Maybank

FX

Global

FX Flash

AUD: Pressure on AUD to Ease

Shift to Neutral - Converge with Other DM Central Banks

RBA left cash target rate unchanged at 4.35% this morning and more notably, dropped its tightening bias in its policy statement, spurring the AUD to fall. The phrase "a further increase in interest rates cannot be ruled out" was finally omitted and that puts RBA in a similar "neutral" monetary policy stance as most other DM central banks (BoC, BoE, Fed, ECB, etc). AUDUSD is now 0.7% off its intra-day high and its weakness is exacerbated by the recent rise in UST yields as well as BoJ's dovish exit of its negative interest rate policy regime.

In Governor Bullock presser after the decision, she hesitated to give clear guidance on policy trajectory and remains "worried about inflation". This underscores the neutral stance of the RBA board but her acknowledgement of the slowdown in activity at home suggests that the next move is more likely a rate cut. However, that does not mean a rate cut is near as services inflation continue to moderate "more gradually".

Why is the AUD Under Pressure?

AUDUSD slid as RBA had shifted its monetary policy stance from tightening to neutral, joining most of the DM peers. With that, the RBA-DM policy stance has converged. That convergence is reflected in the AUD weakness today.

In addition, we are roughly one day away from Fed's next policy decision. Markets are pricing in risks of a hawkish Fed with focus especially on the dot plot. That had exacerbated AUD's weakness.

In recent days, markets continued to remain concerned over China's developers' ability to meet their debt obligations as well. Weakness in China's property market on top of a lack of bazooka fiscal stimulus had spurred iron ore to fall sharply. Iron ore (62% Fe, Qingdao) is now around 27% off its Jan highs, dragging the AUD lower.

Dips Are Opportunities to Accumulate the AUD

We hold a constructive view of the AUD **as convergence between RBA-other DM policy stance is done (shift to neutral), barring little change in Fed's guidance on 21 Mar**.

We maintain 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, well after the Fed's likely timing of Jun/Jul**. That could imply a divergence between Fed and RBA at some point that could be in the favour of AUD.**

We also expect **global growth to bottom out at some point (2H) as the world embarks on somewhat synchronized easing monetary policies this year** that should in turn, lift appetite for risk assets, positive for pro-cyclical AUD. **We keep our 12month forecasts at 0.70 for now.**

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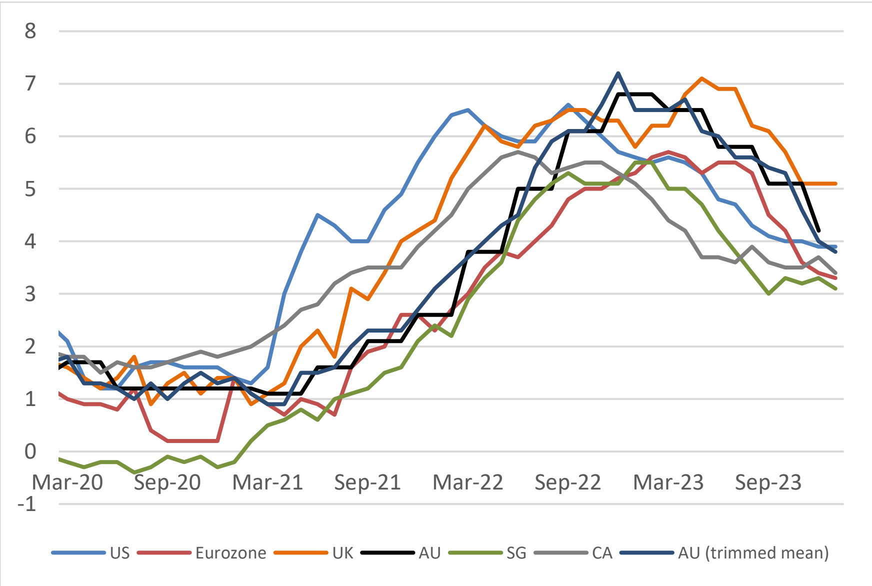
RBA Finally Omits Tightening Bias in its Policy Statement

RBA left cash target rate unchanged at 4.35%, in line with expectations. Most notably, the central bank dropped its tightening bias at its policy meeting this morning, spurring the AUD to fall. The phrase "a further increase in interest rates cannot be ruled out" was finally omitted and that puts RBA in a similar "neutral" monetary policy stance as most other DM central banks (BoC, BoE, Fed, ECB, etc). AUDUSD is now 0.7% off its intra-day high and its weakness is exacerbated by the recent rise in UST yields as well as BoJ's dovish exit of its negative interest rate policy regime that spurred broad USD strength since early Asia.

First, the policy statement released this morning acknowledged that there is progress on inflation but the economic outlook "remains uncertain". While services inflation remains elevated, it is also "moderating at a more gradual pace". So this inflation backdrop and slowing growth environment (weak household consumption) likely gave RBA decision committee the confidence to drop its tightening bias from the statement.

Second, the phrase "the Board is not ruling anything in or out" is inserted in place of the tightening bias that was dropped. This suggests all options on the table and a shift to a more neutral stance. The central bank, like many others, is data-dependent.

Chart 1: The fall in Australia's CPI is Now Matched with Most DM Peers



Source: Bloomberg, Maybank FX Research & Strategy

RBA Governor Bullock Remains Non-Committal to Policy Action

Governor Bullock then held a presser an hour later. When she was asked about whether she was concerned about the economy, her reply was that she is still worried about inflation. Similar to other central bankers, she spoke about wanting to be "more confident" that inflation is heading towards the target range before considering a rate cut. So overall, she still strived to sound more cautious about giving guidance on the timing of rate cuts and preferred to err on the side of caution by keeping rates elevated for longer.

Bullock also acknowledged that activity is slowing and businesses have mentioned that demand is easing in some "discretionary sectors". This suggests that the next rate action is more likely a rate cut rather than a hike.

We look for RBA to Cut only in Aug

Does that mean that the RBA is close to easing monetary policy? The AUD decline is a reflection of RBA's shift from the relatively more hawkish end of the spectrum to a more neutral zone. There is nothing in Bullock's presser and RBA's policy statement that suggest that RBA is close to a rate cut.

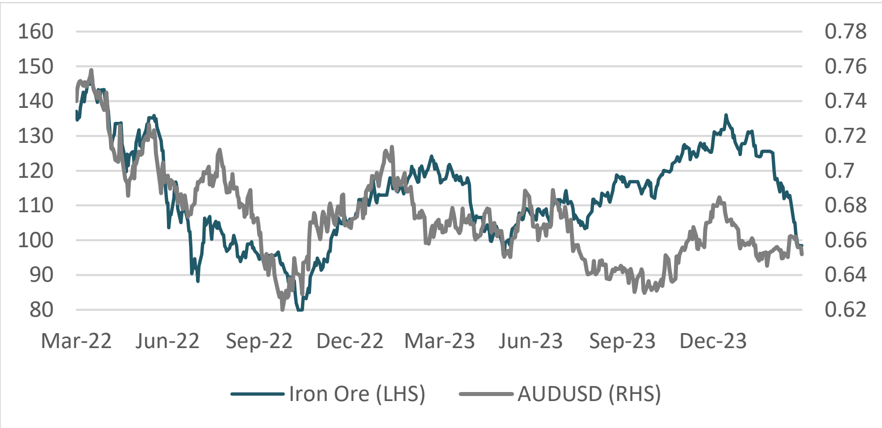
Cash rate futures now suggest that traders have almost fully priced in a rate cut in Aug this year. That is in line with our expectations.

AUD Reaction

AUDUSD slid as RBA had shifted its monetary policy stance from tightening to neutral, joining most of the DM peers. With that, the RBA-DM policy stance has converged. That convergence is reflected in the AUD weakness today.

Another reason for the weakness in the AUD is due to China. Markets continue to witness headlines of China's developers facing cash-flow difficulties/default risks. Property investment is still on the decline. Should China's property sector remain in the doldrums and limited infrastructure spending expected, demand for Australia's commodities (energy and base metals) could be weak and that translates to further decline in its terms of trade as well as the AUD. Well, that had basically played out already.

Chart 2: Pullback in Iron Ore Weighs on AUDUSD



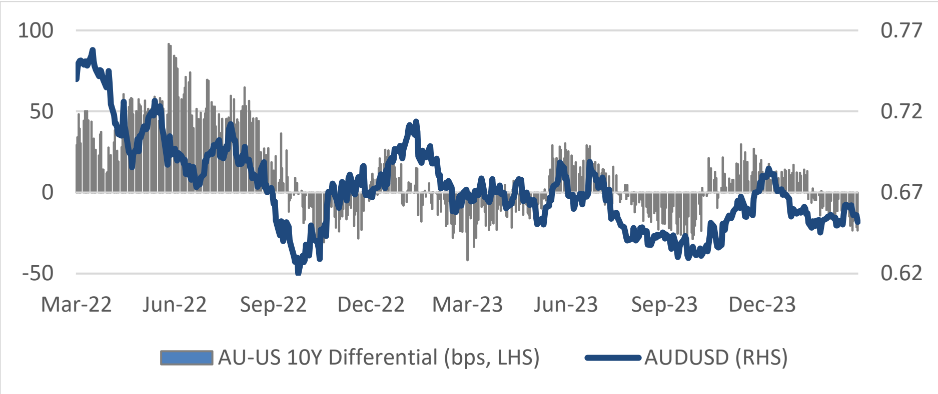
Source: Bloomberg, Maybank FX Research & Strategy

In addition, we are roughly one day away from Fed's next policy decision. Markets are pricing in risks of a hawkish Fed with focus especially on the dot plot. Based on the Dec's summary of economic projections (aka SEP), Fed officials guided for policy rates to be lowered by 75bps by the end of 2024. Recent inflation metrics spurred further hawkish repricing with some speculating that the upcoming dot plot could provide guidance for only 50bps cut. While there is a significant uncertainty on the guidance itself, recent US CPI prints spooked due to its overshoots on expectations rather than real evidence of inflation re-acceleration. Core services remain the biggest contributor to the monthly headline CPI for Feb but even that seem to have moderated (from 0.4ppt to 0.28ppt). In addition, there are US data that suggest weakness in activity already (ISM Mfg, Services, retail sales). There is also the risk of commercial real estate buckling under the pressure of elevated rates. As such, Fed's guidance on Wed (or Asia Thu 2am SGT) may not change in terms of policy rates but there could be marginal tweaks in other economic outlook (GDP, CPI). We reckon the hawkish re-pricing in the USD could be overdone, exacerbated by BoJ's dovish rate hike. These external drivers have amplified the weakness of the AUD today as well and could be at risk of unwinding.

AU-US Rate Differential To Turn Positive Once UST Yields… Yield

AU-US 10y yield differential has flipped into discount recently due to the surge in UST yields. That has dragged on the AUDUSD. We continue to expect RBA to cut much later than the Fed and an eventual fall in the UST yields to weaken the greenback and boost the AUDUSD pairing.

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



Source: Bloomberg, Maybank FX Research & Strategy

In our 6 Feb note on AUD, we had warned about downside risks to the AUD as RBA is already perceived to be most hawkish and risk of a convergence could result in some AUDUSD weakness. That turned out to be true to some extent today. However, we see these downside risks as fairly priced in at this point. **The next policy decision is on 7 May. We hold our view that RBA could cut rates by around 50bps within this year, likely only from Aug 2024.**

Dips Are Opportunities to Accumulate the AUD

Taken together, we hold a constructive view of the AUD **as convergence between RBA-other DM policy could be done, barring little change in Fed's guidance on 21 Mar. 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, well after the Fed's likely timing of first cut Jun/Jul.** That could imply a policy divergence between Fed and RBA that could be in the favour of AUD. We also expect **global growth to bottom out at some point as the world embarks on somewhat synchronized easing monetary policies this year** that should in turn, lift appetite for risk assets, positive for pro-cyclical AUD. **We keep our 12month forecasts at 0.70 for now.**

Chart 5: AUDUSD Daily Chart – Rising Trend Channel

AUDUSD tests the lower bound of the rising trend channel that has been in the making since the start of the year. Violation here could open the way towards 0.6450. This is quite the pivotal level, right ahead of the coming FOMC decision that could determine the next leg of the AUDUSD pairing. Rebounds to bring this pair towards 0.6590-resistance before the next at 0.6670. MACD is neutral. Stochastics are turning from overbought conditions.

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