NAB Business Survey - AUD Insights

by NAB Group Economics

September Quarter 2015

National Australia Bank

- The NAB Quarterly Business Survey provides a rich source of information about Australian business, their behaviours and the environment in which they operate. In addition to the well-known questions around sales, profitability, employment and the like, one focus of the Survey revolves around currency markets.
- **In particular, firms are asked about how they are being affected by the level of the AUD, and what strategies they have employed to address currency risk.** In regard to managing currency risk, the survey delves a little deeper into the currency hedging strategies employed by business to get an idea of the degree of FX exposure they have, the time period they are hedged for and whether currently hedged positions are favourable or not.
- **Despite the degree of AUD depreciation since mid-2014, there is actually a higher proportion of firms in the survey indicating a negative impact from the current level of the AUD** (around a third of firms). While this is counter to the idea that a lower AUD will aid the economy's transition through the end of the mining boom, **this appears to largely reflect significant variation in the impact across industries** – driven primarily by a sharp deterioration reported by the wholesale sector, and to a lesser extent the retail and transport sectors . Other key sectors of the economy (such as services), appear to be largely insulated or are better off from the depreciation.
- **As the AUD has depreciated, firms appear to have become even more focussed on hedging and import substitution, as opposed to greater cost cutting (e.g. downsizing). By far the most common strategy remains currency hedging.** Hedging behaviours tend to vary notably between exporters and importers in the survey. **In particular, currency depreciation over recent years appears to be having the greatest impact on exporter hedging**, with these firms electing to hedge a growing share of their exposure (32% in Q3 2015 compared with 24% in Q1 2013). Yet, at the same time they are also reducing the average hedge tenor (almost 8 months in Q3 2015 compared to almost 10 months in Q1 2013) (see page 4 for further discussion). In contrast, **importers have kept a fairly constant share of their FX exposures hedged in recent quarters** (35%), although this is below the levels seen back in 2013 (around 40%).
- Interestingly, **larger export firms** have increased their FX exposures that are hedged markedly in recent quarters, to over 40% in Q3 2015 (compared to 27% in Q1 2014). **Medium exporters** have pulled back after a big increase over 2014. The proportion of FX exposures hedged by importers has been relatively steady across all firm sizes in recent quarters (see p8).

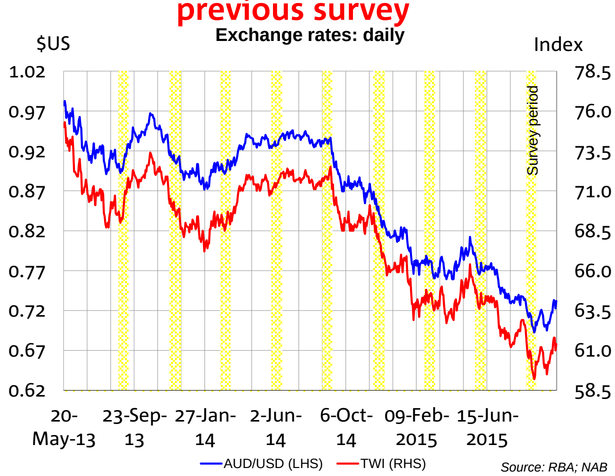
Contents

For more information contact: James Glenn, Senior Economist: (03) 9208 8129 or Riki Polygenis, Head of Australian Economics (03) 8697 9534

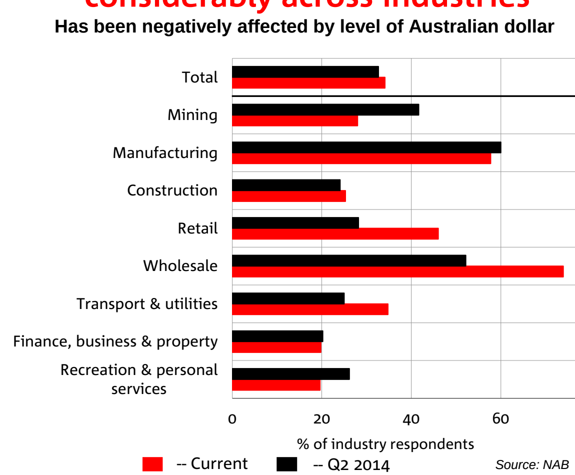
Business & the AUD

- In NAB's Quarterly Business Survey, we have asked businesses how they have been affected by the level of the Australian dollar, and what strategies they have been using to mitigate the negative impacts. The interviews for this question were conducted between 24 August and 9 September, when the exchange rate averaged $US 0.71 and 60.3 on a TWI basis. These levels are below those seen during the June survey period ($US 0.77 and 64.2 on a TWI basis) and below current rates (around $US 0.73).
- **According to the survey, around a third of non-farm businesses reported an adverse impact from the AUD.** This is up from Q2 2015, which is somewhat surprising given the lower level of the AUD since the last survey (although there has been a reasonable degree of currency volatility during the period). The share of firms reporting an adverse impact is also higher than in the June quarter 2014 when the AUD was valued much higher (see middle chart below).
- **The industry break-down gives some indication as to why this might be the case.** In particular, much of the deterioration seems to stem from industries including wholesale, retail and transport, all of which have firms that could potentially have a high degree of import reliance – or have become more reliant on imports as a result of the elevated AUD in recent years. It is still wholesale and manufacturing that have the highest proportion of firms reporting an adverse impact from the current level of the AUD, although manufacturing has improved, while service sectors appear to be most insulated, which could reflect less import competition and few foreign input costs. Mining and personal services appear to have experienced the greatest benefit (fall in the index) from AUD depreciation since mid-2014.
- **In terms of how businesses are responding to the negative effects, firms appear to have become even more focused on hedging and import substitution as the AUD has depreciated, as opposed to greater cost cutting (e.g. downsizing). Hedging remains by far the most common strategy employed (and rose further this quarter).** Retail has the highest share of firms uncertain about what strategies to employ to manage currency risk, although firms in most industries appear to be more uncertain compared to last quarter).

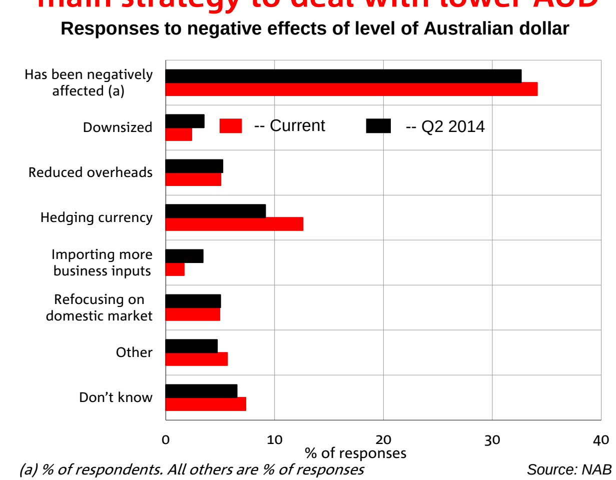
Exchange rate has fallen since the previous survey



Impact of lower AUD varies considerably across industries



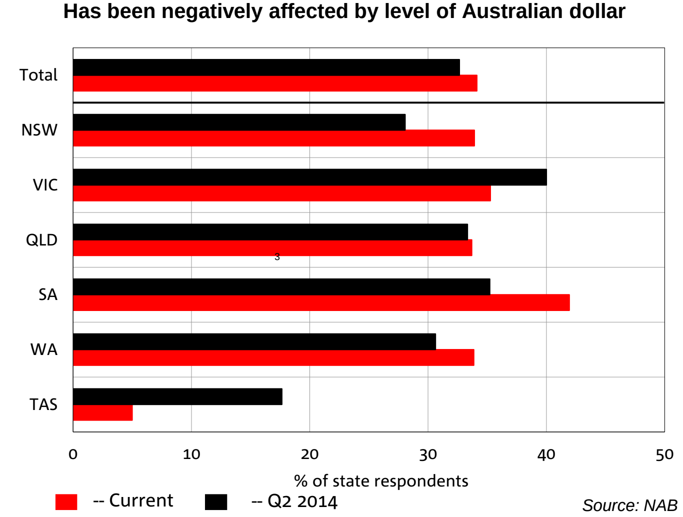
Hedging and import substitution are main strategy to deal with lower AUD



Business & the AUD (cont.)

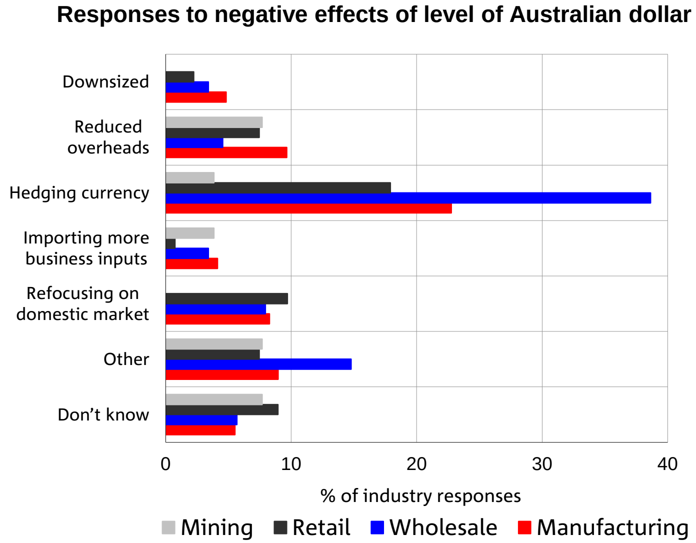
- Hedging was important for wholesalers, manufacturers and retailers, but while this is the most common strategy for most industries, mining and construction were exceptions. Downsizing was the most common strategy used by construction firms, while miners chose to focus on reducing overheads and ‘other’ strategies.
- Negative exchange rate effects are mixed across the mainland states, although most showed a deterioration from mid last year. Victoria was the main exception for the mainland states, but still recorded the second highest negative impact – consistent with the larger manufacturing base. South Australia reported the biggest increase in the share of firms negatively affected by the AUD and now has the highest overall proportion.
- It is surprising that NSW has not seen the same sort of improvement as Victoria given the diverse industry mix, while Queensland and WA do not appear to have improved despite the clear benefits of a lower AUD for commodity exporters and tourism.

Impact of $A mixed across states

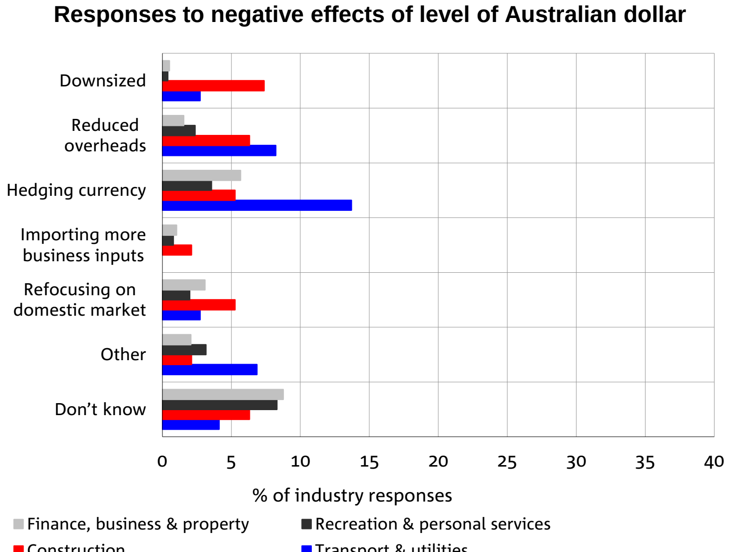


Source: NAB

Most industries see hedging as preferred currency strategy (not in mining and construction)



Source: NAB

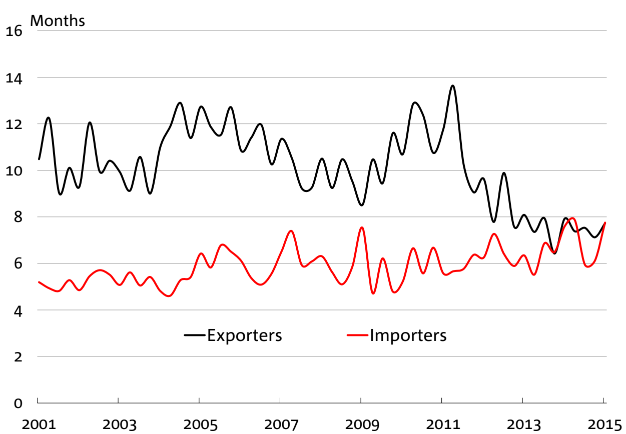


Source: NAB

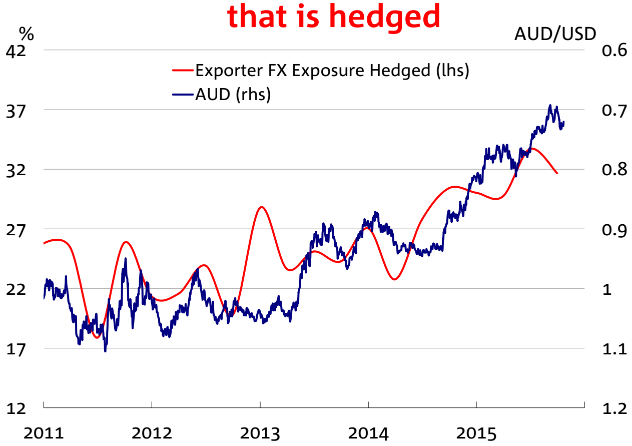
AUD Hedging Activity

- Given the importance of hedging strategies in managing currency risk, the NAB Business Survey also asks firms to provide additional detail about their current hedging positions
- **In Q3 2015, firms that considered themselves primarily engaged in exporting kept their currency hedging near the highest level since at least 2001.** This is perhaps a little surprising given AUD depreciation against the USD during the survey period and our expectation that it could depreciate further as the US approaches 'lift-off' for interest rates – although the timing for this is hotly debated. Heightened uncertainty over emerging economies – especially at the time the survey was undertaken – is also significant given the AUD's status as a proxy for these economies. **But while exporters are increasing the proportion of the FX exposures that are hedged, they have reduced their average hedge tenor (shown in months below) from the elevated levels seen back in 2011 – although this has been stable for a couple of years now.** Exporters have gone from hedging for more than a year ahead on average back in 2011, to a little less than 8 months currently.
- Importers have traditionally reported a higher degree of hedging, consistent with the underlying strength of the currency in the spot market over much of the period. However, **the proportion of FX exposure that has been hedged by importers has been surprising steady in recent quarters and a little below the levels seen of recent years** – although the number of months ahead importers are hedged has trended gradually higher.
- Interestingly, **larger export firms** have increased their FX exposures that are hedged markedly in recent quarters, to over 40% in Q3 2015 (compared to 27% in Q1 2014). **Medium exporters** have pulled back after a big increase over 2014. The proportion of FX exposures hedged by importers has been relatively steady across all firm sizes in recent quarters (see p8)

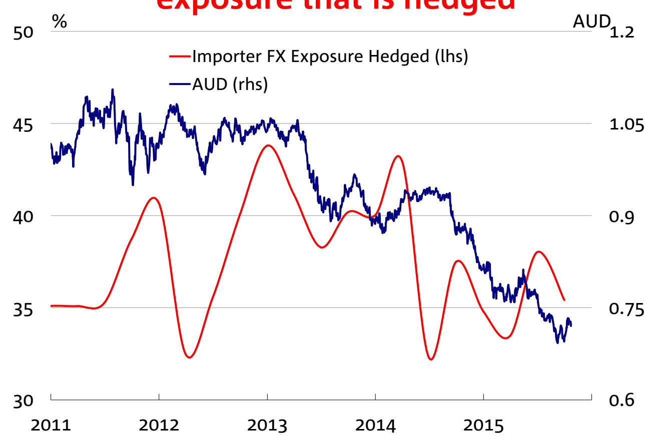
Average hedge tenor – number of months out firms are hedged



Proportion of exporter FX exposure that is hedged



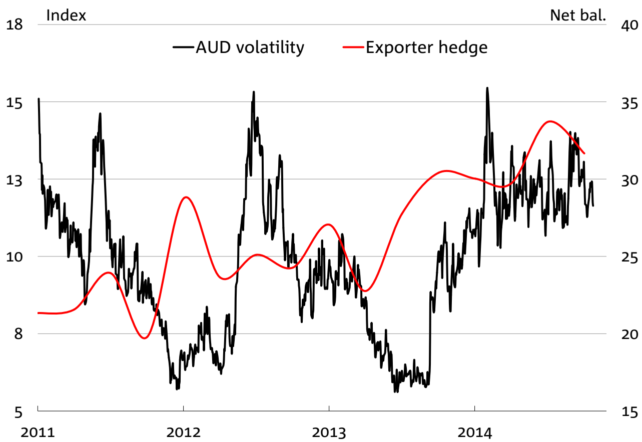
Proportion of importer FX exposure that is hedged



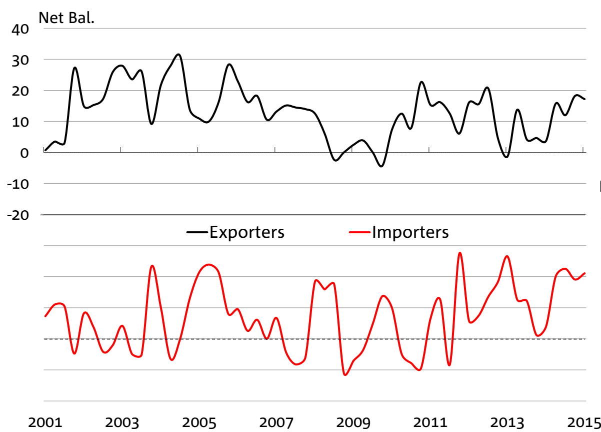
AUD Hedging Activity

- These results suggest a number of things about hedging behaviour of Australian firm's. **The tendency for exporters to hedge more of their FX exposures as the AUD depreciates suggests that firms are protecting against the risk that current levels of the AUD are temporary, and that a bounce back in the AUD could occur.** (If on the other hand firms were strongly convinced of further depreciation (which bolters export earnings), the proportion of FX exposures hedged would actually fall.) **Exporters may also be protecting against volatility, given the notable increase in fx volatility in recent years**
- **For importers, the response to AUD depreciation is less clear. Compared to when the AUD was above parity with the USD, importers are now hedging a smaller share of their exposure.** This may suggest that importers are being more opportunistic and waiting for the AUD to bounce before re-entering hedging positions. It may also imply that many importers are not expecting further AUD depreciation, although the proportion hedged has trended modestly higher from last year's low, perhaps suggesting some increasing degree of concern about further depreciation.
- For the most part, firms feel that their current hedge positions are favourable, and have been improving as the AUD depreciates. Our index of firms favourable hedging positions (a net balance) suggests that both exporters and importers held significantly more favourable FX positions in Q3 than in previous quarters. This seems somewhat counter-intuitive for exporters in particular, given many hedges have been taken out at higher AUD levels than the current spot rate – they may be favourable however when compared with firms' budgeted levels.
- This outcome differs from past experience when exporters tended to be unhappy with their hedged positions following sharp AUD depreciations. In contrast, importers are unhappy when there is a particularly sharp appreciation. One interesting observation is that importers tend to be unhappy more frequently than exporters, which could suggest that importers are worse at predicting AUD trends – a possible consequence of trend AUD appreciation since the start of the millenium?

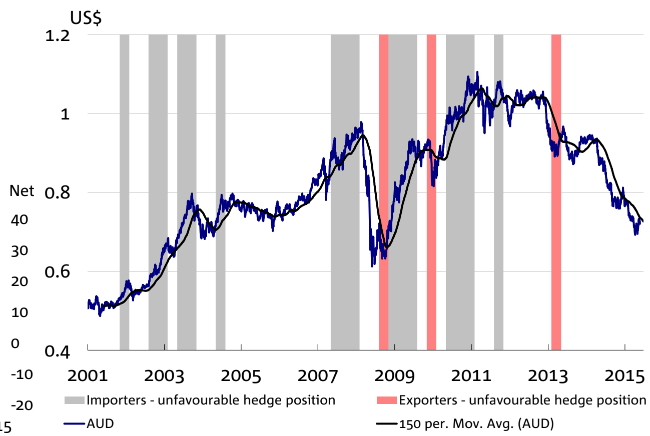
Hedging has increased along with AUD volatility



Hedging positions were much more favourable in Q4



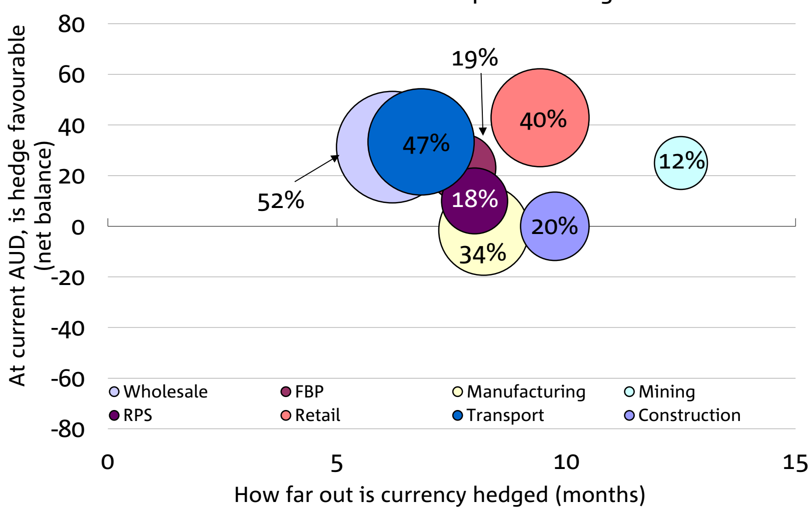
Importers unhappy about their hedging positions much more often than exporters



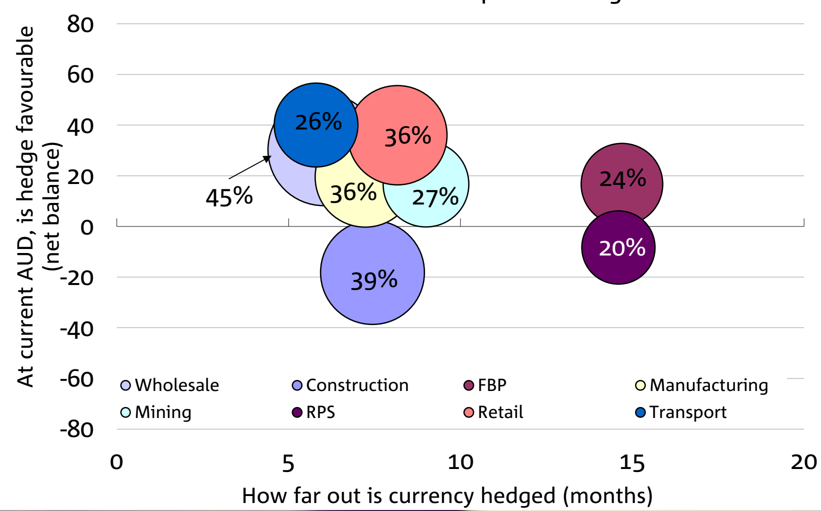
Australian foreign currency exposure and hedging practices.

- Firms responses to the survey questions on hedging practices can vary significantly depending on which industry they are primarily engaged in – although it should be noted that survey sample sizes also vary greatly by industry. In Q3 2015, wholesale export and import firms had the largest proportion of FX exposure hedged, consistent with indications above (p2) that this industry is particularly (negatively) affected by the AUD at current levels.
- Exporters in retail and transport reported the most favourable hedge positions in Q3, while manufacturing was the worst – although the manufacturing index has been relatively volatile and fell sharply in the quarter. Importers in transport and retail had the most favourable positions, while construction was one of the worst.
- Most firms tend to only hedge for a period less than a year ahead, reflecting the uncertainty of transactions further out. Firms in industries with durable and homogenous good and engage in long-term contracts (eg. mining) will sometimes hedge for longer periods.

NAB Survey - Exporter Hedge Positions
Bubble size = % of AUD exposure hedged



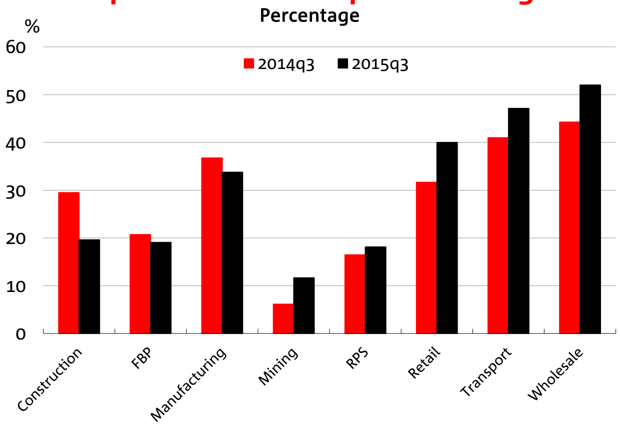
NAB Survey - Importer Hedge Positions
Bubble size = % of AUD exposure hedged



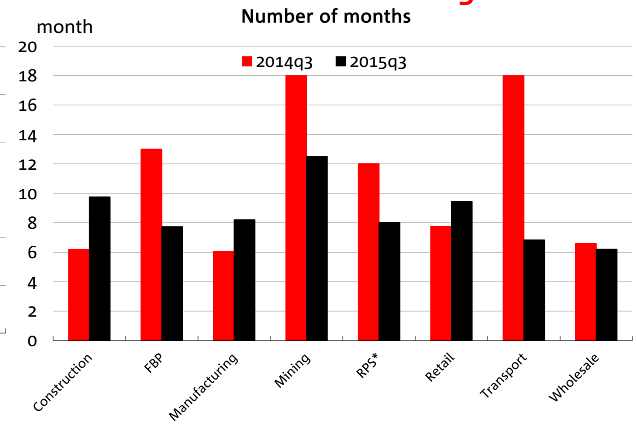
Details: Currency hedging by industry

Exporting firms by industry*

Proportion of FX exposure hedged

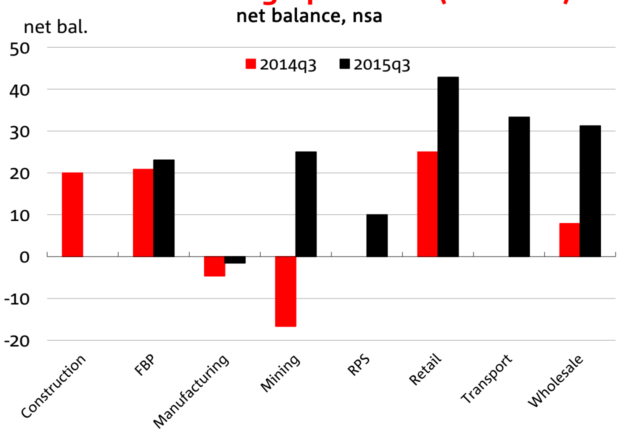


Number of months hedged



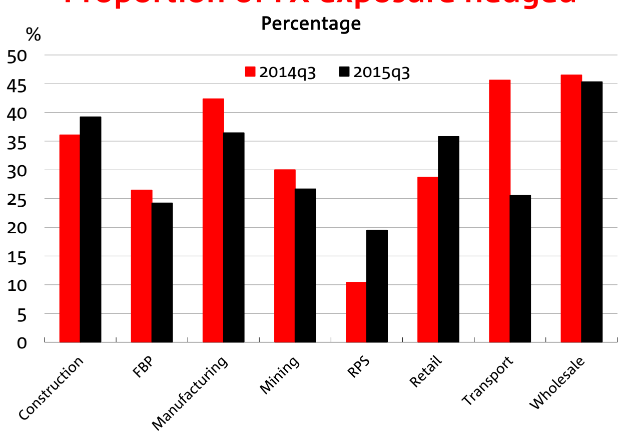
*Some data unavailable

Favourable hedge position (net bal.)

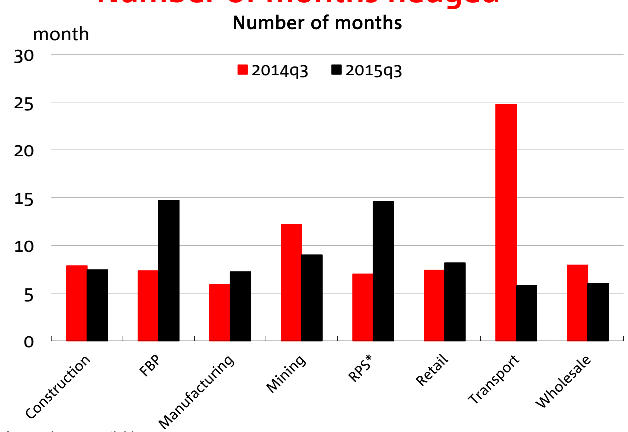


Importers – larger firms hedge more, but have pulled back recently*

Proportion of FX exposure hedged

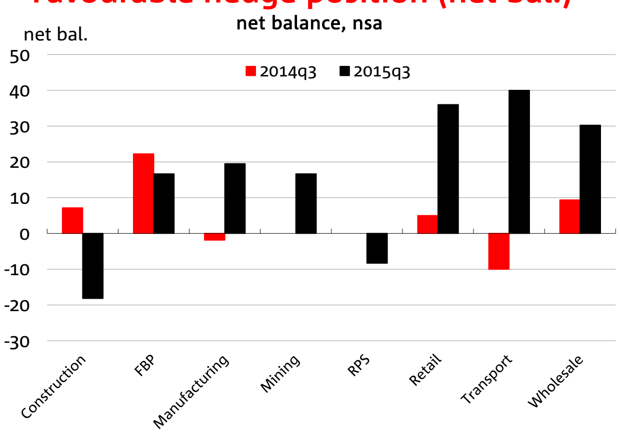


Number of months hedged



*Some data unavailable

Favourable hedge position (net bal.)

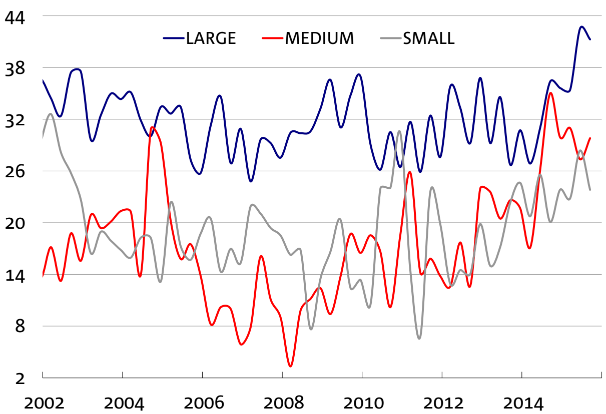


*FBP = Finanace/ business/ property services; RPS = Recreation & personal services

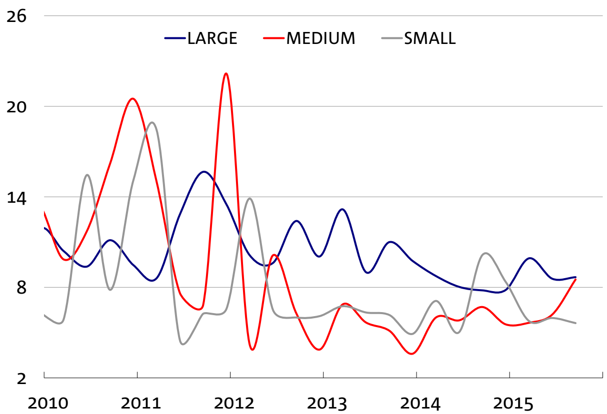
Details: Currency hedging by firm (employment) size

Exporters – larger firms tend to be more hedged, although the gap has narrowed

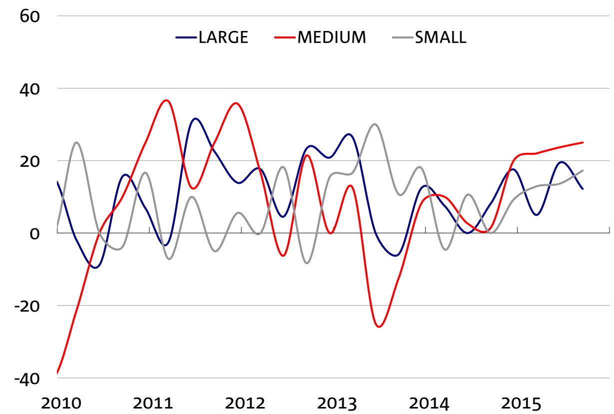
Proportion of FX exposure hedged



Number of months hedged

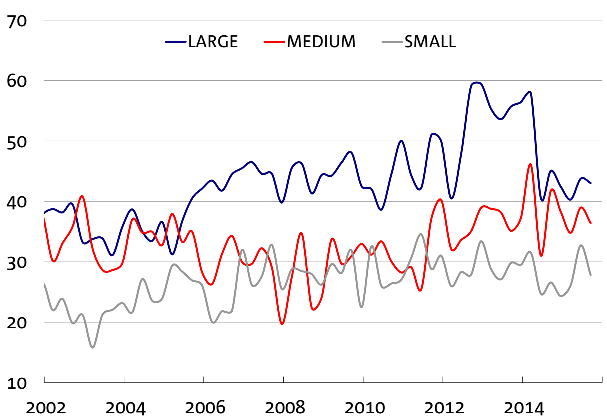


Favourable hedge position (net bal.)

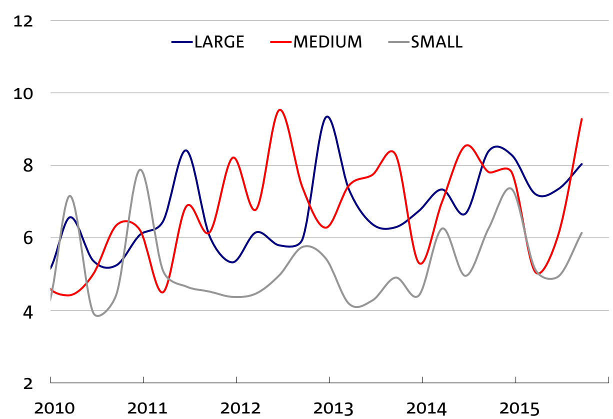


Importers – larger firms hedge more, but have pulled back recently

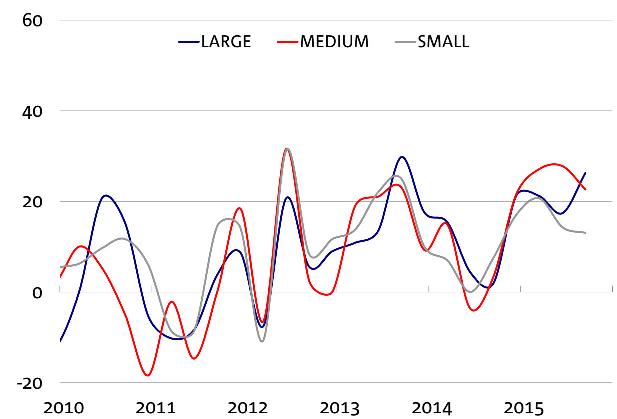
Proportion of FX exposure hedged



Number of months hedged



Favourable hedge position (net bal.)



Group Economics
Alan Oster
Group Chief Economist
+61 3 8634 2927

Jacqui Brand
Personal Assistant
+61 3 8634 2181

Australian Economics and Commodities
Riki Polygenis
Head of Australian Economics
+(61 3) 8697 9534

James Glenn
Senior Economist – Australia
+(61 3) 9208 8129

Vyanne Lai
Economist – Australia
+(61 3) 8634 0198

Amy Li
Economist – Australia
+(61 3) 8634 1563

Phin Ziebell
Economist – Agribusiness
+(61 4) 75 940 662

Industry Analysis
Dean Pearson
Head of Industry Analysis
+(61 3) 8634 2331

Robert De Iure
Senior Economist – Industry Analysis
+(61 3) 8634 4611

Brien McDonald
Senior Economist – Industry Analysis
+(61 3) 8634 3837

Karla Bulauan
Economist – Industry Analysis
+(61 3) 86414028

International Economics
Tom Taylor
Head of Economics, International
+61 3 8634 1883

Tony Kelly
Senior Economist – International
+(61 3) 9208 5049

Gerard Burg
Senior Economist – Asia
+(61 3) 8634 2788

John Sharma
Economist – Sovereign Risk
+(61 3) 8634 4514

Global Markets Research
Peter Jolly
Global Head of Research
+61 2 9237 1406

Australia
Economics
Ivan Colhoun
Chief Economist, Markets
+61 2 9237 1836

David de Garis
Senior Economist
+61 3 8641 3045

Tapas Strickland
Economist
+61 2 9237 1980

FX Strategy
Ray Attrill
Global Co-Head of FX Strategy
+61 2 9237 1848

Rodrigo Catril
Senior Currency Strategist
+61 2 9293 7109

Interest Rate Strategy
Skye Masters
Head of Interest Rate Strategy
+61 2 9295 1196

Credit Research
Michael Bush
Head of Credit Research
+61 3 8641 0575

Simon Fletcher
Senior Credit Analyst – FI
+61 29237 1076

Distribution
Barbara Leong
Research Production Manager
+61 2 9237 8151

New Zealand
Stephen Toplis
Head of Research, NZ
+64 4 474 6905

Craig Ebert
Senior Economist
+64 4 474 6799

Doug Steel
Markets Economist
+64 4 474 6923

Kymberly Martin
Senior Market Strategist
+64 4 924 7654

Raiko Shareef
Currency Strategist
+64 4 924 7652

Yvonne Liew
Publications & Web Administrator
+64 4 474 9771

Asia
Christy Tan
Head of Markets Strategy/Research, Asia,
+ 852 2822 5350

UK/Europe
Nick Parsons
Head of Research, UK/Europe,
and Global Co-Head of FX Strategy
+ 44207710 2993

Gavin Friend
Senior Markets Strategist
+44 207 710 2155

Derek Allassani
Research Production Manager
+44 207 710 1532