Sure-Fire Loser Aussie Turns Winner as RBA Seen Ending Rate Cuts

2015-05-13 07:38:06.715 GMT

(For a Currencies column daily alert: SALT FXCOL.)

By Netty Ismail

(Bloomberg) -- The Australian dollar's days as a sure-fire loser are ending.

After the Reserve Bank of Australia chose not to comment last week on whether it would keep cutting interest rates, hedge funds erased bets on an Aussie decline and strategists boosted forecasts for the first time in months. The currency responded by climbing above 80 U.S. cents, moving further away from the 75-cent level RBA Governor Glenn Stevens favors to keep the economy competitive.

Stevens's reluctance to pursue ever-looser monetary policy for fear of inflating a real-estate bubble leaves the Aussie at the mercy of investors lured by the highest government-bond yields of any top-rated nation. That means his only hope of a weaker currency may be a surge in the U.S. dollar fueled by the Federal Reserve's plan to raise interest rates this year.

"Australian interest rates, whichever way you cut it, are still well above comparable global rates and that attracts money to the Australian dollar," said Shane Oliver, head of investment strategy ion Sydney at AMP Capital Investors Ltd., which manages $124 billion. "That problem won't be eliminated until the interest-rate differential is closed."

He trimmed bets on a declining Aussie last month, and would add back to those short positions if the currency strengthens above 83 cents.

"The Aussie would have had its little relief rally and would start to head back lower again," Oliver said.

Rate-Cut Rally

Australia's dollar was at 79.84 cents at 8:36 a.m. in London, having risen from 78.48 cents before the RBA on May 5 withheld comments about further easing that were included in its previous two policy statements. The currency rallied on the omission even though officials cut the key interest rate to a record-low 2 percent.

The Aussie has been climbing for about a month amid speculation the central bank would be reluctant to cut borrowing costs below 2 percent and a rebound in commodity prices. The currency is heading for its first quarterly gain in a year, snapping its steepest decline since 2009.

It's up 5 percent since March, after falling 19 percent in the past three quarters. Since last week's policy statement, forecasters surveyed by Bloomberg have raised the median mid-year estimate for the Aussie to 76 cents.

"I wouldn't expect markets to get too aggressive on Aussie shorts with the RBA on hold near term," said Sean Callow, a strategist at Westpac Banking Corp. in Sydney. "They don't need to fear another rate cut in the short term."

Forecast Raised

Westpac boosted its end-of-June estimate for the currency to 78 cents from 75 cents. The bank predicts the Aussie will decline to Stevens's preferred level in the third quarter, pushing back a 73-cent forecast to the end of the year as likely U.S. interest rate increases starting in September are expected to weigh on the currency.

Bullish wagers on the Aussie exceeded bearish ones by 626 contracts in the week through May 5, according to the latest data available from the Commodity Futures Trading Commission in Washington. Hedge funds and other large speculators had been betting on declines since the week ended Sept. 30 and net shorts increased to a record 76,851 in early March.

The Aussie has attracted buyers as the nation's benchmark 10-year bond yield climbed to a high for this year of 3.04 percent on Tuesday. By comparison, 10-year U.S. Treasuries yield 2.25 percent and German bunds 0.68 percent.

Iron Ore

The currency has also been benefited from a rebound in iron ore, Australia's biggest export earner, which has surged 34 percent from its April 2 trough. That's eased the pressure on the terms of trade, or export prices relative to import prices.

Treasurer Joe Hockey said Tuesday Australia's budget deficit will be A$35.1 billion ($28 billion) in the 12 months starting July 1, A$5 billion narrower than economists forecast.

"The bounce in the iron-ore price should keep the Australian dollar at these levels," said Roger Bridges, the chief global strategist for interest rates and currencies in Sydney at Nikko Asset Management Australia. "The Reserve Bank would be very worried about the Australian dollar going too high, but at the moment they are probably comfortable around these levels."

Money-market traders have dropped bets for further easing in Australia, which is struggling with the end of a mining boom and a slowdown in China. The implied yield on December interbank cash-rate futures was at 1.89 percent on Wednesday, from a low of 1.60 percent on April 2. Last week's rate cut followed a quarter percentage-point reduction on Feb. 3 that was its first since 2013.

"Until the course of the U.S. monetary policy reverses, we're unlikely to see the Aussie dollar coming down significantly against the U.S. dollar," said Ray Attrill, global co-head of currency strategy at National Australia Bank Ltd. in Sydney.

For Related News and Information:

Foreign-exchange dashboard: XDSH <GO>

Currency forecasts: FXFC <GO>

Foreign-exchange platform: FXIP <GO>

Financial-conditions monitor: FCON <GO>

To contact the reporter on this story:

Netty Ismail in Singapore at +65-6212-1106 or

nismail3@bloomberg.net

To contact the editors responsible for this story:

Garfield Reynolds at +61-2-9777-8695 or

greynolds1@bloomberg.net

Caroline Salas Gage, Nicholas Reynolds