Trade Idea – Foreign Exchange
Risks shift to the downside for the Aussie
12th May 2016

**RBA cuts rates**

- On the 3rd May the Reserve Bank of Australia (RBA) took the decision to cut interest rates in response to recent signs of weak inflationary pressure. While the move itself was not a complete surprise (55% probability priced in prior to RBA meeting), the quarterly monetary policy statement that accompanied the meeting revealed that the bank’s central view towards inflation had taken a marked shift. The bank had slashed inflation forecasts by 50-100bps to reflect a new base scenario, whereby underlying inflation would sit at the bottom of the target 2-3% range for the entirety of the forecast period (to Jun-18, see Figure 1). Since the meeting, the AUD has fallen 3.3%* on a trade weighted basis but market pricing of further cuts have not really moved (only one further cut priced in this year). Going forward, we believe that in the near term, the AUD has potential to come under further pressure, especially if Australian inflationary measures remain subdued and prompt the RBA to pursue a more aggressive easing path.

![Figure 1: Inflation forecasts slashed](image)

**Weak wages underpin inflation outlook**

- The latest monetary policy statement highlights that “the outlook for domestic cost pressures is a key source of uncertainty” for the RBA’s own inflation predictions. Data from the Australian Bureau of Statistics (ABS) reveals that recent wage growth and headline inflation numbers have been particularly lacklustre, falling despite above trend growth and declining unemployment (see Figure 2). Furthermore, inflation expectations have fallen sharply since the turn of the year, raising concerns that low expectations will become embedded in wage levels. These risks will place additional emphasis on ABS wage and inflation data due on the 18th May and 26th July respectively. Should they disappoint, the AUD will likely fall against its developed market counterparts as expectations of further easing rise.

*All figures quoted are sourced from Bloomberg unless stated otherwise.
Speculative longs fall from highs

- Speculative long AUD positions fell for the first time in almost two months last week as the RBA’s dovish monetary policy statement and the recent fall in bulk commodity prices has led investors to reassess the recent upward trend. In coming months, we expect that net speculative positioning, which is at three year highs, will continue to fall from current elevated levels and pressure the AUD lower.

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