Report on justifying my aud usd short position

Business, Marketing

For this assignment, I followed the international financial markets in the period December 19-30, 2011. After analyzing a large volume of information, I made a decision to go short the Australian dollar against the US dollar. Here I offer you my reasoning.

My decision revolves around four reasons, which, in order of significance, are:

the slowdown of the Chinese economy and its effect on commodity prices;

the European sovereign debt crisis and its effects on the global economy;

the possibility of a housing bubble popping in Australia;

the historically high level at which the AUD trades against the USD.

The first reason, which may very well be considered the most important one or at par with the European debt crisis, is the slowdown of the Chinese economy. On December 30, 2011, the Financial Times reported that, " Commodities markets posted their first annual fall since 2008 as they faced headwinds from the European sovereign debt crisis and weaker growth in China." Discussion is ongoing whether there will be a soft or a hard landing, but the general sentiment is that the Chinese economy is slowing down. Some point to a housing bubble as a possible threat, others – local governments' debt. Irrespective of the cause, a slowdown in China's growth will have a large impact on the commodities market and as a Wealth Creator article put it, " In very simple terms, China is the world's biggest manufacturing producer, America is the world's biggest consumer and Australia is the world's biggest mine." This, if China starts buying less Australian coal and iron ore, there will be major negative effects on the Australian economy and currency.

The other big issue is Europe's sovereign debt crisis, which too has been mentioned in the Financial Times article. The second half of 2011 was extremely volatile with different European countries veering on the edge of default. Problems in Europe can easily spread around the world and negatively affect the global economy, especially considering the slow pace of recovery everywhere. Should any government defaults or other economically destabilizing events occur, Australia's commodity-based economy would be one of the hardest hit by one such return to recessionary conditions.

Another lurking danger for the Australian economy, its financial system and its currency is the hot housing market. The Economist house-price indicators published on November 24, 2011 in an article titled " Clicks and mortar," indicate that house prices in Australia have risen 150% since 1975. This compares with about 20% for the USA. Furthermore, house prices have increased 60% against average income over the same period, while they have declined over 30% in the US (largely thanks to the burst of the US housing bubble in 2008-2009). I have reproduced these two graphs below.

The last factor in my decision to short the AUD/USD was the historically high level at which it currently is, as seen on this graph provided by Google Finance:

I believe, and I think it is common sense, that what goes up must come down and there is no clearer evidence of the historical high of the AUD/USD exchange rate than the chart above. The Australian dollar has surpassed the pre-crisis level. The huge cap in 2008-2009 very well illustrates what could happen should any of the aforementioned scenarios come to fruition. But even if no major blowup occurs, global growth will most probably be slow in 2012 and this does not bode well for a large commodity producer as Australia. This is why I consider a short position in the AUD/USD pair a very reasonable bet for the coming year.

Works Cited

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