

Wednesday, 10 December 2014

Australian Dollar Outlook

Renewed Weakness

- **We recently revised our cash rate outlook. We no longer expect the RBA to raise rates next year. This view implies a weaker profile for the AUD next year. We now expect the Australian dollar to end next year at US\$0.7500.**
- **The US Federal Reserve remains on track to begin normalising monetary policy next year, which should continue to give the USD a boost.**
- **An RBA on hold next year, ongoing USD strength and renewed weakness in the prices of Australia's key commodities suggests the risks are to the downside for the AUD/USD next year.**

We recently revised our forecasts for the cash rate outlook. We now expect the Reserve Bank to leave rates on hold next year. The record low cash rate is having a positive impact on economic activity, however, the pace of growth remains below trend. It now seems unlikely that growth will gather sufficient pace during 2015 to warrant lifting the cash rate. The risk of a cut in the cash rate has also increased.

The revision in our cash rate forecasts implies a weaker outlook for the Australian dollar, mainly against the US dollar.

We continue to expect the US Federal Reserve to start raising rates next year, most likely in June but a rate hike sooner cannot be ruled out. Therefore, Australian-US interest-rate spreads should narrow further and pressure the AUD/USD exchange rate lower.

The Fed has emphasised the data dependence nature of policy going forward. Recent economic data suggests then that the Fed is still on track to normalise monetary policy next year, ahead of other key central banks. Key data being considered in policy making is employment. The strength of the recent jobs numbers suggests a further tightening of the US labour market and it adds to the case for rate hikes next year in the US. Continued labour market gains should help support consumer confidence and spending. Lower oil prices will also give household disposable income a shot in the arm, given the US's status as a net oil importer. While inflationary pressures are still relatively contained, we expect that eventually inflation will build and the US Fed will want to begin the process of normalising monetary policy.

The Australian dollar has also broken under key technical levels (US\$0.8540 in late November) and commodity prices have declined further, especially those of the bulk commodities, hurting the local currency. The AUD also acts as proxy to the Chinese economy and recent Chinese economic data has been patchy. China's central bank recently cut the lending rate to help revive the economy but more stimulus might still be needed.

We now expect the Australian dollar to finish 2015 at US\$0.7500 rather than US\$0.8200. Our detailed forecasts are on the next page.

EXCHANGE RATE FORECASTS

End Quarter Forecasts

	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
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USD Exchange Rates

AUD-USD	0.8100	0.7800	0.7700	0.7600	0.7500
USD-JPY	121.00	122.00	123.00	124.00	125.00
EUR-USD	1.2200	1.2000	1.1900	1.1800	1.1700
GBP-USD	1.5900	1.5800	1.5900	1.5900	1.6000
USD-CHF	0.9500	0.9600	0.9700	0.9800	0.9900
USD-CAD	1.1300	1.1300	1.1300	1.1400	1.1400
NZD-USD	0.7700	0.7600	0.7500	0.7500	0.7400
USD-CNY	6.1500	6.1800	6.2000	6.2100	6.1800
USD-SGD	1.3100	1.3200	1.3200	1.3200	1.3200

AUD Exchange Rates

AUD-USD	0.8100	0.7800	0.7700	0.7600	0.7500
AUD-EUR	0.6640	0.6500	0.6470	0.6440	0.6410
AUD-JPY	98.00	95.20	94.70	94.20	93.80
AUD-GBP	0.5090	0.4940	0.4840	0.4780	0.4690
AUD-CHF	0.7700	0.7490	0.7470	0.7450	0.7430
AUD-CAD	0.9150	0.8810	0.8700	0.8660	0.8550
AUD-NZD	1.0520	1.0260	1.0270	1.0130	1.0140
AUD-CNY	4.9820	4.8200	4.7740	4.7200	4.6350
AUD-SGD	1.0610	1.0300	1.0160	1.0030	0.9900

* Note that the AUD cross exchange rates have been rounded.

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