2. International and Foreign Exchange Markets

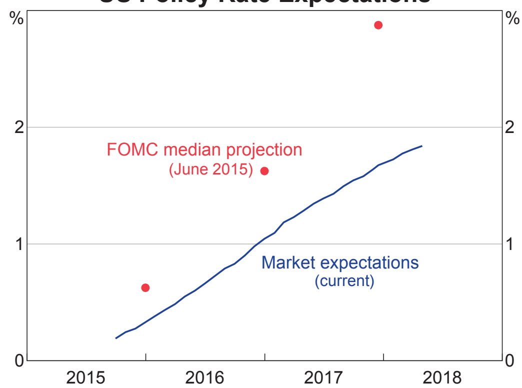
The major developments in global financial markets over recent months have been an escalation of concerns that Greece may exit the euro area, a correction in bond yields from the extremely low levels reached in mid April, a sharp but partial unwinding of the past year's rapid increase in Chinese share prices and a depreciation of the exchange rates of commodity-exporting nations (including Australia). The US Federal Reserve has continued to signal that it is nearing the point where it will raise the federal funds rate.

Central Bank Policy

The US Federal Reserve left its policy stance unchanged over recent months, but statements by members of the Federal Open Market Committee (FOMC) have increasingly signalled that they believe the conditions necessary to increase the policy rate may be met by the time of their September meeting. FOMC members' projections following their June meeting are consistent with this, with the median projection being for two rate increases this year (Graph 2.1). Beyond this, the FOMC expects the pace of increase in the federal funds rate to be gradual, with the median FOMC projection being for 100 basis points of tightening in 2016 and 125 basis points in 2017. This path remains higher than market-implied expectations, which only fully price in the first increase in December and a total of 125 basis points of tightening over the following two years.

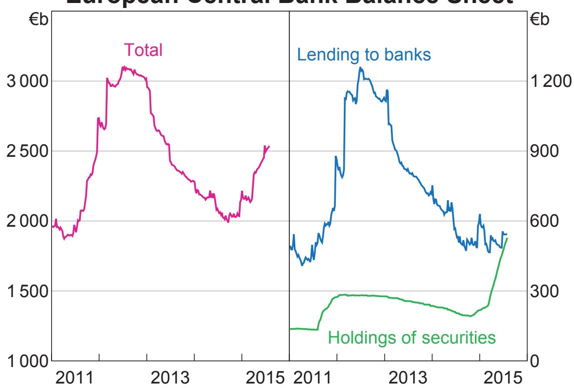
The European Central Bank (ECB) continued to expand its balance sheet rapidly over recent months (Graph 2.2). This expansion has been underpinned by holdings of securities resulting from its asset

Graph 2.1
US Policy Rate Expectations



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

Graph 2.2
European Central Bank Balance Sheet



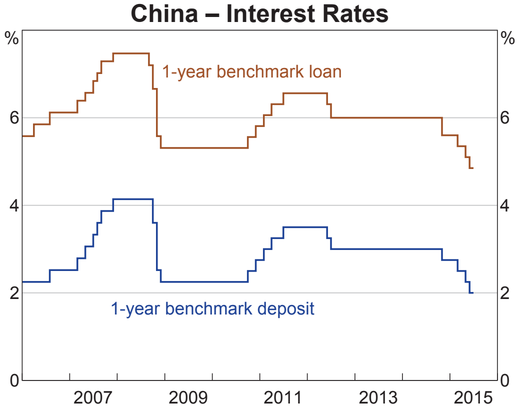
Source: ECB

purchase programs, which have increased by €300 billion since the start of the year. Lending to banks has been broadly stable over the past year as banks offset repayments of 3-year long-term refinancing operation (LTRO) loans by borrowing under targeted LTROs; loans extended under this facility (which commenced last September) now amount to almost €400 billion, with Italian, French and Spanish banks the largest users.

The Bank of Japan's (BoJ) balance sheet is also expanding rapidly as a result of its quantitative easing program, under which it aims to increase the money base by about ¥80 trillion this year. The BoJ continues to forecast that it will reach its 2 per cent target for inflation by around the middle of next year.

The People's Bank of China (PBC) eased monetary policy further in response to low inflation, the impact of that on real interest rates and softening economic growth. The PBC cut most benchmark lending and deposit rates by 25 basis points in both May and June, bringing the cumulative decline in 1-year benchmark rates to 115 and 100 basis points, respectively, since November last year (Graph 2.3). The PBC has also ensured that liquidity in the money market remains ample; reductions in reserve requirement ratios and targeted extensions of loans to certain banks have more than offset a reduction in liquidity from foreign exchange reserve sales over the course of 2015, leaving money market rates below average levels of recent years. Moreover, the PBC has provided support to the equity market. Beyond this, the State Council has announced its intention to make the loan-to-deposit ratio (LDR) non-binding, which would relax the current restrictions that the LDR imposes on banks' funding mix and asset composition and may thereby contribute to a further easing of monetary conditions.

Graph 2.3
China – Interest Rates



Source: CEIC Data

Central banks in a number of other countries eased monetary policy further in June or July, including those of Canada, New Zealand and Norway (Table 2.1). In each case, the decision was motivated by, among other things, slower growth in commodity-related investment and/or reduced incomes due to lower terms of trade. The Reserve Bank of New Zealand (RBNZ) also adjusted its macroprudential policy settings to tighten restrictions on investor borrowing for housing purchases in Auckland, while relaxing those for borrowing elsewhere.

Table 2.1: Monetary Policy

	Policy rate Per cent		Most recent change
Euro area	0.05	↓	Sep 14
Japan[a]	na		na
United States[b]	0.125	↓	Dec 08
Australia	2.00	↓	May 15
Brazil	14.25	↑	Jul 15
Canada	0.50	↓	Jul 15
Chile	3.00	↓	Oct 14
China[a]	na		na
India	7.25	↓	Jun 15
Indonesia	7.50	↓	Feb 15
Israel	0.10	↓	Feb 15
Malaysia	3.25	↑	Jul 14
Mexico	3.00	↓	Jun 14
New Zealand	3.00	↓	Jul 15
Norway	1.00	↓	Jun 15
Russia	11.00	↓	Jul 15
South Africa	6.00	↑	Jul 15
South Korea	1.50	↓	Jun 15
Sweden	–0.35	↓	Jul 15
Switzerland[b]	–0.75	↓	Jan 15
Thailand	1.50	↓	Apr 15
Turkey	7.50	↓	Feb 15
United Kingdom	0.50	↓	Mar 09

(a) The Bank of Japan's main operating target is currently the money base; China does not have an official policy rate
(b) Midpoint of target range
Sources: Central banks; RBA; Thomson Reuters;

The Swedish central bank also eased policy further in July, announcing both a reduction in its policy rate and a further expansion of its sovereign bond purchase program. The expansion will see it purchase over 20 per cent of the stock of outstanding government bonds during the course of 2015, a higher proportion than any other central bank has previously purchased in a single year.

The central banks of both India and South Korea lowered interest rates by a further 25 basis points over recent months, due to concerns about softening economies, while the Russian central bank unwound part of its 2014 monetary tightening. In contrast, the central banks of Brazil and South Africa continued to tighten policy in response to inflation concerns.

Greece

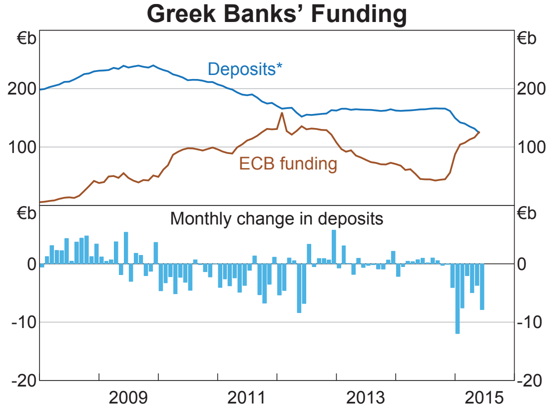
Greece and its official sector creditors reached agreement on the broad parameters of a third financial assistance program in mid July and are negotiating the details with an aim of completing this by mid August. A final decision on the program will require approval by European governments, with some requiring parliamentary authorisation for this (most notably, Greece and Germany). The agreement followed the closure of Greek banks for an extended period, after previous talks broke down when the Greek Government called a referendum in late June on whether to accept the terms then on offer by its official sector creditors, and a no vote in this referendum.

The terms of the proposed agreement include a 3-year program offering financial assistance of between €82 and €86 billion. Of this, €10–25 billion is allocated to potential bank recapitalisation needs, with €10 billion to be made available immediately after an agreement is finalised. The remainder of the financial assistance program would cover the Greek Government's debt obligations over the next three years. In return, the Government agreed to: restore the primary budget to a sustained surplus of 3½ per cent of GDP by 2018; raise and streamline a range of taxes; reduce pension payments; privatise additional assets; and commit to reforms of the labour market. Many of these terms are more onerous than those made available before the referendum, and Greece's creditors required many to be legislated before the start of negotiations to 'restore trust'. This legislation has since been passed.

In response to Greece's legislative action, the European Union provided a €7 billion bridge loan that enabled Greece to clear its arrears at the International Monetary Fund (IMF) and repay a maturing bond held by the ECB.

A key near-term challenge facing Greek authorities is how to restore the banking sector to normal functioning. Greek banks closed following the calling of the referendum, and various restrictions were placed on bank withdrawals (most notably a deposit withdrawal limit of €60 per day and the prohibition of bank transfers overseas without approval). This followed an acceleration of deposit outflows over June (Graph 2.4). The ECB decided not to raise the cap on liquidity assistance as the prospect of Greece defaulting on its obligations increased, but has raised it twice since the agreement. While Greek banks have reopened, there has been very little relaxation of the restrictions on bank withdrawals and most controls on international transfers remain in place.

Graph 2.4
Greek Banks' Funding

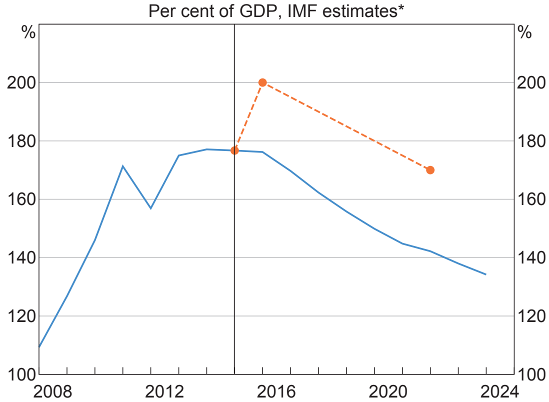


* Non-financial, non-government

Sources: Bank of Greece; ECB; RBA

In the longer term, the main challenge for the Greek Government is to reduce its debt to a sustainable level. The IMF now estimates that Greece's debt would peak at close to 200 per cent of GDP over the next two years, accounting for the new loan but not for the full economic impact of the closure of the Greek banking system (Graph 2.5).

Graph 2.5
Greek Government Debt
Per cent of GDP, IMF estimates*



* Preliminary, from the June (solid line) and July (dotted line) debt sustainability analyses

Sources: European Commission; IMF

European leaders have agreed to discuss debt relief to make Greece's debt sustainable following the first disbursement of funds under the proposed program, but explicitly ruled out nominal haircuts on debt. The IMF has stated that maturity extensions could make Greece's debt sustainable, but only if they are 'very dramatic' and accompanied by a large grace period during which no interest or principal is paid to European governments (which account for the majority of its obligations; Table 2.2). The IMF will not be involved in a new program until it is satisfied that the Eurogroup has made sufficient concessions to ensure Greece's debt is sustainable.

Table 2.2: Greek Government Debt
As at March 2015

	€b	Per cent of total
Owed to official sector	233	77
Joint loans by EU governments	131	43
Bilateral loans by EU governments	53	18
ECB bond holdings[(a)]	27	9
IMF	22	7
Owed to private sector	69	23
Securities	40	13
Other	29	10
Total	**302**	**100**

(a) Mainly bonds acquired outright through the Securities Market Program; includes holdings by national central banks

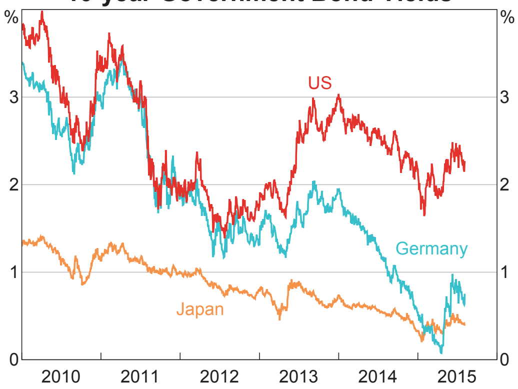
Sources: Bloomberg; ECB; European Commission; Eurostat; IMF

Sovereign Debt Markets

Yields on 10-year US and German government bonds have risen notably since mid April, with those on German Bunds around 70 basis points higher and those on US Treasuries having risen by 40 basis points (Graph 2.6). Yields are now back around the levels observed in early December 2014. This rise largely reflected a correction from the extremely low levels they had reached in early April (with a low of 8 basis points for the 10-year Bund yield). These moves have been more than matched by a rise in real yields, with inflation compensation embedded in nominal bonds falling alongside lower commodity prices over recent months. Japanese government bond (JGB) yields have also risen modestly since mid April.

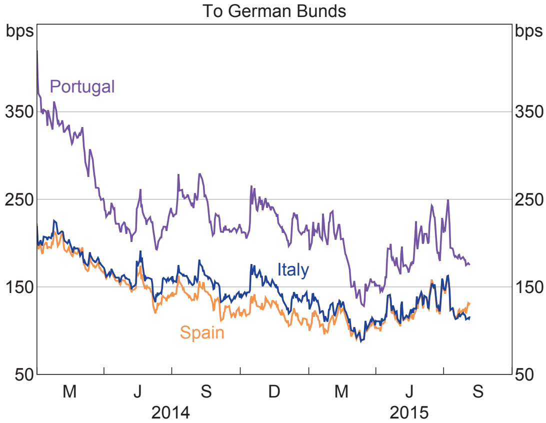
The spreads between yields on bonds issued by governments of the euro area periphery and German Bunds became more sensitive to developments in Greece as concerns about a possible breakdown of negotiations grew, but the increases in June and early July have been largely unwound since (Graph 2.7). The size of the moves in periphery sovereign bond spreads remained much smaller than in 2011 and 2012.

Graph 2.6
10-year Government Bond Yields



Source: Bloomberg

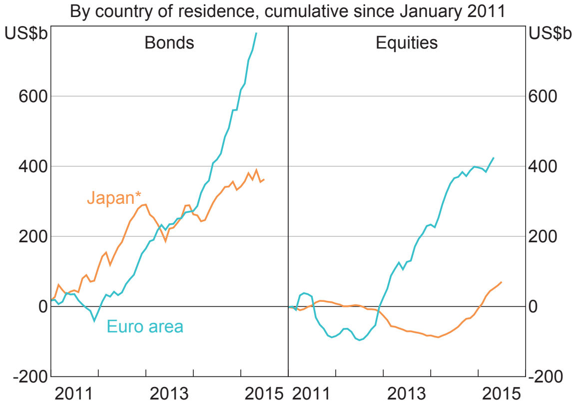
Graph 2.7
Euro Area 10-year Government Bond Spreads
To German Bunds



Source: Bloomberg

The asset reallocation by the Japanese Government Pension Investment Fund (GPIF), brought about by a reduction in its target allocation to JGBs from 60 to 35 per cent (with a corresponding increase in the allocation to domestic equities and international securities), looks now to be largely completed. At the end of March, the GPIF was within its target allocation range for both domestic equities and international securities. Consistent with this, Japanese residents' purchases of foreign assets have slowed over recent months (Graph 2.8). In contrast, European investors have been large purchasers of foreign bonds in the

Graph 2.8
Purchases of Foreign Portfolio Assets
By country of residence, cumulative since January 2011



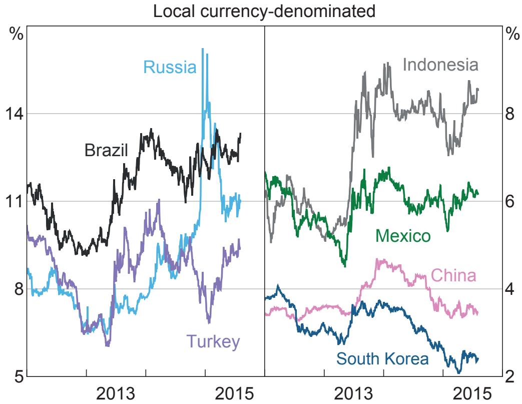
* Provisional data after May 2015

Sources: ECB; Japanese Ministry of Finance; RBA

first five months of the year. In combination with continued net sales by foreign investors, including those from Japan, this has resulted in large net bond capital outflows from Europe.

Yields on local currency bonds issued by emerging market sovereigns have risen since mid April but the magnitude of these moves was notably smaller than in Germany and the United States (Graph 2.9). There continued to be few signs of a reallocation away from emerging market bonds despite the US Federal Reserve moving closer to tightening policy.

Graph 2.9
10-year Government Bond Yields
Local currency-denominated



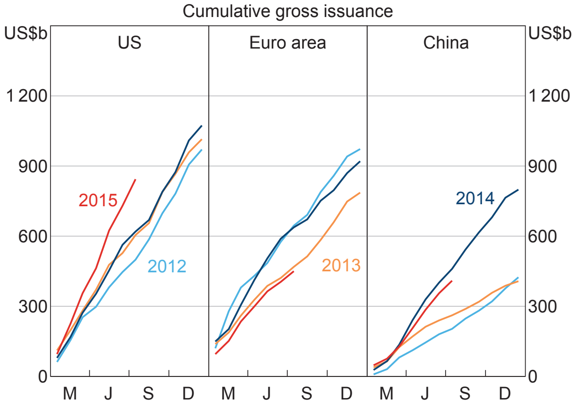
Sources: Bloomberg; Thomson Reuters

Credit Markets

Spreads on bonds issued by US and euro area corporations have risen moderately over recent months, alongside the evolving situation in Greece and developments in oil prices. The recent rise has seen US corporate bond spreads return close to their recent peaks in January, while euro area financial and investment-grade spreads are also above their levels of a year ago. Nonetheless, spreads remain low by historical standards.

Bond issuance by US corporations in 2015 to date has been well ahead of prior years (Graph 2.10). The increase in issuance partly owes to acquisition-related fund raising, with a third of issuance this year used in part for that purpose (compared with one fifth in 2014), and to efforts to raise funds ahead of an expected tightening in monetary policy later this year. In contrast, corporate bond issuance in Europe has been weak this year, with uncertainty surrounding Greece weighing of late. Chinese corporations have issued sizeable quantities of debt in 2015, though at a slightly slower pace than in 2014.

Graph 2.10
Global Corporate Bond Issuance
Cumulative gross issuance



Sources: Dealogic; RBA

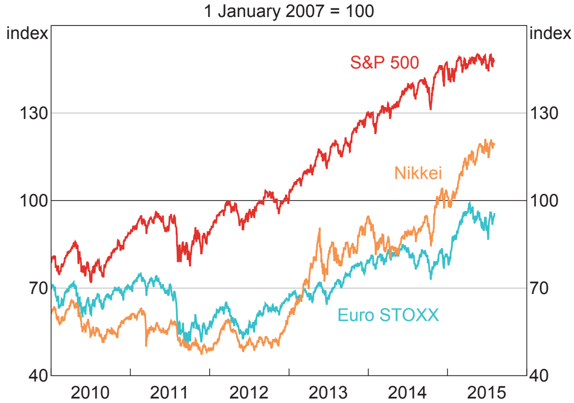
In China, issuance of infrastructure-linked bonds that are commonly used by local government financing vehicles (LGFVs) has slowed in 2015. However, the impact of this on local governments' ability to fund infrastructure via LGFVs has been mitigated somewhat by progress of the program under which local governments can swap high-cost LGFV debt into lower-yielding municipal bonds. This has seen bond issuance by local governments treble to around CNY1.3 trillion this year. Accordingly, combined LGFV and local government bond issuance has been well ahead of that issued at the same time last year, alleviating earlier concerns about a funding shortfall. Issuance is likely to remain sizeable over the remainder of the year, given that the total quota available for local government issuance is currently CNY2.6 trillion.

Equities

US and euro area equity prices have been broadly unchanged over recent months, despite fluctuating in response to the evolving situation in Greece and falls in Chinese equity prices (Graph 2.11; Table 2.3). These developments had a greater impact on euro area share prices, which at one stage were more than 10 per cent below their mid-April peak. In Japan, share prices have continued to increase, to be almost 20 per cent higher than at the start of the year.

US banks posted strong profits in the June quarter, although the sizeable increase compared with the same period in 2014 partly reflected lower legal expenses. Beyond this, the increase in profits owed to a rise in client activity on both the trading and

Graph 2.11
Major Share Price Indices
1 January 2007 = 100



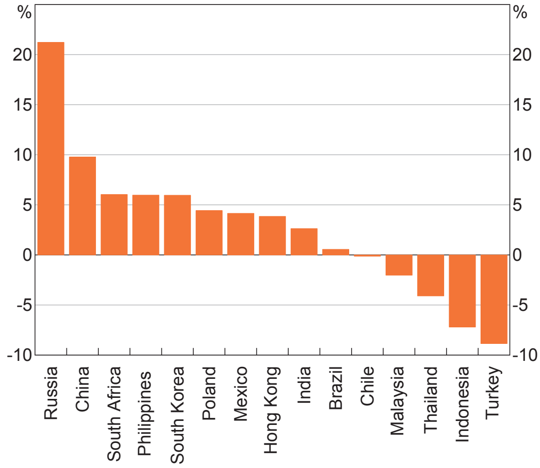
Source: Bloomberg

Table 2.3: Changes in International Share Prices
Per cent

	Over 2014	2015 to date
United States – S&P 500	11	2
Euro area – STOXX	2	18
United Kingdom – FTSE	–3	3
Japan – Nikkei	7	18
Canada – TSE 300	7	–1
Australia – ASX 200	1	5
China – MSCI All China	28	10
MSCI indices		
– Emerging Asia	5	–2
– Latin America	–4	0
– Emerging Europe	–8	3
– World	**7**	**5**

Source: Bloomberg

Graph 2.12
Changes in Emerging Market Share Price Indices
Since the start of 2015



Source: Bloomberg

advisory side, as well as a pick-up in mortgage origination. European banks have generally increased their profitability over the quarter and strengthened their capital ratios. Profits from retail banking, wealth management and equities trading tended to increase, while loan loss provisions continued to decline and a number of banks made further progress in reducing their cost bases.

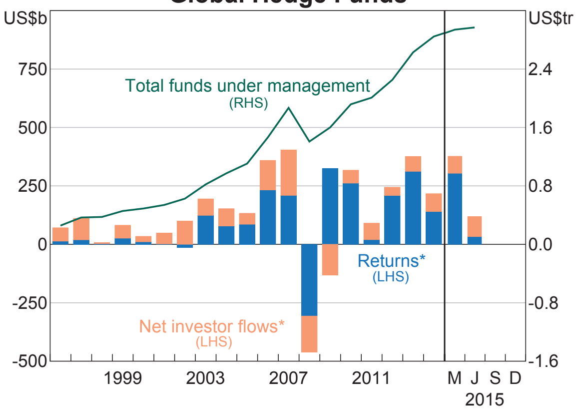
While provisions for legal expenses have declined, six US and European banks agreed in June to pay almost US$6 billion in fines to various US and UK authorities for misconduct and manipulation of foreign exchange markets. A number of these banks also pleaded guilty to criminal charges of market manipulation. The fines bring the amount paid by banks to global regulators since the end of 2008 to US$200 billion.

Equity prices in emerging market economies have drifted down since late April or early May, but are mostly still higher than at the start of the year (Graph 2.12). Chinese equity prices have declined by 30 per cent since mid June to be back around end-March levels. As discussed in 'Box A: The Recent Decline in Chinese Equity Prices', this decline largely reflects some correction from excessively high levels and has been associated with a partial reversal of the sharp run-up in margin debt over the prior year. Equity prices stabilised for a time following aggressive policy intervention, but subsequently fell again as investors questioned the continuation of this support. Hong Kong equity price indices have been weighed down by these declines, owing to the large number of Chinese companies listed in Hong Kong, but the decline in other Hong-Kong listed companies' share prices has been modest. Brazilian share prices have also fallen by around 15 per cent from their peak three months ago, reflecting concerns about deteriorating fiscal and economic conditions (amid lower commodity prices).

Hedge Funds

Global hedge funds recorded an asset-weighted return on investments of 3.9 per cent over the year to the June quarter 2015, outperforming a balanced portfolio of global bonds and equities. The strongest performance came from funds investing in emerging Asia and macro funds, which trade according to views on broad economic developments. Hedge funds continue to receive net inflows which, combined with positive investment returns, saw funds under management rise by 1 per cent over the quarter to almost US$3 trillion (Graph 2.13).

Graph 2.13
Global Hedge Funds



* Annualised for 2015 data
Sources: Hedge Fund Research, Inc.; RBA

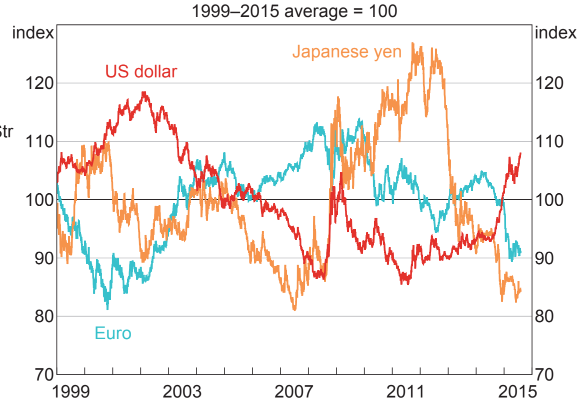
Foreign Exchange

Foreign exchange markets have continued to be influenced by the divergent outlooks for monetary policy in the United States and other major advanced economies. A renewed decline in global commodity prices has also contributed to some larger movements in exchange rates over recent months, although volatility in the main developed market currency pairs has been little changed at around its 20-year average.

The US dollar has appreciated against most other currencies since mid May to be around 5 per cent higher on a trade-weighted basis, and is around 17 per cent higher than its mid 2014 level (Graph 2.14; Table 2.4). The sustained appreciation reflects market participants' ongoing expectations that the FOMC will increase the federal funds rate later this year and that other major economies will maintain current monetary policy settings or ease further.

The euro has appreciated by 2 per cent on a trade-weighted basis and by 3 per cent against the US dollar since mid April, alongside a marked increase in German Bund yields. The appreciation has occurred notwithstanding the developments

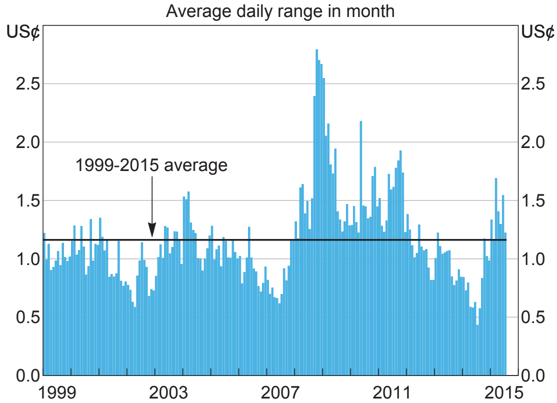
Graph 2.14
Nominal Trade-weighted Indices
1999–2015 average = 100



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

in Greece, although in recent months the intraday range for the EUR/USD exchange rate has been above its average since the introduction of the euro (Graph 2.15). Despite its recent appreciation, the euro has depreciated by around 8 per cent over 2015 to date, and is 13 per cent lower than its peak in March 2014 on a trade-weighted basis.

Graph 2.15
Intraday Range in EUR/USD
Average daily range in month



Sources: Bloomberg; RBA

The Swiss franc has depreciated by around 4 per cent against the euro since mid April, but remains 12 per cent above its level immediately prior to the Swiss National Bank (SNB) abandoning its minimum exchange rate policy in January. The evolving situation in Greece contributed to increased

Table 2.4: Changes in the US Dollar against Selected Currencies
Per cent

	Over 2014	2015 to date
Brazilian real	12	32
New Zealand dollar	5	20
Canadian dollar	9	13
Swedish krona	21	11
Australian dollar	9	11
Mexican peso	13	11
European euro	14	11
Malaysian ringgit	7	11
South African rand	10	11
Russian rouble	76	9
Indonesian rupiah	2	9
South Korean won	4	8
Thai baht	1	7
Singapore dollar	5	4
Japanese yen	14	4
Philippine peso	1	2
Indian rupee	2	1
Chinese renminbi	2	0
UK pound sterling	6	0
Swiss franc	11	–2
TWI	**9**	**7**

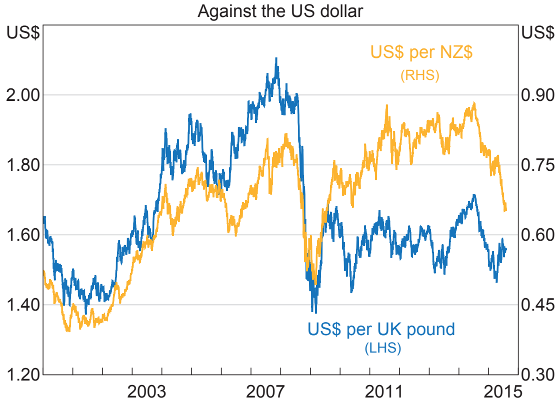
Sources: Bloomberg; Board of Governors of the Federal Reserve System

demand for the franc and the SNB confirmed it had intervened in the foreign exchange market in late June to offset appreciation pressure on the franc following the decision by Greek authorities to hold a referendum and introduce capital controls.

The Japanese yen has depreciated by 5 per cent against the US dollar and by 2 per cent on a trade-weighted basis since mid May, and in June the yen reached its lowest level against the US dollar since 2002. In real trade-weighted terms, the yen remains around 30 per cent lower than its multi-decade average.

The New Zealand dollar has depreciated by around 15 per cent against the US dollar since late April when the RBNZ moved to an easing bias and subsequently reduced its policy rate in June and July (Graph 2.16). The Canadian dollar and Norwegian krone have depreciated by around 9 per cent and 11 per cent respectively against the US dollar since mid May alongside both central

Graph 2.16
New Zealand Dollar and UK Pound
Against the US dollar



Source: Bloomberg

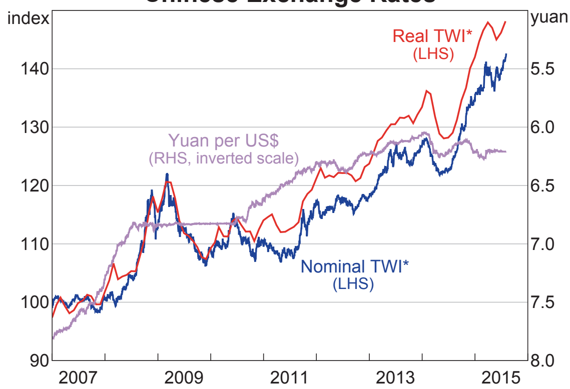
banks easing monetary policy and a decline in oil prices. In contrast, the UK pound has appreciated by 7 per cent against the US dollar since mid April, in part due to market participants' expectations of the timing of the Bank of England's first rate increase being brought forward.

The Chinese renminbi (RMB) has been little changed against the US dollar since mid March and volatility has declined to low levels. The PBC's daily fixing rate for the RMB against the US dollar has also been little changed over this period and the RMB remains in the bottom half of its +/-2 per cent trading band against the US dollar. Consistent with the broad-based appreciation of the US dollar, the RMB has appreciated by around 6 per cent on a trade-weighted basis over 2015 to date, to be 16 per cent higher than its mid 2014 level (Graph 2.17). This primarily reflects an appreciation of the RMB against the euro and the yen. In late July China's State Council called for the PBC and State Administration of Foreign Exchange to widen the RMB exchange rate trading band against the US dollar, although this is yet to be implemented. The trading band was previously widened to +/-2 per cent in March 2014 (from +/-1 per cent).

The stock of Chinese foreign currency reserves decreased by US$36 billion (around 1 per cent) over the June quarter, to be around US$300 billion lower than its peak at the end of June 2014 (Graph 2.18). The decline in reserves since mid 2014 has reflected both capital outflows from the private sector and exchange rate valuation effects from a broadly stronger US dollar.

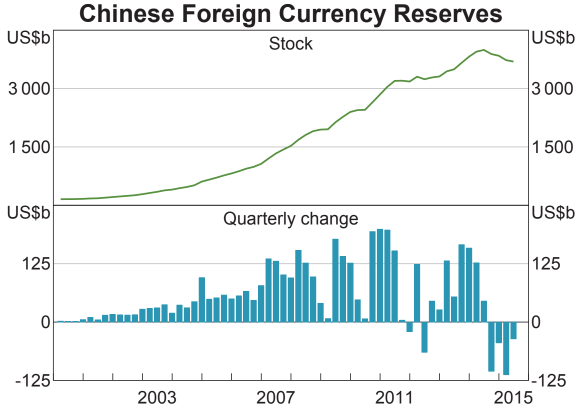
Most other Asian and emerging market currencies have depreciated against the US dollar since mid May and over 2015 to date (Graph 2.19). The depreciations have tended to be more pronounced for the currencies of commodity exporters. However, volatility in most emerging market currencies has declined over recent months and is currently around its post-2009 average.

Graph 2.17
Chinese Exchange Rates



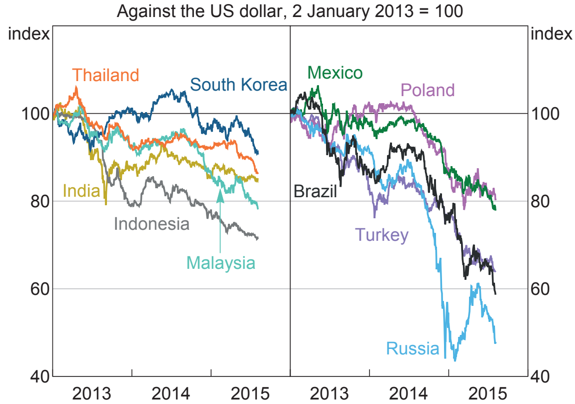
* Indexed to 2007 average = 100
Sources: BIS; Bloomberg; RBA

Graph 2.18
Chinese Foreign Currency Reserves



Source: CEIC Data

Graph 2.19
Asian and Emerging Market Currencies
Against the US dollar, 2 January 2013 = 100



Source: Bloomberg

After having appreciated by a little more than 40 per cent against the US dollar between late January and mid May, the Russian rouble has since depreciated by around 23 per cent. The depreciation has coincided with declines in global oil prices, the Russian central bank's daily purchases of foreign currency between mid May and late July to replenish its foreign currency reserves, and further monetary policy easing. Russia's gross foreign currency reserves had declined by US$125 billion between mid 2014 and April 2015 but have since increased moderately.

In Asia, the South Korean won has depreciated by around 9 per cent against the US dollar since its peak in late April, alongside a softening in economic conditions and the Bank of Korea's decision to reduce its policy rate in June. In South America, the Brazilian real has depreciated by around 16 per cent against the US dollar since late April and is 24 per cent lower over 2015 to date. Declining commodity prices and deteriorating economic and fiscal conditions have contributed to the depreciation of the currency.

The gross foreign currency reserves of most Asian and other emerging market economies have been little changed or have increased modestly since the end of March (Table 2.5). Two exceptions are Malaysia and Indonesia, whose foreign currency reserves have declined by 4 per cent and 3 per cent respectively since the end of March. Bank Indonesia reported that the decline in its reserves was partly attributable to the sale of foreign exchange to stabilise the rupiah.

Australian Dollar

Since the previous *Statement*, the Australian dollar has depreciated by 5 per cent on a trade-weighted basis and by 8 per cent against the US dollar, to be around its lowest level since 2009 (Graph 2.20; Table 2.6). The depreciation was similar to that of other commodity exporters. A number of factors have contributed to the depreciation, including declines in key commodity prices, uncertainty about the outlook for China and market participants' ongoing assessment of the outlook for US monetary

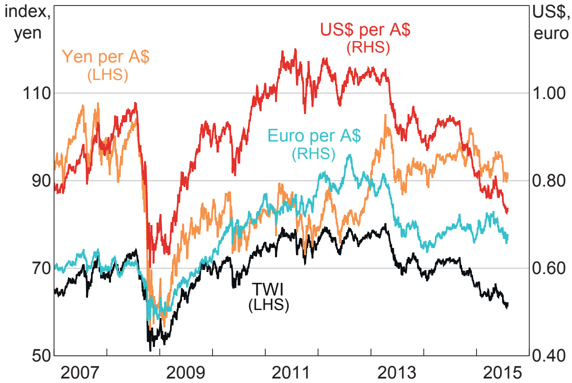
Table 2.5: Gross Foreign Currency Reserves[(a)]

	Percentage change since:		Level
	End June 2014	End March 2015	US$ equivalent (billions)
China	–7	–1	3694
Taiwan[(b)]	0	2	422
South Korea	2	2	362
Brazil	–1	2	360
India	14	4	329
Hong Kong	4	1	324
Russia	–28	1	302
Singapore	–9	2	251
Mexico	2	–1	184
Thailand	–4	3	152
Indonesia	1	–3	102
Turkey	–10	–1	99
Malaysia	–23	–4	92
Ukraine	–39	3	9

(a) Data to end June for China, Hong Kong, Singapore, Mexico, Thailand, Indonesia, and Ukraine; to 15 July for Malaysia; to 24 July for India, Russia and Turkey; to end July for Taiwan, South Korea and Brazil
(b) Foreign exchange reserves (includes foreign currency and other reserve assets)
Sources: Bloomberg; CEIC Data; IMF; RBA

policy. Since mid 2014, the Australian dollar has declined by 14 per cent on a trade-weighted basis and by 23 per cent against the US dollar.

Graph 2.20
Australian Dollar



Sources: Bloomberg; RBA

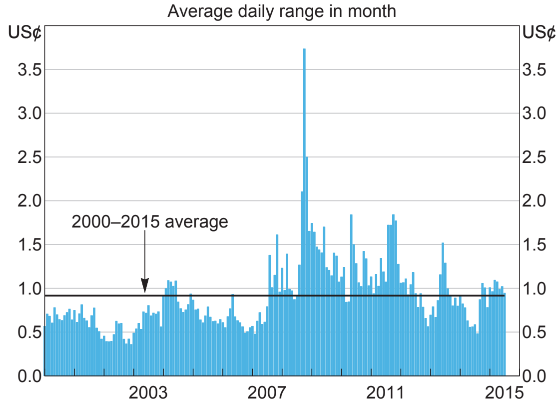
Table 2.6: Changes in the Australian Dollar against Selected Currencies
Per cent

	Over 2014	2015 to date
New Zealand dollar	–4	8
Canadian dollar	0	2
European euro	4	0
Malaysian ringgit	–2	0
South African rand	1	0
Indonesian rupiah	–7	–2
South Korean won	–5	–3
Thai baht	–8	–4
Singapore dollar	–4	–6
Japanese yen	4	–6
Indian rupee	–6	–9
Chinese renminbi	–6	–10
US dollar	–8	–10
UK pound sterling	–3	–10
Swiss franc	2	–11
TWI	**–3**	**–7**

Sources: Bloomberg; RBA

Volatility in the Australian dollar has been little changed over 2015 to date, with the average intraday trading range for the AUD/USD exchange rate remaining slightly higher than its post-2000 average (Graph 2.21).

Graph 2.21
Intraday Range in AUD/USD
Average daily range in month



Sources: Bloomberg; RBA

Capital Flows

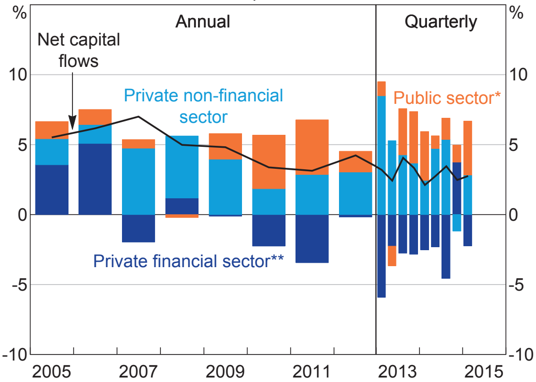
Net capital inflows to the Australian economy were equivalent to 2.8 per cent of GDP in the March quarter, and were primarily directed to the public sector. There was also a small net inflow to the private sector as a whole, with net inflows to the private non-financial sector more than offsetting net outflows from the private financial sector (Graph 2.22).

Within the public sector, the net inflow to the general government sector continued to largely reflect foreign purchases of Australian Government securities (AGS). In contrast to the previous three quarters, the state and local government sectors also received a net inflow, albeit relatively modest. However, with net inflows largely proportional to net issuance of AGS and state and local government debt, the foreign ownership shares were little changed at 66 and 25 per cent respectively.

Graph 2.22

Australian Capital Flows

Net inflows, per cent of GDP



* Excludes official reserves and other RBA flows

** Adjusted for US dollar swap facility in 2008-09

Sources: ABS; RBA

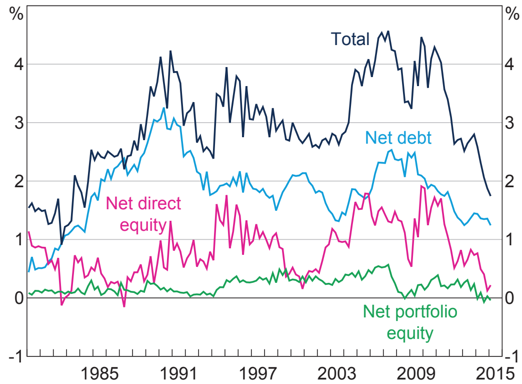
The net inflow to the private non-financial sector in the March quarter was entirely due to a sharp increase in foreign investment in the mining sector, following negligible net flows in the December quarter. In contrast, there was a net outflow from the private financial sector, largely reflecting net debt outflows from the banking sector. This more than offset a net inflow to the 'other financials' sector (which includes superannuation and other types of investment funds), which reflected a repatriation of Australian investments in foreign bonds. This quarter was the first time the 'other financials' sector had not recorded a net equity outflow since the June quarter 2013.

Notwithstanding the increase in net capital inflows, Australia's (seasonally adjusted) net income deficit narrowed further in the March quarter to 1.7 per cent of GDP – its lowest share of GDP since June 1984 (Graph 2.23). The narrowing of the net income deficit was driven by a decline in the value of payments on Australia's debt liabilities. ✠

Graph 2.23

Net Income Deficit

Per cent of GDP



Sources: ABS; RBA