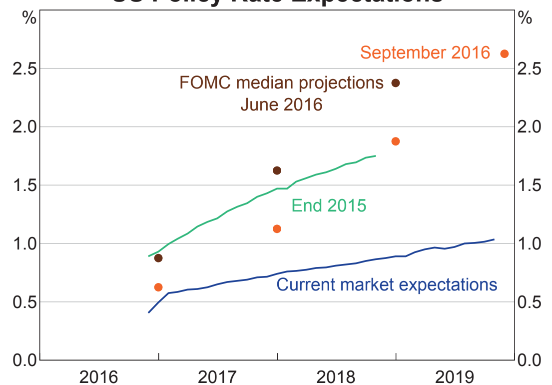
2. International and Foreign Exchange Markets

Global financial markets continue to be influenced by evolving expectations for monetary policy in the major economies. In recent months, sovereign yields have risen following a scaling back of expectations for further monetary stimulus in most of the larger developed economies; market-based measures of expected inflation have also increased, which may reflect a more balanced outlook for the risks around global inflation. Yields in the United Kingdom have increased particularly sharply, and the UK pound has depreciated, as concerns have risen that the United Kingdom may lose access to the European Single Market as a consequence of its exit from the European Union. Movements in other major currencies have been modest. Major market equity prices have generally traded in narrow ranges following a relatively quick recovery from the declines recorded in the wake of the UK referendum. Emerging market share prices have seen strong increases over recent months.

Central Bank Policy

The US Federal Open Market Committee's (FOMC's) target range for the federal funds rate remains at 0.25–0.50 per cent. However, the FOMC has indicated that the case for a rate increase has continued to strengthen in recent months and minutes from the September meeting noted that the decision not to increase the target range at that meeting was a close call. Recent FOMC discussions have centred on the degree of unutilised capacity in the labour market and the risk that delaying tightening might lead to a need for a faster rate of increases in the future. FOMC members now anticipate a 25 basis point increase in the policy range in December 2016, broadly in line with market pricing, which currently implies around a four-in-five chance of such an increase. Forecasts for increases in the policy rate in 2017 have been scaled back by FOMC members. However, members still expect 50 basis points of increases during 2017, in contrast to market expectations for at most 25 basis points of tightening (Graph 2.1).

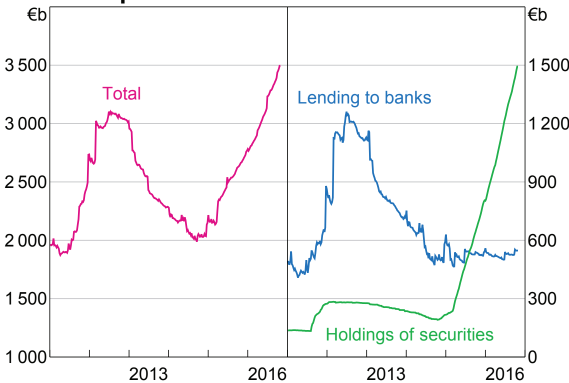
Graph 2.1
US Policy Rate Expectations



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

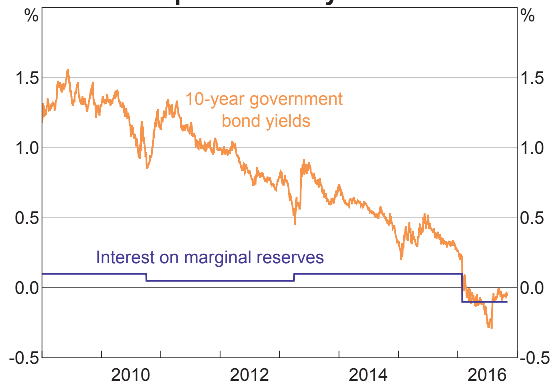
The European Central Bank (ECB) has left policy unchanged since it announced additional stimulus measures at its March meeting, though in September it tasked committees with evaluating options to ensure the continued smooth implementation of its asset purchase program. The evaluation could result in the modification of some of the existing constraints to asset purchases (such as minimum yield requirements, holding limits and the requirement for purchases to be proportional to members' contributions to the ECB's capital), which

seem likely to become increasingly binding in the months ahead. The ECB's current asset purchase program is scheduled to run until at least March 2017; market observers expect an extension, either at the current pace of €80 billion per month or with a gradual tapering of purchases. At the same time, the take-up of ECB term funding by euro area banks continues to be modest; allotments at the second targeted long-term refinancing operation in September were €34 billion (net of repayments), similar to the €31 billion of net borrowing at the June quarter allotment, compared with a total capacity of €1.6 trillion (Graph 2.2).

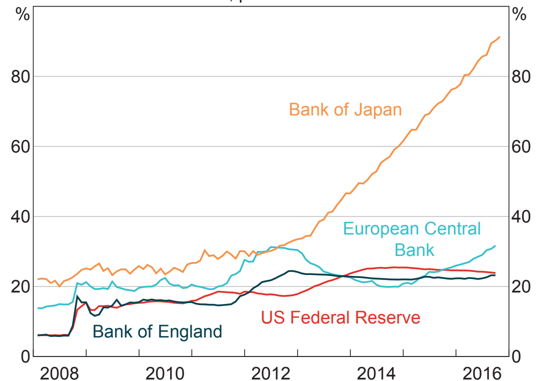


Sources: European Central Bank; Thomson Reuters

The Bank of Japan (BoJ) announced the results of its comprehensive review of monetary policy and changes to its monetary policy framework at its September meeting. The BoJ committed itself to exceeding the 2 per cent inflation target for some period of time to increase inflation expectations. To achieve this, the BoJ announced that the targeted expansion of the monetary base has been replaced with a new framework: Quantitative and Qualitative Monetary Easing with Yield Curve Control. To exert control over the yield curve, the BoJ will use the interest rate on marginal reserves held at the central bank (which it left unchanged at –0.1 per cent) to control short-term interest rates and the purchase of Japanese government bonds (JGBs) to control long-term interest rates. In particular, it will target a 10-year JGB yield of around zero per cent, which is consistent with its current level (Graph 2.3). The BoJ has announced that it expects purchases of JGBs to continue at around the current rate of ¥80 trillion per year (Graph 2.4).



Sources: Bank of Japan; Bloomberg



Sources: Central banks; Thomson Reuters

The Bank of England (BoE) lowered its policy rate by 25 basis points to 0.25 per cent at its August meeting, noting downside risks to economic activity owing to uncertainty generated by the result of the UK referendum, and suggested that this is close to the effective lower bound, which it believes is slightly above zero. It also announced several additional monetary stimulus programs. It will purchase £60 billion of UK government bonds

over the 6 months beginning August 2016 and £10 billion of sterling-denominated corporate bonds over the 18 months beginning September 2016. Eligible corporate bonds are those issued by companies the BoE considers to be making a 'material contribution' to the UK economy and include a number of foreign companies with a UK presence. The BoE also announced a Term Funding Scheme, which provides funding to banks at the BoE's policy rate to help reinforce the transmission of monetary policy to the real economy; banks have borrowed £1.3 billion under this scheme so far. The BoE anticipates that the total take-up of the scheme will be around £100 billion.

In China, the volatility and level of interbank interest rates increased a little in recent months in part because of unexpected changes to the maturity of the People's Bank of China's (PBC's) open market operations. The PBC has left system-wide reserve requirement ratios unchanged since a 50 basis point reduction in February and has held benchmark interest rates steady so far this year.

A number of other central banks have also eased policy in recent months, largely in response to ongoing low inflation (Table 2.1). The Reserve Bank of New Zealand reduced its policy rate by 25 basis points to 2.0 per cent, noting a persistently high exchange rate. The Central Bank of Russia, the Reserve Bank of India and the Central Bank of Brazil all lowered policy rates in response to declines in inflation. Bank Indonesia also lowered its target rate by 25 basis points, noting weaker-than-expected growth and low inflation. In contrast, the Bank of Mexico raised its policy rate by 50 basis points, its fourth increase this year, to counter inflationary pressures stemming from a depreciation of the exchange rate.

Table 2.1: Monetary Policy

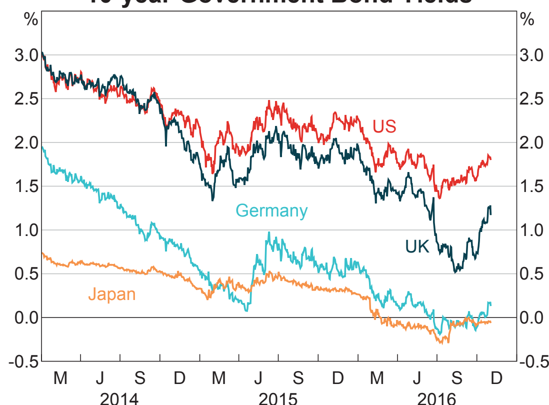
	Policy rate Per cent		Most recent change
Euro area[a]	–0.40	↓	Mar 16
Japan[a]	–0.10	↓	Jan 16
United States[b]	0.375	↑	Dec 15
Australia	1.50	↓	Aug 16
Brazil	14.00	↓	Oct 16
Canada	0.50	↓	Jul 15
Chile	3.50	↑	Dec 15
India	6.25	↓	Oct 16
Indonesia	4.75	↓	Oct 16
Israel	0.10	↓	Feb 15
Malaysia	3.00	↓	Jul 16
Mexico	4.75	↑	Sep 16
New Zealand	2.00	↓	Aug 16
Norway	0.50	↓	Mar 16
Russia	10.00	↓	Sep 16
South Africa	7.00	↑	Mar 16
South Korea	1.25	↓	Jun 16
Sweden	–0.50	↓	Feb 16
Switzerland[b]	–0.75	↓	Jan 15
Thailand	1.50	↓	Apr 15
Turkey	7.50	↓	Feb 15
United Kingdom	0.25	↓	Aug 16

(a) Marginal rate paid on deposits at the central bank
(b) Midpoint of target range
Sources: Central Banks; RBA; Thomson Reuters

Sovereign Debt Markets

After declining sharply over the first six months of the year, yields on 10-year sovereign bonds in major developed markets have increased over the past few months (Graph 2.5). The recent rises partly reflect an unwinding of the risk aversion that affected markets in the wake of the UK referendum result in late June, as well as a scaling back of expectations for further monetary stimulus in the euro area, Japan and the United Kingdom. Better economic data, higher commodity prices and, relatedly, rising market-based measures of inflation expectations have also contributed. The rise in major market yields has seen the share of government bonds trading with a negative yield decline from around 30 per cent in early July to around 20 per cent currently.

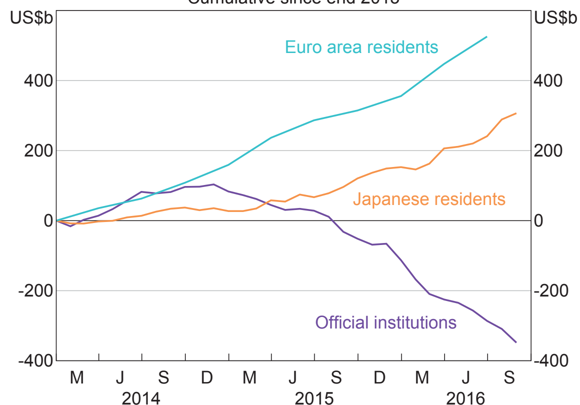
Graph 2.5
10-year Government Bond Yields



Source: Bloomberg

Graph 2.6
Foreign Purchases of US Bonds

Cumulative since end 2013



Sources: Bloomberg; European Central Bank; Ministry of Finance Japan; RBA; Thomson Reuters

Yields in the United Kingdom have seen the largest moves among the major government bond markets this year. After falling sharply in the wake of the UK referendum result, yields rose as market-based inflation expectations increased following a significant depreciation of the UK pound and comments by Prime Minister May that suggested that fiscal policy will be eased.

In the United States, better economic data and rising expectations of an increase in interest rates by the US Federal Reserve in December have been reflected in higher US Treasury yields.

Following the BoJ's announcement of its yield curve control policy in September, yields on 10-year JGBs have remained close to the BoJ's new target of around zero per cent for these yields.

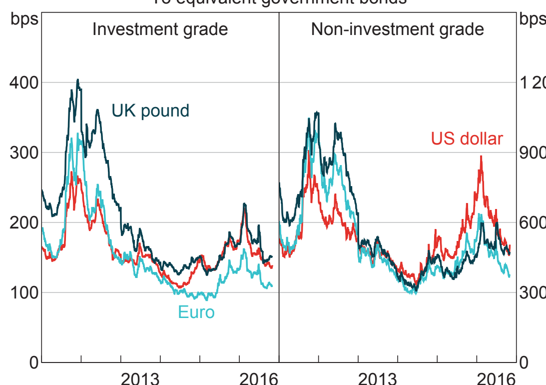
Japanese and euro area residents have continued to make sizeable purchases of foreign bonds over 2016, particularly of US securities, although purchases by Japanese residents have slowed of late (Graph 2.6). These purchases have occurred in response to the ongoing influence of BoJ and ECB purchases in their domestic sovereign bond markets. However, total foreign resident holdings of US bonds have been broadly unchanged, reflecting an offsetting reduction in foreign official institution holdings over that period, consistent with a reduction in reserves held by several oil-exporting nations and China.

Spreads on bonds issued by governments in the European periphery over German Bunds were generally little changed in recent months. Spreads on Italian government bonds have widened relative to those on Spanish government bonds over 2016, reflecting the possibility of a 'no' vote at the December constitutional referendum in Italy, which could lead to a repudiation of the reform agenda of Prime Minister Renzi. Spreads on Portuguese government bonds have widened over the year, reflecting concerns surrounding the country's fiscal position and weak growth prospects.

Movements in yields on local currency-denominated emerging market sovereign bonds have been mixed in recent months, but yields are generally lower over 2016. Brazilian government bond yields have declined by around 45 basis points since the previous *Statement*, reflecting the official appointment of a new president in late August, a lower inflation outlook, the announcement of economic reforms and a reduction in the Central Bank of Brazil's policy rate. In contrast, local currency-denominated Philippine government bond yields have risen by around 85 basis points over the period, largely reversing the sharp decline in yields that followed the country's presidential election in May.

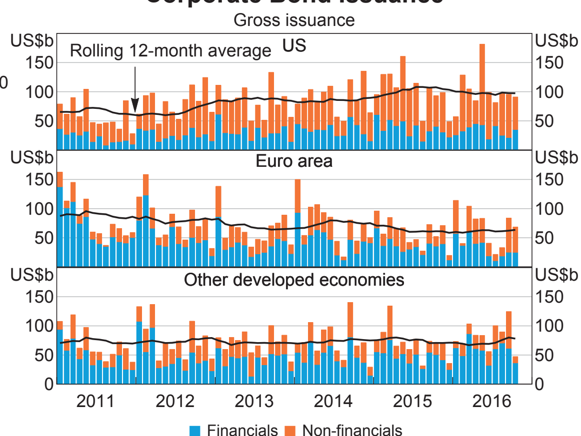
Credit Markets

Borrowing costs for investment grade corporations in major bond markets have generally risen over the past few months, but by less than the increase in sovereign bond yields, and spreads remain around historically low levels (Graph 2.7). Borrowing costs for non-investment grade corporations in these markets have fallen, partly reflecting the prevalence of resource-related issuers that benefit from higher commodity prices. In the United States, forecasts of higher earnings have supported debt serviceability expectations and contributed to flows into corporate bond funds. In the euro area, continued corporate bond purchases by the ECB have supported the market; having purchased around €8 billion per month since June, the ECB now holds €38 billion of corporate bonds, which is a small share of the investment grade market.



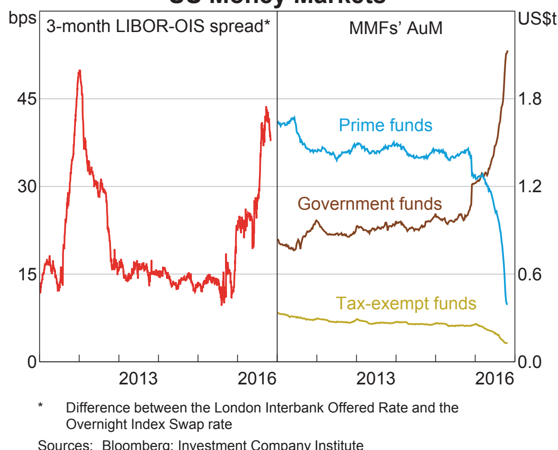
In the United Kingdom, the sharp rise in sovereign yields has resulted in overall borrowing costs rising for UK firms, despite spreads on UK corporate bonds narrowing following the BoE's announcement of its Corporate Bond Purchase Scheme. The program started on 27 September and to date the BoE has purchased around £2 billion of corporate bonds. The pace of these purchases has so far been faster than implied by the BoE's policy of buying £10 billion over 18 months.

Gross corporate bond issuance has remained strong, particularly in the US, with firms borrowing in part to roll over existing debt at lower interest rates, and to finance share buybacks and acquisitions (Graph 2.8). Corporate bond issuance in the euro area and the United Kingdom picked up following the announcement of corporate bond purchase programs by the respective central banks. The first two euro-denominated non-financial sector corporate bonds with negative yields to maturity were issued in August. Issuance by corporations in other developed economies has also been robust. Issuance by financial firms in US dollars has been particularly strong, partly due to the lower cost of issuing in US dollars and swapping the proceeds into local currencies. Yen-denominated issuance by Japanese firms, though a small segment of the global corporate bond market, has also increased over the past few months.



In recent months, short-term bank funding rates in US dollar markets rose to their highest levels since 2012 due to the implementation of US money market fund (MMF) reforms (Graph 2.9). As a result of these reforms, the value of assets under management (AuM) of prime MMFs (those that lend to banks) has declined by more than US$1 trillion, or around 70 per cent, over the past year as some prime funds have switched their classification

Graph 2.9
US Money Markets

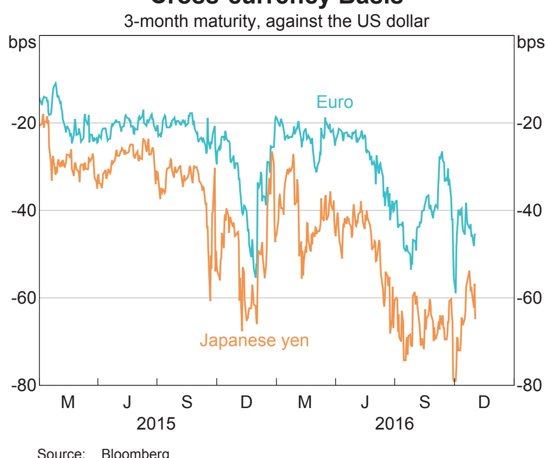


* Difference between the London Interbank Offered Rate and the Overnight Index Swap rate

Sources: Bloomberg; Investment Company Institute

Graph 2.10
Cross-currency Basis

3-month maturity, against the US dollar



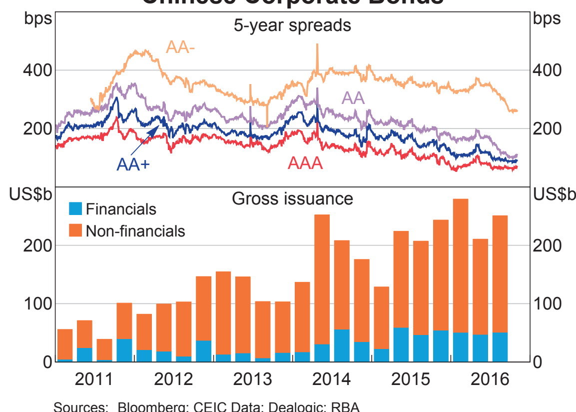
Source: Bloomberg

to government-only funds and investors have reallocated away from prime funds. Since the reforms came into effect, spreads on short-term bank funding have narrowed slightly and the weighted-average maturity of prime funds' assets has increased modestly.

The premium for borrowing US dollars in exchange for yen in short-term foreign exchange swap markets fell to its lowest level since June alongside the slowing in the pace of foreign bond purchases by Japanese residents in recent weeks (Graph 2.10). The cost of borrowing in exchange for euros has increased and rose sharply around the end of the September quarter, in part as concerns rose about the capital position of European banks.

Gross and net bond issuance by Chinese corporations increased in the September quarter, following slower issuance in the June quarter (Graph 2.11). Investor sentiment towards the corporate bond market in China has improved, despite the first liquidation of a company that had issued bonds in the interbank market. A number of factors have contributed to the improved sentiment, including: a lower frequency of missed bond payments over recent months; reports of increased government support for a number of state-owned companies; the release of draft regulations that would restrict the ability of banks' wealth management products to invest funds in

Graph 2.11
Chinese Corporate Bonds



Sources: Bloomberg; CEIC Data; Dealogic; RBA

asset classes considered riskier than corporate bonds; and a recovery in commodity prices, which has supported firms in a number of industries. Correspondingly, spreads on lower-rated corporate bonds over Chinese government bonds have narrowed significantly over recent months and spreads on highly rated bonds have been stable around historical lows, although corporate leverage in China remains at a high level.

In late September, Chinese authorities approved the first deal (for Sinosteel, a central government-owned enterprise) under a new debt-for-equity swap program, which aims to reduce the debt burden of companies in overcapacity industries. In

October, the State Council released guidelines for reducing corporate leverage, including encouraging the use of a number of measures that have been implemented recently, such as debt-for-equity swaps, mergers and acquisitions, bankruptcies and the securitisation of non-performing loans. The guidelines for debt-for-equity swaps specify that companies that have little prospect of returning to profitability are prohibited from participating and that the process is to be market oriented.

Spreads on US dollar-denominated bonds issued by other emerging market corporations over US Treasuries have mostly continued to narrow in recent months, in line with changes in sovereign bond spreads. Bond issuance by emerging market corporations has increased recently, but remains low over the year.

Equities

Global equity prices recovered quickly from the declines recorded in the wake of the UK referendum and have subsequently mostly traded in narrow ranges (Graph 2.12). Periods of volatility stemming from changes in the outlook for monetary policy have been brief. In the United States, share prices have been supported by expectations that aggregate corporate earnings in the September quarter will increase for the first time since mid 2015, although uncertainty around the outcome of the US presidential election has weighed on share prices more recently. European and Japanese share prices have benefited from the continued highly accommodative monetary policy of their respective central banks. Purchases of exchange-traded funds by the BoJ have provided additional support in Japan. However, equity prices in both markets remain below their levels at the start of the year (Table 2.2). In the United Kingdom, share prices have more than recovered from their sharp falls following the UK referendum result, despite concerns around the ramifications of a possible exit by the United Kingdom from the European Single Market, and have outperformed most other developed markets over the year. Internationally focused firms in particular have outperformed, reflecting the sharp depreciation of the UK pound.

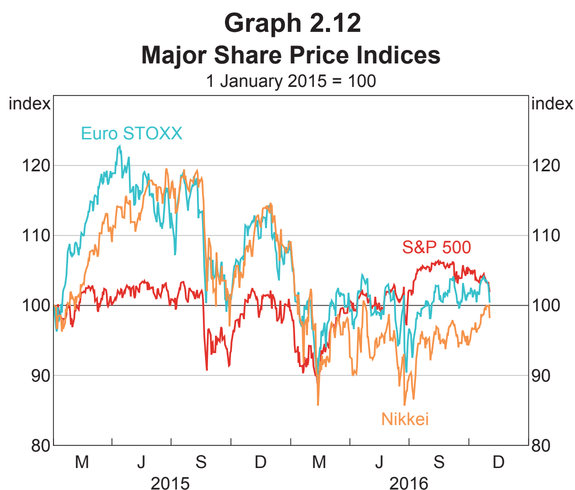
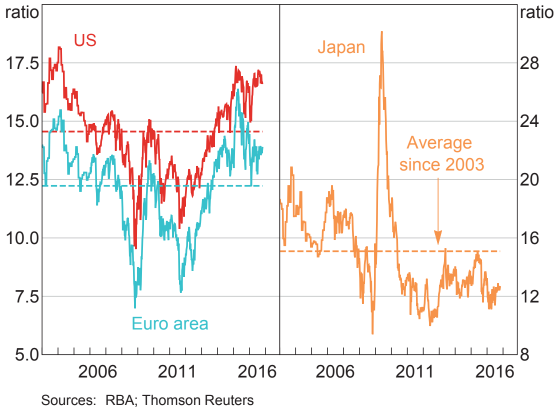


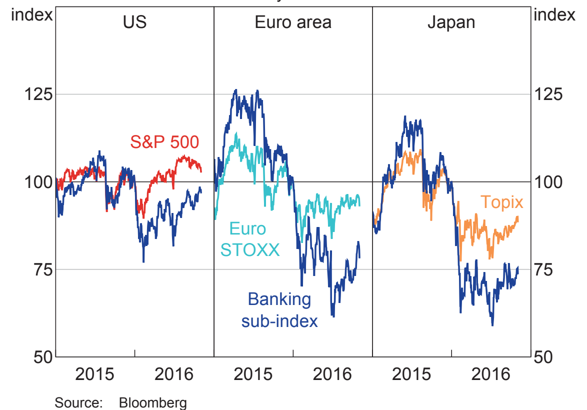
Table 2.2: Changes in International Share Prices
Per cent

	2016 to date
United States – S&P 500	3
Euro area – STOXX	–7
United Kingdom – FTSE	10
Japan – Nikkei	–10
Canada – TSE 300	12
Australia – ASX 200	–1
China – MSCI All China	–7
MSCI indices	
– Emerging Asia	8
– Latin America	27
– Emerging Europe	7
– World	**2**

Source: Bloomberg

In the United States, and to a lesser extent in the euro area, valuation measures such as forward price-to-earnings ratios remain relatively high, though levels are within historical ranges (Graph 2.13). The elevated valuations in part reflect historically low interest rates, as well as expectations of an extended recovery in corporate earnings.

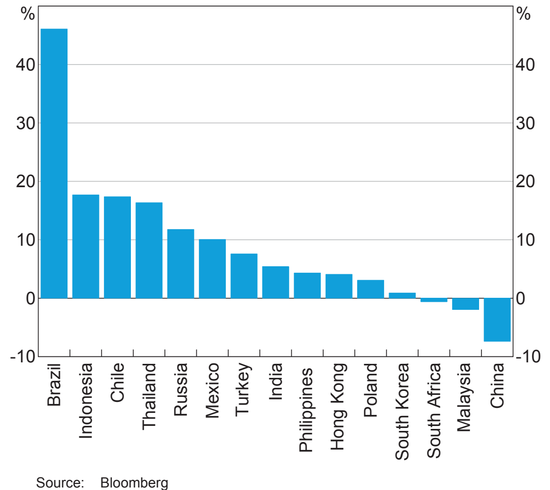




Japanese valuation measures remain below their long-run average.

Bank share prices in the United States and euro area have outperformed their respective broader indices since recovering from their lows that followed the UK referendum result, but remain below their levels at the start of the year (Graph 2.14). This outperformance occurred despite a period of concern around the size of potential fines that may be imposed on Deutsche Bank by the US Department of Justice. September quarter profits for the major US and European banks were generally higher than in the same period last year and were higher than analysts' forecasts, because of an increase in client fixed income and currency trading activity, which rose due to volatility following the UK referendum and ahead of the implementation of US money market fund reforms.

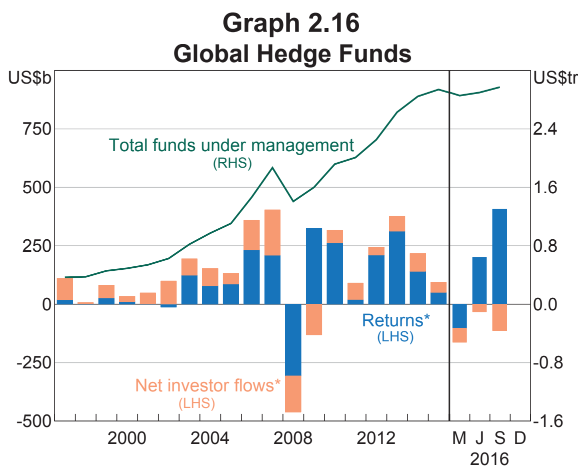
Share prices in emerging markets have risen slightly over recent months and have outperformed most developed markets since the beginning of the year (Graph 2.15). Chinese equity prices have risen recently, but are still below their levels at the beginning of the year following sharp declines in early 2016. Hong Kong share prices have benefited from a significant increase in southbound investment via the Shanghai-Hong Kong Stock Connect scheme; differences between share prices



in Hong Kong and on the mainland A-share market of Chinese companies with a dual listing (the AH Premium) have narrowed to their lowest level since December 2014. Share prices in Brazil have risen by around 45 per cent since the beginning of the year, outperforming other developed and emerging equity markets owing to a rise in commodity prices, reduced political uncertainty and a more favourable economic outlook. Over 2016, emerging market equity indices have increased by about 10 per cent, driven by Latin America and, to a lesser extent, emerging Asia.

Hedge Funds

Global hedge funds recorded an asset-weighted return on investment of 2.1 per cent over the September quarter, underperforming a balanced portfolio of global bonds and equities (Graph 2.16). Equity-focused funds posted the strongest returns, particularly those that invest in the technology, healthcare and energy sectors. Funds focused on emerging markets also experienced strong returns, led by funds targeting emerging Asia. Investors made net withdrawals from hedge funds for the fourth consecutive quarter, but positive investment returns resulted in funds under management increasing by more than US$70 billion over the September quarter to US$3 trillion.



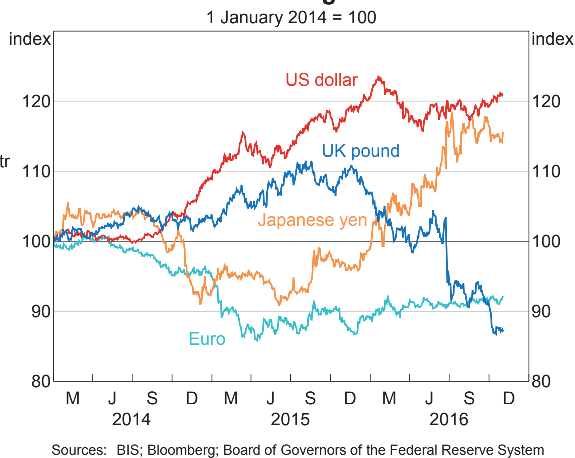
* Annualised for 2016 data

Sources: Hedge Fund Research, Inc.; RBA

Foreign Exchange

The current and expected policies of the major central banks continue to be an important driver of foreign exchange markets. In addition, the UK pound, which depreciated significantly after the June referendum result to leave the European Union, has depreciated further over the past month in response to developments around the timing and nature of the United Kingdom's exit. Despite a pick-up in volatility in the UK pound, observed and forward-looking measures of volatility in other developed market currency pairs remain around their long-run averages.

The US dollar is little changed on a trade-weighted basis (TWI) since the start of the year, but in the intervening period has moved in line with changing expectations about the timing and extent of policy rate increases by the FOMC (Graph 2.17). The euro has appreciated against the US dollar and on a trade-weighted basis since the beginning of 2016, alongside a scaling back of expectations for further monetary stimulus by the ECB (Table 2.3).



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

The UK pound has continued to depreciate over the past few months despite economic data releases having been stronger than expected. In particular, the currency has depreciated since early October, prompted by a speech by Prime Minister May that set out a broad timetable for the exit and intimated that it was likely to involve the United Kingdom leaving the European Single Market. The UK pound has depreciated by 16 per cent against the US dollar and by 15 per cent on a trade-weighted basis from its level immediately prior to the UK referendum in late June, and is now around its lowest level on a trade-weighted basis in over 100 years (Graph 2.18). Realised volatility also increased very notably on 7 October when the UK pound depreciated sharply early in the Asian trading session; the currency

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

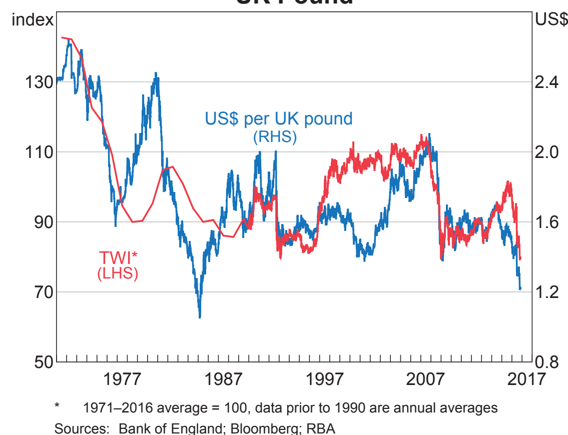
	Over 2015	2016 to date
UK pound sterling	6	20
Mexican peso	17	13
Swedish krona	8	6
Chinese renminbi	5	4
Philippine peso	5	3
Indian rupee	5	1
European euro	11	–2
South Korean won	8	–2
Singapore dollar	7	–2
Malaysian ringgit	22	–3
Swiss franc	1	–3
Thai baht	10	–3
Canadian dollar	19	–3
New Taiwan dollar	4	–4
Australian dollar	12	–5
Indonesian rupiah	11	–5
New Zealand dollar	14	–6
Russian rouble	24	–12
Japanese yen	0	–14
Brazilian real	50	–18
Trade-weighted index	**10**	**0**

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

quickly retraced some of the decline to finish the day only around 1 per cent lower against the US dollar. While the trigger for the initial decline remains unclear, the depreciation occurred when liquidity was low.

The Japanese yen rose significantly over the first half of 2016, and in July reached its highest level in almost three years against the US dollar and on a trade-weighted basis. Thereafter, the yen has tended to move sideways, with the appreciation being arrested by expectations that a further easing of monetary policy would be announced following the BoJ's comprehensive review of monetary policy in late September. In the event, the easing was less than expected but the yen has continued to move

Graph 2.18
UK Pound



* 1971–2016 average = 100, data prior to 1990 are annual averages
Sources: Bank of England; Bloomberg; RBA

broadly sideways, in part because of the widening in the differential between yields on Japanese bonds and those of other major sovereigns.

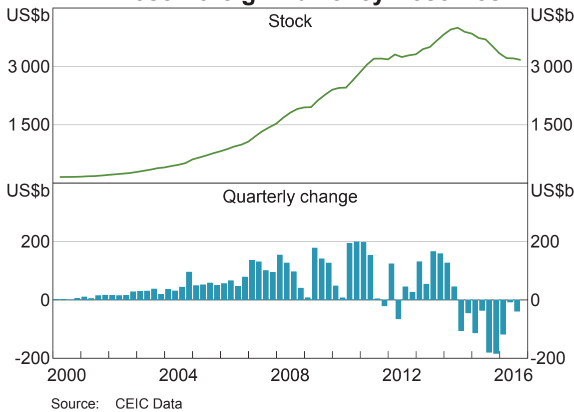
The Chinese renminbi (RMB) has been little changed on a trade-weighted basis over recent months. This partly reflects some easing of concerns about the near-term economic outlook in China, which had weighed on the RMB over much of the previous year; the RMB remains 7 per cent lower on a trade-weighted basis since the start of the year and 10 per cent lower since its August 2015 peak (Graph 2.19). Against the US dollar, the RMB has depreciated by 4 per cent since the start of the year, to trade at its lowest level since 2010. Realised volatility in the RMB against the US dollar has declined since March, reflecting the gradual nature of the RMB's recent depreciation.

The value of the PBC's foreign currency reserves has been broadly stable since February, at around US$3.2 trillion (29 per cent of GDP) following sharp declines in the year to the March quarter 2016 (Graph 2.20). On 1 October the RMB entered the basket of currencies that determine the value of the IMF's Special Drawing Right (SDR) following the IMF Executive Board's decision in November 2015. The RMB has a weight of around 11 per cent in the basket, the third largest weight after the US dollar and the euro. In September, the World Bank issued the first tranche of bonds denominated in SDRs (but

Graph 2.19
Chinese Exchange Rates

* 2007 average = 100
Sources: BIS; Bloomberg; RBA

Graph 2.20
Chinese Foreign Currency Reserves

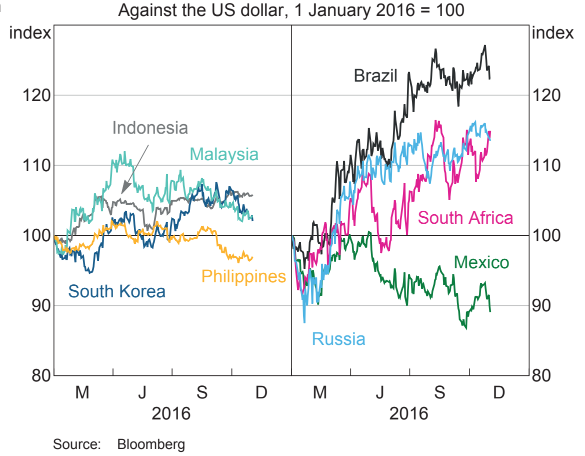


Source: CEIC Data

settled in RMB) in the onshore Chinese market, after becoming the first entity to receive approval from the PBC to issue such bonds.

Over the past few months, most emerging market currencies have been little changed or have depreciated against the US dollar (Graph 2.21). Increased expectations of further monetary policy tightening in the United States have weighed on emerging market currencies, and depreciations have generally been more pronounced in countries experiencing domestic political uncertainty. One exception has been the Russian rouble, which has appreciated by 5 per cent against the US dollar alongside stronger oil prices, to be around 30 per cent higher than its trough in

Graph 2.21
Asian and Emerging Market Currencies



Source: Bloomberg

mid January. Over the past few months, volatility in emerging market currencies declined to be around its average level since 2010.

The Mexican peso has depreciated a little against the US dollar since the previous *Statement* but has experienced large swings in its value over the period, reflecting developments in the US presidential election campaigns (Graph 2.22). From a longer-run perspective, the peso has depreciated by around 25 per cent against the US dollar since the end of 2014, consistent with the currency's use as a hedging and speculative instrument for risk in emerging market economies, uncertainty around US monetary policy and lower oil prices over this period.

The gross foreign currency reserves of most emerging market economies have been little changed or have increased slightly since the end of June (Table 2.4). The increase in Indonesia's gross foreign currency reserves since the end of June has partly reflected Bank Indonesia intervening to stem appreciation pressure in the rupiah following increased capital inflows, including as a result of the implementation of a tax amnesty program.

Australian Dollar

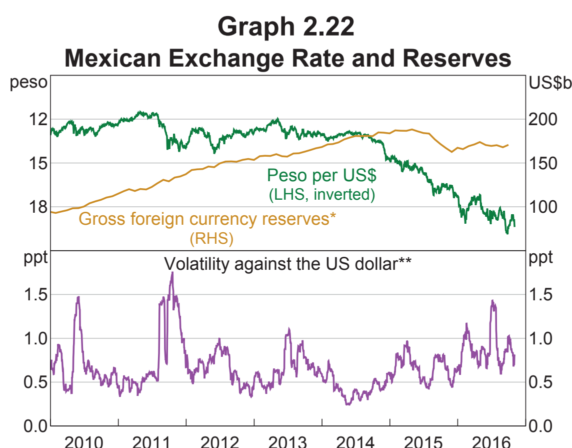
Since its most recent trough in late May, the Australian dollar has gradually appreciated and is now 7 per cent higher against the US dollar and on

Table 2.4: Gross Foreign Currency Reserves[(a)]

	Percentage change since:		Level
	End September 2015	End June 2016	US$ equivalent (billions)
China	–10	–1	3 166
Saudi Arabia	–15	–3	545
Taiwan[(b)]	2	1	437
South Korea	2	2	368
Brazil	1	1	354
Hong Kong	7	1	354
India	5	1	342
Russia	2	0	316
Singapore	1	2	251
Thailand	16	1	171
Mexico	–1	1	171
Indonesia	14	6	109
Turkey	0	0	100
Malaysia	5	1	90

(a) Data to end August for Mexico and Saudi Arabia; to end September for China, Hong Kong, Indonesia, Singapore, South Korea, Taiwan and Thailand; to 14 October for India, Malaysia, Russia and Turkey; and to 21 October for Brazil
(b) Foreign exchange reserves (includes foreign currency and other reserve assets)
Sources: Bloomberg; CEIC Data; Central Banks; IMF; RBA

Graph 2.22
Mexican Exchange Rate and Reserves



* Data to end September 2016
** Rolling 22-day standard deviation of daily percentage changes
Sources: Bank of Mexico; Bloomberg; IMF; RBA

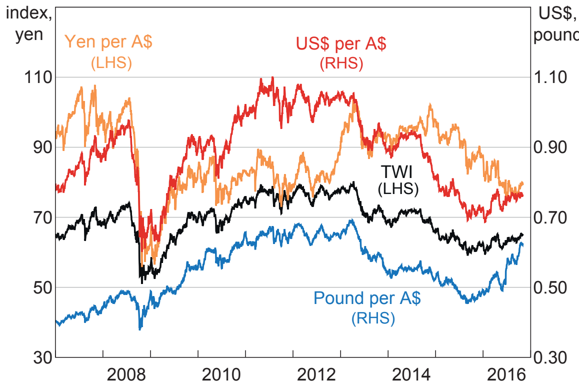
a trade-weighted basis (Table 2.5; Graph 2.23). The appreciation over this period has occurred alongside a rise in the terms of trade, and largely reflects appreciations against the RMB and, to a lesser extent, the UK pound. However, the Australian dollar remains around 30 per cent lower against the

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

	Over 2015	2016 to date
UK pound sterling	–6	26
Chinese renminbi	–7	9
Indian rupee	–7	6
US dollar	–11	5
European euro	–1	3
South Korean won	–4	3
Singapore dollar	–5	3
Malaysian ringgit	9	2
Swiss franc	–10	2
Thai baht	–2	2
Canadian dollar	6	2
Indonesian rupiah	–1	–1
New Zealand dollar	2	–1
South African rand	19	–9
Japanese yen	–11	–9
Trade-weighted index	**–6**	**4**

Sources: Bloomberg; RBA

Graph 2.23
Australian Dollar



Sources: Bloomberg; RBA

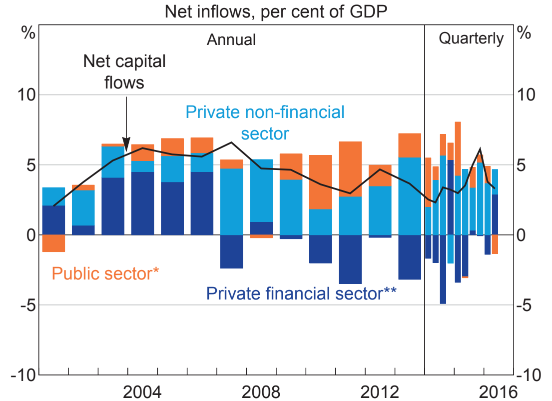
US dollar and around 20 per cent lower on a trade-weighted basis than its peak in the first half of 2013.

Capital Flows

Net capital inflows to the Australian economy were equivalent to 3½ per cent of GDP in the June quarter, around 1 percentage point lower than the average of net capital inflows over the past 15 years (Graph 2.24). Consistent with the pattern of capital flows observed since 2007, recent net capital inflows have largely reflected flows to the private non-financial sector. Most of these net inflows were directed to the mining sector (which is majority foreign owned). Net inflows to the general government sector have continued at a moderate pace over recent years. Notwithstanding this, the foreign ownership share of Australian Government Securities declined by around 4½ percentage points (to around 60 per cent) over the first half of 2016, as net issuance was larger than foreign purchases; the foreign ownership share of state government debt increased slightly.

Australia's lower-than-average current account deficit, corresponding to the below-average capital inflows, has partly reflected a longer-term decline in the net income deficit. The net income

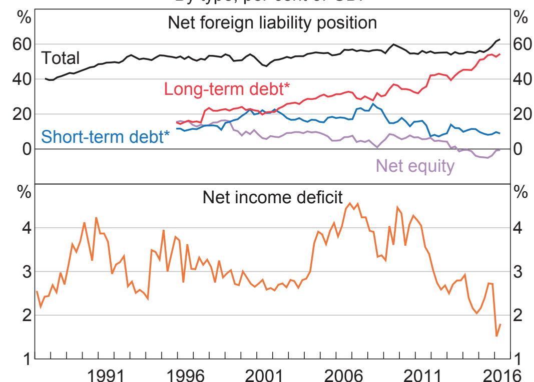
Graph 2.24
Australian Capital Flows
Net inflows, per cent of GDP



* Excludes official reserves and other RBA flows
** Adjusted for US dollar swap facility in 2008 and 2009
Sources: ABS; RBA

deficit, which largely comprises payments made on Australia's net foreign liabilities, has fallen to historically low levels. In the past few years, the decline has reflected higher receipts from foreign equity assets owned by Australian entities. Australia's net foreign liability position increased to a little over 60 per cent of GDP at the end of the June quarter, with recent increases mostly reflecting valuation effects (Graph 2.25). ✢

Graph 2.25
Net Foreign Liabilities
By type, per cent of GDP



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