



**Nicholas Tubb, General Manager of Ruesch Australia, discusses current factors affecting the outlook for the Australian Dollar (and outlines what forwarders can do to mitigate against currency fluctuations eroding their profit margins).**

In the past twelve months, imports totalling \$179 billion have entered Australia, with 68% of invoices from overseas suppliers being denominated in foreign currencies. With the Australian Dollar appreciating over 7% against the Euro and Japanese yen since January, but depreciating against the US and New Zealand Dollars by over 7% during the same period, it is clear that companies involved in international trade need an effective strategy to mitigate against exchange rate risk and protect their bottom line. As we approach the end of 2005 near 1 year lows against the US Dollar (our most commonly traded currency counterpart) and at all-time lows against the New Zealand Dollar, it is important to take stock of current conditions and formulate a currency risk management plan for the New Year. An assessment of the risks presently facing the Aussie Dollar, as well as the sources of support, is crucial in understanding the dynamics driving the market.

**Risks facing the Australian Dollar:**

With the market focused on the difference in various countries' interest rates, and thus the relative yields on those currencies, the Reserve Bank's current neutral status on monetary policy is providing little support to the Aussie Dollar. The US Federal Reserve is expected to continue its rate tightening policy, and Australia's longstanding interest rate premium is already down to 1.5%, its lowest in four years. In addition, our economy faces headwinds in the shape of cooling household spending, high oil prices, and a sluggish housing market. Australia's rising current account deficit is now almost 5% of GDP, a figure provoking some concern among analysts.

**Sources of support for the Australian Dollar:**

Despite rising interest rates in other parts of the world (in particular the US) Australia still maintains the second highest rates in the developed world (after New Zealand). Annual retail inflation is at the top of the Reserve Bank's 2-3% target range, which could point to future interest rate rises and thus an improved differential over other currencies. In addition, the tight labour market (unemployment is at a 29 year low, providing scope for wage inflation) as well as high commodities prices (the benchmark CRB Index hit a 25 year high in September), could both become sources of support for the Australian currency. Finally, robust global conditions supporting these record high commodities prices are also helping to underpin Australian economic growth.

### Keys to Australian Dollar performance over the next 6 months:

As the underlying factor in the Australian dollar's popularity continues to be its high interest rates, so therefore the monetary policy actions of the Reserve Bank in comparison to its global counterparts will prove to be crucial. Demand for the Australian dollar will wane if the US and New Zealand continue their tightening policy, or if the ECB and Swiss National Bank begin to raise interest rates too. High energy prices and the risk of inflation will be watched carefully, as these could curb global economic growth, and commodities prices in particular need to maintain their bullish trend in order to provide continued support to Australia's economy. Also, any further revaluation of the Chinese currency would increase the Asian giant's purchasing power and support Australian industry (through rising commodities prices). The main driver of Australian Dollar activity, however, will be Australian interest rate differentials rather than growth fundamentals, and depending on other Central Bank actions, we could be in for a rough ride.

### What can forwarders do to protect against exchange rate risk?

With markets constantly moving, and driven by technical as well as economic and geopolitical factors, exchange rate fluctuations are almost impossible to predict. It is still possible, however, to make informed decisions about how and when to purchase foreign currency, based on companies' individual circumstances. By working with an entity which understands your business, a significant amount of pain can be taken out of the process by sound management of the exchange rate risk. In particular, the following elements should be taken into consideration when formulating strategies to manage currency exposure:

**Minimum margin:** by constantly monitoring the exchange rate relative to your "minimum margin rate" (i.e., the rate at which your profit margin is at its minimum tolerable level) for each deal or budget period, you ensure bottom line protection.

**Invoice terms:** it is vital to not only synchronise the purchase and delivery of currency with the terms of the invoice, but also to build in flexibility to be able to adapt to delayed shipments, early settlement discounts, etc. If you use tools such as forward contracts, you should incorporate flexible delivery windows so that you are not tied to a specific purchase date.

**Risk-aversion:** you also need to decide how averse a strategy to adopt to your foreign currency purchases. For example, adopting a policy of covering 80% of your future currency requirements with forward contracts enables you to "play with" the remainder and try to coincide the final purchase with favourable market conditions. Many forwarders need to balance the bottom line protection (by hedging) and the competitive environment (i.e., the possibility of rivals being able to undercut at the time of delivery due to more advantageous exchange rates).

Whether your company is making payments to overseas agents, paying foreign government tariffs and taxes on behalf of clients, or settling charge-backs for weight discrepancies, it is critical to plan how you will deal with the exchange rate risk. Of course, assisting you with formulating your currency risk management strategy, and providing you with market information, is only part of the service you should be receiving from your foreign exchange supplier. Providers today need to offer processing and reporting efficiencies to take away the additional pain of what can be a cumbersome part of the Accounts Payable procedure. By employing STP streamlining, and tailoring both the strategic and procedural expertise to

your exact requirements, foreign payment specialists (in contrast to the “fx houses” of old) can introduce real value to today’s international organisations.

Ruesch International is a premier provider of both foreign and domestic payment solutions in the U.S., Europe, and Australia. Ruesch has served more than 30,000 clients (including 125 of the Fortune 1000) and processes more than \$24 billion in transactions annually. The company’s Sydney office will become operational during December 2005.

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