

# Volatility in global markets: What does it mean for Australian-based business?

Date: October 2011

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**Commonwealth**Bank

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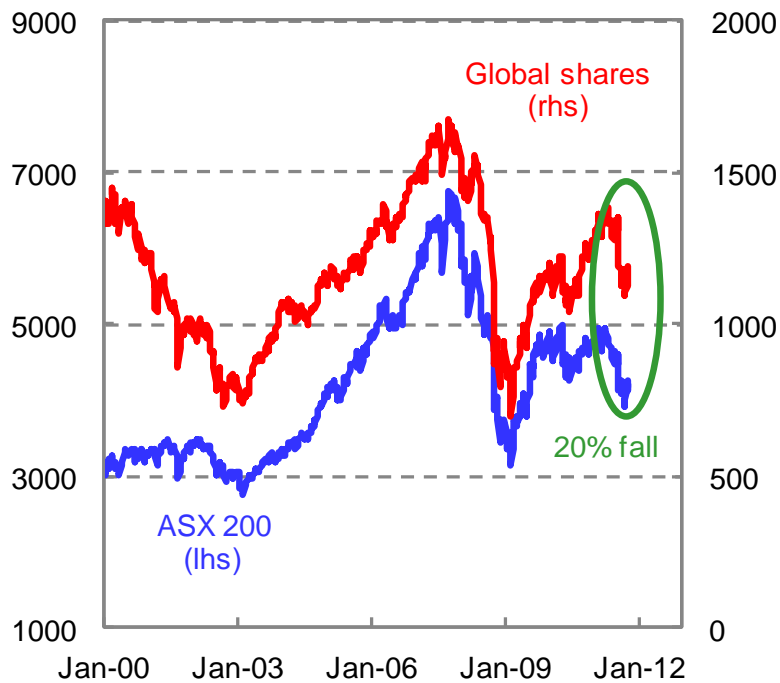
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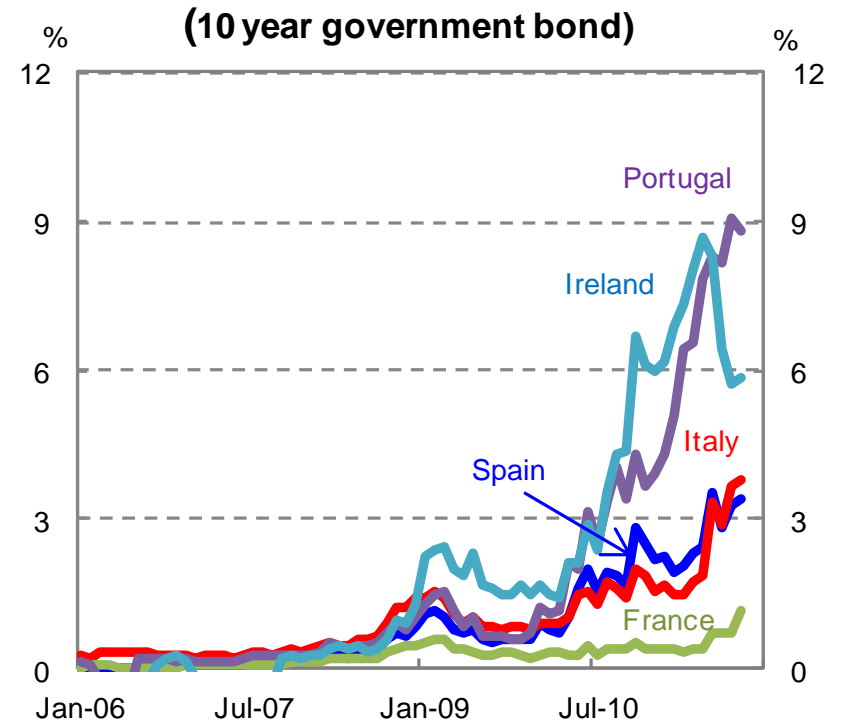
# Global backdrop

## Wall of worry

### SHARE MARKETS



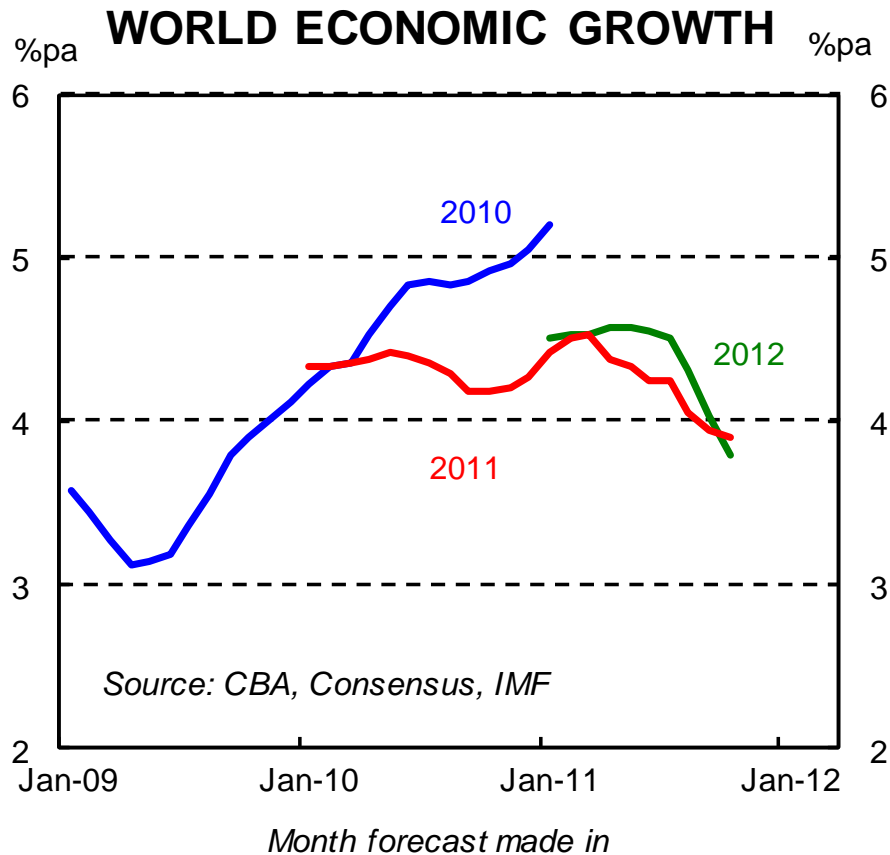
### SPREAD TO GERMAN BONDS



- Market participants have sold shares and commodities and bought safe government bonds.

# Global backdrop

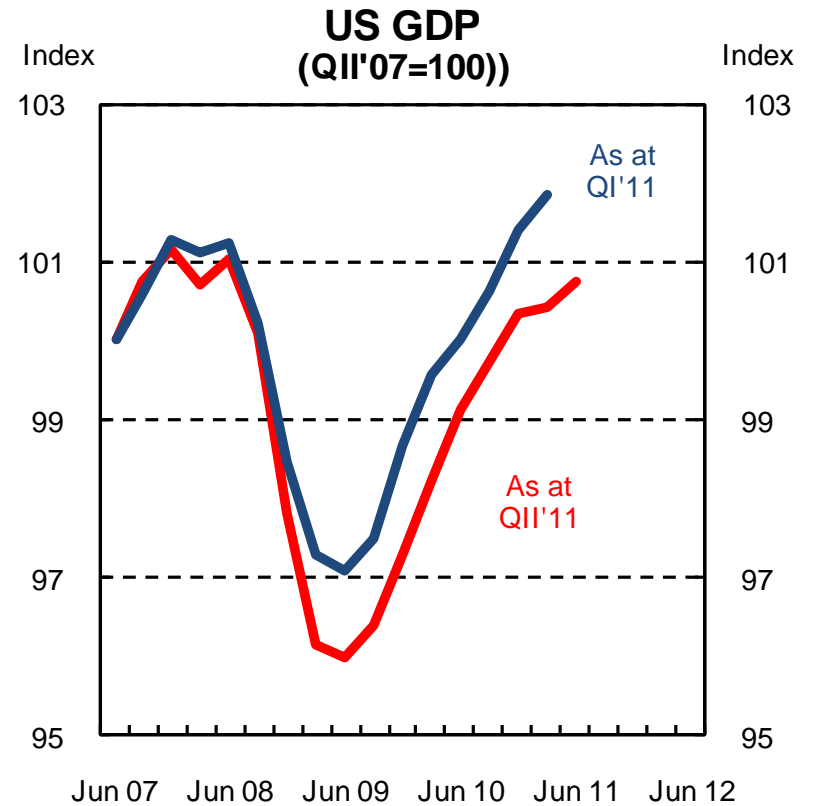
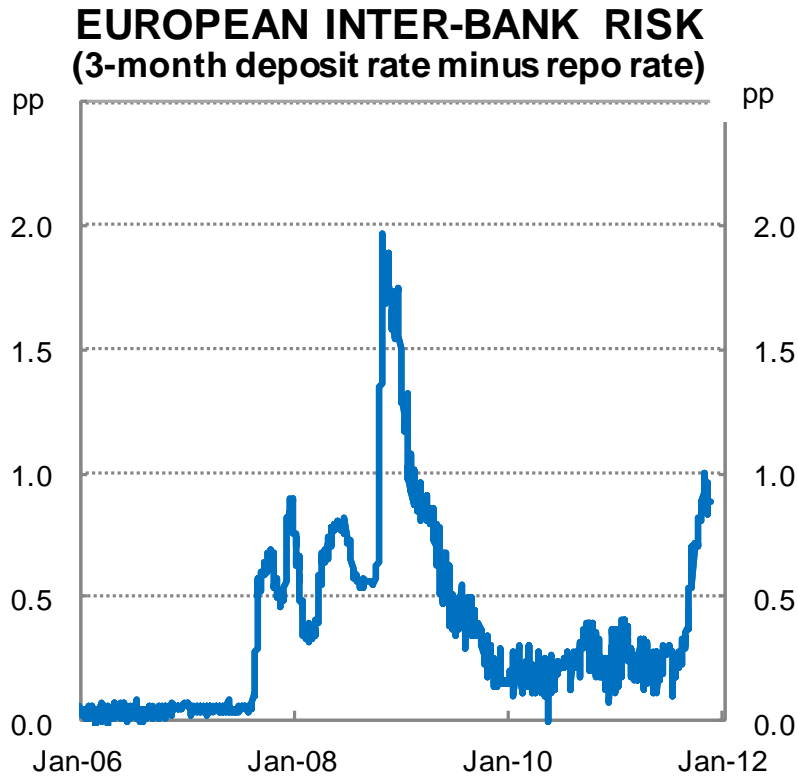
## Lower expectations



- Market participants are becoming concerned about the outlook for the global economy.
- But total global growth is expected to be close to average because of emerging economies.

# Global backdrop

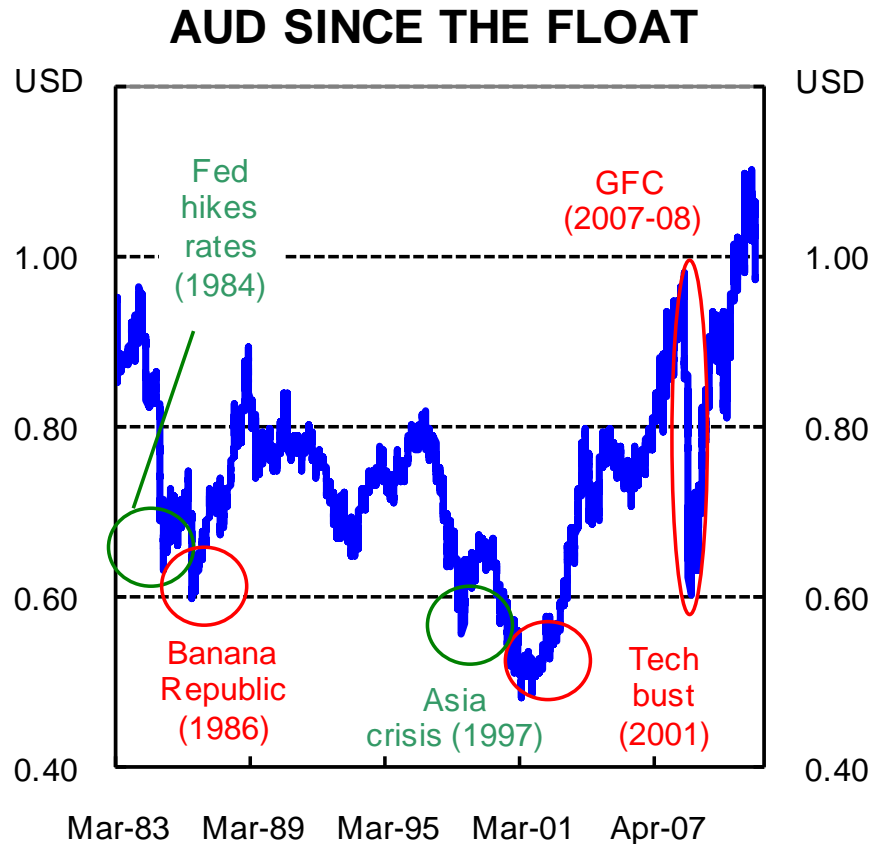
## Problems in Europe and US



- European banks do not trust each other. US economy is weaker than initially thought.

# Global backdrop

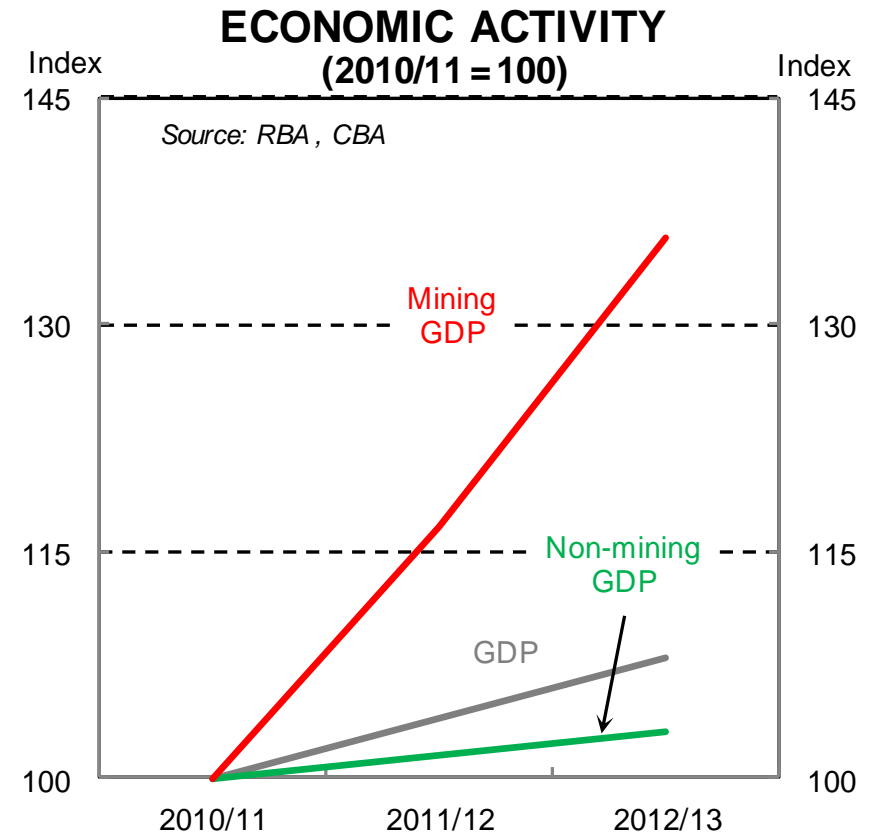
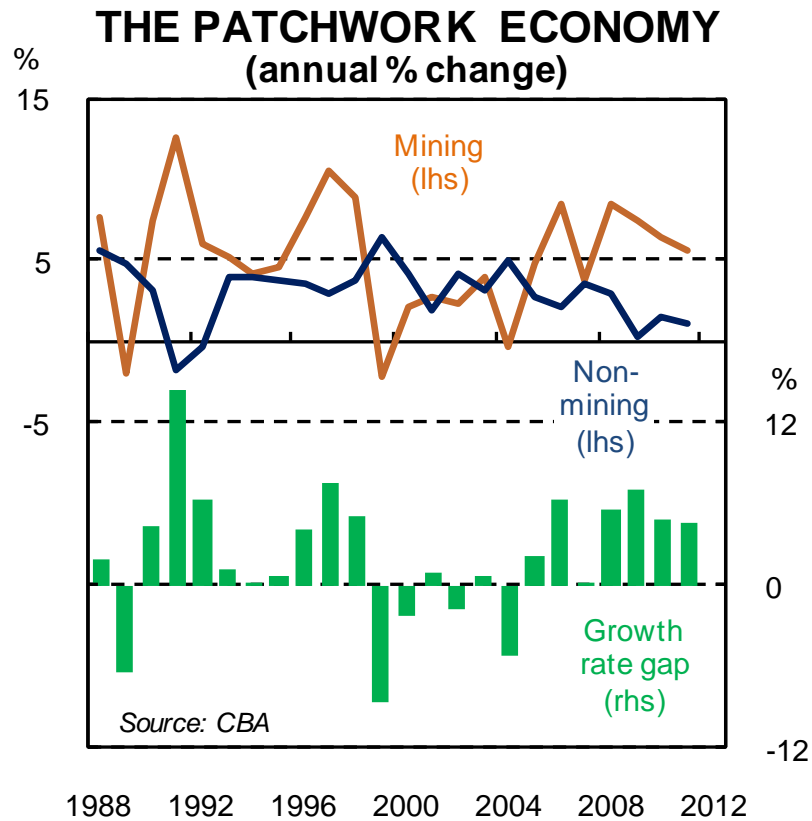
## Offshore matters



- Offshore influences are very important for AUD.
- Recently, AUD has been on a 25 US cent round trip.
  - USD 1.10 down to USD 0.95, then
  - USD 0.95 up to USD 1.05.

# Australian economy

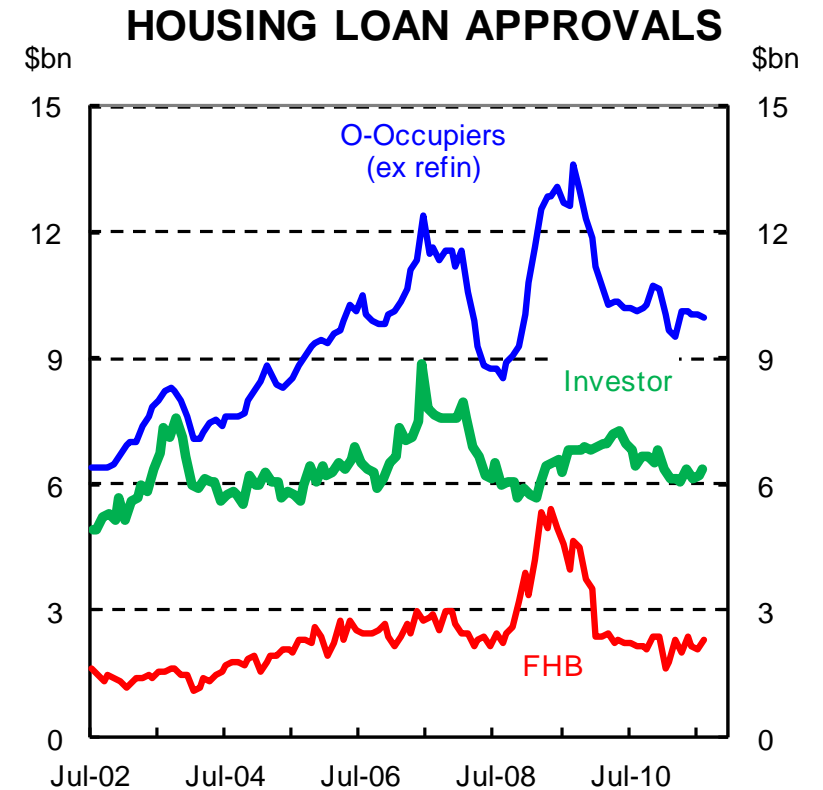
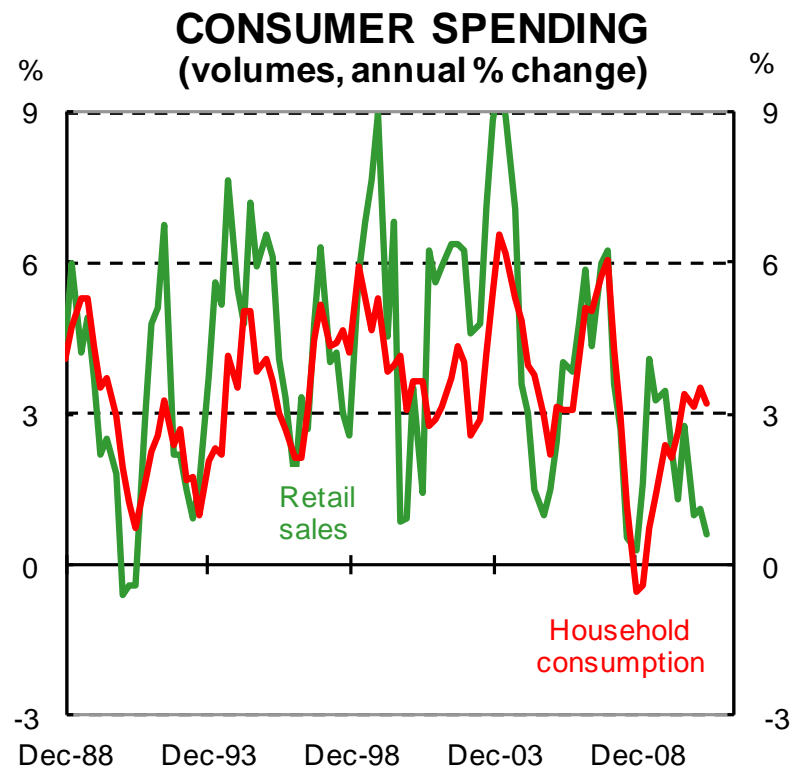
## Multi-speed



- RBA expects above-trend growth: resources sector account for  $\frac{2}{3}$  of all growth.
- Mining to expand at  $\approx 16\%$ pa; non-mining economy to grow at just  $1\frac{1}{2}\%$ pa.

# Australian economy

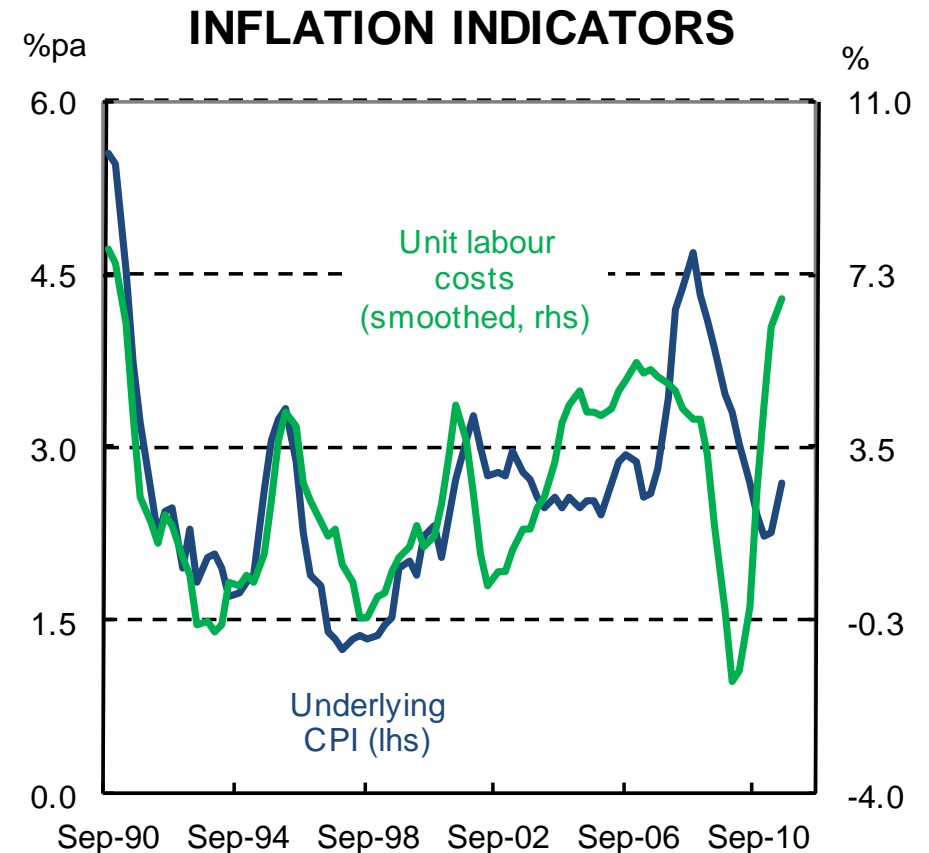
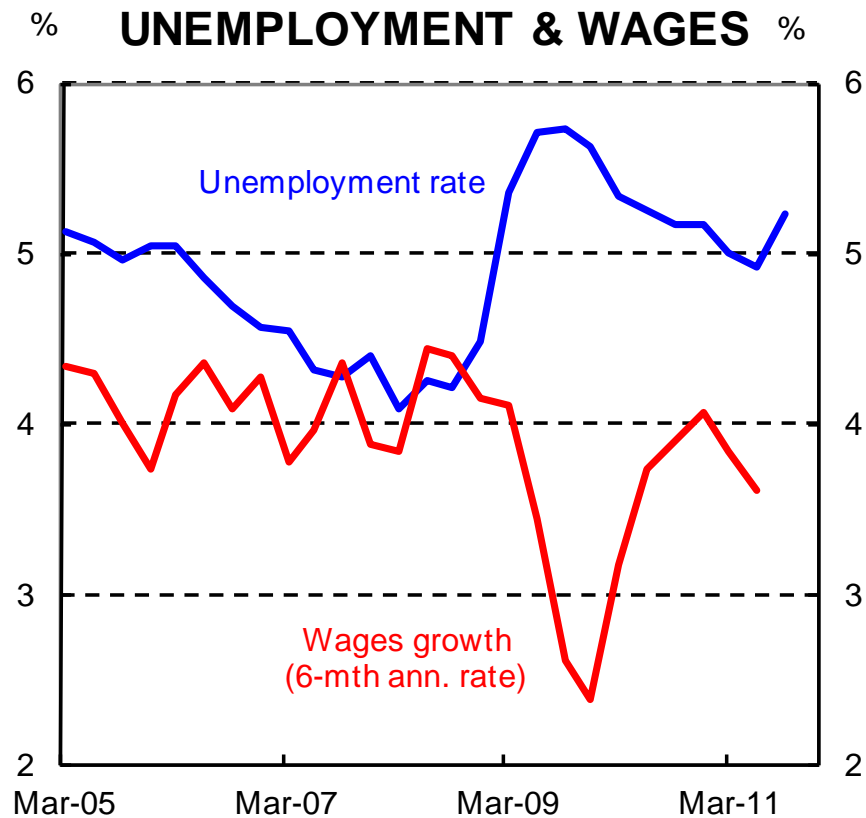
## Cautious consumer?



- Consumers are spending, just not in the shops.
- Housing is held back by low affordability.

# Australian economy

## Tight labour market

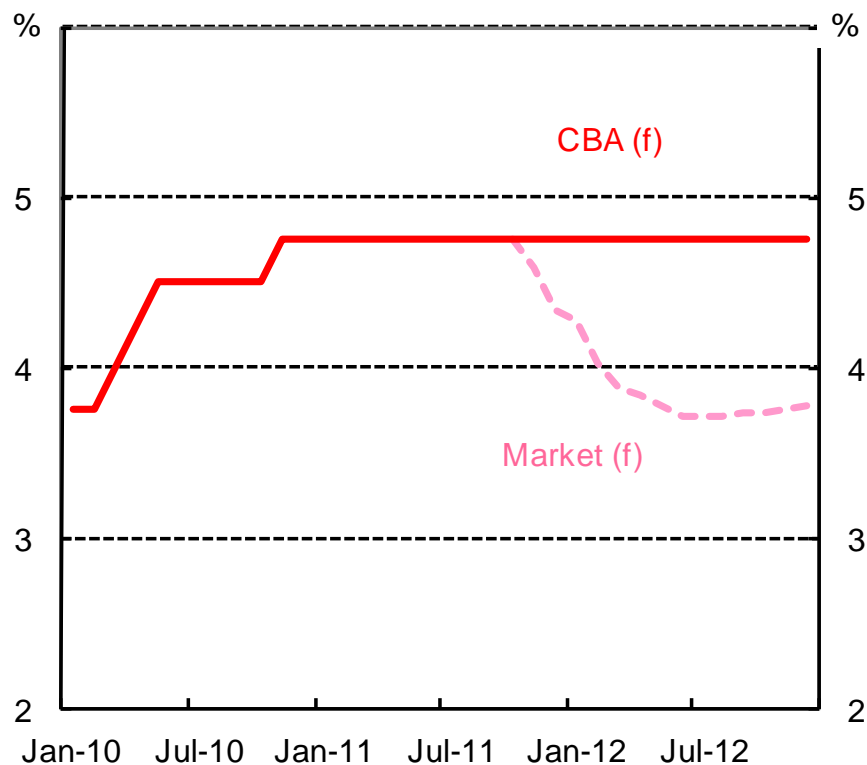


- Our tight labour market plus poor productivity performance is putting upward pressure on businesses costs and inflation.

# Australian economy

## Cash rate on hold

### CBA & MARKET RATE FORECASTS



- Domestic inflation pressures justify rate hike.
- But risks around Europe raise risk of a cut.
- Bottom line: on hold for now.
- The money market is continually pricing in steep near term rates cuts that the RBA has not delivered.

# Exchange rate

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## Our FX forecasts

	End period					
	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
AUD-USD	1.04	1.07	1.08	1.08	1.08	1.05
AUD-EUR	0.75	0.75	0.75	0.75	0.76	0.74
AUD-NZD	1.27	1.29	1.29	1.29	1.29	1.28
AUD-GBP	0.65	0.66	0.66	0.66	0.67	0.65
AUD-JPY	80	82	83	84	85	84
AUD-CAD	1.04	1.06	1.06	1.06	1.06	1.03
AUD-CHF	0.90	0.90	0.91	0.91	0.92	0.89
AUD-SGD	1.24	1.26	1.26	1.26	1.29	1.27

# Exchange rate

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## Highly liquid

### Global currency market turnover

Daily averages in April 2010, % of total

EUR/USD	28
USD/JPY	14
GBP/USD	9
AUD/USD	6
USD/CAD	5
USD/CHF	4
EUR/JPY	3
EUR/GBP	3
EUR/CHF	2
USD/SEK	1

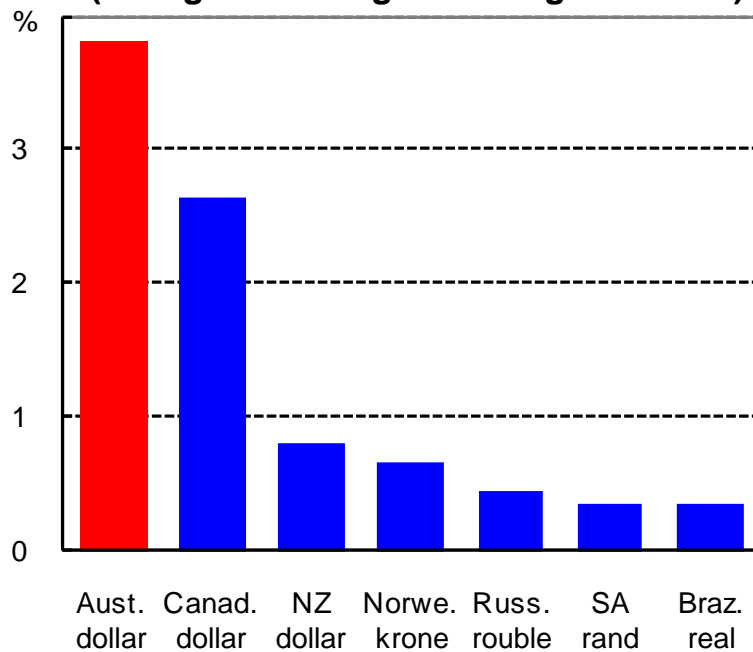
Source: Bank for International Settlements (2010)

- AUD/USD is the fourth most liquid currency pair.

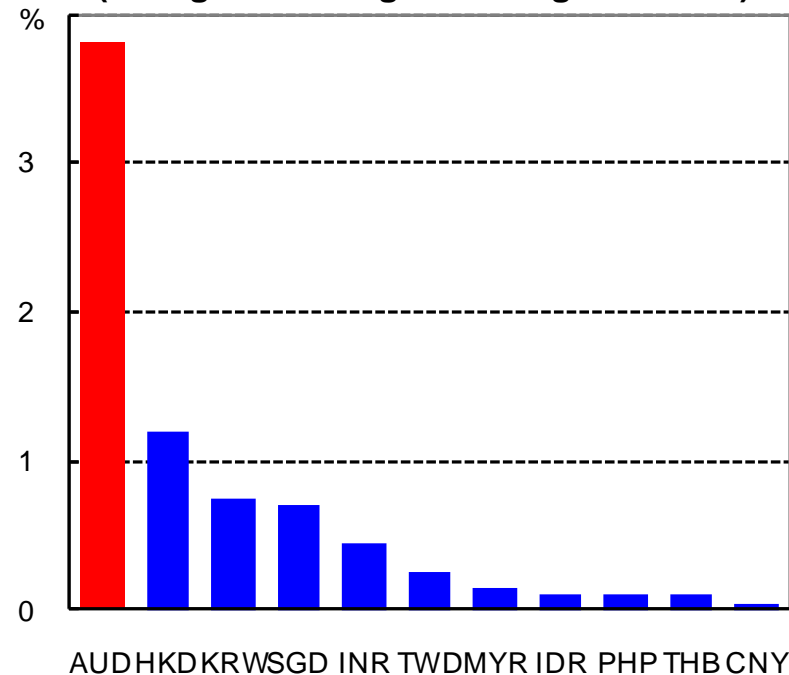
# Exchange rate

## Foreign influences matter

**COMMODITY CURRENCIES**  
(% of global foreign exchange turnover)



**ASIAN CURRENCIES**  
(% of global foreign exchange turnover)



- AUD is most liquid commodity currency.
- AUD is used as a proxy for emerging Asia because it is the most liquid currency in Asia (outside of JPY).

# Exchange rate

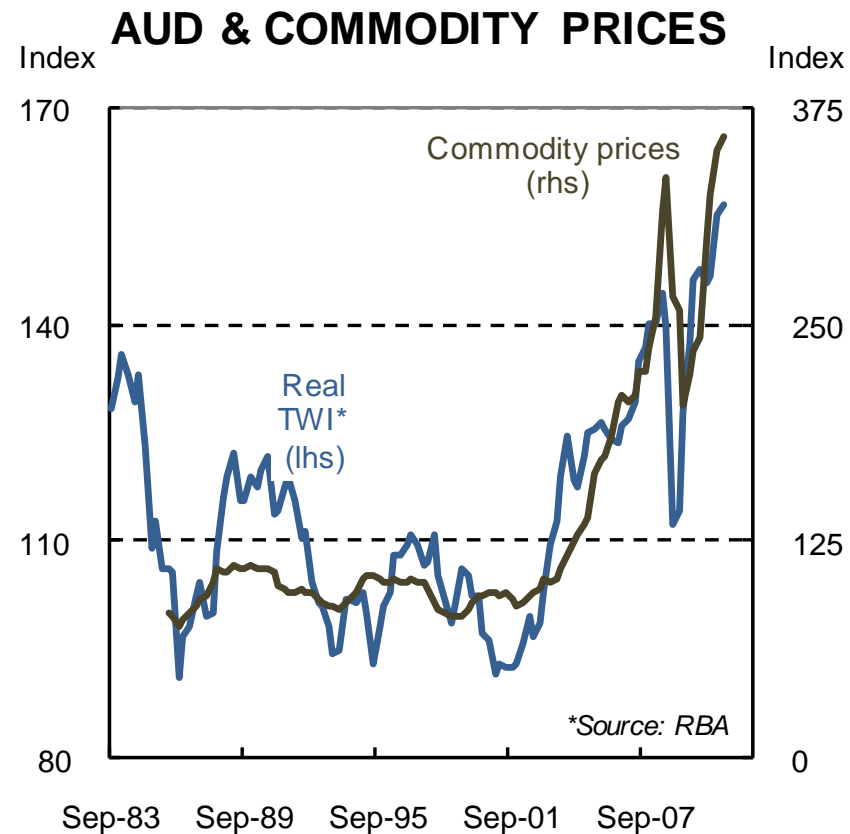
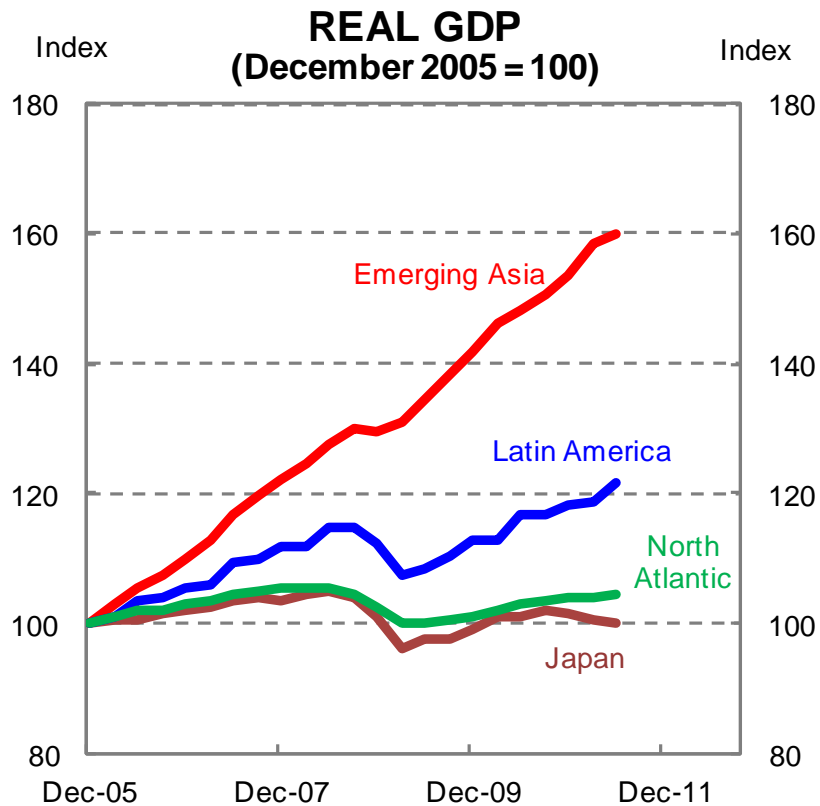
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## The Big Three

- Trends in the USD against major currencies
  - USD to remain strong into end of 2011 but soften a touch in 2012 because of policy easing by the Fed
- Interest rate spreads
  - Not as useful for predicting AUD compared to the past
- Commodity prices
  - Chinese growth returns to 'normal' growth; commodity prices ease from extremes

# Exchange rate

## World economy is changing

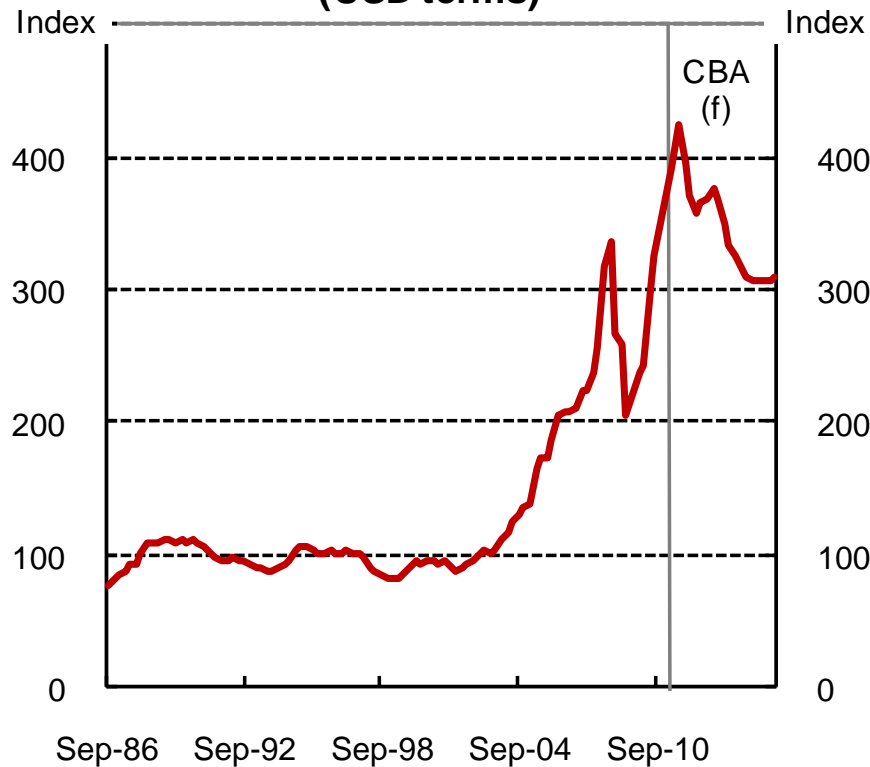


- Global economic growth and global mining and energy prices are being driven by emerging East Asia.

# Exchange rate

## Structural break in commodity prices

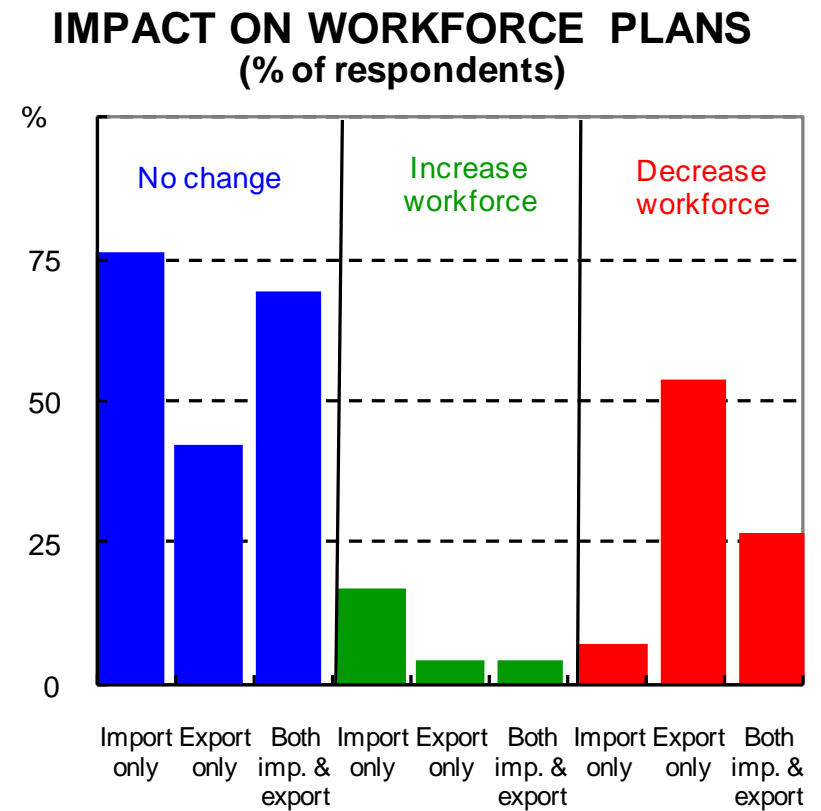
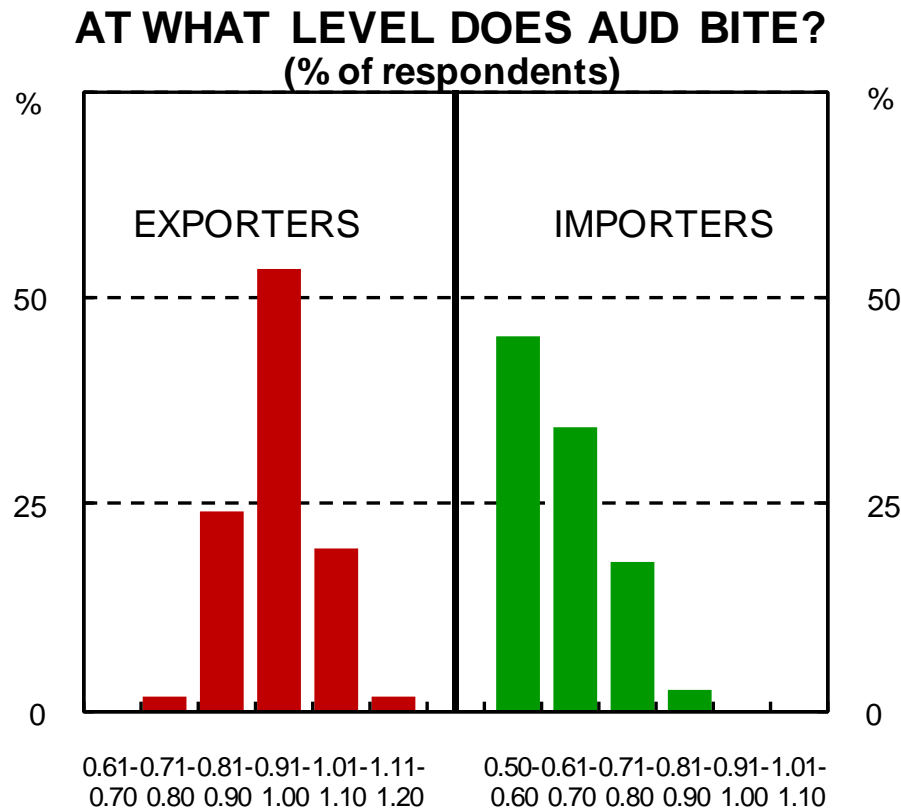
### CBA COMMODITY PRICE INDEX (USD terms)



- We expect commodity prices to ease gradually but remain at a very high level.
- We predict AUD will average 0.96 over the next five years.

# Aussie Dollar Barometer

## Is the high Australian dollar biting?

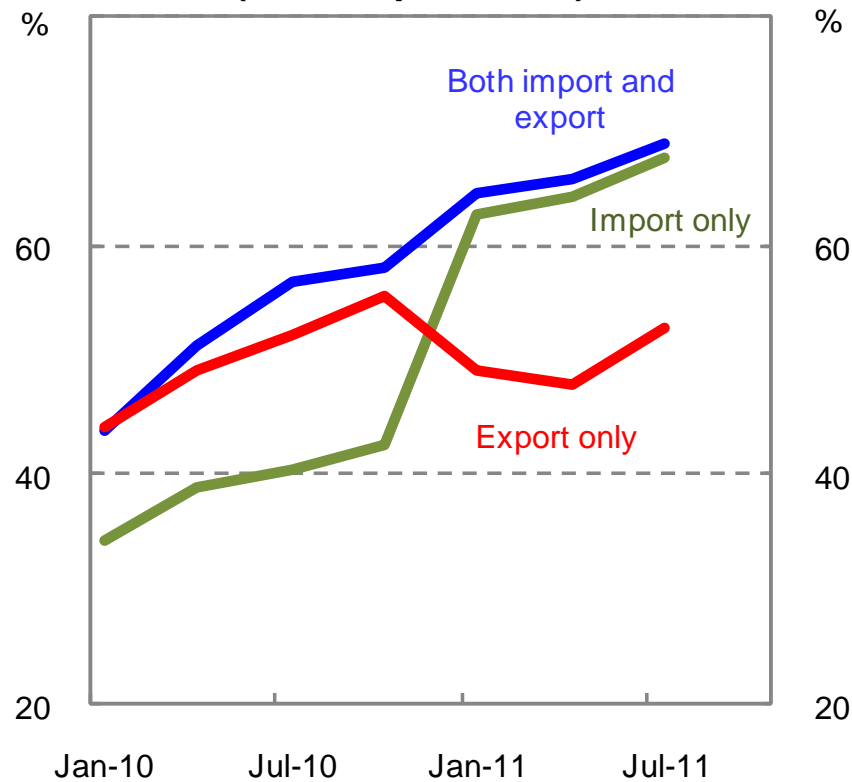


- The point of pain for small and medium businesses is 91-100 US cents.
- Exporters are planning to cut jobs.

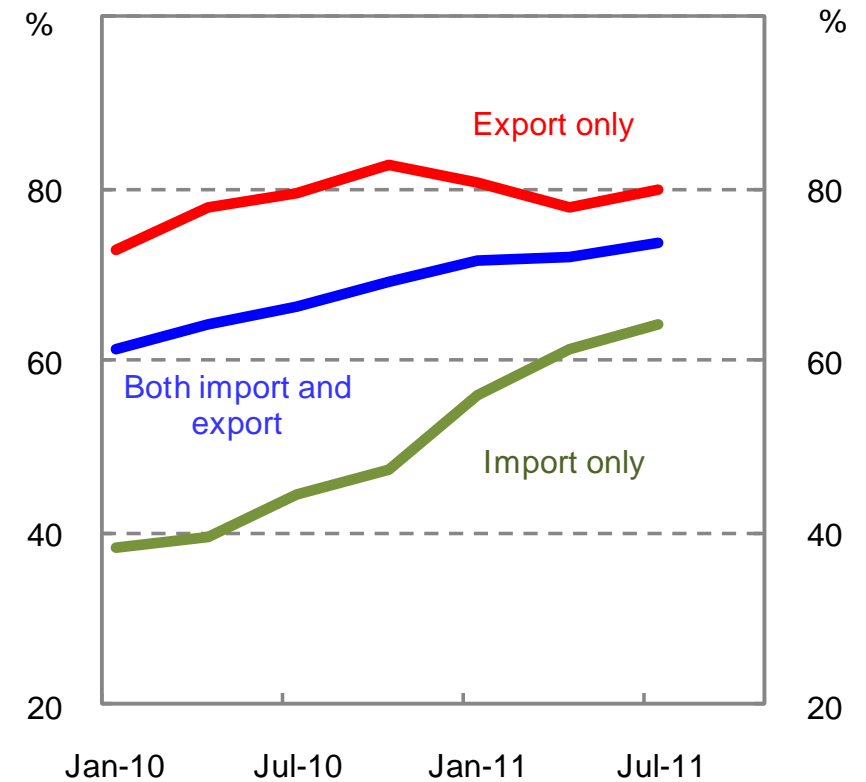
# Aussie Dollar Barometer

## Hedging plans

### PLANS TO HEDGE (% of respondents)



### HEDGE PROPORTIONS

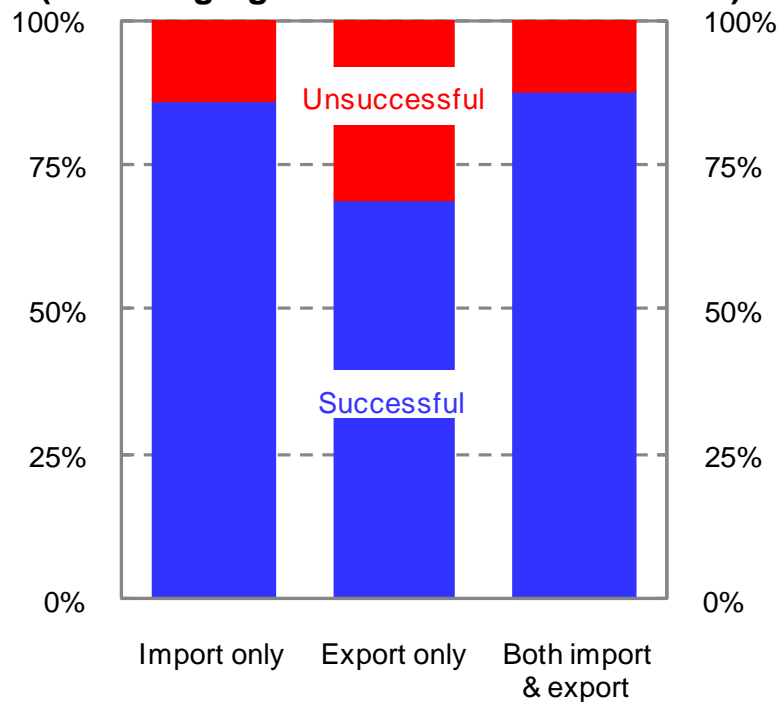


- Hedging is used by more importers to hedge more currency exposure.

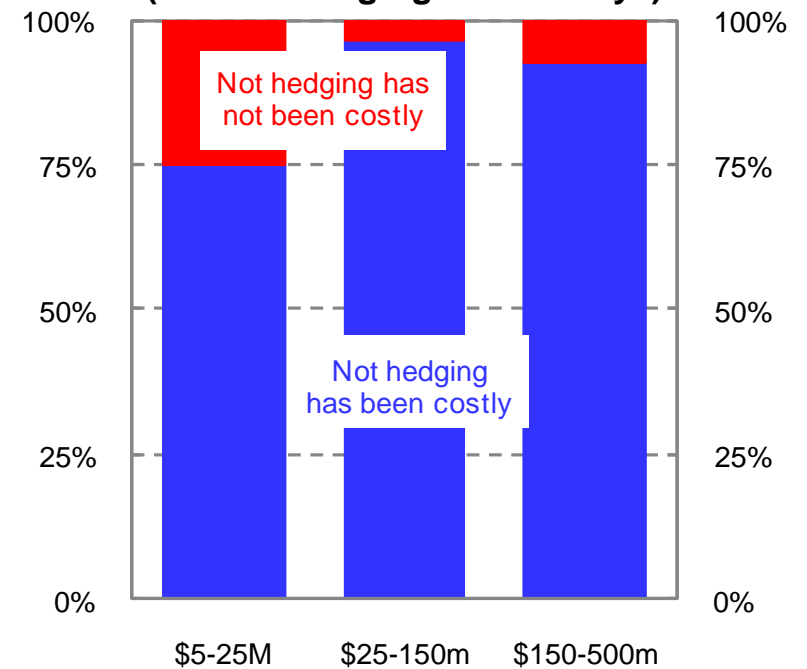
# Aussie Dollar Barometer

## Successful?

### HEDGING CURRENCY EXPOSURES (Was hedging successful or unsuccessful)



### COST OF NOT HEDGING (Has not hedging been costly?)

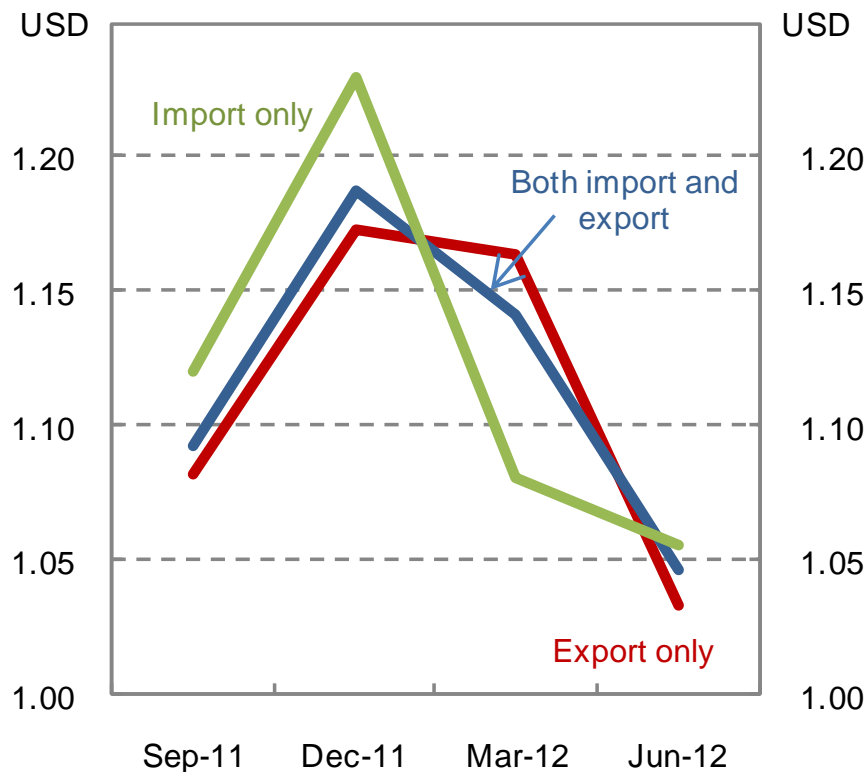


- Hedging is generally judged to be successful while not hedging is generally judged to not be successful.

# Aussie Dollar Barometer

Bullish

## AUD BAROMETER PREDICTIONS



- Importers are very optimistic about the AUD – expecting it to reach US\$1.23 by the end of the year.
- CBA is not as optimistic.

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