1. The International Environment

Globally, inflation was very high in 2022 but appears to have peaked around the end of the year. Energy prices have eased from their mid-2022 peaks. In addition, inflation in the prices of many traded goods has slowed from its earlier, rapid pace as the global supply and demand for these goods has become more balanced. However, inflation in consumer services – which has been driven by strong demand and strong wages growth – is still too high for overall inflation to be consistent with central banks' targets. Wages growth appears to be slowing, but it is still around its fastest pace in at least a decade.

Global growth moderated over 2022, and is forecast to remain well below its historical average over the next two years, constrained by higher interest rates in most economies. The impact of rate rises on global growth and inflation is likely to build through 2023. Nonetheless, the near-term outlook has improved a little over recent months after China dropped most of its COVID-19 restrictions earlier than expected, inflation showed clearer signs of peaking and global gas prices declined.

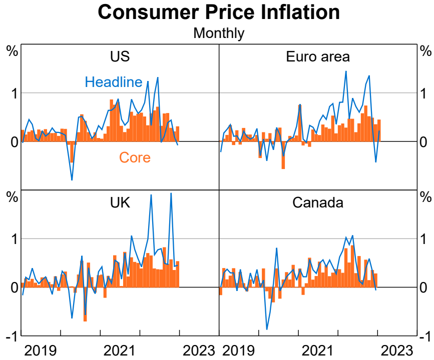
Central banks in many countries have slowed the pace of increase in policy rates, noting early signs of a moderation in the growth of economic activity and the rate of inflation and citing the risk of over-tightening given the lags in the transmission of monetary policy. Market participants' expectations for the path of policy rates in most advanced economies over the next 12 months are little changed since three months ago, but expectations for interest rates beyond the end of 2023 have declined slightly. Medium and longer term government bond yields have also declined, corporate bond spreads have narrowed and equity prices have increased. The US dollar has depreciated on a trade-weighted (TWI) basis alongside declines in US Government bond yields relative to those of other major advanced economies and more positive risk sentiment since the start of the year.

Globally, inflation remains too high, but is now moderating

Year-ended inflation remains high and well in excess of central banks' targets in most advanced economies. However, both headline and core inflation have moderated over recent months, suggesting that inflation may have peaked late in 2022 (Graph 1.1). Inflation in high-income Asian economies has also moderated from well-above target levels, although it never reached the high levels seen in other advanced economies.

Graph 1.1

Consumer Price Inflation



Sources: RBA; Refinitiv

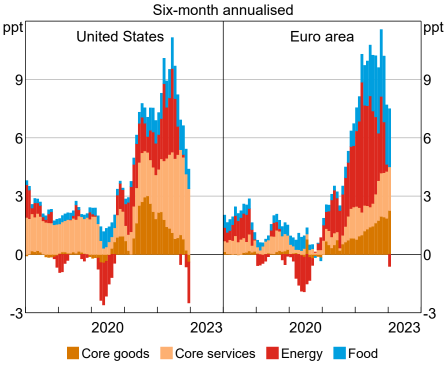
Much of the recent moderation in inflation has occurred because energy prices have declined over recent months (Graph 1.2). The fall in petrol prices late last year resulted from slowing global growth and the gradual resolution of supply disruptions brought about by embargoes on imports of Russian oil. Global gas prices have also retraced much of their mid-2022 increase, as unseasonably warm weather during the European winter has reduced demand there. Lower energy demand has in turn reduced pressure on thermal coal markets and on electricity prices in Europe. Despite these developments, global energy prices remain high in historical terms. Food price inflation also remains high, but agricultural commodities prices (such as wheat) have declined slightly over recent months (Graph 1.3).

Importantly, there has also been a clear easing in core inflation in most advanced economies. This has been driven by a fall in core goods inflation – at least outside of the euro area – as strong investment in global manufacturing over recent years has helped to increase the supply of goods at the same time as the growth of global demand has eased. Inventories have been rebuilt, backlogs of work have declined and reported delivery times have shortened (Graph 1.4). Shipping costs – which have contributed significantly to rising final prices of goods in recent years – have fallen sharply and are now back around pre-pandemic levels. The improvement in the global supply of goods was temporarily disrupted by the spread of COVID-19 in China, which impaired the ability of firms based in China to produce and deliver. This was evident in the official Purchasing Managers' Index (PMI) measure of delivery times, which lengthened in November and December before resolving in January.

By contrast, services prices continue to rise quickly and are now the main driver of overall inflation in advanced economies. Housing services inflation has been a key component of this and is yet to show signs of easing. That said, advertised rents have decreased in recent months in the United States, and this should

Graph 1.2

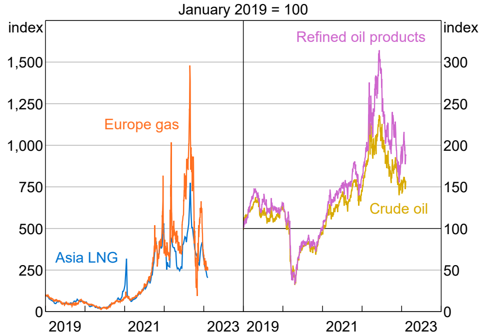
Contributions to Headline Inflation



Sources: BLS; Eurostat; RBA; Refinitiv

Graph 1.3

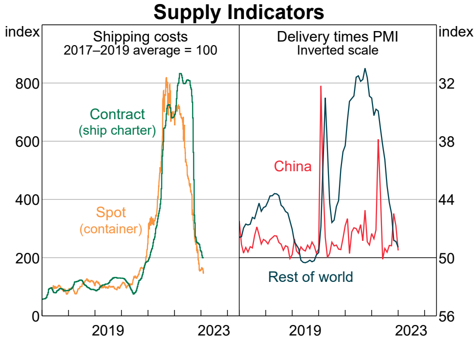
Energy Commodity Prices



Sources: Bloomberg; RBA; Refinitiv

Graph 1.4

Supply Indicators



Sources: RBA; Refinitiv

result in inflation of rents moderating over the second half of 2023. Inflation in other services remains strong but is no longer increasing. The outlook for inflation in these prices depends significantly on the evolution of wages.

Wages growth is very strong, but has peaked in some countries

Wages growth remains around its fastest pace in at least a decade across a range of advanced economies. However, it is no longer rising in most economies and has started to moderate in the United States and Canada, especially in retail, hospitality and other services industries where it had previously been very strong (Graph 1.5). In the United States, the slowdown is also evident in advertised wages, which have historically provided an early indication of future wages growth. These early signs of moderation are consistent with a modest reduction in labour demand across economies, as seen in declining (though still high) job vacancies (Graph 1.6).

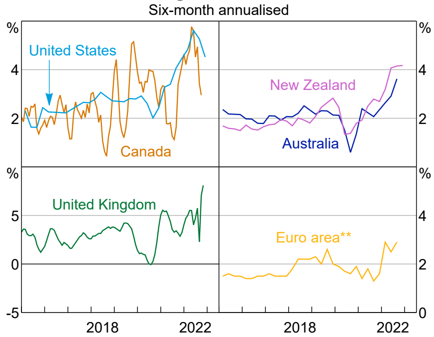
Growth in advanced economies has slowed further

GDP growth in advanced economies was modest over the second half of 2022, well below the strong outcomes seen in 2021 (Graph 1.7).

Graph 1.5

Wages Growth*

Six-month annualised



* Labour cost indices used where available; average earnings for Canada and the United Kingdom (compositionally controlled for the United Kingdom prior to April 2022 and for Canada throughout).

** Year-ended.

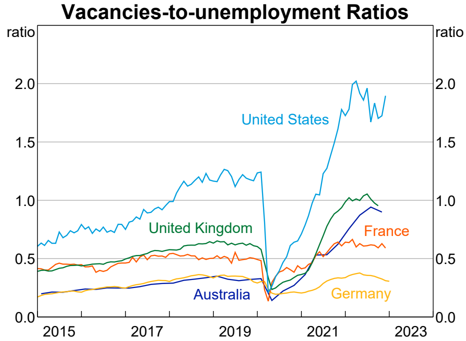
Sources: BoE; RBA; Refinitiv; Statistics Canada

The slowing in growth was broadly in line with the projections made by forecasters in mid-last year. Growth in North America and high-income east Asia has been stronger than in Europe; GDP was broadly flat in the euro area in the December quarter.

Consumption has continued to grow in most advanced economies, albeit at a more moderate pace than previously, despite high prices reducing real disposable incomes (Graph 1.8). Spending on services has continued to recover, while the level of goods spending has either stabilised or fallen only moderately. Evidence from central banks' liaison suggests that consumers are, however, increasingly trading down to lower priced products and are more

Graph 1.6

Vacancies-to-unemployment Ratios

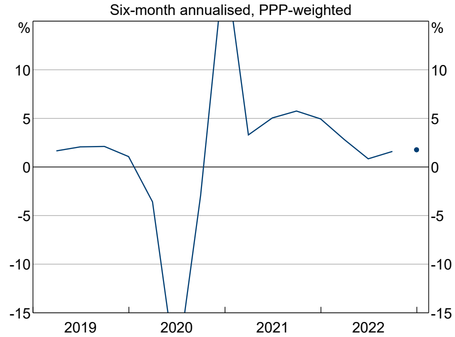


Sources: RBA; Refinitiv

Graph 1.7

Advanced Economies – GDP Growth*

Six-month annualised, PPP-weighted



* Trough is -21 per cent in the June quarter of 2020 and peak is 21 per cent in the December quarter of 2020; forecasts are used for December quarter of 2022 where actual data are unavailable.

Sources: CEIC Data; Consensus Economics; RBA; Refinitiv actively seeking the best prices as real incomes are squeezed.

With consumption growing more quickly than income, household saving rates have declined further across advanced economies, and particularly in the United States. In the United States and Canada, saving rates have declined across most income groups; survey data suggest that the falls have been largest for the lowest income households. Outside the United States, consumption could be supported by further declines in saving rates, which remain above or around pre-pandemic averages. In addition, households still have large savings buffers accumulated in 2020 and 2021, which could support consumption growth for some time.

The demand for housing has continued to weaken considerably in the second half of 2022 in response to sharp rises in interest rates. In the United States and the United Kingdom, housing starts fell by over 15 per cent over the second half of the year. Housing prices have also fallen significantly in several advanced economies and stopped growing in others. By contrast, growth in business investment has only slowed moderately. Investment intentions have declined over recent months but are only a little lower than the historical average.

Weaker goods demand in advanced economies and a slowing in the pace of inventory rebuilding has resulted in falling export volumes from east Asia (Graph 1.9). Exports from China and several other east Asian economies have declined significantly in recent months, unwinding part of the very strong growth recorded in the two years prior. The decline in exports in the region has been concentrated in electronic equipment.

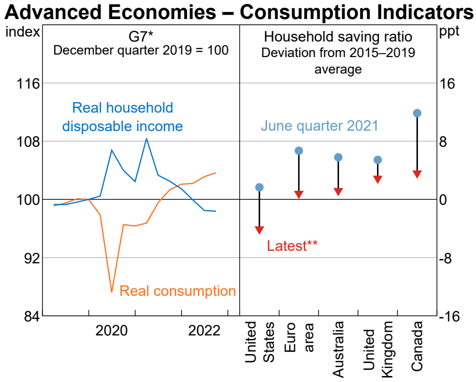
Employment growth has also moderated in most advanced economies (Graph 1.10). However, it is still stronger than growth in the working-age population in many of these economies and surveyed measures of hiring intentions remain high. Unemployment rates remain near generational lows, but indicators of labour market tightness – such as vacancy rates and other survey measures – have declined from the historical highs of mid-2022.

Chinese authorities have lifted most COVID-19 restrictions …

COVID-19 has spread quickly throughout China since November. Confirmed cases escalated most notably from mid-December, after the authorities abruptly removed most COVID-19 restrictions, and hospitalisations and deaths

Graph 1.8

Advanced Economies – Consumption Indicators

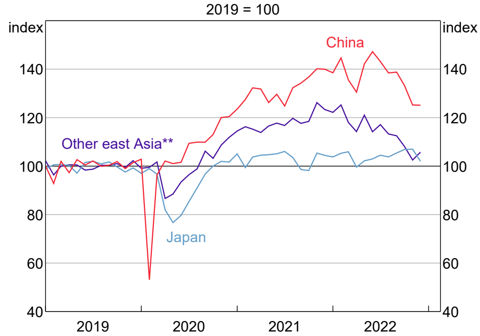


* PPP-weighted.
** September quarter 2022 for euro area, Australia, United Kingdom and Canada; December 2022 for United States.
Sources: ABS; RBA; Refinitiv

Graph 1.9

East Asia – Export Volumes*

2019 = 100

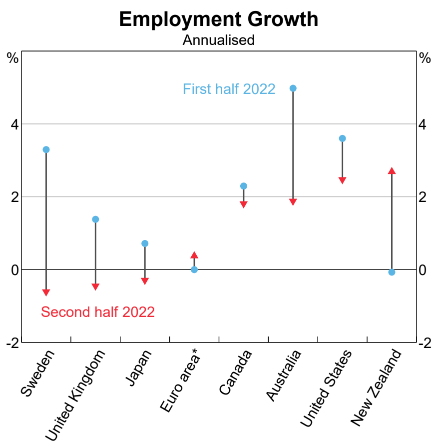


* Deflated using US import price deflator by country.
** PPP-weighted average of South Korea, Taiwan, Singapore and Hong Kong.
Sources: CEIC Data; RBA; Refinitiv

have increased sharply from low levels as a result.

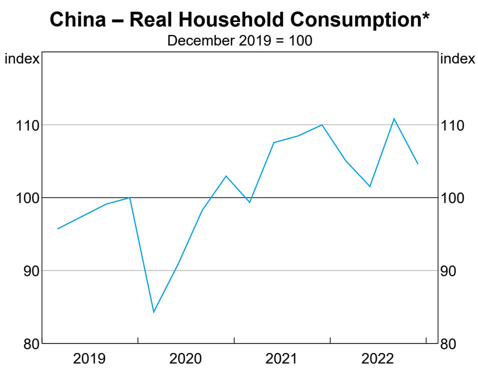
The initial imposition of restrictions in November to contain the spread of COVID-19, and then disruptions caused by widespread sickness in December, contributed to Chinese GDP remaining flat in the December quarter. There was a large fall in household consumption, with spending on services particularly weak (Graph 1.11). Exports also declined in the quarter, but manufacturing and infrastructure investment continued to increase.

Graph 1.10



* Second half 2022 rate is imputed from a sample of euro area countries.
Sources: RBA; Refinitiv

Graph 1.11



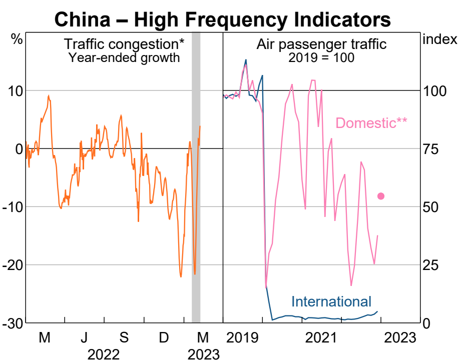
* Urban households only.
Sources: CEIC Data; RBA

High-frequency activity indicators imply Chinese economic activity bounced back sharply in January. Population mobility, as measured by traffic congestion, picked up to be comparable with early-2022 levels in a number of cities before the (pre-pandemic) normal Lunar New Year decline (Graph 1.12). Indicators of service consumption over the Lunar New Year period were also significantly higher than in 2022. Domestic air passenger traffic picked up in December, and timely indicators show this accelerated into January, and the number of people dining out is likewise recovering from the COVID-19 disruptions. International travel has shown early signs of lifting following the removal of quarantine rules for inbound travellers.

… and are focused on supporting growth, including in the property sector

Statements from the Central Economic Work Conference in December – the conference where China's leaders meet to set the economic policy agenda – indicate that authorities are placing more emphasis on stimulating growth than over the past few years, when containing COVID-19, reducing leverage in the property sector and limiting other financial risks were given more prominence. Indications that this is

Graph 1.12



* Smoothed; holiday adjusted in 2022; shaded area represents Lunar New Year holiday period in 2023.
** Dot represents estimate for January using high frequency data.
Sources: CEIC Data; RBA; WIND Information

flowing into a more supportive regulatory policy stance are already emerging. The People's Bank of China (PBC) has also instructed banks to expand lending, and some local governments have received an advanced quota of special purpose bonds.

Given the importance of the property sector for economic activity in China, authorities are also moving to provide more support to the sector in response to continued weakness in residential investment, new housing sales and housing prices (Graph 1.13). A range of restrictions have been relaxed, including on developers' access to pre-sales funds and their ability to raise equity finance and offshore debt. In addition, banks have been encouraged to lend to the sector. To this end, the PBC has expanded its re-lending program to encourage lending to some developers, and it has directed policy banks to extend new lines of credit. There has also been a raft of measures from both the national and provincial governments to encourage households to buy homes in cities with falling housing prices. Official commentary suggests that further policies will be rolled out to support home buyer demand in 2023.

Prices of property developers' equity and bonds have increased sharply as authorities have announced further support to the sector. This is particularly evident for developers with less leverage that have already received some form of policy support (Graph 1.14). While market pricing suggests the announced measures have reduced the likelihood of further developer defaults, many developers remain highly leveraged and subject to considerable financial pressure.

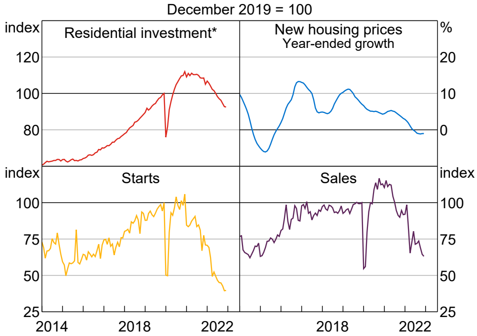
The improved outlook for Chinese growth has lifted bulk commodity prices …

The increased emphasis on supporting economic growth in China has driven a sharp rebound in the iron ore price. The iron ore price has risen by 50 per cent over recent months, as markets assessed that the shift in policy priorities in China would result in more infrastructure spending and property construction than previously anticipated (Table 1.1). Base metals prices rose in anticipation of the change in COVID-19 restrictions and policies boosting industrial and construction demand. The reopening of the Chinese economy has improved the outlook for coal demand, although the price of thermal coal declined sharply in January in response to reduced energy demand in Europe. Notably, the Chinese authorities have permitted the resumption of Chinese purchases of Australian coal, after a pause in imports since 2020 – at which time,

Graph 1.13

China – Residential Property Indicators

December 2019 = 100



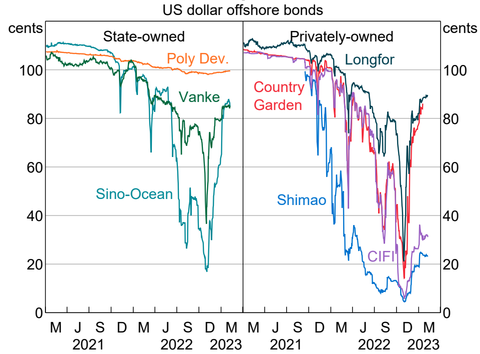
* Nominal developer fixed asset investment.

Sources: CEIC Data; RBA

Graph 1.14

Chinese Developer Bond Prices

US dollar offshore bonds



Source: Bloomberg

Table 1.1: Commodity Price Growth[a]

SDR terms; percentage change

	Since previous *Statement*	Over the past year
Bulk commodities	3	–12
– Iron ore	49	–14
– Coking coal	5	–18
– Thermal coal	–34	2
LNG – Asia spot price	–41	–22
Rural	–6	–7
Base metals	9	–9
Gold	10	8
Brent crude oil[b]	–13	–10
RBA ICP	–1	5
– Using spot prices for bulk commodities	–4	–8

(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodity prices are spot prices.

(b) In US dollars.

Sources: Bloomberg; McCloskey by OPIS; Refinitiv; RBA

China was the second largest destination for Australian thermal coal.

… and led to a repricing of assets

Chinese equity prices and government bond yields increased sharply following the unexpectedly rapid removal of policies aimed at suppressing COVID-19 and a stronger focus by authorities on stimulating growth (Graph 1.15). The PBC eased monetary policy a little further in late November when it announced a 25 basis point cut to the reserve requirement ratio for most banks, citing a need to maintain sufficient liquidity and reduce banks' funding costs. Business credit growth has increased over recent months, as authorities have encouraged banks to increase lending for infrastructure investment projects and provide additional support to property developers. However, household credit growth remains very soft, reflecting ongoing weakness in the property market.

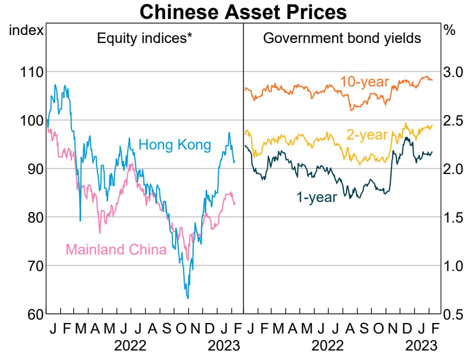
Consistent with the improved growth outlook in China and the broad-based depreciation of the US dollar, the Chinese renminbi appreciated against the US dollar after reaching its lowest level since 2007 in late October.

Global growth forecasts for 2023 remain subdued

Forecasts for overall GDP growth in Australia's major trading partners in 2023 and 2024 are unchanged compared with three months ago, at around 3½ per cent (Graph 1.16). This is well below average growth in the decade prior to the pandemic. Forecasts for growth in the three

Graph 1.15

Chinese Asset Prices



* Indexed to 3 January 2022 = 100.

Sources: Bloomberg; CEIC Data

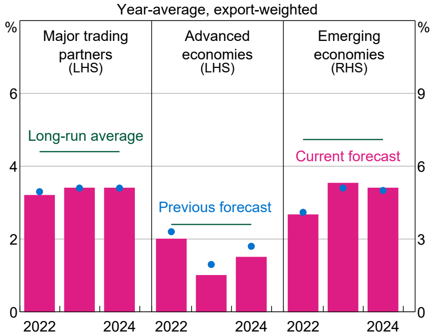
largest economies – the United States, the euro area and China – have all been revised up, though there have been offsetting downward revisions to the outlook in other Asian economies reflecting the effects of slowing global trade. Nonetheless, the risks around the outlook are more balanced than has been the case for some time.

The decision by Chinese authorities to remove COVID-19 restrictions brought forward the expected recovery in consumption growth in China and has removed some downside risk. Lower energy prices and the initial decline of global inflation have also helped improve the outlook and reduce the risks facing the US and European economies. The main drag on global growth is still expected to be the synchronised tightening of monetary policy in advanced economies over the past year; the impact of higher interest rates on demand is expected to build over 2023, reflecting lags in the transmission of monetary policy to economic activity. The consensus of market economists is for mild contractions in GDP in the United States and euro area, with a somewhat more prolonged recession expected in the United Kingdom. Unemployment rates are also expected to rise but to remain fairly low in the broader historical context.

Graph 1.16

GDP Growth

Year-average, export-weighted



Sources: ABS; CEIC Data; Consensus Economics; RBA; Refinitiv

Risks to the global outlook are broadly balanced, with plausible scenarios for both stronger and weaker growth and inflation than is currently expected. The key uncertainties are:

- *The Chinese economy's near-term path out of the COVID-19 suppression phase is highly uncertain.* Economies have typically seen strong rebounds in household consumption after ceasing restrictions. This could also be true in China if households choose to spend more than expected of the considerable household savings they have accumulated over recent years. In addition, the recovery could be strengthened by a more supportive economic policy stance. However, if health outcomes are worse than expected, consumers may be more hesitant to spend. It is also possible that factors such as prolonged weakness in the property sector could weigh on the economy by more or for longer than currently envisaged.
- *It is uncertain how the rise in interest rates and still high energy prices will affect growth in other economies.* The effects of rapid monetary policy tightening are not yet fully reflected in economic outcomes given lags in the transmission of monetary policy (which are typically 12–18 months). Both the overall effect and the lags could turn out to be more or less than expected. The impact of policy tightening could be amplified because it has occurred simultaneously across many economies. On the other hand, household and corporate balance sheets are in better shape than in previous episodes when monetary policy has been tightened quickly, which could lead to a more muted response. Given that estimates of the neutral policy rate are highly uncertain, it is also not clear at which point policy becomes contractionary. This uncertainty about the potency and timing of monetary policy effects creates an environment where there is substantial risk of tightening either too

much or not enough to bring inflation back in line with central banks' targets.

- *It is not clear how responsive inflation will be to slowing demand and rising supply.* Inflation has tended to exceed forecasts over the past year. If this has occurred because of lingering factors related to the pandemic, inflation could continue to surprise on the upside in the year ahead. This could also occur if medium to longer term inflation expectations rise or if the pass-through of high energy prices to retail prices is larger than expected. On the other hand, if surprisingly high inflation outcomes simply reflect prices being more sensitive to the balance between demand and supply than previously believed, inflation could decline faster than expected as demand eases and supply expands.

Central banks have raised policy rates further, but some have slowed the pace of tightening

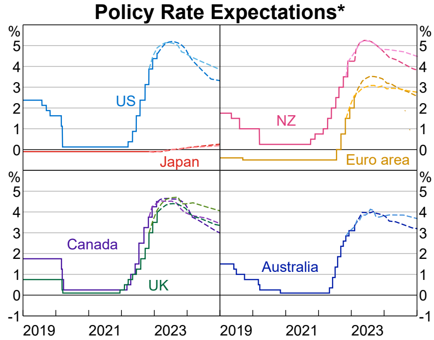
Central banks in most economies have increased their policy rates further to address high inflation and mitigate the risk it becomes embedded in price- and wage-setting behaviours. Market participants' expectations for further increases in policy rates have been little changed for most advanced economy central banks over the past three months or so (Graph 1.17). Market pricing is consistent with the expectation that policy rates will reach a peak in the first half of 2023 and then decline a little in the second half of the year (Graph 1.18). While most advanced economy central banks have begun slowing the pace of increases as their policy rates have reached or neared restrictive levels, several have signalled that their policy rates will need to be raised further and remain at restrictive levels for some time to return inflation to target.

Movements and projections by central banks have included the following:

- The US Federal Reserve (Fed) increased the target range for its policy rate by 25 basis points to 4.5–4.75 per cent at its February meeting. This followed an increase of 50 basis points at the December meeting, and increases of 75 basis points at the previous four meetings. While policymakers anticipate that further increases will be required to return inflation to the Fed's target over time, Chair Powell indicated that it was appropriate to move in smaller increments as the policy rate entered restrictive territory. Fed projections of the level of the policy rate required to achieve its inflation target were revised up at the

Graph 1.17

Policy Rate Expectations*

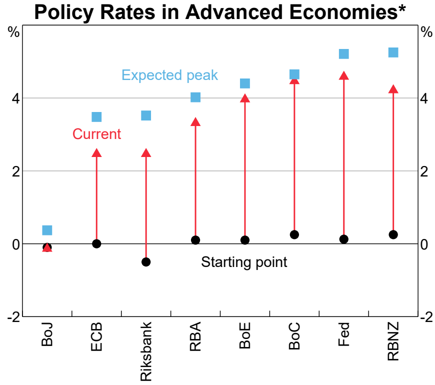


* Darker dashed lines show expectations implied by current overnight indexed swap rates; lighter dashed lines show the same expectations as at the November SMP.

Sources: Bloomberg; RBA

Graph 1.18

Policy Rates in Advanced Economies*



* Squares show expectations implied by overnight indexed swap rates.

Sources: Bloomberg; RBA

December meeting to a median of 5.1 per cent.

- The European Central Bank (ECB) raised its policy rates by 50 basis points at its February meeting, bringing its key policy rate to 2.5 per cent, following an increase of 50 basis points at its December meeting, and increases of 75 basis points at the previous two meetings. The ECB stated that it intends to raise interest rates by another 50 basis points at its March meeting and will then evaluate the subsequent path of monetary policy needed to return inflation to target.
- The Bank of England (BoE) increased its policy rate by 50 basis points at its February meeting to 4 per cent, following a 75 basis point increase at its December meeting and a 50 basis point increase at its November meeting. Policymakers believe inflation has peaked, and expect it to decrease sharply in the second half of 2023, as the United Kingdom experiences an expected prolonged recession. The BoE expects inflation to be below target in 2024 and 2025.
- The Bank of Canada (BoC) increased its policy rate by 25 basis points at its January meeting to 4.5 per cent, following a 50 basis point increase at its December meeting. The BoC has stated that if economic developments evolve in line with its forecasts, it expects to hold the policy rate at its current level while it assesses the impact of the cumulative increases to date. The BoC noted it is prepared to raise the policy rate further if this is needed to return inflation to target.
- The Reserve Bank of New Zealand (RBNZ) increased its policy rate by 75 basis points to 4.25 per cent at its November meeting. The RBNZ said that monetary policy will need to tighten further in order to be confident that inflation will return to its 1–3 per cent target range, and forecasts the New Zealand economy to enter recession in 2023.
- Among other advanced economies, Sveriges Riksbank increased its policy rate by 75 basis points to 2.5 per cent at its November meeting, the Swiss National Bank increased its policy rate by 50 basis points to 1 per cent at its December meeting, and Norges Bank and the Bank of Korea each raised their policy rate by a cumulative 50 basis points since November to 2.75 per cent and 3.5 per cent, respectively. While Norges Bank did not increase its policy rate at its most recent meeting in January, it indicated that a further increase is likely at its next meeting in March.

In contrast to other advanced economy central banks, the Bank of Japan (BoJ) has left its key policy rate unchanged at –0.1 per cent and communicated that it will retain its approach to providing monetary policy stimulus until inflation remains sustainably above its 2 per cent target. At its December meeting, the BoJ announced it would increase its regular monthly purchases of Japanese Government Bonds (JGBs) while allowing yields on 10-year JGBs to trade in a wider band of ±0.5 per cent. The BoJ noted that the changes were made to improve bond market functioning, which had deteriorated under the previous target band of ±0.25 per cent. At its January meeting, the BoJ modified the terms of an existing lending facility with the aim of providing further support to market functioning and the formation of the yield curve.

Most central banks have continued to reduce their holdings of assets purchased under quantitative easing programs via bond maturation or through active sales (Graph 1.19). The BoC and the Riksbank are allowing bonds to mature without reinvestment, while the Fed has continued to reinvest part of the proceeds from maturities. From March 2023, the ECB will start the process of quantitative tightening by no longer fully reinvesting the principal payments from maturing securities. The BoE has been selling short- and medium-term bonds purchased under earlier quantitative easing programs and recently announced it would begin selling long-maturity gilts as part of its ongoing quantitative tightening operations. The BoE had delayed these sales for a time due to dysfunction in government bond markets in September and October 2022; the BoE has recently completed the sale of £19 billion of government bonds purchased under a temporary program to address this dysfunction. Also, the RBNZ is selling assets purchased under its quantitative easing program to New Zealand Debt Management, the issuer of New Zealand Government bonds. The BoJ is now the only major central bank that is still adding to its bond holdings.

Central banks have continued to wind down term funding schemes that were established or expanded during the pandemic (Graph 1.20). Most funding provided under the Fed, BoJ and Riksbank term funding schemes has already been repaid. Lending under the RBA's Term Funding Facility is due to mature between April 2023 and June 2024, while a significant proportion of remaining lending under the ECB's term funding scheme is expected to mature or be repaid over the first half of 2023. Most lending under the BoE and RBNZ's term funding schemes is not due to mature until 2024 or later.

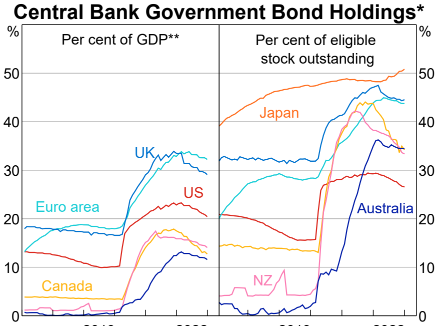
Central banks in most emerging market economies have also raised policy rates further since three months ago (Graph 1.21). Inflation has continued to remain above target in most economies, although the recent appreciation of many emerging market exchange rates has eased some concerns around inflationary pressures and portfolio flows into these markets have increased over recent months (Graph 1.22). Most central banks in Asia are expected to raise rates further this year, with an exception being the central bank of Malaysia, which held the policy rate steady in January. Central banks in Latin America – which started raising policy rates earlier than others (around mid-2021) – are now at or near their expected peaks. The central banks of Brazil and Chile each held rates steady at their most recent meetings.

Medium and longer term government bond yields have declined in most advanced economies

Medium and longer term government bond yields have declined in most advanced

Graph 1.19

Central Bank Government Bond Holdings*



* Central government debt only for all countries except the euro area. Holdings data for euro area only include bonds held as part of asset purchase programs; holdings data for the United Kingdom does not include purchases for financial stability purposes; holdings for other central banks also include bonds held for operational or liquidity purposes.

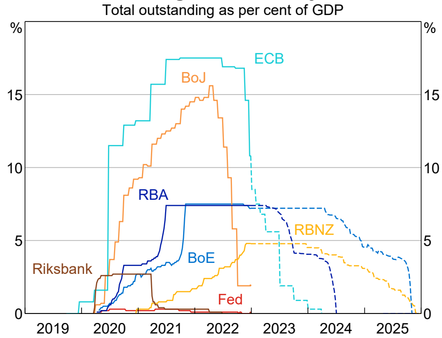
** Four-quarter rolling sum. Japan (not shown) is currently at 98 per cent of GDP.

Sources: Central banks; debt management offices; RBA; Refinitiv

Graph 1.20

Term Funding Scheme Projections*

Total outstanding as per cent of GDP



* Only includes schemes created in response to COVID-19 pandemic. Projected repayments and/or maturities are represented by dashed lines. Projections for the ECB are from the December 2022 ECB Survey of Monetary Analysts. Projections for the BoE, RBA and RBNZ are based on the assumption all funding is held until maturity.

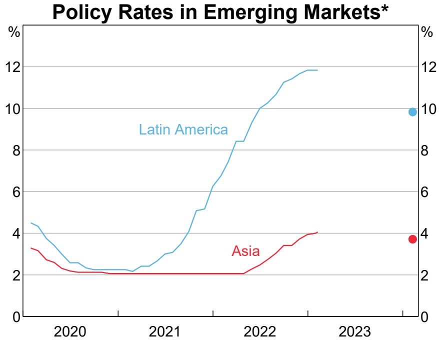
Source: Central banks

economies in recent months, though they remain around their highest levels since the early 2010s (Graph 1.23). This decline in yields partly reflects expectations that most central banks will reduce policy rates from their expected peaks more quickly than anticipated because longer term inflationary pressures appear to have eased a little sooner than forecast. Consistent with this, longer term real yields and market-implied inflation expectations have eased. Longer term expectations remain in the 2–2½ per cent range in most advanced economies (Graph 1.24). Yields on JGBs increased sharply following the BoJ's decision to widen the target band on 10-year bonds under its yield curve control policy, but then declined following the BoJ's January meeting.

Emerging market sovereign bond yields have also declined since late last year (Graph 1.25). Spreads between US-dollar-denominated emerging market sovereign bonds and US Treasuries have narrowed alongside an improvement in risk sentiment and a broad-based depreciation of the US dollar. Emerging market sovereign bond issuance has also picked up since the start of the year.

Graph 1.21

Policy Rates in Emerging Markets*

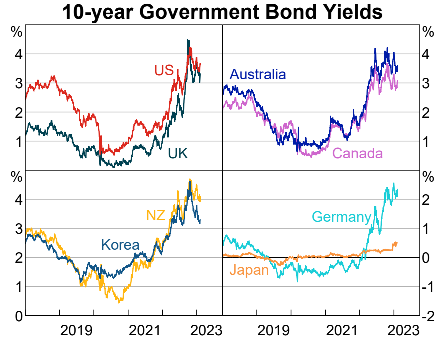


* Simple average across economies; solid lines show actual, dots show one-year market-implied policy rate.

Sources: Bloomberg; RBA; Refinitiv

Graph 1.23

10-year Government Bond Yields

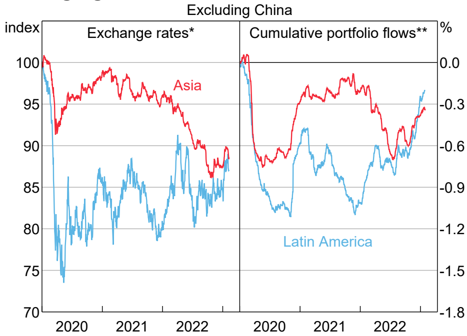


Sources: Bloomberg; Yieldbroker

Graph 1.22

Emerging Market External Financial Conditions

Excluding China



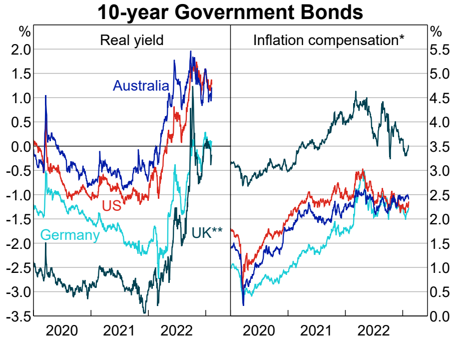
* Against the US dollar; 1 January 2020 = 100.

** Per cent of GDP; includes bond and equity flows.

Sources: Bloomberg; IIF; RBA; Refinitiv

Graph 1.24

10-year Government Bonds



* Spread between yields on nominal and inflation-linked bonds.

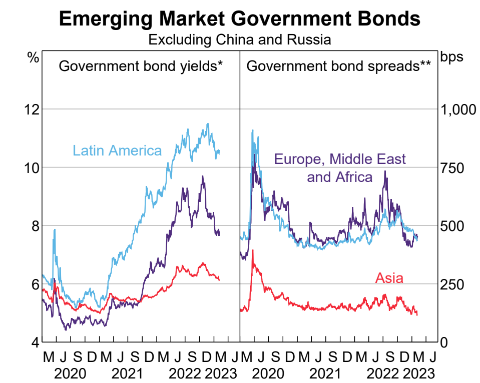
** UK inflation-indexed bonds are linked to Retail Prices Index (RPI) inflation, which is currently 2.9 percentage points higher than CPI inflation. RPI inflation is typically higher than CPI inflation because of differences in calculation methods and the inclusion of owner-occupied housing costs in the RPI.

Sources: Bloomberg; RBA; Yieldbroker

Private sector financial conditions have eased a little

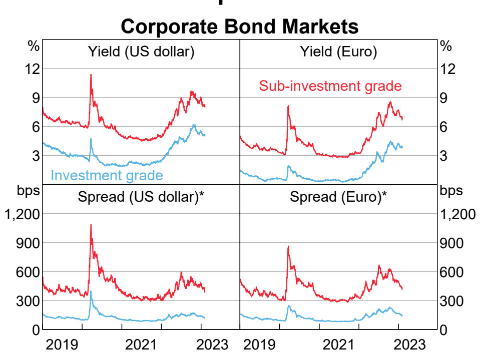
Conditions in corporate bond markets have eased in recent months, with corporate bond yields declining by more than government bond yields (Graph 1.26). This narrowing in credit spreads partly reflects an easing of concerns about the impact of monetary policy tightening on the economy, particularly for sub-investment grade firms. Corporate default rates to date have remained at low levels relative to history. By contrast, financial conditions for households have continued to tighten in response to higher policy rates (see 'Box A: Mortgage Interest Payments in Advanced Economies – One Channel of Monetary Policy').

Graph 1.25



* Local currency bonds, weighted by market value.
** US-dollar-denominated bonds; spreads to equivalent US Treasury.
Sources: JPMorgan; RBA

Graph 1.26



* Spread to equivalent maturity government bond yield.
Source: ICE Data is used with permission

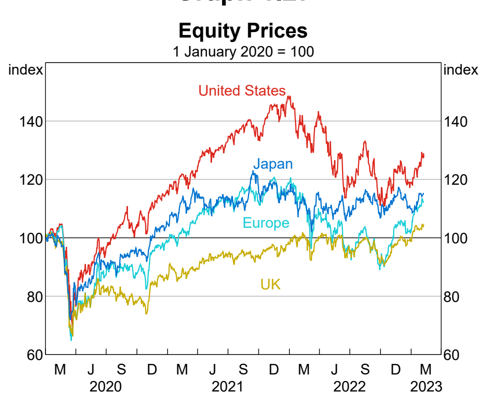
Equity prices in most major markets have increased in recent months (Graph 1.27). This in part reflects the decline in government bond yields over the same period, which increases the present valuations of future company earnings. More positive sentiment about the outlook for global growth also played a role. Measures of equity price volatility have declined further to be around their lowest levels since the onset of the pandemic. Equity issuance has remained subdued since early 2022 in both the United States and Europe.

The US dollar has depreciated from multi-decade highs

The US dollar has depreciated by around 6 per cent on a TWI basis since early November alongside a decline in shorter term US Government bond yields relative to those of other major advanced economies (Graph 1.28). This is consistent with the moderation in inflation in the United States and a tempering of expectations about how restrictive the US policy rate will need to be. Meanwhile, government bond yields in Europe and Japan have increased. Despite the recent depreciation, the US dollar remains around 4 per cent higher than its level at the beginning of 2022.

The Japanese yen has appreciated by around 6 per cent on a TWI basis over recent months

Graph 1.27



Source: Bloomberg

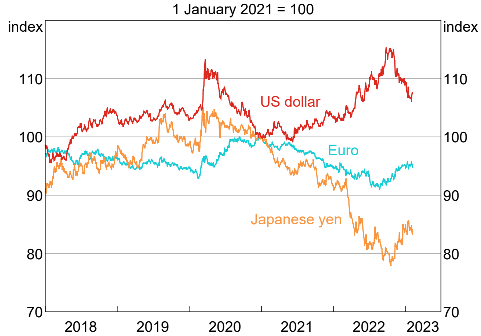
alongside a narrowing in yield differentials between JGBs and US Government bonds. In particular, the Japanese yen appreciated sharply following the BOJ's unexpected decision to widen the target band for 10-year JGB yields in December. The euro has also appreciated a little on a TWI basis over recent months, consistent with an increase in yields on German Government bonds relative to other those in other major advanced economies. The reduction in gas prices following a mild winter in Europe appears to have also alleviated some concerns among market participants about the outlook for growth there.

The currencies of commodity-exporting economies have been mixed. The Canadian dollar and Norwegian krone have depreciated, consistent with lower oil prices. Meanwhile, the New Zealand dollar is little changed, and the Australian dollar has appreciated slightly, supported by the reopening of the Chinese economy and higher prices for some key commodity exports (see chapter on 'Domestic Financial Conditions' for developments in the Australian dollar). ✈

Graph 1.28

Trade-weighted Exchange Rates

1 January 2021 = 100



Source: Bloomberg