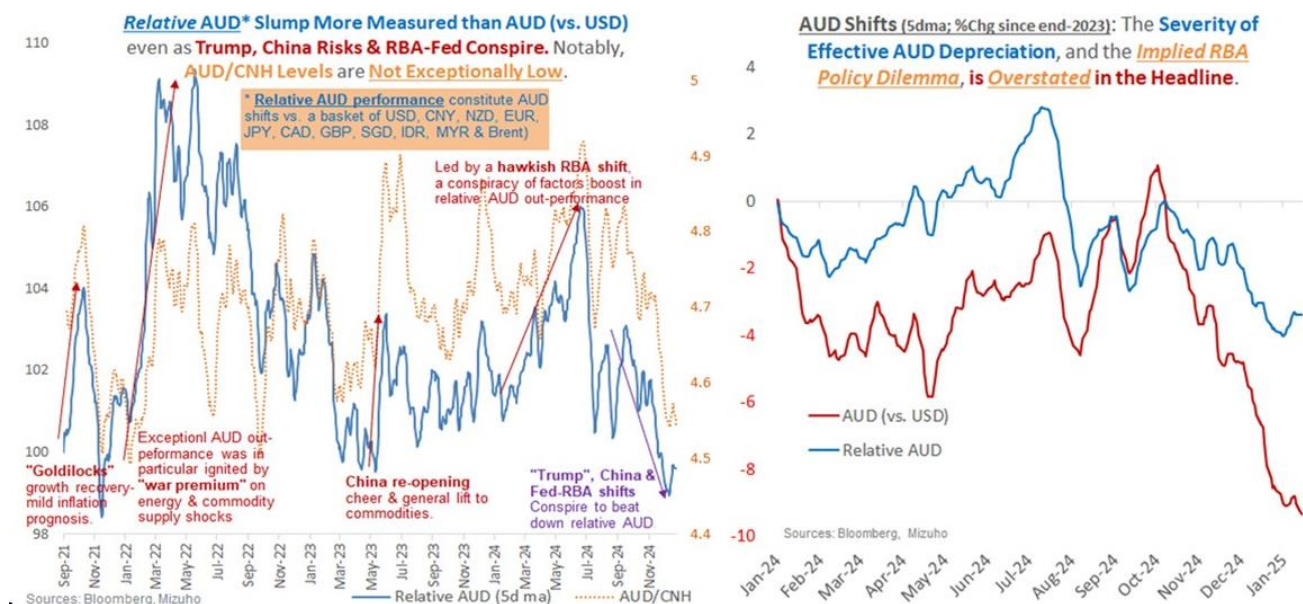


Why AUD Bears Will Not Intimidate the RBA

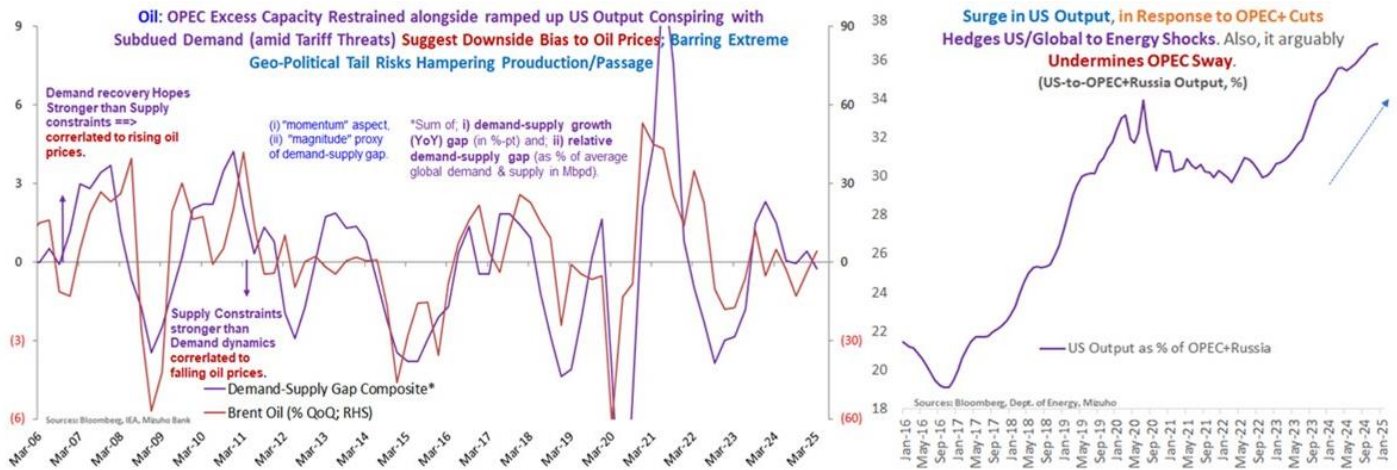
"Your focus determines your reality" - Qui-Gon Jinn in Star Wars: Episode I – The Phantom Menace.

In a Nutshell:

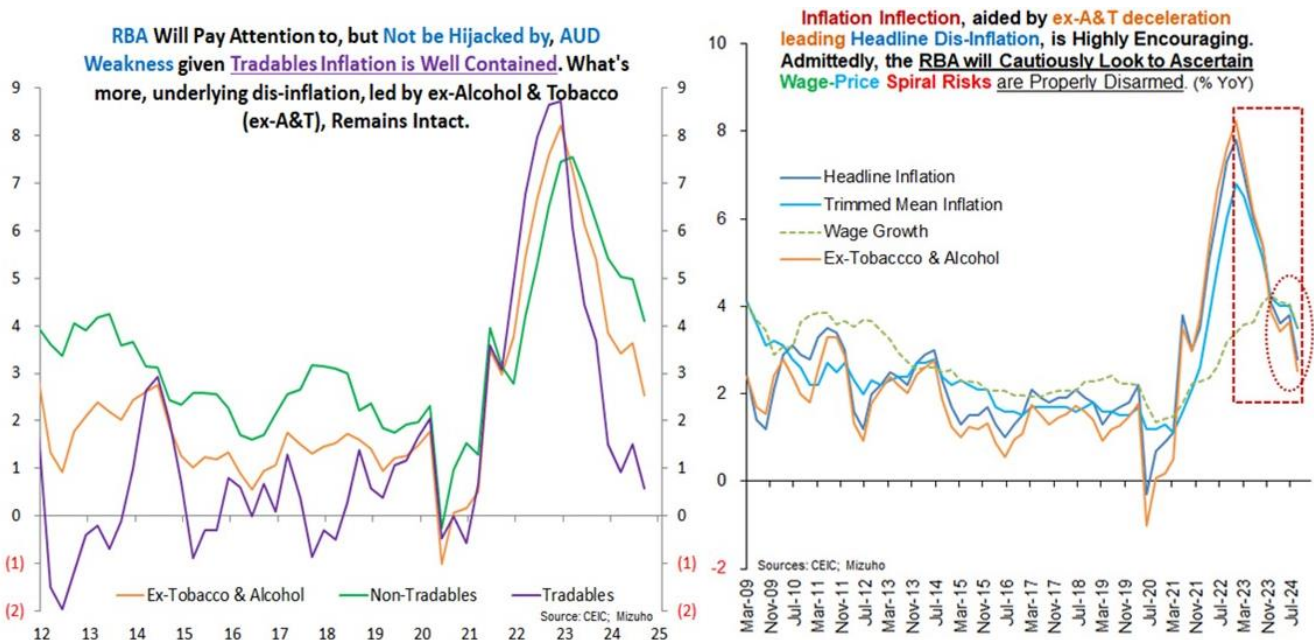
- **Sharp AUD depreciation challenges, but does not incapacitate, the RBA** (in terms of scope to ease). The **RBA's focus is growth-inflation dynamics, not the AUD** (even if it is of some concern).
 - For one, **imported inflation risks from AUD drop are exaggerated** by bilateral AUD-USD shifts,
 - What's more, **tradable inflation is assuring subdued** further diminishing the risks of inflation flaring up. Especially as **underlying dis-inflation dynamics are intact**. More so, as **subpar growth and fragile underlying consumer dynamics dampen demand-pull risks** further.
 - Notably, **real rate spread pick-up** from Fed's front-loaded easing alongside more **advantageous (to AUD) inflation dynamics provides RBA doves with sufficient cover**.
 - **RBA Outlook: Rate cuts set for no later than April**, with *February a distinct option*. **Risks tilted to more, not fewer cuts**, vis-à-vis our **call for a cumulative 75bp of cuts in 2025**.
 - **AGB Yields**: Consequently, **front-end (3Y) yields could head towards 3.1-3.4%**, with **10Y set for 4.0-4.2%**, **entailing some bull steepening**; possibly mildly accentuated on fiscal slippage.
 - **AUD**: Partial recovery to 0.68 by late-2025/early-2026 **subject to near-term accentuation of downside risks**; assuming initial intensification of Trump-China-Fed risks scale back to reveal some relief.
 - **Structural Caveat for AUD**: Lower commodity demand multipliers from China stimulus though could stymie a fuller recovery consistent with past China stimulus.
- A **brutally bearish turn in the AUD** (down 10-11% since end-Sep 2024) to sub-0.62 **will inconvenience, but not intimidate, the emerging RBA doves (into inaction)**.
 - After all, **the RBA's distinctly dovish shift**, (although still conditional on disinflation not being derailed) is **validated by a confluence of less sticky inflation and a sobering shortfall in growth**.
 - **But the trouble is, the RBA's shift has coincided with a sharp and sustained drop in AUD** (to test 61 cents), which typically threatens to **complicate plans for easing**.
 - And to be sure, **imported inflation risks re-introduced by AUD plunge of this magnitude** (10-11% since end-Sep 2024 and nearly-5% in just Dec), **simply cannot be dismissed**.
 - **Nonetheless, concerns of AUD bears hijacking RBA doves are overblown** on five counts.



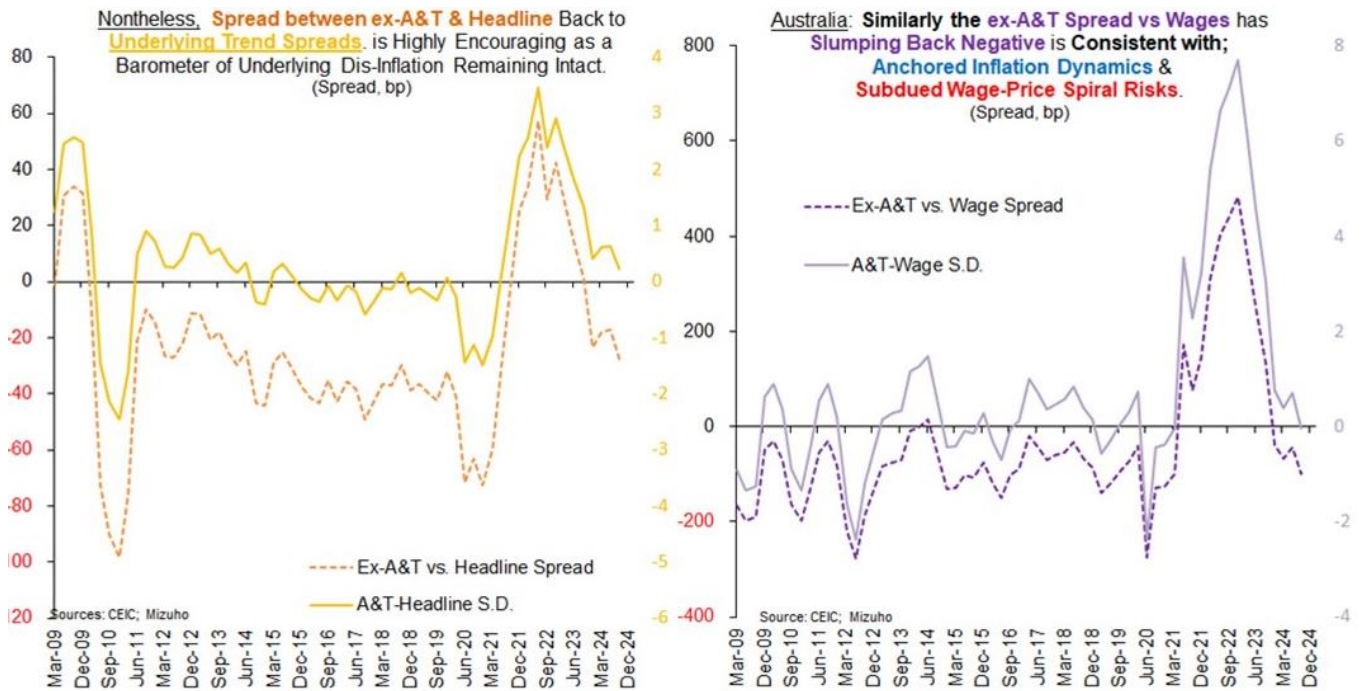
- **Wider Russian Sanctions:** Brent crude has jumped over \$80/bbl in response to **significantly widened net of sanctions on Russia’s oil exports** – hitting **shipping , trading and insurance**.
- **Supply Crimp Fears:** The **bullish (crude) price reflex**, presumably **driven by fears supply being materially crimped** (to the order of 500K-800Kbpd) for is **wholly justified**. And **may be more upside shocks left**.
- **But Not a Game-Changer:** **But** the **grander demand-supply dynamics** are still **shaping up for relatively stable, not soaring, oil prices**.
- **Five Key Mitigating Factors:** To be sure, geo-political shifts continue to pose a serious upside risk to oil. But there are **five mitigating factors** to **quell fears of unremitting bullish trend in oil**.



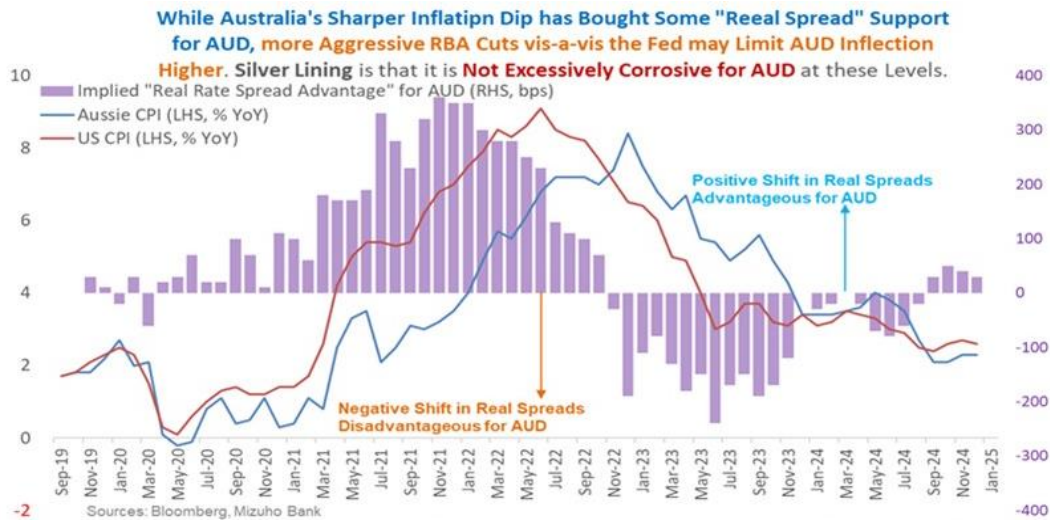
- **First, headline AUD drop** (vis-à-vis the USD) **overstates the effective imported inflation risks** insofar **that relative AUD pullback** (against a wider, more import-relevant basket) is **materially more measured** *.
- **Second, and crucially, the threat of resurgent inflation on account (more diminished) relative AUD stumbles** is **still exaggerated** given that **tradables inflation is much more subdued**.



- **Third, the broader, underlying dis-inflation dynamics are encouragingly intact**. Especially so **with dampened demand-pull factors** that are further **stifled** (rather than alleviated) **by a weaker AUD**.

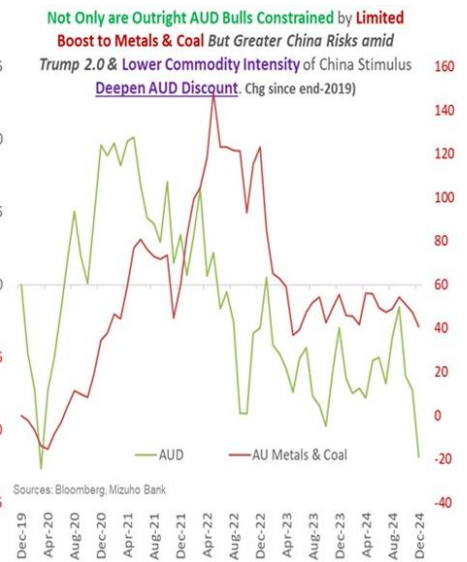
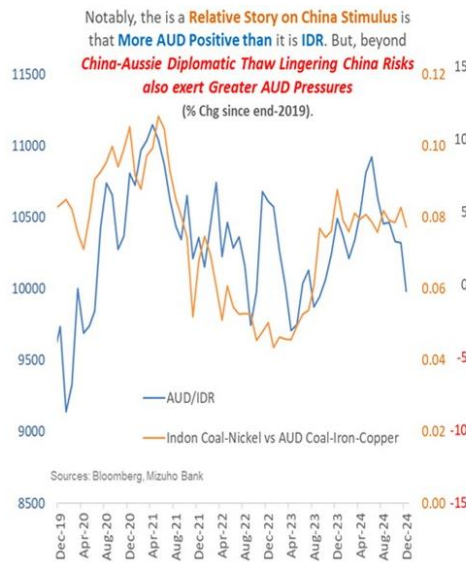
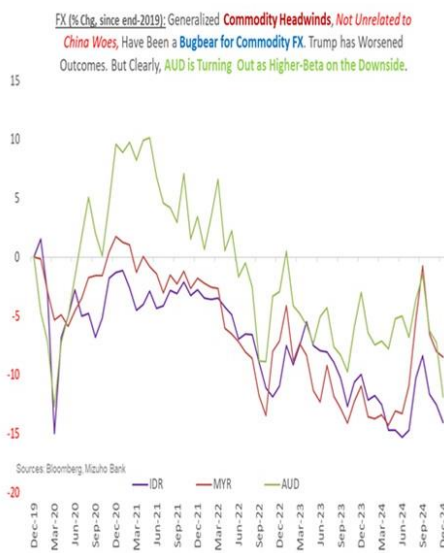


- Fourth, **growth boost from a softer AUD is significantly curtailed**, given the double-whammy of structural constraints on commodity-driven growth multipliers and perversely compromised consumption dynamics.
- On the former, **commodities-led boost from a softer AUD is stymied** in more demand-constrained world, marked by **diminished marginal commodity demand from China's prolonged property market slump**.
- In fact, a **cheaper AUD compromises affordability**, it **perversely accentuates stress on already struggling consumption** – real retail sales have been languishing.
- Simply put, **AUD pressures not only exaggerate inflation risk**, but may **exacerbate** (rather than alleviate) **persistently stressed sub-trend growth**.
- Finally, Fed cuts, while short of flipping nominal rate spreads to be a source of AUD boost, nevertheless provides incremental comfort for the RBA to ease (gradually).
- Specifically, by **blunting AUD (pressures) trade-off involved in easing** as **real spreads are marginally supportive of AUD** (albeit tentatively, depending on projected rate path).



- The upshot is that the *sharp AUD stumble may augment* (timing/pacing), *but not outright arrest, RBA rate cuts*. After all, the **RBA's focus is growth-inflation dynamics, not the AUD** (as much of a concern it may be).
- We expect that the **RBA will initiate its first rate cut no later than April, although February is "live" and arguably compelling** for a cut if inflation remains reasonably tame.
- **RBA Outlook**: For the year, we **expect 75bp of cumulative cuts**, with the **balance of risks tilted to more, not fewer, cuts**. And preferably front-loaded, subject to inherited constraints from the Fed.
- Especially *given that the threat of adverse demand shocks, intensifying economic pain amid already woefully sub-par growth, edge out* the risk of sustained demand-pull price dynamics taking hold.
- **AGBs Yields**: The resultant impact on the **AGB yield curve** will probably be **tilted to some bull steepening**, with *fiscal slippage an incremental dampener on long-end pullback*.
 - 3Y AGBs are set to head lower to 3.1-3.4% (from ~4.0% now)
 - 10Y AGBs with potential to head to 4.0-4.2% (from ~4.6% currently)

- **AUD**: Notwithstanding the RBA’s rate cuts, **AUD** looks **set for a bumpy, partial recovery** (to ~0.68) by year-end, although *subject to persistent, if not dominant, downside risks initially*. This is on account of/conditional on;
 - Stretched US exceptionalism**, and *corresponding USD outperformance, fading alongside Trump-China risks*; with *resultant, slightly higher-beta lift to AUD* (reversing recent higher-beta downturn)
 - Weakness in excess of commodity fundamentals already baked in**, therefore setting **AUD up for slightly more emphatic “relief” gains**.
 - More **encouraging signs of China stimulus** (with resultant economic backstop for China), with **commodity channel lift for AUD**. Although, *diminished commodity demand multipliers from China stimulus* will likely *dampen the extent of attendant AUD rebound*.



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