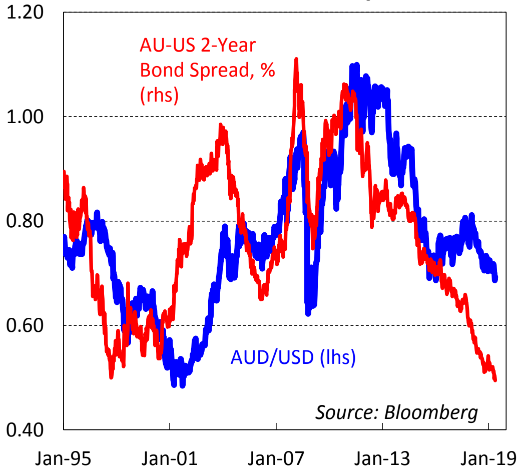
Monday, 27 May 2019

Australian Dollar Outlook

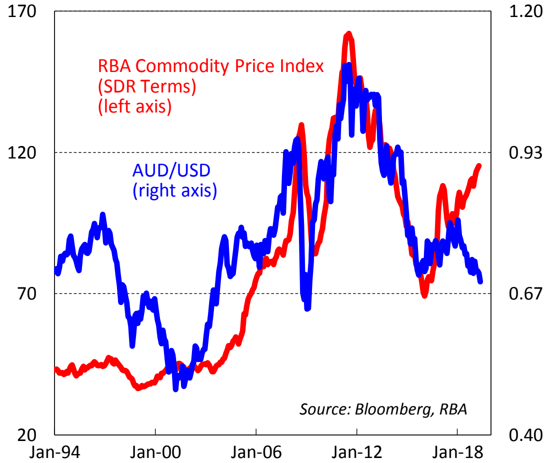
The Swinging 60's

- **Growing expectations that the RBA would reduce the official cash rate has seen the AUD convincingly break through the US 70 cent support level. Other factors have also been at play, including a re-escalation of trade tensions between the US and China and persistent concerns about the global growth outlook.**
- **We are expecting three 25 basis point rate cuts this year, taking the cash rate to 0.75% in November. Our expectations suggest a lower cash rate by end 2019 than what markets are implying. So if the RBA lowers the cash rate three times this year, it would likely place further modest downward pressure on the AUD.**
- **The recent move by the US to impose further tariffs is a major turnaround from the progress in trade talks earlier in the year. The ban on Huawei and potentially other Chinese tech firms also provide a worrying development in China and US relations, which will impact the global economy. With no end-game in sight, these concerns should continue to weigh on the Australian dollar.**
- **Working in the other direction is the resilience in commodity prices. Iron ore prices have continued to lift and are expected to stay elevated over the next few months. Relatively high commodity prices should limit how far the Australian dollar will depreciate.**
- **Ongoing trade concerns and domestic factors, however, are expected to have an overall negative impact on the Australian dollar. Our end of year forecast for the Australian dollar is 66 US cent, down from 68 US cents previously.**

AUD/USD & AU-US 2-Year Government Bond Spread



AUD/USD & Commodity Prices



The Australian dollar has been on a downward trend ever since reaching a cyclical high of US$0.8136 on 26 January 2018. A loss of momentum in the global economy, particularly over the second half of 2018, and the trade tensions between the US and China have been key drivers behind the Australian dollar's decline.

The Australian dollar mostly held above 70 US cents, from late 2018 through to April this year. More recently however, growing expectations that the RBA would reduce the official cash rate has seen the AUD convincingly break through70-US cents, which had been a key support level. Other factors have also been at play, including a re-escalation of trade tensions between the US and China and persistent concerns about the global growth outlook.

Downside risks to the domestic economy remain. The outlook for consumer spending continues to be weak, given high household debt levels and ongoing slow wage growth. Importantly, it is becoming increasingly likely that the downward trend in the unemployment rate from late 2014 to the end of last year has stalled. Employment growth has remained strong, but leading indicators have become mixed, and point to employment growth moderating.

Weak momentum in the domestic economy and the ongoing downside risks have indicated that the likelihood of the RBA reducing the cash rate by the RBA has become increasingly likely over the course of this year. We are expecting three 25 basis point rate cuts this year, taking the cash rate to 0.75% in November.

Markets have almost priced in with certainty that the RBA will lower the official cash rate when it meets on June 4. Further, two 25 basis point rate cuts are fully priced in by the end of the year and a small chance of a third. While markets are anticipating a lower cash rate, our expectations suggest a lower cash rate than what markets are suggesting. If the RBA lowers the cash rate three times this year, it would likely place further modest downward pressure on the AUD.

Another factor which is likely to continue to weigh on the Australian dollar is the ongoing trade tensions. The recent move by the US to increase tariffs on China is a major turnaround from the progress made in trade talks earlier this year. Moreover, this latest round of tariffs is likely to increasingly hit the US economy. The ban on Huawei and potentially other Chinese tech firms also provide a worrying turn in China and US relations, which will negatively impact the global economy. With no end-game in sight, these concerns should continue to weigh on the Australian dollar.

Working in the other direction is the resilience in commodity prices. Iron ore prices have continued to lift as global supply constraints persist, and are expected to stay elevated over the next few months. Relatively high commodity prices should limit how far the Australian dollar will depreciate. Fiscal stimulus in China might also lift Chinese growth and further support commodity prices.

Ongoing trade concerns and domestic factors, however, are expected to have an overall negative impact on the Australian dollar. Given the change in our view for the cash rate and the re-escalating of trade tensions, our end of year forecast for the Australian dollar is 66 US cents, down from 68 US cents previously.

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Please see detailed forecasts on following page

EXCHANGE RATE FORECASTS

	End Quarter Forecasts						
	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
USD Exchange Rates							
AUD-USD	0.6900	0.6800	0.6600	0.6600	0.6700	0.6700	0.6800
USD-JPY	110.00	111.00	112.00	112.00	112.00	111.00	110.00
EUR-USD	1.1100	1.1000	1.1000	1.1100	1.1200	1.1300	1.1400
GBP-USD	1.2700	1.2800	1.2800	1.2800	1.2900	1.2900	1.3000
NZD-USD	0.6500	0.6400	0.6500	0.6500	0.6600	0.6600	0.6700
AUD Exchange Rates							
AUD-USD	0.6900	0.6800	0.6600	0.6600	0.6700	0.6700	0.6800
AUD-EUR	0.6220	0.6180	0.6000	0.5950	0.5980	0.5930	0.5960
AUD-JPY	75.90	75.50	73.90	73.90	75.00	74.40	74.80
AUD-GBP	0.5433	0.5310	0.5160	0.5160	0.5190	0.5190	0.5230
AUD-NZD	1.06	1.06	1.02	1.02	1.02	1.02	1.02

* Note that the AUD cross exchange rates have been rounded.

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