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SE Market Wrap

HD **$A slides from Fed's bold leap**

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The United States Federal Reserve's faster than expected timeline for interest rate rises has sparked a fresh US dollar rally and sent the Australian dollar to a six-month low in moves that will be greeted enthusiastically by the Reserve Bank of Australia.

Foreign exchange markets responded to the Fed's more hawkish interest rate expectations with US dollar buying and commodity currencies sliding.

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The Australian dollar was at US89.69¢ late Thursday.

Emerging markets currencies were knocked lower by the outcome of the meeting in Washington.

Global **bonds** barely moved however, indicating markets are not at risk of a shock increase in the cost of borrowing.

Meanwhile, **China** upped its accommodative policy settings for the second time this week. It has lowered the repo rate, equivalent to the cost of borrowing, after on Wednesday injecting liquidity into the financial system.

That was enough to reverse a slide in Australian stocks on Thursday, which closed up 8.5 points to 5415.8 points. Japan's Nikkei jumped above 16,000, its highest since January thanks to the yen falling to a six-year low against the greenback.

The ructions out of the US are consistent with a bold leap higher for the greenback which has been suppressed by years of monetary stimulus undertaken by the Fed. And all signs point to the latest moves representing a sustained Australian dollar retreat to below US90¢ and lower.

"I think it would be very much aligned with what Glenn Stevens would have expected and I think the RBA would be quite pleased," said Colonial First State head of economic and market research Stephen Halmarick.Doveish rhetoric

He highlighted that in spite of a doveish rhetoric in the Fed's statement, members' forecasts – represented by the 'dots' chart – signified the Fed was more advanced as a collective in its interest rate expectations.

"The dots were quite hawkish in that the median of the Fed committee has raised where they think interest will be at the end of next year," Mr Halmarick said, suggesting the equivalent of five interest rate increases in 2015 on the new guidance.

"The timing is still open for discussion but the pace of tightening is faster."

He credited the Fed for appealing to both the hawks and doves and retaining the flexibility to slow its path to raising the Fed funds rate from the 0 per cent bound. "I would describe it as the 'something for everybody' Fed meeting. I think that was a deliberate strategy.

"I think what it is, is Janet Yellen saying 'we know we're moving towards when rates are going to rise but we want to get there gradually … deliberately'." "She doesn't want a big reaction in the market, [the Fed] don't want bond yields to move higher. Let's stretch out the hawkishness."

JP Morgan currency strategist Sally Auld alluded to a compromise at the Fed considering the language of the statement "wasn't particularly hawkish" and yet the progression of "the dots" indicated a more hawkish tilt. "Yellen was at pains to emphasise in her press conference that if the data improves more quickly than they expect, they will be faster to hike," she said. "She's really saying the whole story is still very data dependent.

"She's putting the market on notice that 'considerable time' doesn't mean they just sit there and do nothing."Traders getting a grip

Ms Auld was referring to the Fed's repeating of the wording "considerable time" which keeps the central bank's options open with regard to how long it will wait after bond purchases are stopped before the first rate rise.

Bond purchases will end next month after an uninterrupted winding back of quantitative easing.

However, it appears that just as traders are getting a grip on the direction for the Fed in 2015, the world's second-biggest economy – **China** – is tweaking its policy settings in ways that will have equally significant but opposing effects on the Australian market.

Twice this week, **China**'s central bank moved to ease monetary policy in response to the latest economic data that showed the output from the nation's factories fell to their lowest level since the financial crisis. Economists said **China**'s target growth rate of 7.5 per cent would not be met unless the People's Bank of **China** eased policy. On Thursday, the central bank cut the 14-day repurchase rate by 20 basis points to 3.5 per cent which followed Wednesday's liquidity injection of Yuan 500 **billion** ($90 **billion**) into the banking system through short-term loans.

Illustrating the impact of **Chinese** stimulus, the Australian dollar, which is a proxy for **Chinese** growth in the eyes of international investors, was trading as low as US89.38¢ 9am Sydney time but was as high as US89.75¢ after midday as it became apparent The People's Bank of **China** (PBOC) was in the market again.

Goldman Sachs said **China**'s liquidity injection was equivalent in its impact on the banking system to 0.5 of a percentage point of interest rate cuts. "Given policymakers have shown a willingness to loosen in the face of weaker data, we believe growth will rebound in the coming months and the government will be able to reach the 'around 7.5 per cent' full-year [gross domestic product] growth target for 2014," Goldman said in a report.**China** crackdown

The Fed and the PBOC cap off a big week for Australian investors which started off on unsteady footing as the **iron ore** price hovers at almost five-year lows. The plunge in the commodity price and until now, high Australian dollar, have represented a double blow for the **mining** sector underscoring the importance of a weaker local currency.

China also intensified its crackdown on low-grade **coal** imports in a blow to Australian exporters. And the RBA, in its minutes from the September policy meeting, publicly aired its concerns around the risk of asset bubbles forming in its low-rates environment.

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