1. The International Environment

Growth in a number of our trading partners eased in the second half of 2018, and growth looks to have broadly continued at this more moderate rate into 2019. The slowing has been partly the result of a sharp slowing in global trade. This has been particularly evident in trade-exposed sectors such as manufacturing and trade-oriented economies in Asia and the euro area. Export orders data suggest that trade growth could remain subdued in the near term. However, in many economies, domestically focused sectors such as services and retail trade have been more resilient than externally focused sectors, with strong labour market conditions and accommodative financial conditions providing support.

The sharp slowing in trade is related to slowing growth in China, as well as developments in trade policies and a turn in the cycle in the electronics industry. Chinese authorities are continuing their efforts to support domestic growth in a manner that does not increase financial stability risks, by easing fiscal and monetary policy. Recent data in China show that growth in industrial production, fixed asset investment and total social financing has increased, suggesting momentum has picked up. Overall, growth in Australia's major trading partners is expected to be around 3¾ per cent in 2019 and 2020, which is at, or a little below, potential.

Despite tight labour market conditions and a pick-up in wages growth in advanced economies, inflationary pressures remain subdued. Core inflation has been weaker than expected and is below central banks' inflation targets in most advanced economies. Headline inflation has declined because of the fall in oil prices in late 2018, although oil prices have risen over 2019 to date. More generally, commodity price outcomes have been mixed. Supply disruptions in Brazil and, to a lesser extent, Australia have boosted iron ore prices significantly; this has resulted in the outlook for Australia's terms of trade being stronger than expected at the time of the February *Statement on Monetary Policy*.

Major central banks have revised down their forecasts for growth and inflation over recent months, and have highlighted the downside risks. Moreover, central banks see little, if any, upside risks to inflation despite increasingly tight labour markets. Accordingly, they have signalled that policy is likely to be more accommodative than previously anticipated. As a result, financial conditions have eased in recent months, largely unwinding the sharp tightening that occurred at the end of 2018. Sovereign bond yields have declined to very low levels and the spread between long- and short-term yields is low. At the same time, credit spreads and equity risk premiums have generally declined or remained steady, leaving the overall cost of financing for corporations low.

The accommodative outlook for policy in advanced economies and China has also contributed to a general improvement in financial conditions for emerging market economies. In emerging Asia, a more subdued

inflation outlook and stabilisation in capital flows have allowed central banks that tightened policy last year to generally pause of late.

Global trade growth has slowed

Global trade growth has fallen further in early 2019 and data on new export orders suggest that trade growth will remain subdued in the near term (Graph 1.1). The impact of slower trade growth has been particularly evident in manufacturing; in some trade-oriented economies, particularly in east Asia, conditions in the manufacturing sector have eased to below their post-crisis averages.

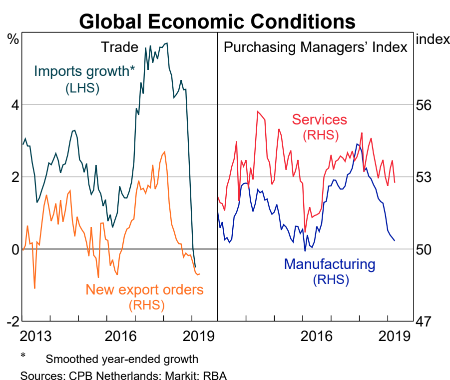
One of the factors behind the sharp slowing in trade is the slowing in domestic demand growth in China. US protectionist measures that have already been enacted and their supply chain effects are also likely to have contributed to the broad-based slowing in trade (Graph 1.2). The outlook for trade policy remains uncertain. Bilateral trade negotiations between the United States and China are continuing. While there had been reports of progress in recent months, the US administration has recently threatened additional tariffs in the near term. There is also a risk that the US administration increases automotive tariffs; this would particularly affect US trade with the European Union and Japan which have significant automotive sectors. Any negative developments on trade policy could harm global growth.

A decline in Chinese domestic demand growth has been one factor behind the slowdown in trade …

In China, real GDP growth eased in the March quarter, in quarterly and year-ended terms (Graph 1.3). Subdued growth in investment in the quarter was partly offset by a pick-up in consumption growth and a lift in net exports. The Chinese Government lowered the 2019 GDP growth target at their annual congress in March to 6–6.5 per cent, down from a target of around 6.5 per cent in 2018. This recognises the structural decline in growth that has been apparent for some time and the additional downward pressure on growth in the past year that has arisen from regulatory measures to address financial risk. The government also changed the target for the urban unemployment rate from 'below' 5.5 per cent to 'around' 5.5 per cent, and emphasised the need to support employment. Authorities reiterated their focus on supporting growth through measures to support smaller and private firms.

Graph 1.1

Global Economic Conditions

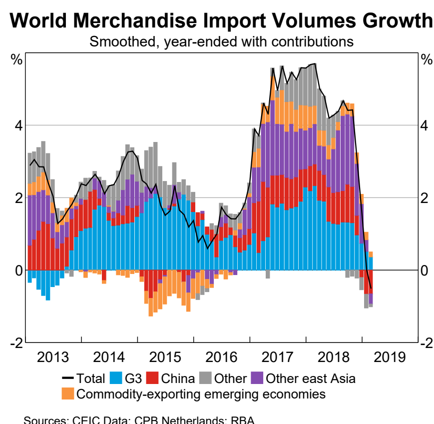


* Smoothed year-ended growth

Sources: CPB Netherlands; Markit; RBA

Graph 1.2

World Merchandise Import Volumes Growth



Sources: CEIC Data; CPB Netherlands; RBA

… but monthly activity indicators suggest momentum in China has strengthened more recently …

A range of disaggregated Chinese activity indicators have picked up in recent months (Graph 1.4). Growth in industrial production increased in March. Some of this represented a bringing forward of activity ahead of value-added tax changes in April, but some of the pick-up is likely to persist. The number of industrial products for which output is falling has declined, manufacturing purchasing managers indexes (PMIs) have strengthened and growth in industrial sector profits rebounded in March. Growth in fixed asset investment has also increased in recent months, driven by infrastructure investment (which has been supported by fiscal policy) and real estate. Growth in retail sales has increased in both nominal and real terms in the March quarter.

Conditions in Chinese property markets are also improving. Growth in real estate investment has been relatively stable, but has been supported by a pick-up in spending on construction and fittings rather than land purchases by developers (Graph 1.5). Housing prices rose in most cities in the March quarter. Housing sales have increased strongly in recent months, absorbing some of the inventory that has built up over the past year. Authorities have reiterated their commitment to limiting speculative activity, but recently announced reforms to loosen restrictions on rural–urban and inter-city migration that are likely to support prices and investment in smaller cities in the medium term.

Producer price inflation has declined over the past year, reflecting subdued conditions in the industrial sector and low fuel price inflation (Graph 1.6). Core consumer price inflation has been relatively stable recently. In contrast, headline consumer price inflation has increased, mainly due to a sharp increase in fresh

Graph 1.4

China – Activity Indicators

* Based on weighted geometric mean of growth rates of industrial products
** Average of official and Caixin measures
*** RBA estimates prior to May 2014
**** Deflated by retail price index
Sources: CEIC Data; Markit; RBA

Graph 1.3

China – GDP Growth

* Seasonally adjusted RBA estimates prior to December quarter 2010
Sources: CEIC Data; RBA

Graph 1.5

China – Residential Property Indicators

* Contributions of residential and non-residential investment
** Construction, installation, equipment purchases and other
Sources: CEIC Data; RBA

vegetable and pork prices; the recovery in pork prices is partly due to supply shortages stemming from the spread of the African swine flu.

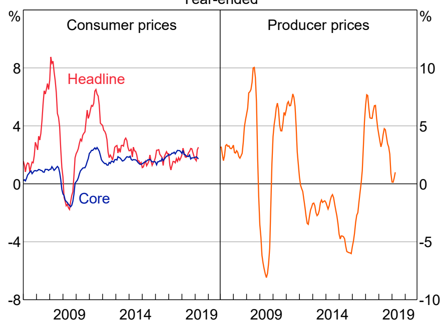
Chinese merchandise exports were little changed in the March quarter, while imports declined. Trade with the United States has weighed on Chinese exports and imports, as a result of tariff increases from late last year and front-loading in 2018 to avoid these tariffs. Shipments of Australian coal have been taking longer to clear customs in recent months. While this has weighed on Chinese imports of Australian coal, the effect on overall coal imports has been largely offset by increased coal imports from other countries.

… supported by targeted policy easing

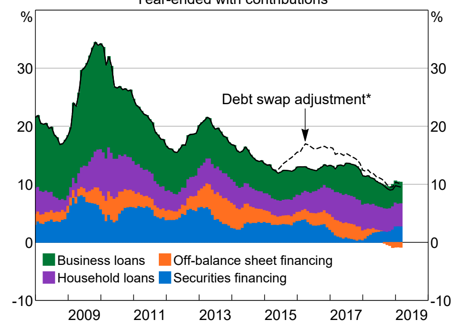
The Chinese authorities are continuing their efforts to support growth in a manner that does not increase financial stability risks, through a targeted easing of fiscal and monetary policy. In early March, the Chinese Government announced additional measures to increase spending on infrastructure, as well as an increase in the quota for local government 'special bonds' (see Box A: China's Local Government Bond Market). Authorities also announced significant cuts to the value added tax rate. As a result, the general government budget deficit is projected to widen slightly in 2019, in both headline and underlying terms.

Growth in total social financing has picked up slightly since the start of 2019 because strong growth in bank credit has offset the continued contraction of off-balance sheet financing (Graph 1.7). Chinese authorities have reiterated their commitment to keeping the ratio of debt-to-GDP stable. Meanwhile, the authorities have continued to support financing conditions for private businesses, in particular micro- and small-sized enterprises (MSEs); official estimates suggest that private firms account for more than 60 per cent of GDP and over 80 per cent of urban employment. Financial regulators have instructed large state-owned banks to increase the stock of lending to MSEs by at least 30 per cent in 2019. The authorities have also announced further targeted cuts to reserve requirement ratios for some small and medium-sized banks. They also stated that the resulting release of funds should be directed towards lending to MSEs.

Graph 1.6



Graph 1.7



Elsewhere in east Asia the decline in trade has weighed on investment

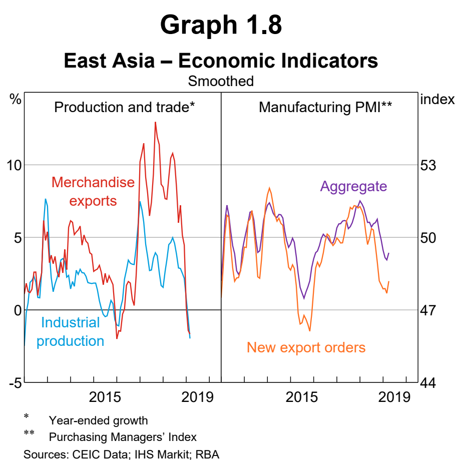
In most economies in east Asia, export growth has eased sharply and survey measures of new export orders are below average (Graph 1.8). Industrial production growth has slowed and surveyed business conditions have also eased to below average levels in many economies in the region.

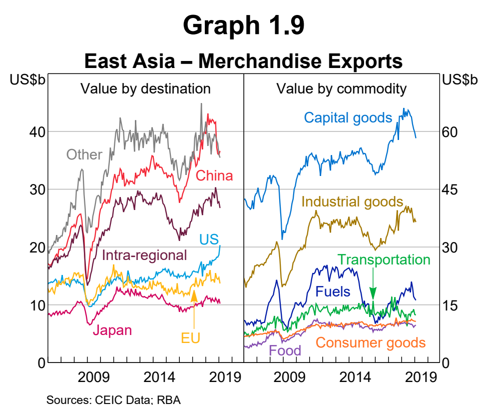
The fall in export growth has been most pronounced in exports to China, consistent with slowing domestic demand in China (Graph 1.9). The effects of US–China trade tensions on supply chains in the region are also apparent in intra-regional exports. However, lower-cost economies in the region, such as Vietnam, the Philippines and Thailand, could potentially benefit from production shifting away from China to avoid higher US tariffs. Export growth to the major advanced economies has been relatively resilient; export growth has picked up to the United States and has moderated only a little to the European Union and Japan.

The slowing in trade and the recent weakness in industrial production in east Asia has been evident in capital and industrial goods exports, particularly in the semi-conductor sector. This follows very strong growth in this sector in 2016. The slowdown reflects a cyclical downturn in global demand for semi-conductors, driven by lower smartphone demand in China and a shift to less frequent device upgrades by consumers. The impact on the region has been amplified by the fall in semi-conductor prices over 2018, after they rose strongly in 2017. Business investment contracted in the economies with sizable semi-conductor sectors, such as South Korea, largely because of the completion of earlier investment to add to productive capacity in the electronics sector.

While the declines in export growth have been similar across economies, those most exposed to global trade, such as South Korea and Singapore, have been more adversely affected in other respects. In particular, business investment growth slowed sharply in these economies, while it has held up in the less trade-exposed economies (Graph 1.10). South Korean GDP fell in the March quarter because investment and exports contracted; consumption growth slowed but remained positive.

In Indonesia, growth has been more resilient because consumption and investment growth have eased only slightly (Graph 1.11). The significant monetary policy tightening in Indonesia in 2018 has had limited effect on





domestic demand because the pass-through to banks' lending rates has been limited.

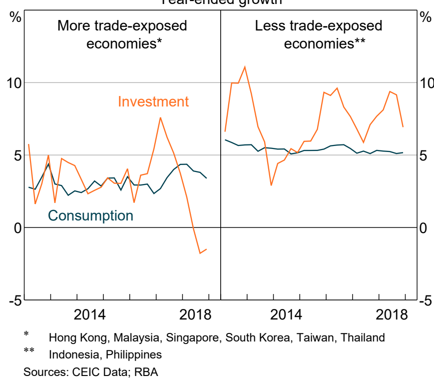
In India, growth remains relatively robust

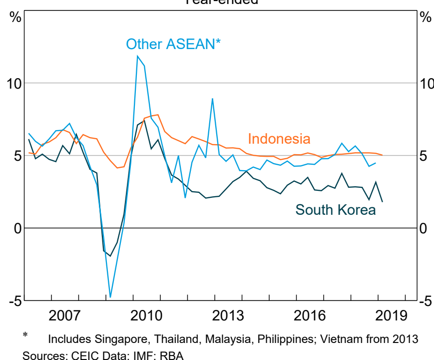
In India, which relies less on merchandise trade than most economies in the region, economic growth edged higher in the December quarter, but over the year the pace has declined (Graph 1.12). Investment and export growth remained robust in the quarter, while growth in private and public consumption slowed. Growth in other parts of the economy, such as industrial and steel production, have also eased in recent months. Core inflation (which excludes food and fuel) continues to moderate. Headline inflation picked up in February and March, but remains low, primarily due to weak food price inflation.

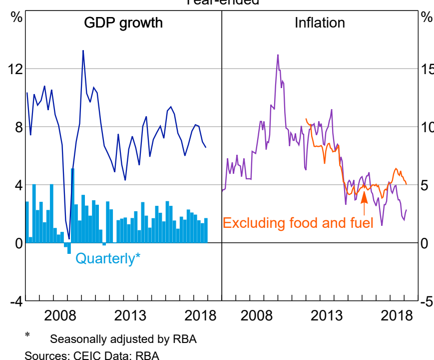
Growth in the major advanced economies has generally eased from above potential

Growth momentum has generally moderated across the major advanced economies from rates that were well above potential in 2017 and early 2018. Weaker external demand and policy uncertainty have weighed on growth to varying degrees (Graph 1.13). Manufacturing sectors have been particularly affected while service sectors and consumption have been relatively resilient.

In the United States, domestic demand continued to slow in early 2019 although a fall in imports contributed to stronger-than-expected GDP growth in the March quarter. Over the past year, growth in exports and business investment has slowed. Investment intentions have also eased but remain relatively high (Graph 1.14). The protracted US Government shutdown and severe weather dampened domestic activity around the turn of the year; consumption growth was weak while residential investment contracted further. A number of

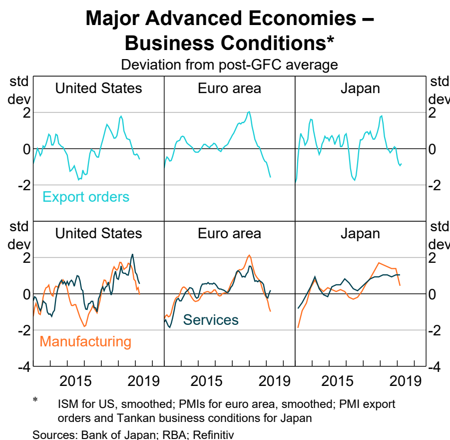


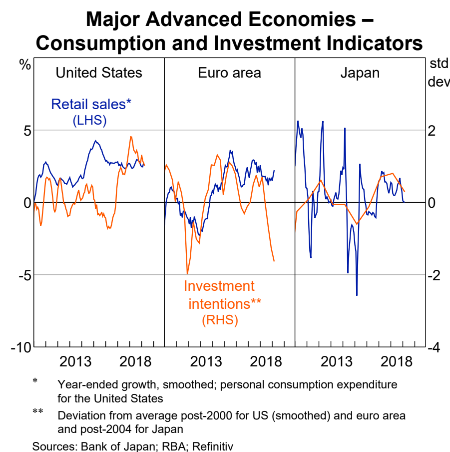




factors are likely to support consumption growth in the near term, although at a slower pace than during the past year when consumption was buoyed by tax cuts. Consumer sentiment is elevated, the labour market remains strong and wages growth has picked up.

In the euro area, growth picked up a little in the March quarter. New export orders suggest that the external demand weakness that has been dampening recent growth is likely to persist into the June quarter. Investment growth slowed in 2018 and investment intentions have eased further this year because of the weaker external conditions and the ongoing uncertainty about trade policies and the United Kingdom's exit from the European Union. More positively, temporary factors that disrupted the automotive industry and key transportation channels in late 2018 and into early 2019, appear to have been largely resolved. Moreover, retail sales growth and consumer confidence remain above average in 2019, supported by strong employment growth.





Japanese GDP growth appears to have slowed abruptly in early 2019, driven by external demand. Exports to China and the rest of Asia were weak, new export orders have been subdued and surveyed conditions in the manufacturing sector have declined sharply. Business investment appears to have held up in the March quarter but investment intentions have moderated. In contrast, business conditions in the services sector remain buoyant, consistent with the above-average growth in domestic demand.

Tight labour markets in advanced economies are supporting consumption and wages growth has increased …

Employment growth remains high and above working-age population growth in the major advanced economies in 2019 (Graph 1.15). While employment growth has slowed a little in some of these economies since mid 2018, it has held up well relative to the slowing in GDP growth, which is similar to the experience in Australia. Unemployment rates are at multi-decade lows in many advanced economies. Tight labour markets have also encouraged higher participation rates. Employment intentions have declined a little in the United States and the euro area but remain at a high level. Vacancy rates remain very high and firms

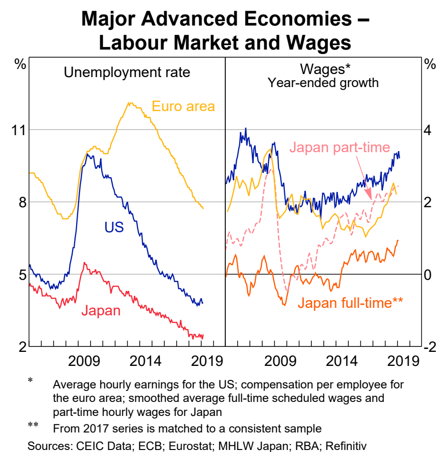
continue to report widespread difficulties in filling jobs. This labour market strength is supporting ongoing growth in household income and consumption.

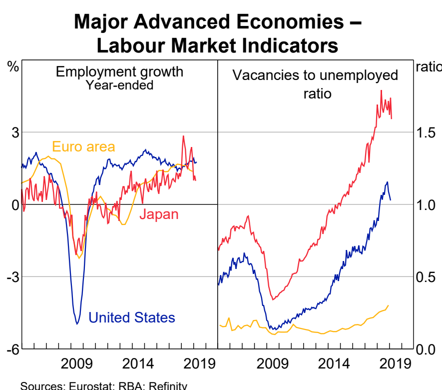
Wages growth increased notably over 2018 in the major advanced economies, continuing the trend of recent years (Graph 1.16). US wages growth is around the highest of the current expansion. Wages growth in the euro area in late 2018 was around the highest since 2010, although it has softened a little recently. In Japan, it appears that full-time wages growth remains positive and wages in the more cyclically sensitive part-time sector have continued to grow at a very high rate relative to the past decade. In some advanced economies such as New Zealand, Spain and South Korea substantial increases to minimum wages will also contribute to wages growth.

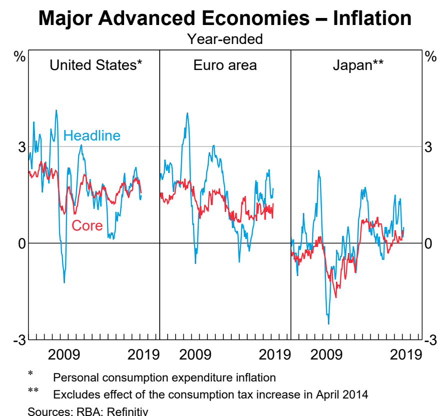
… but global inflation remains subdued

Core inflation is low in the three major advanced economies, despite ongoing capacity constraints. It is also now below central bank targets in each of these economies, given the easing in the US Federal Reserve's preferred core inflation measure in recent months (Graph 1.17). Headline inflation has fallen because of the oil price decline in late 2018; oil prices have retraced some of this fall more recently. Higher US–China tariffs have increased costs for some producers in these economies. Inflation expectations of professional forecasters and measures derived from financial markets have generally declined over the past six months; consumer expectations have also eased, except in Japan.

Core inflation also remains generally subdued in the east Asian region, while headline inflation has declined because of the fall in oil prices in late 2018 (Graph 1.18). In the Philippines, inflation has returned to the central bank's







target range following substantial policy tightening over 2018. Inflation continues to be low in Malaysia because of changes in consumption taxes.

Trading partner growth has moderated and is expected to continue at a similar rate in 2019 and 2020

Growth in Australia's major trading partners is expected to be around 3¾ per cent in 2019 and 2020 (Graph 1.19). This is noticeably slower than the relatively fast pace of growth in 2017 and in the first half of 2018, but remains at, or a little below, potential. Recent data have led to some small downward revisions to the global growth outlook, mainly because of lower growth in parts of Asia as a result of the more pervasive slowing in global trade. Global inflation is expected to be a little lower, and monetary policy is expected to be more accommodative over the forecast period than at the time of the February *Statement*, in line with financial market expectations. Risks around trade and other policies remain and could weigh on growth more than currently expected. In contrast, the risks around the global impetus from Chinese demand are more balanced, in light of emerging signs that policy stimulus is supporting growth in China.

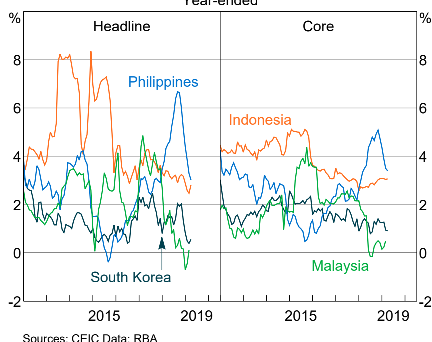
In China, near-term growth is expected to be supported by targeted policy-easing measures, but continue to moderate further out because of longer-term structural factors such as the declining working-age population. In the United States, GDP growth is expected to moderate from its very strong rate in 2018 to be around estimates of potential by 2020. Some of this moderation can be explained by the waning effects of the recent fiscal stimulus, although markets expect monetary policy to be more accommodative than previously.

In 2019, the moderate growth expected in most other regions reflects a mix of subdued external demand being counterbalanced by resilient domestic demand. In parts of east Asia, trade effects on manufacturing and investment have been particularly evident. In Japan, the slowing in external demand and the related easing in manufacturing sector conditions are expected to be offset by the boost from consumption being brought forward ahead of an October 2019 increase in the consumption tax, leaving growth around potential. In the euro area, GDP growth is expected to be below potential in 2019 because of weaker external demand and its effects on investment; the investment

Graph 1.18

East Asia – Inflation

Year-ended

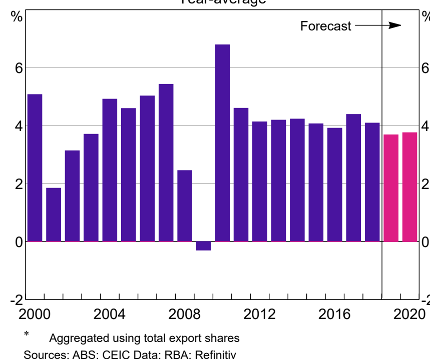


Sources: CEIC Data; RBA

Graph 1.19

Australia's Trading Partner Growth*

Year-average



* Aggregated using total export shares

Sources: ABS; CEIC Data; RBA; Refinitiv

weakness is expected to be compounded by the effects of continuing political uncertainty about the United Kingdom's exit from the European Union. Consumption is expected to remain supported by tight labour markets.

Fiscal policy will provide support in 2019 in a number of countries, with the exception of Japan (Graph 1.20); structural deficits are set to increase in 2019 in the United States, and in the euro area led by Germany. Monetary policy in trading partner economies is also expected to be more accommodative over the forecast period than at the time of the February *Statement*.

Central banks have signalled that accommodative policy is likely to persist for longer

A number of major central banks have signalled that policy settings are likely to remain more accommodative than earlier expected. This shift has reflected lower projections for growth and inflation, and policymakers have highlighted increased downside risks. Market participants have further revised their expectations for policy rates lower since the previous *Statement* (Graph 1.21). Market pricing implies that monetary policy rates in most advanced economies are expected to remain at, or below, current levels through to mid 2020.

In the United States, the Federal Reserve (Fed) has lowered its projections for the path of its policy rate and continued to state that it will take a patient and flexible approach to setting policy. In its most recent forecast update, the Fed revised its central projections for growth down modestly, while indicating the upside risks to inflation are limited despite ongoing tightness in the labour market. The Federal Open Market Committee (FOMC) now projects its policy rate is most likely to remain unchanged in 2019, followed by one increase in 2020 (in December, officials projected two increases in 2019 and one in 2020) (Graph 1.22). By contrast, market pricing suggests that the FOMC is expected to lower its policy rate by the end of this year, in part reflecting a perception that risks to growth and inflation are skewed to the downside.

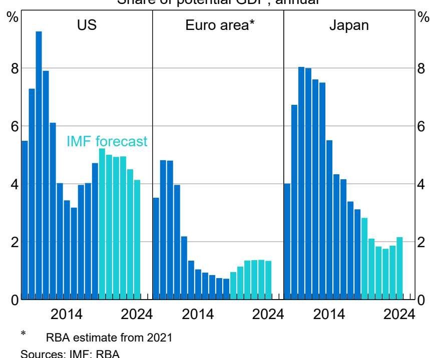
The Fed has also announced that the decline in its asset holdings will slow from May and cease from the end of September, sooner than market participants had expected (Graph 1.23). Based on this guidance, the Fed's securities portfolio will settle higher than market participants had expected a few months ago.

The European Central Bank (ECB) expects to leave its policy rate unchanged until at least the

Graph 1.20

Major Advanced Economies – Structural Fiscal Deficits

Share of potential GDP, annual

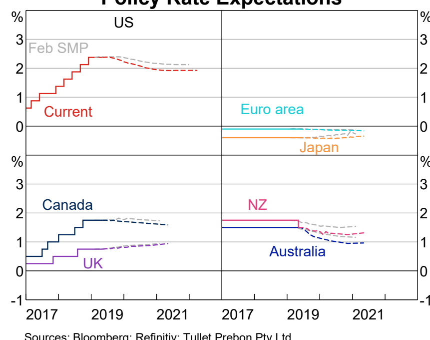


* RBA estimate from 2021

Sources: IMF; RBA

Graph 1.21

Policy Rate Expectations



Sources: Bloomberg; Refinitiv; Tullet Prebon Pty Ltd

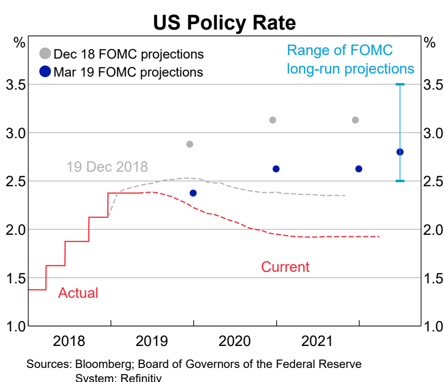
end of 2019, three months later than previously signalled. This reflects noticeable downward revisions by the ECB to its near-term economic growth and inflation forecasts, and its view that risks are tilted to the downside. Market pricing is broadly consistent with this policy guidance. The ECB also announced a third series of lending operations to euro area banks on favourable terms, beginning in September (labelled 'Targeted Long-term Refinancing Operations', TLTRO-III). The new program addresses concerns that financial conditions might otherwise have tightened unhelpfully for current monetary policy settings as loans from the previous program are repaid in the year ahead.

The Bank of Japan (BoJ) has continued to provide monetary stimulus by maintaining very low interest rates and expanding its balance sheet. At its April meeting, the BoJ stated that it expects to leave its policy settings unchanged until at least the second quarter of 2020. Market participants expect the current policy stance to be maintained for an extended period. Inflation forecasts have been consistently revised lower in the past year, with inflation now expected to reach 1.3 per cent by 2020 compared with expectations of 1.8 per cent a year ago (and against a target of 2 per cent).

A number of other central banks have signalled a more accommodative outlook for policy settings, citing the weaker outlook for growth and downside risks. The Bank of Canada stated that their monetary policy settings are expected to remain more accommodative than previously anticipated, though officials have stated that the next move is more likely to be up than down. Market pricing suggests that the policy rate will remain unchanged for some time. At its May meeting, the Reserve Bank of New Zealand (RBNZ) lowered its policy rate by 25 basis points to 1.5 per cent, and noted that the outlook for policy is now more balanced. The RBNZ lowered its forecasts for activity and employment growth, and noted that inflation is expected to return to the 2 per cent midpoint of its target range by mid-2021, a little later than previously indicated. Market pricing suggests that the policy rate is expected to be lowered again by early next year. Bank of England (BoE) officials continue to point to the outcome of Brexit as a significant source of uncertainty, and note that it is likely to shape the next move in the BoE's policy rate, which could be up or down. Market participants expect that the policy rate will be increased around the middle of 2021, a little later than previously expected.

Graph 1.22

US Policy Rate

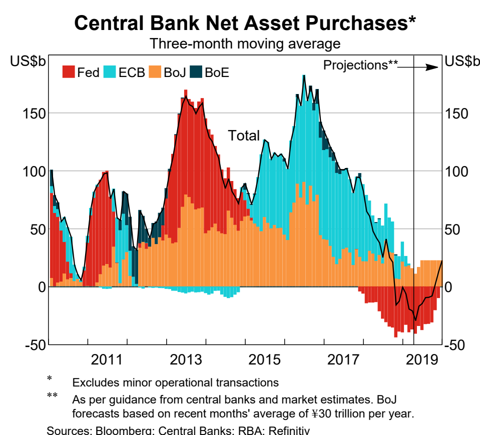


Sources: Bloomberg; Board of Governors of the Federal Reserve System; Refinitiv

Graph 1.23

Central Bank Net Asset Purchases*

Three-month moving average



* Excludes minor operational transactions

** As per guidance from central banks and market estimates. BoJ forecasts based on recent months' average of ¥30 trillion per year.

Sources: Bloomberg; Central Banks; RBA; Refinitiv

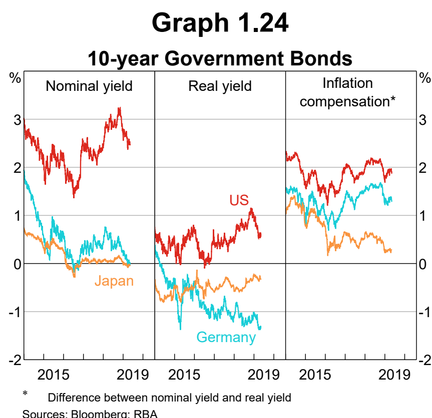
Government bond yields have fallen to low levels …

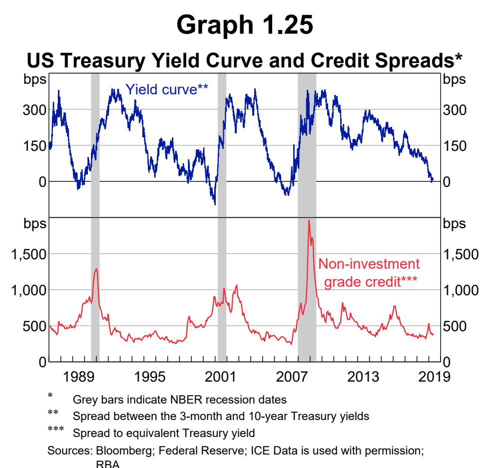
In recent months, the yields of long-term government bonds have declined to be near historically low levels (see 'Box B: Why Are Long-term Bond Yields So Low?'). In Germany and Japan, long-term yields are again close to the record low levels seen in 2016 (Graph 1.24). The declines in bond yields since late last year have reflected a noticeable fall in real yields and lower inflation compensation. This is consistent with the downward revisions to macroeconomic projections by central banks and market participants, and the lowering of policy rate expectations. In addition, term premiums – the compensation that investors demand for the additional risk of holding long-term rather than short-term bonds – have declined to be around record low levels.

Yield curves have also flattened in recent months. For a short period, long-term bond yields in the United States were below those of some short-term interest rates (Graph 1.25). This so-called 'inversion' of the yield curve attracted attention from market participants, as persistent inversions have tended to precede economic downturns in the United States by 12–18 months. However, this signal from the yield curve is likely to be distorted by the very low term premium, which is around 200 basis points below its long-term average. Also, other market indicators for future economic conditions are not currently pointing to an economic downturn. For example, credit spreads on high-yield corporate bonds in the United States remain low. Credit spreads tend to increase when market participants perceive a rise in the risk that borrowers will default on their debt obligations, as is commonly seen in an economic downturn.

… and the cost of financing for corporations has declined

Corporate bond yields have declined since the start of the year, more than reversing the increase experienced in late 2018. Over the year to date, the decline has mostly reflected lower credit spreads – the premium above government bond yields that investors demand as compensation to invest in corporate bonds. This improvement in conditions has encouraged non-financial firms to increase their issuance of bonds, particularly those firms with lower credit ratings (Graph 1.26). By contrast, issuance of leveraged loans has remained subdued. This may reflect ongoing concerns that investors have about credit quality in this market or that





the shift in the outlook for monetary policy has reduced the demand for securities like leveraged loans with floating interest rate coupons.

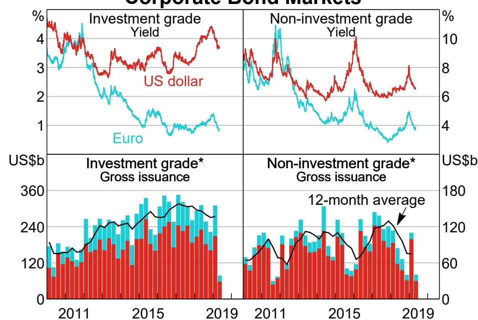
Equity prices globally have risen strongly since the start of the year and are now close to, or above, their levels in September last year (Graph 1.27). In the United States, equity prices are around record highs. Increases globally largely reflect changes in investors' appetite for, or perceptions of, risk, and expectations that central bank policy will be more accommodative than previously anticipated. This has more than offset the effect on equity prices of modest downward revisions to expected corporate earnings in 2019. Measures of equity market valuations, such as the price-earnings ratio, remain around their long-term averages after declining notably in the final quarter of 2018.

Spreads in short-term money markets (over and above expected policy rates) have declined substantially this year (Graph 1.28). In US dollar markets, conditions have eased following the tightness associated with the regulatory constraints on banks' balance sheets that bind at the end of the calendar year. Also, there have been strong inflows to money market funds that invest in short-term securities issued by banks and corporations. In addition, the US Treasury has shifted some of its issuance from short-term bills toward longer-term bonds.

The US dollar is little changed and currency volatility is low

The US dollar remains a little below its levels of late 2018 on a trade-weighted (TWI) basis (Graph 1.29). Following a sustained appreciation over much of 2018, from mid December the US dollar depreciated alongside a more pronounced shift in the outlook for monetary policy in the United States than in other major economies. The euro has depreciated slightly since the start of the year on a TWI basis alongside weaker-than-expected macroeconomic data and expectations that the

Graph 1.26



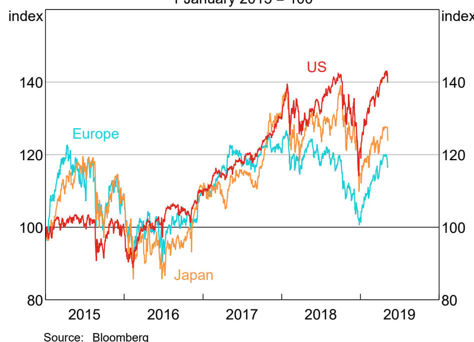
* Non-financial corporations; June quarter-to-date

Sources: Dealogic; ICE Data is used with permission

Graph 1.27

Equity Prices

1 January 2015 = 100

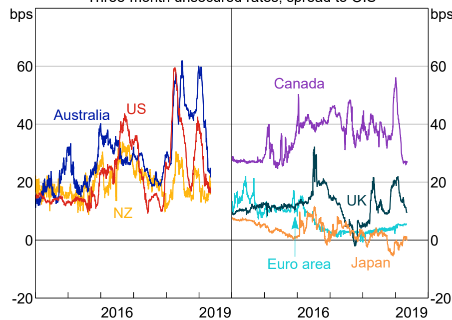


Source: Bloomberg

Graph 1.28

International Money Markets

Three-month unsecured rates, spread to OIS



Sources: ASX; Bloomberg; Tullet Prebon (Australia) Pty Ltd

ECB's monetary policy settings will remain more accommodative than previously anticipated. The Japanese yen has appreciated of late, to be back around its levels of late 2018. Volatility in the currencies of advanced economies has declined since the start of the year to be around its lowest level of the past several years.

In China, financial markets have reacted to stronger-than-expected economic data and an increase in trade uncertainty

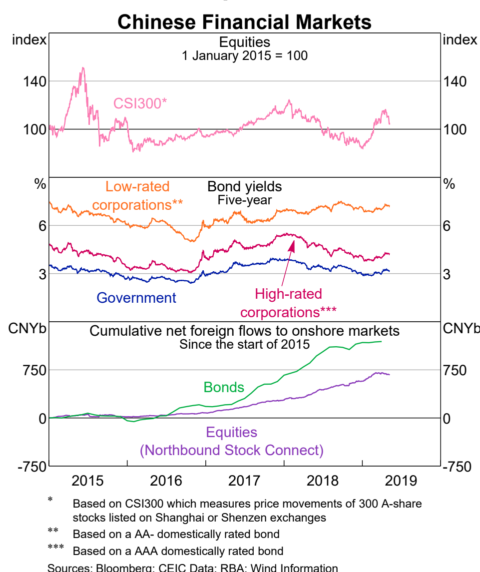
The pick-up in Chinese activity indicators in recent months has led to some paring back of market participants' expectations for the pace of further monetary easing by the People's Bank of China. Accordingly, yields on Chinese government and corporate bonds have increased, although for the government and high-rated corporations, yields remain at low levels (Graph 1.30). Equity prices have increased by a bit more than 20 per cent since the start of the year although have declined a little of late because of renewed concern regarding US–China trade negotiations.

The Chinese renminbi has depreciated recently amid renewed trade uncertainty (Graph 1.31). However, more broadly, the renminbi has continued to be supported by ongoing strong private capital inflows and a rise in bond yields in China relative to those in advanced economies. Chinese foreign currency reserves have remained stable at a little above US$3 trillion.

Announced increases in the weights of Chinese securities in major global financial indices have supported strong capital inflows into China's onshore bond and equity markets. The Chinese authorities have been seeking to expand foreign investors' access to its capital markets in recent

Graph 1.30

Chinese Financial Markets

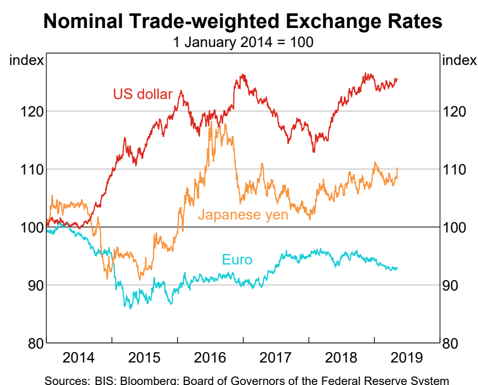


* Based on CSI300 which measures price movements of 300 A-share stocks listed on Shanghai or Shenzen exchanges
** Based on a AA- domestically rated bond
*** Based on a AAA domestically rated bond
Sources: Bloomberg; CEIC Data; RBA; Wind Information

Graph 1.29

Nominal Trade-weighted Exchange Rates

1 January 2014 = 100



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

Graph 1.31

Chinese Exchange Rates

* Indexed to 1 January 2014=100
Sources: Bloomberg; China Foreign Exchange Trade System; RBA

years, including by enhancing investment channels between Mainland China and Hong Kong. The authorities have stated their intention to further expand market access for foreign investors, especially to its financial services sector.

Financing conditions have improved in many emerging economies, but risks remain

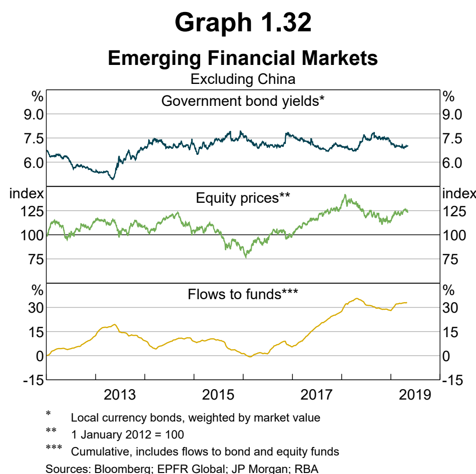
In many emerging market economies, asset prices and exchange rates have been relatively stable in recent months (Graph 1.32). There have been inflows into emerging market mutual and exchange traded funds, and emerging market governments have increased their issuance of US dollar bonds. The more stable conditions reflect lower policy rate expectations in the United States and elsewhere, measures adopted by the authorities to support growth in China, and tighter monetary and/or fiscal policies implemented in some emerging market economies in response to market stresses during 2018.

A number of central banks in emerging market economies have shifted their policy rate guidance in recent months as financial market conditions have stabilised. In Asia, the central banks that had tightened policy last year have generally paused of late (Graph 1.33). The shift in stance has reflected downward revisions to global growth forecasts, subdued domestic inflationary pressures and an easing of current account and financial stability risks since last year. The central banks of India and Malaysia have both eased policy this year.

Although financial conditions in emerging markets have been generally stable in 2019, risks remain for some economies with specific macrofinancial and/or political vulnerabilities. In Turkey and Argentina, currencies have again depreciated and central banks have further tightened monetary policy in recent months alongside persistently high inflation and political uncertainty associated with recent and upcoming elections (Graph 1.34). To date, these developments have not spilled over in any noticeable way to other emerging markets, including in Asia.

There have been some large movements in commodity prices in recent months

The benchmark iron ore spot price has increased since the previous *Statement* to be around its highest level since early 2017 (Graph 1.35; Table 1.1). Prices rose sharply in late



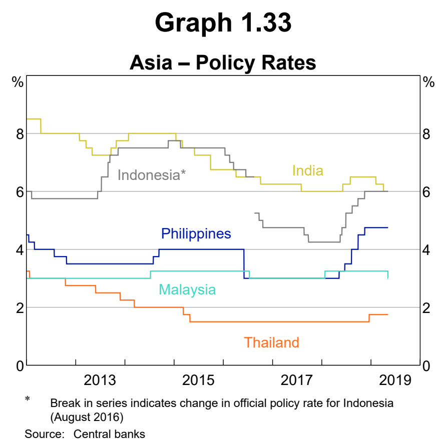


Table 1.1: Commodity Price Growth[(a)]

	Since previous *Statement*	Over the past year
Bulk commodities	3	31
– Iron ore	8	55
– Coking coal	2	19
– Thermal coal	–10	–12
Rural	2	2
Base metals	–2	–14
Gold	–2	0
Brent crude oil[(b)]	15	–7
RBA ICP	2	11
– Using spot prices for bulk commodities	0	14

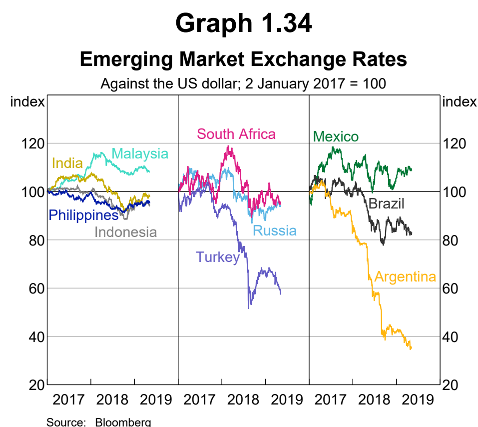
(a) Prices from the RBA Index of Commodity Prices (ICP); bulk commodity prices are spot prices

(b) In US dollars

Sources: Bloomberg; IHS Markit; RBA

January following the collapse of a tailings dam in Brazil and subsequent mine closures, and have increased further since. Around 6 per cent of global seaborne supply has been affected by the Brazilian mine closures. However, increased production at other Brazilian mines and draw-downs of stockpiled ore are expected to partly offset the lost production. An extended period of high iron ore prices may also encourage higher-cost production in other countries to come back online. More recently, supply side disruptions at Australian ports as well as a pick-up in Chinese steel production following the end of Chinese winter production restrictions, have also supported prices. Nevertheless, significant uncertainty remains around the outlook for iron ore seaborne supply and prices.

After an extended period of pronounced price differentials in the iron ore market, the discount for lower-grade ore has narrowed substantially relative to the benchmark price in recent months. This narrowing has been driven by steel



makers substituting towards lower-grade ore to support margins in response to lower steel prices in late 2018, and because of a reduction in higher-quality Brazilian supply. The smaller discount should provide some support to Australia's iron ore export values because lower-grade products account for around 40 per cent of Australia's iron ore exports.

Oil prices have increased considerably since the previous *Statement,* but remain around 18 per cent below their peak in October 2018 (Graph 1.36). The increase in prices reflects reduced supply since December 2018. Saudi Arabia has cut production by more than its commitment under the December OPEC+ agreement and production has declined for some countries exempt from the agreement, including Iran, Venezuela and Libya. These supply reductions have offset continued increases in US production.

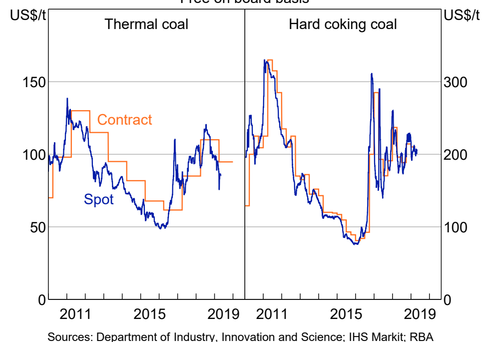
Australian thermal coal prices have declined sharply since the previous *Statement* (Graph 1.37). A reported softening in Chinese demand over the past couple of months has weighed on prices, and customs clearance times for Australian coal at some Chinese ports have lengthened. Weaker demand from Asia more broadly and increased supply from Russia, the United States and more recently Australia have also weighed on prices. Just prior to a large decline in the spot price in early April, the 2019 Japanese fiscal year benchmark price was agreed at 14 per cent lower than the 2018 benchmark price; around one-quarter of Australia's thermal coal exports are sold on contract based on the benchmark price. Coking coal prices have increased slightly since the previous *Statement* reflecting a pick-up in Chinese demand because of increased steel production.

Base metal prices are generally lower since the previous *Statement* (Graph 1.38). Price movements in recent months have been driven by sentiment regarding the outlook for global demand, as well as an easing of supply concerns.

Graph 1.37

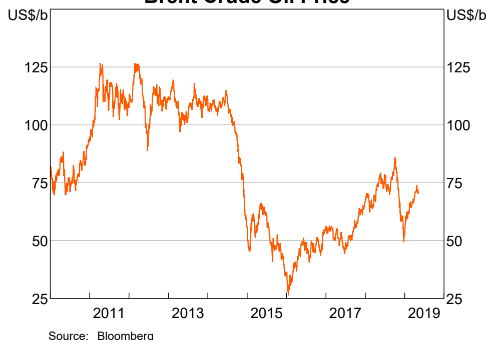
Coal Prices

Free on board basis



Graph 1.36

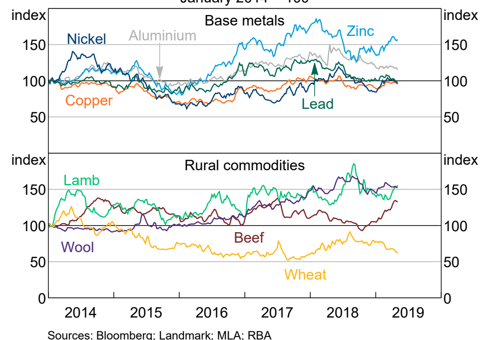
Brent Crude Oil Price



Graph 1.38

Base Metal and Rural Prices

January 2014 = 100



Prices for Australian rural exports have increased slightly since the previous *Statement* because higher beef prices have been only partly offset by lower global wheat prices. Beef prices have increased by more than 40 per cent since their October trough, supported by strong global demand and, to some extent, a moderate slowing in Australian beef production rates in recent months. Meanwhile, the decline in wheat prices over recent months follows the improved outlook for northern hemisphere wheat production.

Australian export prices (including the prices of non-commodity exports) are expected to have increased in the March quarter, largely reflecting higher iron ore prices. Export prices are still likely to decline over the next few years as Chinese demand for bulk commodities moderates and global supply increases (see 'Economic Outlook' chapter). ✠