

RBA unlikely to help the Aussie dollar's clouded outlook

The re-escalation of trade wars and the drop in the Chinese Yuan is dampening appetite for the highly-exposed AUD. Tomorrow's Reserve Bank of Australia meeting is unlikely to deliver any cuts nor give relief to the battered currency



The Reserve Bank of Australia governor, Philip Lowe

A combination of rising trade tensions and monetary easing has kept any rally above 0.70 in AUD/USD short-lived during the past few months. As President Trump surprised the market with a new round of tariffs on Chinese exports, AUD dropped more than twice as much as its New Zealand and Canadian peers, NZD and CAD. That's hardly surprising given that Australia is the most exposed G10 economy to Chinese imports.

RBA to pause while keeping the door open for more

The lack of appetite for the Australian currency is likely exacerbated by the dovish RBA stance that keeps the rate outlook unsupportive for the currency. Rate expectations for the RBA came under pressure two weeks ago as Governor Lowe made it clear that the central bank "is prepared to provide additional support by easing monetary policy" should inflation fail to approach the target.

2Q CPI numbers, released on Wednesday, marginally beat estimates (1.6% vs 1.5%). That helped

convince the markets that the RBA will keep rates unchanged tomorrow after cutting in the last two meetings; that's indeed in line with our view. Signs of a stabilising housing market will also play a role in prompting a pause in the easing cycle. At the time of writing, the implied probability of a cut tomorrow is less than 9%, suggesting that rates are unlikely to find support should the RBA match expectations and keep rates on hold. In terms of forward-looking language, we see very few reasons for Governor Lowe to deviate from his recent dovish rhetoric, not least since the re-escalation in the US-China trade war has reignited downside risks for the Australian export-based economy.

Another cut may be delivered by the end of the year

Looking ahead, headline inflation still appears far from the (ambitious) 2.5% RBA mid-point target, which – in line with Lowe's recent rhetoric – makes us believe that another cut may be delivered by the end of this year. Markets have already priced in an 85% probability of this happening, so further pressure on Australian rates should not be massive. However, it will remain to be seen whether, in light of the new round of US tariffs and the recent rate cut by the Fed, markets will frontload more easing by the RBA.

AUD short-term downside risks remain high

With the RBA unlikely to come to the rescue of AUD, the clouds above the currency are likely to linger for some time. Much will depend on the developments in the US-China trade war and in particular on how the tensions will impact Chinese economic data. But, for the time being, the balance of risks for the Aussie dollar remains heavily tilted to the downside. In turn, while we do not expect AUD/USD to trade far from our 0.68 forecast at the end of Q3, we acknowledge a sizeable risk of the pair moving below 0.67 in the coming weeks, especially given the absence of support from the dovish RBA.

Looking ahead, our trade team continues to expect a de-escalation in trade tensions towards the end of the year, with both China and the US making concessions on their way to strike a trade deal. Supported by a stubbornly short market positioning (-33% of open interest, as of last Friday), AUD/USD will likely have the chance to rebound towards 0.6900 in 4Q19.

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