



Issue 32:

The Australian Dollar – Overpriced?

Introduction

- The Australian dollar is near its two-year high at US\$0.797/A\$
- Recent strength in the Aussie dollar's value has widely been attributed to Australian macroeconomic and global factors:
 - The Australian unemployment figure of 5.6% in June is near its lowest point in 3.5 years
 - The Prime Minister, among others, has suggested that the RBA's new 'neutral cash rate' of 3.5% indicates a series of interest rate increases may be approaching
 - A weaker US dollar, driven by a more dovish interest rate policy from the Federal Reserve

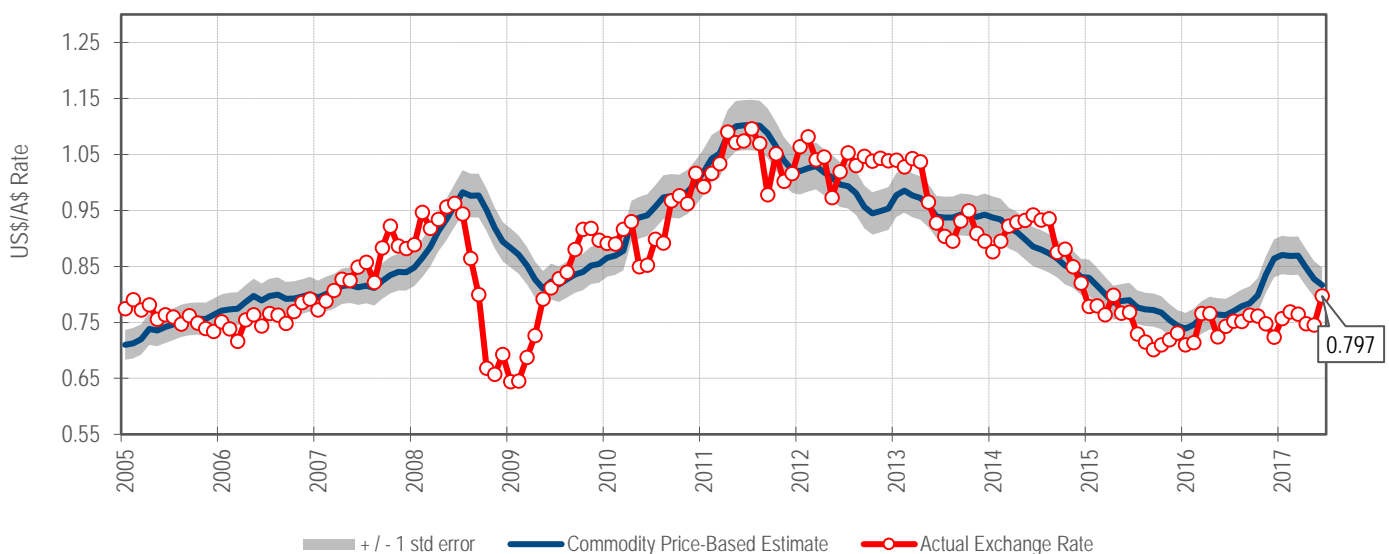
- This follows a 12-month period when the Aussie dollar stubbornly refused to follow exceptionally strong commodity prices, particularly in the bulks
- While prices for commodities are down from their Jan-May peaks, prices (and forecasts) for key commodities remain generally above their 2016 levels, bolstering the recent strength in the Aussie dollar
- The sentiment for commodities we've picked up on in conversations with miners, developers and mining service executives is on the rise, with exploration budgets increasing across commodities and junior developers finding financing for their projects (eg, Heron's Woodlawn)

Commodity Price-Based Exchange Rate Model

With commodity prices accounting for as much as 80% of the Australian dollar's movement, what do their movements imply for the Aussie dollar?

- Purely commodity-price based modelling indicates that at US\$0.797/A\$ the Aussie dollar is fairly valued and within one standard error of the predicted price

Commodity Prices	Jul 2016 Avg	High Jul 16-Now	%ch	Now	%ch
Iron Ore (US\$/t)	57	95	+66%	69	+22%
Met Coal (US\$/t)	96	314	+228%	176	+84%
LNG (US\$/mmbtu)	3.1	3.6	+17%	2.9	-4%
Therm Coal (US\$/t)	62	81	+30%	83	+34%
Gold (US\$/oz)	1,340	1,364	+2%	1,247	-7%
Crude Oil (US\$/b)	54	61	+12%	51	-6%
Alumina (US\$/t)	1,629	1,962	+20%	1,909	+17%



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