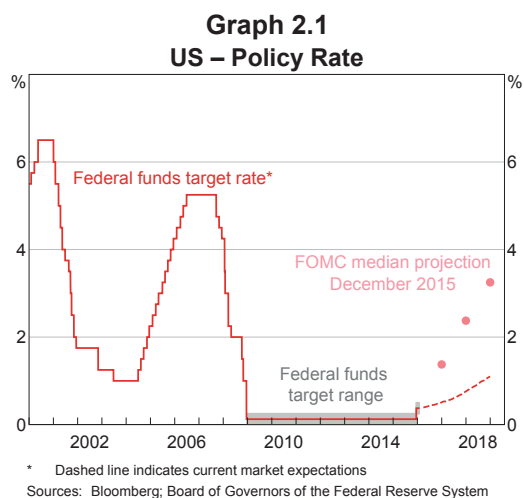


## 2. International and Foreign Exchange Markets

Concerns about the outlook for the Chinese economy and declines in oil prices have been major drivers of financial markets over the past six months and have recently contributed to large declines in equity and corporate bond prices, a fall in sovereign bond yields and depreciations in the currencies of a range of commodity exporters. Much of the recent concern about China has stemmed from uncertainty about the Chinese authorities' intentions for the future value of the renminbi (RMB). This has seen capital flow out of China and an associated decline in its foreign exchange reserves which, together with asset sales by the sovereign wealth funds of oil-producing nations, has probably contributed to the market volatility. These concerns have overshadowed the first tightening in US monetary policy in almost 10 years and a further easing of monetary policy in the euro area and Japan, although the divergence in monetary policy between these three regions has continued to influence exchange rates.

### Central Bank Policy

The US Federal Open Market Committee (FOMC) voted in December to raise its target range for the federal funds rate for the first time in almost 10 years, lifting it by 25 basis points to 0.25–0.50 per cent (Graph 2.1). The Committee judged that there had been a considerable improvement in labour market conditions and it was sufficiently confident that inflation will rise to its objective over the medium term. The Federal Reserve's new operational tools proved effective in raising market rates, with the federal funds rate trading very close

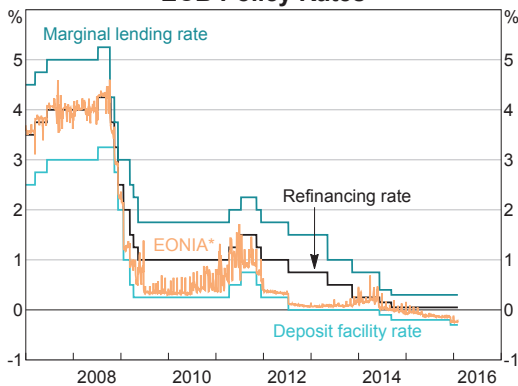


to the midpoint of the target range since the decision (other than briefly at year-end).

The FOMC emphasised that the stance of monetary policy remains very accommodative and that it expects only gradual increases in the federal funds rate over coming years. Consistent with this, the FOMC's median projection at its December meeting was for the federal funds rate to rise by around 100 basis points in each of the next three years, which would be materially slower than in prior periods of tightening. Nonetheless, this is a significantly faster pace of adjustment than was implied by market pricing at that time, and this gap widened further in January as falls in global equity and oil prices led investors to lower their expectations for future policy rate increases. Markets are no longer pricing in an increase in the federal funds rate in 2016.

The European Central Bank (ECB) eased policy further in December by lowering the interest rate it pays on central bank reserves from –20 to –30 basis points (Graph 2.2). The ECB also extended the earliest date at which it will cease purchasing assets (from September 2016 to March 2017) and committed to reinvest principal from maturing security holdings and to meet any liquidity demanded in its open market operations until at least early 2018. This package of measures was less than markets had expected, and with President Draghi subsequently stating that the ECB will ‘review and possibly reconsider’ its monetary policy stance at its next meeting in March, markets are pricing in an additional 10 basis point reduction in the deposit rate at that time. Under current policy settings, the ECB’s balance sheet is scheduled to expand by over €700 billion this year, having increased by €620 billion over 2015, to reach 33 per cent of GDP and exceed its previous peak (Graph 2.3).

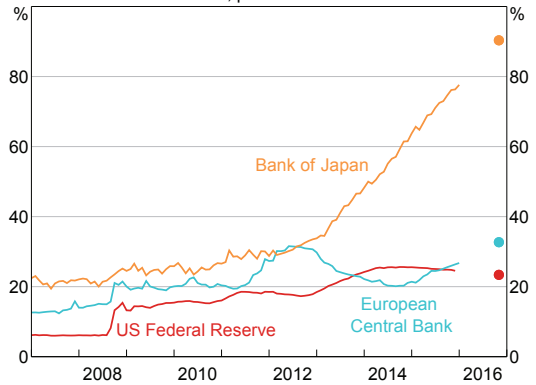
**Graph 2.2  
ECB Policy Rates**



\* Euro overnight index average  
Sources: Bloomberg; Thomson Reuters

The Bank of Japan (BoJ) increased its monetary stimulus in late January by introducing a negative interest rate on deposits held at the BoJ (–10 basis points, compared with +10 basis points since late 2008). Its decision reflected concerns that lower oil prices and uncertainty about the global economy could delay the timing of when inflation will rise to its 2 per cent target. The negative interest rate

**Graph 2.3  
Central Bank Balance Sheets\***  
Assets, per cent of GDP



\* Dots are RBA projections for year end based on central bank communications  
Sources: Central banks; IMF; RBA; Thomson Reuters

will only apply to a small portion of central bank deposits as a consequence of a tiered interest rate system that leaves most deposits remunerated at +10 basis points, but it sets the marginal cost of new deposits and therefore affects market pricing. The negative interest rate will supplement the BoJ’s ongoing expansion of its balance sheet, which increased by ¥80 trillion (14 per cent of GDP) over 2015 and is expected to expand by a similar amount this year. The BoJ forecasts that the combination of these measures will lift inflation to its target by late 2017, about six months later than it projected in October.

Interbank interest rates in China have been stable since mid 2015, after declining by 225 basis points over the first half of the year as the People’s Bank of China (PBC) reduced system-wide reserve requirement ratios (RRRs) and benchmark term interest rates. The stability in interbank rates came despite large sales of foreign exchange reserves (see section on ‘Foreign Exchange’) and only modest changes to the amount of liquidity supplied by the PBC between late October 2015 (when it last lowered RRRs) and mid January 2016. The PBC recently injected large amounts of short-term liquidity to counter a seasonal increase in demand associated with Chinese New Year, but is wary of

injecting too much liquidity to avoid exacerbating depreciation pressure on the RMB. The PBC is transitioning towards a monetary policy corridor framework that is more comparable to that of other central banks. As part of this process, it lowered the interest rate applicable on its standing lending facility (the likely upper bound on interbank rates) from November.

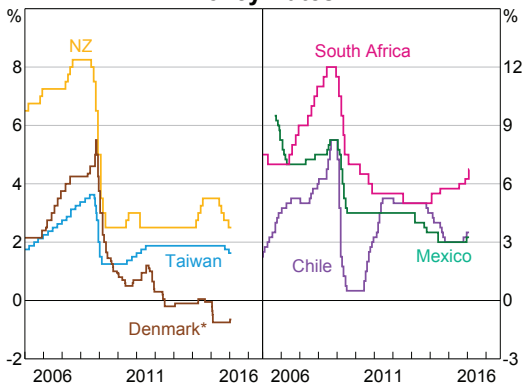
A number of emerging market central banks have recently raised interest rates to stem inflationary pressure emanating primarily from a depreciation of their currencies against the US dollar (including Mexico, Chile and South Africa) (Graph 2.4; Table 2.1). In Chile and South Africa, these tightenings have occurred despite subdued economic activity due in large part to the impact of lower commodity prices. A number of economies whose exchange rates are pegged to the US dollar also raised interest rates immediately after the Federal Reserve's December decision (including Hong Kong), while the central bank of Denmark reversed some of its early 2015 monetary easing in response to abating capital inflows from the euro area (although its policy rate remains well below zero).

**Table 2.1: Monetary Policy**

	Policy rate Per cent		Most recent change
Euro area <sup>(a)</sup>	-0.30	↓	Dec 15
Japan <sup>(a)</sup>	-0.10	↓	Jan 16
United States <sup>(b)</sup>	0.375	↑	Dec 15
Australia	2.00	↓	May 15
Brazil	14.25	↑	Jul 15
Canada	0.50	↓	Jul 15
Chile	3.50	↑	Dec 15
China <sup>(c)</sup>	na		na
India	6.75	↓	Sep 15
Indonesia	7.25	↓	Jan 16
Israel	0.10	↓	Feb 15
Malaysia	3.25	↑	Jul 14
Mexico	3.25	↑	Dec 15
New Zealand	2.50	↓	Dec 15
Norway	0.75	↓	Sep 15
Russia	11.00	↓	Jul 15
South Africa	6.75	↑	Jan 16
South Korea	1.50	↓	Jun 15
Sweden	-0.35	↓	Jul 15
Switzerland <sup>(b)</sup>	-0.75	↓	Jan 15
Thailand	1.50	↓	Apr 15
Turkey	7.50	↓	Feb 15
United Kingdom	0.50	↓	Mar 09

(a) Marginal rate paid on deposits at the central bank  
 (b) Midpoint of target range  
 (c) China does not have an official policy rate  
 Sources: Central banks; RBA; Thomson Reuters

**Graph 2.4  
Policy Rates**



\* Certificate of deposit rate  
 Sources: Central banks; Thomson Reuters

In contrast, the Reserve Bank of New Zealand lowered its policy rate by a further 25 basis points in December, having reduced it by a total of 75 basis points earlier in the year, in response to the

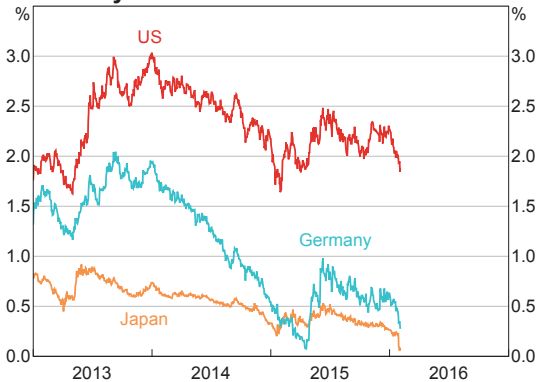
disinflationary impact of a lower terms of trade and the strength of labour supply. Bank Indonesia also reduced its policy rate by 25 basis points in January as it judged that the risks of further exchange rate depreciation had diminished following the smooth implementation of the Federal Reserve's first interest rate increase, while the central bank of Taiwan lowered its policy rate in response to weak external demand.

## Sovereign Debt Markets

Yields on 10-year US Treasury bonds increased slightly over 2015, while trading in an 80 basis point range, but have fallen by 40 basis points

since the start of 2016 as concerns about the outlook for the Chinese economy intensified and oil prices fell (Graph 2.5). In contrast, yields on 2-year US Treasuries are still higher than at the start of 2015, as falls early this year only partially offset a notable rise late last year when expectations increased that the Federal Reserve would begin to tighten policy in December. Yields on 10-year German Bunds have closely tracked those on 10-year US Treasuries, but yields on 2-year Bunds have fallen to a record low, reflecting the outlook for monetary policy in the euro area. Yields on 10-year Japanese government bonds fell sharply after the BoJ introduced a negative interest rate, having drifted down since mid 2016, and are now at an historical low of around 5 basis points.

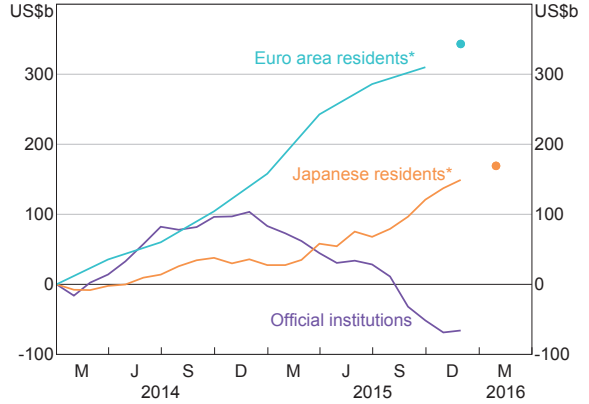
**Graph 2.5**  
**10-year Government Bond Yields**



Source: Bloomberg

Foreign official institutions sold or let mature a significant amount of US bonds over the first 11 months of 2015 (Graph 2.6). The decline in foreign official holdings of US bonds is consistent with a significant decline in the value of reserves held by China and several oil exporting nations (see section on 'Foreign Exchange'), and is likely to understate the extent of selling due to the use of custodial managers. Sales of US bonds by reserve managers have been offset by sizeable purchases by European and Japanese residents, reflecting a reallocation by these investors from their respective domestic bond markets in response to ECB and BoJ purchases of domestic sovereign bonds.

**Graph 2.6**  
**Foreign Purchases of US Bonds**  
Cumulative since end 2013



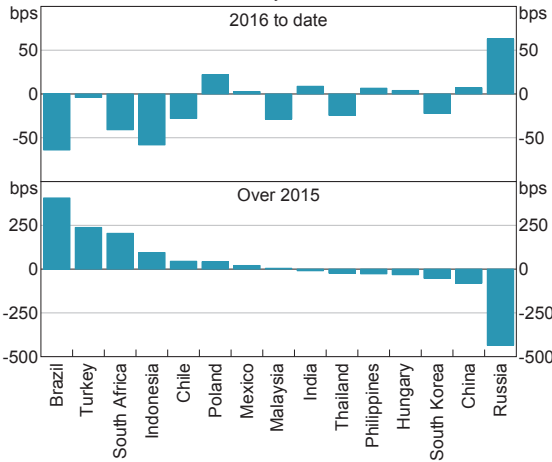
\* Preliminary after September 2015 (euro area) and November 2015 (Japan); dots show level if share of US bond purchases remained constant

Sources: Bloomberg; ECB; Ministry of Finance Japan; RBA; Thomson Reuters

The spread between yields on Portuguese government bonds and German Bunds has risen over recent months, to be around 75 basis points wider than over most of 2015. The recent widening is the result of concerns about a partial retreat from fiscal restraint by the country's new government. Spreads on bonds issued by most other governments of the euro area periphery have been reasonably stable since concerns about Greece abated in July.

Yields on 10-year local currency bonds issued by emerging market sovereigns were generally little changed over 2015, broadly consistent with movements in US Treasuries (Graph 2.7). The Federal Reserve's decision to tighten policy had little impact on yields, although emerging market bond funds continue to see redemptions. However, yields on Brazilian, Turkish and South African bonds all rose significantly over 2015 as their exchange rates depreciated, inflation persisted at an elevated level and the Brazilian and South African central banks tightened policy; fiscal and political concerns have been an important additional factor in these countries. Yields on Russian sovereign bonds resumed rising in 2016 as oil prices fell and the rouble depreciated, but remain well below their

**Graph 2.7**  
**Change in 10-year Government Bond Yields**  
 Local currency-denominated



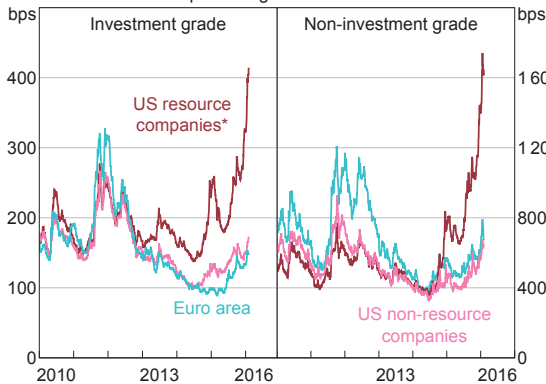
Sources: Bloomberg; Thomson Reuters

level at the start of 2015 when investors were more concerned about the associated sovereign risk.

## Credit Markets

Spreads on US corporate bonds have risen notably over recent months, to be well above their trough in mid 2014 (Graph 2.8). This widening continues to be concentrated among bonds issued by resource companies, particularly those with a below-investment grade credit rating, which are now trading at wider spreads than at any time in at least

**Graph 2.8**  
**Corporate Bond Spreads**  
 To equivalent government bonds



\* Energy, metals, mining and steel sectors

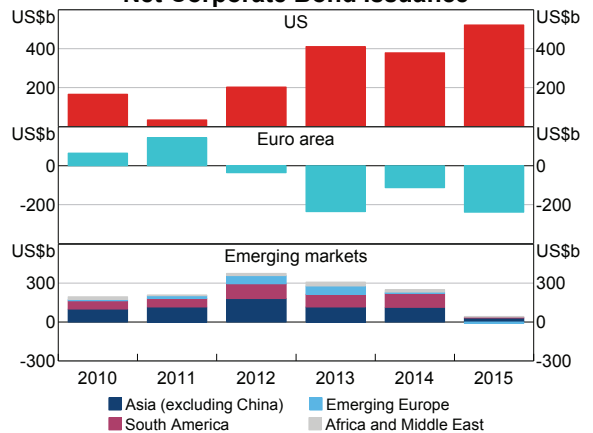
Sources: Bank of America Merrill Lynch; RBA; Thomson Reuters

15 years. Abstracting from such companies, there has been a more modest widening of spreads on non-investment grade bonds – taking them back to their historical average – and only a small rise in spreads on investment grade bonds. Spreads on euro area corporate bonds have also widened since mid 2015 but remain around their historical averages.

Redemptions from US bond funds increased over the last few months of 2015 as credit spreads widened, creating cash flow challenges for some funds. This was most prominent for Third Avenue's Focused Credit Fund, which suspended all redemptions from mid December so that it could liquidate its portfolio (which comprised mostly distressed and highly illiquid debt investments) in a more orderly manner.

Net issuance of US corporate bonds in 2015 was significantly higher than in prior years, with many corporations seeking to fund merger and acquisition activity (which was strong over that period) and/or lock in their funding costs ahead of an expected tightening in US monetary policy (Graph 2.9). Indicative of the former, brewer AB InBev raised US\$46 billion in January 2016, the second largest issue ever. Demand for the bonds was very strong, with a record US\$110 billion of

**Graph 2.9**  
**Net Corporate Bond Issuance**



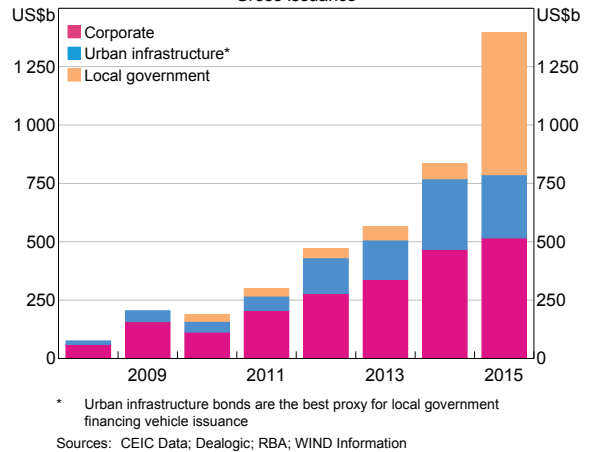
Sources: Dealogic; RBA

subscriptions. In contrast, net issuance by euro area corporations in 2015 was at its lowest since 2007.

Issuance by corporations in emerging markets was low throughout the second half of last year, causing net bond issuance to be minimal in 2015. The decline since mid last year was broad based across regions and industries, but was more pronounced for US dollar-denominated bonds than for local currency-denominated ones. Spreads on US dollar-denominated emerging market corporate bonds generally widened by less than spreads on US non-investment grade bonds, notwithstanding the Federal Reserve having raised rates; the stronger performance of emerging market bonds compared with those issued by US corporations suggests that the decline in issuance by emerging market corporations was more likely to have been due to reduced funding needs than relatively weak demand for their bonds. However, the increase in spreads was more pronounced for Brazilian corporate bonds as lower commodity prices reduced the profitability of the largest US dollar borrowers and political concerns increased.

Chinese gross corporate bond issuance increased a little in 2015, and local currency-denominated credit spreads continued to narrow despite concerns about deteriorating corporate profitability. The increase in issuance was stronger when abstracting from urban infrastructure bonds that are usually issued by (corporate) local government financing vehicles (Graph 2.10). The decline in urban infrastructure bond issuance was largely the result of local governments refinancing such bonds (as well as bank and/or shadow bank loans) by issuing bonds directly as part of the debt swap program. Direct issuance of local government bonds rose sharply as a result, substantially lowering the funding cost of local governments (given spreads on these bonds are well below those charged on urban infrastructure bonds).

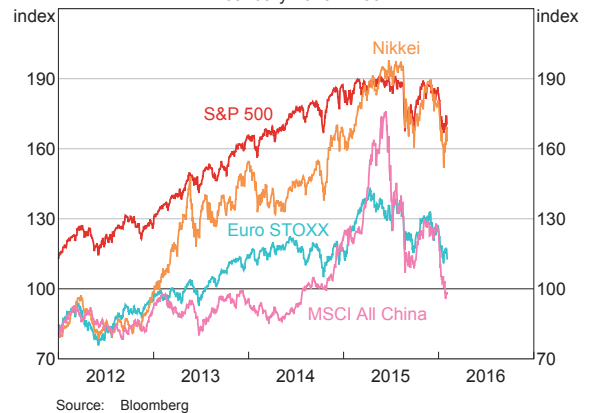
**Graph 2.10**  
**Chinese Bond Issuance**  
Gross issuance



## Equities

Global equity prices were little changed in aggregate over 2015 (Graph 2.11; Table 2.2). European and Japanese markets increased, supported by monetary stimulus, but US share prices were little changed as strong increases in large technology companies were offset by considerable declines in the energy and material sector. Chinese equity prices finished 2015 little changed, despite large swings during the year, while other emerging market equity indices fell amid capital outflows from emerging market equity funds.

**Graph 2.11**  
**Major Share Price Indices**  
1 January 2010 = 100



**Table 2.2: Changes in International Share Prices**  
Per cent

	Over 2015	2016 to date
United States – S&P 500	-1	-7
Euro area – STOXX	8	-10
United Kingdom – FTSE	-5	-6
Japan – Nikkei	9	-10
Canada – TSE 300	-11	-3
Australia – ASX 200	-2	-8
China – MSCI All China	2	-22
MSCI indices		
– Emerging Asia	-8	-8
– Latin America	-11	-4
– Emerging Europe	-4	-4
<b>– World</b>	<b>-1</b>	<b>-8</b>

Source: Bloomberg

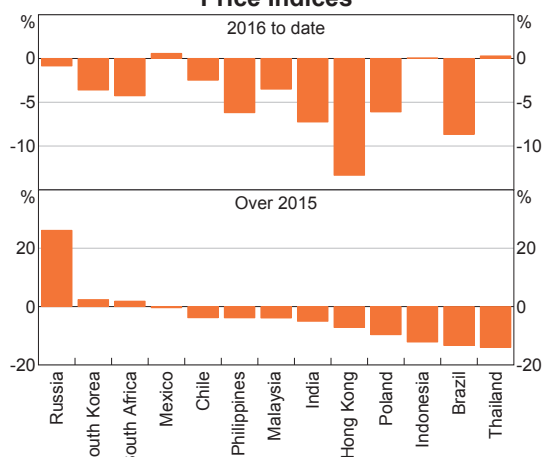
Global share prices fell by up to 10 per cent in early 2016, with a more than 20 per cent decline in Chinese equity prices causing investors globally to question the outlook for the Chinese economy and declines in oil prices further weighing on sentiment.

The declines in Chinese equity prices since the start of 2016 are attributable to a variety of factors that weighed on retail investor sentiment. These include: uncertainty about the authorities' intentions for the RMB (see section on 'Foreign Exchange'); lower-than-expected manufacturing survey data; concerns about the impending end to a selling ban on major shareholders that had been in place for the past six months; and newly introduced market-wide circuit breakers that appear to have exacerbated selling pressure. In response to these declines, the authorities introduced restrictions on the pace at which major shareholders can sell and abolished the market-wide circuit breakers. Chinese share prices are now below the trough seen in early August 2015, but they remain substantially higher than in mid 2014. Regulated margin loans outstanding roughly halved over the second half

of 2015 and fell a little further over January, in part due to the authorities lowering the permissible borrowing limits in December.

Share prices in other emerging markets have continued to fall this year, but the declines have tended to be less pronounced than in advanced economies (Graph 2.12). The main exceptions have been for Hong Kong and Brazil, which are heavily exposed to China and commodity prices, respectively.

**Graph 2.12**  
**Change in Emerging Market Equity Price Indices**



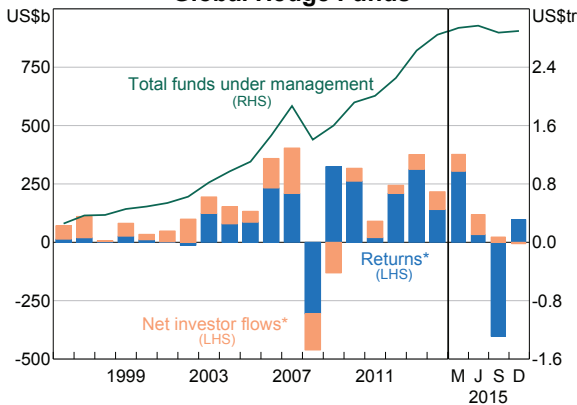
Source: Bloomberg

Annual profits at the six largest US banks increased by almost 25 per cent in 2015 to US\$93 billion. The increase was primarily due to a reduction in litigation and other expenses, while revenue was little changed. Despite falling, litigation expenses continued to weigh on fourth quarter profits at Goldman Sachs due to its US\$5 billion settlement with US authorities over allegations of mis-selling mortgage-backed securities before the financial crisis. This brings the industry-wide value of fines for such offences to US\$68 billion. European banks that have reported to date have, in aggregate, posted lower profits than in 2014, with increased charges for litigation and restructuring costs weighing on results.

## Hedge Funds

Global hedge funds recorded an asset-weighted return on investment of 0.5 per cent over the December quarter 2015, underperforming a balanced portfolio of global bonds and equities. The small return over the quarter followed a 3 per cent loss over the September quarter and saw hedge funds in aggregate post zero returns over 2015. Funds focussed on emerging markets and those investing in expectation of particular events underperformed over 2015. Investors made small net withdrawals from hedge funds in the December quarter, but assets under management rose by 2 per cent over the year to US\$2.9 trillion (Graph 2.13).

**Graph 2.13**  
**Global Hedge Funds**



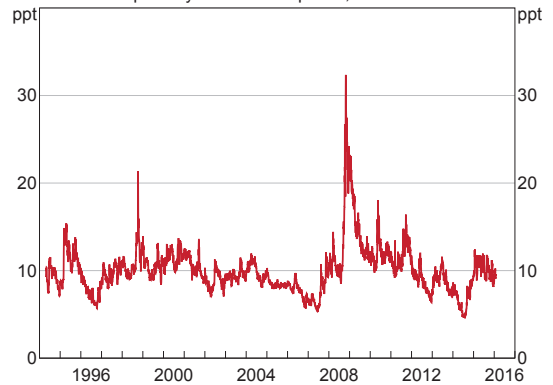
\* Annualised for 2015 data  
Sources: Hedge Fund Research, Inc.; RBA

## Foreign Exchange

Concerns about the outlook for global growth, particularly in China, as well as further declines in oil prices and periods of heightened volatility in global equity markets have led to some sizeable movements in exchange rates over recent months. Changes in the current and prospective stance of monetary policy in the major advanced economies have also contributed. Notwithstanding this, volatility in the main developed market currency pairs has been little changed and is not particularly high (Graph 2.14).

**Graph 2.14**

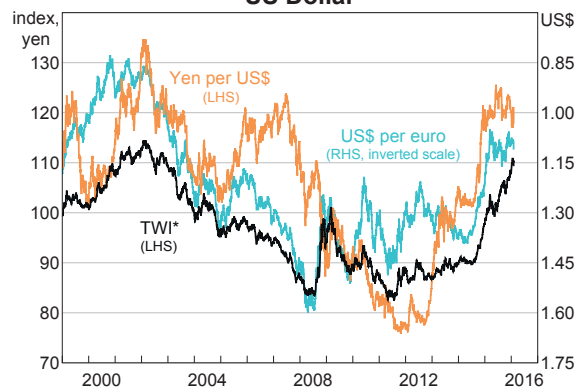
**Volatility in Developed Market Currencies\***  
Implied by one-month options, annualised



\* EUR/USD, USD/JPY, GBP/USD, AUD/USD, USD/CAD, USD/CHF, EUR/JPY, EUR/GBP, EUR/CHF; weighted by turnover  
Source: Bloomberg

The US dollar has appreciated over recent months (Graph 2.15; Table 2.3). In light of concerns about global growth and sharp falls in some commodity prices, the appreciation of the US dollar has generally been more pronounced against the currencies of commodity exporters. The appreciation has also reflected market participants' expectations of a gradual increase in the federal funds rate while other major economies maintain current monetary policy settings or ease further. The US dollar appreciated by 10 per cent over 2015 and is 22 per cent higher on a trade-weighted basis

**Graph 2.15**  
**US Dollar**



\* 1 January 1999 = 100  
Sources: Bloomberg; Board of Governors of the Federal Reserve System



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

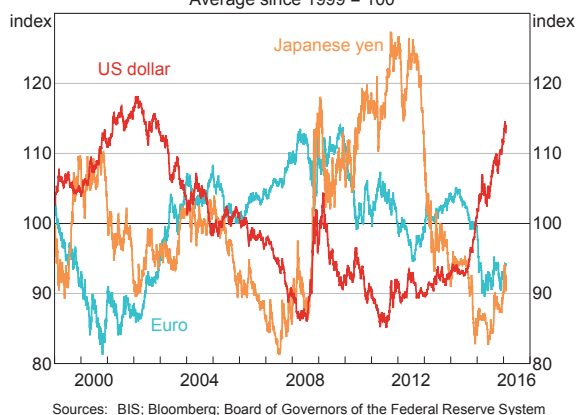
	Over 2015	2016 to date
Russian rouble	24	7
Mexican peso	17	6
South Korean won	8	4
Indian rupee	5	3
New Zealand dollar	14	2
Philippine peso	5	2
Australian dollar	12	2
New Taiwan dollar	4	1
Chinese renminbi	5	1
UK pound sterling	6	1
Swiss franc	1	0
Indonesian rupiah	11	0
Swedish krona	8	0
Canadian dollar	19	0
Singapore dollar	7	0
Thai baht	10	-1
Brazilian real	50	-2
Japanese yen	0	-2
European euro	11	-2
Malaysian ringgit	22	-3
<b>TWI</b>	<b>10</b>	<b>1</b>

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

since mid 2014. Nevertheless, in real terms, the US dollar is only around 5 per cent higher than its longer-term average.

The euro depreciated by 4 per cent on a trade-weighted basis and by 7 per cent against the US dollar between mid October and early December alongside market participants' expectations for further easing by the ECB at its December meeting. However, the euro subsequently appreciated as the policy measures announced at the December meeting were seen as less than market participants' expectations (see section on 'Central Bank Policy'). The euro is around 5 per cent higher on a trade-weighted basis than the cyclical low it reached in April 2015 (Graph 2.16).

**Graph 2.16**  
**Nominal Trade-weighted Indices**  
Average since 1999 = 100



The Japanese yen appreciated by 4 per cent against the US dollar and by 6 per cent on a trade-weighted basis between early December and late January. The appreciation of the yen was particularly sharp in the first week of January, alongside the deterioration in risk sentiment and heightened volatility in global equity markets. Following the BoJ's decision to increase monetary stimulus on 29 January, the yen depreciated by around 2 per cent against the US dollar and on a trade-weighted basis, but has subsequently reversed.

Some other developed market currencies have experienced sizeable depreciations against the US dollar over recent months. In particular, continued declines in global oil prices since mid October have contributed to further large depreciations of the Norwegian krone and Canadian dollar. The UK pound has depreciated by 6 per cent against the US dollar since mid September, alongside a paring back of market participants' expectations for policy tightening by the Bank of England.

The RMB has depreciated by 5½ per cent against the US dollar and by 4 per cent on a trade-weighted basis since August when the PBC changed its methodology for calculating the daily RMB fixing rate against the US dollar. On a trade-weighted basis, the RMB has traded within a ±3 per cent

range since the start of 2015; this is not a large range by the standards of most currencies and the level of the RMB trade-weighted index is still well above its mid 2014 trough (Graph 2.17).

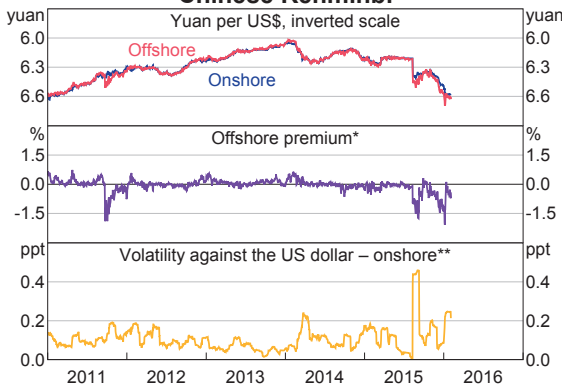
**Graph 2.17**  
**Chinese Exchange Rates**



\* 2007 average = 100  
Sources: BIS; Bloomberg; RBA

Since August, the PBC has generally set the daily RMB fixing rate against the US dollar broadly in line with the previous day's closing spot exchange rate and overnight market movements, which has resulted in a gradual depreciation of the currency (Graph 2.18). However, the speed of depreciation of the RMB against the US dollar in the onshore market increased in the first week of January, and the RMB depreciated by more in the offshore

**Graph 2.18**  
**Chinese Renminbi**



\* Negative spread indicates that one US dollar buys more yuan in the offshore market than the onshore market

\*\* Rolling 22-day standard deviation of daily percentage changes

Sources: Bloomberg; RBA

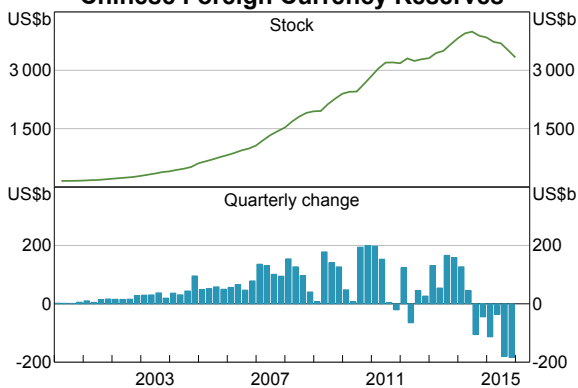
market; the discount for buying RMB in the offshore market widened to 3 per cent intraday on 7 January. The PBC reportedly intervened to close the gap between the onshore and offshore rates by buying RMB in the Hong Kong spot foreign exchange market. This led to a large reduction in the supply of RMB in this market and the overnight interest rate for interbank RMB loans in Hong Kong briefly spiked to 67 per cent. Since 8 January, the PBC has set the RMB daily fixing rate against the US dollar higher than implied by the previous day's closing spot rate and overnight market movements. The offshore discount has widened again recently to the levels seen in November.

On 30 November 2015, the IMF Executive Board agreed to add the RMB to the basket of currencies that determine the value of the IMF's Special Drawing Right (SDR), effective from 1 October 2016. The IMF assessed that there was sufficient basis to determine that the RMB was 'freely usable'. The RMB's weight in the SDR basket will be 11 per cent, which is higher than both the Japanese yen and the UK pound.

On 11 December, the China Foreign Exchange Trade System (CFETS) announced that it will regularly publish RMB exchange rate indices. The official publication of these indices, and subsequent communication by PBC officials, is consistent with the authorities' desire to shift the focus of the market away from the US dollar-RMB bilateral exchange rate towards the trade-weighted index when assessing its commitment to keep the RMB broadly stable. However, it is likely to be difficult to maintain stability of the RMB, given the magnitude of private capital outflows. CFETS has also extended the onshore market's trading hours to 11.30 pm China standard time from 4.30 pm as part of a trial that started on 4 January, although it is still treating the 4.30 pm exchange rates as the official closing prices. On 18 January, the PBC announced that it would apply reserve requirements to onshore yuan deposits from offshore financial institutions, starting from 25 January.

The value of the PBC's foreign currency reserves decreased by US\$183 billion over the December quarter, and by US\$108 billion in the month of December (Graph 2.19). This reflected large net private capital outflows, which have been mainly driven by Chinese residents responding to expectations for RMB depreciation by, for example, paying down their foreign currency-denominated liabilities. The PBC's foreign currency reserves decreased by US\$513 billion (or 13 per cent) over 2015 to US\$3.3 trillion, and are US\$663 billion below their peak in June 2014.

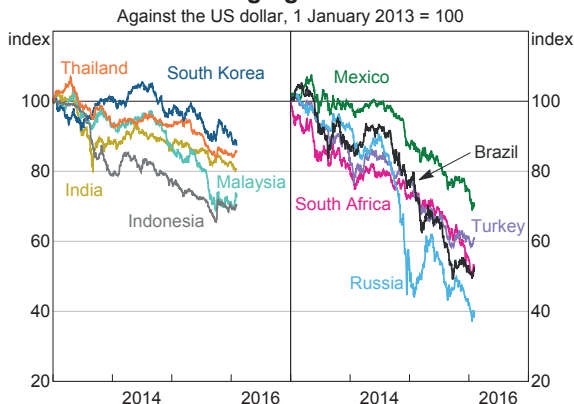
**Graph 2.19**  
**Chinese Foreign Currency Reserves**



Source: CEIC Data

Most other Asian and emerging market currencies have depreciated further against the US dollar over recent months, continuing a trend that has been evident since mid 2014. The depreciations have tended to be more pronounced for the currencies of oil and other commodity exporters. Most notably, the Mexican peso has depreciated by 10 per cent, and the Russian rouble and South African rand have depreciated by 20 per cent and 18 per cent against the US dollar respectively since mid October (which coincided with the start of another fall in oil prices; Graph 2.20). In addition to the declines in commodity prices, the depreciation of the South African rand has also coincided with increased domestic political uncertainty. Volatility in most emerging market currencies is above its average since 2010.

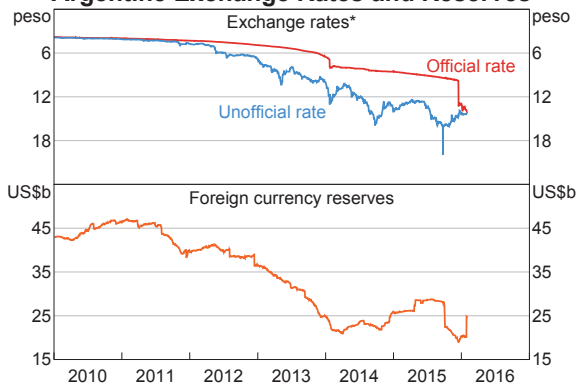
**Graph 2.20**  
**Asian and Emerging Market Currencies**



Source: Bloomberg

The Argentine peso has depreciated by 30 per cent against the US dollar since early December after capital controls were removed and the peso was allowed to float by the new government (Graph 2.21). Argentina's foreign currency reserves had fallen to US\$20 billion, but increased by around US\$5 billion on 29 January following a loan to the central bank from a number of commercial banks.

**Graph 2.21**  
**Argentine Exchange Rates and Reserves**



\* Against the US dollar, inverted scale

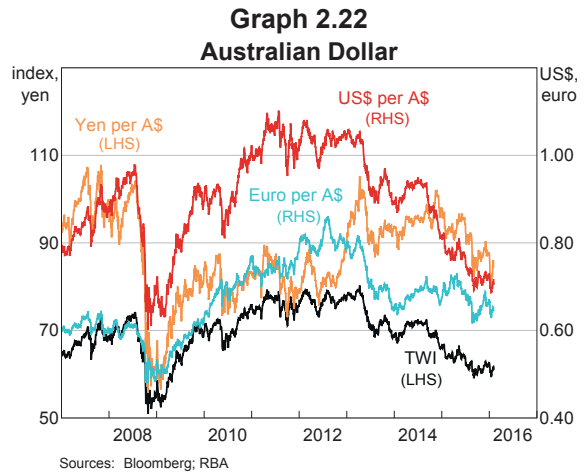
Sources: Bloomberg; IMF; RBA; Thomson Reuters

The gross foreign currency reserves of some oil-producing nations declined significantly over 2015. Most notably, Saudi Arabia's reserves declined by US\$115 billion, reflecting sales of foreign securities alongside a deterioration in the country's fiscal position. Since the end of September 2015, gross

foreign currency reserves of most other emerging market economies have been little changed, with the exception of Mexico and Turkey where reserves have declined further, and Hong Kong and Indonesia where reserves have increased (Table 2.4). The Mexican central bank has continued to intervene in the foreign exchange market by holding regular US dollar sales in an attempt to curb depreciation pressures on the currency. In contrast, the Hong Kong Monetary Authority purchased US dollars in October and early November as the Hong Kong dollar traded close to the upper limit of its trading band.

### Australian Dollar

Since the previous *Statement*, the Australian dollar has appreciated a little on a trade-weighted basis and has been little changed against the US dollar, despite having depreciated by around 5 per cent over the first half of January (Graph 2.22; Table 2.5). Over this period, changes in the Australian dollar have reflected fluctuations in global sentiment and commodity prices, which have occurred alongside



uncertainty about the outlook for China. Against the US dollar and on a trade-weighted basis, the Australian dollar is currently around 4 per cent higher than the low it reached in September 2015.

Volatility in the Australian dollar has increased since the previous *Statement*, with the average intraday trading range for the AUD/USD exchange rate in January slightly higher than its post 2000 average (Graph 2.23).

**Table 2.4: Gross Foreign Currency Reserves<sup>(a)</sup>**

	Percentage change since:		US\$ equivalent (billions)	Level
	End December 2014	End September 2015		
China	-13	-5	3 330	
Saudi Arabia	-16	-6	604	
Taiwan <sup>(b)</sup>	2	0	426	
South Korea	1	0	360	
Hong Kong	11	6	350	
Brazil	-1	-1	350	
India	10	-1	325	
Russia	-6	0	309	
Singapore	-3	-2	245	
Mexico	-9	-2	167	
Thailand	0	1	149	
Indonesia	-5	5	100	
Turkey	-13	-8	92	
Malaysia	-19	1	86	
Argentina	-4	-11	25	

(a) Data to end December for China, Hong Kong, Indonesia, Mexico, Saudi Arabia, Singapore, South Korea, Taiwan and Thailand; to 15 January for Malaysia; to 22 January for India, Russia and Turkey; to end January for Argentina and Brazil.

(b) Foreign exchange reserves (includes foreign currency and other reserve assets).

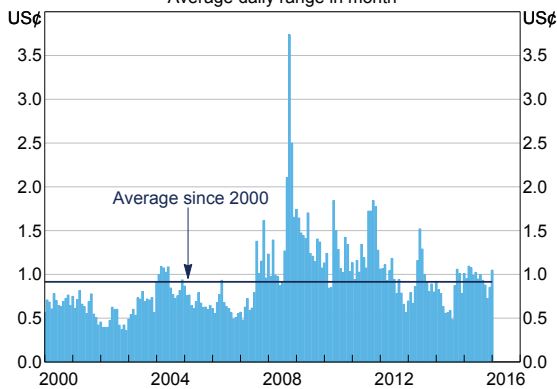
Sources: Bloomberg; CEIC Data; central banks; IMF; RBA

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

	Over 2015	2016 to date
South Korean won	-4	2
South African rand	19	2
Indian rupee	-7	1
New Zealand dollar	2	1
Chinese renminbi	-7	0
UK pound sterling	-6	-1
Swiss franc	-10	-1
US dollar	-11	-2
Indonesian rupiah	-1	-2
Canadian dollar	6	-2
Singapore dollar	-5	-2
Thai baht	-2	-2
Japanese yen	-11	-3
European euro	-1	-4
Malaysian ringgit	9	-5
<b>TWI</b>	<b>-6</b>	<b>-2</b>

Sources: Bloomberg; RBA

**Graph 2.23**  
**Intraday Range in AUD/USD**  
Average daily range in month

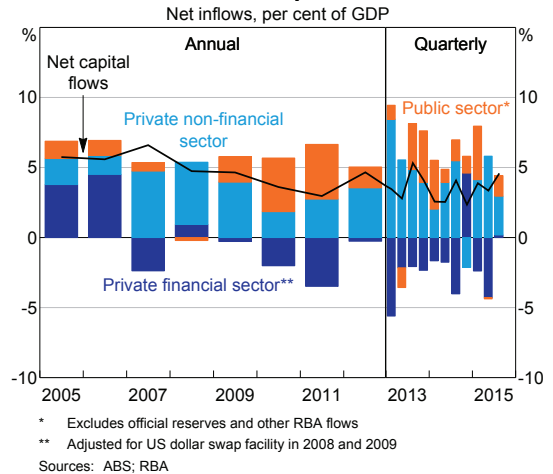


Sources: Bloomberg; RBA

## Capital Flows

Net capital inflows to the Australian economy were equivalent to 4.6 per cent of GDP in the September quarter, and were largely directed to the private non-financial sector, in particular the non-mining sector (Graph 2.24). In contrast, the mining sector recorded a small net outflow in the quarter, the first outflow since the December quarter 2010. Net inflows to the private financial sector were negligible in the September quarter, with net inflows to 'other financials' (which includes superannuation funds and other investment funds) mostly offset by net outflows from the banking sector. Net outflows from the banking sector were partly due to an increase in short-term loans by Australian banks to foreign entities.

**Graph 2.24**  
**Australian Capital Flows**  
Net inflows, per cent of GDP



\* Excludes official reserves and other RBA flows

\*\* Adjusted for US dollar swap facility in 2008 and 2009

Sources: ABS; RBA

There were modest net inflows to the public sector in the September quarter, which were primarily directed to the general government sector. However, the net inflow to the general government sector was smaller than the net issuance of Australian Government securities (AGS) in the quarter and the foreign ownership share of AGS decreased by 2 percentage points to 63 per cent.

Consistent with the net capital inflows in the September quarter, Australia's net foreign liability position increased to 57 per cent of GDP (Graph 2.25). The net income deficit, which largely comprises payments made on Australia's net foreign liability position, widened to 2.6 per cent of GDP in the September quarter reflecting an increase in the stock of debt liabilities and the yield paid on portfolio equity liabilities. ❖

