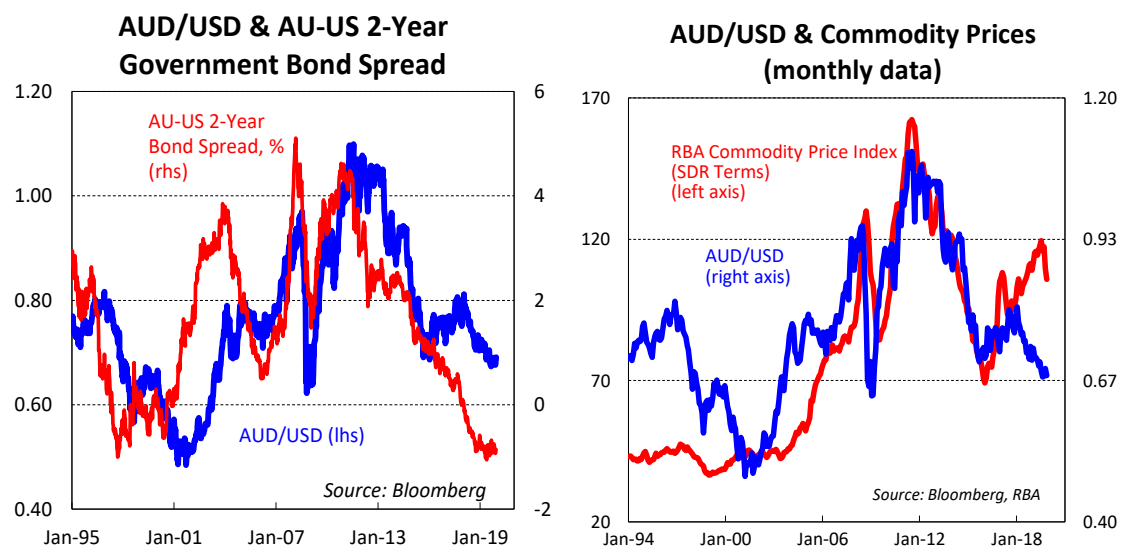


Monday, 16 December 2019

Australian Dollar Outlook

Where's the Action?

- The Australian dollar fell to a recent low of 66.71 US cents on October 2, down from this year's high of 72.95 US cents on January 31.
- Developments around trade relations between the US and China have been the dominant theme driving market sentiment and the Australian dollar for nearly two years. The global trade tensions have been a key factor in bringing down the Australian dollar.
- Downside risks to the Australian economic outlook have also placed downward pressure on the currency. Domestic economic growth is close to its weakest in a decade and the RBA has lowered the cash rate three times this year to a record low of 0.75%.
- Risks for the Australian dollar continue to be skewed towards the downside. While a “phase-one” deal between the US and China has given investors hope that trade tensions are thawing, global growth prospects remain mixed.
- Moreover, Australian economic growth is expected to remain below trend and fall short of the RBA's forecasts. We expect that the RBA will ease monetary policy further in 2020.
- Despite the various risks to the global and domestic economy, movements in the Australian dollar and currency markets overall this year have been extremely muted. The trading range of the Australian dollar this year has been one of the narrowest since the dollar was floated in 1983. Indeed, only 1991 had a narrower trading range in the post-float era.
- We expect just a modestly lower AUD next year. Our end 2020 AUD forecast is 67 US cents, but we expect it could fall lower over the first half of next year.



Developments around trade relations between the US and China have been the dominant theme driving market sentiment and the Australian dollar for nearly two years. The global trade tensions have been a key factor in bringing down the Australian dollar from this year's high of 72.95 US cents on January 31. In addition, momentum in the global economy has weakened. The Australian dollar tends to move closely with prospects for the global economy.

Downside risks to the Australian economic outlook have also placed downward pressure on the currency. Domestic economic growth is close to its weakest in a decade and the RBA has lowered the cash rate three times this year to a record low of 0.75%.

These headwinds have brought down the Australian dollar to a recent low of 66.71 US cents on October 2.

More recently, a "phase-one" deal between the US and China has given investors hope that trade tensions are thawing. The rebound in risk appetite has helped lift the Australian dollar from its lows. Additionally, there has been a substantial unwinding of expectations of further monetary policy easing.

Nonetheless, risks for the Australian dollar continue to be skewed towards the downside.

The outlook for the global economy remains mixed. Indicators around the world are still pointing to activity struggling, particularly within manufacturing, although they have stabilised more recently. In the US, employment is continuing to be resilient, but remain at risk of moderating as the economy softens. Moreover, phase one of the US-China trade agreement does not mean the trade issues have been eliminated; the underlying issues at the heart of the US-China trade deal remain.

Commodity prices have fallen from their recent peaks and are expected to fall further given signs of weakening momentum in the Chinese economy and ongoing challenges in the global economy. That said, the Australian dollar has had limited reaction to the surge in iron ore prices in the middle of this year due to supply disruptions from Brazil. Therefore, the recent fall in commodity prices may not have a substantial impact in bringing down the Australian dollar. Although historically, commodity prices have had a strong relationship with the Australian dollar, this relationship has broken down somewhat over the past few years.

Weak economic growth domestically also poses further downside risks for the Australian dollar. Growth remains well below trend, and is expected to remain so over the coming year. Importantly, this would suggest economic growth will fall short of the RBA's forecasts. We expect that the RBA will lower the cash rate another two times next year. There is also a good chance the RBA will embark on a quantitative easing program (bond purchases) over the second half of next year.

With these risks in mind, we also note that movements in the Australian dollar and currency markets overall this year have been extremely muted by historical comparison. The trading range of the Australian dollar this year has been among the narrowest since the dollar was floated in 1983. Only 1991 had a narrower trading range in the post-float era.

However, the narrow range is in part reflective of the economic conditions we are facing. Consistently slower rates of economic growth and ongoing low inflation have translated to expectations that interest rates will remain at very low levels for an extended time. While developments on the trade tensions continue to be the key risk for the Australian dollar, which is

subject to considerable uncertainty, we expect just a modestly lower AUD. Our end 2020 AUD forecast is 67 US cents, but expect it could fall lower over the first half of next year when the RBA is expected to embark on further monetary policy easing.

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Please see detailed forecasts below

EXCHANGE RATE FORECASTS

	End Quarter Forecasts						
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21

USD Exchange Rates

AUD-USD	0.6600	0.6600	0.6700	0.6700	0.6800	0.6900	0.7200
USD-JPY	107.00	106.00	105.00	105.00	106.00	107.00	108.00
EUR-USD	1.0900	1.1000	1.1100	1.1200	1.1300	1.1400	1.1500
GBP-USD	1.3300	1.3200	1.3200	1.3100	1.3100	1.3100	1.3100
NZD-USD	0.6400	0.6400	0.6500	0.6500	0.6600	0.6600	0.6700

AUD Exchange Rates

AUD-USD	0.6600	0.6600	0.6700	0.6700	0.6800	0.6900	0.7200
AUD-EUR	0.6060	0.6000	0.6040	0.5980	0.6020	0.6050	0.6260
AUD-JPY	70.60	70.00	70.40	70.40	72.10	73.80	77.80
AUD-GBP	0.4962	0.5000	0.5080	0.5110	0.5190	0.5270	0.5500
AUD-NZD	1.03	1.03	1.03	1.03	1.03	1.05	1.08

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

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