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FX

Global

FX Flash

AUD: Downside Risks Still Beckon

Sporadic Hints of a Shift Towards Neutral

RBA left cash target rate unchanged today at 4.35% and kept its tightening bias, noting that "a further increase in interest rates cannot be ruled out". While the central bank acknowledged that inflation is easing, "it remains rather high" and inflation could only return to 2-3% in 2025 and to the mid-point in 2026. There was no clear pivot to neutral as RBA kept the reference to the possibility of further hikes unlike what we have seen in the policy statements from the Fed, BoC, BoE, etc. As such, RBA seems a tad more hawkish than peers, providing the AUDUSD a mild boost today.

Despite the lack of an official pivot, the overall tone of the policy statement seems to have turned a tad less hawkish as "services inflation is now expected to decline gradually as demand moderates and growth in labour and non-labour costs eases". This contrasts with the Dec statement which highlighted concerns on "persistent" services price inflation. Both headline and trimmed mean CPI were also adjusted lower in the Statement on Monetary Policy.

The AUDUSD edged higher on the decision, strengthening further into Governor Bullock's press conference and was last seen at the 0.65-handle, holding on to around 0.45% gains today. While Governor Bullock stresses that inflation is still a key priority, she had also mentioned that nothing is ruled out and that suggests that **risks to policy are actually two-sided**.

Still Wary of Downside Risks to the AUDUSD Near-term

We hold our view that RBA is likely to bring the cash target rate 50bps lower from 4.35% to 3.85% by the end of the year and the first cut could come in Aug.

We still see downside risks to our AUDUSD in the near-term. The fate of the Chinese economy normally has sentiment spillovers on AUD. AUDUSD also faces asymmetric risks (skewed to the downside) when it comes to future Australian data releases as RBA's stance is already relatively hawkish vs. peers (Fed, BoE, BoC).

The pair may come under further pressure should current market narrative of US exceptionalism gain further traction and that also adds to the risks of Fed-RBA policy converging on the timing of rate cuts, given markets' tendencies to overshoot. A completion of the bearish head and shoulders AUDUSD price reversal could bring the AUDUSD towards the 0.62-figure. This could come to fruition within Feb and could potentially threaten our forecasts.

However, we also want to stand by our constructive view of the AUDUSD for 2024. We still see possibility for the AUDUSD rise beyond the near-term volatility as we expect 1) US to achieve soft-landing, 2) global growth to bottom out at some point, 3) somewhat synchronized easing monetary policies this year should lift appetite for risk assets and that is constructive for the pro-cyclical AUD. We keep our 12month forecasts at 0.70 for now.

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For 2024, there are a few changes made to the RBA decision process and its communication, as recommended after the review conducted last year.

Table 1: Key Changes to RBA

New	Previous
Meetings are conducted over two days	One-Day Meeting
Eight Policy Decisions a Year	Monthly meetings except for Jan
Post-Decision Statement Issued by the Board	Post-Decision Statement Issued by the Governor
Media conferences after each meeting	No media conference
Quarterly Economic Outlook Released on Rate Review Day	Quarterly Economic Outlook Released on the Fri after rate review (typically Tue).

Source: RBA, Bloomberg

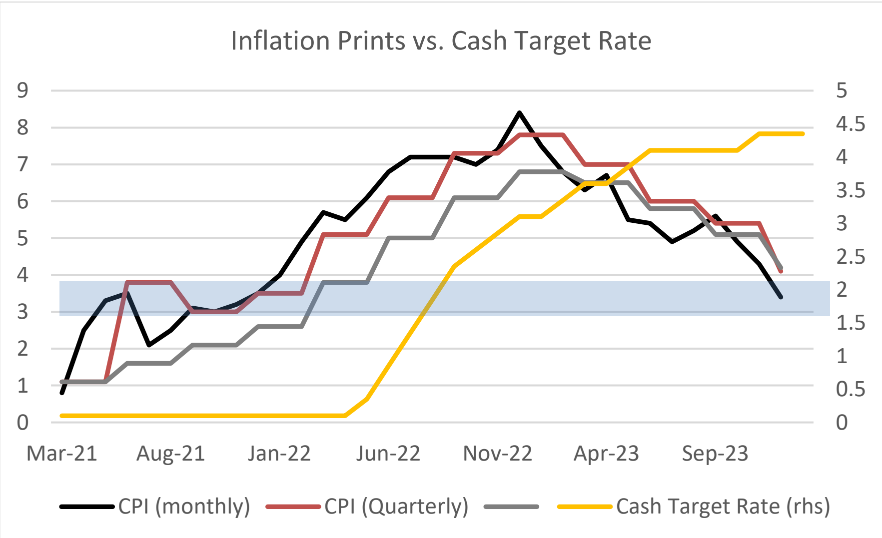
On top of the above, the Statement on Monetary Policy now discloses more economic assumptions and forecasts to improve the transparency of their considerations and decision.

No official Pivot to Neutral, But Statement is Less Hawkish

RBA left cash target rate unchanged today at 4.35% and kept its tightening bias, noting that "a further increase in interest rates cannot be ruled out". While the central bank acknowledged that inflation is easing, "it remains rather high". The guidance in the statement suggest that inflation could return to 2-3% only in 2025 and to the mid-point in 2026.

There was no clear pivot to neutral given the reference to the possibility of further hikes unlike what we have seen in the policy statements from the Fed, BoC, BoE, etc. That suggests that RBA is more likely to be late in the easing cycle vs. these other central banks.

Chart 1: Disinflation Has Been In Progress



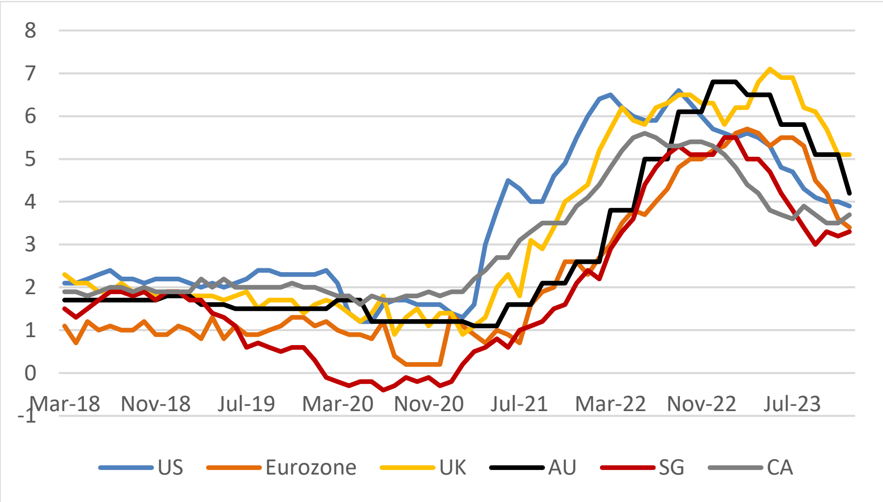
Source: RBA, ABS, Bloomberg, Maybank FX Research & Strategy

Despite the lack of an official pivot, the overall tone of the policy statement seems to have turned a tad less hawkish as "services inflation is now expected to decline gradually as demand moderates and growth in labour and non-labour costs eases". Headline CPI has been supported by elevated insurance premiums and rentals.

This contrasts to the Dec statement which highlighted concerns on "persistent" services price inflation. As such, RBA seems a tad more re-assured with the disinflation progress despite a lack of an outright pivot. When we compare Australia's inflation with its peers, the quarterly inflation measure that the central bank repeatedly highlighted (at 4.1%y/y for the quarter ending Dec) might have seemed elevated, the Dec print was a much lower 3.4%y/y which suggests good momentum in disinflation into the last month of that quarter.

As expected, the Statement on Monetary Policy also revealed a downgrade of CPI inflation forecast for year ending Jun 2024 to 3.3% (vs. 4.0% seen in Nov) and 3.2% for Dec 2024 (vs. prev. 3.5%). GDP is also revised lower to 1.8% for 2024 vs. 2.0% seen in Nov. The cash target rate is assumed to end the year around 3.9% and to eventually reach 3.2% by Jun 2026. The path of the cash target rate is actually lower than what was guided in the Nov SoMP.

Chart 2: The fall in core CPI Might be A Tad Slower Vs. G7 counterparts but it is catching up



Source: Bloomberg, Maybank FX Research & Strategy

<u>**Economic Outlook Remains Largely Unchanged, Still Uncertain**</u>

The statement largely left its assessment on economic outlook and risks largely unchanged, noting the uncertainty on the outlook for the Chinese economy, implications of the war in Ukraine and MiddleEast. The lags of monetary policy transmission, pricing behaviour of firms and wages will still be monitored.

RBA Governor Bullock at Her First Post-Policy Presser

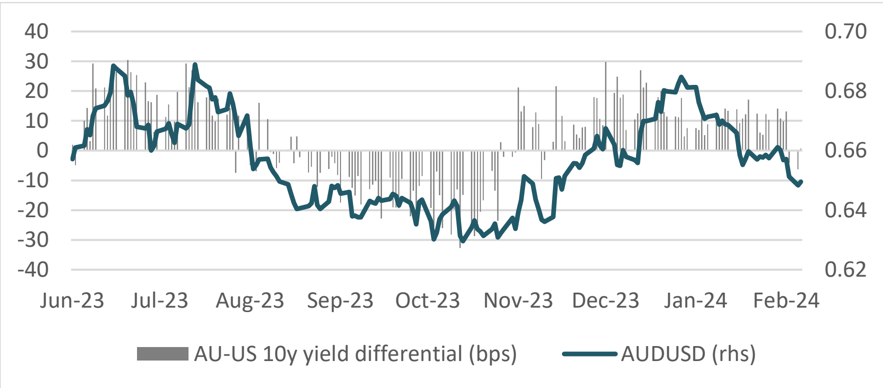
AUD started to strengthen further as Governor Bullock tried to drive the point that inflation remains the priority for the central bank. The rate hike in Nov is based on the data and such words also imply that future decisions are too, dependent on data outcomes given how much uncertainty there is on the economy as well as inflation, outlined in the statement. Cash rate futures now suggest a rate cut in Aug almost fully priced.

"We haven't ruled anything out, and we haven't ruled anything in" was her answer to questions about whether there could be more rate hikes. This further reinforces the fact that RBA is unwilling to let go of its tightening bias, much unlike other G7 central banks who had their first policy decisions in 2024 and that kept the AUD supported. That said, we should also take this phrase to suggest that risks to future policy trajectory are actually ***two-sided*** and that RBA is actually, **on a neutral stance.**

To be clear, Australian bonds have shifted well before the policy decision of the Fed and the RBA. The flip of the AU-US yield premium into discount seems to coincide with the release of Australia's CPI report, underscoring how markets have started to price possible dovish shift of the RBA since. **The next policy decision is on 19 Mar. We hold our view that RBA could cut rates by around 50bps within this year, likely from Aug 2024.**

With RBA also in data-dependent mode, there is a risk that any downside surprise to data could inspire greater AUD declines. In fact, AUDUSD faces asymmetric risks (skewed to the downside) when it comes to future data releases as RBA's stance is already relatively hawkish vs. peers (Fed, BoE, BoC). In addition, the current market narrative is now centered on US exceptionalism and strong US data has been lifting UST yields, pressuring the AU-US yield gap. Further US economic outperformance could keep the AUDUSD on the decline.

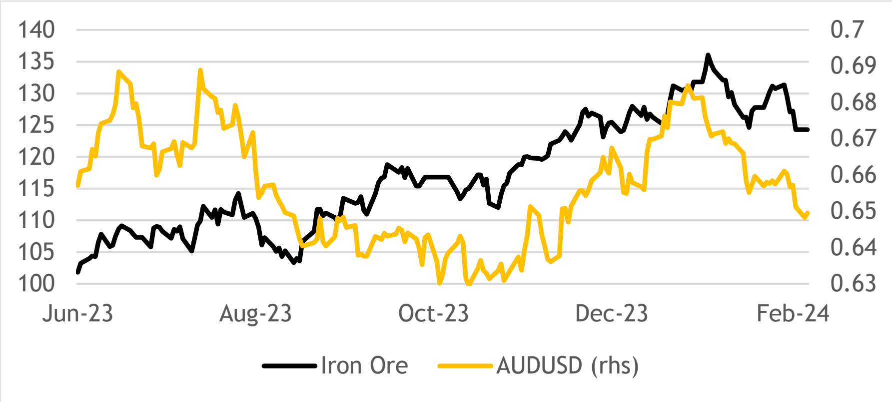
Chart 3: AU-US Yield Differential back in Negative Terrain, Drags on AUD



Source: Bloomberg, Maybank FX Research & Strategy

The USD strength is not just spurred by the US data, concomitant rise in the UST yield. The USD is also underpinned by jitters over the Chinese economy, (albeit bourses on mainland China are boosted today by talks of President Xi being briefed on the equity markets) as well as lingering concerns on Eurozone's growth. The fate of China's economy (Australia's biggest trading partner and export destination) has an outsized impact on the AUD. With the outlook for China still fragile and global growth slowing, base metal prices such as the iron ore (Australia's top export product) could remain vulnerable to further declines and that could keep AUDUSD under pressure.

Chart 4: Pullback in Iron Ore Weighs on AUDUSD



Source: Bloomberg, Maybank FX Research & Strategy

AUDUSD At Risk of Plunging towards 0.62

For a while now, we have been warning on our GM Daily notes that we see a head and shoulders formation for the AUDUSD and this is indeed, coming to fruition with the break of the neckline around the 0.6520 that opens the way towards towards 0.6450 before 0.6360 and then at 0.6290 and 0.6200. Rebounds to meet resistance around 0.6540 (100-dma), 0.6575 (200-dma).

Chart 5: AUDUSD Daily Chart - Neckline of the Head and Shoulders Bearish Pattern Broken

In this note, we acknowledged downside risks to our AUDUSD forecast based on the current market narrative of US exceptionalism and the risks of Fed-RBA policy convergence in the timing of rate cuts. This could come to fruition within Feb. However, we also want to stand by our view that the trajectory for the AUDUSD remains to the upside beyond the near-term as we expect 1) US to achieve soft-landing, 2) global growth to bottom out at some point, 3) easing monetary policies this year should lift appetite for risk assets and that is constructive for the pro-cyclical AUD. We keep our 12month forecasts at 0.70.

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