The AUD - Steep Hill to Climb

• The AUD has enjoyed the USD’s broad retreat
• The case for a higher AUD is not unreasonable
• However, the bulls face numerous hurdles

Like many a currency, the AUD has made the most of the USD’s broad retreat since the June FOMC; but do bulls really have sufficient motivation to carry it higher from here?

Of course, with the USD now in the grip of uncertainty as to what extent the Fed is prepared to cut rates this year, then the AUD could yet enjoy an extended run into the 70s. And bulls could even call on other supportive factors in addition.

The first thing to be noted there is that the price of iron ore is currently in the midst of a protracted uptrend of impressive proportions. Prices have risen by around 60% over the past two months and by more than 130% in the past five. And industry forecasts for global demand – more than half of which is furnished by Australia – are glowing.

The market is also poring over the tax cuts announced by the new Liberal National government and to what extent this will alter anticipated monetary stimulus. Indeed, the RBA has been a keen advocate of fiscal support.

Newswatch

1. Larry Kudlow assures that US-China trade talks will ‘continue in earnest this coming week’

2. Australian retail sales growth disappoints again in April
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And with CFTC data still suggesting that non-commercial accounts have yet to reconsider their sizeable short positions in the currency (66,320 as of the end of June), the prospects of the AUD enjoying a further upleg – pending a compliant USD – does not seem unreasonable.

Bulls may already be eyeing the post November 2018 downtrend and 200 day MA at 71 cents.

However, the bulls also face numerous hurdles. Firstly, we do not concur with the hawkish tones inferred by some from Tuesday’s policy statement.

Certainly, RBA policy is now data dependent after two 25bp cuts, but this is not unexpected given the need to retain policy flexibility given low ammunition at a crucial stage of the cycle.

But this aside, the potential for further cuts is all too clear given the RBA’s emphasis on spare capacity. Recall that the RBA lowered its assessment of the natural rate of unemployment last month (to 4.5%) – a decision that gave life to an active debate about whether rate cuts were being seriously underestimated.

And unemployment is proving to be sticker than the RBA expected.

The motivation to cut rates further is all too clear given the RBA’s emphasis on spare capacity

In terms of the AUD itself, readers will also recall Governor Lowe’s emphasis on the currency as “an important channel” through which easing stimulates growth. That Mr Lowe made this comment to highlight the problems when “everyone is easing” only emphasizes the importance the...
RBA places on a competitive currency, which is entirely understandable given Australia’s USD denominated commodity earnings.

In terms of risks to the stronger AUD view, there is also the CNY to consider and its near decade long, 84% daily correlation with the AUD (viz-a-viz the USD). As readers will be aware, we do not preclude debate about the CNY 7 to the USD level resurfacing in view of the country’s current economic performance.

The AUD’s upside is not without risks, therefore. But one final point: despite the fact Beijing has something of a history of policy shifts in June, July and August, we see that three month atmf implied volatility in AUD/USD still anticipates one of the quietest periods on record.

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