

AUD shoots higher after 'neutral' RBA minutes

RBA talk of a 3.5% neutral cash rate has lifted short-term local interest rates and seen AUD/USD break the 0.79 level



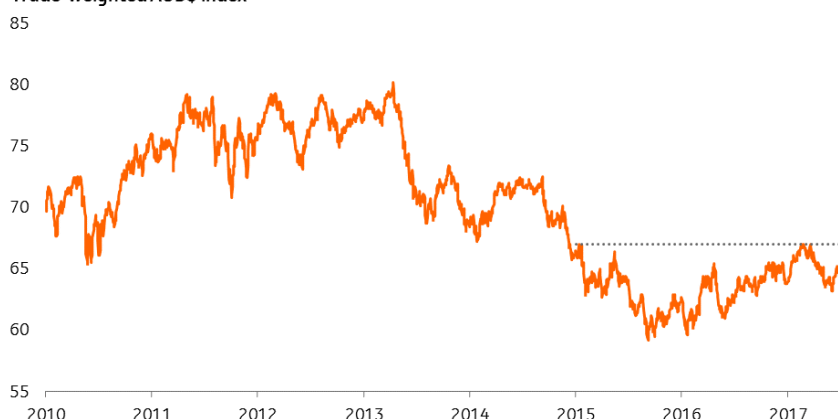
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RBA didn't have to say much to sound hawkish in a benign market

While there was probably little intention to send any direct policy signals, talk around the neutral interest rate and the degree of accommodative monetary policy in the July minutes was enough for the Reserve Bank of Australia to catch the current hawkish market contagion. The brief discussion around the terminal cash rate being at 3.5% has lifted 2Y Australian yields +5bp higher, with a further narrowing of AU-US rate differentials enough to see AUD/USD breach the 0.79 level for the first time since May 2015.

Trade-weighted AUD\$ testing multi-year highs

Trade-weighted AUD\$ index



"An appreciating exchange rate would complicate this adjustment" - RBA

We may be once again witnessing a classic case of markets front-running central bank policy. There was nothing in the latest minutes that suggested the RBA were ready to embark on a Fed-like tightening cycle; our Chief International Economist [Rob Carnell](#) notes that for this to happen we would need to see a notable pickup in domestic inflation and wages.

Equally, for some time the RBA's mantra has been that "an appreciating exchange rate would complicate this [ongoing economic] adjustment". While there is little domestic-policymakers can do about a weak US dollar, the fact that the trade-weighted AUD is also testing multi-year highs will be of some concern. With a 2017 RBA rate hike still looking highly unlikely - and iron ore prices expected to remain soft - there is little fundamental justification for the trade-weighted AUD\$ to move much above the 67.00 level.

What to watch out for next...

Two keys events to look out for in the next week which will test the current short-term AUD bullish momentum:

1. RBA Deputy Governor Debelle's speech on Friday is aptly called "Global Influences on Domestic Monetary Policy". Markets will be looking for clarity on the near-term direction of policy rates, while it'll be interesting to see whether officials will attempt to talk down ("jawbone") the AUD.
2. With inflation playing a key role in the RBA's policy reaction function, 2Q CPI data next week (26 July) will be critical for markets. Any disinflationary signs - as witnessed in neighbours New Zealand this week - could limit any near-term AUD upside.

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