

October 2010

PARITY & BEYOND

WHAT IT MEANS TO SOME

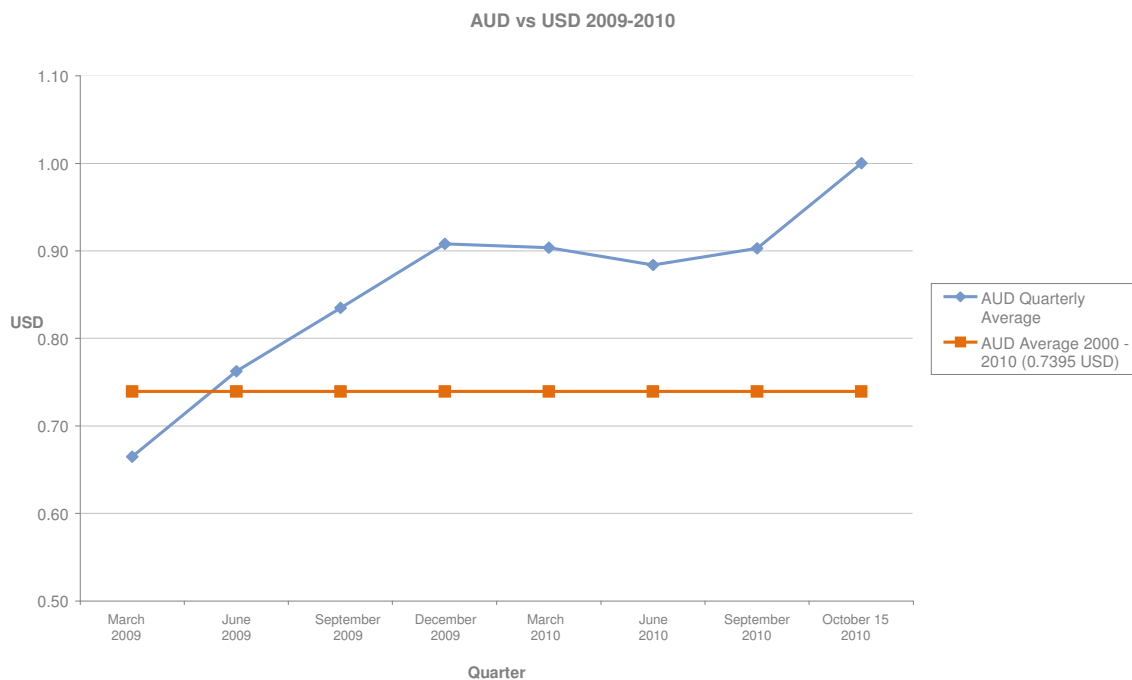
OVERVIEW

The current strength of the Australian dollar and rapid increase to reach parity with the US dollar has a vast range of implications for industries within the Australian economy, particularly if these levels are maintained or exceeded. Invariably, there will be winners and losers in such an environment.

Taylor Woodings considers the adverse impact of parity on exporters and the tourism and hospitality industries and recommends various ways to mitigate the risks of a strong Australian dollar.

UPWARD TRAJECTORY

The AUD is at its strongest since 1983, and reached parity with the USD on 15 October 2010. It is also at all time highs against other major currencies of key trading partners and inbound tourist markets such as the GBP, EUR, CHF and JPY. The upward trajectory of the AUD relative to the USD over the last two years compared with the average exchange rate since 1 January 2000 is shown in the graph below.



TOURISM AND HOSPITALITY

- As in 1989 and 2003, when a sudden structural change hit the tourism industry in the form of the pilot strike and the SARS outbreak, an “x” factor event like this exchange rate movement could severely effect the cashflows of tourism businesses.
- Revenues in the domestic tourism sector have been impacted by both:
 - A decline in inbound tourism from overseas as Australia is now regarded as a high cost travel destination; and
 - Australians choosing to travel abroad rather than domestically as a result of the relative cheaper alternatives to domestic destinations and the low cost of airline travel.
- These factors more broadly, will affect regional economies dependent upon tourism as a major source of income, including those close to the major cities.
- Declining revenues, coupled with other pressures such as rising interest rates and cautious bank lending policies, will continue to place pressure on entities in this sector.

EXPORTERS

Entities with sales denominated in overseas currencies such as the USD will continue to be adversely affected.

- Sectors such as manufacturing, farming and the wine industry have felt the adverse effects of the strength of the AUD for some time but if the strength of the AUD continues it could bite far deeper into the economy.
- Benefits derived from improved terms of trade in respect of the cost of inputs have generally not offset the effects of the strong AUD.
- Australia is now very uncompetitive on a labour rate basis to the rest of the world.

TAYLOR WOODINGS VIEW – WHAT TO DO?

Are sales revenues, contracts, pricing lists, market prices or other cash flows denominated in foreign currencies such as the USD?

- Review financial modelling and assumptions to ensure that changes in the exchange rate have been factored into the forecasting.
- If exchange rates are not directly relevant, conduct a sensitivity analysis for drops in revenue due to loss of trade.
- Make contingency plans in the event that adverse affects are felt in the medium term.
- Consider managing foreign exchange risk through hedging and seek professional advice.
- Continue to monitor the ongoing situation and adjust cost structures if necessary and where possible adjust prices.
- Incorporate re-pricing and break clauses into key contracts to ensure future erosion of margin can be passed on to customers if possible and to limit exposure to escalating costs if there is a sudden correction to the recent strength in the AUD.

More Information

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