



RESERVE BANK OF AUSTRALIA

Teacher Immersion Event 2024

H.C. Coombs Centre, Kirribilli
19 July 2024

Education



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Explaining and Teaching Economic Concepts in the Classroom

Exchange Rates

Education



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Exchange Rates

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Outline

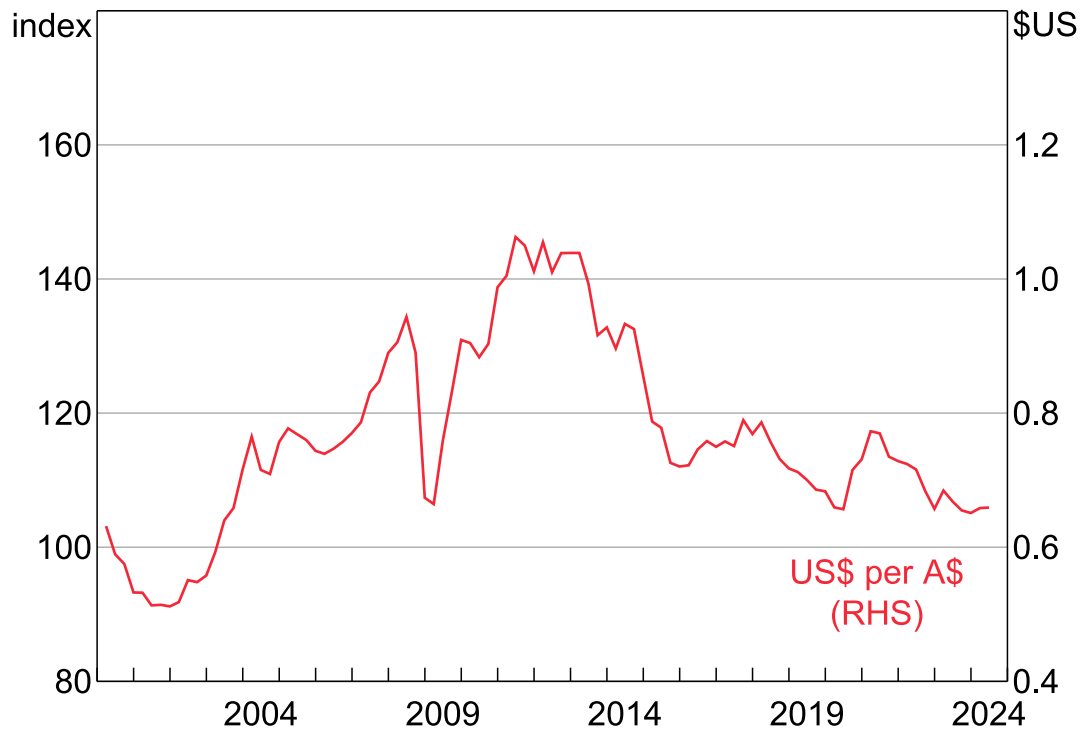
- Types of exchange rates
- Exchange rate regimes
- What drives movements in the AUD?
- Why do we care about the AUD?



What are exchange rates?



Australian Dollar

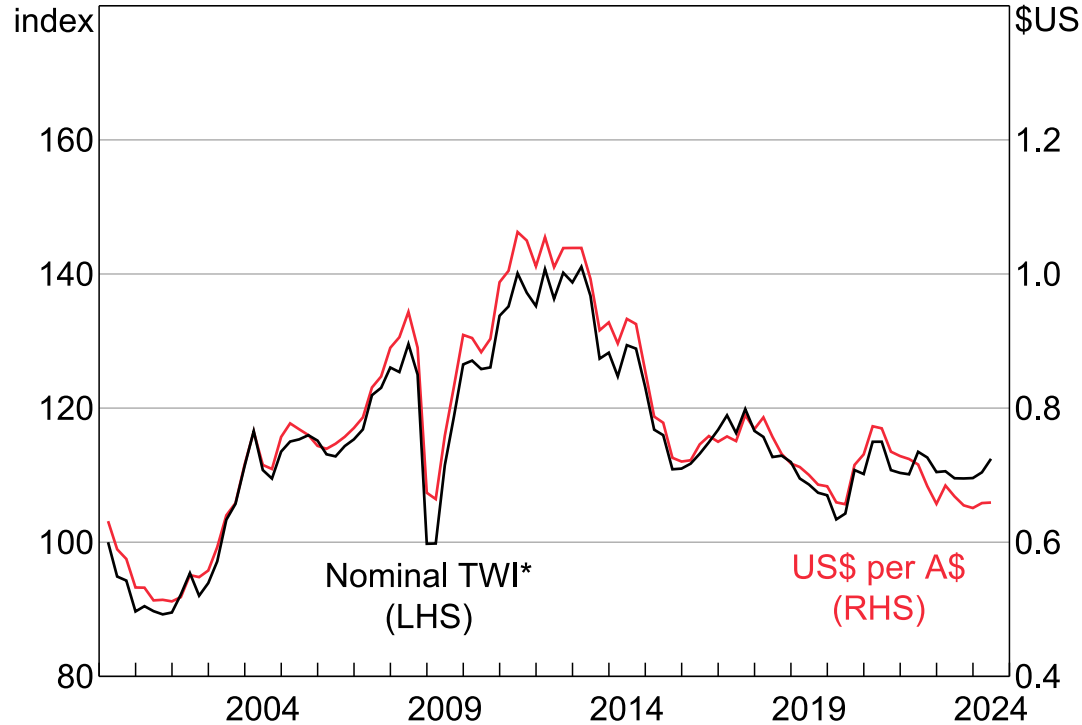


* March 2000 = 100

Sources: Bloomberg; RBA.



Australian Dollar

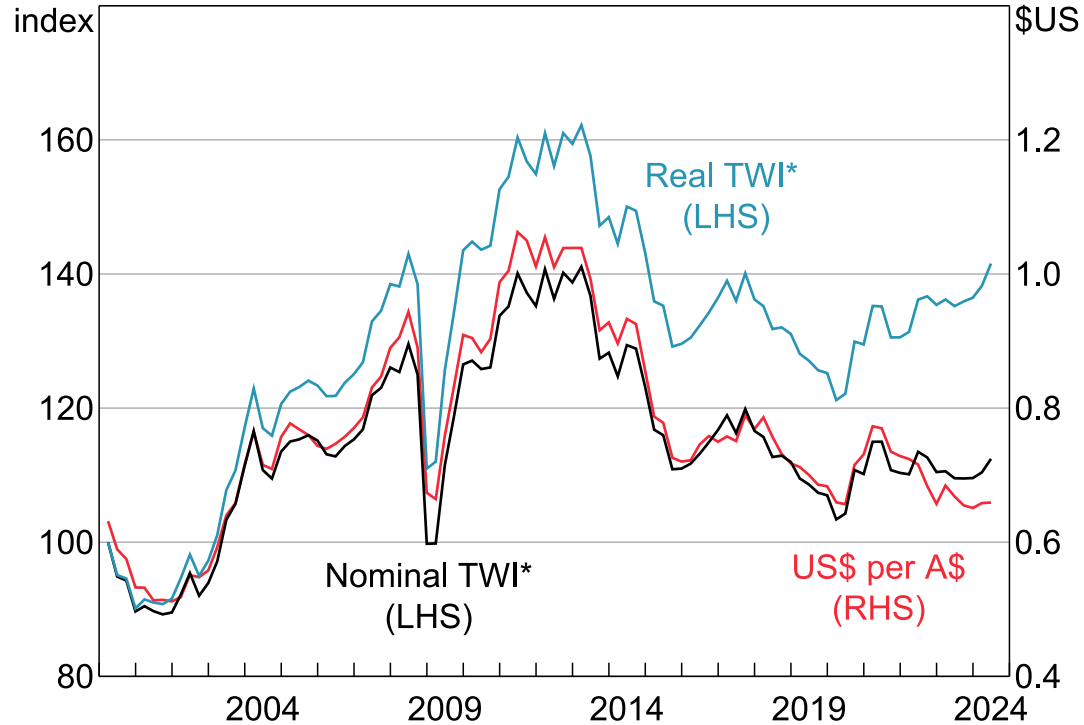


* March 2000 = 100

Sources: Bloomberg; RBA.



Australian Dollar



* March 2000 = 100

Sources: Bloomberg; RBA.



Exchange rate regimes





Exchange rate regimes

- Fixed





Exchange rate regimes

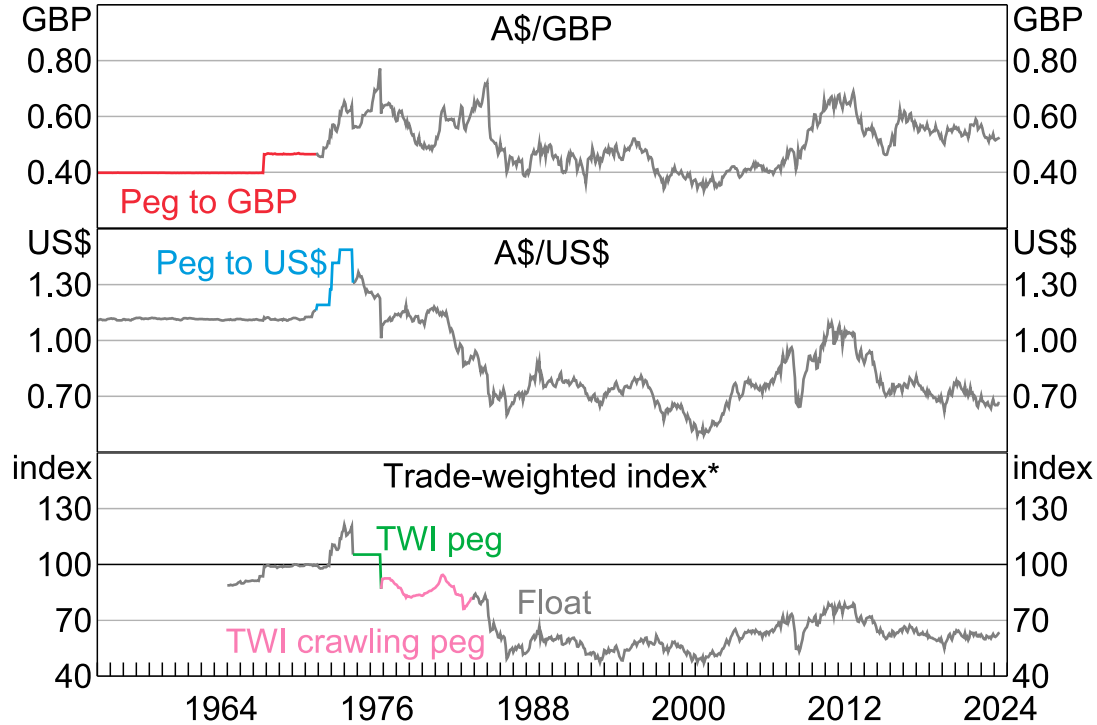
- Fixed
- Flexible





Australian Dollar

Monthly

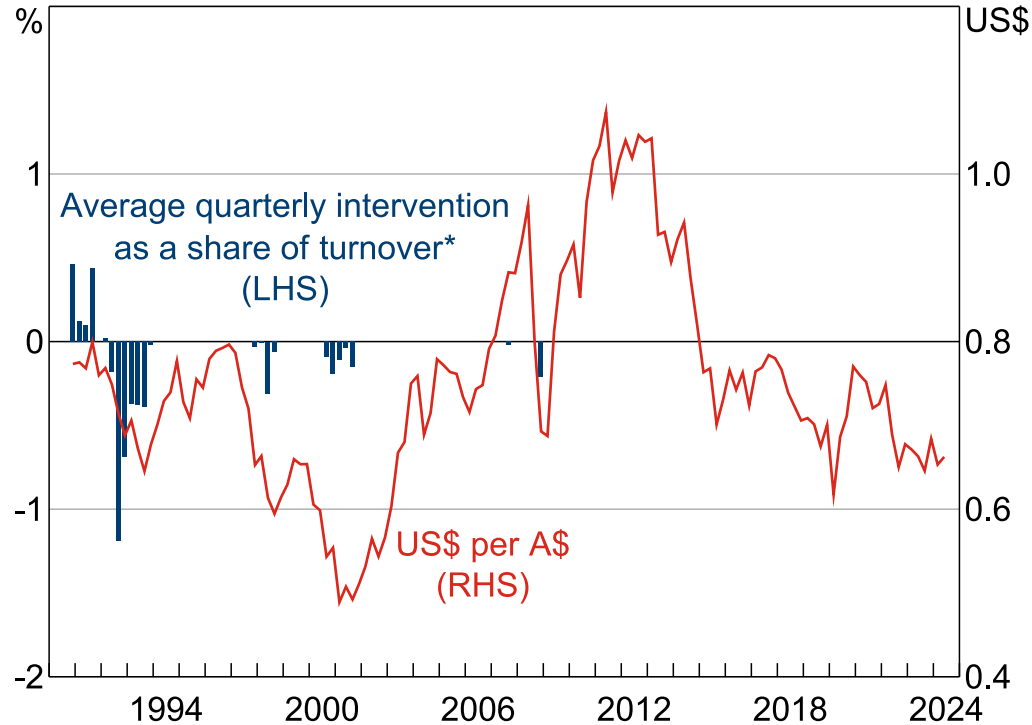


* May 1970 =100.

Sources: Bloomberg; Global Financial Data; LSEG; RBA.



RBA Foreign Exchange Intervention*



* Since 1990; a positive value indicates a purchase of foreign exchange, while a negative value indicates a sale of foreign exchange.

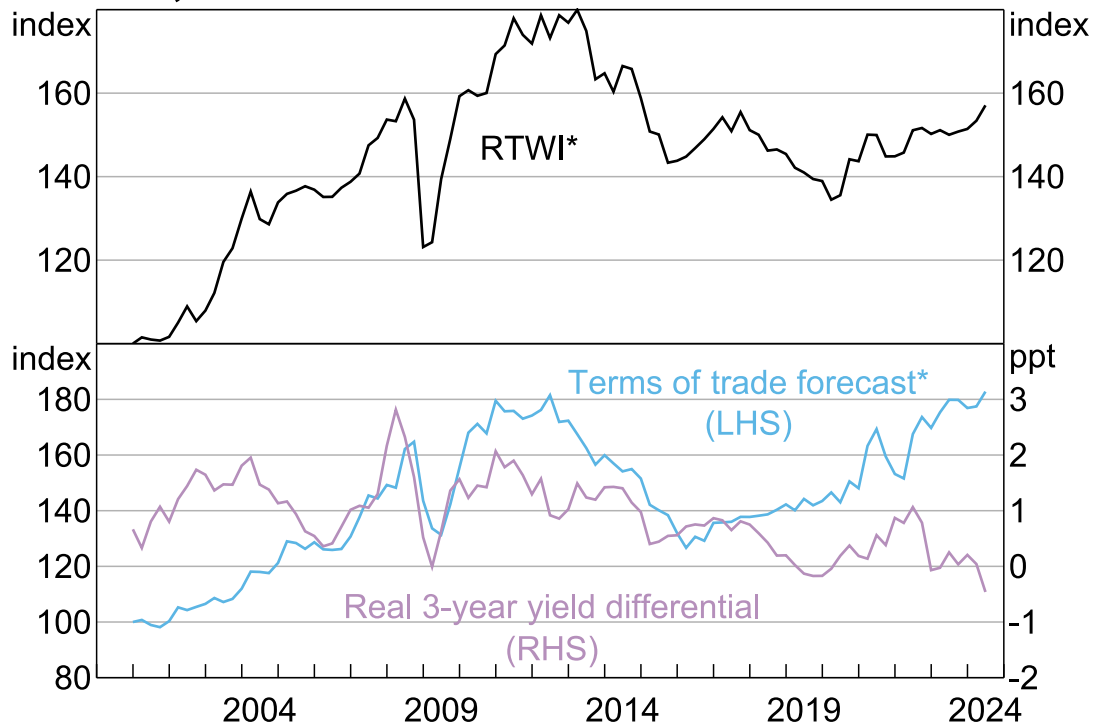
Sources: Bloomberg; RBA.



What drives movements in the AUD?



RTWI, Terms of Trade and Yield Differentials

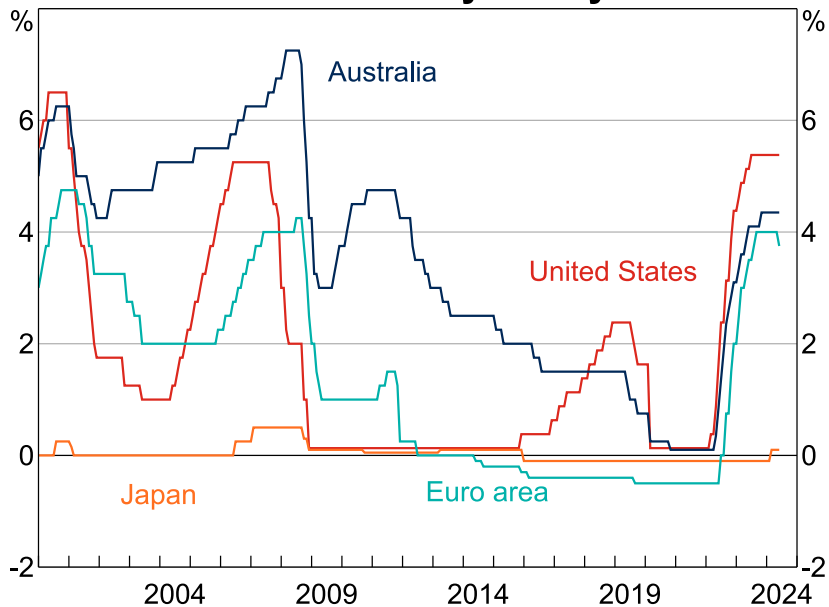


* December 2000 = 100.

Sources: Bloomberg; RBA.



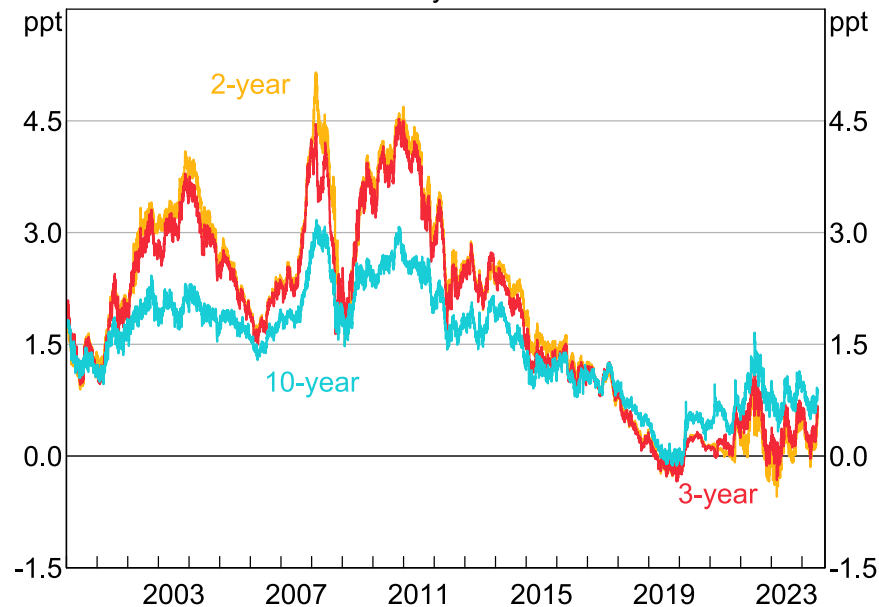
Advanced Economy Policy Rates



Source: Central banks.

Interest Rate Differentials*

Australian yield less G3



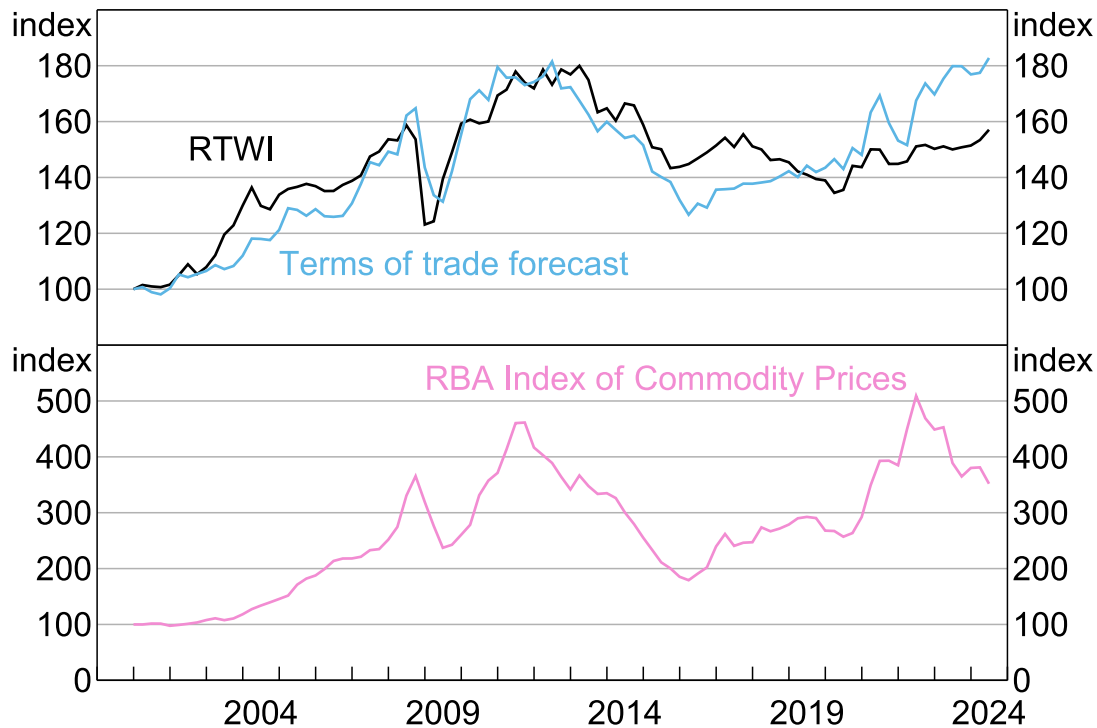
* G3 weighted by GDP.

Source: RBA; Bloomberg.



RTWI, Terms of Trade and Commodity Prices

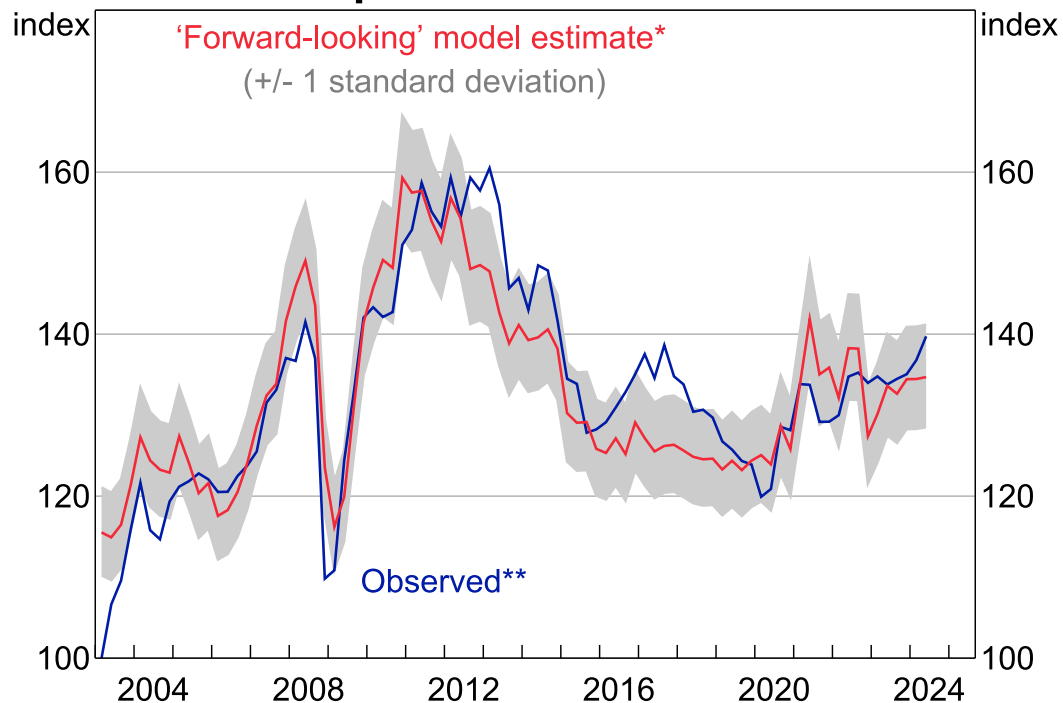
December 2000 = 100



Sources: Bloomberg; RBA.



'Equilibrium' Real TWI



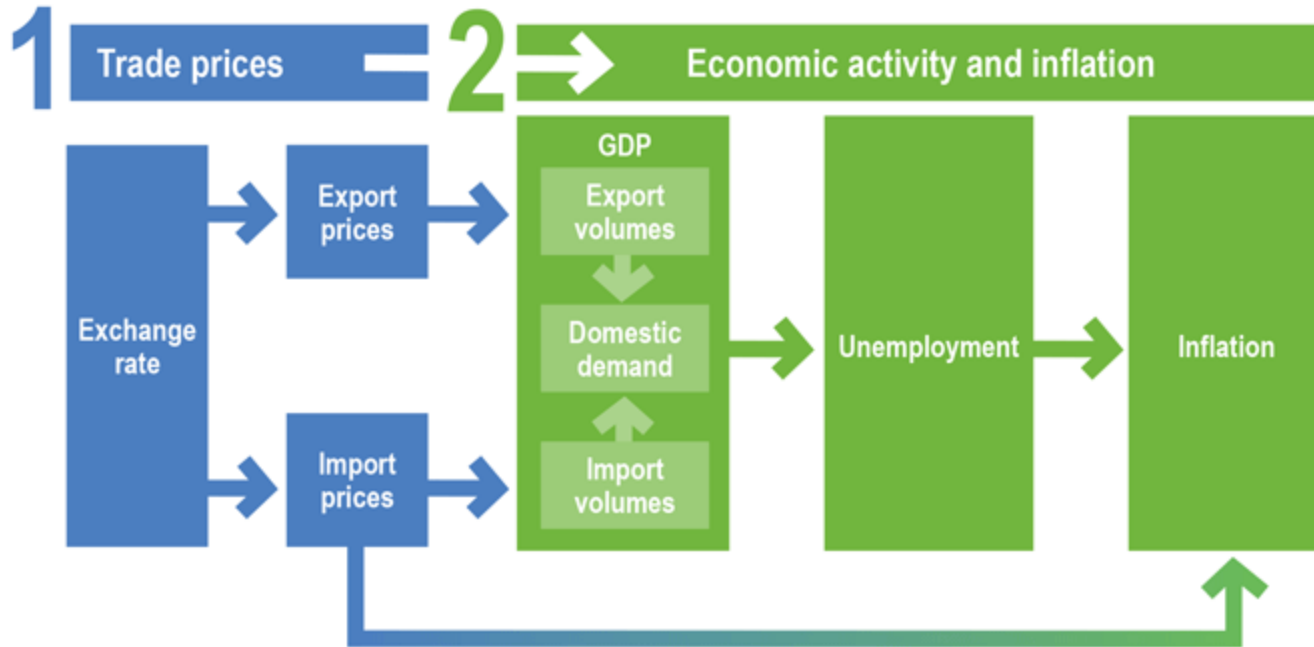
* Using terms of trade forecast and real Australian Government bond yield curve factors relative to the G3; standard deviation based on model errors.

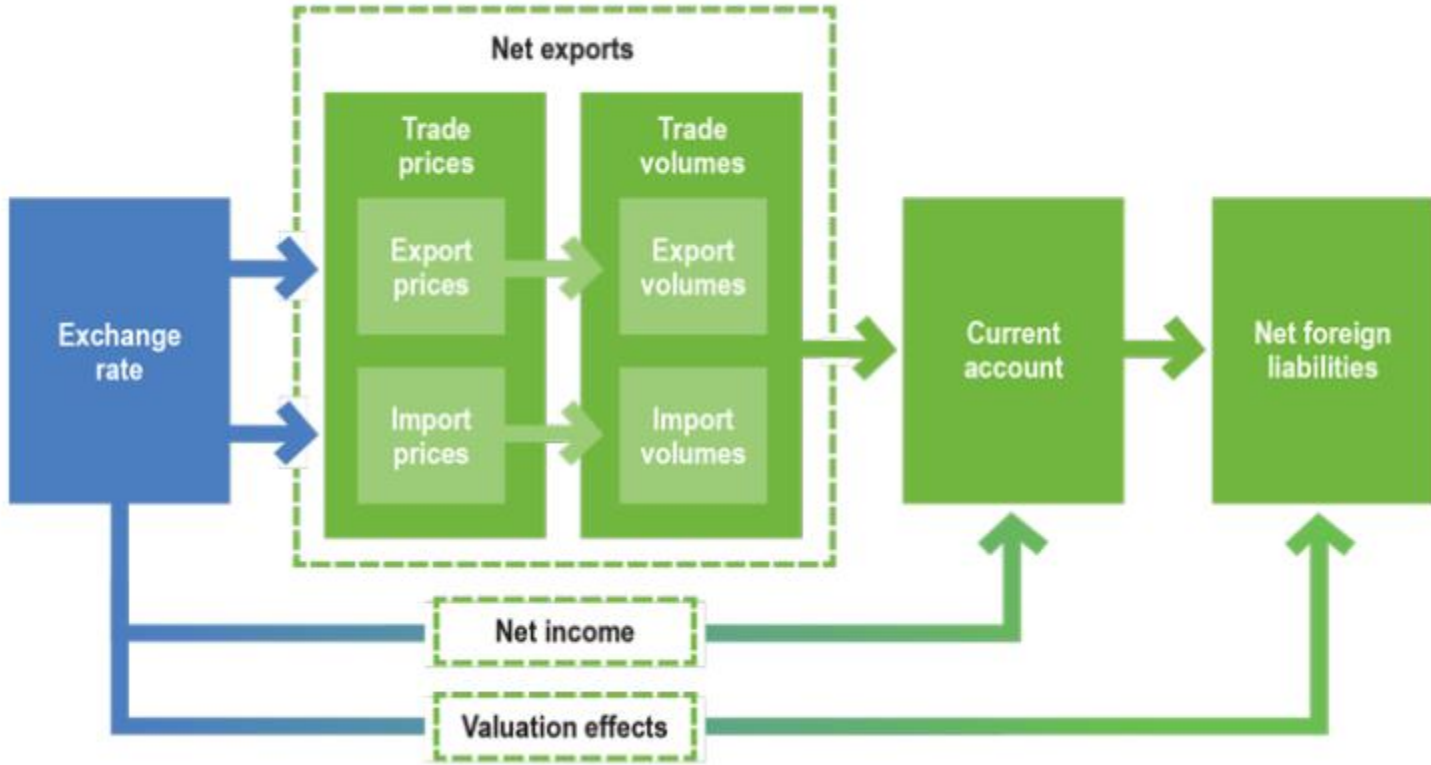
** Indexed to March 2003 = 100; quarterly average real TWI.

Sources: Bloomberg; RBA.



Why do we care about the AUD?







Where to learn more



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Exchange Rates and their Measurement

An exchange rate is a relative price of one currency (expressed in terms of another currency (or group of currencies)). For economies like Australia that actively engage in international trade, the exchange rate is an important economic variable. Changes in it affect economic activity, inflation and the nation's balance of payments. (See [Explainer: Exchange Rates and the Australian Economy](#)) The Australian dollar is also the sixth most traded currency in foreign exchange markets. There are different ways in which exchange rates are measured and, over the years, there have been different operational arrangements for determining the value of Australia's exchange rate.

They purchase inputs to production from other countries and enter contracts to export their goods and services elsewhere.

Cross rates

Bilateral exchange rates also provide a basis for calculating 'cross rates'. A cross rate is an exchange rate calculated by reference to a third currency. For instance, if the exchange rate for the euro (EUR) against the US dollar is known as well as for the Australian dollar against the US dollar, the exchange rate between the euro and the Australian dollar (EUR/AUD) can be calculated by using the AUD/USD and EUR/USD rates (that is, $EUR/AUD = EUR/USD \times USD/AUD$).

Measuring Exchange Rates

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Exchange Rates and the Australian Economy

An exchange rate is the value of one currency in terms of another currency. Exchange rates matter to Australia's economy because of their influence on trade and financial flows between Australia and the rest of the world. Changes in exchange rates affect the Australian economy in two main ways:

1. There is a **direct effect** on the prices of goods and services produced in Australia relative to the prices of goods and services produced overseas.
2. There is an **indirect effect** on economic activity and inflation as changes in the relative prices of goods and services produced domestically and overseas influence decisions about production and consumption.

Together these effects also have implications for the balance of payments. This Explainer describes the effects of exchange rate movements and highlights the main channels through which these changes affect the Australian economy.

If the exchange rate between the Australian dollar and the US dollar is 0.75 then one Australian dollar can be converted into US75c. An increase in the value of the Australian dollar is called an appreciation. A decrease in the value of the Australian dollar is known as a depreciation. (For more information on exchange rates and their measurement, see [Explainer: Exchange Rates and their Measurement](#).)

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Drivers of the Australian Dollar Exchange Rate

Australia has a floating exchange rate, which means that movements in the Australian dollar exchange rate are determined by the demand for, and supply of, Australian dollars in the foreign exchange market. There are a number of factors that affect demand and supply in this market. Some factors have longer-term effects on the value of the Australian dollar, while others influence its value over shorter periods of time. This Explainer highlights some of the key drivers of the Australian dollar exchange rate. It also discusses foreign exchange intervention and the circumstances in which the Reserve Bank of Australia (RBA) might decide to intervene in the foreign exchange market.

An exchange rate is the value of one unit of a currency relative to the value of another currency (or group of currencies). For instance, the value of the

economy see [Explainer: Exchange Rates and their Measurement](#) and [Explainer: Exchange Rates and the Australian Economy](#).

Longer-term Drivers

Interest rate differentials and capital flows

Australia's interest rate differential measures the difference between interest rates in Australia and those in other economies. The interest rate differential is a key driver of the demand for, and supply of, Australian dollars. It is also an important driver of capital flows, which measure the money that flows into, and out of, Australia for investment

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Introduction to the Australian Dollar Exchange Rate

26 February 2021

A Video Explainer introducing concepts related to the exchange rate

Introduction

Australian Dollar

[rba.gov.au/education](#)

Exchange Rates and the Australian Economy

26 February 2021

A Video Explainer discussing how changes in the exchange rate affect the economy

Exchange rates and the Australian economy

Export volumes

[rba.gov.au/education](#)

Drivers of the Australian Dollar Exchange Rate

26 February 2021

A Video Explainer discussing what factors drive changes in the value of the Australian Dollar

Drivers of the Australian Dollar exchange rate

Australian Dollar and Interest Rate Differential

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