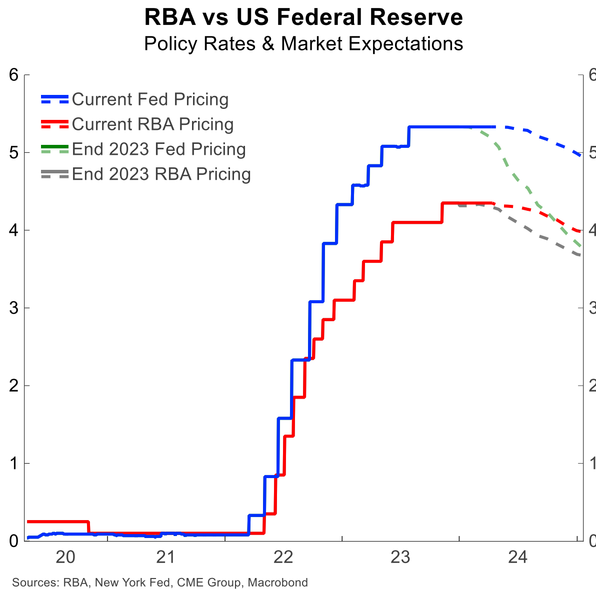
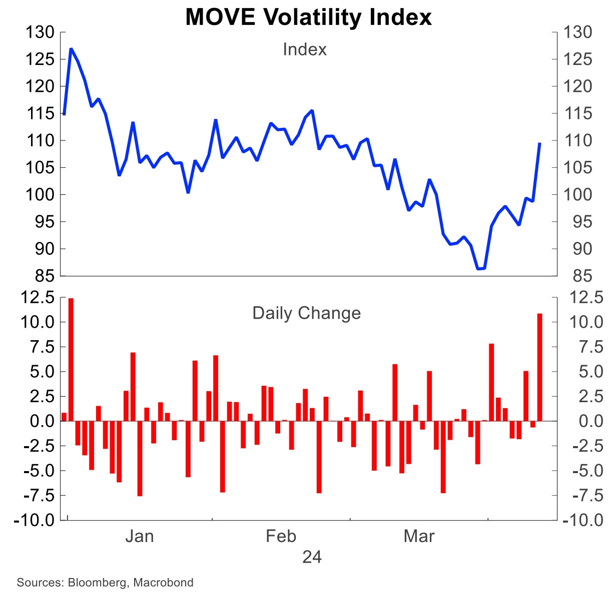
Thursday, 11 April 2024

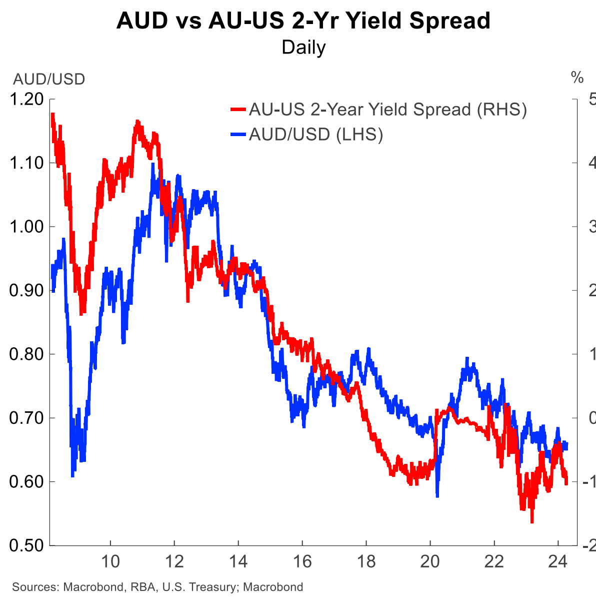
Foreign Exchange Insights

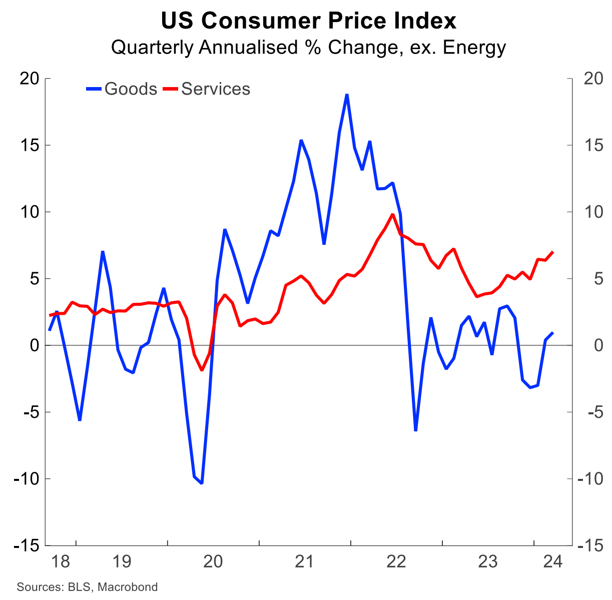
'Higher for Longer' Risks Deepen

- **There were massive moves in financial markets overnight after the US inflation report printed above market expectations for the third straight month.**
- **The US consumer price index (CPI) rose by 0.4% in March, higher than the consensus forecast for a rise of 0.3% and taking the annual rate up 0.3 percentage points to a six-month high of 3.5%. The core CPI, which excludes food and energy costs, increased by 0.4% last month and the year-on-year rate remained unchanged at 3.8%, defying expectations for a downtick.**
- **Paired with the recent blockbuster jobs report, it spurred traders to lengthen the odds on when the US Federal Reserve will start cutting rates.**
- **The MOVE index – measuring volatility in bond markets – recorded its second biggest spike in 2024, as the US 2-year yield jumped the most in almost 13 months and the 10-year yield by the most in 18 months (in basis points).**
- **Since the start of this year, when speaking with our customers, a consistent risk we've flagged is the potential for the "higher for longer" theme to continue.**
- **The recent data in the US is suggesting persistent price pressures are an ongoing risk and the return to the inflation target may take longer.**
- **In Australia, it's a different story with recent data showing a faster fall in inflation than policymakers expect, although the unemployment rate has remained very low. It means markets no longer expect policy rates by the end of this year to be markedly different from where they are today – as they did at the end of 2023 (see chart below).**
- **Further, markets now see a wide differential continuing (blue and red dotted plot) between US and Australian policy rates rather than narrowing as they did at the end of 2023 (green and grey dotted plot).**
- **This has implications not just for bond markets but also the Australian dollar. The divergence in rate cut timing risks for the RBA and Fed will continue to dominate the outlook for the AUD/USD and Australian importing and exporting businesses.**
- **The AUD/USD has spent the past year in a trading range of 62.70 US cents and 68.55 US cents. It has been constrained from piercing through 69.00 US cents by the appeal of higher US interest rates relative to Australian interest rates.**
- **Overnight, the AUD/USD had its biggest move lower in 13 months with the move from 66.29 US cents to 65.12 US cents.**
- **In the near term, the AUD/USD may rise modestly and try to consolidate after the massive moves overnight, but the risk is that the AUD/USD remains under downward pressure in coming months if the data continues to fail to endorse a near term rate cut from the US.**









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