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$US1.50 a prospect as dollar dazzles

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So, the **higher-than-feared inflation figures** have whipped the Australian dollar to a **fresh post-float record** against the greenback.

The next barrier is $US1.11, and, longer term, the Australian dollar has $US1.50 written all over it, so long as the China boom continues.

For the currency herd, in fact, the Aussie dollar has undergone a significant change. Our currency is no longer just a "risk trade", which is a currency that waxes in the good times then wanes when things get rocky on the global economic front.

Risk has risen lately amid the spectre of a US debt default, but the local dollar has risen too.

True, the greenback is getting a thrashing as investors lose confidence in America. And there's nowhere to turn. There would have been a flight of capital into the euro, yet Europe is in disarray as Greece heads for inevitable default and other euro members teeter. The yen has risen but Japan's post-growth economy makes it a less-than-appetising destination for capital.

There is the Swiss franc, which has shot the lights out. But this small European tax refuge has a case of capital-overload. As a result, the Aussie, rather than being sold off in recent weeks, has pushed to new highs.

Reserve Bank governor Glenn Stevens noted recently that other central banks have been buying our buck. It's a proxy for commodities, Australia's debt-to-GDP ratio is low and our interest rates are relatively high. And privately Stevens – despite the pain for exporters – wants the dollar high. It keeps a lid on growth, and inflation, and saves him having to hoist interest rates.

Now, more than ever a proxy for China, the dollar has broken links with its dollar-bloc mentor the greenback. But it is also proving resilient like never before – and this is the essential change – even as instability has taken grip on the world economic stage.

Rate gap

As long as China holds, the fundamentals are solid. As much as anything, the strong currency is down to high interest rates. Whereas rates in the US, Japan and Europe remain depressed, the base rate here at 4.75 per cent is the highest in the developed world. The interest rate differential attracts foreign investors. They chase the high rates, the rising dollar.

And as long as commodities keep rising, inflationary pressures will continue and rates here will stay higher than the rest of the world.

Then there's the most recent trade numbers, for the June quarter. The "terms of trade" rose 5.3 per cent to the highest level since records began in the 1870s. We cannot underestimate the potency of this metric. The terms of trade is the measure of export to import prices, how well Australia does versus the rest of the world, on the basis of relative prices.

It was the agricultural trade, wool and wheat, which delivered this nation's wealth last century, brought us our standard of living. Now, it's coal and iron ore, gold and base metals.

The Reserve Bank estimates that for every year the terms of trade stays at these levels it is worth about 12 to 15 per cent of Australia's $1.3 trillion annual economic output – as much as $200 billion.

And so it is that, as long as China keeps on and commodities prices keep pushing higher, the local dollar will keep rising.

With the US economy – and its currency – in terminal decline, the trend is the Aussie's friend.

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