Keeping a Lowe profile

Australia's top central banker will need to mind his language at a pivotal event this weekend, writes **Michael Heath**

AS Reserve Bank governor Philip Lowe jets into the US this weekend to discuss a global economy increasingly buffeted by presidential tweets, he'll want to have his messaging right to avoid upsetting one of the few metrics moving his way.

The Australian dollar has dropped almost 17 per cent against the greenback since early last year, reaffirming its role as a key economic shield from shocks that have ranged from the 1997-98 Asian financial crisis to the 2008 global meltdown.

Yet with US President Donald Trump urging his nation's central bank to slash interest rates and weaken the greenback, that traditional cushion could be at risk.

"When global economic growth slows and when US-China trade tensions escalate, the US dollar typically strengthens," Commonwealth Bank chief currency and rates strategist Richard Grace said.

The Aussie would likely fall further if not for expectations of the US Federal Reserve cutting rates by another 0.75 percentage points by mid-2020, narrowing the gap between Australia and US rates "and generating some extra support for global economic growth".

FRONT FOOT

Australia has shown itself an early mover in the new global easing cycle — cutting rates in June and again last month to an all-time low of 1 per cent — in what is looking increasingly like a race to the bottom.

Those reductions helped push the Aussie dollar to a 10-year low.

That has lifted the competitiveness of exporters and import-competing industries at a time when the economy has decelerated sharply.

Dr Lowe will need to choose his words wisely when he speaks on a panel at the annual conference of central bankers in Jackson Hole, Wyoming, this weekend.

The RBA is broadly forecast to cut the cash rate twice more by early next year, but the governor has signalled he's on hold for now as he waits to see how the back-to-back cuts play out.

Any suggestion from him of a longer pause could spark a jump in the Aussie come Monday.

At its meeting on August 6, according to minutes released this week, the RBA board spent some time discussing global currency markets, highlighting their increased volatility in response to the US-China economic confrontation.

"In particular, the yen had appreciated against the US dollar while the Chinese yuan had depreciated," the minutes said.

"Members took note of the market commentary that the US and Japanese authorities could intervene in an effort to lower the value of their currencies."

If major banks did try to depreciate their currencies, the Aussie dollar would probably rise in response.

In the meantime, it is finding a degree of support from a dramatic improvement in Australia's current account.

The current account could record its first surplus — meaning that broadly, the value of exported goods and services is bigger than the amount the nation spends importing goods and services — for the first time since 1975 in figures due on September 3.

SUPPORT ACT

CBA analysts believe that in the next couple of years the current account will average a deficit of just 0.2 per cent of the economy, measured by gross domestic product.

That compares with 4.2 per cent over the past three decades.

"The structural improvement in Australia's current account deficit is a major supporting valuation factor for the Australian dollar," Mr Grace said.

A spike in the price of iron ore, Australia's biggest export, has also brought a huge windfall on the trade side.

Still, the second quarter could prove to deliver a peak as Brazil's supply problems are resolved and Chinese mills scale back output, with iron ore futures falling through $US80 a tonne after having hit $US120 about mid year.

With the RBA's cash rate forecast to fall to 0.5 per cent, the scope for local banks to pass on any further cuts will be crimped unless Dr Lowe opts for unconventional measures.

Either way, the currency is likely to prove an ever more important monetary policy channel for the RBA in the period ahead.

Analysts believe that if the past is any guide, the Aussie will keep falling and pull the economy through, allowing Australia to extend its 28-year run without recession.

BLOOMBERG

Primed for tough run

MEDIA

PRIME Media is back in the black but the regional broadcaster tips a fall in earnings over the coming years.

The group yesterday reported a net profit for the year to June of $7.4 million — a turnaround from the $12.28 million in the red the previous year.

But advertising revenue fell 4.7 per cent as gains from the federal election fell short of those from the Commonwealth Games a year earlier.

Prime's revenue in regional Victoria and New South Wales fell 5 per cent, compared with a market decline of 4.1 per cent.

The Seven Network affiliate said earnings before interest, tax, depreciation and amortisation fell 14.8 per cent to $38.47 million. It expects earnings of $23 million to $25 million this financial year

Prime wrote $14 million off the value of its TV licences and other assets. Prime shares fell 5 per cent, or 1c, yesterday to 19c.

BWX aces doubters

COSMETICS

A BETTER-than-expected result from the company behind Sukin skincare products has stung short sellers.

BWX shares surged 29 per cent yesterday after the Melbourne-based company met its full-year earnings forecast and predicted solid sales growth.

Short sellers make money when the price of a stock falls. If they no longer think that will happen, they buy the stock to close out their positions, pushing the price higher.

Yesterday, BWX delivered a net profit for the year to June of $9.5 million, down 70 per cent. But it posted $21.3 million in underlying earnings — which strips out one-offs — meeting its updated forecast.

New chief executive David Fenlon said the company had "a clear strategic road map to deliver a turnaround". Shares in BWX rocketed 28.8 per cent to close at $3.

There is danger in expecting low rates to last

SHORT CUT

ROGER MONTGOMERY

CONSENSUAL hallucination is the phrase being attached to some of the absurd market valuations now being achieved by profitless companies.

Cheap and abundant capital remains the fuel for the willingness to bet on the fortunes of start-ups, most of which will never make it.

The danger of low short-term rates lies in the investor's willingness to believe they will last forever.

Buying a long-duration asset like shares or a property because rates are low in the short term can be a dangerous proposition. We can see this in the chase for relative yields.

I have frequently written about the dangers of chasing relative yields and I have warned investors in the past when it has been most dangerous, for example when Telstra was bid up to $6.60 in January 2015.

The danger today is that investors are only looking at central banks for their guidance on interest rates, when the market can also set rates through credit spreads.

We often highlight the US High Yield spread chart from the St Louis Federal Reserve, which shows how quickly spreads can spike.

And don't forget, if the population of high net worth investors have bought shares in companies before initial public offerings through private equity funds, who is left to buy the shares when those companies actually float on the stock market?

A concentration of money in a similar theme has always preceded a significant correction.

While markets remain buoyed by low interest rates, investors need to remember the October-to-December 2018 sell-off when bond rates climbed.

In the past week, Boston Fed president Eric Rosengren signalled he was unwilling to support further rate cuts.

He noted US economic conditions including unemployment were solid, inflation was heading towards the 2 per cent target and that further cuts could trigger a worrying increase in debt and risk. He also added current monetary and fiscal policy was "accommodative".

Elsewhere, McKinsey has warned that "ominous" signs of a repeat of the Asian debt crisis are appearing.

The consulting firm analysed the balance sheets of more than 23,000 Asia Pacific companies and concluded most face "significant stress" in servicing their debts.

They noted that in China, India and Indonesia, more than a quarter of long-term debt in 2017 was held by companies showing interest cover of less than 1.5 times.

The interest coverage ratio is used by analysts and accountants to determine how easily a company can pay its interest expenses on outstanding debt.

The ratio is calculated by dividing a company's earnings before interest and taxes by the company's interest expenses for the same period.

If the ratio is only 1.5 times, a significant decline in debt is required lest a drop in revenues or an increase in operating costs or interest rates triggers insolvency.

Finally, BHP this week posted its biggest annual profit in five years and record dividends, but chief executive Andrew Mackenzie noted that global headwinds, such as slowing Chinese steel demand, and softening global economic growth could adversely impact demand next year.

Some analysts are suggesting capital returns from BHP have peaked due to rising costs and capital expenditure, as well as lower commodity prices and a decline in revenues from asset sales.

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