



**BANCORP**

BANCORP TREASURY SERVICES LIMITED

**Barrington**  
TREASURY SERVICES

---

# TREASURY

---

# TRENDS

---

ISSUE 380

15 November 2011 | [www.bancorptreasury.com](http://www.bancorptreasury.com)

## HOW DO YOU RATE?

*When it is obvious that the goals cannot be reached, don't adjust the goals, adjust the action steps.* **Confucius**

---

### Looking back

Heightened economic uncertainty and increased market volatility over the past year have sharpened the minds of company Boards and senior executives about the importance of treasury risk management. As a result, Boards and management have taken greater ownership of the key governance aspects of treasury risk management, specifically policy, enterprise-wide communication, reporting and risk management practices, while risk managers have prioritised key aspects and taken advantage of enhancements in technology. Importantly, the ranking of cash and liquidity risk as the most important aspect of treasury risk management has not changed.

Recent surveys have reinforced the importance of the essential issues and have brought some more sensitive issues to the forefront. Now, treasury risk managers rank issues in the order of importance as follows:

- Cash and liquidity risk
- Holistic view of risk
- Interest rate risk
- Foreign exchange risk
- Operational risk

Cash and liquidity risk management has retained its top spot and the monitoring of a number of aspects of cash and liquidity management has been strengthened. There is an increased level of Board involvement in setting and reviewing treasury policies and understanding of financial exposures and treasury products.

The majority of respondents in one survey reported significant changes in the composition of policies towards liquidity and debt, for example requiring minimum liquidity levels and a diversification of borrowing sources and debt maturities against a background strategy of deleveraging. There is also increasing recognition of the importance of managing treasury risks to the health and survival of the entire organisation.

An increasing number of organisations are tying treasury risk management into the organisation as a whole. This has resulted in organisations finding better ways to work within business units and with external parties, such as trading partners and bank counterparties.

Many treasury risk managers are still dissatisfied with the quality of information received from business units but the application of better technology and monitoring actual against forecasted cashflows have enhanced the effectiveness of cash and liquidity risk management.

As would be expected with heightened market volatility in the three years since the Global Financial Crisis erupted with the collapse of Lehman Brothers in September 2008, there has been an increased focus on managing interest rate, foreign exchange and commodity risks. This has resulted in better governance and enhanced reporting of interest rate and foreign exchange exposures and hedging instruments and an increased understanding by Boards of the hedging instruments approved and used.

Survey respondents also reported that the treasury risk management function was playing a greater strategic advisory role rather than acting in a solely risk management capacity.

---

### How do you rate?

How would your organisation react to having an uncharacteristic or unexplained treasury related loss splashed in the media?

Over the past year, several public reporting entities have had the spotlight turned on substantial and possibly embarrassing losses on hedging instruments. Mostly these losses have come about following bad risk management decisions, either because the organisation did not know or understand the exposures properly, the wrong hedging instruments were chosen, there was a loss of vision or there was bad risk management advice (internal or external).

Essentially, the offending and often embarrassed organisations forgot that treasury risk management (hedging) is meant to achieve certainty of cash flows, margins, revenues and costs and to protect the value of assets and liabilities.

Key questions to be asked are:

- How open and healthy is the relationship between the organisation's governance managers (Board) and risk managers (Executive)?
- How much of an enterprise-wide role do the managers of treasury-related risks have?

**Continued on back page**

# AUSTRALASIA ECONOMY & MARKETS

## 2011 – a challenging year

Whichever side of the Tasman Sea you live on, 2011 has been a difficult and challenging year. Economic developments in the US and Europe have driven sentiment, leading to higher levels of volatility in all markets: commodities, equities, currencies and interest rates.

In Australia the sharemarket's ASX200 has declined by 13% since April, this despite the fact that the RBA's commodity price index has risen by 5% in AUD terms over the corresponding period. The slowing economy led the RBA to cut the cash rate by 25 basis points to 4.50% in November, noting that "*confidence [was] subdued outside of the resources sector.*" Certainly the 'mining versus non mining' phrase has been a recurrent one in 2011, with retail and tourism especially hard hit sectors.

Neither has New Zealand been immune to the hardships faced by many other countries. The Christchurch earthquake resulted in the RBNZ initiating an emergency 50 basis point cut in the Official Cash Rate in March, while a longer term consequence of the tragedy will be the effect on the government's finances with bigger deficits and increases in debt-to-GDP forecast over the next few years. The ANZ Commodity Price Index has fallen 7.9% since it peaked in May. A large part of this relates to dairy prices, with Fonterra's twice monthly auctions recording falls in eight of the last nine auctions, leading the dairy giant to cut its forecast payout to farmers to between \$6.70 and \$6.80.

## Looking ahead

The European sovereign debt crisis dominated the news in the second half of the year in particular, and will continue to have a big influence on global economic sentiment and growth. Also lurking in the background but conveniently forgotten lately courtesy of the Greece/European debt crisis is the 'elephant in the room' that is the US government's debt mountain, now USD14.98 trillion and climbing.

But for Australia and New Zealand the challenges ahead will probably be less formidable than for many other countries, largely due to the 'China factor'. Chinese GDP growth, currently 9.1% p.a., is forecast to fall but the government target in the period 2011 to 2015 is still a very respectable 7.0%. China is Australia's number one export destination and New Zealand's number two behind Australia. Thus both countries' reliance on China will insulate them somewhat from a projected continuation of the economic slowdown in many other parts of the world.

## The problems and the lessons from 2011

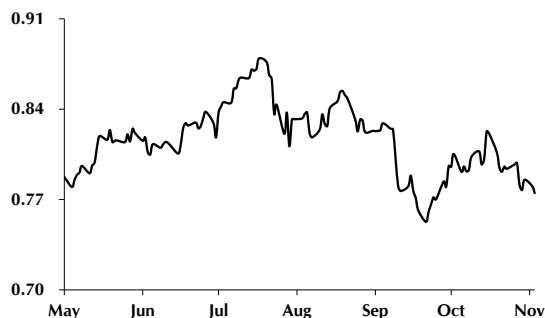
Two major problems have faced those businesses with treasury risks this year. One is the heightened level of volatility in markets, where sentiment and thus pricing has regularly changed on a daily basis. The other is that the global slowdown has led to forecast exposures having to be revised.

When the two factors are put together the result is often a toxic mix – so much so that it has been commented on by a number of listed public companies when the annual results have been released. From one company "*The benefits of a rapidly appreciating AUD against the USD were favourable to input costs*" but "*these benefits were more than offset by the company's hedging losses.*" Another company in announcing its annual result reported a NZD29.27 million loss on the value of forward foreign currency contracts.

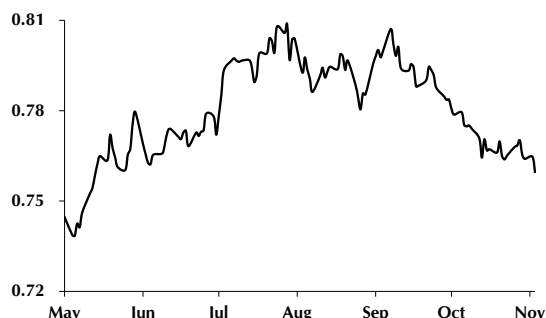
One lesson is the danger of relying on forecasting financial market prices as the basis for making risk management decisions. Who predicted the NZD/USD to fall 15% over a two month period or the AUD/USD to drop by 10% over a five week period? Likewise in the debt markets in New Zealand, who expected interest rates to stay lower for longer as first the earthquake and then the sovereign debt crisis drove market sentiment?

Secondly the year's events demonstrate the absolute necessity to be sure of one's exposures before any risk management (hedging) decisions are made. Slowing export sales coupled with a declining currency produce an unwelcome outcome for corporate treasurers. Looking ahead to 2012, an old cliché but a good one: 'Expect the unexpected'.

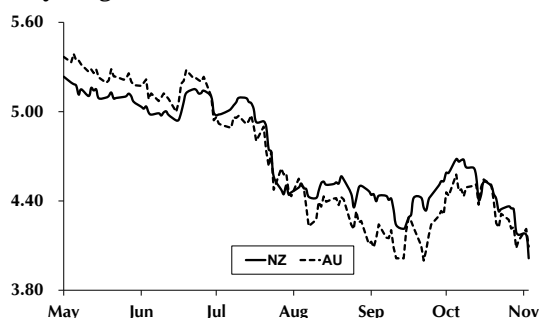
New Zealand dollar/US dollar



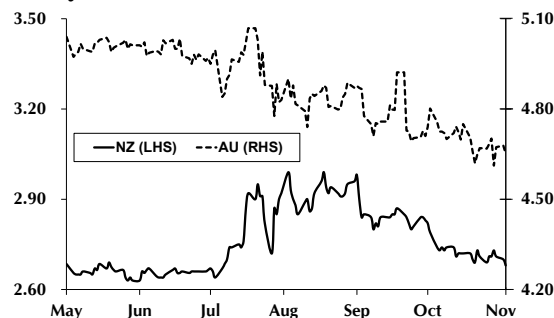
New Zealand dollar/Australian dollar



10 year government bonds



90 day bank bills



# WORLD ECONOMY & MARKETS

## World economy into a “lost decade”?

On 15 September we lamented the 3rd anniversary of the Lehman Brothers collapse and the beginning of the GFC. Since then the world economy has struggled to gain traction as the problems of excessive debt in private sector have been catapulted into the public domain. The focus is now on the unsustainable borrowing and reckless spending of debt laden nations such as Greece, Italy and the US. In addition, policy responses to the global recession have compounded the debt problem with central banks and governments printing and borrowing even more money in an attempt to maintain jobs and revive failing economies.

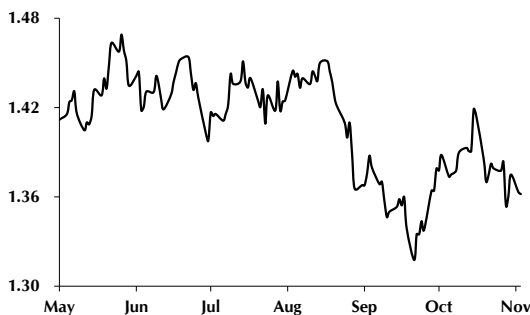
We are three years down the so called ‘road to recovery’ and now harsh austerity measures on households and workers are being enforced to help governments rein in excess public debt. If you get the feeling that the debt problem has just gone full circle back to where it all started, you’re probably not wrong.

The reality of the problem is also being acknowledged by those trying to solve it. The head of the of the International Monetary Fund, Christine Lagarde, recently said *“If we do not act boldly and if we do not act together, the economy around the world runs the risk of a downward spiral of uncertainty, financial instability, and potential collapse of global demand. Ultimately, we could run the risk of what some commentators are already calling the lost decade.”* She urged China and other countries to do more to prevent the debt crisis from spreading around the world.

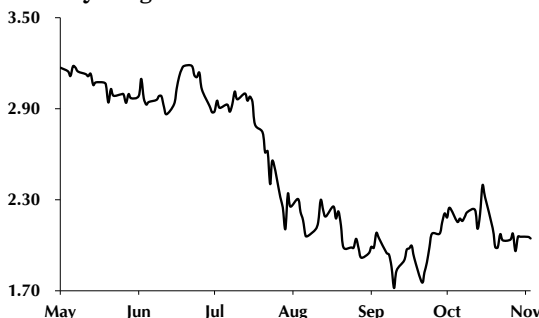
## How did we get through 2011?

Over the past year we have continued to emphasise uncertainty and volatility as the only certainty. We have seen the value of commodities, equities, interest rates and foreign exchange rates swing wildly, taking their lead from something as childlike as ‘sentiment’. Is the world looking good this week or is it looking bad? It is now obvious that the light at the end of the tunnel has had little to do with sound economic fundamentals or the economic policies of governments, but has more to do with the emotions of market participants?

### Euro/US dollar



### US 10 year government bond



Through this period we have reinforced that businesses must focus on what they can control, ensure they have confidence over their exposures and understand what they are trying to achieve through prudent hedging. Importantly, unlike many market participants, keep your emotions well away from risk management. Prudent treasury policies have helped by ensuring that hedging is sensible, timely and relevant. Staggered policy parameters allowed businesses to target volatility as required without forcing businesses to make significant one-off decisions. This has allowed cover to be built gradually and created hedge profiles that have helped businesses navigate these very turbulent times.

Unfortunately we continue to expect that businesses will struggle against difficult trading conditions, rising costs and reduced margins. This can only be compounded in multiples if risk management has been reckless, based on emotions and not specifically related to risk management.

## What to expect in 2012?

Expect more of the same: plenty of uncertainty and volatility, especially if turmoil in the Eurozone spread. The dire state of the US economy has recently been put aside with markets clearly focused on the Eurozone but its issues have not gone away. Expect attention to return to the US sometime soon; its unsustainable debt levels and the weakness of the USD will once again dominate markets.

In addition, difficult credit markets could restrict funding, thus hampering investment and further weakening global demand. Asian nations from China, South Korea and the Philippines are now experiencing slower growth, and Christine Lagarde has reinforced that *“no country can be immune”* to the effects of Europe’s turmoil.

This means in 2012 businesses cannot be complacent and must remain alert and cautious. Treasury risks such as funding, foreign exchange and interest rates will be volatile and prone to significant moves. Be prepared.

### US dollar/Japanese yen



### Standard & Poor’s Goldman Sachs Commodity Index



# HOW DO YOU RATE?

Contd. from front page

- How much of the hedging activity is based around company forecasts and how much based on market forecasts?
- How often are the underlying policies, forecasts and hedging activities critically reviewed?
- How do your treasury risk management activities compare to best practice?

## Looking ahead

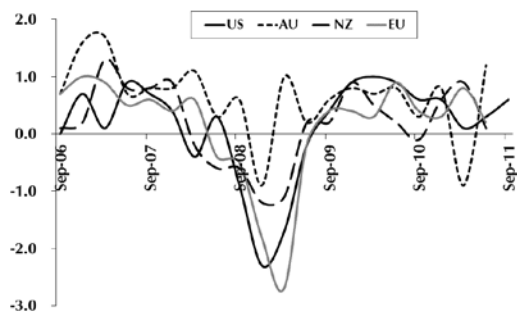
Heightened uncertainty and volatility are expected to remain a market characteristic for some time. Liquidity and funding related issues have been and will remain the greatest treasury risk management focus and the main driver of change in that area. After all, liquidity is critical to the organisation's survival. An organisation fails not because it makes a loss but because it cannot pay its bills.

As with any risk management activity, it is important to honestly acknowledge, understand, measure and report the exposures and all the related hedging activity. That encompasses policy setting and reviewing, transparency in internal and external relationships, management and Board reporting, education of those responsible for risk management, performance measurement and openness to

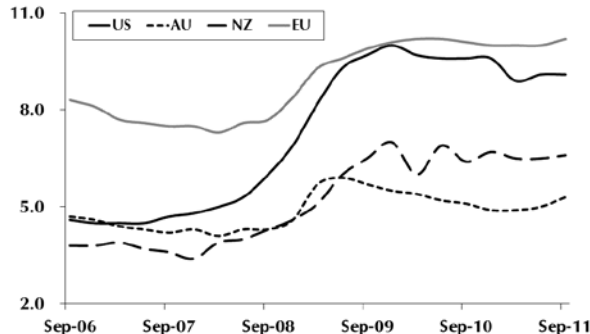
(not necessarily full blown adoption of) new ideas and technology. In addition hedging must be done while recognising the futility of financial market forecasting and performance measurement must be done away from the harsh light of hindsight.

2011 has been a tough, unpredictable and volatile year and 2012 is shaping up to be no different. You cannot change or master the financial markets but you can change how you manage the risks caused by market-related exposures. If you do not know how that can be done, ask someone independent and experienced.

## GDP growth (QoQ)



## Unemployment rate



Text finalised 15 November 2011

This document has been prepared by Bancorp Treasury Services Limited ("BTSL") and Barrington Treasury Services Pty Limited ("Barrington"). Whilst all reasonable care has been taken to ensure the facts stated are accurate and the opinions given are fair and reasonable, neither BTSL, Barrington, nor any of their directors, officers or employees shall in any way be responsible for the contents. No liability is assumed by BTSL or Barrington, their directors, officers or employees for action taken or not taken on the basis of this document. ACN 46 050 931 541 Operating under AFSL Licence No. 244594

### Bancorp Treasury Services Limited

#### Auckland

Level 11  
AXA Centre  
191-201 Queen Street  
PO Box 4270 1140  
Phone +64 9 912 7600  
Fax +64 9 912 7601

Email: [admin@bancorptreasury.com](mailto:admin@bancorptreasury.com)  
Website: [www.bancorptreasury.com](http://www.bancorptreasury.com)

#### Wellington

Level 7  
Wellington Chambers  
154 Featherston Street  
PO Box 3007 6140  
Phone +64 4 473 0804  
Fax +64 4 473 0814

#### Christchurch

Level 2  
Bradley Nuttal House  
79 Cambridge Tce  
PO Box 173 8140  
Phone +64 3 374 2193  
Fax +64 3 374 2195

### Barrington Treasury Services Pty Limited

#### Sydney

Level 1, Bridgepoint, 1-3 Brady St, Mosman  
NSW 2088  
PO Box 462 Spit Junction NSW 2088  
Freephone 1800 425 079  
Email: [admin@barringtontreasury.com](mailto:admin@barringtontreasury.com)  
Website: [www.barringtontreasury.com](http://www.barringtontreasury.com)



**BANCORP**

BANCORP TREASURY SERVICES LIMITED

**Barrington**  
TREASURY SERVICES