

AUSSIE DOLLAR OUTLOOK

Monday, 20 April 2009

Summary

- We expect the Australian dollar to grind higher over the rest of this year.
- Improving risk appetites and interest-rate differentials are among the major drivers of our forecasts.
- The fragile world economy, however, will ensure volatility continues to plague the Aussie dollar.

We published new forecasts for the Australian dollar earlier this month. We lifted our AUD forecasts but left our profile for the AUD intact. We maintained the profile because we continue to believe that the AUD will trend higher through the rest of this year and into next year. In terms of the balance of risks to our forecasts, we think they lie to the upside.

The recent firmer performance in equities reflects an improvement in risk appetites among market participants. One measure of risk aversion, the VIX volatility index, has improved to now stand at 33.9. This level is the lowest close in nearly seven months and is also well under half its level at the peak of the global credit crisis (note the lower the index, the greater the risk appetite of investors).

Risk appetites are improving due largely to the growing view among investors that the worst may now be over. While economic activity in the world's largest economy, the US, may remain sluggish for months to come, there is a growing view that the downturn is no longer intensifying. Consensus also believes that world economic activity will start to look better (albeit slightly) towards the end of the year and start of 2010. With the AUD closely tied to the fortunes of world growth prospects and the appetite for risk, this anticipation is helping the AUD scale higher. The anticipation is also spurring a lift in the prices of base metals, which are among Australia's key exports.

The world economic stage is, however, still fragile. So this fragility means that the AUD will continue to be characterised by considerable volatility. Nevertheless, looking through this volatility, we expect the AUD will trend higher through the rest of this year.

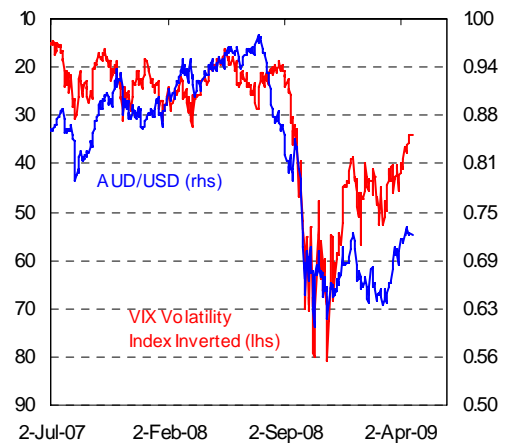
Risk appetites are a key factor steering the AUD's directions. Interest-rate differentials remain another key influence. Local interest rates remain attractive compared to those of other major economies. In terms of the cash rate, further rate cuts from the RBA are still a clear possibility, but we believe the cash rate is not significantly far from its low point; we expect only another 75bp in total easing (at most) by the end of the year. Changes in the cash rate affect the entire structure of interest rates in the economy. An analysis of Australian-US government bond spreads, suggest some further upward potential for the AUD.

No discussion on the AUD would be complete without considering China. It's because the AUD's worth is also tightly tied to China. China's economy has slowed markedly to 6.1%pa in Q1, but this data disguises an improvement in data witnessed more recently. Market sentiment is building that the worst of China is over; RBA's Deputy Governor recently said in a speech "it is quite possible that the past six months will turn out to have been the period of maximum weakness in the Chinese economy". And various Chinese officials in have recently also have been talking up China's outlook for growth.

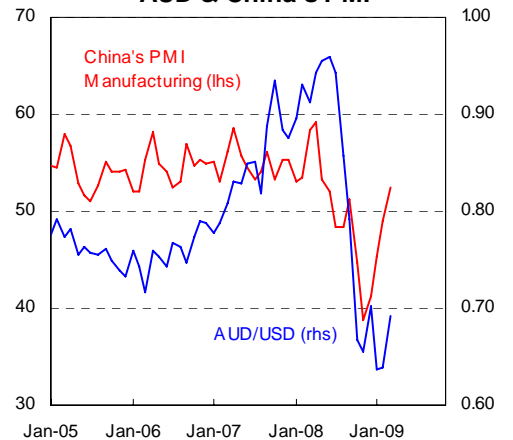
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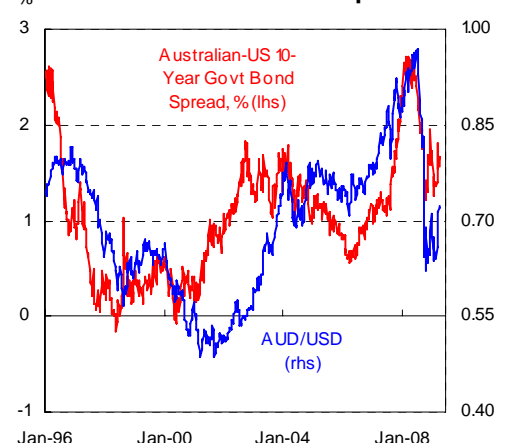
AUD/USD & Risk Appetites



AUD & China's PMI



AUD & 10-Year Bond Spread



ST GEORGE BANK EXCHANGE RATE FORECASTS
Effective 6 April, 2009

	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
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USD Exchange Rates

AUD-USD	0.7000	0.7300	0.7700	0.7800	0.7900
USD-JPY	102.00	104.00	106.00	108.00	110.00
EUR-USD	1.2900	1.2800	1.3000	1.3300	1.3500
GBP-USD	1.4500	1.4700	1.4900	1.5100	1.5300
USD-CHF	1.1600	1.1500	1.1700	1.1800	1.1800
USD-CAD	1.2600	1.2400	1.2300	1.2200	1.2200
NZD-USD	0.5500	0.5700	0.5900	0.6100	0.6300
USD-CNY	6.8200	6.7900	6.7600	6.7200	6.7100
USD-SGD	1.5400	1.5400	1.5300	1.5200	1.5100

AUD Exchange Rates

AUD-USD	0.7000	0.7300	0.7700	0.7800	0.7900
AUD-EUR	0.5430	0.5700	0.5920	0.5860	0.5850
AUD-JPY	71.40	75.90	81.60	84.20	86.90
AUD-GBP	0.4830	0.4970	0.5170	0.5170	0.5160
AUD-CHF	0.8120	0.8400	0.9010	0.9200	0.9320
AUD-CAD	0.8820	0.9050	0.9470	0.9520	0.9640
AUD-NZD	1.2730	1.2810	1.3050	1.2790	1.2540
AUD-CNY	4.7740	4.9570	5.2050	5.2420	5.3010
AUD-SGD	1.0780	1.1240	1.1780	1.1860	1.1930

* Note that the AUD cross exchange rates have been rounded.

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