Why traders love the Aussie dollar

by David James - BRW

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An unusually popular currency, its valuation reflects both domestic performance and international influences. The Australian dollar is now the fifth-most-traded currency in the world behind the US dollar, the euro, the yen and the pound sterling.

Local providers of online platforms say currency trading has grown in popularity since the global financial crisis.

Buying or selling the Australian dollar is the second most popular trade on the books of Capital CFDs , its marketing manager Ashley Jessen says. Euro-US dollar arbitrage trades are the most popular.

“The pick-up in [foreign exchange trading] has been phenomenal," he says. “People got out of shares trading because of the sudden drops in value. They then asked where they could go. I have been surprised how fast forex trading took off.

“In 2006-07, share CFDs [contracts for difference, a leveraged form of investment] were our top product. Now it is: number one, forex, number two, indices, number three, commodities and then share CFDs, which are only 3-6 per cent of total activity. Forex is a continuous market. It only gaps about three times a year."

Smart traders know how to make money by allocating risk and reward effectively, Jessen says.

“Most traders will get it wrong 50 to 60 per cent of the time but the smart ones allocate so that they take low risk and can get high rewards," he says.

“The rewards can be high when you get on the back of a good trend, but the smart traders understand the risk-reward balance."

Companies use foreign exchange trading for different reasons. Some with large overseas operations actively trade on their foreign exchange desks to earn additional profits.
Others just hedge in an effort to reduce risk, such as Medibank Private head of treasury Graeme Sala.

“We are interested in passively hedging our overseas assets," he says. “We are not in a situation where we want to get in and out quickly. If there is an extreme event we might follow the trends. But we are not sitting at our desks hitting buttons. It is ... about risk mitigation." Sala says about 3 per cent of his forex portfolio is actively traded, using a Bloomberg portal which instantly lists before him the spot prices available from the major trading banks.

The liquidity of the forex market is a big part of its attraction, the head of research for the trading platform ForexCT , Steven Dooley , says. The move by the Australian Securities and Investment Commission in 2010 to ban short selling caused traders looking to take short positions to move away from the sharemarket in favour of currency trading and many stayed there, he adds.

These traders use the Australian dollar as a proxy for what is happening in China. Because the yuan is fixed against the greenback, traders cannot invest directly in China. “You see it any time there is important data coming out of China," he says. “The traders take Aussie dollar positions in expectation."

It is only partially true that the Australian dollar is a haven, Dooley warns. The Australian dollar reflects volatility in equity markets and commodities, so “to that extent it is a risk-sensitive currency ... But yields in the Australian bond market are tight, so that is perceived as low risk. The global perception is that Australia has a secure bond market. But when there is [fear] about the globe, investors only go into the US bond market for a safe haven".

Another reason for interest in the Australian dollar is its proximity to the Asian markets, Investment Trends senior analyst Pawel Rockiki says.

“It is also well regulated, and from a trader’s perspective the Australian currency is easy to trade and easy to link to a ‘risk on’ or ‘risk off’ call."

He says the Australian dollar will be of interest to traders who are “following the global economy with an Asian twist".

The Australian dollar's link to commodity prices is another attraction, as are the comparatively high interest rates for parked Aussie dollars.

"There is also the carry trade, where people borrow in one country where money is cheaper and invest in Australian dollars," Rockiki says.

Australia's relatively low level of government debt is also a positive factor for the Australian dollar, especially for those going long. Consultant McKinsey & Company says Australia has unusually low government debt at 22 per cent of gross domestic product, although household debt is 110 per cent of GDP and total debt is 277 per cent of GDP, just below the United States' 279 per cent of GDP.

Most of the European countries have total debt of more than 300 per cent of GDP but it tends to be excessive government debt that causes sovereign crises, not private debt. This can be seen by comparing Greek with German debt. Greece's total debt, 267 per cent of GDP, is less than Germany's total debt, whose level is 278 per cent of GDP. But Germany's government debt is only 83 per cent of GDP, whereas Greece's government debt is much higher, at 132 per cent of GDP.

Another factor determining a currency's attraction is how open its financial markets are. Japan's total debt is a massive 512 per cent of GDP, and its government debt is 226 per cent of GDP. But Japanese capital markets tend to be inward looking and most of that debt is owed internally, so it affects currency valuations less as they typically reflect cross-border investment patterns.

Perception is also crucial to how currencies perform. Greece and southern European countries are seen by the markets to be mired in unsustainable debt, a crisis that is threatening the future of the euro. But the truth is very different. The chief economist for Morgan Stanley , Gerard Minack , says Europe is not exceptionally leveraged. "The large European economies are mid-range, while Greece is the least levered economy in the sample. The euro zone is less levered than the US, UK or Japan."

Minack suggests that a crisis is looming for currencies in highly indebted economies. "There is a difficult end-game facing policymakers in all the highly levered economies. Every major Western country is heading to unsustainable public sector debt levels on current policies." Australia, which has low public debt, is clearly an exception to this and it could lead to a sustained period of currency strength.

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