PICTET 1805

Flash Note

Currencies: AUD and NZD

No rate hikes in sight for antipodean currencies

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At their November monetary meeting, both the RBA and the RBNZ kept their official cash rates unchanged at, respectively, 1.50% and 1.75%.

The RBA sounded relatively cautious given low wage growth and high household debt. The RBNZ was more upbeat in light of the potential for more fiscal stimulus under the new coalition government and the recent sharp NZD depreciation. However, a rate hike remains highly unlikely in either country in the first half of 2018.

The Australian dollar could be vulnerable in the coming months given uncertainty regarding household consumption and high speculative long positions in the futures market.

We are keeping our 3-month and 6-month forecasts unchanged at USD0.70 for the NZD/USD rate. However, we are lowering slightly our 3-month and 6-month forecasts for the AUD/USD rate to USD0.75 from USD0.76.

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The Reserve Bank of Australia (RBA) and the Reserve Bank of New Zealand (RBNZ) both kept their official cash rates unchanged at, respectively, 1.50% and 1.75% at the end of their November monetary policy meetings. Neither central bank seems in a rush to raise rates.

Household consumption remains at risk in Australia

While the growth and employment outlooks remain positive, the RBA is increasingly concerned by low wage growth and high household debt (standing at 190% of disposable income). Should households start to anticipate a persistently low wage growth environment, it would entail significant risk for household consumption. In such an environment, the RBA will, in our view, remain cautious and wait for improvements in the domestic consumption outlook before raising rates. The slight downward revisions in the inflation outlook suggest that a rate hike remains highly unlikely in the first half of 2018. Furthermore, the RBA is well aware that any appreciation in the Australian dollar weighs on the growth and inflation outlook.

The RBNZ is becoming a bit more hawkish

Based on the RBNZ's latest projection for the cash rate, the central bank is becoming a bit more hawkish, thanks to a strong growth outlook, terms of trade that remain favourable, prospects for a supplementary fiscal stimulus under the new coalition government, and depreciation of the New Zealand dollar (the trade-weighted index has lost -5.6% since the start of the year). Consequently, the concerns raised in some quarters that the September general election would trigger a significantly more dovish monetary stance seem a bit exaggerated.

Furthermore, CPI inflation is around the midpoint of the RBNZ's 1%-3% target range and the unemployment rate was just 4.6% in the third quarter (vs. an average of 6.1% since 1986). That being said, the RBNZ is in no hurry to raise rates, which are unlikely to loom until 2019 at the earliest, according to the central bank's own projections.

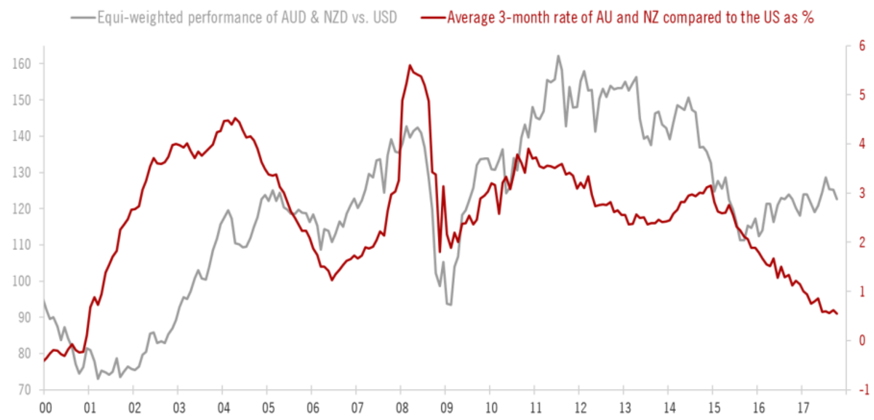
Interest-rate differentials to further weigh on NZD and AUD

Antipodean currencies tend to be highly influenced by interest-rate differentials (*see chart 1*) and trends in the commodity market (*see chart 2*).

With the Fed expected to remain in rate-hiking mode at least for the next six months, interest-rate differentials should continue to weigh on the antipodean currencies relative to the US dollar. And while the large down cycle in commodities of 2014-2015 is most likely behind us, the outlook for some key Australian exports remains weak. The RBA's November Statement on Monetary Policy forecasts that Australia's terms of trade will decline in the next few years due to low-cost competition and easing demand from China.

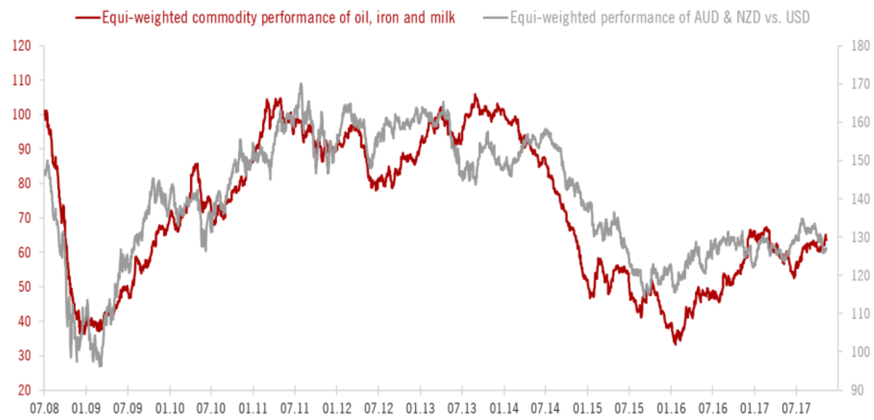
Valuation is unlikely to be supportive of antipodean currencies either. Although not extremely overvalued, they are among the most expensive major currencies based on CPI purchasing-power parity.

Chart 1: antipodean currencies vs. interest-rate differential



Source: Pictet WM – AA&MR, Thomson Reuters

Chart 2: antipodean currencies vs. commodity prices



Source: Pictet WM – AA&MR, Bloomberg

Antipodean currencies unlikely to outperform

Overall, the aforementioned factors are not particularly supportive of significant antipodean spot performance in the next 12 months. Although our three-month and six-month projections point to a stable exchange rate relative to the greenback for both currencies, we see some downside risk for the Australian dollar due to one-sided positioning among speculators.

Large speculative net long positions had built up in the AUD and NZD futures markets by mid-July. Thereafter, the uncertainty linked to the general election led to a sharp decline in the New Zealand dollar (-9.0% relative to the US dollar from 26 July to 26 October) with speculative positions moving into net short territory.

However, despite some weakness in the Australian dollar during the same period (-4.3% relative to the US dollar), speculative positions remain significantly long in that currency (*see chart 3*). Given the risk to the growth outlook stemming from household consumption trends, the Australian dollar seems in our view particularly vulnerable in the next few months.

Consequently, we are keeping our three-month and six-month NZD/USD rate forecast unchanged at USD0.70, but we are lowering our forecast for the AUD/USD rate to USD0.75 from USD0.76.

Chart 3: NZD/USD vs. CFTC net long NZD positions (divided by open interest)

Source: Pictet WM – AA&MR, Thomson Reuters