Box A: Composition of Capital Flows in 2000

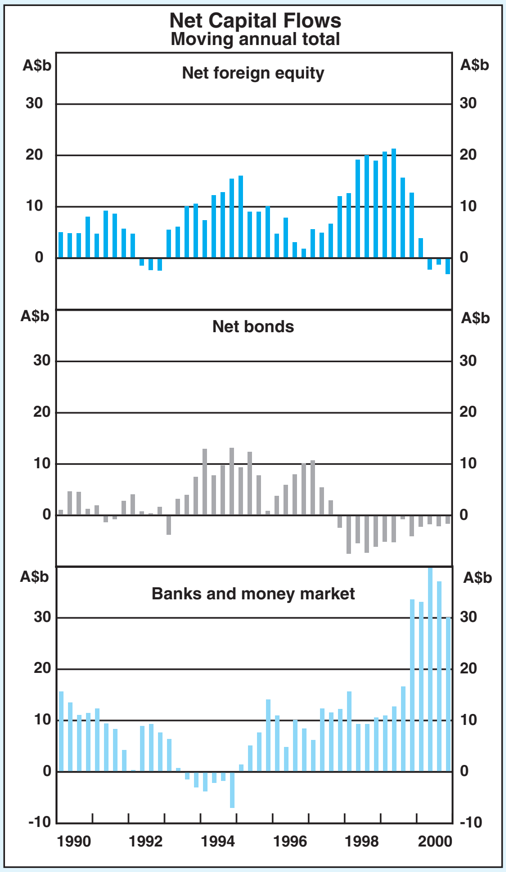
This Box summarises recent data on capital flows into and out of Australia.

Capital flows can be disaggregated in various ways. Graph A1 breaks the flows down into three main types: equity flows; bond flows (mainly government bonds); and flows channelled through the banking system and money market. For each category the flows are shown in net terms – i.e. the difference between inflows and outflows. The data are also smoothed to some extent by showing four quarter moving totals.

The main points that can be observed from the graph are as follows:

- net equity flows fell away sharply during 2000 after being quite strong through 1998 and 1999;
- bond flows have been negative since 1997. This is the period when bond yield differentials relative to the US narrowed very sharply; and
- inflows through banks and the money market have increased strongly. These flows incorporate overseas borrowings by banks, which are on-lent to Australian households and businesses, as well as purchases of Australian corporate short-term debt by foreigners. It is important to note that the foreign borrowings by banks are either directly in Australian dollars or hedged back to Australian dollars. Banks use foreign borrowings as a way of diversifying their funding base, not to take on currency risk.

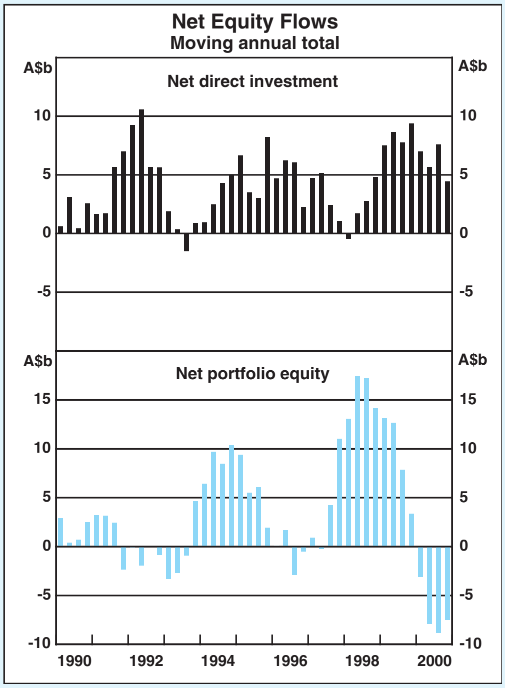
Graph A1



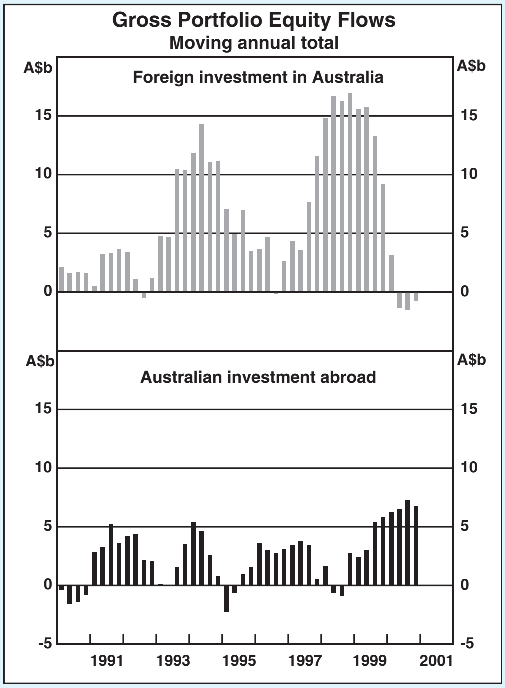
Equity flows can be disaggregated further, into direct investment (i.e. investment in Australian companies by overseas companies) and portfolio investment (essentially investment through share markets by funds managers and other institutions). This disaggregation is shown in Graph A2, and highlights that the decline of equity inflows into Australia last year was almost entirely due to swings in portfolio equity. Net direct investment has remained strong – i.e. overseas companies are continuing to find attractive investment opportunities in Australia.

Net portfolio equity flows can, in turn, be disaggregated further, into investment by foreigners into Australian shares and investment by Australians into foreign shares (Graph A3). This shows that the net outflows of portfolio equity investment in 2000 occurred because foreigners stopped investing into Australian shares (and in fact reduced their holdings of shares) while Australians increased their purchases of foreign shares.

Graph A2



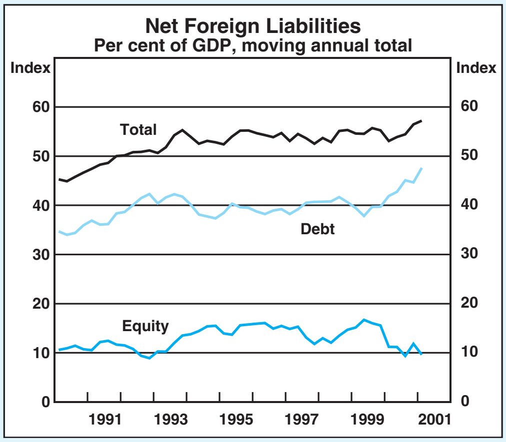
Graph A3



These changes in the composition of capital flows have been reflected in the outstanding claims that foreigners have on Australia. As a proportion of GDP, net foreign liabilities have not changed much over recent years, at around 55 per cent, but there has been a shift away from equity to debt over the past couple of years (Graph A4).

The currency composition of Australia's foreign assets and liabilities can be seen in Graph A5. It shows that Australia's net foreign liabilities are not reflected in a foreign currency exposure. Australia has more foreign-currency assets than liabilities, as most liabilities to foreigners are in Australian dollars. ✠

Graph A4



Graph A5