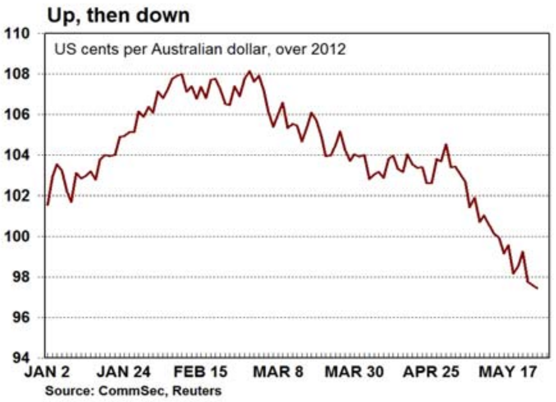
Aussie, Aussie, Aussie

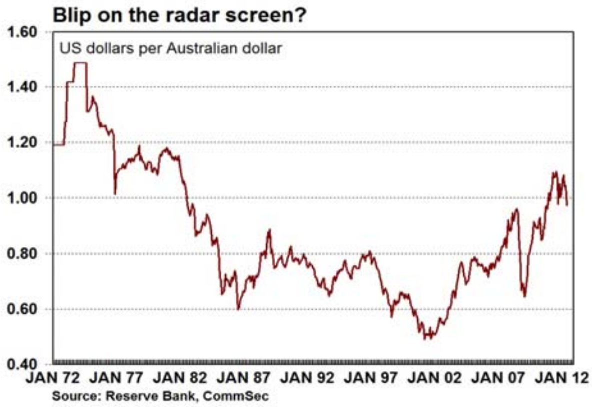
Economic & financial issues

- **<u>The weaker Aussie dollar.</u> The Aussie dollar has fallen in response to a bout of new jitters about Europe and China. The weaker currency has a raft of implications for the Australian economy.**
- **<u>Winners & losers across Corporate Australia.</u> CommSec has analysed where the top 40 listed companies earn their money across the globe. Only 58 per cent of revenues from top 40 companies are generated solely from Australia.**

What does it all mean?

- Movements in the Aussie dollar mean different things to different people. Consumers tend to love a stronger Aussie dollar as it typically leads to cheaper imported goods and cheaper foreign travel. And the perennial question about when to buy travellers cheques is far less relevant today. Nowadays most travellers use travel cards from banks and other foreign institutions – adding foreign currency to their cards gradually over time and thus reducing the risk of adverse currency movements just when you are about to leave for your holidays.
- Businesses tend to take a different view on the Aussie dollar with most favouring a weaker currency. Exporters, rural producers, tourism operators and manufacturers favour a weaker currency to boost competitiveness. Retailers also prefer a weaker Aussie dollar as it may mean fewer Aussies travel overseas or buy goods on-line thus increasing the chances that the goods will be purchased in Australia.
- The complication is that some businesses purchase equipment from abroad and at the same time derive most of their income from Australia. Banks and other service businesses like hairdressers fall under this category. And these businesses are more likely to be ambivalent about currency changes or favour a stronger Aussie dollar.
- Clearly some listed companies are more exposed to both currency fluctuations and operating conditions in other parts of the globe. CommSec has analysed the geographical segment information provided by the top 40 listed companies in their latest annual reports. In aggregate, surprisingly only 58 per cent of revenue generated by the top 40 companies comes from Australia. Fortescue, Oil Search, Iluka, Rio Tinto and BHP Billiton all earn only a modest fraction of their incomes from Australia. By contrast Asciano, AGL Energy, QR National and ASX are all focussed on the domestic market. It's important for investors to be aware of where company income is generated.





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REVENUE BY COUNTRY (per cent of total)

	Australia (*inc NZ)	UK	Europe (*inc Middle East) & Africa) (+ inc UK)	China	Japan	Asia (*Asia Pacific)	North America (*inc Brazil)	NZ (+ Fiji)	Other (+ PNG)	TOTAL
BHP Billiton	7.6	1.5	11.7	28.2	12.5	22.0	8.6	0.0	7.8	100.0
CBA	88.1	0.0	0.0	0.0	0.0	0.0	0.0	8.3	3.6	100.0
Westpac	91.1	0.0	0.0	0.0	0.0	0.0	0.0	8.3	0.6	100.0
ANZ	70.3	0.0	0.0	0.0	0.0	14.3	0.0	15.4	0.0	100.0
NAB	74.8	0.0	12.7+	0.0	0.0	1.1	3.0	8.4	0.0	100.0
Telstra	92.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	7.6	100.0
Wesfarmers	97.8	0.0	0.0	0.0	0.0	0.0	0.0	2.1	0.1	100.0
Woolworths	91.9	0.0	0.0	0.0	0.0	0.0	0.0	8.1	0.0	100.0
Rio Tinto	2.5	1.4	11.5	30.7	16.6	15.9	16.7	0.0	4.7	100.0
CSL	12.6	0.0	19.1	0.0	0.0	0.0	38.3	0.0	29.9	100.0
Westfield	35.0*	34.5	0.0	0.0	0.0	0.0	30.6*	0.0	0.0	100.0
Woodside	10.6	0.0	0.0	0.0	0.0	70.8	4.7	0.0	14.0	100.0
Newcrest	54.6	0.0	14.0	2.2	24.9	1.4	2.9	0.0	0.0	100.0
QBE	24.5	0.0	20.5	0.0	0.0	2.9*	26.2	0.0	25.9	100.0
Origin Energy	81.0	0.0	0.0	0.0	0.0	0.0	0.0	18.1	0.9	100.0
Santos	91.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	8.7	100.0
AMP	96.8	0.0	0.0	0.0	0.0	0.0	0.0	3.2	0.0	100.0
Brambles	11.2	0.0	33.0	0.0	0.0	9.0*	40.9	0.0	5.9	100.0
Suncorp	83.3	0.0	0.0	0.0	0.0	0.0	0.0	16.7	0.0	100.0
Orica	34.7	0.0	0.0	0.0	0.0	0.0	13.8	0.0	51.5	100.0
Amcor	15.6	0.0	0.0	0.0	0.0	0.0	30.1	0.0	54.3	100.0
Macquarie	52.4	0.0	16.3*	0.0	0.0	5.6*	25.7	0.0	0.0	100.0
Transurban	98.9	0.0	0.0	0.0	0.0	0.0	1.1	0.0	0.0	100.0
Fortescue	0.0	0.0	0.0	96.8	0.0	0.0	0.0	0.0	3.2	100.0
Westfied Retail	87.8	0.0	0.0	0.0	0.0	0.0	0.0	12.2	0.0	100.0
Oil Search	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0+	100.0
Stockland	97.1	2.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
AGL Energy	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
IAG	64.4	6.7	0.0	0.0	0.0	1.9	0.0	27.0	0.0	100.0
Coca Cola Amatil	73.7	0.0	0.0	0.0	0.0	0.0	0.0	8.7+	17.6	100.0
Iluka	0.1	0.0	28.8	0.0	0.0	48.5	21.3	0.0	1.3	100.0
GPT	92.7	0.0	0.5	0.0	0.0	0.0	2.0	4.8	0.0	100.0
QR National	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
Worley Parsons	28.7*	0.0	10.1	0.0	0.0	20.3*	41.0	0.0	0.0	100.0
ASX	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
Sonic Healthcare	47.8	0.0	17.6	0.0	0.0	0.0	23.4	0.0	11.2	100.0
Goodman	58.6*	22.6	15.5	0.0	0.0	3.3	0.0	0.0	0.0	100.0
Incitec Pivot	59.0	2.1	0.0	0.0	0.0	0.0	26.5	0.0	12.4	100.0
Dexus	80.9	0.0	0.0	0.0	0.0	0.0	16.0	0.0	3.1	100.0
Asciano	100.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	100.0
TOTAL	**58.3**	**0.9**	**5.0**	**8.2**	**3.8**	**6.5**	**7.1**	**4.7**	**5.7**	**100.0**

Source: CommSec, Annual Reports

Asia may include China & Japan if not specified. Europe may include UK if not specified. GPT has since discontinued overseas operations.

Listed companies: Revenue by country

- Of the top 10 listed companies, BHP Billiton and Rio Tinto have the greatest diversification of revenues although China dominates, accounting for 28.2 per cent of BHP Billiton's revenue and 30.7 per cent of income at Rio Tinto. CSL also derives just 12.6 per cent of revenue from Australia with 38.3 per cent of revenue from the United States. Australian banks, together with Telstra, Wesfarmers and Woolworths are largely exposed to the Australian and New Zealand economies. However NAB generates 12.7 per cent of revenue from Europe and ANZ derives 14.3 per cent of revenue from Asia.
- Of the listed companies ranked 11-20, AMP and Santos are largely exposed to the domestic economy but other companies have a far greater spread of operations across the globe. Both Woodside Petroleum and Brambles only generate around 11 per cent of revenue from Australia.
- Of the listed companies ranked 21-30, Fortescue derives all revenue from China while Oil Search obtains all income from Papua New Guinea. Only AGL Energy is totally dependent on the Australian market with Transurban (98.9 per cent) and Stockland (97.1 per cent) heavily focussed on Australia.
- And of companies ranked 31-40, Asciano, QR National and ASX are wholly focussed on the Australian economy. By contrast mineral sands miner, Iluka, derived just $2 million (0.1 per cent) of its $1536.7 million revenue from Australia in the last financial year with almost half of all revenue from Asia. WorleyParsons received 28.7 per cent of its revenue from Australasia last financial year with 21.1 per cent of revenue from the US and 19.9 per cent from Canada.

Recent movements in the Aussie dollar

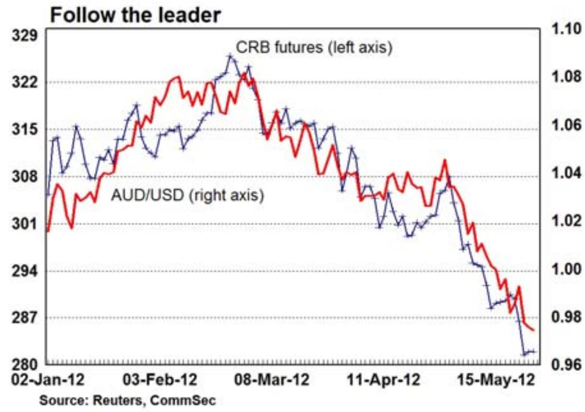
- The Aussie dollar started 2012 at US101.56 cents, rose to highs of US108.56c on February 29 and has since eased to US98c. The Aussie is near six-month lows – the low of US96.86 cents on May 23 was the lowest since October 6 last year.
- Since the start of the year the Aussie has fallen by around 4 per cent against the US dollar, 5.5 per cent against Pound Sterling, 1 per cent against the Euro, 1.4 per cent against the Japanese yen, 1.6 per cent against the NZ dollar and lost 3 per cent on a trade weighted basis.
- Over the past year the Aussie has lost around 7 per cent against the US dollar and almost 4 per cent against Pound Sterling but is up 4 per cent against the Euro.

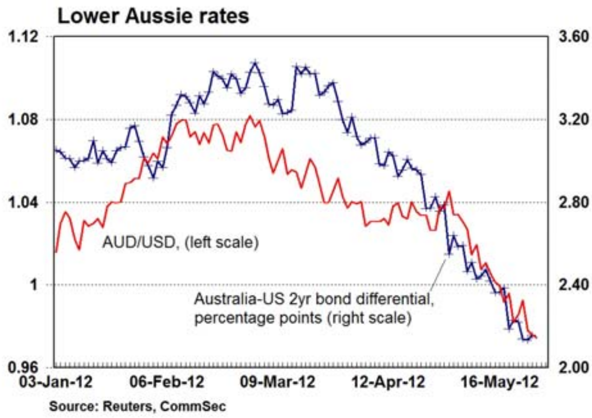
Longer-term averages

- Over 2012 the Aussie dollar has traded in a near US12 cent range – from US96.86c to US108.56c. On average over the past 25 years the Aussie has traded in a US14 cent range each calendar year. So the volatility of the Aussie over 2012 is still regarded as normal. In 2011, the Aussie traded in a US16.94c range, traded over a US21.88c range in 2010, a US31.6 cent range in 2009 and traded a US38.45c range in 2008.
- The Aussie dollar hit 29½ year highs against the US dollar on July 27 last year at US110.8 cents before retreating. The Aussie also hit a 22-year high against the Euro at 82.41 euro cents on February 7 this year and hit a fresh 27-year high against pound sterling on February 15 at 68.69 pence.
- The all-time low for the Aussie dollar was US47.73c on April 2 2001.
- Despite recent declines, the Aussie is above 3-year averages against all major currencies except the Japanese yen. The Aussie is near US98c (3yr average US96.07c); 78 euro cents (70.27 euro cents); 62.5 pence (60.56 pence); NZ$1.29 (NZ$1.2784); 78 Japanese yen (81.2 yen); 73.5 trade weighted index (72.5 TWI).

Aussie dollar influences

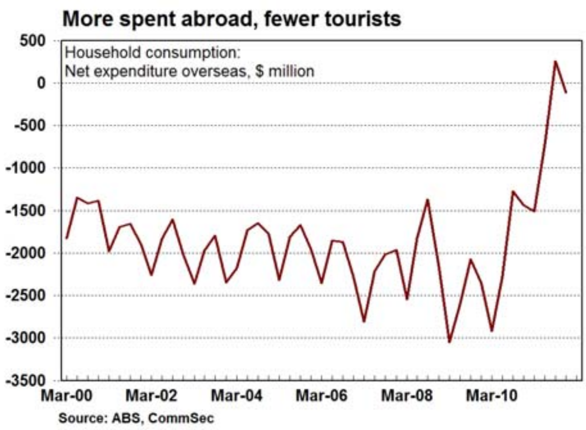
- There are a range of factors that can drive the Aussie dollar higher or lower. Some factors are common to most currencies: political and social stability; interest rate differentials; financial system stability; and government budget deficits and debt levels. But the Australia is a major producer of raw materials or commodities. So if there are risks to the global economy, the Aussie dollar tends to soften. China is also Australia's largest customer so a weaker Chinese economy will put downward pressure on the Aussie dollar.
- The Aussie dollar is perceived as a "fair weather friend" – that is, it tends to do rise when there is optimism across the global economy. This perception is tied to Australia's commodity reliance. So in the current period the Aussie dollar is weakening in line with other "commodity currencies" while safe-haven currencies (generally those less dependent on global economic conditions) like the Japanese yen and Swiss franc are favoured. The US dollar is also favoured in volatile times as it has the most liquid financial markets in the globe.
- It is clear from the charts that lower Australian interest rates and weaker commodity prices explain the drop of the Aussie dollar from March.

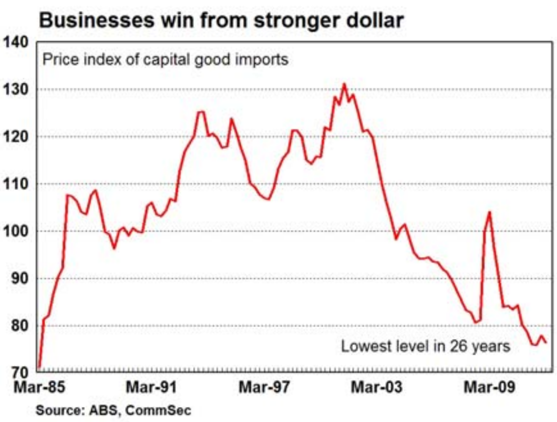


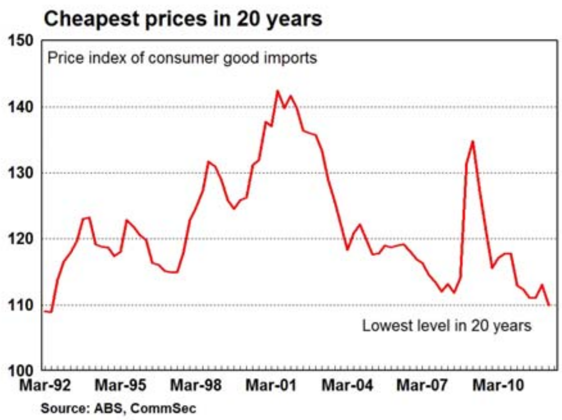


Aussie dollar and import prices

- The Aussie dollar bottomed against the US dollar in April 2001 at US47.73 cents. Understandably the price index of imported goods peaked in the June quarter 2001.
- The Aussie dollar has more than doubled since the lows while the price index of capital goods has fallen by 42 per cent to 26-year lows and the price index of consumer goods has fallen by 23 per cent.
- Clearly there is more than just the Aussie dollar influencing prices, but the stronger Aussie dollar has been a key factor keeping inflation in check in Australia.
- The weaker Aussie dollar could lead to higher prices for imported goods – all other factors being equal. But in the current environment retailers are loathe to lift prices and risk losing sales. Aussie shoppers have more options nowadays – able to check pricing on the internet, not just of similar goods in Australia, but similar goods across the globe.

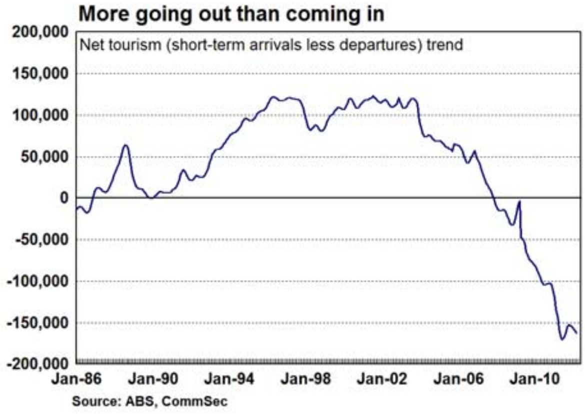


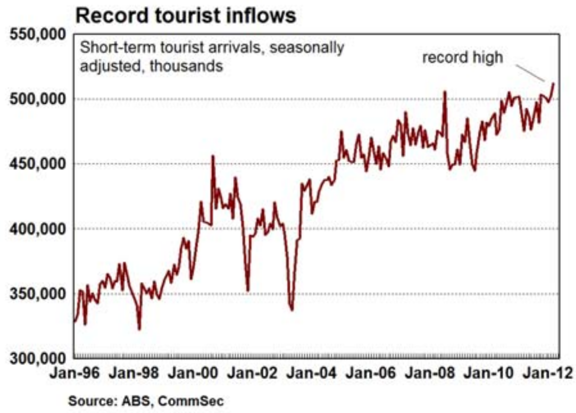




Aussie dollar and tourism

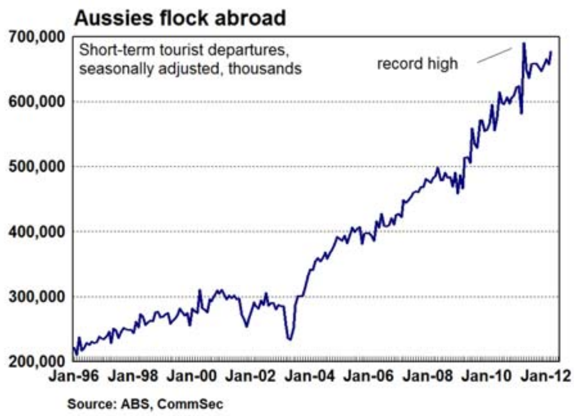
- Despite the strength of the Aussie dollar, tourist arrivals to Australia hit record highs in March. So clearly there is much more than just the currency influencing tourism trends. Certainly the stronger Aussie dollar would be an influence on the budget travel market such as backpackers, but this has been offset to some extent by the falling cost of travel. And for other segments there is the influence of rising wealth and incomes – especially in the Asian region.
- One of the key factors contributing to a near record tourism deficit (more departures than arrivals) is the fact that Aussies are flocking abroad in record numbers. The recent softness in the Aussie dollar may cause some to revise travel plans. But travellers will also weigh up the relative cost and attractiveness of local tourist destinations with overseas resorts. The cost of travel, incomes, health of the job market and cost of living are other key influences. Domestic tourism must continue to work on keeping costs low and improve the value offering. And more operators need to focus on opportunities provided by Asian tourists rather than trying to keep the cork in the bottle of outbound travel.

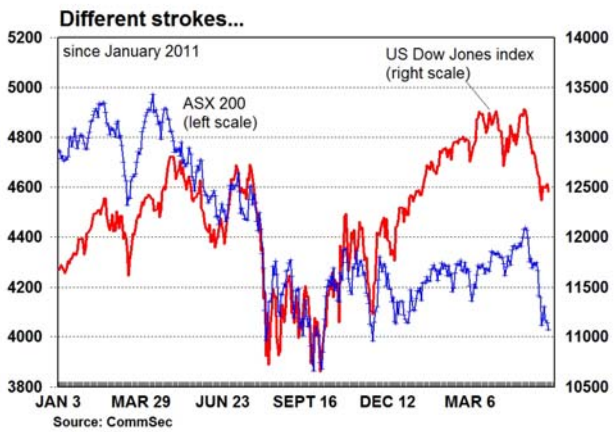




Aussie dollar and overseas investors

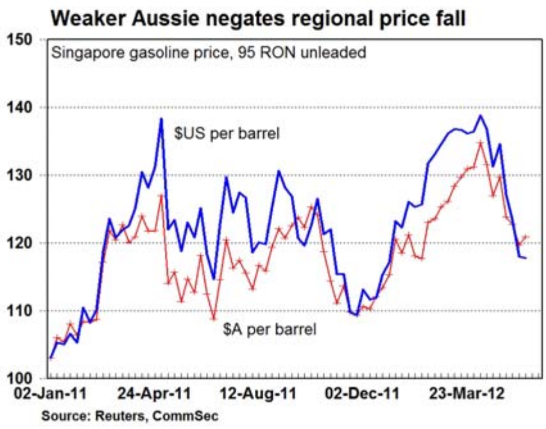
- The Aussie sharemarket has historically tracked the US Dow Jones fairly closely. But late last year the two indexes separated with the Dow Jones outperforming. Since highs set in late October 2011, the Dow Jones has lifted by almost 2 per cent while the ASX 200 has fallen by more than 7 per cent.
- Even since the start of 2012 the Dow has gained 2 per cent while the ASX 200 has fallen by 1 per cent. So what can explain the Australian sharemarket's under-performance?
- In part the under-performance has been attributed to the slowdown of the Chinese economy, reducing demand for mining stocks. At the same time, technology has been in favour, boosting the allure of the US sharemarket.
- But the strength of the Aussie dollar has also been blamed for the under-performance of Aussie shares with foreign investors reportedly noting that Aussie shares had become less attractive when viewed in US dollar terms. The Aussie dollar was at US95 cents in early October 2011, rising to US108 cents in late February 2012. The 14 per cent lift in the Aussie dollar outpaced a weaker 6 per cent lift in the





CRB futures commodity index.

- While the strong Aussie dollar may have restrained interest in Australian stocks, some will note that the share of foreign holdings of Australian shares has actually been rising in recent years, hitting a 19-year high of 46.6 per cent in the December quarter 2011.
- Still, while the foreign share has lifted, in part that reflects the reduced interest of domestic investors in shares. Actually foreign holdings of Australian shares fell 10 per cent from the March to the December quarters of 2011, down from $593.4 billion to $537.8 billion. Foreign holdings of Aussie shares are actually lower than four years ago.
- The bottom line is that the jury is out. Currency fluctuations may influence foreign demand for shares, but there are various other factors also at work.

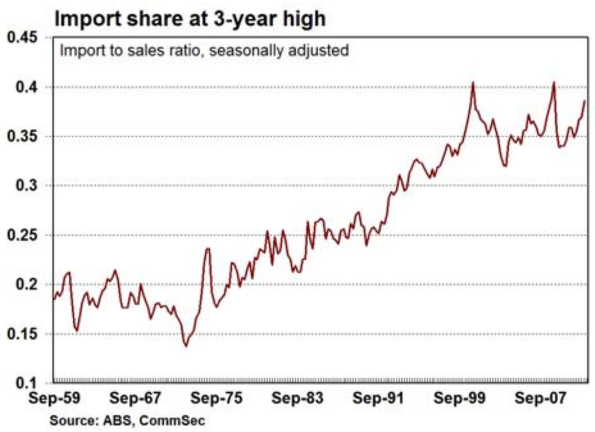


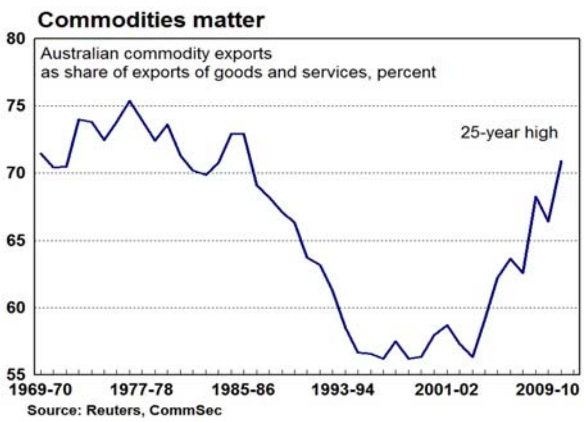
Aussie dollar and petrol

- Australia imports most of its petrol needs and the reference price is the Singapore gasoline price. The Singapore gasoline price peaked at US$138.81 per barrel in early April but has since fallen around 15 per cent to US$117.77 a barrel. That should mean cheaper petrol – that is, provided the Aussie dollar stays constant. But the Aussie dollar has also fallen over the period.
- The good news is that the gasoline price has fallen by slightly more than the Aussie dollar. In fact Singapore gasoline has fallen in local currency terms from US$134.77 to US$120.86. And that is indeed leading to cheaper petrol with discounted petrol in Sydney selling for 129 cents a litre.
- As always, it is a case of not just looking at changes in the oil price, but looking at the oil price in Australian dollar terms.

Aussie dollar outlook

- Our CBA commodity strategists expect the weakness of the Australian dollar to be relatively short-lived. The expectation is that the European situation will be less of an influence over the second half of the year. Should Greek voters opt for a government that doesn't support staying in the euro region (not our central scenario), EU officials will work to ensure that its exit is as painless as possible. Other countries are not expected to exit the euro region. European countries will continue to employ a "do what it takes" approach in stabilising the European debt crisis.
- European countries now appear to be more focussed on a longer-term work-out of debt issues. While discipline will be applied to reduce budget deficits, stimulus will also be important to keep economies growing and thus stimulate tax receipts.
- Further we expect that Chinese authorities will be more focussed on boosting growth than controlling inflation over the second half of 2012 and into 2013. Certainly authorities have been successful in getting inflation under control and now they turn their attention to stimulating growth.
- It is also expected that global interest rates will remain at super low levels into 2013. While Australian interest rates may ease in coming months, they will remain at relatively high levels in relation to both advanced and developing nations.





- Our strategists expect the Aussie dollar to be around US105 cents in December 2012 and US104 cents in June 2013.

Aussie sharemarket outlook

- Despite another flare up on the European debt crisis, we haven't revised our forecasts for the Australian sharemarket. Over the first five months of the year the All Ordinaries lifted almost 400 points. Then in the space of 13 days during May, 400 points was wiped off the index as fear took hold. Clearly there is uncertainty about how Greek voters will act in the second attempt at elections on June 17, but we believe that authorities will do what it takes to keep the Eurozone together.
- Over the year we have consistently maintained that the All Ordinaries index would end the year around 4,650 points (ASX 200 4,600 points) and we see no reason at present to change that forecast – at least until we see how European developments pan out over the next month.

What are the implications for interest rates and investors?

- A few months ago the Reserve Bank expressed concern that the Aussie dollar was not budging despite weaker commodity prices. Well the Aussie dollar has played catch-up, falling 10 per cent from late February highs, and just short of the 13 per cent slide in commodity prices. The lower Aussie dollar should provide a boost to the competitiveness of local goods, retailers, manufacturers and tourist operators versus overseas goods. Miners and rural producers have less to gain as the Aussie dollar has fallen in line with commodity prices. Service businesses also are generally are unaffected by the weaker Aussie dollar but they could pay more for imported computers and machinery in coming months.
- On balance, the weaker Aussie dollar provides a boost for the local economy, and the stimulus will be weighed up by the Reserve Bank when it next sets interest rates. But to insulate Australia against overseas weakness, interest rates need to be below longer-term averages with the hope that the Aussie dollar falls to a greater extent than commodity prices – providing a boost to rural and mining sectors as well. So the case for lower interest rates remains. We expect a cut of at least another 25 basis points over the next few months.
- The May rate cut didn't provide the boost to sentiment that the Reserve Bank wanted. So the risk is that the Reserve Bank won't wait until August (our preferred timing of the next rate cut) before cutting rates again and could move in June. Certainly wage and price inflation is not a worry for the Reserve Bank currently.
- A large number of the top 40 Australian companies aren't affected by the weaker Aussie dollar. Banks, retailers, telecom and utility companies are little influenced by currency changes. But a weaker Aussie could actually boost the attractiveness of our heavy-weight companies for foreign investors.
- Investors in a number of mining, energy, healthcare and property companies clearly need to pay more attention to currency fluctuations. But while these companies obtain the majority of revenue from overseas, hedging strategy will clearly be important in determining the actual impact on day-to-day operations. Currency translation effects will also be important in the reporting of bottom-line results.
- Iluka, Fortescue, Brambles, BHP Billiton, Rio Tinto, Oil Search, CSL, Woodside, WorleyParsons, QBE and Westfield are most exposed to conditions outside Australia. While some of these companies adopt natural hedging strategies (for instance BHP Billiton – as the Aussie dollar tends to track commodity prices) others employ different strategies.

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