

Are the Tides Turning?

- The AUD was within the range of 1.02-1.06 for around ten months. After this prolonged period of stability, it has fallen sharply in only a few weeks.
- What has changed? A major factor behind recent weakness in AUD has been US dollar strength. US economic data has been in the improvement lane and markets are now pondering the prospect of an unwinding of quantitative easing. Some Fed officials are expecting this could happen as soon as June. This has been a key change to sentiment within financial markets – the realization that QE cannot go on forever. An end to asset purchases will stop “debasement” of the US dollar, which has kept the greenback under downward pressure for so long.
- At the same time, recent data from China has raised question about the strength of its economic recovery, and therefore the outlook for commodities. Combined with an ongoing easing stance from the RBA (markets are pricing in at least one more 25 basis point rate cut by end of year), these factors have reduced the relative attractiveness of the AUD.
- We are of the view that the Chinese recovery will be sustained, as the government has the scope to support the economy if necessary to maintain its target of 7.5 percent annual growth. Additionally, there are headwinds that remain for the US economy given substantial Federal budget cuts have been implemented. Thus the notion that the Fed could start unwinding asset purchases within a few months is premature, and we believe the Fed will not seriously consider pulling back stimulus until later than currently anticipated by markets.
- This would suggest the AUD should not drift too far away from parity for too long. Our forecast of 1.02 by end 2013 and 1.00 by end 2014 reflects our view of a later pullback in stimulus from the Federal Reserve, the relative strength of the Australian economy and positive prospects for China.

	EXCHANGE RATE FORECASTS		
	Jun-13	Sep-13	Dec-13
AUD-USD	1.0000	1.0100	1.0200
AUD-EUR	0.7813	0.7953	0.8095
AUD-JPY	102.00	105.04	107.10
AUD-GBP	0.6579	0.6689	0.6800
AUD-NZD	1.2195	1.2317	1.2289

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