

# BIENVILLE MACRO REVIEW

*Australia's Slowing Economy*

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# AUSTRALIA'S SLOWING ECONOMY

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## Summary

*Over the past year, Australia's economy has begun to slow. As a result, yields have fallen, and the Australian dollar (AUD) has depreciated quite substantially. Several factors suggest further currency deterioration:*

- PMI data shows that the manufacturing sector, a longtime beneficiary of China's rapid growth, is now contracting as China's import growth has slowed to zero. (Slides 3 and 4)
- Additionally, the services sector is also experiencing a sharp slowdown. (Slide 5)
- In order to combat the rapid slowdown, the Reserve Bank of Australia (RBA) has turned dovish, cutting policy rates from 4.75% to 2.75%. At 4.75%, Australia's policy rates were the highest in the developed world, attracting considerable capital flows over the past several years. (Slide 6)
- As policy rates have declined, interest rates across the curve have also fallen. (Slide 7)
- As a result, the interest rate gap relative to that of the U.S. and of other developed countries has begun to narrow. Converging interest rates and slowing growth have recently weighed on the AUD. (Slide 8)
- Despite the mining boom, which supercharged Australian exports over the past few years, Australia surprisingly runs a current account deficit. As China's growth continues to slow, the current account deficit is likely to widen. (Slide 9)
- Foreign investors have been heavy participants in the Australian bond and currency markets in order to benefit from higher interest rates and speculate on the rising commodity currency. (Slide 10)
- If the AUD continues to depreciate, foreign investors will be forced to cut losing positions, exacerbating the currency's decline. (Slide 12)

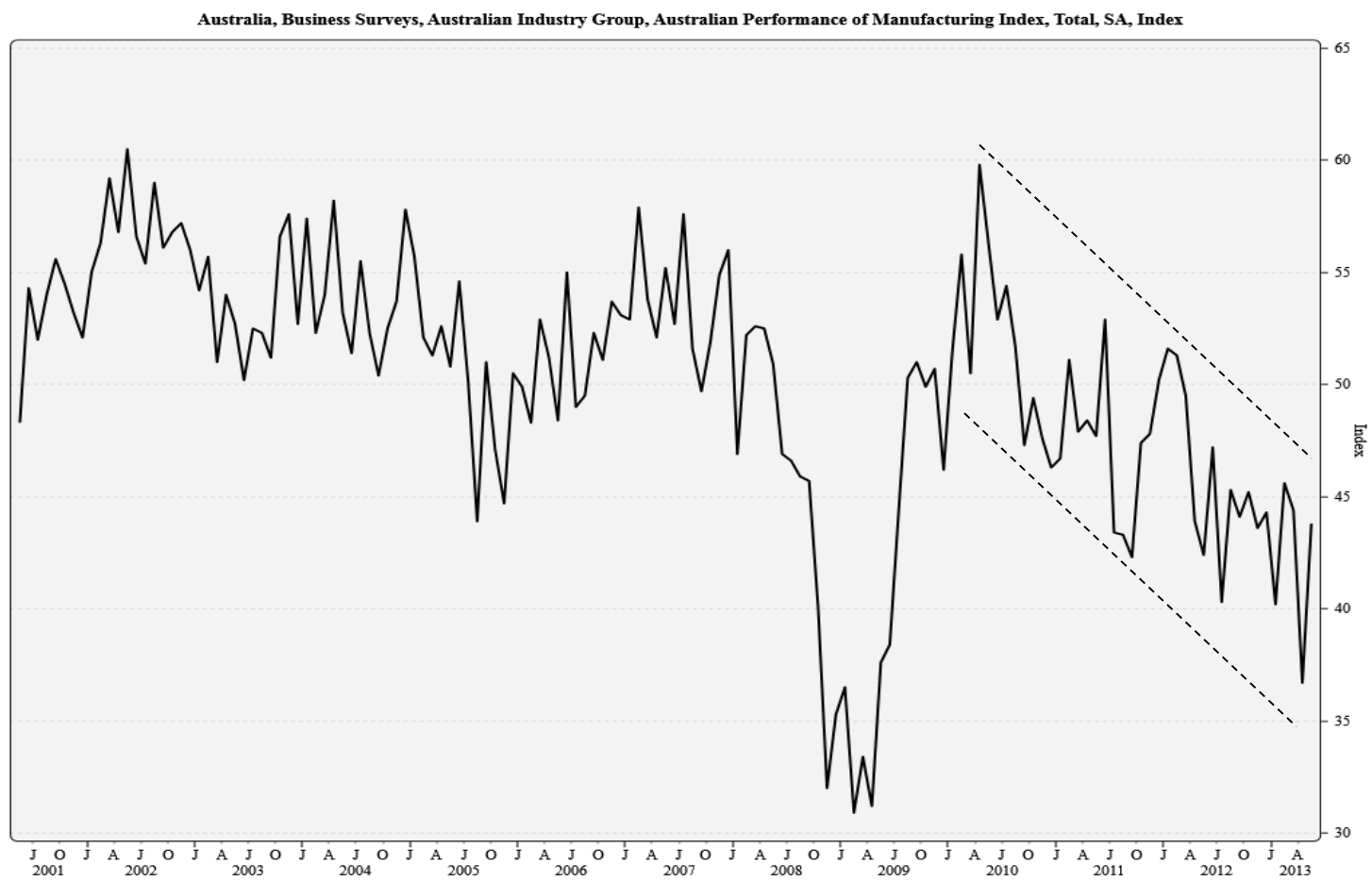


# AUSTRALIA'S SLOWING ECONOMY

Manufacturing data has slowed considerably...

*A strong AUD, which has reduced export competitiveness, coupled with weakness in China, has put substantial pressure on the manufacturing sector in Australia*

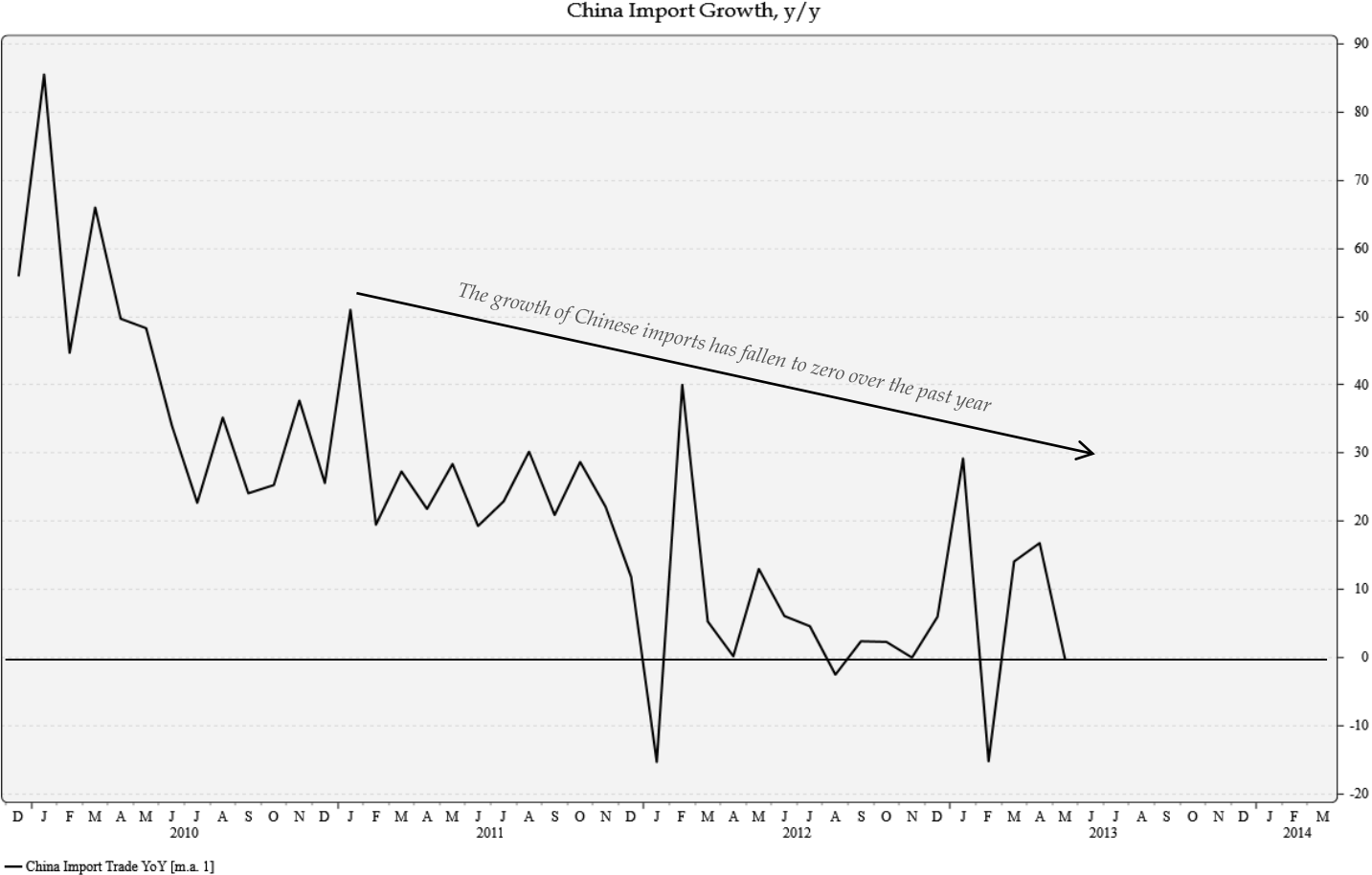
*Manufacturing has been under such pressure that Ford recently ceased production in the country for the first time in 90 years*



# AUSTRALIA'S SLOWING ECONOMY

Part of Australia's slowing growth can be directly tied to China's declining import growth...

*China's economy has been slowing over the past year. As a result, imports have been declining, and aside from holiday-related fluctuations, have settled around zero*



Source: Macrobond



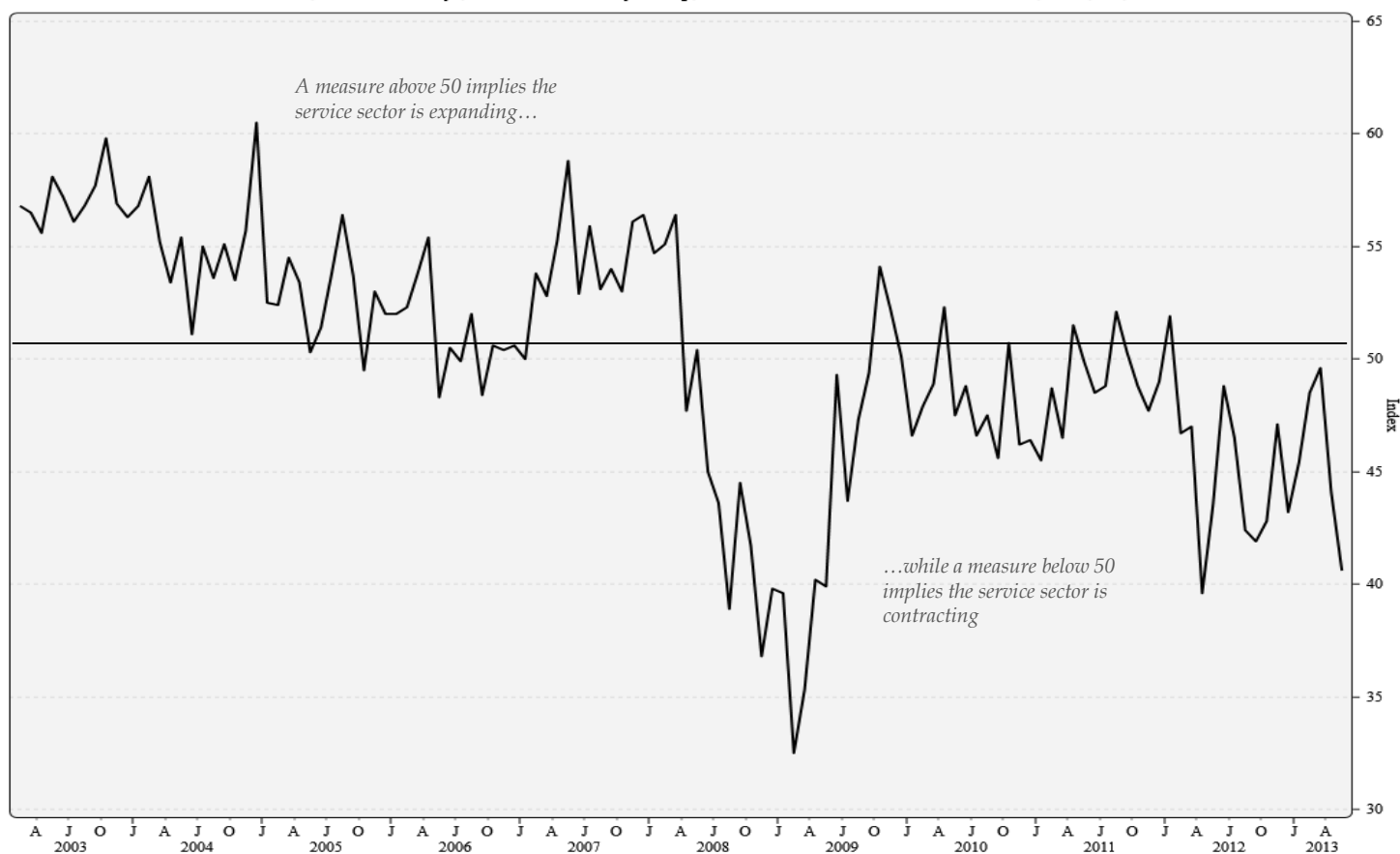
# AUSTRALIA'S SLOWING ECONOMY

And the services sector has been contracting every month for over a year...

*The services sector has deteriorated with the poor housing market, despite the RBA's interest rate cuts*

Jan 2012	Feb 2012	Mar 2012	Apr 2012	May 2012	Jun 2012	Jul 2012	Aug 2012	Sep 2012	Oct 2012	Nov 2012	Dec 2012	Jan 2012	Feb 2012	Mar 2012	Apr 2012	May 2012
51.9	46.7	47	39.6	43.5	48.8	46.5	42.4	41.9	42.8	47.1	43.2	45.4	48.5	49.6	44.1	40.6

Australia, Business Surveys, Australian Industry Group, Australian Performance of Service Index, Total, SA, Index



Source: Macrobond



# AUSTRALIA'S SLOWING ECONOMY

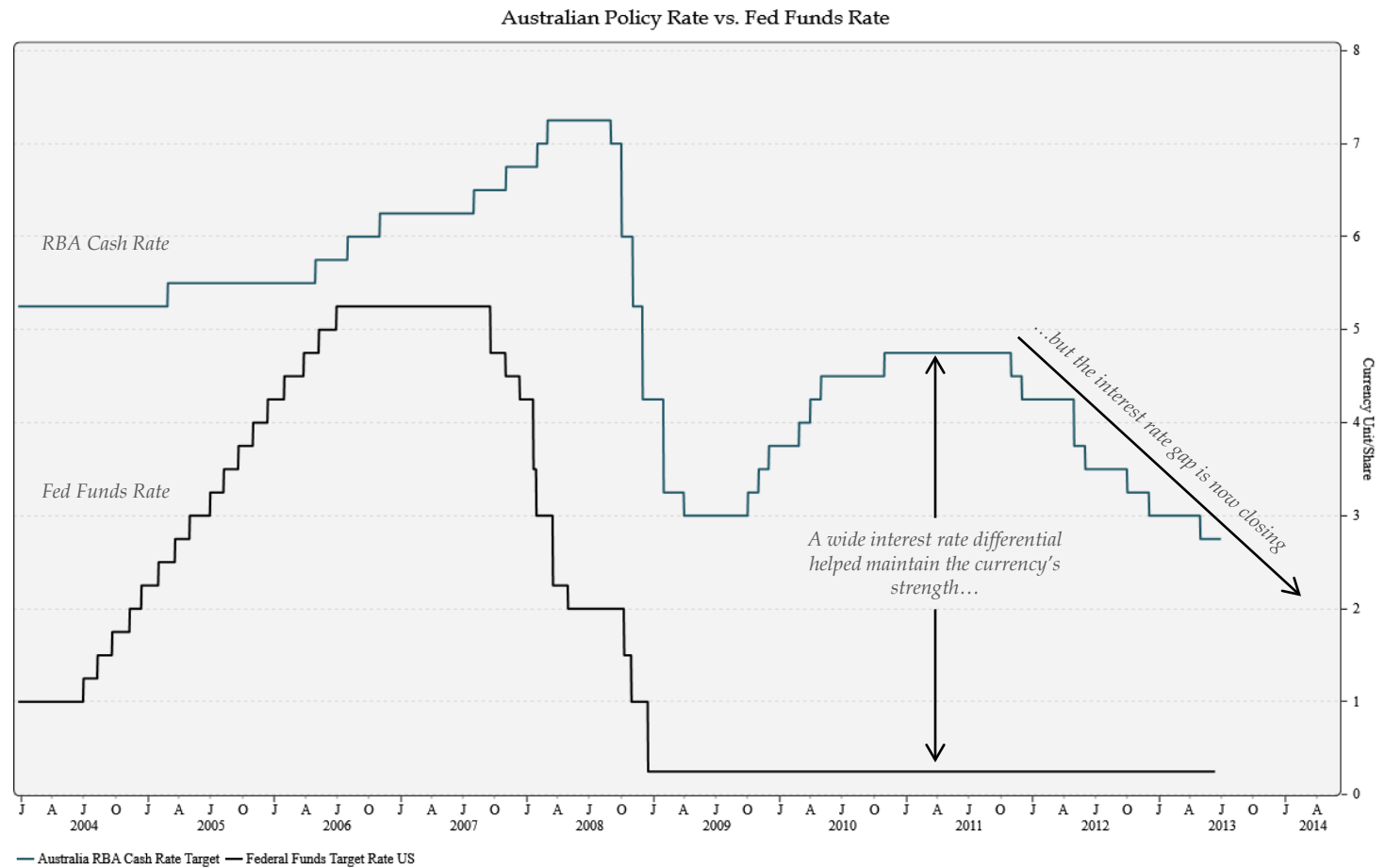
In response to the high level of the currency and deteriorating growth, the RBA has been cutting interest rates...

*The Reserve Bank of Australia has been cutting rates over the past year*

*Once the highest in the developed world, Australian rates are now converging with those of the Federal Reserve*

*To diversify the country's growth (which has been dependent on commodity exports), the RBA remains committed to a dovish monetary policy*

*This will increase the global competitiveness of the manufacturing sector, while putting pressure on the currency*



Source: Macrobond



# AUSTRALIA'S SLOWING ECONOMY

Lower policy rates have resulted in a large decline in 5-year interest rates...

*The continued low interest rate environment, coupled with the slower economy in the past year, has brought 5-year interest rates to new lows*

*Interest rates near 5% following the financial crisis were attractive to foreign investors in need of yield*

Australia, Government Benchmarks, Macrobond, Government Bonds, 5 Year, Yield



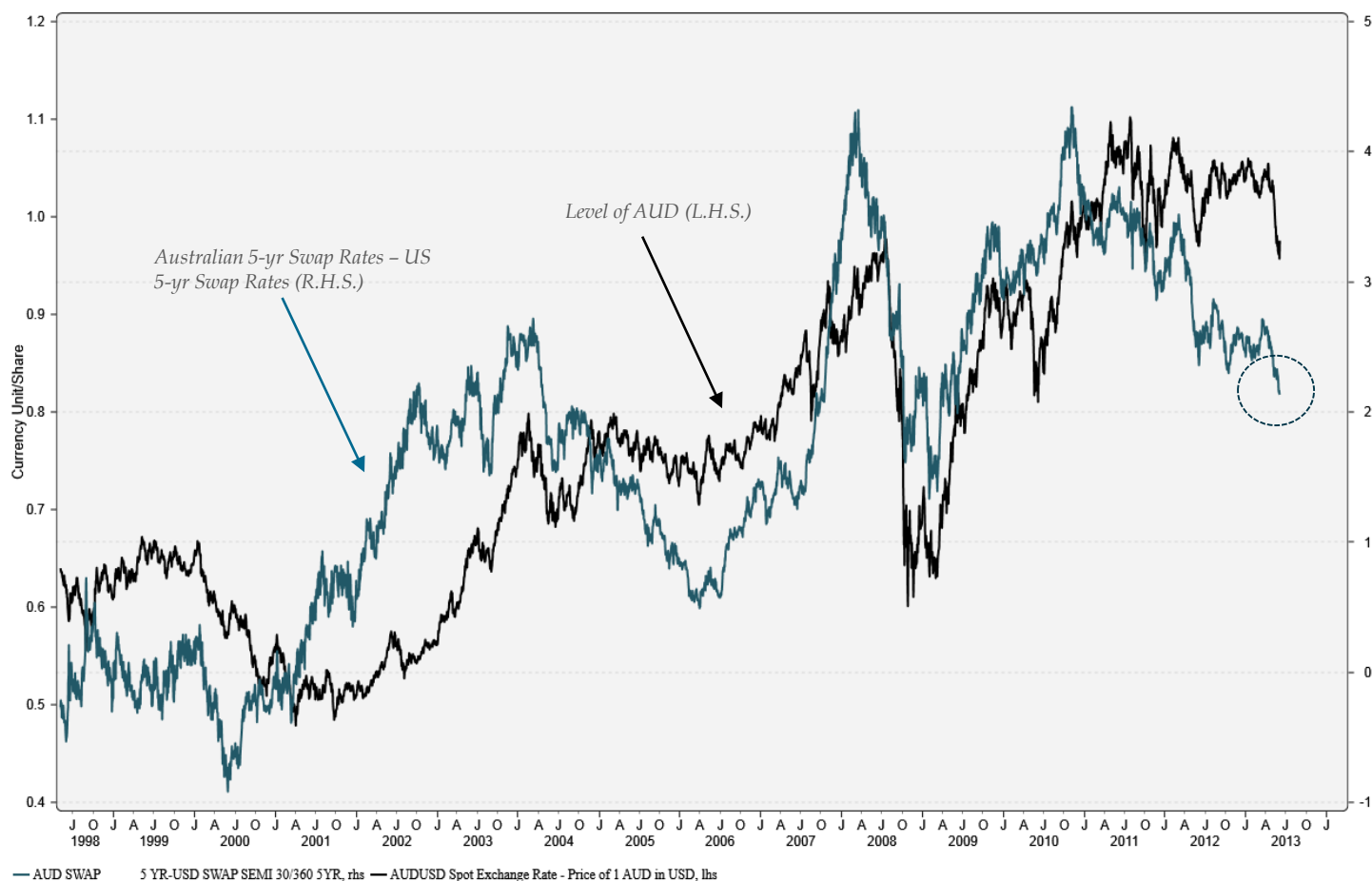
Source: Macrobond



# AUSTRALIA'S SLOWING ECONOMY

The interest rate gap strengthened the AUD, but its recent narrowing suggests further depreciation...

*Just as Australia's interest rate differential supported the AUD, a narrowing of the gap should drag the currency down*



Source: Macrobond



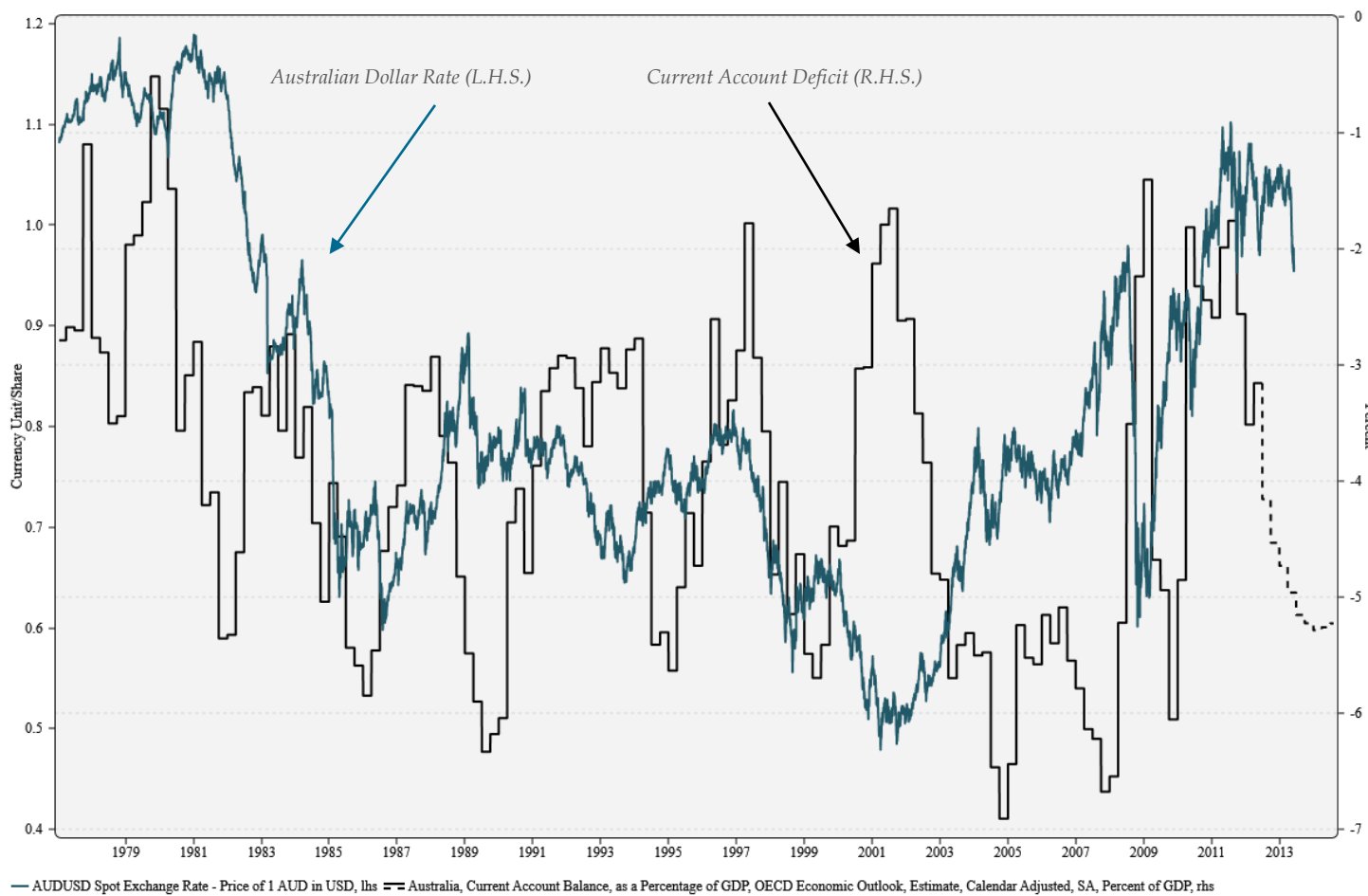


# AUSTRALIA'S SLOWING ECONOMY

Similarly, the widening current account deficit argues for a weaker currency...

*For decades, narrow current account deficits have supported the Australian dollar...*

*...but with this deficit now widening, the currency faces pressure to depreciate*



Source: Macrobond

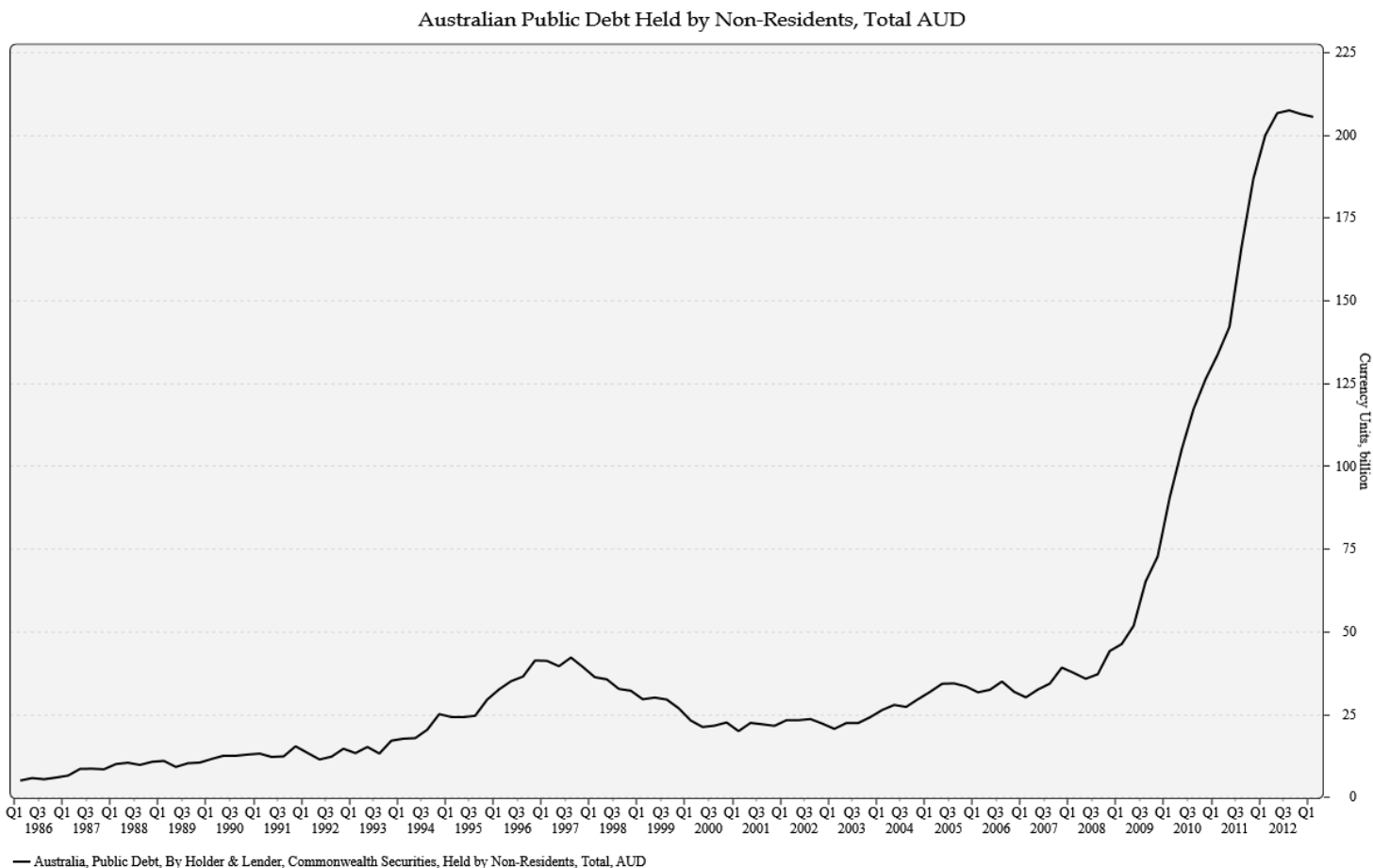


# AUSTRALIA'S SLOWING ECONOMY

The heavy participation by non-residents increases the likelihood of a larger sell-off in the currency...

*As one of the few AAA-rated countries with attractive government bond yields, foreigners have crowded into Australian debt since 2009*

*Foreign ownership of government debt has skyrocketed in the past few years*



Source: Macrobond



# AUSTRALIA'S SLOWING ECONOMY

The Australian dollar has started to weaken versus the U.S. dollar....

*Recently, the deterioration in Australia's economic data has culminated in a weaker currency*



Source: Macrobond



# AUSTRALIA'S SLOWING ECONOMY

Foreign investors who have entered the market over the past two years are now sitting on losses ...

*A recent fall in the Australian dollar has caused losses for foreign investors who entered the market over the past two years*

*Despite the AUD's decline YTD, the currency is vulnerable to an exacerbated sell-off as foreigners exit their positions*



Source: Macrobond



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