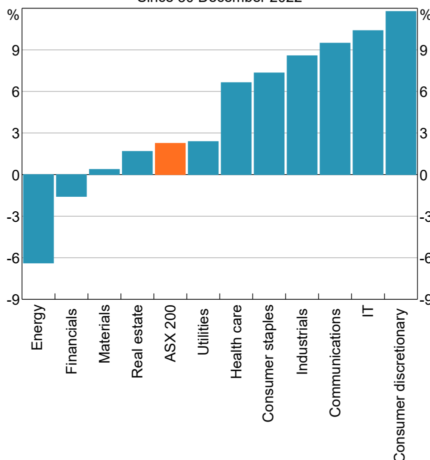


Source: Bloomberg

Graph 3.31

Change in Equity Prices

Since 30 December 2022



Source: Bloomberg

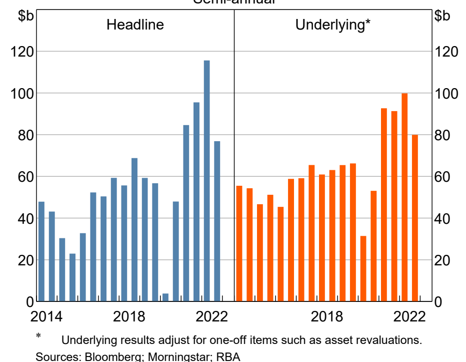
The Australian dollar has depreciated over recent months

The Australian dollar has depreciated by around 4 per cent against the US dollar and 3 per cent on a TWI basis since early February to be slightly lower over the year to date (Graph 3.34). It is currently a touch below US$0.67. The depreci-

Graph 3.32

ASX 200 Profits

Semi-annual



* Underlying results adjust for one-off items such as asset revaluations.

Sources: Bloomberg; Morningstar; RBA

ation is consistent with lower prices for Australia's key commodity exports, including for iron ore and coal, as well as increased uncertainty among market participants following the emergence of concerns about banks offshore (see Chapter 1: The International Environment). Meanwhile, the yield differential between Australian Government bonds and those of the major advanced economies is little changed from its levels in early February, having increased of late.

In trade-weighted terms, the Australian dollar is around its levels in early 2022, when many central banks began raising their policy rates. This is consistent with yield differentials being overall little changed over this period. The level of the Australian dollar (in real TWI terms) has remained broadly consistent with model estimates implied by historical relationships with forecasts of the terms of trade and real yield differentials (Graph 3.35).[8]

Australia's financial account deficit narrowed in 2022

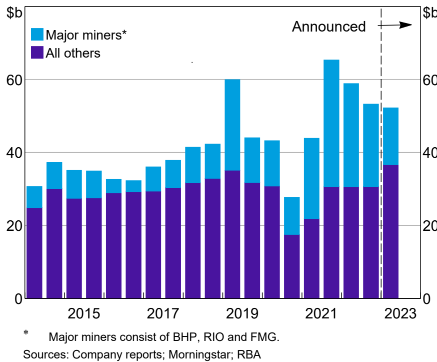
Australia continued to be a net exporter of capital in 2022, although the financial account deficit has narrowed. This is the corresponding balance to Australia's current account surplus and reflects the difference between national savings and investment over this period.[9] Net outflows of capital in 2022 reflected private non-bank corporations – including superannuation funds – investing in foreign debt and equity assets (Graph 3.36). Partly offsetting these outflows were inflows associated with Australian banks issuing offshore debt securities as they prepared for TFF maturities. In addition, there were inflows related to foreign investment in AGS.

Australia's net foreign liability position was little changed over 2022 at around 35 per cent of GDP (Graph 3.37). This reflected a narrowing in the net foreign equity asset position; foreign equity prices declined relative to those in

Graph 3.33

ASX 200 Dividends

Semi-annual

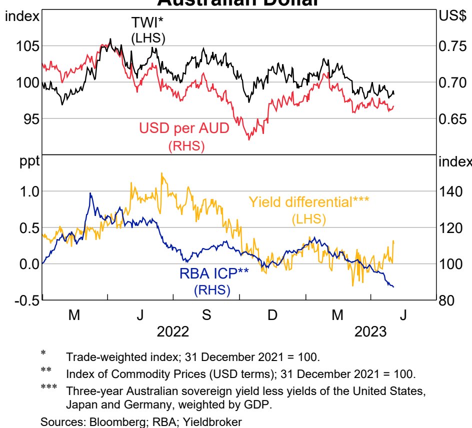


* Major miners consist of BHP, RIO and FMG.

Sources: Company reports; Morningstar; RBA

Graph 3.34

Australian Dollar



* Trade-weighted index; 31 December 2021 = 100.

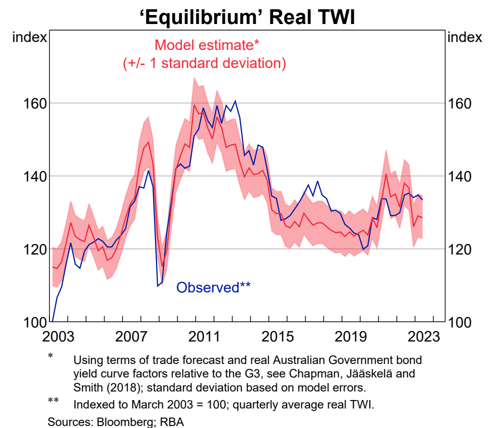
** Index of Commodity Prices (USD terms); 31 December 2021 = 100.

*** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.

Sources: Bloomberg; RBA; Yieldbroker

Graph 3.35

'Equilibrium' Real TWI



* Using terms of trade forecast and real Australian Government bond yield curve factors relative to the G3, see Chapman, Jääskelä and Smith (2018); standard deviation based on model errors.

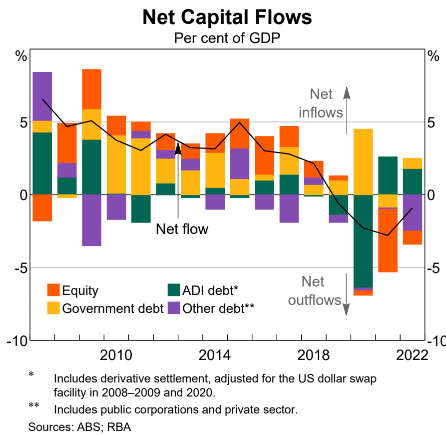
** Indexed to March 2003 = 100; quarterly average real TWI.

Sources: Bloomberg; RBA

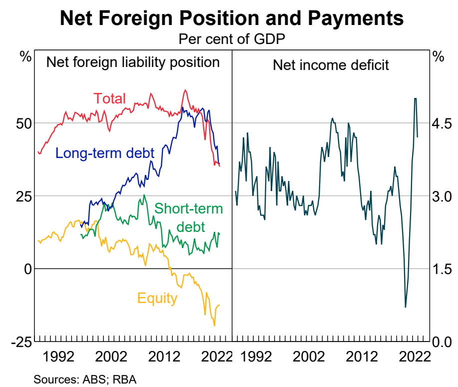
Australia, which was offset by a decline in the net debt liability position that reflected valuation effects associated with rising interest rates. The net foreign liability position remains around its lowest level since the 1980s.

The net income deficit (NID) – which reflects net payments made to service the net foreign liability position – widened over the year and remains at a high level compared with the past decade. The widening of the NID reflected an increase in dividend payments to non-residents associated with high operating profits amid elevated commodity prices, and increased payments on portfolio debt liabilities related to higher interest rates. ✠

Graph 3.36



Graph 3.37



Endnotes

[1] See RBA (2023), 'The Australian Financial System', Financial Stability Review, April. Available at <https://www.rba.gov.au/publications/fsr/2023/apr/australian-financial-system.html>

[2] For more information, see ACCC (2023), 'Retail Deposits Inquiry 2023'.

[3] See RBA (2019), 'Box D: The Distribution of Variable Housing Interest Rates', *Statement on Monetary Policy*, November. Available at <https://www.rba.gov.au/publications/smp/2019/nov/box-d-the-distribution-of-variable-housing-interest-rates.html>

[4] See Lovicu G, J Lim, A Faferko, A Gao, A Suthakar and D Twohig (2023), 'Fixed-rate Housing Loans: Monetary Policy Transmission and Financial Stability Risks', RBA *Bulletin*, March. Available at <https://www.rba.gov.au/publications/bulletin/2023/mar/fixed-rate-housing-loans-monetary-policy-transmission-and-financial-stability-risks.html>

[5] See Kent C (2023), 'Long and Variable Monetary Policy Lags', Speech at the KangaNews DCM Summit, 20 March. Available at <https://www.rba.gov.au/speeches/2023/sp-ag-2023-03-20.html>

[6] See RBA (2023), 'Household and Business Finances in Australia', *Financial Stability Review*, April. Available at <https://www.rba.gov.au/publications/fsr/2023/apr/household-business-finances.html>

[7] From the April 2023 release, the financial aggregates were updated to remove the effect of lending to warehouse trusts in business credit. Business credit now reflects credit to non-financial businesses. See RBA (2023), 'Changes to Statistical Tables', 21 April. Available at <https://www.rba.gov.au/statistics/tables/changes-to-tables.html#d20230421>

[8] See Chapman B, J Jääskelä and E Smith (2018), 'A Forward-looking Model of the Australian Dollar', RBA *Bulletin*, December. Available at <https://www.rba.gov.au/publications/bulletin/2018/dec/a-forward-looking-model-of-the-australian-dollar.html>

[9] For more information, see Adams N and T Atkin (2022), 'The Significant Shift in Australia's Balance of Payments', RBA *Bulletin*, March. Available at <https://www.rba.gov.au/publications/bulletin/2022/mar/the-significant-shift-in-australias-balance-of-payments.html>