

2. International and Foreign Exchange Markets

Global financial markets were relatively calm over the latter part of 2013, notwithstanding a decision by the US Federal Reserve to commence the process of reducing its monthly asset purchases in December. In part this relative calm owed to active assurance by the Federal Reserve, the European Central Bank (ECB) and the Bank of Japan (BoJ) that policy will remain very accommodative for an extended period. These assurances were accompanied by a reduction in the ECB's main policy rate in November and the BoJ's ongoing commitment to continue increasing its balance sheet over 2014.

Since the start of 2014, however, global share prices have fallen sharply. In the major markets bond yields have also fallen although yields have increased noticeably in emerging markets, as certain country-specific factors and renewed concern about the risks associated with the Fed reducing its asset purchases dampened risk sentiment. While the US dollar has been broadly stable on a trade-weighted basis since the start of the year, it has continued to appreciate against a number of emerging market and commodity currencies. The Australian dollar has depreciated further in recent months.

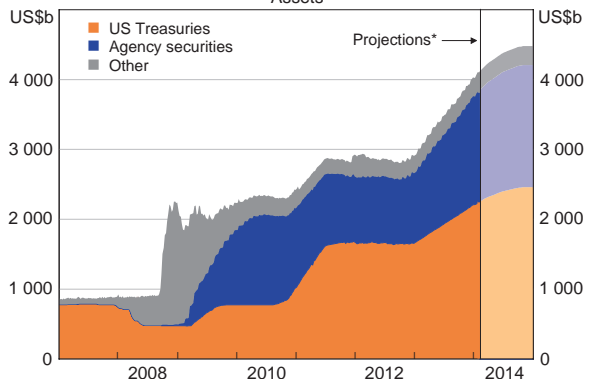
Central Bank Policy

The US Federal Reserve commenced the process of scaling back its asset purchase program following its December meeting, reducing its monthly purchases of US Treasuries and agency mortgage-backed securities (MBS) by US\$5 billion each. The Fed subsequently scaled back its asset purchases by a further US\$10 billion at its late January meeting, to US\$35 billion of Treasuries and US\$30 billion of

agency MBS per month. These reductions occurred in light of the improvement in the outlook for the labour market, with concerns that the marginal benefit of additional purchases may be declining and that a further expansion in holdings could raise financial stability risks also contributing. The accompanying statements signalled that the Fed anticipates it will continue to scale back its purchases in similar 'measured steps' over 2014, conditional on economic data broadly conforming to expectations. Market commentators have interpreted this as meaning a US\$10 billion reduction at each upcoming meeting, which would see the Federal Reserve cease all asset purchases later this year. If this expectation is realised, the Fed's holdings of assets will rise by a further US\$450 billion over 2014, having increased by US\$1.1 trillion over 2013 (Graph 2.1).

In an effort to assure markets that monetary policy will remain highly accommodative for a considerable

Graph 2.1
US Federal Reserve Balance Sheet
Assets



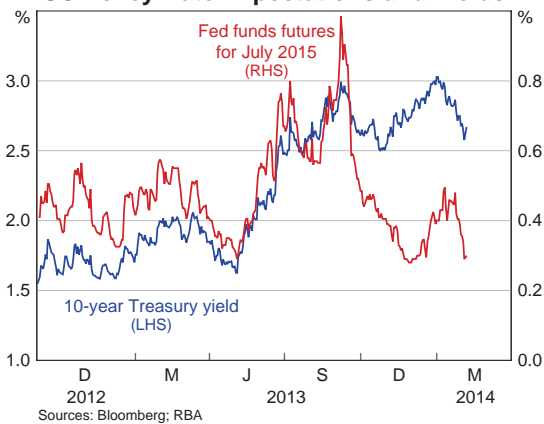
* Projections assume purchases decline by US\$10 billion per meeting, evenly split between Treasuries and agency MBS, and finish in October 2014

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

time, the announcement of the reduction in asset purchases in December was accompanied by a statement that the Fed expects to leave the federal funds rate unchanged until 'well past the time' that the unemployment rate falls below 6½ per cent, especially if inflation continues to be below its 2 per cent target. Consistent with this, the median expectations of the members of the Federal Open Markets Committee (FOMC) for the level of the federal funds rate in 2015 and 2016 were revised down by 25 basis points and now imply 50 basis points of tightening in 2015, followed by 100 basis points in 2016.

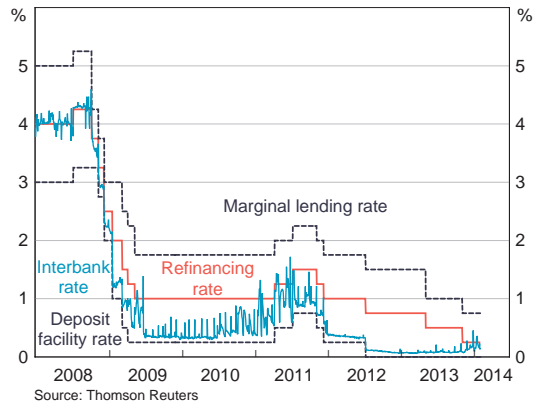
This changing emphasis by the Fed over the second half of 2013 saw expectations for future short-term interest rates decouple from longer-term bond yields from late September (Graph 2.2). However, since mid January, both the implied path of the federal funds rate and long-term bond yields have fallen noticeably in response to some weaker US economic data and an increase in risk aversion. Current market pricing indicates the first increase in the fed funds rate is expected in late 2015.

Graph 2.2
US Policy Rate Expectations and Yields



The ECB reduced its policy rate by a further 25 basis points to 0.25 per cent at its November meeting, in response to below-target inflation (Graph 2.3). The ECB also lowered the rate at which it lends funds overnight by 25 basis points, but left the rate of interest on deposits at the ECB unchanged at

Graph 2.3
ECB Interest Rate Corridor

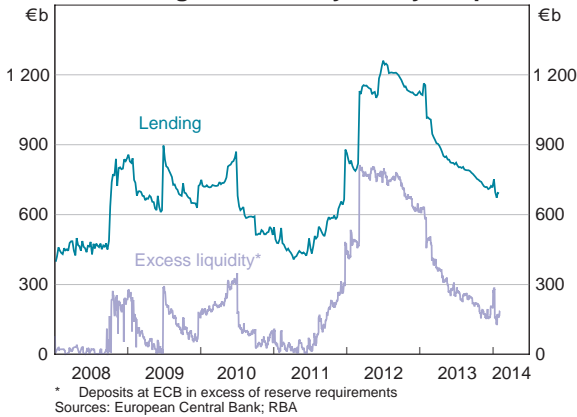


0 per cent. The ECB concurrently announced an extension of its commitment to fully provide for any liquidity needs of the Eurosystem – at terms of 3 months or less – to at least July 2015, a year later than previously advised. This is aimed at ensuring that ample liquidity is available when the 3-year long-term refinancing operations (LTROs) mature in early 2015. More recently, the ECB 'strongly emphasised' its commitment to maintain accommodative policy for an extended period following its January meeting, and clarified that it would be prepared to ease monetary policy further in response to an unwarranted tightening of financial conditions or a softening of the medium-term outlook for inflation. In line with this, markets are not pricing in any rise in euro area interest rates for almost three years.

The ECB's balance sheet has continued to contract over recent months, with lending for monetary policy purposes declining by around €100 billion since September and by more than €550 billion since its peak in mid 2012 (Graph 2.4). The recent decline has been driven by prepayments of 3-year loans extended under the ECB's LTRO in late 2011 and early 2012, with almost half of the initial €1 trillion disbursement now repaid. Spanish banks continue to account for the largest share of this prepayment, having repaid around 40 per cent of their estimated initial €300 billion loan, though Spanish and Italian banks still account for almost three-quarters of outstanding borrowing. The resulting decline in

Graph 2.4

ECB Lending for Monetary Policy Purposes



* Deposits at ECB in excess of reserve requirements
Sources: European Central Bank; RBA

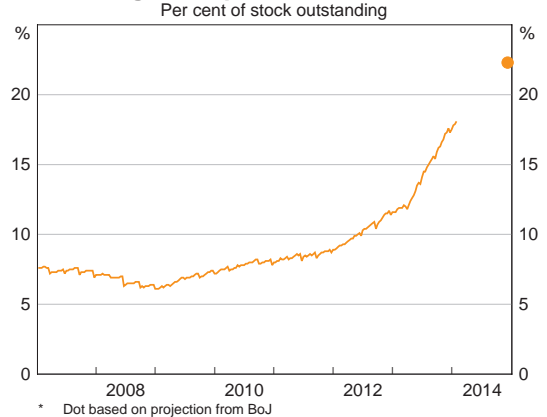
excess liquidity has contributed to a rise in interbank rates, with a marked spike over year-end and again in January (Graph 2.3).

The BoJ continues to provide monetary stimulus, with its balance sheet expanding rapidly. Total asset holdings rose by ¥60 trillion between the announcement of its Quantitative and Qualitative Monetary Easing program in April 2013 and the end of the year, and are scheduled to increase by a further ¥70 trillion over 2014. The majority of this rise in asset holdings reflects purchases of Japanese government bonds (JGBs), with the BoJ increasing its share of total JGBs outstanding by 6 percentage points since April, to 18 per cent (Graph 2.5). Governor Kuroda continues to assert that the BoJ is likely to meet its target of raising inflation to 2 per cent on a sustainable basis by 2015. However, market commentators generally expect additional stimulus to be injected this year.

Market expectations for the timing of the first rise in UK policy interest rates were brought forward over the second half of 2013, and currently are for an increase in 2015 (Graph 2.6). This revision to expectations has been in response to improving economic data, particularly the fall in the unemployment rate to just above the 7 per cent threshold contained in the Bank of England's forward interest rate guidance (which will be reconsidered in February). In contrast, markets do not expect a rise in interest rates in Canada until 2016, consistent with statements by the Bank of Canada that downside risks to inflation have increased.

Graph 2.5

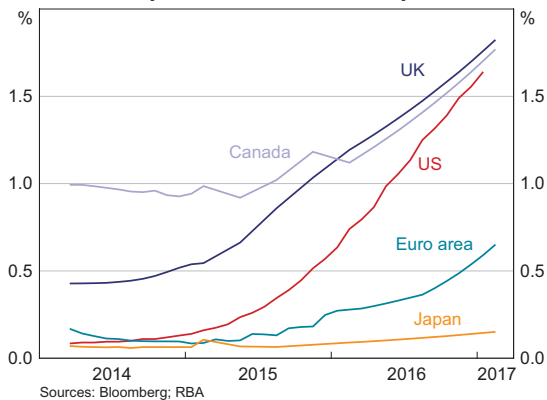
BoJ Holdings of Japanese Government Bonds*



* Dot based on projection from BoJ
Sources: Bank of Japan; RBA

Graph 2.6

Market Implied Interest Rate Expectations



Sources: Bloomberg; RBA

Liquidity in Chinese money markets has continued to tighten over recent months, with the overnight Shanghai Interbank Offered Rate (SHIBOR) averaging around 50 basis points higher in the December quarter than in the September quarter, and more than 100 basis points higher than in the year to June 2013 (Graph 2.7). The People's Bank of China has on occasions injected liquidity quite quickly to alleviate tensions, while at other times allowing liquidity to remain tight for some time, leading to higher and at times volatile interbank rates.

Central banks in emerging markets whose exchange rates have depreciated over recent months have continued to tighten policy at recent meetings (Table 2.1). The central bank of Turkey raised its main

policy rate by 550 basis points at an unscheduled meeting in late January (although the effective increase was around half this because of a change in operating procedure), in an attempt to contain the impact of the depreciation of the lira on inflation and macroeconomic stability. The central bank of Brazil tightened policy further in both November and January, in response to higher inflation, with 50 basis point increases on both occasions bringing the cumulative rise in its interest rate since April to

325 basis points. The Reserve Bank of India also raised its policy rate by a further 25 basis points in January to contain upside risks to its inflation projections, while the Reserve Bank of South Africa increased its policy rate by 50 basis points in response to an upgrade of its inflation forecasts, stemming largely from the depreciation of the rand. Bank Indonesia raised policy rates by 25 basis points in November, citing a desire to contain inflation and reduce the current account deficit, and has now raised interest rates by 175 basis

Table 2.1: Monetary Policy

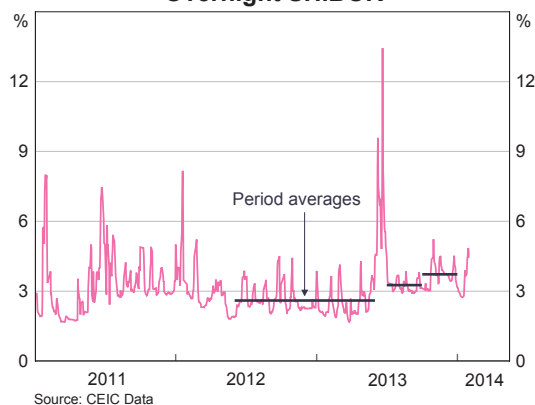
	Policy rate Per cent		Most recent change	Cumulative change in current phase^(a) Basis points
Euro area	0.25	↓	Nov 13	-125
Japan ^(b)	na		na	
United States	0.125	↓	Dec 08	-512.5
Australia	2.50	↓	Aug 13	-225
Brazil	10.50	↑	Jan 14	325
Canada	1.00	↑	Sep 10	75
Chile	4.50	↓	Nov 13	-75
China	6.00	↓	Jul 12	-56
India	8.00	↑	Jan 14	75
Indonesia	7.50	↑	Nov 13	175
Israel	1.00	↓	Sep 13	-225
Malaysia	3.00	↑	May 11	100
Mexico	3.50	↓	Oct 13	-475
New Zealand	2.50	↓	Mar 11	-50
Norway	1.50	↓	Mar 12	-75
Russia	5.50	↑	Sep 12	25
South Africa	5.50	↑	Jan 14	50
South Korea	2.50	↓	May 13	-75
Sweden	0.75	↓	Dec 13	-125
Switzerland	0.00	↓	Aug 11	-275
Taiwan	1.875	↑	Jun 11	62.5
Thailand	2.25	↓	Nov 13	-125
Turkey	10.00	↑	Jan 14	550
United Kingdom	0.50	↓	Mar 09	-525
	Current monthly asset purchases		Most recent change	Assets on balance sheet Per cent of GDP
United States	\$65 billion		Jan 14	24.2
Japan	¥6 trillion		Apr 13	48.4
United Kingdom	0		Jul 12	24.5

(a) Current rate relative to most recent trough or peak

(b) Since April 2013, the Bank of Japan's main operating target has been the money base

Sources: RBA; Thomson Reuters; central banks

Graph 2.7
Overnight SHIBOR



points since June. However, it held rates constant in January, stating that the current rate is consistent with reducing inflation and the current account deficit to 'more sound' levels.

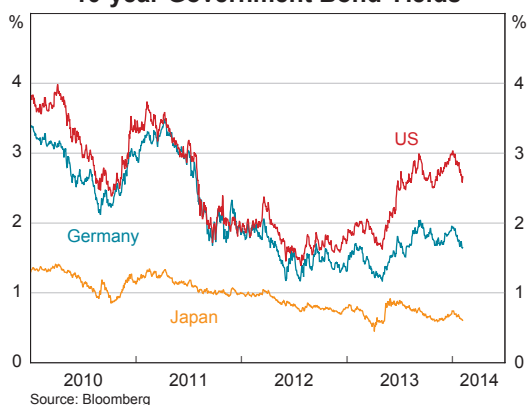
In contrast, the Swedish Riksbank reduced rates by 25 basis points in December, in response to low inflation, while the central banks of Chile and Thailand both cut rates by 25 basis points in November to counter softening economic activity. The reduction in interest rates in Thailand was also intended to guard against the possible impact on the economy of widespread political protests in that country.

Sovereign Debt Markets

Yields on 10-year US Treasuries rose by 30 basis points over December, in response to strengthening economic data, to return to 3 per cent around year-end. This brought the rise in yields over 2013 to 130 basis points as it became clear that the Federal Reserve would reduce the scale of its asset purchase program. However, US yields have since fallen by almost 40 basis points as some economic data disappointed and concerns about the outlook for developing economies resurfaced (Graph 2.8).

Yields on 10-year German Bunds likewise rose by 20 basis points over December, to be 60 basis points higher over 2013, before falling by 30 basis points since the start of 2014. The subdued outlook for euro area inflation and the associated difference in

Graph 2.8
10-year Government Bond Yields



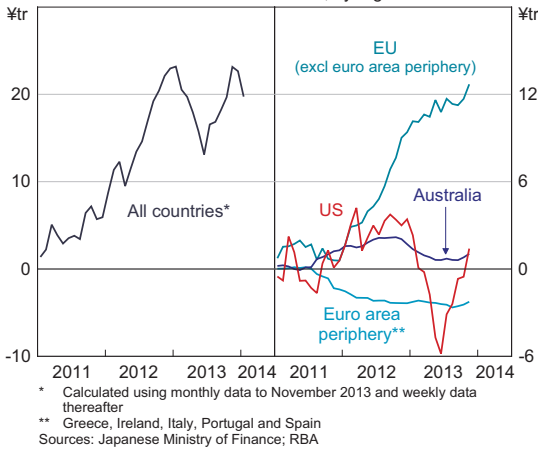
expectations for future Fed and ECB policy rates have continued to restrain yields on Bunds, relative to those on US Treasuries.

The US Congress negotiated a two-year budget deal that unwinds part of the expenditure cuts scheduled for 2014 and 2015. The deal averted the prospect of a mid-January shutdown of essential government services. No deal has yet been struck to raise the debt ceiling, which is currently suspended until 7 February, though the US Treasury's funding capacity can be extended by a few weeks due to the use of various 'extraordinary' measures.

Yields on 10-year JGBs also increased over December, in contrast to the trend decline in yields over the second half of 2013, but have declined since the start of 2014. However, these moves have been less pronounced than for Treasuries and Bunds. Purchases by the BoJ continue to put downward pressure on JGB yields, with such purchases worth 1½ times net issuance in 2013 and expected to again exceed net issuance in 2014.

Japanese residents have increased their holdings of foreign bonds by almost ¥7 trillion since June, reversing the net selling of foreign bonds observed in the first half of 2013 (Graph 2.9). Country breakdowns of these net purchases, available to November, show that transactions in US Treasuries account for most of this fall and rise in foreign bond holdings. Nonetheless, Japanese residents have continued to increase their

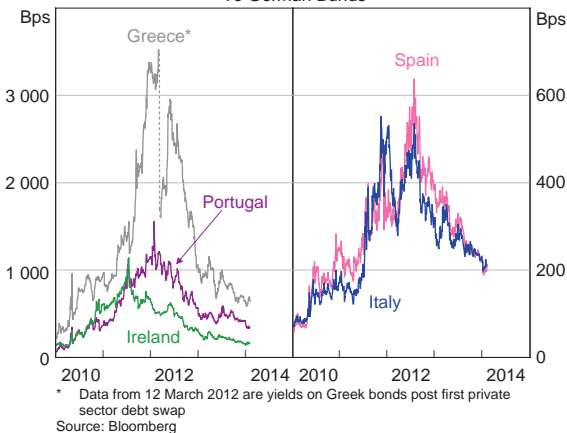
Graph 2.9
Japanese Purchases of Foreign Bonds
 Cumulative since 2011, by region



holdings of European bonds including, in the three months to November, those issued by governments of periphery countries.

The improvement in sentiment towards the euro area periphery accelerated towards the end of 2013. Spreads between yields on Spanish, Irish and Portuguese government bonds and those on German Bunds all narrowed by 150–175 basis points over 2013, while spreads on Italian and Greek bonds narrowed by 100 and 400 basis points (Graph 2.10). The significant narrowing of spreads has reflected an improvement in these countries' competitiveness and reduced current account deficits. As a result,

Graph 2.10
Euro Area 10-year Government Bond Spreads
 To German Bunds



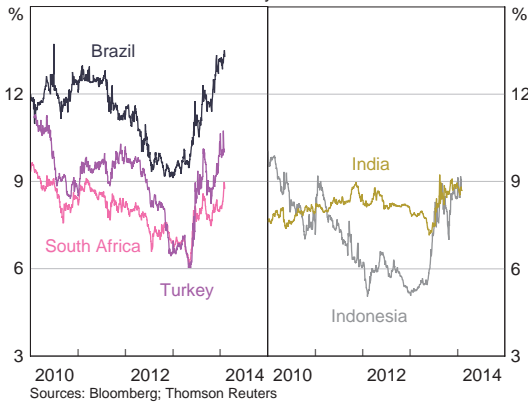
Spanish and Italian bond spreads have fallen to levels last seen prior to concerns about contagion from other periphery economies first surfacing, while Irish, Portuguese and Greek bond spreads are around their lowest level since their need for financial assistance first became apparent. These spreads have been unaffected by the recent deterioration in global risk sentiment.

This improvement in sentiment towards the euro area periphery allowed Spain, Ireland and Portugal to raise considerable funds from bond markets in January. Ireland's issue was its first since exiting its assistance program at the end of last year (Portugal expects to exit its assistance program midyear). All three issues were heavily oversubscribed and bought by a broad range of investors, with foreigners accounting for more than two-thirds of demand. Spanish bank Bankia also managed to issue its first bond since being recapitalised by authorities in early 2012.

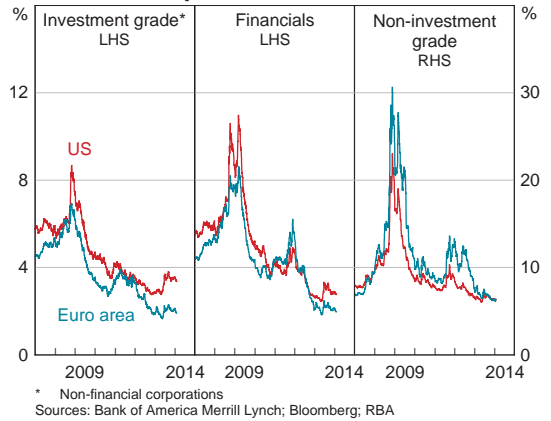
European Union finance ministers agreed in December on a draft regulation for recapitalising failing banks, known as the Single Resolution Mechanism (SRM). Under the agreement, creditors of a failing bank will be required to absorb initial losses, to a minimum of 8 per cent of total liabilities, before the bank is eligible for official assistance. Any official assistance will first be sought from resolution funds to be established via levies on banks. Additional euro-wide public support may become available but, at this stage, not for at least 10 years.

Yields on bonds issued by emerging market sovereigns continued to drift up towards the end of 2013, before moving notably higher over January as concerns about the vulnerability of several developing economies increased (Graph 2.11). Yields on Turkish bonds have risen most sharply over recent months, in response to political tensions and a view that Turkey is especially vulnerable to a change in US monetary policy due to its large external financing needs and foreign currency exposure. Yields on South African and Brazilian bonds have also increased notably, alongside concerns about their current account deficits and a tightening of monetary policy, while yields on Indonesian, Russian and Hungarian bonds

Graph 2.11
10-year Government Bond Yields
 Local-currency denominated



Graph 2.12
Corporate Bond Yields



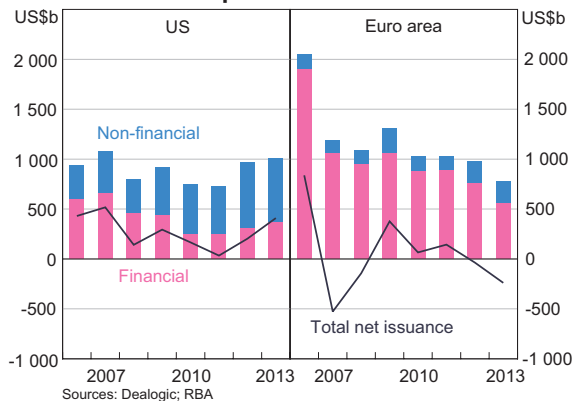
are significantly higher as well. Foreign capital outflows from emerging bond markets slowed significantly around year-end, following a period of heavy outflows in the second half of last year, but increased again in late January. While the withdrawal of capital has been broad based across countries, a significant share reflected outflows from funds invested in Brazil, India, Indonesia, South Africa and Turkey.

Credit Markets

Spreads on bonds issued by US and euro area corporations continued to narrow in late 2013, but have increased in recent weeks. Spreads on non-investment grade bonds have moved most notably, falling by around 130 basis points for US borrowers over 2013 and by 240 basis points for euro area corporations, before rising by 50–60 basis points since mid January. Nonetheless, the cost of borrowing for these issuers remains around historical lows, given that the recent widening in spreads has been largely offset by a fall in sovereign bond yields (Graph 2.12). In contrast, spreads on investment grade bonds issued by US and euro area corporations narrowed only modestly over 2013, and are a little higher so far this year.

Gross bond issuance by US corporations in 2013 slightly exceeded that in 2012 (Graph 2.13). The increase in net issuance, however, was more pronounced; net issuance rose to its highest level

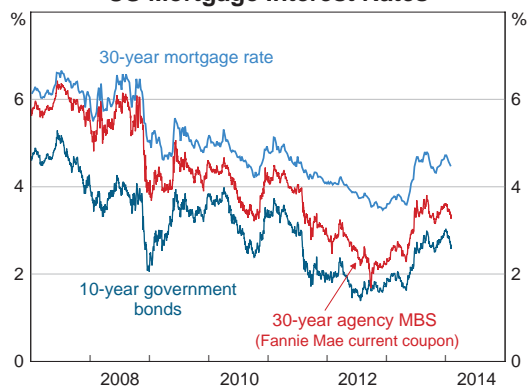
Graph 2.13
Gross Corporate Bond Issuance



since 2007, with financials increasing their stock of outstanding bonds for the first time since 2009. In contrast, euro area gross corporate bond issuance contracted further, and the stock of outstanding bonds declined, with these developments being driven largely by Spanish and Italian banks. Gross and net issuance by emerging market corporations slowed over the second half of 2013, to be slightly lower than in 2012.

Yields on agency MBS have fluctuated alongside moves in US Treasuries, with a 20 basis point rise over December more than unwound since the start of the year (Graph 2.14). There was very little observable change in yields in response to the Federal Reserve's decision to reduce its purchases of MBS. Since the

Graph 2.14
US Mortgage Interest Rates



Sources: Bloomberg; Thomson Reuters

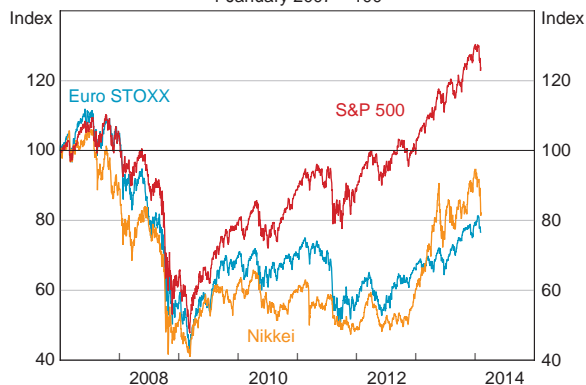
start of 2013, mortgage interest rates have increased alongside the rise in MBS yields, to be around 100 basis points higher.

Equities

Global share prices increased by 23 per cent over 2013 (Graph 2.15; Table 2.2). Japanese equities rose particularly strongly, increasing by 57 per cent over 2013, while US shares rose by 30 per cent. In contrast, emerging market share prices tended to decline over the second half of 2013. More recently, global share prices have fallen significantly in response to some weaker global economic data, along with renewed concerns about the outlook for emerging markets.

US and euro area banking shares have significantly outperformed the broader market over the past year, with their prices up 40 and 25 per cent, respectively, over 2013. The outperformance of US bank share prices has been in part attributable to a 30 per cent increase in profits at the six largest banks over 2013, underpinned by reduced provisions for loan losses, to just over US\$70 billion. US bank earnings were also generally better than expected in the December quarter, as increased earnings from equity raisings and reduced provisions for legal expenses more than offset ongoing weakness in mortgage origination and bond trading. A few European banks have released fourth quarter

Graph 2.15
Share Price Indices
1 January 2007 = 100



Source: Bloomberg

Table 2.2: Changes in International Share Prices
Per cent

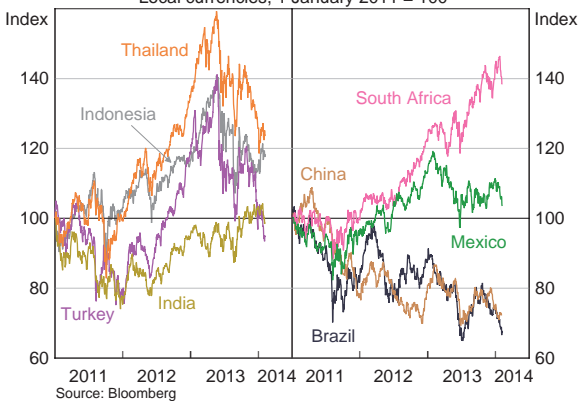
	Over 2013	Since end 2013
United States		
– S&P 500	30	–5
Euro area		
– STOXX	20	–4
United Kingdom		
– FTSE	14	–4
Japan		
– Nikkei	57	–13
Canada		
– TSE 300	10	–1
Australia		
– ASX 200	15	–5
China		
– China A	–7	–4
MSCI indices		
– Emerging Asia	3	–6
– Latin America	–7	–8
– Emerging Europe	–2	–5
– World	23	–5

Source: Bloomberg

profit results. These tended to be mixed, with reduced income from bond trading weighing heavily on some but strength in equity trading supporting others.

Share prices in emerging markets increased a little following the Fed's decision in December to reduce its purchases, owing to its statement that the federal funds rate would likely be unchanged until well after the unemployment rate falls below 6½ per cent. However, emerging market share prices fell noticeably over January, as some weak global data and various idiosyncratic risks were compounded by renewed concerns about these countries' vulnerabilities to a tapering of asset purchases by the US Federal Reserve (Graph 2.16). Countries that have large external financing needs have again been most affected, though political instability in Turkey and Thailand contributed to weak outcomes in those countries and Brazilian stocks fell further in response to tighter monetary policy and some concerns about the outlook for China. Foreign capital has continued to flow out of emerging stock markets in recent months, though at a slower pace than mid last year. The Indian market has been a notable exception, with capital inflow contributing to its outperformance over recent months.

Graph 2.16
Emerging Market Share Price Indices
Local currencies, 1 January 2011 = 100

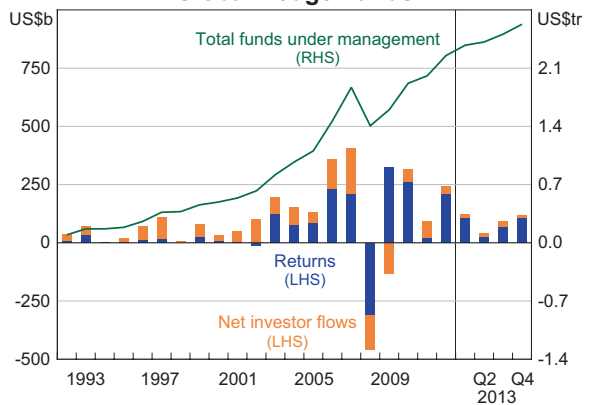


Chinese share prices have been especially weak over recent months, and are now 30 per cent lower than at the start of 2011. The decline in Chinese equities over the second half of 2013 partly reflected ongoing uncertainty about the outlook for monetary policy in light of tightening liquidity conditions. More recently, the resumption of initial public offering activity, after a freeze since October 2012, has weighed on the market.

Hedge Funds

Global hedge funds recorded an average return on investments of 9 per cent over 2013 (Graph 2.17). This was less than the total return from a balanced portfolio of global bonds and equities (including dividends) over the year, extending the period of underperformance to three years. Funds under management increased over the December quarter to US\$2.6 trillion. This was largely as a result of positive returns; net investor inflows remained modest.

Graph 2.17
Global Hedge Funds



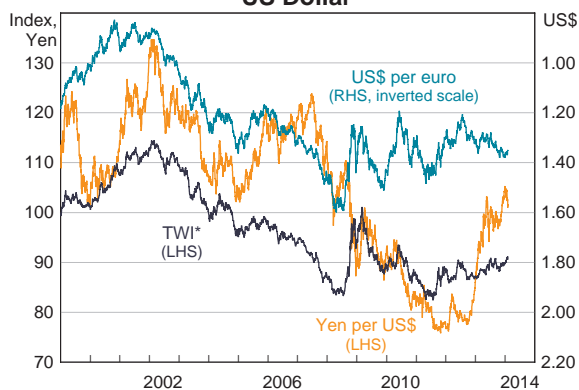
Sources: Hedge Fund Research, Inc.; RBA

Foreign Exchange

While foreign exchange markets have continued to be influenced by changes in market participants' expectations about the outlook for US monetary policy, the increased focus on country-specific vulnerabilities has led to relatively pronounced depreciations for some emerging market currencies.

The US dollar has appreciated by 4 per cent on a trade-weighted basis since the beginning of 2013, but remains 6 per cent below its average over the past 15 years (Graph 2.18). The modest appreciation of the US dollar over the past year masks some divergent movements against individual currencies. Over the past year, the US dollar has appreciated markedly against the Japanese yen as well as against a number of emerging market and commodity currencies, but has been little changed or depreciated against

**Graph 2.18
US Dollar**



* Indexed to average since January 1999 = 100
Sources: Bloomberg; Board of Governors of the Federal Reserve System; RBA

the currencies of some of its major trading partners, including the euro and Chinese renminbi (RMB) (Table 2.3).

The Japanese yen has depreciated by a further 2–3 per cent on a trade-weighted basis and against the US dollar since the end of October. The yen has now depreciated by around 20 per cent in nominal trade-weighted terms since November 2012, and is around 5 per cent below its average over the past 15 years. However, in real effective terms, the yen is currently around 20 per cent below its average of the past 15 years, due to price deflation in Japan throughout much of this period (Graph 2.19). After having appreciated modestly over much of 2013, the euro has been little changed in trade-weighted terms since the end of October and remains slightly higher than its average of the past 15 years.

The RMB has appreciated slightly against the US dollar since the end of October, remaining in the upper part of its ± 1 per cent trading band (Graph 2.20). Over 2013, the RMB appreciated by around 3 per cent against the US dollar and by 8 per cent on a nominal effective basis, with the latter primarily reflecting the RMB’s significant appreciation against the Japanese yen.

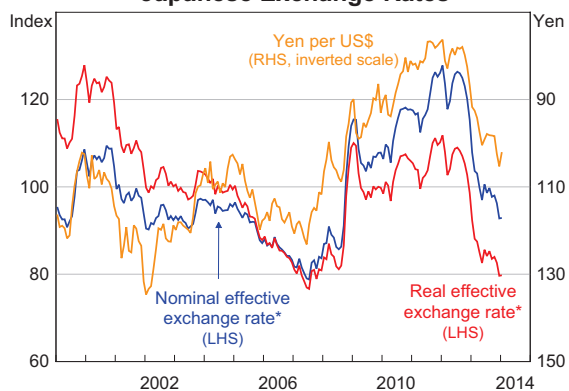
The stock of Chinese foreign currency reserves increased by US\$157 billion (around 4 per cent) over the December quarter, to be US\$508 billion

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

	Over 2013	Since end 2013
South African rand	24	6
Canadian dollar	7	4
South Korean won	-1	3
Philippine peso	8	2
New Taiwan dollar	3	2
Mexican peso	1	2
Brazilian real	15	2
European euro	-4	2
UK pound sterling	-2	2
Swedish krona	-1	1
Swiss franc	-3	1
Malaysian ringgit	7	1
Indian rupee	13	1
Singapore dollar	3	0
Thai baht	7	0
Indonesian rupiah	26	0
Chinese renminbi	-3	0
Australian dollar	17	0
New Zealand dollar	1	0
Japanese yen	21	-4
TWI	3	1

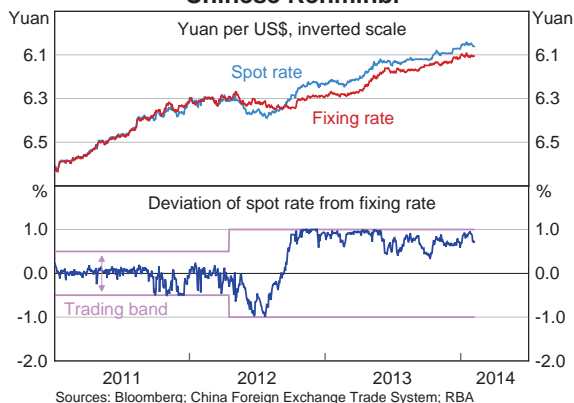
Sources: Bloomberg; Board of Governors of the Federal Reserve System

**Graph 2.19
Japanese Exchange Rates**



* Indexed to average since January 1999 = 100
Sources: BIS; Bloomberg; RBA

Graph 2.20
Chinese Renminbi



Sources: Bloomberg; China Foreign Exchange Trade System; RBA

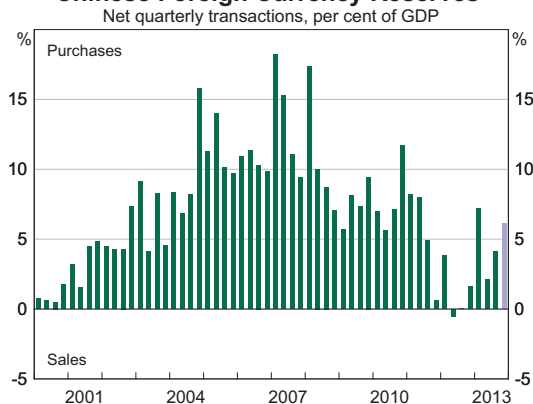
(15 per cent) higher over the year. Consistent with reports of capital inflows, the increase in Chinese reserves over the December quarter is likely to have largely reflected net purchases of foreign currency, although modest positive valuation effects are also likely to have contributed (Graph 2.21). While most other Asian and emerging market countries' foreign currency reserves increased over September and October, a number of countries have since recorded declines (see below).

After having appreciated modestly over September and October, most other emerging market currencies have since depreciated against the US dollar and remain well below their end-April levels (Graph 2.22). However, despite the renewed depreciation pressure, emerging market currency volatility generally remains below the elevated levels reached in mid 2013.

The currencies of countries that are perceived to have relatively weak domestic economic outlooks, unstable domestic political environments and/or external vulnerabilities have typically continued to experience the most pronounced depreciations. In particular, the Turkish lira has depreciated by a further 11 per cent against the US dollar since the end of October, prompting the central bank to increase interest rates at an emergency meeting in late January. The Turkish lira has depreciated by around 20 per cent against the US dollar since the

Graph 2.21

Chinese Foreign Currency Reserves*

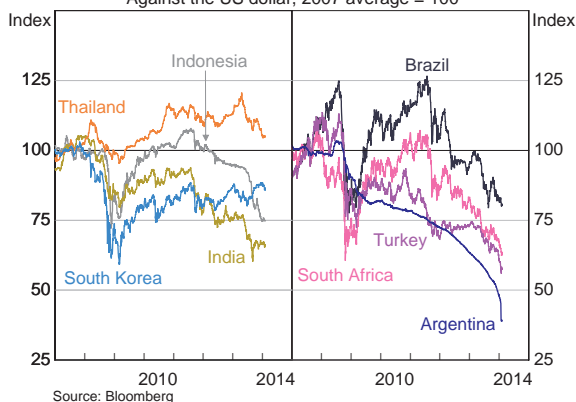


* RBA estimate for the December quarter 2013
Sources: Bloomberg; CEIC Data; RBA

Graph 2.22

Emerging Market Currencies

Against the US dollar, 2007 average = 100



Source: Bloomberg

end of April 2013. The Brazilian real, Indonesian rupiah, South African rand and Thai baht have also depreciated further over recent months to be 10–20 per cent lower since the end of April. In addition, although the Argentine peso had been depreciating since mid 2008, the pace of depreciation picked up noticeably in January as market participants focused on the central bank's increasingly limited capacity to continue to support the currency through foreign exchange market intervention. In contrast, the Indian rupee has been little changed against the US dollar since the end of October, though it remains 14 per cent below its end-April level.

The authorities in some of these countries have continued to enact policy measures or intervene in foreign exchange markets in an effort to counter the pace of depreciation, improve market functioning and/or curb volatility (although one exception is India, where recent stability in the rupee has allowed authorities to end a key policy measure which was used to supply US dollars to state-owned oil companies). The gross foreign currency reserves of a number of Asian and other emerging market countries have declined since the end of October, with most remaining below their end-April levels (Table 2.4).

Australian Dollar

The Australian dollar has depreciated by a further 5 per cent on a trade-weighted basis and against the US dollar since the end of October, more than reversing the appreciation recorded over the previous three months (Table 2.5; Graph 2.23). The Australian dollar has now depreciated by 14 per cent on a trade-weighted basis since its peak in early April 2013, though it remains 9 per cent higher than its average

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

	Over 2013	Since end 2013
South African rand	6	6
Canadian dollar	-8	4
South Korean won	-15	3
European euro	-18	1
UK pound sterling	-16	1
Swiss franc	-16	1
Malaysian ringgit	-8	1
Indian rupee	-3	1
Singapore dollar	-11	0
Thai baht	-8	0
Indonesian rupiah	8	0
Chinese renminbi	-17	0
US dollar	-14	0
New Zealand dollar	-13	0
Japanese yen	4	-4
TWI	-11	0

Sources: Bloomberg; Thomson Reuters; WM/Reuters

Table 2.4: Gross Foreign Currency Reserves
As at end December 2013

	Percentage change since:		Level US\$ equivalent (billions)
	End April	End October	
China	8	2	3 821
Russia ^(a)	-4	-4	439
Brazil ^(b)	-5	-1	351
South Korea ^(b)	6	2	338
India	2	5	268
Thailand	-6	-3	158
Malaysia	-4	-2	122
Turkey ^(a)	-10	-9	101
Indonesia	-7	3	93
South Africa	1	1	42
Argentina ^(b)	-34	-20	22

(a) As at 24 January

(b) As at end January

Sources: Bloomberg; CEIC Data; IMF; RBA

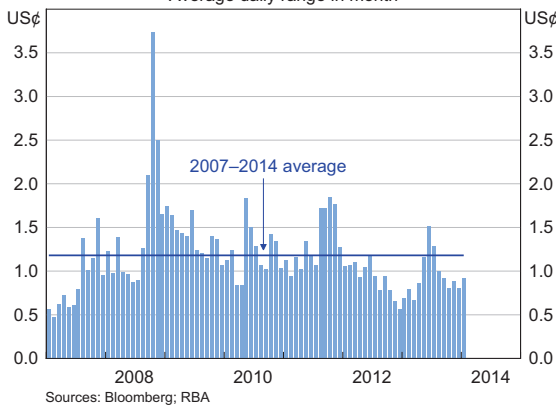
Graph 2.23
Australian Dollar



over the past 15 years and 15 per cent higher than its 15-year average in real terms. The Australian dollar continues to be influenced by changes in market participants' expectations about the outlook for domestic and US monetary policy.

Consistent with developments in other currency markets, intraday volatility in the Australian dollar has remained subdued relative to the elevated levels recorded in mid 2013 (Graph 2.24).

Graph 2.24
Intraday Range in AUD/USD
Average daily range in month



Capital Flows

Net capital inflows to the Australian economy were directed to both the private non-financial and public sectors in the September quarter, a pattern that has been broadly evident since 2009 (Graph 2.25). The mining sector again received a sizeable share of the net inflows to the private non-financial sector, continuing a trend that has been evident since 2011. There was also a relatively large net inflow to the public sector; however, the increase was roughly proportional to net issuance of Commonwealth Government securities (CGS) in the quarter, leaving the foreign ownership share of CGS broadly unchanged at 68 per cent. The net inflows to the private non-financial and public sectors more than offset continued net outflows from the private financial sector in the September quarter. The net outflows from the private financial sector primarily reflected an increase in foreign investment by the non-bank financial sector (including superannuation funds and other types of investment funds) with the Australian banking sector receiving modest net inflows in the quarter. ❖

Graph 2.25
Australian Capital Flows
Net inflows, per cent of GDP

