

2. International and Foreign Exchange Markets

Sovereign Debt Markets

Market sentiment deteriorated in early November due to a perceived lack of progress by European officials in dealing with the debt crisis. Political instability in several euro area countries also contributed to the uncertainty, with new governments being formed in Greece and Italy.

Financial market conditions have improved in the new year. In addition to generally better-than-expected US economic data, sentiment was bolstered by large-scale lending to banks by the European Central Bank (ECB) (see section on 'Central Bank Policy'). This has improved liquidity in the European banking system and reduced the near-term risk of bank failures. Investor sentiment, however, remains vulnerable to developments in the European sovereign debt crisis.

Over the past few months, European policymakers have announced several initiatives to deal with the crisis. These included a 'fiscal compact', agreed to by all European Union (EU) countries except the United Kingdom and the Czech Republic, which will see enforceable fiscal rules and penalties written into a new treaty. The new treaty will be signed in March and will come into force once it has been ratified by 12 euro area countries.

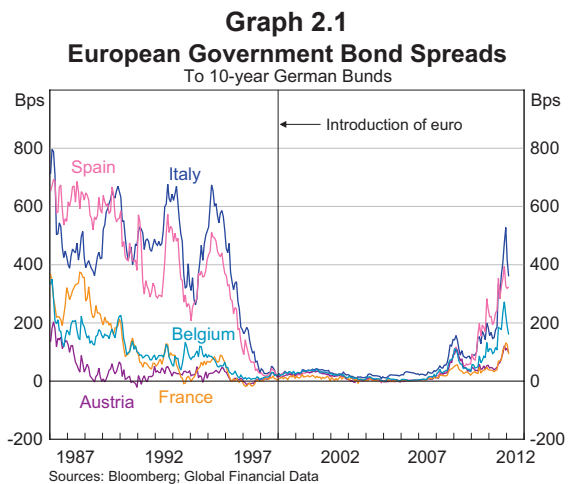
EU governments also pledged a number of measures related to financial bail-out resources:

- euro area nations pledged €150 billion to increase the IMF's resources;
- the permanent European Stability Mechanism (ESM) will be operational from July 2012, one

year ahead of schedule, and its combined lending capacity with the existing European Financial Stability Facility (EFSF) of €500 billion will be reassessed in March this year;

- governments will accelerate payments of capital into the ESM;
- changes to the ESM will be able to be made by a qualified majority of countries, rather than by unanimity;
- leveraging of the current EFSF will be implemented rapidly; and
- private sector involvement in bail-outs, like that for Greece, will not be mandatory in future assistance packages for other countries.

Spreads on sovereign bonds issued by a broad range of euro area countries widened sharply in November, with those for Austria, Belgium, France, Italy and Spain reaching new euro-era highs (Graph 2.1). Reflecting the improvement in sentiment since then, euro area government bond yields have fallen from



their recent peaks (Graph 2.2). Perceptions of the risk of a near-term euro area break-up and/or banking crisis have receded.

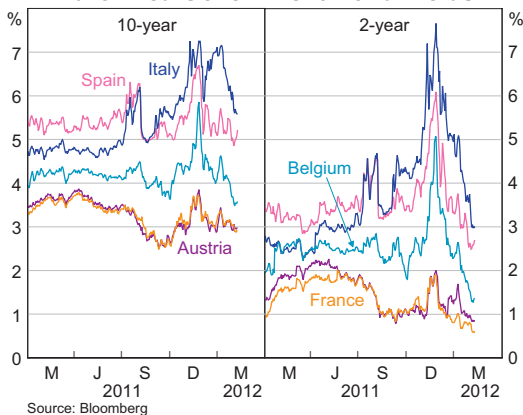
The deterioration in the outlook for euro area economies prompted Standard & Poor's (S&P) and Fitch to place the ratings of many euro area sovereigns on negative credit watch in December. S&P subsequently downgraded the credit ratings of nine euro area sovereigns in January: Italy, Spain, Portugal and Cyprus by two notches; and Austria, France, Malta, Slovenia and the Slovak Republic by one notch. As a result, France and Austria lost their AAA ratings although this had little market impact. S&P also downgraded the EFSF's rating to AA+ (although it is still rated AAA by Fitch and Moody's). Fitch downgraded five euro area sovereigns in late January but reaffirmed France's AAA credit rating.

The agreement on the restructuring of private sector holdings of Greek sovereign debt appears to be reaching a conclusion with a loss in net present value terms of approximately 70 per cent in prospect. The latest EU/IMF disbursements to Greece under the initial assistance package were approved in December despite substantial slippage by Greece in meeting its targets under the program: €73 billion of the €110 billion first assistance package has now been disbursed. Greece is fully funded until 20 March when a €14.4 billion bond matures. The EU

and IMF have also approved the latest disbursements to Ireland and Portugal. Nonetheless, yields on Portuguese government debt increased to euro area highs in recent weeks due to concerns about the possibility of a similar outcome to Greece.

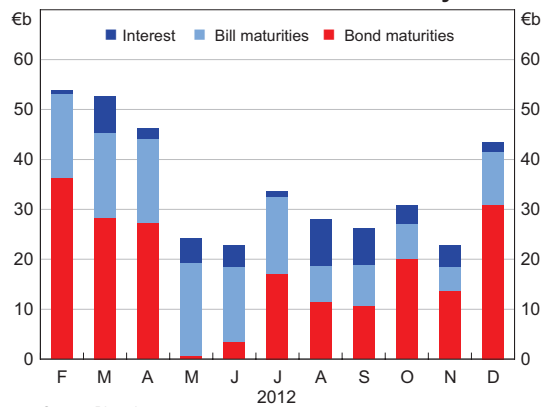
Yields on longer-term Italian government bonds remain relatively high despite falling after the new technocrat government passed a number of fiscal reforms. Investors remain nervous about the large volume of Italian government debt maturing this year (equivalent to around 20 per cent of GDP), particularly over the next few months (Graph 2.3). Yields on Spanish government bonds are well below their November peak, in part due to the government announcing additional budgetary measures and pledging to legislate fiscal rules to enforce budget discipline on both central and regional governments. The fall in yields was despite Spain's 2011 budget deficit being equivalent to at least 8 per cent of GDP compared with the 6 per cent government target. Spain has completed around one-quarter of its anticipated 2012 bond issuance. Belgium's sovereign finances have come under scrutiny in recent months, in part because of its substantial banking sector support. Belgium formed a new government in early December, having had a caretaker government since June 2010.

Graph 2.2
Euro Area Government Bond Yields



Graph 2.3

Italian Central Government Debt Payments



Source: Bloomberg

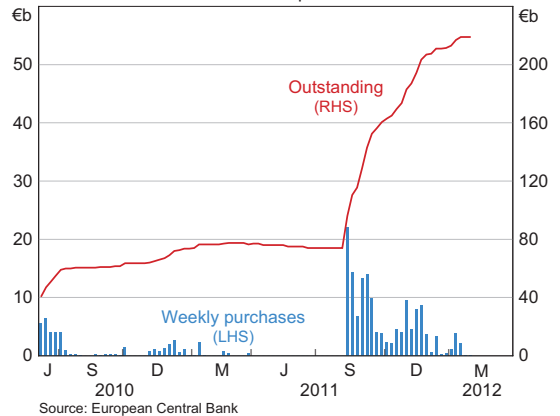
The improvement in investor sentiment has seen the ECB purchase only a small amount of sovereign debt under the Securities Markets Program in recent weeks (Graph 2.4).

Government bond yields in the major advanced economies have remained at low levels due to strong demand for debt issued by the US Government and those sovereigns perceived to have solid AAA ratings. Yields on 10-year US, UK and German government bonds remained around or below 2 per cent, with UK yields falling to a historical low (Graph 2.5). Secondary market yields on very short-term German government securities have been negative in recent months, resulting in the format of German government debt auctions being changed, allowing investors to effectively bid at negative yields. In addition, yields in short-term secured funding markets fell to very low levels, reflecting the dearth of available high-quality government securities to be used as collateral to raise funding.

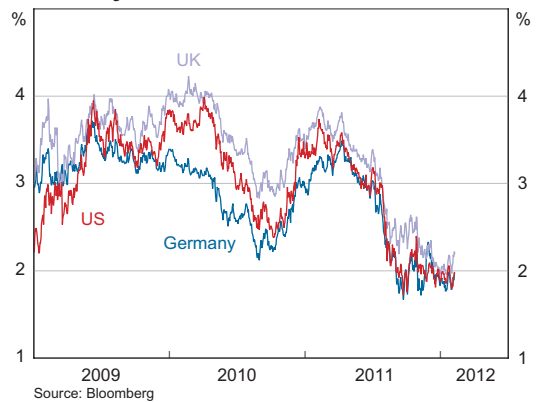
In the United States, the Joint Select Committee on Deficit Reduction (the 'Super Committee'), formed after the debt-ceiling impasse in August, failed to reach an agreement on reducing the US budget deficit. Unless a new agreement is reached, automatic budget cuts of US\$1.2 trillion will be implemented from 2013. These developments have not had any noticeable impact on US government bond yields.

Spreads on US dollar-denominated debt issued by emerging market sovereigns widened sharply from August last year as global risk appetite waned (Graph 2.6). Spreads on emerging European sovereign debt widened particularly sharply due to fears that the euro area debt crisis could spill over to the region, including through banking channels. The rise in Hungarian yields has been particularly stark. In contrast, yields on Indonesian government bonds declined after Moody's upgraded Indonesia's credit rating to investment grade, citing a more favourable assessment of the country's economic strength.

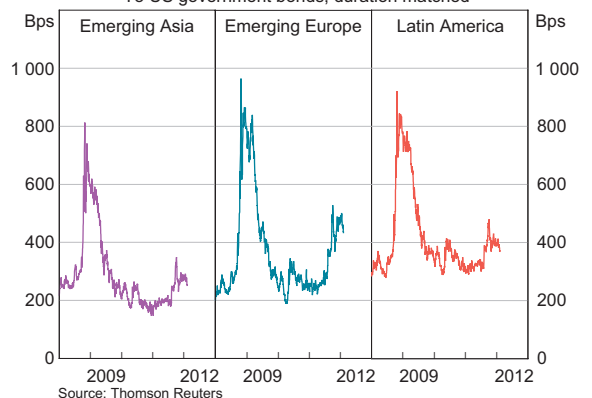
Graph 2.4
ECB Securities Markets Program
Euro area bond purchases



Graph 2.5
10-year Government Bond Yields



Graph 2.6
US Dollar-denominated Sovereign Debt Spreads
To US government bonds, duration matched



Central Bank Policy

A number of central banks have eased monetary policy in recent months as the outlook for global growth has weakened (Table 2.1). Among these, the ECB lowered its policy rate target by a cumulative 50 basis points. In addition, the People's Bank of China and Reserve Bank of India lowered banks' reserve requirement ratios by 50 basis points; these were the first decreases by these banks in around three years.

The ECB has significantly increased its lending to banks and its purchases of sovereign debt since the European sovereign debt crisis escalated in mid 2011.

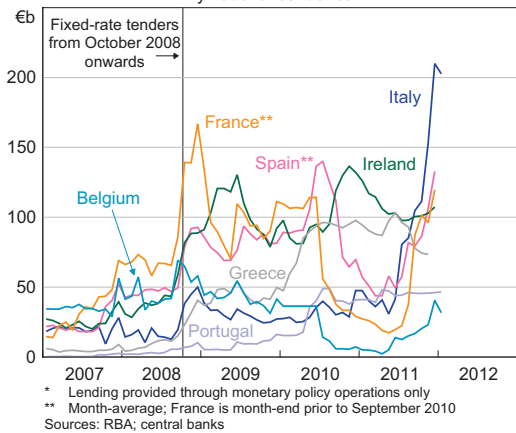
Since June, the ECB's balance sheet has expanded by around one-third to €2.7 trillion. The ECB provided €489 billion of 3-year loans to banks at its policy rate in December, of which around €190 billion was new lending (the difference was loans maturing or rolled into 3-year loans). Lending through the Bank of Italy increased particularly sharply over December, with significant increases also recorded by the national central banks of Belgium, France, Germany and Spain (Graph 2.7). The ECB's actions have allowed banks to secure long-term financing at a time when market-based funding has become increasingly difficult to obtain. The ECB will provide additional 3-year loans at the end of February.

Table 2.1: Policy Rates

	Current level Per cent		Most recent change	Change from 2011 peak Basis points
Euro area	1.00	↓	Dec 11	-50
Japan	0.05	↓	Oct 10	-
United States	0.125	↓	Dec 08	-
Brazil	10.50	↓	Jan 12	-200
Canada	1.00	↑	Sep 10	-
China	6.56	↑	Jul 11	-
India	8.50	↑	Oct 11	-
Indonesia	6.00	↓	Nov 11	-75
Israel	2.50	↓	Jan 12	-75
Malaysia	3.00	↑	May 11	-
Mexico	4.50	↓	Jul 09	-
New Zealand	2.50	↓	Mar 11	-50
Norway	1.75	↓	Dec 11	-50
Russia	8.00	↓	Dec 11	-25
South Africa	5.50	↓	Nov 10	-
South Korea	3.25	↑	Jun 11	-
Sweden	1.75	↓	Dec 11	-25
Switzerland	0.00	↓	Aug 11	-25
Taiwan	1.875	↑	Jun 11	-
Thailand	3.00	↓	Jan 12	-50
United Kingdom	0.50	↓	Mar 09	-

Source: central banks

Graph 2.7
ECB Lending to Banks*
 By national central bank

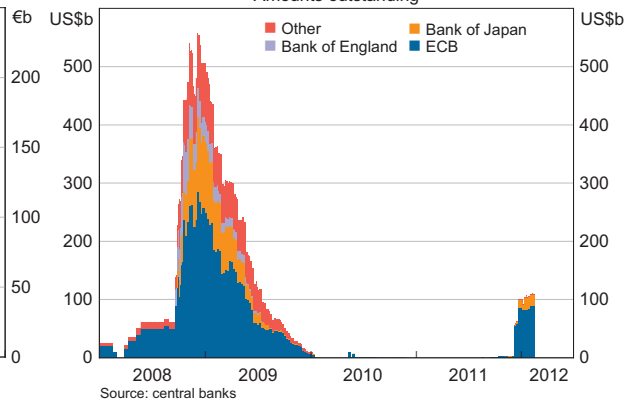


The ECB also announced a broadening of the range of eligible collateral for its market operations to further support banks' access to liquidity. The ECB has lowered the rating threshold for certain asset-backed securities and, as a temporary measure, will allow national central banks to accept certain bank loans as collateral. The ECB also reduced banks' required reserves ratio from 2 per cent to 1 per cent, freeing up additional liquidity.

In response to the increased cost of obtaining US dollar funding for non-US banks, in early December the major central banks announced a decrease in the cost of accessing US dollars under the swap facilities with the Federal Reserve. The margin over the US dollar overnight indexed swap rate fell from 100 basis points to 50 basis points. Subsequently, recourse to the facilities increased sharply to around US\$110 billion but remains relatively modest compared with peak usage at the height of the financial crisis (Graph 2.8). To some extent this reflects European banks having scaled back their US dollar assets and related funding needs over the past few years.

The US Federal Reserve has purchased around US\$175 billion of longer-term US Treasuries as part of a US\$400 billion program to extend the average maturity of its bond holdings, due to be completed

Graph 2.8
Central Bank US Dollar Swap Facilities
 Amounts outstanding



by end June. The Fed currently holds around 30 per cent of outstanding longer-term US Treasuries and this share is expected to rise to around 40 per cent at the completion of the program. The Fed also resumed sales of mortgage-backed securities that its investment vehicle, Maiden Lane II, had acquired in December 2008 as part of AIG's bail out.

The Fed stated after its policy meeting in late January that the federal funds rate target was now likely to remain at exceptionally low levels at least until late 2014. As part of a number of changes to its policy communications, the Fed announced a long-run goal of 2 per cent for inflation (based on the personal consumption expenditure price index) and has commenced quarterly publication (without identification) of each meeting participant's expectations of the policy rate for the next few years and in the longer run.

The Bank of England (BoE) has completed the expansion of its Asset Purchase Facility. The BoE has purchased £75 billion of gilts since October 2011, bringing total asset purchases under the facility to £275 billion.

Financial Policy and Regulation

The European Banking Authority (EBA) released its EU bank recapitalisation plan in early December. The EBA requires banks to have core Tier 1 capital ratios

of 9 per cent by 30 June. After allowing for any losses on holdings of sovereign debt, the 65 participating banks would require about €115 billion in additional capital to meet their required capital ratios. Many banks, however, are expected to meet at least part of their capital ratio targets by shrinking their balance sheets via asset sales and/or restricting lending, particularly outside of the EU. Indeed, a number of banks have recently sold, or announced plans to sell, significant banking operations outside of their home country.

The Obama Administration announced changes to the Home Affordable Modification Program (HAMP) to expand eligibility for mortgage refinancing, including to the owners of rental properties. Incentives for eligible participants (which will now include Fannie Mae and Freddie Mac) to modify loans will also be increased, including a boost in incentive payments from 18 per cent to 63 per cent of principal reduction. Furthermore, HAMP will be extended to December 2013.

In the United Kingdom, the government accepted the vast majority of the recommendations of the ‘Vickers Report’ by the Independent Commission on Banking. Recommendations included increasing capital requirements and the ‘ring-fencing’ of commercial banking activities from wholesale banking groups. Subsequently, the Royal Bank of Scotland (RBS) announced details of its plans to reduce and restructure its wholesale operations. A notable concession will apply, however, to HSBC and Standard Chartered, which will have to meet the higher capital requirements only for assets in the United Kingdom rather than globally.

The UK Government also announced its sale of Northern Rock. Virgin Money is acquiring the bank’s retail and wholesale deposit businesses, along with its performing mortgage book, for at least £900 million. The government had nationalised the bank for £1.4 billion in 2008 and retains the bank’s distressed assets in a ‘bad bank’ to wind down over time. This bad bank has been profitable and paid back around £2.1 billion of its £22.8 billion government loan by

June 2011. The UK Treasury still holds majority stakes in RBS and Lloyds.

French President Sarkozy unveiled plans to introduce a financial transactions tax in France starting in August, irrespective of the outcome of the current EU initiative to introduce such a tax. It is expected to generate around €1 billion a year and will reportedly apply to certain credit default swap and equity transactions. However, unlike the EU’s proposal, bond purchases will be exempt.

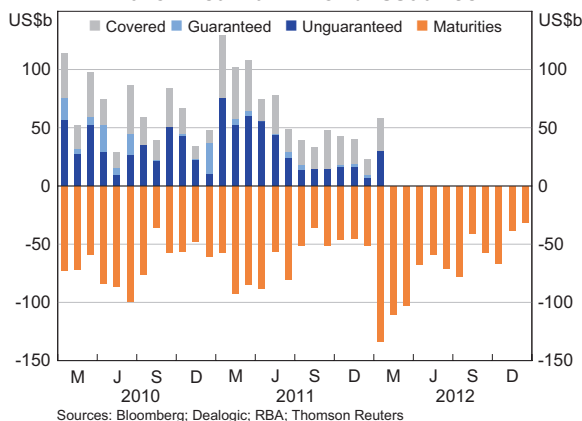
Credit Markets

Conditions in credit markets have improved in recent months but remain strained for European banks. The relative cost of short-term unsecured borrowing in euros has fallen modestly since late December as market sentiment and liquidity have improved following the ECB’s large 3-year lending operation (see section on ‘Central Bank Policy’; Graph 2.9). Euro area bank bond issuance moderated in the second half of 2011, and was very low in December, as yields rose sharply and markets closed to some borrowers (Graph 2.10). While covered bond issuance remained relatively solid, unsecured issuance declined to low levels. Issuance increased in January with the improvement in sentiment but also reflecting the need to refinance sizeable bond maturities in the early months of this

Graph 2.9
Euro Unsecured Interbank Borrowing Spread
To overnight indexed swaps, 3-month maturity



Graph 2.10
Euro Area Bank Bond Issuance

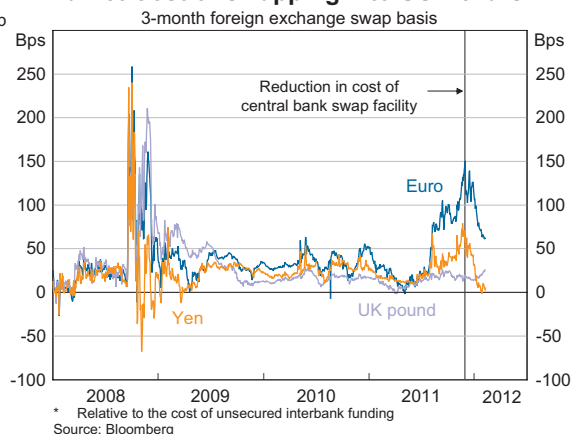


year. Looking ahead, declining economic activity in Europe, balance sheet contraction by euro area banks, and access to 3-year ECB funding is likely to reduce euro area banks' debt funding needs.

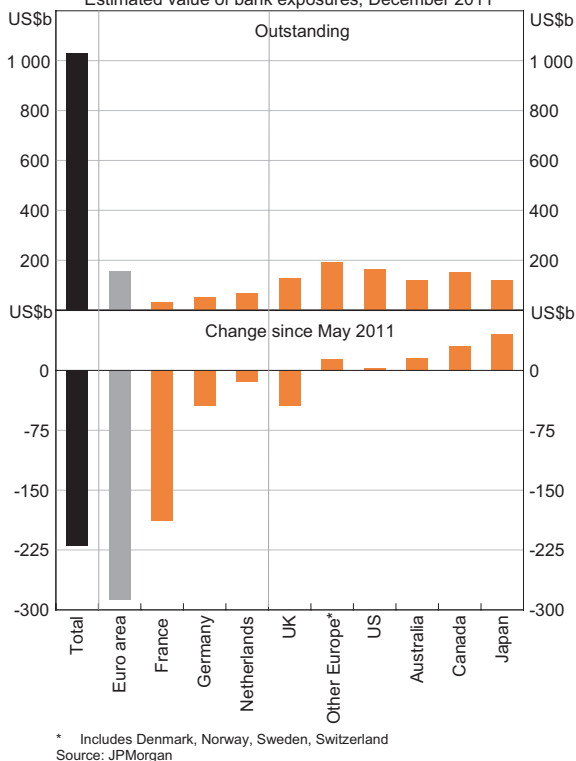
The cost of swapping euros (and yen) into US dollars in the foreign exchange market also declined after the US Federal Reserve reduced the cost to banks of borrowing US dollars via its swap facilities with other central banks (see section on 'Central Bank Policy'; Graph 2.11). Some European banks have continued to scale back their need for US dollars by selling US dollar assets or reducing US dollar lending. The latter includes the provision of trade and commodity finance, which is typically denominated in US dollars. At the same time, US money market funds have continued to reduce their exposures to euro area, particularly French, banks (Graph 2.12).

US banks' bond issuance picked up in January after being relatively subdued over the previous six months. Yields on financial and non-financial bonds in the United States and the euro area have generally fallen in net terms over the past few months (Graph 2.13). Issuance by US non-financial corporates has remained solid but in 2011 was lower than in the previous year (Graph 2.14). In part, this has reflected their strong internal funding growth and significant holdings of cash and other liquid assets.

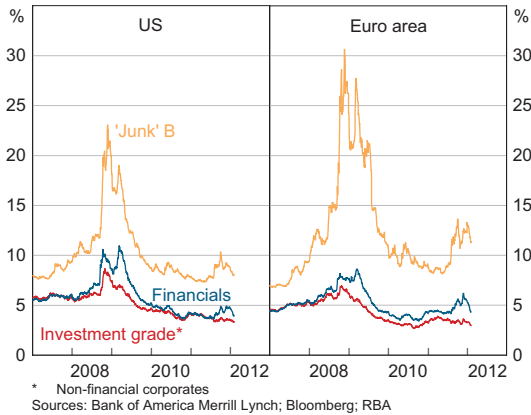
Graph 2.11
Market Cost of Swapping into US Dollars*



Graph 2.12
US Prime Money Market Fund Assets
Estimated value of bank exposures, December 2011



Graph 2.13
Corporate Bond Yields



the deteriorating global growth outlook on the domestic economy.

Equity price indices generally increased over January 2012, supported by the better recent US economic data and the modest improvement in the European debt situation. This occurred despite relatively disappointing US corporate earnings reports for the December quarter. Share price volatility implied by options declined to below long-run averages.

Banking sector share prices significantly underperformed over 2011, particularly in Europe where the market value of some large banks more

Graph 2.14
Non-financial Corporate Bond Issuance

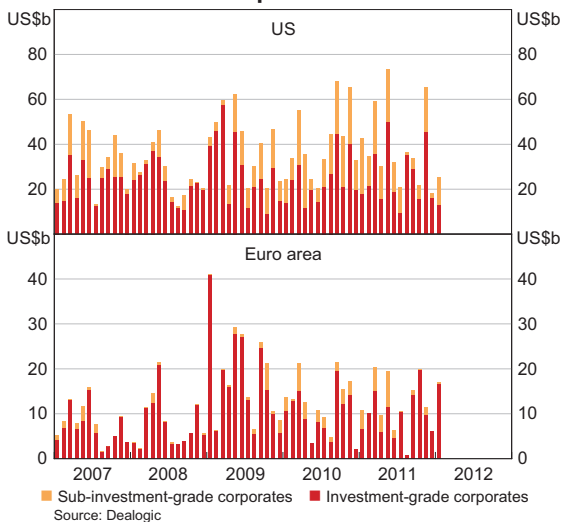


Table 2.2: Changes in International Share Prices
Per cent

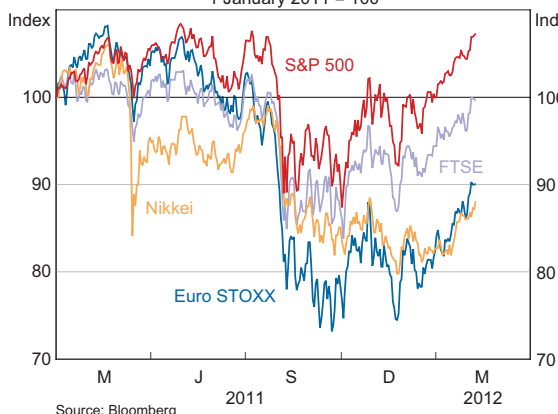
	Over 2011	Since previous Statement
United States		
– Dow Jones	6	7
– S&P 500	0	7
– NASDAQ	–2	8
Euro area		
– STOXX	–18	7
United Kingdom		
– FTSE	–6	6
Japan		
– Nikkei	–17	4
Canada		
– TSE 300	–11	0
Australia		
– ASX 200	–15	3
China		
– China A	–22	–6
MSCI indices		
– Emerging Asia	–16	7
– Latin America	–13	8
– Emerging Europe	–19	5
– World	–9	7

Source: Bloomberg

Equities

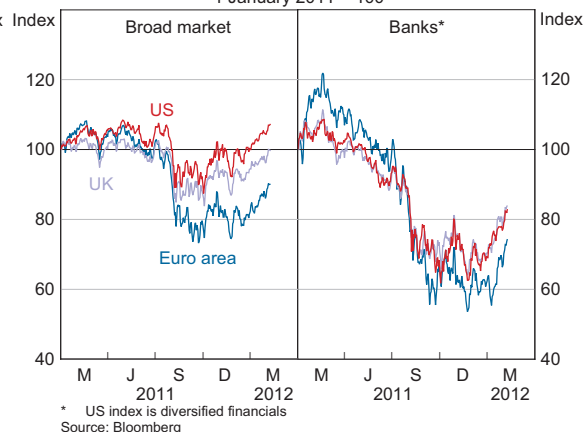
Global equity prices fell by 9 per cent over 2011 and double-digit declines were common across countries. The US equity market was a notable exception, reflecting relatively strong corporate earnings and better-than-expected economic data (Table 2.2, Graph 2.15). Euro area equity prices fell by 18 per cent with financial share prices particularly weak (see below). Chinese equity prices fell by 22 per cent over the year, partly reflecting concerns about the effect of policy tightening and

Graph 2.15
Major Share Price Indices
1 January 2011 = 100



Source: Bloomberg

Graph 2.16
Share Price Indices
1 January 2011 = 100



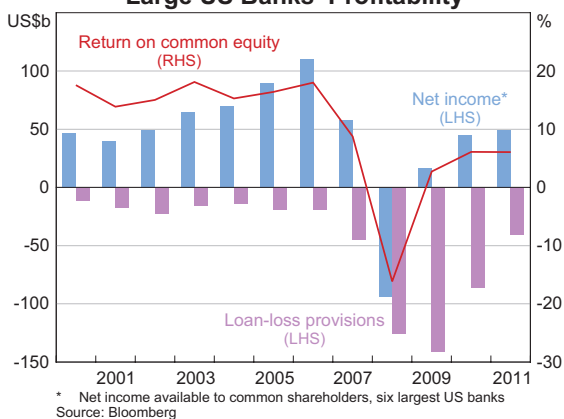
* US index is diversified financials
Source: Bloomberg

than halved (Graph 2.16). The European debt crisis and concerns surrounding euro area banks' need to raise capital to meet regulatory requirements has weighed on their share prices. Moreover, several European and US banks' ratings were downgraded or placed on review for downgrade, including a number of large banks following S&P's shift to new bank rating criteria. Recently, however, banks' share prices have increased in line with the improvement in investor sentiment.

Large US bank earnings for the December quarter were mixed, with weak trading and investment banking revenues weighing on earnings. For 2011 as a whole, aggregate profit for the six largest US banks was about US\$50 billion, marginally higher than in 2010 (Graph 2.17). Profits were boosted by a US\$45 billion fall in loan-loss provisions. Return on common equity remained at less than half pre-crisis rates.

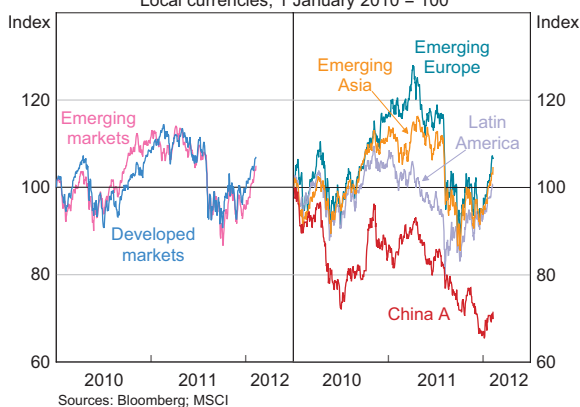
Emerging market equity prices in aggregate underperformed those in developed markets over 2011, reaching their lowest point since mid 2009 (Graph 2.18). In recent months, share prices in most of emerging Asia have risen strongly but Chinese share prices continued to underperform due to concerns about slower growth. In Latin America, equity prices rose particularly sharply in Brazil, in part supported by monetary policy easing.

Graph 2.17
Large US Banks' Profitability



* Net income available to common shareholders, six largest US banks
Source: Bloomberg

Graph 2.18
Share Price Indices
Local currencies, 1 January 2010 = 100

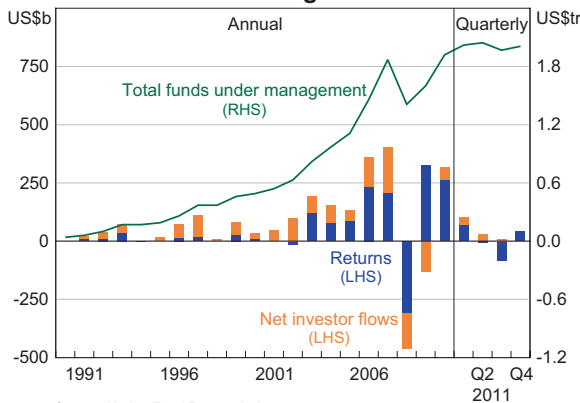


Sources: Bloomberg, MSCI

Hedge Funds

Global hedge funds recorded an average loss on investments of 5 per cent over the year to December (Graph 2.19). While hedge funds significantly underperformed equities over the December quarter, they provided similar total returns (including dividends) for the year as a whole. Funds under management edged up to US\$2.0 trillion, with positive quarterly returns more than offsetting a very small withdrawal of investor contributions, the first net quarterly withdrawal of capital since the December quarter 2009.

Graph 2.19
Global Hedge Funds



Foreign Exchange

The European sovereign debt crisis has continued to drive developments in foreign exchange markets in recent months, although the reduction in news flow saw volatility in foreign exchange markets ease somewhat.

The euro has depreciated against most currencies since late October, having previously been relatively resilient to concerns about the prospects for a near-term resolution to the European debt crisis. This depreciation has generally been more pronounced against non-European currencies, as other European currencies have typically been affected by concerns about possible spillovers from the euro area. Since mid 2011, the euro has depreciated by between 10 and 20 per cent against the US dollar and the

Japanese yen, but by 4–8 per cent against the main Scandinavian currencies and the UK pound (Graph 2.20). In contrast, since early September, the Swiss franc has moved little against the euro as it continues to operate under a ceiling imposed by the Swiss National Bank against the euro. Overall, the euro has depreciated by 8 per cent on a trade-weighted basis since mid last year, to be around its long-run average.

As the euro continued to shift lower in December and early January, previously close correlations between developments in the euro and other assets weakened markedly. In particular, the MSCI World and Euro STOXX equity indices have both risen strongly over the past three months, despite the euro's broad-based depreciation.

The US dollar has appreciated particularly strongly against the euro, but has depreciated against most other currencies since late October (Table 2.3, Graph 2.21). Over the past year, the US dollar is unchanged on a trade-weighted basis and remains well below its long-run average.

The Japanese yen has depreciated modestly against the US dollar from its recent highs reached in late October/early November, following the Japanese authorities intervening in the foreign exchange market by buying up to US\$120 billion to weaken the yen. Overall, the yen is unchanged against the

Graph 2.20
Euro against Selected Currencies

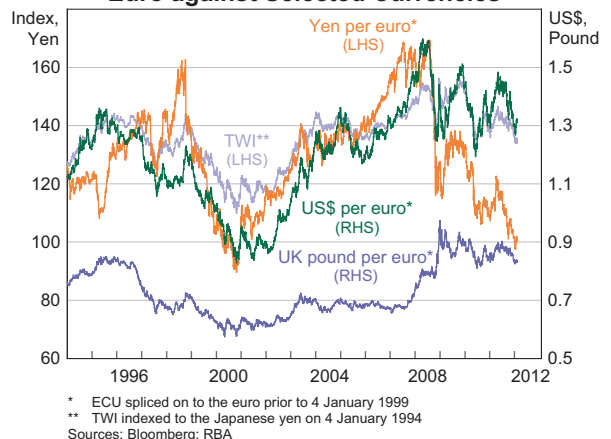


Table 2.3: Changes in the US Dollar against Selected Currencies

	Per cent	
	Over past year	Since previous Statement
European euro	4	4
Swiss franc	-5	4
UK pound sterling	2	1
Swedish krona	3	1
Indian rupee	8	0
Thai baht	0	0
Indonesian rupiah	0	0
Chinese renminbi	-4	-1
Brazilian real	4	-1
Canadian dollar	0	-1
South Korean won	0	-1
Japanese yen	-6	-1
Singapore dollar	-2	-1
Philippine peso	-3	-2
New Taiwan dollar	2	-2
Australian dollar	-6	-4
South African rand	5	-4
Malaysian ringgit	-1	-4
Mexican peso	5	-5
New Zealand dollar	-7	-5
Majors TWI	0	1
Broad TWI	0	-1

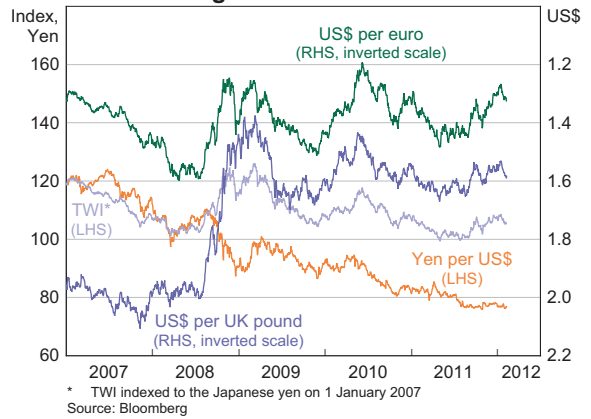
Sources: Bloomberg; Board of Governors of the Federal Reserve System

US dollar over the past six months, and has generally traded in a very narrow range of 76–78 yen per US dollar throughout much of this period. However, the yen has appreciated by 6 per cent against the euro since late October, reaching an 11-year high in January. Reflecting this, Japan’s nominal trade-weighted index has returned to historically high levels, though it remains only slightly above its long-run average in real terms (Graph 2.22).

The Chinese renminbi appears to have come under some downward pressure in the last two months

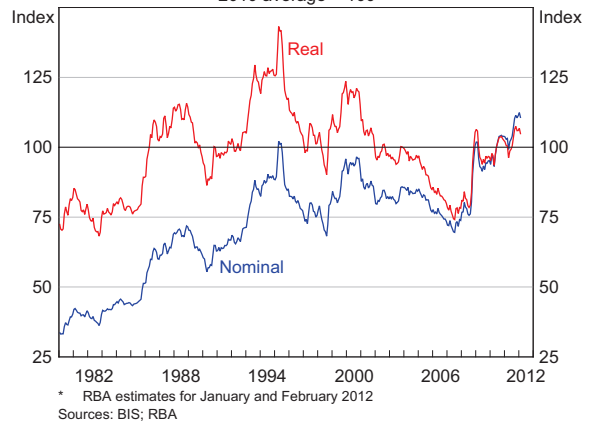
Graph 2.21

US Dollar against Selected Currencies



Graph 2.22

Japanese Effective Exchange Rates*
2010 average = 100



of 2011, reflecting weaker global risk sentiment and some concerns about the outlook for the Chinese economy. This was seen in the renminbi trading close to the bottom of the official trading band throughout December. Also consistent with this, the Chinese authorities reported declines in their foreign exchange reserve holdings in November and December, resulting in the first quarterly decline in China’s reserves since the June quarter 1998 (Table 2.4). Although valuation effects will have contributed to this fall, it seems likely that the Chinese authorities sold foreign exchange to support the renminbi during the quarter. Nevertheless, the authorities have appreciated the currency, albeit

Table 2.4: Foreign Currency Reserves
As at end December 2011

	Three-month-ended change		Level US\$ equivalent (billions)
	US\$ equivalent (billions)	Per cent	
China ^(a)	-21	-1	3 181
Japan	98	9	1 221
Russia	-16	-4	435
Taiwan	-4	-1	386
Brazil	2	1	343
South Korea	1	1	298
India	-13	-5	263
Thailand	-5	-3	165
Indonesia	-4	-4	103
Turkey	-9	-11	77
Chile	4	11	40

(a) Foreign exchange reserves (includes foreign currency and other reserve assets)
Sources: Bloomberg; CEIC; IMF; RBA

only slightly, against the US dollar since the previous *Statement*, taking the cumulative appreciation over 2011 to around 4½ per cent (Graph 2.23).

The apparent downward pressure on the renminbi in late 2011 was also reflected in the offshore (floating) renminbi exchange rate, which traded at a small discount to the onshore rate throughout this period, and in the non-deliverable forward market, which had been pricing in a small expected depreciation of the onshore renminbi exchange rate over the

next year. However, in line with generally improved risk appetite, the offshore rate is now trading at a small premium to the onshore rate, and the non-deliverable forward market is again pricing in a small expected appreciation of the renminbi over the next year.

After depreciating further in the last few months of 2011, other emerging market currencies have appreciated in 2012 to date (Graph 2.24). Emerging European currencies remain relatively weak, reflecting ongoing concerns about spillover effects from the euro area debt crisis. The Turkish lira reached its lowest level against the US dollar in late December since it floated in 2001, prompting the Central Bank of Turkey to intervene to support the currency, with the lira since appreciating by around 10 per cent from this low. Consistent with this reported intervention, Turkey's foreign currency reserves fell over the quarter (Table 2.4).

Emerging Asian currencies have also appreciated since the start of the year, retracing the depreciations seen in late 2011 (Graph 2.25). The Indian rupee depreciated particularly sharply in the latter part of 2011, in response to the deteriorating growth

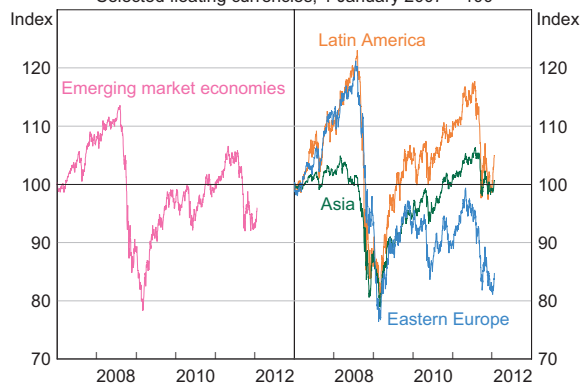
Graph 2.23
Chinese Renminbi*



* Onshore exchange rates
Sources: BIS; Bloomberg; RBA

Graph 2.24
Emerging Market Currencies*

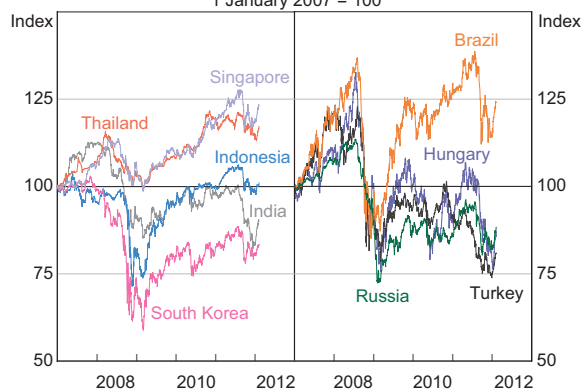
Selected floating currencies, 1 January 2007 = 100



* Against the US dollar; weighted by GDP at PPP exchange rates
Sources: Bloomberg; IMF; RBA

Graph 2.25
Selected Currencies against the US Dollar

1 January 2007 = 100



Source: Bloomberg

outlook for the Indian economy and concerns about India's reliance on external funding. The rupee troughed in mid December and has since recovered around one-half of its decline, supported by the more general improvement in risk sentiment outside of Europe and sales of foreign exchange by the Indian authorities in order to support the rupee.

Australian Dollar

The Australian dollar has traded in a wide range over recent months, but has appreciated significantly since mid December (Table 2.5). In particular, the Australian dollar has appreciated strongly against

the euro, reaching its highest level in early February since the inception of the euro in 1999 and, based on historical movements in the Deutsche mark prior to the euro's introduction, its highest level against a representative European currency since early 1989 (Graph 2.26). This contrasts with much of 2011, when movements in the Australian dollar tended to be closely correlated with developments in the euro. The Australian dollar also reached its highest level since February 1985 against the British pound.

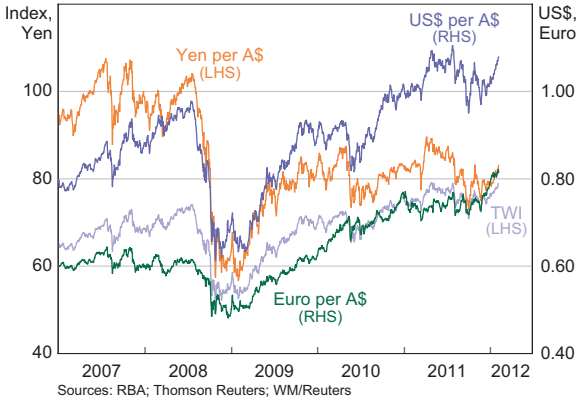
In trade-weighted terms, the Australian dollar is around its highest level since mid last year, notwithstanding a decline in the terms of trade, and has appreciated by around 5 per cent over the past year (Table 2.5). In line with developments in other currencies, intraday volatility in the Australian dollar has eased to levels seen in early 2011.

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

	Over past year	Since previous Statement
European euro	9	8
Swiss franc	1	8
UK pound sterling	8	5
Indian rupee	16	4
Thai baht	6	4
US dollar	6	4
Indonesian rupiah	6	3
Chinese renminbi	2	3
Canadian dollar	6	3
South Korean won	7	2
Japanese yen	-1	2
Singapore dollar	4	2
Malaysian ringgit	6	-1
South African rand	12	-1
New Zealand dollar	-1	-1
TWI	5	3

Sources: Bloomberg; Thomson Reuters; WWM/Reuters

Graph 2.26
Australian Dollar



that had acquired a negative market value for the Australian holder) and a reduction in Australian banks' overseas borrowing (Graph 2.27). These net debt outflows from the Australian banking sector were partly offset by net equity inflows to Australian private non-financial corporations, reflecting continued strong foreign investment in the Australian mining sector and the repatriation of overseas equity investments by Australian firms. ↘

Capital Flows

Consistent with the trend of the past two years, net capital inflows in the September quarter 2011 were directed towards the public sector, reflecting strong foreign purchases of government securities. In contrast, there was a large net outflow of capital from the private sector, predominantly reflecting financial derivative outflows (including margin or final payments made on derivative positions

Graph 2.27
Australian Capital Flows*
Net inflows, per cent of GDP

