2. International and Foreign Exchange Markets

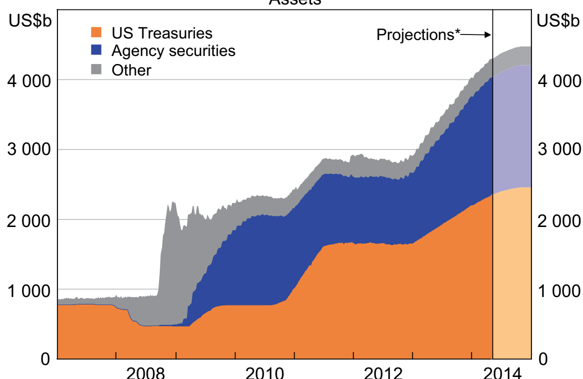
The prices of a range of risk-sensitive global financial assets have rallied strongly since early February, with global equity prices reversing the falls recorded in January, emerging market bond yields generally declining and the currencies of a number of Asian and emerging market economies paring back some of their depreciations against the US dollar that occurred over the latter part of 2013. Demand for corporate bonds globally remains strong, and has strengthened further for lower-rated securities, while yields on sovereign bonds of several euro area 'periphery' economies have fallen to their lowest levels in many decades. The other noteworthy feature of global financial markets in recent months has been historically low levels of volatility across most asset classes. These developments have occurred alongside continued central bank policy accommodation, with the US Federal Reserve recommitting to maintain accommodative policy for a considerable period of time, the Bank of Japan's balance sheet still growing rapidly and the European Central Bank (ECB) signalling its willingness to ease policy further if needed. While geopolitical tensions between Russia and Ukraine have affected markets, the impact has predominantly been confined to eastern Europe.

Central Bank Policy

The US Federal Reserve has continued to scale back the size of its monthly asset purchases by US$10 billion at each of its recent meetings, to now be US$45 billion. A number of Federal Reserve officials have made clear that they expect to continue reducing asset purchases in similar increments at upcoming meetings, absent a notable change in the economic outlook. This would see asset purchases finish later this year. The Fed's balance sheet has expanded by US$275 billion since the start of the year as a result of these purchases and is likely to rise by a further US$175 billion to US$4.5 trillion before purchases end (Graph 2.1).

With asset purchases perceived to be largely on a preset course, the focus of policy has shifted to the timing of future policy rate rises. The Federal Open Market Committee (FOMC) revised its forward interest rate guidance at its March meeting, replacing the previous threshold-based guidance in favour of qualitative guidance that takes account of a wide range of information, including that related to the labour market, inflation pressures and expectations, and financial conditions. Under the new guidance, the FOMC currently states that it anticipates the federal funds rate will be unchanged for 'a considerable

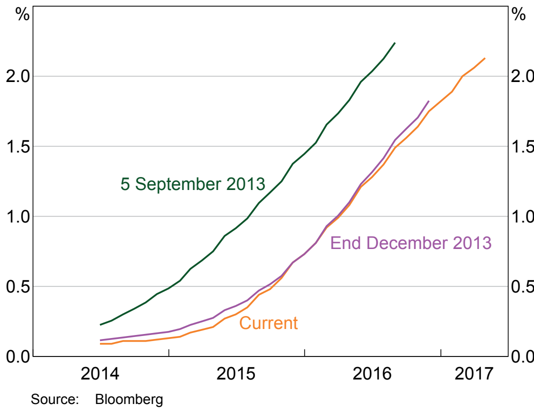
Graph 2.1
US Federal Reserve Balance Sheet
Assets



* Projections assume purchases decline by US$10 billion per meeting, evenly split between Treasuries and agency MBS, and finish in October 2014

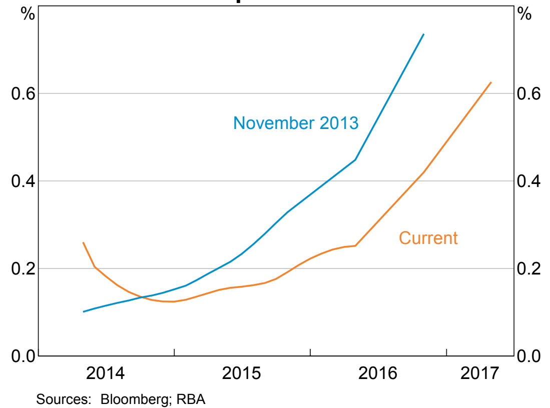
Sources: Board of Governors of the Federal Reserve System; RBA

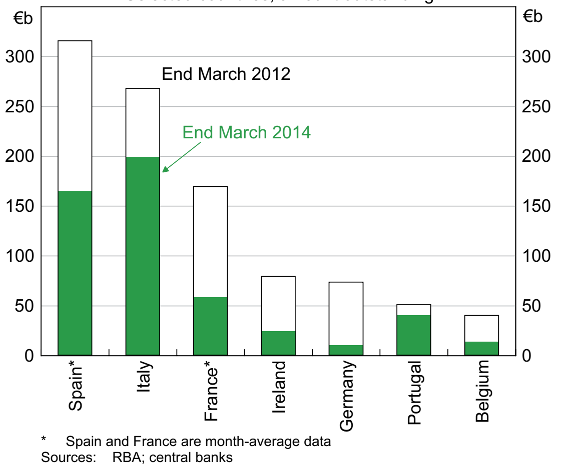
time' after asset purchases end, and will likely remain lower than historical norms for an extended period. Consistent with this, market implied expectations are for the first rise in the federal funds rate to occur around mid 2015 (Graph 2.2).



The ECB has left its policy settings unchanged since November, and continues to state that interest rates will remain at current or lower levels for an extended period. The ECB has committed to ease policy further if the medium-term outlook for inflation declines or if there is an unwanted tightening in money market conditions, including because of an appreciation of the currency. Given the already low level of interest rates, the ECB has said that it is prepared to use a range of unconventional instruments, including purchasing sovereign and corporate bonds or charging banks to hold excess reserves on deposit with the ECB. Reflecting such discussion, and recent weakness in actual and prospective inflation, markets are pricing in a chance of a policy easing later this year and no increase in rates until 2017 (Graph 2.3).

The ECB's balance sheet has continued to shrink in recent months, reflecting prepayment of funds extended under the 3-year long-term refinancing operations (LTRO) in late 2011 and early 2012. More than half of these loans have now been repaid. Spanish banks have accounted for much of the prepayment over the past six months, but still have large outstanding balances (Graph 2.4). Italian





banks have increased the rate at which they are repaying these loans over recent months, though around 75 per cent of their initial drawings remain outstanding, while Portuguese banks have repaid little of their initial drawings. The decline in the ECB's balance sheet has seen excess liquidity fall to around €100 billon, which has pushed the overnight interbank rate towards the main policy rate, after trading near the deposit rate floor since late 2011.

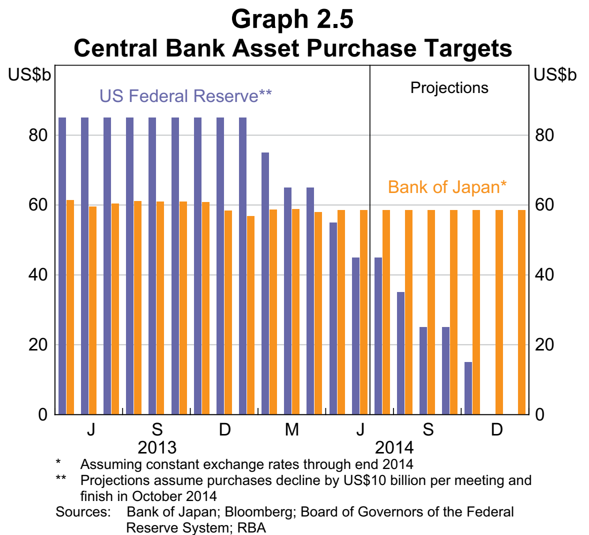
In contrast, the Bank of Japan (BoJ) has continued to expand its balance sheet rapidly, in line with the guidance given in April 2013. With asset purchases by the US Federal Reserve having been scaled back

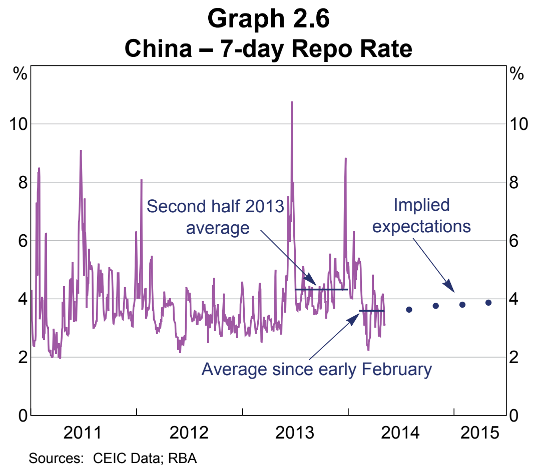
in recent months, the BoJ is now purchasing more assets than the Fed (Graph 2.5). Market pricing suggests that investors are not fully convinced that the BoJ will meet its target of sustainably raising inflation to 2 per cent, leading to a widespread expectation that the BoJ will expand its monetary stimulus in coming months. However, the BoJ maintains that it will reach this target in 2015, and that no further stimulus is required at this point.

Short-term money market rates in China declined notably in February and have generally remained low since then, despite the People's Bank of China (PBC) withdrawing liquidity over this period (Graph 2.6). The 7-day repo rate reached its lowest level in almost two years in March, following an eight month period of tighter conditions. Market commentators widely believe that the PBC has accommodated lower short-term rates as part of its effort to induce a modest currency depreciation, thereby deterring speculative capital inflows. Pricing of interest rate swaps imply that market participants expect rates to rise over the coming year, but to remain somewhat lower than in the second half of last year.

The Reserve Bank of New Zealand (RBNZ) increased rates by 25 basis points at each of its March and April meetings and signalled that rates need to continue rising to a more neutral setting. The RBNZ cited increasing inflationary pressures and considerable momentum in economic growth for its decisions.

In Denmark, the central bank ceased charging banks to deposit excess funds with it, having imposed a 10–20 basis point fee since mid 2012, in response to a reversal of earlier appreciation pressure on its exchange rate with the euro. The Bank of England (BoE) abandoned quantitative forward interest rate guidance as the unemployment rate fell below 7 per cent. Under the revised qualitative guidance issued in February, the BoE signalled that any rise in policy rates is expected to be gradual and that rates are likely to remain below longer-run norms for a considerable time. Market pricing currently indicates that the first increase in UK rates is expected mid next year, with a further 125 basis points of increase priced in over the subsequent 18 months.





Reduced external pressure has seen a number of emerging market central banks, including Indonesia, India, South Africa and Turkey, cease tightening policy in recent months (Table 2.1). However, the central bank of Brazil continued to tighten policy, raising rates by a further 25 basis points at each of its February and April meetings, though hinted in its most recent statement that it may have now reached the end of its tightening cycle. The central bank of Russia raised rates by 150 basis points in early March, in response to financial market volatility following military and geopolitical tensions between it and Ukraine, and by a further 50 basis points in late

Table 2.1: Monetary Policy

	Policy rate Per cent		Most recent change	Cumulative change in current phase[(a)] Basis points
Euro area	0.25	↓	Nov 13	–125
Japan[(b)]	na		na	
United States	0.125	↓	Dec 08	–512.5
Australia	2.50	↓	Aug 13	–225
Brazil	11.00	↑	Apr 14	375
Canada	1.00	↑	Sep 10	75
Chile	4.00	↓	Mar 14	–125
China[(b)]	na		na	
India	8.00	↑	Jan 14	75
Indonesia	7.50	↑	Nov 13	175
Israel	0.75	↓	Feb 14	–250
Malaysia	3.00	↑	May 11	100
Mexico	3.50	↓	Oct 13	–475
New Zealand	3.00	↑	Apr 14	50
Norway	1.50	↓	Mar 12	–75
Russia	7.50	↑	Apr 14	200
South Africa	5.50	↑	Jan 14	50
South Korea	2.50	↓	May 13	–75
Sweden	0.75	↓	Dec 13	–125
Switzerland	0.00	↓	Aug 11	–275
Taiwan	1.875	↑	Jun 11	62.5
Thailand	2.00	↓	Mar 14	–150
Turkey	10.00	↑	Jan 14	550
United Kingdom	0.50	↓	Mar 09	–525
	Current monthly asset purchases		**Most recent change**	**Assets on balance sheet** Per cent of GDP
United States	$45 billion		Apr 14	25.1
Japan	¥6 trillion		Apr 13	51.2
United Kingdom	0		Jul 12	24.3

(a) Current rate relative to most recent trough or peak
(b) Since April 2013, the Bank of Japan's main operating target has been the money base; China does not have an official policy rate
Sources: RBA; Thomson Reuters; central banks

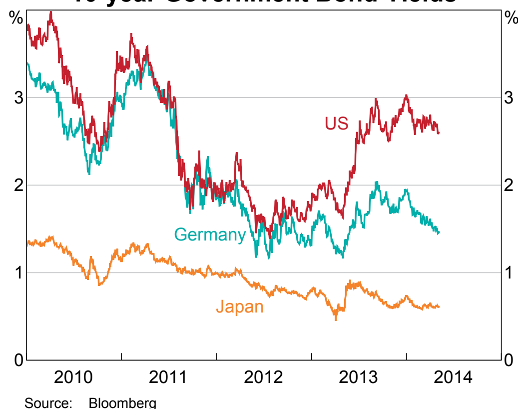
April to stem inflationary pressures ensuing from the depreciation of the rouble. The Ukrainian central bank also raised rates by 300 basis points in April to support its currency.

A number of other central banks in emerging economies have cut rates further in recent months, including Chile, Thailand and Israel.

Sovereign Debt Markets

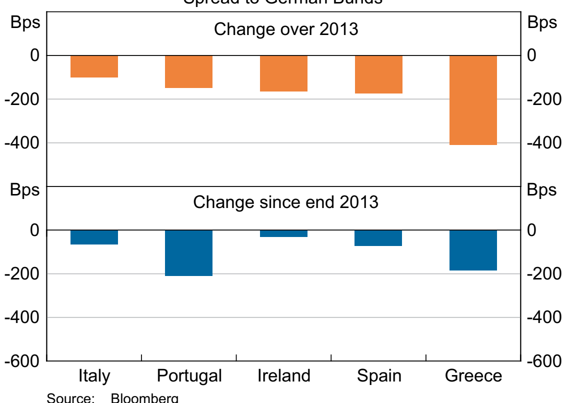
Yields on 10-year US Treasury bonds have been little changed since early February, after falling sharply over January as economic data disappointed and concerns about the outlook for economic growth resurfaced (Graph 2.7). Yields on 10-year Treasuries are currently 45 basis points below their end 2013 level. Yields on German Bunds have continued to

Graph 2.7
10-year Government Bond Yields



Source: Bloomberg

Graph 2.8
Euro Area Periphery 10-year Government Bond Spreads
Spread to German Bunds



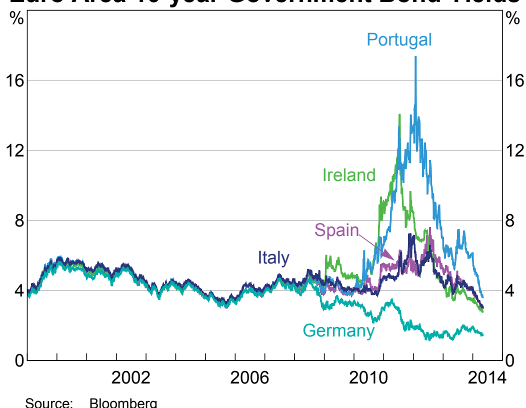
Source: Bloomberg

drift down over recent months to also be around 45 basis points lower than at the end of last year, while yields on 10-year Japanese government bonds have declined modestly. Japanese residents have been repatriating funds invested in foreign bond markets since the start of the year – with selling of US, German, French and UK bonds most pronounced – unwinding half of the increase in their foreign bond holdings over the second half of last year.

Spreads between yields on 10-year bonds issued by euro area periphery governments and those on German Bunds have continued to narrow in 2014, having declined significantly over 2013 (Graph 2.8). The persistent narrowing in spreads has occurred alongside ongoing speculation of further ECB policy action, including asset purchases. As a result, yields on Italian, Irish and Spanish bonds are at their lowest levels in many decades. Yields on Portuguese and Greek bonds are at their lowest levels since 2006 and 2010 (Graph 2.9).

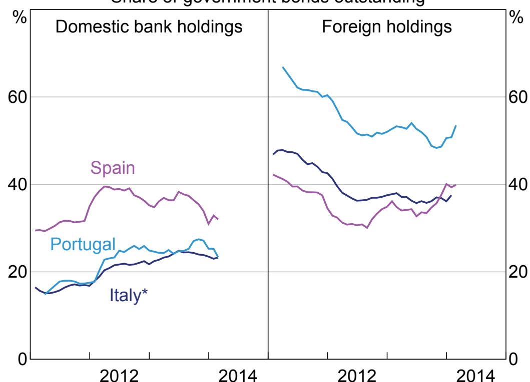
The fall in euro area periphery spreads has occurred alongside an increase in foreign investor demand for such bonds. The share of Spanish sovereign bonds owned by foreigners increased notably over the second half of 2013, unwinding two-thirds of the earlier fall in foreigners' share of outstanding bonds, and foreigners' share of Portuguese debt has also risen since November (Graph 2.10). Foreign participation in recent bond issues by governments of the euro area

Graph 2.9
Euro Area 10-year Government Bond Yields



Source: Bloomberg

Graph 2.10
Holdings of Sovereign Debt Securities
Share of government bonds outstanding



* Domestic bank holdings include holdings of money market funds

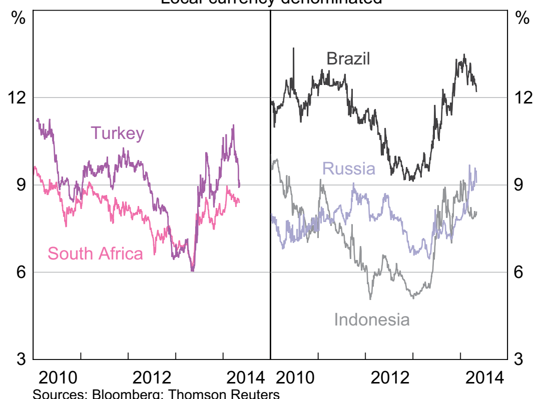
Sources: Bank of Italy; Bank of Portugal; European Central Bank; RBA; Spanish Treasury

periphery has also tended to exceed 75 per cent of total bids lodged. However, foreign holdings of Italian debt have increased only modestly, with their share of outstanding bonds little changed since early 2012.

Rising demand for euro area sovereign bonds has allowed a number of governments to return to bond markets in 2014. The Greek Government issued its first long-term bond in four years in April, with the €3 billion issue seven times oversubscribed. Ireland and Portugal also followed up their January bond issues with further issuance in March and April. Periphery banks that had been excluded from bond markets have also recently been able to raise funds for the first time in many years, with issues by a few Greek banks most notable.

The European Banking Authority (EBA) released details of the adverse scenario underlying its upcoming bank stress tests, in conjunction with the ECB. It assumes that investor demand for all countries' long-term bonds falls sharply, resulting in a large rise in US and German bond yields and an even larger rise in yields on bonds issued by euro area periphery governments. The scenario also assumes a stalling in the process of euro area financial reform and bank balance sheet repair, alongside declining credit quality in some countries. Under such a scenario, it is projected that global demand declines notably, while in the euro area, GDP falls by a cumulative 6½ percentage points and the unemployment rate rises by over 2 percentage points, relative to the baseline forecast over 2014–16. The assumed shocks are also projected to result in a marked rise in short-term euro area interest rates and bank funding costs, while asset prices fall by varying amounts across countries (with declines of around 15–20 per cent for housing, equities and commercial real estate across the euro area). Banks that fail to meet the minimum 5.5 per cent Common Equity Tier 1 (CET1) capital ratio under the adverse scenario would have 9 months to raise additional capital, which can include a limited amount of Additional Tier 1 capital instruments that have unconditional conversion triggers set at a CET1 ratio of 5.5 per cent or higher.

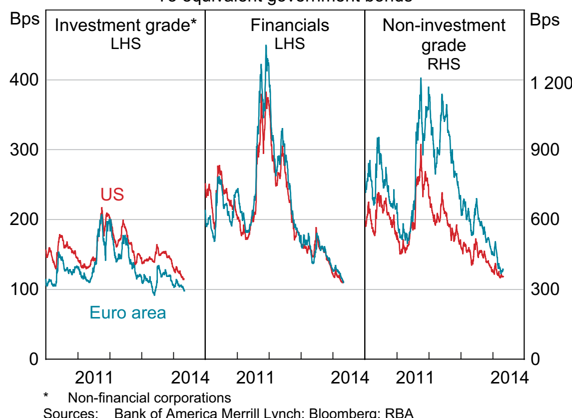
Bond yields in emerging markets have also fallen since early February, after rising sharply over January, as concerns about the external vulnerability of emerging market economies abated (Graph 2.11). These declines have occurred alongside a return of foreign investors to many emerging bond markets. The decline over recent months has been pronounced for Indonesian government bonds, with yields on such securities falling by 110 basis points in response to perceptions that its economy is proving more resilient than previously thought. Yields on Brazilian and Turkish government bonds have declined by a similar amount as investors have scaled back expectations of future Brazilian policy tightening and local elections affirmed support for Turkey's ruling party, while those on South African bonds have also declined; in each case, though, yields remain elevated. The most notable exception has been yields on Russian and Ukrainian bonds, which have both risen by more than 100 basis points following escalating tensions between the two nations.



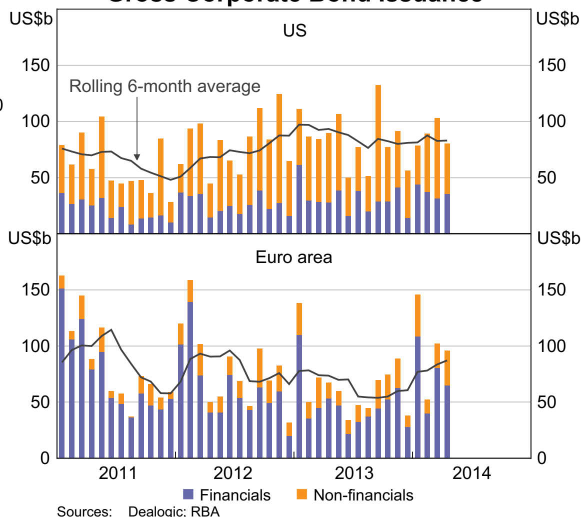
Credit Markets

Corporate bond spreads in the United States and euro area have continued to narrow over recent months, to be around their lowest levels since 2007 (Graph 2.12). Spreads on non-investment grade corporate bonds have narrowed most sharply, particularly in the euro

Graph 2.12
Corporate Bond Spreads
To equivalent government bonds



Graph 2.13
Gross Corporate Bond Issuance

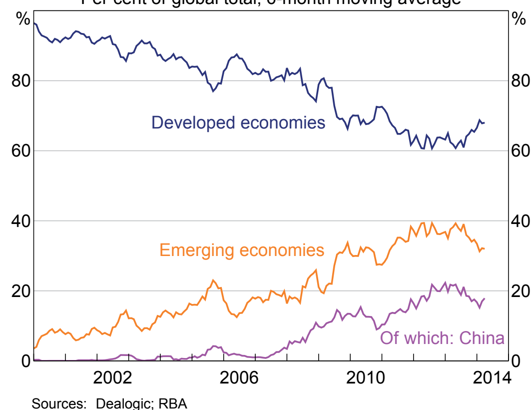


area where such spreads are more than 100 basis points tighter than in early February. Demand for such assets has been supported by the general improvement in investor sentiment, which in the euro area includes speculation that the ECB may decide to undertake a program of purchasing public and private assets. Spreads on non-investment grade bonds in the United States have narrowed by around 50 basis points since early February, while spreads on investment grade corporate bonds in both economies have narrowed modestly.

Banks in the euro area periphery have taken advantage of improved access to markets to issue bonds in recent months. Issuance by euro area non-financial corporations has also increased. Within this, demand for new non-investment grade bonds has been notably strong, as evidenced by French telecommunications company Numericable (rated B+ and BB- by ratings agencies) undertaking the largest ever issue of non-investment grade bonds in April. The company issued almost US$11 billion in medium- and long-term bonds after attracting offers around seven times larger than that. As a result of these and other raisings, total issuance by euro area corporations has picked up notably in 2014 (Graph 2.13). Issuance by US corporations has been steady, having remained more consistent than in the euro area over recent years. The largest issue in recent months has been by Apple, which issued US$12 billion in new investment grade bonds following its then-record US$17 billion issue in April 2013.

Issuance by emerging market corporations remains well below that seen in the first half of last year. As a result, the share of global non-financial corporate bond issuance accounted for by emerging market borrowers has fallen sharply over the past six months, having increased steadily over several years (Graph 2.14). Both the recent decline and the preceding increase have largely been driven by Chinese non-financial corporations.

Graph 2.14
Non-financial Corporate Bond Issuance
Per cent of global total, 6-month moving average



More recently, credit risk in the Chinese corporate bond market has received attention after the first corporate bond default in the onshore Chinese market occurred in early March. The missed coupon payment amounted to a fairly small sum, and the company had been in clear financial distress for some time, but the episode was notable in that authorities did not attempt to ensure support for the company to meet its payment. This raised concerns that the incident may lead to a marked reassessment of credit risk in the corporate bond market, which some believe is underpriced due to the perception that corporate bonds are implicitly guaranteed by the government (though spreads on lower rated bonds are sizeable). Spreads on corporate bonds rated AA- by local credit agencies (which in China are viewed as non-investment grade) widened by around 60 basis points in the weeks following the default.

Equities

Share prices in advanced economies recovered strongly over February, fully unwinding the falls recorded over January as concerns about global economic growth resurfaced, and have since been broadly unchanged (Table 2.2; Graph 2.15). Share prices in most advanced economies are now slightly above their levels at the end of last year. The main exception has been Japan, with the Nikkei 14 per cent lower than at the end of last year. Nonetheless, this follows a rise of almost 60 per cent in 2013, and share prices are still around 70 per cent above their trough in mid 2012.

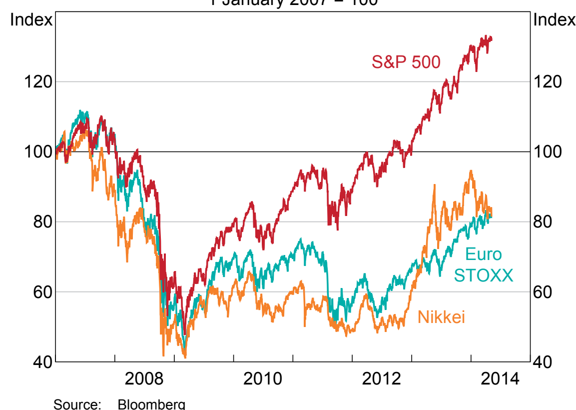
The share prices of US financial institutions have slightly lagged the broader market in recent months despite earnings being generally better than expected in the March quarter. For the six largest US banks, March quarter net income fell by almost US$1 billion compared with the previous quarter and by almost US$2 billion compared with the same period last year, though much of this reflects increases in charges for litigation expenses. Compared with a year earlier, most banks recorded declining revenue from mortgage origination and fixed income and

Table 2.2: Changes in International Share Prices
Per cent

	Over 2013	Since end 2013
United States		
– S&P 500	30	2
Euro area		
– STOXX	20	2
United Kingdom		
– FTSE	14	1
Japan		
– Nikkei	57	–14
Canada		
– TSE 300	10	8
Australia		
– ASX 200	15	2
China		
– China A	–7	–5
MSCI indices		
– Emerging Asia	3	–1
– Latin America	–7	1
– Emerging Europe	–2	–6
– World	**23**	**0**

Source: Bloomberg

Graph 2.15
Major Share Price Indices
1 January 2007 = 100



Source: Bloomberg

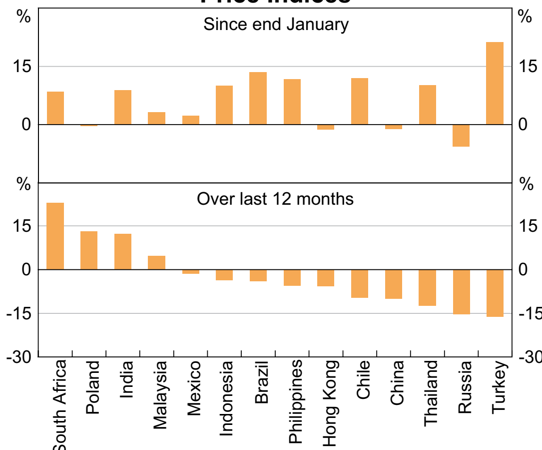
commodity trading, partly offset by strength in several banks' wealth management and equity underwriting businesses and reduced ongoing expenses. European banks' share prices have also risen by slightly less than the broader market, despite profits increasing significantly in the March quarter. Twelve of the largest European banks have reported March quarter income to date, with net income for these banks rising by €24 billion compared with the previous quarter – largely due to one-off changes last quarter – to be in line with the same period last year. Declining revenue from fixed income trading was also a theme of European banks' results, though was more than offset by a fall in loan-loss and litigation provisions and operating expenses.

Share prices in emerging markets have increased roughly in line with those of advanced economies since early February, though with considerable divergence across countries (Graph 2.16). Share prices have risen by 20 per cent in Turkey, and by around 10 per cent across a range of Asian economies, as concerns about the external vulnerability of Indonesia and India abated and foreign investors returned to these markets. Share prices in a number of commodity-producing nations have also rallied strongly, including Brazil, Chile and South Africa, despite commodity prices falling and mining stocks underperforming over much of this period as investor concerns about the Chinese economy increased. In contrast, Chinese stocks continued to underperform other markets. Russian share prices have also fallen heavily over concerns that economic sanctions imposed on it following its incursion into Ukrainian territory will hamper growth. Concerns about the impact of tensions between Russia and Ukraine have also weighed on other markets in eastern Europe, such as Poland and Hungary.

Hedge Funds

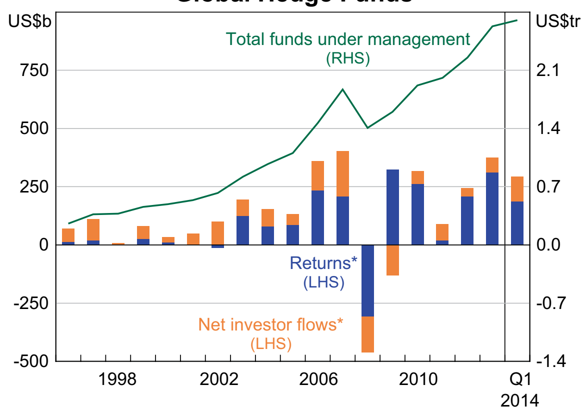
Global hedge funds recorded an average return on investments of 6.5 per cent over the year to the March quarter. Hedge funds significantly underperformed the total return from a balanced portfolio of global bonds and equities over the past year, and have now underperformed for three years, though this has occurred alongside a considerable reduction in the volatility of hedge fund returns. Hedge funds continue to receive new inflows which, combined with positive investment returns, saw funds under management increase by US$75 billion over the March quarter to US$2.7 trillion (Graph 2.17).

Graph 2.16
Change in Emerging Market Equity Price Indices



Source: Bloomberg

Graph 2.17
Global Hedge Funds

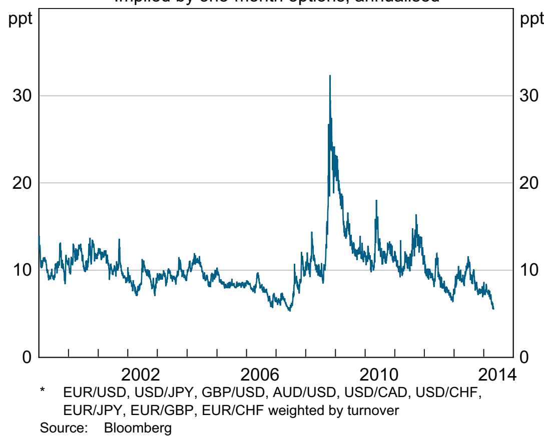


* Annualised for 2014:Q1
Sources: Hedge Fund Research, Inc.; RBA

Foreign Exchange

Conditions in foreign exchange markets have been subdued in recent months, with volatility in the main developed market currency pairs around its multi-year lows (Graph 2.18). Emerging market and other 'growth-sensitive' currencies have generally appreciated against the US dollar since late January/early February, as market participants have reassessed the economic outlook for some countries and, in some cases, revised their assessments of perceived external vulnerabilities.

Graph 2.18
Volatility in Developed Market Currencies*
Implied by one-month options, annualised

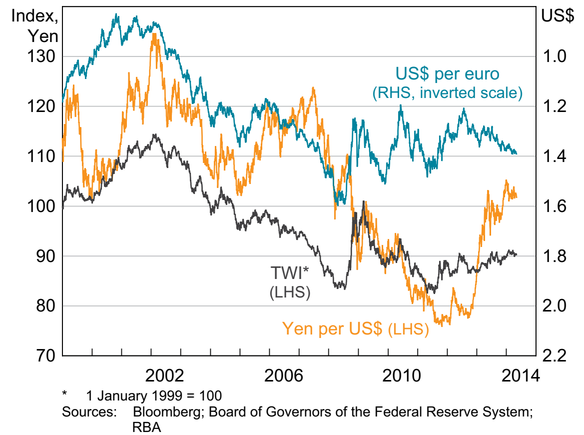


* EUR/USD, USD/JPY, GBP/USD, AUD/USD, USD/CAD, USD/CHF, EUR/JPY, EUR/GBP, EUR/CHF weighted by turnover
Source: Bloomberg

The US dollar has been little changed on a trade-weighted basis over 2014 to date, and indeed is little changed since mid 2012 (Graph 2.19). However, there have continued to be some divergent movements in the US dollar against individual currencies. Over 2014 to date, the US dollar has tended to depreciate against those currencies that it had appreciated most against in 2013, but has appreciated against the currencies of some of its major trading partners, including the Chinese renminbi (RMB) and the Canadian dollar (Table 2.3).

After having depreciated by around 20 per cent against the US dollar and on a trade-weighted basis over 2013, the Japanese yen has since appreciated by 3–4 per cent on both measures. In real effective terms, the yen is around 20 per cent below its average over the past 15 years. The euro has also appreciated

Graph 2.19
US Dollar



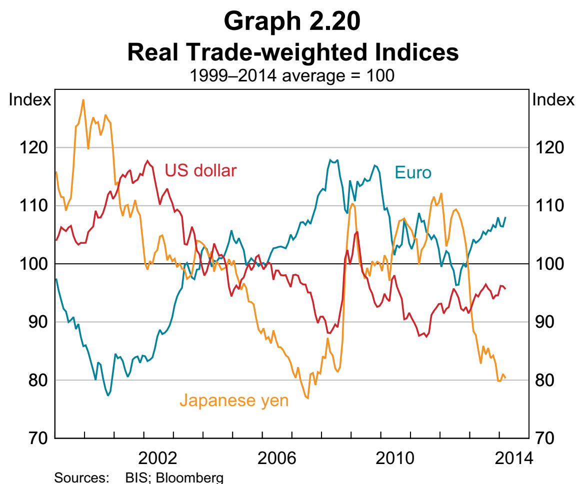
* 1 January 1999 = 100
Sources: Bloomberg; Board of Governors of the Federal Reserve System; RBA

Table 2.3: Changes in the US Dollar against Selected Currencies
Per cent

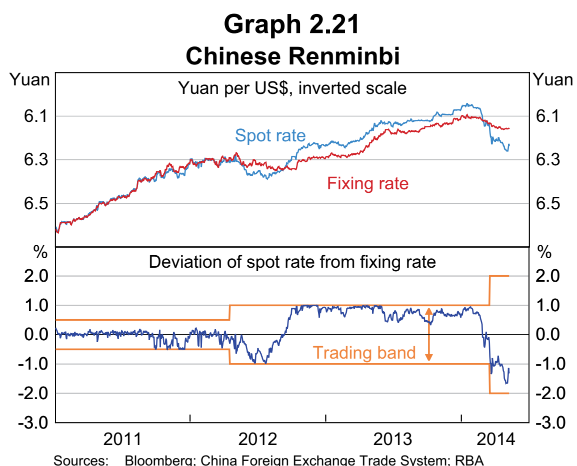
	Over 2013	Since end 2013
Chinese renminbi	–3	3
Canadian dollar	7	3
New Taiwan dollar	3	1
Swedish krona	–1	1
Philippine peso	8	0
South African rand	24	0
Mexican peso	1	–1
Thai baht	7	–1
Singapore dollar	3	–1
Malaysian ringgit	7	–1
European euro	–4	–1
Swiss franc	–3	–2
UK pound sterling	–2	–2
South Korean won	–1	–3
Indian rupee	13	–3
Japanese yen	21	–3
Australian dollar	17	–4
Indonesian rupiah	26	–5
New Zealand dollar	1	–5
Brazilian real	15	–6
TWI	**3**	**0**

Sources: Bloomberg; Board of Governors of the Federal Reserve System

modestly on a trade-weighted basis over 2014 to date, with ECB President Draghi recently noting that further strengthening in the exchange rate could warrant additional monetary policy easing. On a nominal trade-weighted basis, the euro is currently around 4 per cent higher than its average since the introduction of the single currency in 1999, while in real effective terms it is around 8 per cent higher than its average over the same period (Graph 2.20).

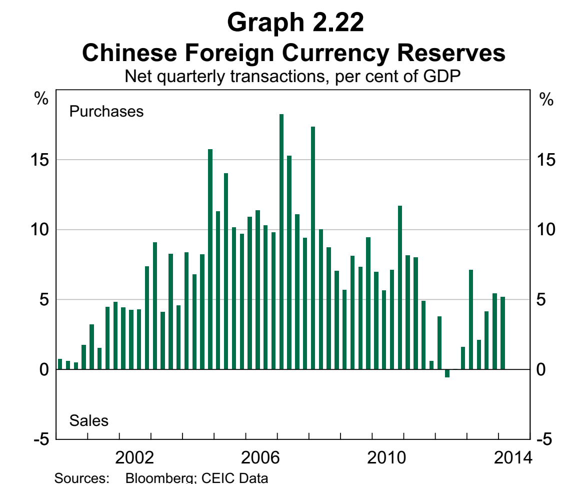


The Chinese RMB has depreciated by around 3 per cent against the US dollar since mid January (Graph 2.21). This follows a period of sustained but gradual appreciation, with the RMB having appreciated by 6 per cent against the US dollar between mid 2012 and early 2014.



Consistent with China's plan to move towards a more market-determined exchange rate regime and, in particular, to encourage greater two-way volatility in the RMB, the PBC widened the RMB's daily trading band against the US dollar to +/-2 per cent around its daily fixing rate (from +/-1 per cent) in mid March. In the month leading up to the widening of the trading band, the RMB spot rate had depreciated by more than the PBC's daily RMB fixing rate. As a result, the spot rate had returned to around the centre of the trading band for the first time since late 2012 by the time the band was widened. The RMB spot rate has since depreciated further, and is currently trading around 1 per cent below the fixing rate.

The stock of Chinese foreign currency reserves increased by US$127 billion (around 3 per cent) over the March quarter, largely reflecting net purchases of foreign currency by the PBC (Graph 2.22; Table 2.4). This is broadly consistent with reports that the PBC intervened in the foreign exchange market in the lead-up to the widening of the RMB's trading band against the US dollar.



Chinese authorities have also continued to take steps towards internationalising the RMB. In particular, the PBC has signed a Memorandum of Understanding with both the Bundesbank and the Bank of England to establish official RMB clearing banks in Frankfurt and London. Once established, these clearing banks will have more direct access to onshore RMB liquidity,

Table 2.4: Gross Foreign Currency Reserves(a)

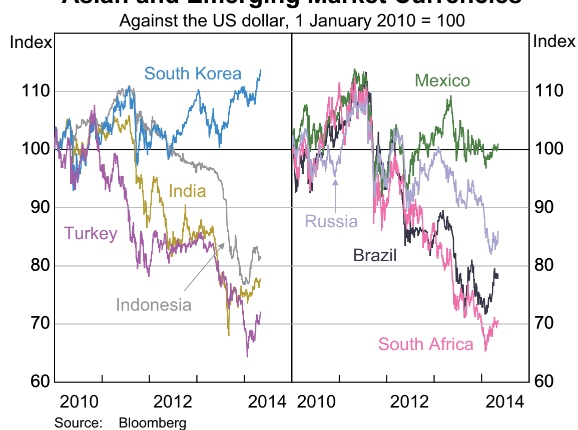
	Percentage change:		Level
	End April 2013 to end December 2013	2014 to date	US$ equivalent (billions) Most recent observation
China	8	3	3 948
Russia	–1	–6	426
Brazil	–5	2	356
South Korea	6	2	344
India	2	5	282
Thailand	–6	0	158
Turkey	–3	–2	107
Indonesia	–7	6	99
South Africa	1	–1	41
Argentina	–25	–10	22
Ukraine	–20	–34	12

(a) Data to end March for China, South Africa, South Korea and Thailand; 25 April for India, Russia and Turkey; end April for Argentina, Brazil, Indonesia and Ukraine

Sources: Bloomberg; CEIC Data; IMF; RBA; central banks

including approval to transact in China's onshore foreign exchange market. In Australia, the Sydney branches of two Chinese banks both launched RMB clearing services in February. As neither of these banks are 'official' clearing banks, they will continue to make use of their existing Mainland Chinese and/or Hong Kong operations to facilitate cross-border RMB transactions. In early April, the Australian Treasurer announced that the RBA and the PBC are working together on potential future RMB clearing and settlement arrangements in Sydney.

Other Asian and emerging market currencies have generally appreciated against the US dollar since late January/early February, with the appreciation more marked for those currencies that had experienced the most pronounced depreciation pressure in mid to late 2013 (Graph 2.23). Nevertheless, most of these currencies remain 10–15 per cent below their end April 2013 levels, with the notable exception of the South Korean won, which has appreciated by 8 per cent against the US dollar over the same period. The recent appreciation of most Asian and emerging market currencies has coincided with improvements in some of these countries' economic outlooks and/or modest reassessments by market participants of their perceived external vulnerabilities.



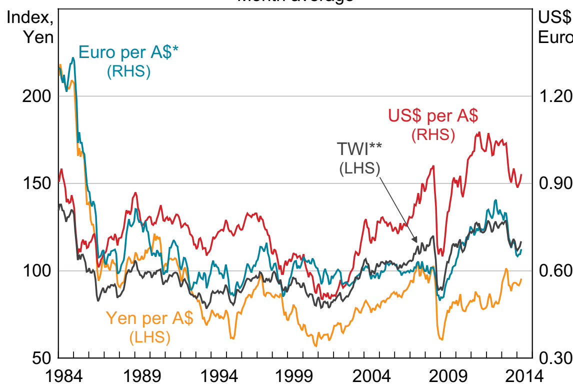
The key exception to the general trend of appreciation against the US dollar has been the Ukrainian hryvnia, which has depreciated by around 30 per cent since the end of 2013 in response to the geopolitical tensions and related concerns about the country's ability to service its external debt. The Russian rouble has depreciated by around 6 per cent since the beginning of the year, with the scale of the depreciation limited by sizeable foreign exchange market intervention by the Russian central bank. Other Eastern European currencies have been relatively unaffected to date.

Most Asian and emerging market central banks' foreign currency reserves have been little changed or increased modestly over the year to date (Table 2.4). The key exceptions were Argentina and Ukraine, whose reserves declined by 15–30 per cent over the March quarter, while Russia recorded a US$23 billion (5 per cent) decline in its foreign currency reserves over the same period. In all three cases, the declines reflected episodes of greater-than-usual sales of foreign currency by the local central banks to support their respective currencies. More recent data indicate that foreign currency sales in Russia and Argentina have since returned to more normal levels.

Australian Dollar

The Australian dollar has appreciated by 4–5 per cent on a trade-weighted basis and against the US dollar since the previous *Statement* (Graph 2.24; Table 2.5). While the recent appreciation against the US dollar has been evident for a broad range of other currencies that had depreciated significantly over mid to late 2013, the Australian dollar has also been supported by improving local economic data. Although the Australian dollar is still around 10 per cent below its recent peak in April 2013, it nevertheless remains 16 per cent above its post-float average in nominal trade-weighted terms and around 30 per cent above its post-float average in real trade-weighted terms.

Graph 2.24
Australian Dollar
Month average



* Deutsche Mark spliced for observations prior to 1999
** Indexed to post-float average = 100
Sources: Bloomberg; RBA; Thomson Reuters

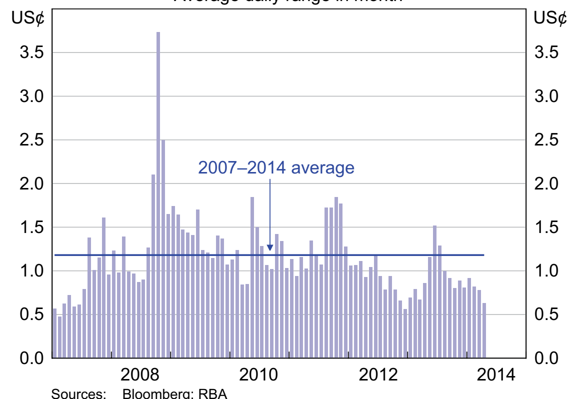
Table 2.5: Changes in the Australian Dollar against Selected Currencies
Per cent

	Over 2013	Since end 2013
Chinese renminbi	–17	8
Canadian dollar	–8	7
US dollar	–14	5
South African rand	6	4
Thai baht	–8	4
Singapore dollar	–11	3
Malaysian ringgit	–8	3
European euro	–18	3
Swiss franc	–16	3
UK pound sterling	–16	2
South Korean won	–15	2
Indian rupee	–3	1
Japanese yen	4	1
Indonesian rupiah	8	–1
New Zealand dollar	–13	–1
TWI	**–11**	**4**

Sources: Bloomberg; RBA

Consistent with developments in other currency markets, intraday volatility in the Australian dollar has moderated further, with the average intraday trading range for the AUD/USD exchange rate in April around multi-year lows (Graph 2.25).

Graph 2.25
Intraday Range in AUD/USD
Average daily range in month

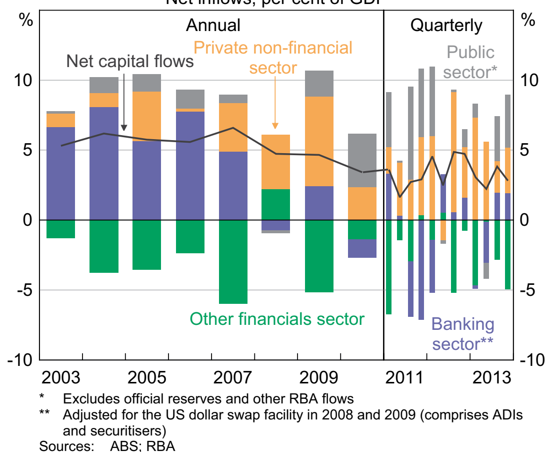


Sources: Bloomberg; RBA

Capital Flows

Net capital inflows to the Australian economy were directed primarily to the public sector in the December quarter 2013. There was also a small net inflow to the private sector as a whole, with net inflows to the private non-financial sector and the banking sector largely offset by continued net outflows from other financial institutions (which include superannuation and other types of investment funds) (Graph 2.26).

Graph 2.26
Australian Capital Flows
Net inflows, per cent of GDP

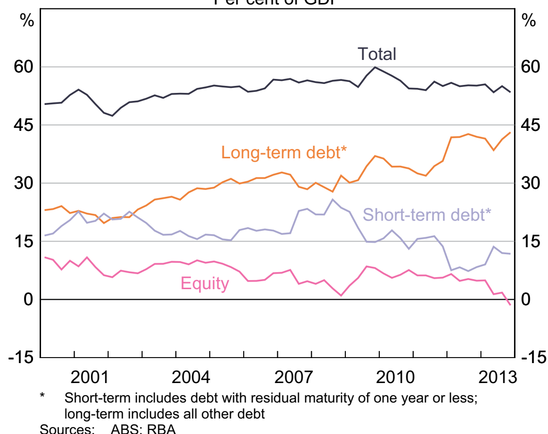


* Excludes official reserves and other RBA flows
** Adjusted for the US dollar swap facility in 2008 and 2009 (comprises ADIs and securitisers)
Sources: ABS; RBA

The net inflow to the public sector largely reflected foreign purchases of national government debt, but also included inflows to the state and local government sector. Net foreign purchases of Commonwealth Government securities (CGS) were again roughly proportional to net issuance in the quarter, leaving the foreign ownership share of CGS little changed at around 67 per cent. The net inflow to the state government sector contributed to a slight increase in the foreign ownership share of state government securities to 31 per cent, although this share remains low compared with recent years.

Within the private sector, a sizeable share of the net inflow of capital to non-financial firms continued to be directed to the mining sector. The net inflow to the banking sector largely reflected foreign purchases of Australian bank bonds. In contrast, the net outflow from the non-bank financial sector was driven by an increase in overseas equity investment by Australian institutions. This increase in foreign equity investment contributed to Australia recording a small net equity asset position for the first time since the series commenced in 1988, with positive valuation effects related to the depreciation of the Australian dollar in mid to late 2013 also playing a role (Graph 2.27). ✢

Graph 2.27
Net Foreign Liabilities
Per cent of GDP



* Short-term includes debt with residual maturity of one year or less; long-term includes all other debt
Sources: ABS; RBA