Trade Idea – Foreign Exchange

Aussie rally intact
19th August 2016

**AUD ploughs higher**

- The AUD rally has continued unfettered over the past month, rising despite an interest rate cut by the Reserve Bank of Australia (RBA) and a disappointing inflation report for the second quarter. The currency has received considerable support from a buoyant Chinese housing market which has seen the price of Australian commodity exports climb on average 15% since the beginning of June (see Figure 1). The AUD has also benefitted from the external financial environment where relatively healthy yields (Australia 10yr sovereign is the second highest in the G10 currency complex) are rare and in high demand. While in the longer term, we may see the AUD rally running out of steam, in the nearer term, strong momentum and a favourable landscape are likely to see the currency continue on its path higher. We prefer to express a bullish AUD view against the EUR, as the US Dollar has potential to strengthen in coming weeks especially if the US Federal Reserve presents a hawkish stance at its September meeting.

![Figure 1: Export prices climb further](source: Bloomberg, ETF Securities)

**Near term risks diminish**

- The AUD has recently managed to avoid a lot of near term risks that previously faced the currency (see: [Uncertainty to weigh on the Aussie](#)). The election result, while far from convincing, didn’t result in a hung parliament and the incumbent retained its majority in the lower house. Furthermore, this Wednesday Moody’s affirmed Australia’s prized triple-A credit rating which was at risk due to growing government debt. Had the election outcome resulted in a hung parliament then it would have likely threatened the country’s credit outlook and had knock on effects for the currency.

**RBA reveals little**

- At its latest monetary policy meeting the RBA cut rates and voiced concern over lacklustre inflation and weak economic growth, but failed to exhibit urgency to ease monetary measures even further to boost these metrics. Unlike their Antipodean counterparts, the RBA made little mention of the recent strength of the AUD in hampering inflation, instead focusing on weak

*All figures quoted are sourced from Bloomberg unless stated otherwise.*
domestic price pressure as a key cause of poor price growth in recent months. Unless the RBA takes the bold step of actively voicing intentions to ease monetary conditions further we do not believe market pricing of further cuts will materialise and therefore see limited downward pressure coming on the AUD from near term monetary policy action.

**Sustainability of commodity support in question**

- The monetary policy statement that accompanied the RBA’s August meeting devoted an entire segment to the Chinese housing market, which has been instrumental in supporting Australian commodity export prices since the start of the year. It details the strong pickup in Chinese housing cycle and how this has largely been driven by government stimulus measures aimed at tackling burgeoning housing inventory in the country. In line with our longer term bearish AUD view, the RBA believes the sustainability of the recent upturn in Chinese housing market could be limited, and so in the longer term commodity prices could be at risk. However for now, we see strong investment demand and favourable regulations keeping the market afloat and translating into continued support for the AUD.

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