1. The International Environment

Inflation remains high globally. Although headline inflation is past its peak in most advanced economies and in much of east Asia, progress in reducing core inflation has slowed in recent months. Falling energy prices and a normalisation in global supply chain conditions have contributed to the easing in headline inflation. However, inflation in the prices of services remains strong; services price inflation tends to be relatively persistent and is more closely related to wages growth, which remains high in most advanced economies. Unemployment rates remain very low and labour markets are tight, but less so than a few months ago.

Economic growth in advanced economies has slowed in response to higher interest rates but by less than had been expected. Household consumption continued to expand in the United States in the March quarter but has contracted in some euro area economies; business investment has slowed only modestly. Chinese economic activity has begun to recover quickly this year, following the removal of COVID-19 containment measures, with services consumption especially strong. Elsewhere in Asia, growth has been more muted. Global growth is expected to remain below average in the next two years. Financial stability concerns related to banking sector stresses have subsided but would pose downside risks to the economic outlook if the situation were to deteriorate once more.

Central banks in many advanced economies have increased policy rates further, although some have emphasised greater uncertainty over the outlook for policy rates following the emergence of stress in parts of the banking system in the United States and Switzerland. Market participants' expectations for the path of policy rates have fallen in most advanced economies recently. This reflects the possibility that recent banking stress may tighten financial conditions so that central banks need to increase policy rates by less than previously expected. Government bond yields declined in line with policy rate expectations, while bond market volatility increased. Corporate bond spreads have widened and equity prices have recovered from earlier declines. Conditions in foreign exchange markets have remained relatively stable over recent months; the US dollar is little changed since the February *Statement*. While the cost of borrowing US dollars in foreign exchange swap markets increased following the emergence of concerns about banks offshore, strains in these markets eased following the actions of central banks in response to these concerns.

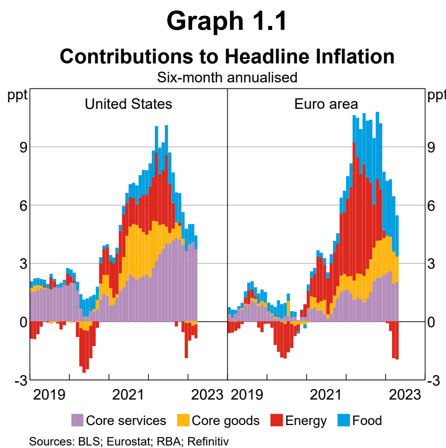
Global inflation remains high, and progress towards inflation targets has slowed

Year-ended inflation remains high but has declined in headline terms. While energy prices have fallen further, food price inflation remains high, especially in the euro area and the United Kingdom, where production has been constrained by poor growing conditions and earlier high energy prices (Graph 1.1). Core inflation has also moderated from its peak, but the pace of decline has slowed and recent monthly inflation data have remained strong in

a number of advanced economies (Graph 1.2). This slower progress in reducing core inflation is being monitored closely by central banks as some components of core inflation can be quite persistent. Central banks in advanced economies are forecasting that inflation will fall further this year, although in most cases it is expected to take a couple of years to return to target.

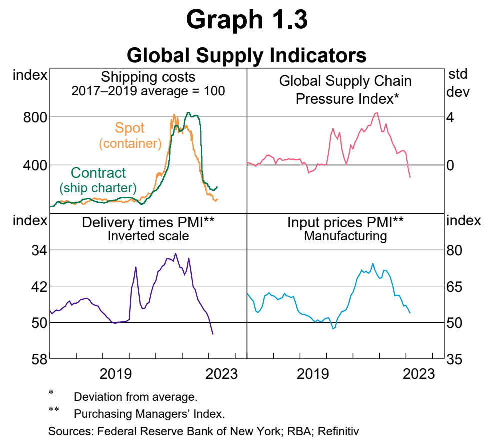
In the goods sector, core inflation slowed sharply in several advanced economies in the second half of 2022 as energy prices fell and supply chain pressures eased (Graph 1.3). Progress has slowed in recent months as supply chain conditions have broadly eased to around pre-pandemic levels, though some indicators including input cost inflation and shipping costs have continued to fall. Core goods inflation has declined by more in the United States and Canada than it has in the euro area and the United Kingdom, where second-round effects of earlier high energy prices have kept inflation higher (Graph 1.4).

Core services inflation remains high and has been the main driver of inflation in advanced economies over the past six months or so. Housing services inflation has been a key component of this and is yet to peak. That said, in the United States, declines in advertised rents suggest that housing services inflation is likely to slow before the end of 2023. Inflation in the prices of other core services remains strong and may prove to be relatively persistent; these



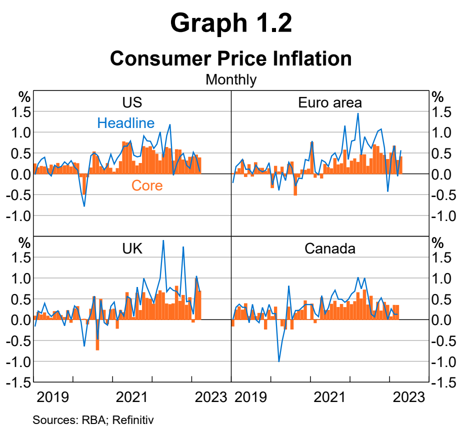
Graph 1.1
Contributions to Headline Inflation
Six-month annualised

Sources: BLS; Eurostat; RBA; Refinitiv



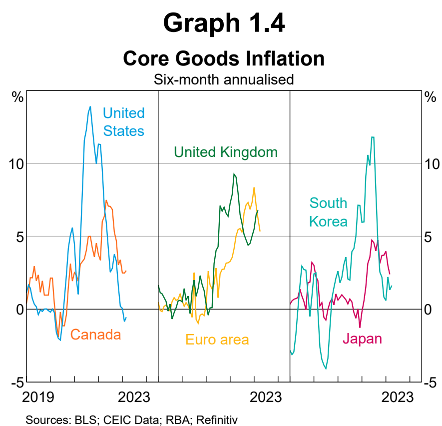
Graph 1.3
Global Supply Indicators

* Deviation from average.
** Purchasing Managers' Index.
Sources: Federal Reserve Bank of New York; RBA; Refinitiv



Graph 1.2
Consumer Price Inflation
Monthly

Sources: RBA; Refinitiv



Graph 1.4
Core Goods Inflation
Six-month annualised

Sources: BLS; CEIC Data; RBA; Refinitiv

services are closely related to domestic demand conditions and wages growth, both of which have been slightly stronger in recent months than expected by many forecasters (Graph 1.5).

Labour markets are tight but less so than a few months ago

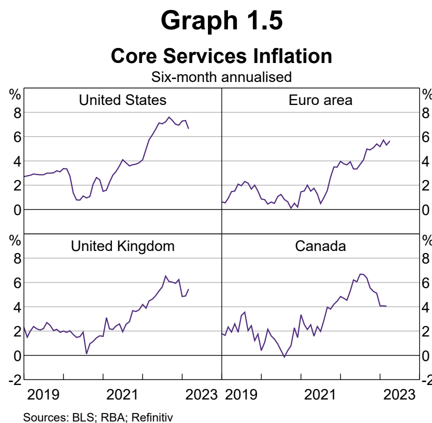
Unemployment rates remain near historical lows in advanced economies, but some timelier indicators of labour market conditions suggest labour demand has eased a little. Employment growth has generally remained robust but has slowed in a few economies; vacancy rates have declined but are still high in most economies (Graph 1.6). Information from business surveys and central banks' liaison with firms suggest that it is becoming easier to find workers as labour supply is increasing; employment intentions are expected to remain relatively flat over the coming year.

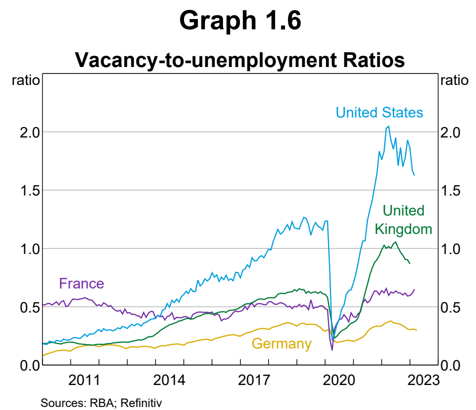
Wages growth appears to have peaked, or at least plateaued, in most advanced economies, though it is still above rates consistent with inflation targets in many countries (Graph 1.7).

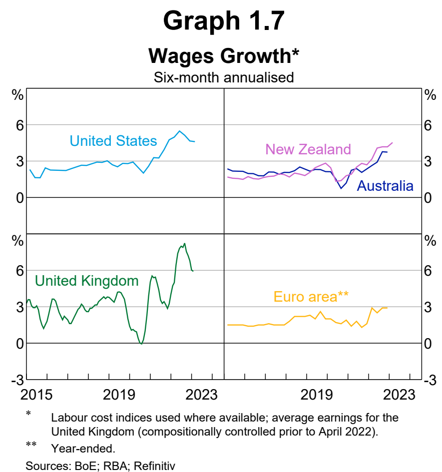
Economic activity in advanced economies was subdued in early 2023

GDP growth in advanced economies was subdued in the March quarter; however, growth was not as weak as expected in February when forecasts were for activity in most economies to stall or contract (Graph 1.8). Household consumption continued to grow solidly in the United States in the March quarter, but it contracted in some euro area economies. In east Asia, the weaker goods demand from advanced economies led to falls in exports, which in turn weighed on GDP in the March quarter. Industrial production in east Asia also fell, and inventories remained high.

Tight labour market conditions and a decline in household savings ratios over the past year have supported household consumption, albeit to varying degrees across countries. Real household incomes stopped declining in recent quarters, reflecting strong growth in nominal







incomes and falling energy prices. However, in Europe, real household incomes remain below pre-pandemic levels (Graph 1.9). Central banks' liaison with firms suggests that consumers continue to trade down to less expensive goods in response to these pressures. Consumer confidence was little affected by recent banking sector stress, though it remains below average.

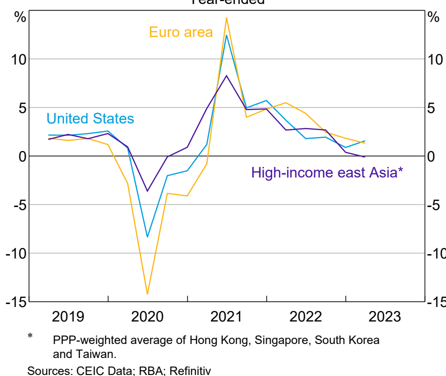
Consumer spending continues to be driven by a recovery in services consumption, as expenditures on goods and services continue to rebalance after the pandemic. Spending on dining out is above pre-pandemic levels across a range of advanced economies and surveyed business conditions in the services sector remain expansionary (Graph 1.10). By contrast, goods consumption continued to decline in the March quarter in most economies; the United States is a notable exception, with goods consumption remaining around pandemic peaks. New orders in the manufacturing sector have weakened in a number of advanced economies, consistent with softer goods demand.

The housing sector continues to weaken in almost all advanced economies in response to higher interest rates, but housing prices appear to have stabilised in some economies recently (Graph 1.11). Forward-looking indicators such as building approvals and housing starts have generally continued to fall sharply, suggesting residential investment will weigh on growth in the coming quarters. In the United States, however, indicators such as housing approvals, starts and sales have ticked up since the start of 2023 following sharp declines over 2022.

Graph 1.8

GDP Growth

Year-ended

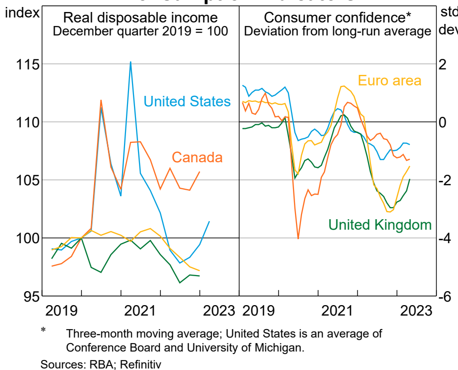


* PPP-weighted average of Hong Kong, Singapore, South Korea and Taiwan.

Sources: CEIC Data; RBA; Refinitiv

Graph 1.9

Consumption Indicators



* Three-month moving average; United States is an average of Conference Board and University of Michigan.

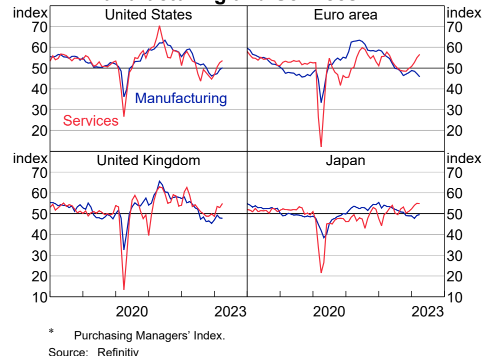
Sources: RBA; Refinitiv

Activity in China is recovering …

The removal of COVID-19 restrictions towards the end of 2022 contributed to strong economic growth in China in the March quarter of 2023. The Chinese economy grew by 2.2 per cent in the quarter, and by 4.5 per cent in year-ended terms (Graph 1.12). This was driven by a rebound in household services consumption as consumers took advantage of the reopening, but household goods consumption declined

Graph 1.10

Manufacturing and Services PMI*



* Purchasing Managers' Index.

Source: Refinitiv

further (Graph 1.13). Fixed asset investment increased in the March quarter, driven by strong growth in infrastructure investment, which has in turn been supported by government policies. Merchandise exports rebounded, though this may be temporary if it is related to the filling of order backlogs. Strong growth in the March quarter followed an upward revision in the December quarter of 2022, indicating more resilience to COVID-19 lockdowns than previously recognised.

Property fixed asset investment continues to weigh on growth in China, but there are early signs that demand for new housing is recovering in response to policy support and the improved economic outlook (Graph 1.14).

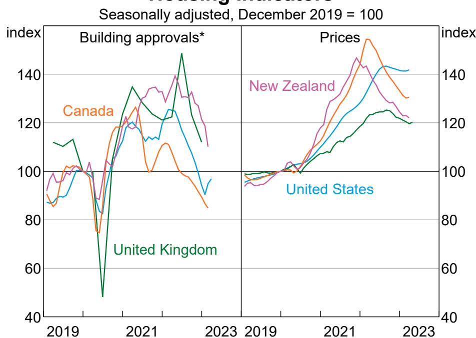
The level of new housing sales rebounded by more than expected in the March quarter. New housing prices also rose through the beginning of 2023, and across a growing share of cities. The lift in sales could support future real estate investment, but the flow through to investment typically takes time. New housing starts – a leading indicator of construction – had picked up following the removal of COVID-19 restrictions but declined back to low levels in March.

Property developers have faced significant financial pressure over recent years. While equity and bond prices of less-leveraged developers (and those that have received direct policy

Graph 1.11

Housing Indicators

Seasonally adjusted, December 2019 = 100



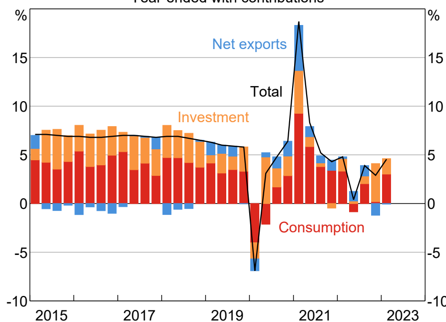
* Three-month moving average used for Canada, New Zealand and the United States; quarterly housing starts are used for the United Kingdom.

Sources: national sources; RBA; Refinitiv

Graph 1.12

China – GDP Growth

Year-ended with contributions

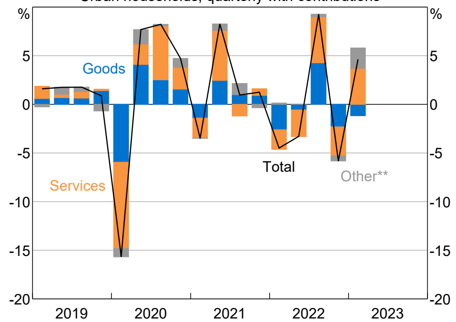


Sources: CEIC Data; RBA

Graph 1.13

China – Real Household Consumption Growth*

Urban households, quarterly with contributions



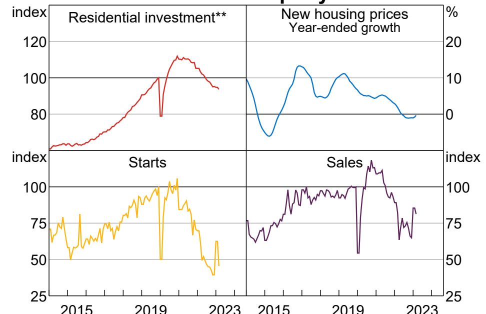
* Each component seasonally adjusted by the RBA and deflated using headline CPI.

** Rents and miscellaneous goods and services.

Sources: CEIC Data; RBA

Graph 1.14

China – Residential Property Indicators*



* December 2019 = 100 for index series.

** Nominal developer fixed asset investment.

Sources: CEIC Data; RBA

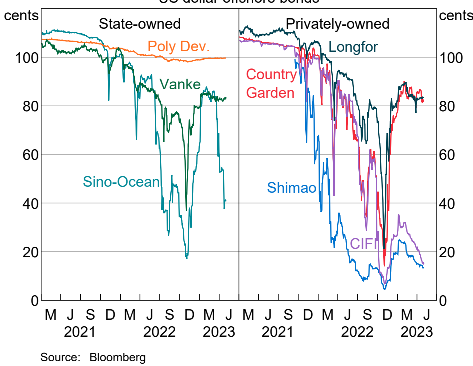
support) have increased sharply, many developers are still under significant financial stress (Graph 1.15). This may dampen the pace of recovery in real estate investment.

Despite activity recovering in China, inflation has declined further and is still well below authorities' target of 3 per cent. Lower inflation has been driven in large part by declines in domestic food prices over the past few months, following the increases seen in 2022 due to cold weather and COVID-19 disruptions. Non-food price inflation has also been low in recent months, partly driven by lower energy prices (Graph 1.16).

Graph 1.15

Chinese Developer Bond Prices

US dollar offshore bonds

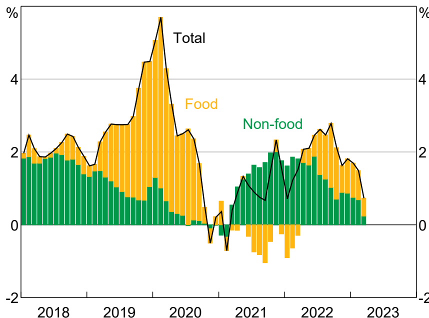


Source: Bloomberg

Graph 1.16

China – Consumer Price Inflation*

Year-ended with contributions



* Seasonally adjusted by the RBA; CPI basket weightings as per Bloomberg estimate 2019.

Sources: Bloomberg; CEIC Data; RBA

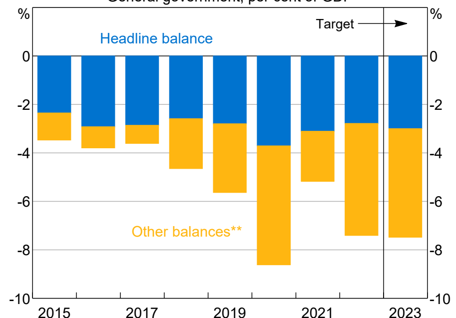
… as Chinese authorities announced a growth target of 'around 5 per cent' alongside broadly neutral fiscal policy …

At the National People's Congress in March, Chinese authorities emphasised their focus on ensuring economic stability, stimulating domestic demand, and preventing and reducing major financial risks. Authorities announced a GDP growth target of 'around 5 per cent' for 2023, which was a little lower than most forecasts for growth at the time. The announced fiscal stance is neutral, with authorities budgeting for a broadly unchanged deficit-to-GDP outcome, suggesting an intention to provide ongoing fiscal support instead of reducing the deficit (Graph 1.17). The local government special bond quota for 2023 remains high but is a little lower than last year's final quota. Local government special bonds are typically tied to infrastructure projects, so this, along with an already large pipeline of infrastructure projects, should continue to support infrastructure investment in 2023.

Graph 1.17

China – Consolidated Budget*

General government, per cent of GDP



* Values for 2023 assume nominal GDP level implicit in budget documents (growth of 7.5 per cent).

** Includes balance of government-managed funds; adjusts for transfers to and from Central Budget Stabilisation Fund; removes transfers from government-managed funds to general government.

Sources: CEIC Data; MoF; RBA

… and eased monetary policy further

The People's Bank of China eased monetary policy modestly in March by lowering its reserve requirement ratio by 25 basis points for most banks (Graph 1.18). Business credit growth increased in the March quarter, supported by existing policy measures focused on infrastructure investment and the property sector. Household credit growth remains weak but has increased a little from its recent lows alongside a rise in property sales.

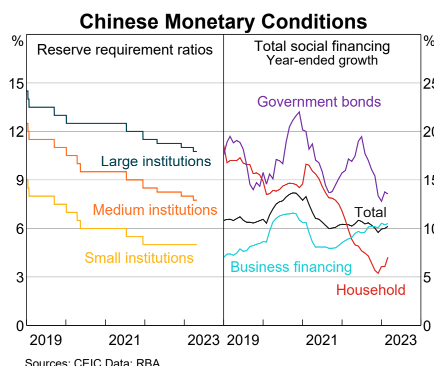
Chinese Government bond yields have declined to be around their lowest levels since late 2022, while equity prices have been little changed over recent months. The Chinese renminbi has remained relatively stable against the US dollar, despite a narrowing in the interest rate differential between Chinese and US Government bonds.

Most commodity prices have declined since February

Thermal coal and gas prices have declined over the past three months, but they remain around double their pre-pandemic averages due to ongoing reduced gas supply from Russia (Graph 1.19; Table 1.1). Recent declines in prices were driven by ongoing weaker demand for gas and coal as relatively warm weather conditions persisted throughout the peak gas-use season in the northern hemisphere. This supported (already elevated) gas storage levels and coal inventories and contributed to an easing in concerns about medium-term energy supply. Oil prices have declined since the beginning of February; tighter financial conditions associated with concerns about some smaller US banks and concerns that the US Treasury may soon not be able to meet all of its payment obligations if the US debt ceiling is not increased have been viewed as increasing the risk of weaker oil demand. Iron ore and Australian coking coal prices decreased, driven partly by weaker steel demand in China. Australian coking coal prices were also driven lower by the resolution of supply disruptions in Queensland. Base metals prices declined moderately.

Global growth forecasts have been revised a little higher, but remain below average with risks skewed to the downside

Overall, year-average GDP growth in Australia's trading partners is forecast to be around 3¾ per cent in 2023 and 3½ per cent in 2024 – well below its pre-pandemic decade average of 4½ per cent (Graph 1.20). This is a little stronger than three months ago, driven by upgrades to growth forecasts in China and high-income economies in east Asia. Although Consensus forecasts for GDP growth in major advanced



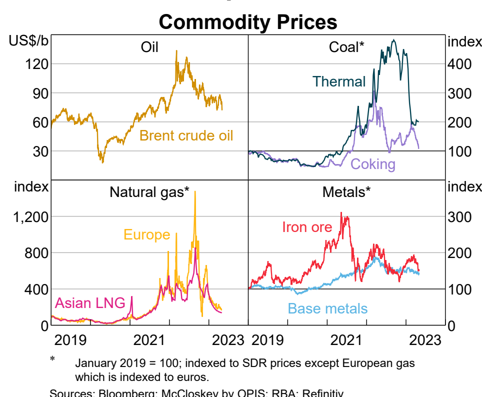


Table 1.1: Commodity Price Growth[(a)]

SDR terms; percentage change

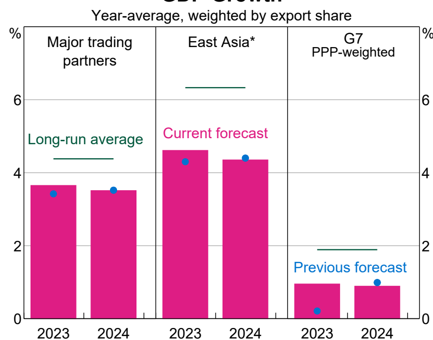
	Since previous *Statement*	Over the past year
Bulk commodities	−23	−40
– Iron ore	−20	−29
– Coking coal	−35	−51
– Thermal coal	−17	−49
LNG – Asia spot price	−5	−24
Rural	−6	−16
Base metals	−4	−19
Gold	9	9
Brent crude oil(b)	−14	−32
RBA ICP	−8	−17
– Using spot prices for bulk commodities	−17	−29

(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; RBA

economies in 2023 have also been revised higher, GDP is still forecast to contract slightly in the United States and the United Kingdom in the coming quarters. Recent stresses among some banks in the United States and Europe have increased downside risks to the forecasts and have led to modest downward revisions to Consensus forecasts in some advanced economies from the December quarter of this year.



The upward revision to the forecast for China's economic growth in 2023 has occurred in response to evidence that the Chinese economy was less affected by the COVID-19 restrictions of late last year than had been expected. The authorities' intentions to maintain supportive fiscal policy also contributed to the upgrade. Year-average GDP growth is forecast to comfortably exceed the authorities' growth target of 'around 5 per cent' announced in March. Elsewhere in Asia, forecasts have been revised up slightly in reaction to the improved outlook for major advanced economies and China; however, to the extent the recovery is services-led, the flow-on effects to other economies could be relatively muted.

The outlook for global economic activity is subject to a range of risks, with the balance skewed to the downside. The key uncertainties are:

- *The pace of disinflation is uncertain, resulting in greater-than-usual uncertainty about the outlook for monetary policy.* Monetary policy transmission is uncertain, both in terms of

lags and the overall effect on output and inflation. In addition, some parts of inflation (e.g. rents) could prove to be highly persistent. If progress in reducing inflation stalls, monetary policy may need to be tighter and require a sharper slowing in economic activity than currently expected, especially if inflation expectations were to rise. The required slowing in activity could, at least initially, be difficult to achieve, given that substantial additional savings in some advanced economies and still very tight labour markets could support household consumption for some time. Alternatively, it is possible that inflation could slow more quickly than expected, particularly as there may be further disinflationary pressures on final goods prices. The risk of spillovers to global goods inflation from the Chinese economy's reopening is judged to be low at this stage, given supply chain issues have dissipated, and goods demand in China remains weak.

- *Financial stability concerns and resulting tighter financial conditions could slow economic activity.* Although the global banking system has remained resilient in the face of recent bank failures, there is uncertainty about the overall effect on global financial conditions, most notably in the United States. If stresses were to widen and financial conditions were to tighten more significantly, this would pose downside risks to real economic activity through a combination of reduced credit availability, lower asset prices and weaker confidence, in turn weighing on spending and investment decisions. Uncertainty about the magnitude of these effects, coupled with broader uncertainty about the potency and timing of monetary policy effects, creates an environment where there is substantial risk of tightening either too much or too little to bring inflation back in line with central banks' targets.
- *The risks to the Chinese economic outlook are balanced.* The Chinese authorities' supportive policy settings, along with the boost to consumption from the lifting of COVID-19 restrictions, may generate a stronger recovery this year than currently expected. This could be further supported if recent improvements in property markets were sustained over the year. However, soft external demand, particularly from advanced economies, could weigh on exports more than currently anticipated. The recovery could also be hampered if household consumption growth stalled following its initial rebound from the removal of COVID-19 restrictions, if residential investment was constrained by property developers' ongoing efforts to repair their balance sheets, or if fiscal stimulus supported demand by less than expected.

Central banks have raised policy rates further, with some nearing their expected peak

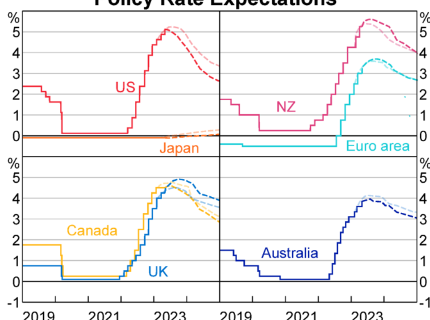
Central banks in most advanced economies have increased policy rates further to slow the pace of inflation and mitigate the risk that above-target inflation becomes embedded in price- and wage-setting behaviours. Market-implied policy rate expectations declined sharply in March as concerns emerged about some banks in the United States and Switzerland. Concerns about widespread banking stress subsided somewhat following the response of regulators in these countries. Market-implied policy rate expectations have increased in many advanced economies, though they remain below the levels seen earlier in the year.

Market pricing suggests policy rates are at or near their peak in most advanced economies, with rates expected to decline in some

economies in the second half of the year (Graph 1.21). However, most advanced economy central banks have signalled that policy rates may need to remain at restrictive levels for some time to ensure inflation returns to target.

Key news from central banks includes:

- The US Federal Reserve (Fed) increased the target range for its policy rate by a cumulative 50 basis points to 5–5.25 per cent at its March and May meetings. Chair Powell noted that the Fed will assess incoming data and take into account the lagged effect of tightening to date in determining the extent to which additional policy firming may be appropriate.
- The European Central Bank (ECB) raised its key policy rate by 50 basis points to 3 per cent at its March meeting, in line with the guidance it had provided in February. The ECB stated that the future path of the policy rate would be data dependent considering the elevated level of uncertainty.
- The Bank of England (BoE) increased its policy rate by 25 basis points to 4.25 per cent at its March meeting. The BoE indicated that a further tightening in monetary policy would be required if there was evidence of more persistent inflationary pressures.



- The Bank of Canada (BoC) kept its policy rate unchanged at 4.5 per cent at both its March and April meetings. It noted that it remains prepared to raise the policy rate further if needed.
- The Reserve Bank of New Zealand (RBNZ) increased its policy rate by a cumulative 100 basis points to 5.25 per cent at its February and April meetings. The RBNZ said future policy rate decisions will depend on the extent to which core inflation and inflation expectations continue to moderate.
- The Bank of Japan (BoJ) left its key policy rate unchanged at –0.1 per cent at its March and April meetings and communicated that it will continue monetary easing (via asset purchases) until inflation remains sustainably above its 2 per cent target.
- Among other advanced economy central banks: Sveriges Riksbank increased its policy rate by a cumulative 100 basis points to 3.5 per cent at its February and April meetings; the Swiss National Bank (SNB) increased its policy rate by 50 basis points to 1.5 per cent at its March meeting; Norges Bank increased its policy rate by 25 basis points to 3 per cent at its March meeting; and the Bank of Korea left its policy rate unchanged at 3.5 per cent at both its February and April meetings.

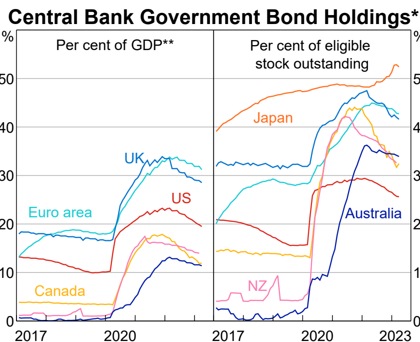
Most central banks have continued to reduce their holdings of assets purchased under quantitative easing programs (Graph 1.22). The BoC is allowing bonds to mature without reinvestment, while the Fed has continued reinvesting part of the proceeds of maturing bonds. In March, the ECB began to reduce its bond holdings by only partially reinvesting maturities. The BoE and RBNZ have continued to sell their bond holdings. The Riksbank recently commenced sales of its holdings of longer dated government bonds in addition to allowing other assets to mature without

reinvestment. 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 established or expanded during the pandemic (Graph 1.23). 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, while most lending under the BoE and RBNZ's term funding schemes is not due to mature until 2024 or later.

Graph 1.22

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.

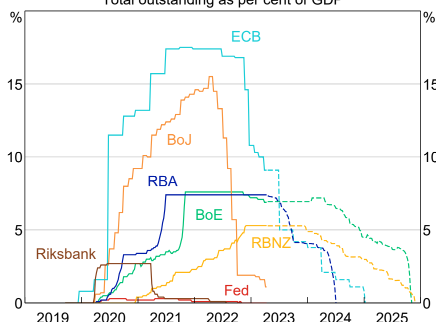
** Four-quarter rolling sum. Japan (not shown) is currently at 101 per cent of GDP.

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

Graph 1.23

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 most recent ECB Survey of Monetary Analysts. Projections for the BoE, RBA and RBNZ are based on the assumption all outstanding funding is held until maturity.

Source: Central banks

In emerging market economies, central bank policy rates are widely expected to have reached or be close to peak levels (Graph 1.24).

Central banks expanded liquidity support for banks

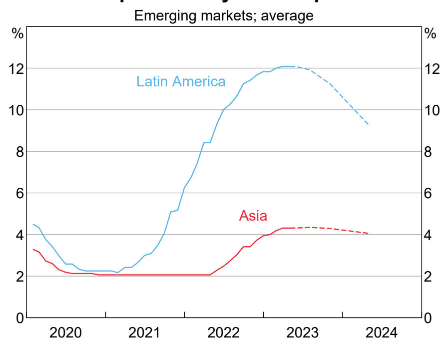
Following some bank failures in the United States and the takeover of Credit Suisse by UBS, a number of advanced economy central banks acted to safeguard financial stability by providing extraordinary liquidity support to banks. The Fed introduced a Bank Term Funding Program (BTFP) to complement its existing discount window facility in providing liquidity support to otherwise solvent banks. Compared with the discount window, the BTFP offers funding at a longer term and at a fixed rate, and values (a narrower range of eligible) collateral at par rather than at market value. The Fed provided US$165 billion of liquidity to banks via the BTFP and discount window in the week following the collapse of Silicon Valley Bank (SVB). Since then, use of these facilities has declined slightly to US$155 billion (Graph 1.25). The SNB announced new liquidity facilities to support the merger of Credit Suisse and UBS.[1]

The BoC, BoE, BoJ, ECB, Fed and SNB also enhanced the provision of US dollar liquidity by increasing the frequency of their seven-day

Graph 1.24

Market Implied Policy Rate Expectations*

Emerging markets; average



* Solid lines show actual policy rates; coloured dashed lines show market-implied policy rates; Latin America comprises Brazil, Chile and Mexico; Asia comprises India, Malaysia, Philippines and Thailand.

Sources: Bloomberg; RBA; Refinitiv

operations through existing swap arrangements from weekly to daily. More recently, the central banks reverted to a weekly frequency for these operations, highlighting the improvement in US dollar funding conditions and low demand at recent operations.

Government bond yields declined amid heightened volatility

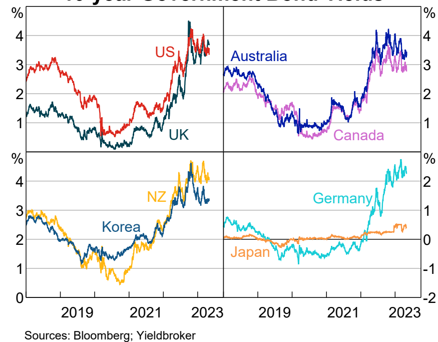
Government bond yields declined from their recent peaks in most advanced economies following the emergence of concerns about some banks in the United States and Switzerland (Graph 1.26). Volatility in government bond yields increased to be around its highest levels since 2008 (though volatility has since eased a bit), and measures of liquidity have deteriorated (Graph 1.28). Market makers are typically less willing to provide liquidity during periods of heightened uncertainty, resulting in more volatile trading conditions. Both real yields and market-implied inflation expectations have declined from levels reached earlier in the year, although longer term market-implied inflation expectations remain in the 2–3 per cent range in most advanced economies (Graph 1.27).

The United States has been using extraordinary measures to remain under its statutory debt limit since mid-January. US Treasury Secretary Yellen has indicated the Treasury may no longer be able to meet all of its payment obligations on time from as early as 1 June. Spreads on US Government credit default swaps have risen over recent months and yields on Treasury bills maturing within the window when the Treasury is expected to have exhausted its extraordinary measures to remain within the debt limit are noticeably higher than those falling outside this range.

Volatility in emerging market government bond yields also rose, but by less than in advanced economies (Graph 1.28). Local-currency sovereign bond yields have declined alongside those in advanced economies, while spreads between US-dollar-denominated emerging market sovereign bonds and US Treasuries have widened amid the heightened uncertainty in global financial markets (Graph 1.29). This has

Graph 1.26

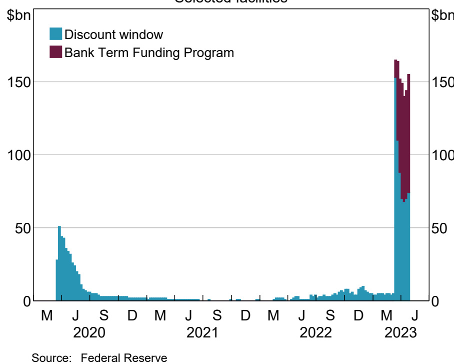
10-year Government Bond Yields



Graph 1.25

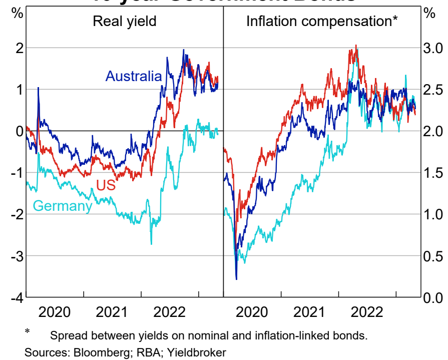
Federal Reserve Liquidity

Selected facilities



Graph 1.27

10-year Government Bonds



been most evident in Latin America, which has stronger financial and trade links to the United States.

Private sector financial conditions have tightened somewhat

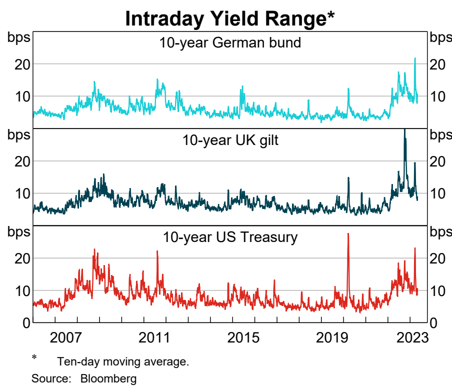
Corporate bond spreads have widened in recent months, reflecting increased uncertainty about the economic outlook following the collapse of SVB. Taking into account the decline in government bond yields, corporate bond yields in the United States are little changed, while corporate bond yields in Europe have increased (Graph 1.30). There has been limited issuance of corporate bonds below investment grade in the United States and Europe in recent months. Bond issuance by banks in the United States for this year so far has been much lower than previous years.

Equity prices in major markets declined following the collapse of SVB; however, they have since recovered to their levels prior to the collapse of SVB in Europe, while in the United States they are 4 per cent higher (Graph 1.31). By contrast, bank equity prices remain more than 10 per cent below their levels prior to the collapse of SVB due to concerns about future earnings. Equity issuance has remained subdued since early 2022 in both the United States and Europe.

Since the emergence of stress at a number of US regional banks, there has been an outflow of

Graph 1.28

Intraday Yield Range*

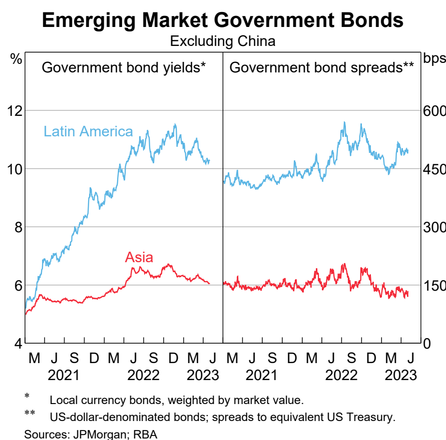


* Ten-day moving average.
Source: Bloomberg

Graph 1.29

Emerging Market Government Bonds

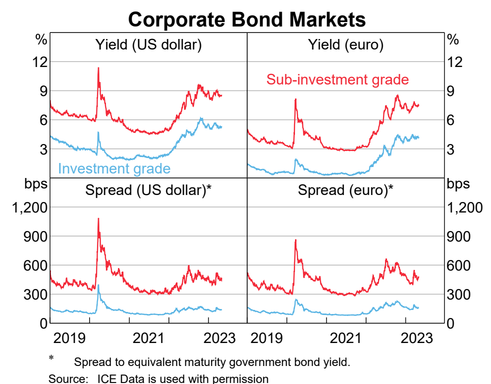
Excluding China



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

Graph 1.30

Corporate Bond Markets

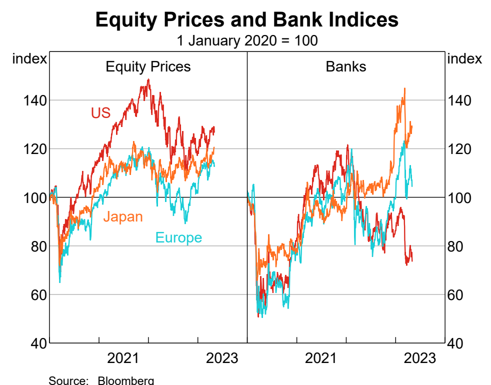


* Spread to equivalent maturity government bond yield.
Source: ICE Data is used with permission

Graph 1.31

Equity Prices and Bank Indices

1 January 2020 = 100



Source: Bloomberg

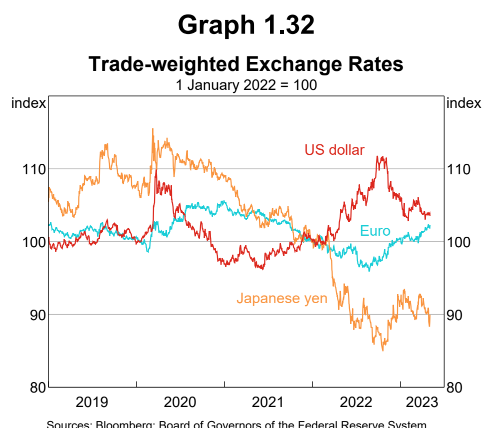
more than US$400 billion in commercial bank deposits in the United States, with a few vulnerable institutions experiencing very large outflows. Withdrawn deposits appear to have largely been invested in US money market funds, which offer higher returns than bank deposits. These banks have replaced lost deposit funding by borrowing from the Fed's liquidity facilities and from Federal Home Loan Banks. Stress at some banks does not appear to have led to a significant contraction in aggregate bank lending in the United States, although that may still occur in the period ahead. In particular, the Fed has indicated that small- and medium-sized banks in the US have continued to tighten credit standards in recent months. Smaller banks (those outside the top 25), which have been most affected by the stress, make up around one-third of all household lending and one-half of all commercial lending in the United States. The ECB has also reported a substantial tightening of credit standards by euro area banks in the first quarter of 2023, along with a decline in demand for credit.

The US dollar remains below its 2022 highs

The US dollar is little changed on a trade-weighted (TWI) basis since the February *Statement* but is around 7 per cent lower than its peak in October 2022 (Graph 1.32). It did, however, depreciate against the currencies of some other advanced economies, such as the euro and the UK pound, following the collapse of SVB in early March. This largely reflected a decline in the yield differential between US Treasury bonds and the government bonds of other advanced economies, as stress in parts of the US banking system weighed on yields there more than elsewhere.

The euro has appreciated a little over recent months, while the Japanese yen depreciated following the BoJ's decision to leave monetary policy unchanged at its April meeting. Meanwhile, the currencies of commodity-exporting economies, including the Australian dollar, have generally depreciated (see Chapter 3: Domestic Financial Conditions).

Foreign exchange markets have been far less volatile than bond markets. This partly reflected the broad decline in yields across most advanced economies, which resulted in more moderate changes in yield differentials. While the cost of borrowing US dollars in foreign exchange swap markets increased following the emergence of concerns about banks overseas, strains in these markets eased following central banks' actions in response to these concerns – including through increasing the frequency of existing US dollar foreign exchange swap line operations (see above). More generally, foreign exchange markets have continued to function well over the recent period.



Endnotes

[1] For more detail, see RBA (2023), 'Box A: Recent International Bank Failures – Causes, Regulatory Responses and Implications', *Financial Stability Review*, April. Available at <https://www.rba.gov.au/publications/fsr/2023/apr/box-a-recent-international-bank-failures-causes-regulatory-responses-and-implications.html>