

# FX and Rates Watch - Australia & New Zealand

## Postcard from Australia

### A tale of two central banks

There were three key themes that emerged from our corporate and institutional clients in Sydney, Melbourne and Brisbane:

1. Risks that fewer cuts are priced in the US.
2. Risks that the RBA is forced to cut earlier than most anticipated late last year.
3. Long bias in AUD and AU rates but falling conviction as China risk sentiment plumbs to new lows but USD depreciation in the second half of 2024 remains the base case.

### Economic divergence

Downside surprises to monthly inflation and retail sales have reinforced an increasingly durable trend of softer-than-expected economic data in Australia. While Q4 2023 Australian GDP printed in line with expectations, household final consumption was conspicuously weak and the savings ratio rebounded for the first time in 10 quarters.

### Jobs will be key to the timing of cuts

Clients broadly agreed that Australian jobs data might ultimately be the catalyst for rate cuts given disinflation has proceeded faster than expected over the past few months. Several clients noted the risks of cuts as early as May, though, and highlighted the risk of weak jobs in March and an Q1 2024 CPI print (released in late April) consistent with inflation undershooting the target in April.

### The RBA is turning dovish

We broadly agree with domestic clients but note that further confirmation of recent trends will be required to bring forward the timeline for cuts. BofA's RBA Sentiment Indicator suggests the RBA has turned more dovish in response to softer-than-expected data and we see rising probability of an earlier start to the easing cycle if unemployment and CPI continue to print in line with recent trends (Exhibit 4). Against this backdrop, there is a risk that the RBA delivers a more dovish message than the market expects next week. Our long bias in front-end rates is growing while we closed our long AUD/NZD recommendation ahead of this event risk ([FX Alpha 14 March 2024](#)).

### Positioning is a challenge

One of the challenges for our view that investors should go long front-end rates is positioning. We have seen a significant increase in the number of respondents to BofA FX & Rates Sentiment Survey expressing long FX and rates views although the latest data indicates our global investor base increasingly prefers to express a long bias through FX than Australian duration (Exhibit 1, Exhibit 2).

*(continued over page)*

18 March 2024

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Timestamp: 18 March 2024 01:01AM EDT

## How to express a bullish view

We acknowledge our global clients' bullish view on AUD but see USD depreciation (particularly in H2 2024) as the main driver of AUD/USD appreciation. We also see rising risk of an earlier start to the RBA easing cycle. Our favourite long expressions are in the front end or add curve steepeners. We recommend fading any flattening in the YM/XM (3y/10y bond futures) curve below 35bps. The US curve has also flattened more aggressively than the AU curve since the start of the year, taking out some of the downside risks for AU curve steepeners.

## Positioning favours long bias in 2y rates

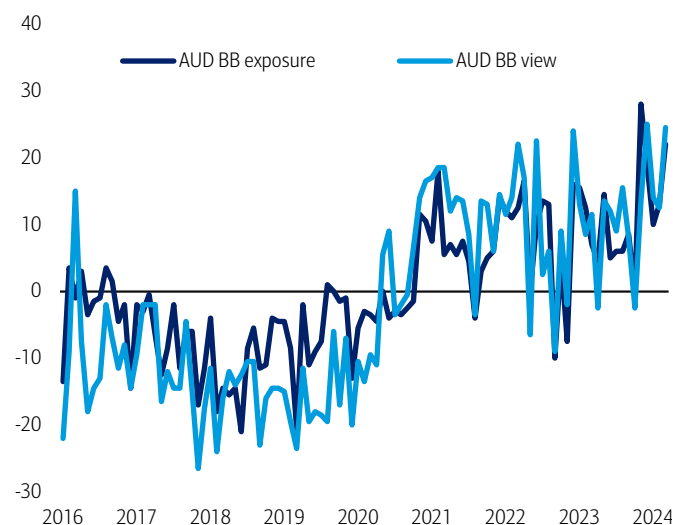
The main challenges for trading strategy with a long bias in AU rates are positioning and price movements in US rates. The market is clearly long but we are watching 2y bonds/1y1y swaps because the 2s3s segment of the AU bond curve has also flattened aggressively, closing in on 5y lows (Exhibit 3). We see expressions like 2s3s (or long 1y1y vs 2y1y swaps) as a popular carry trade that could quickly unwind if the market meaningfully reprices the start of the RBA's easing cycle. Long 2y rates therefore looks cheap but the FOMC meeting and AU jobs report will be key to near-term moves.

## AUD FX beta and hedge ratios

While there was broad agreement that the growing footprint of superannuation funds would impact a range of markets, there was some debate around the likelihood of durably higher FX hedge ratios on international equities ([Rise of the super funds 22 February 2024](#)). Investors agreed the beta of AUD to global equities seemed weaker (supporting higher hedge ratios) but expected hedging decisions to be more reactive to either FX spot levels or evidence of AUD not selling off upon a sharp equity correction.

### Exhibit 1: FX exposure and view: AUD

Into the RBA, AUD longs extended in line with sentiment...



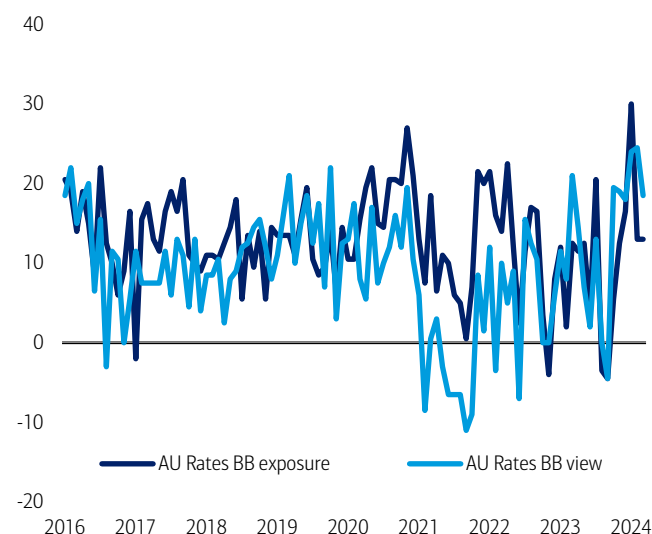
Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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### Exhibit 2: Duration exposure and view: AU

...and AU duration longs somewhat pared back as bullishness moderated



Source: BofA Global Research FX and Rates Sentiment Survey

BB is the Bull-Bear Index for exposure and view. It weights responses to create an index ranging from -100 to +100, zero representing neutral. See appendix for formulas.

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**Exhibit 3: 2s3s exceptionally flat**

Fade the flattener trade by going long 2y AU rates

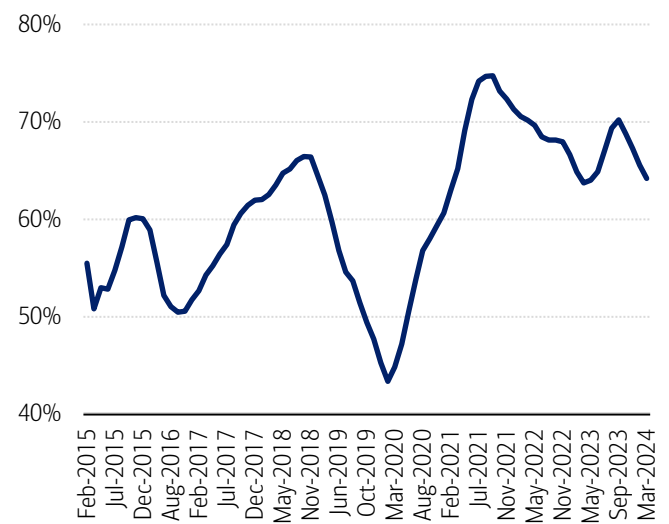


Source: BofA Global Research, Bloomberg

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**Exhibit 4: BofA RBA sentiment Indicator**

We see rising probability of cuts in H2 2024 if current trends persist



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