Forex Focus: Aussie Will Still Rise Despite Soft CPI

By Nicholas Hastings

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LONDON (Dow Jones)--The Aussie's rally over $0.90 for the first time since early May may have been driven largely by expectations of another rise in Australian interest rates.

These expectations could have been dashed by softer-than-expected inflation figures earlier Wednesday.

However, international developments could take up the slack as optimism over the global recovery returns and even recent concerns about China's slowdown subside.

See how the Aussie rose over $0.90 and then fell back after the consumer price data:

http://www.dowjoneswebservices.com/chart/view/4316

For the Aussie, which generally benefits when investor appetite for risk improves, this can only be good news.

For the last few weeks, the Australian dollar has found support as the Reserve Bank of Australia has raised expectations that interest rates will be increased as early as next week.

Growth data have proved strong and consumer prices look set to keep on rising. In the event, the core consumer price index only rose 2.7% in the second quarter instead of 3.0% as expected.

This could halt rate-hike expectations in their tracks.

But strong trade data have also been showing that export prices are holding up well, adding to the impression of steady flows into the Aussie.

Also, other factors are now entering the Aussie-positive equation.

Over the past few days global risk sentiment has shown a distinct recovery, helped by the release of the European bank stress tests last Friday as well as by hopes that the global recovery is still well underway after all.

Although the bank stress tests were hardly seen as a resounding success, and have left residual concerns about the health of the European financial system, they did lower the market's immediate concerns about sovereign risk.

This has coincided with reassurances from the U.S. that the country is not entering a double-dip recession and signs in the euro zone that growth may be stronger than expected.

Elsewhere, rate increases in India as well as Israel contribute to the view that the expansion of some economies remains robust enough to withstand monetary tightening.

This improved sentiment is evident in the latest rally in global equity markets, a move that is often closely correlated with gains in the Australian currency, especially against the U.S. dollar.

Additional help for the Australian currency could also be coming from China.

A rally in iron ore and steel prices combined with signs of a rebound in Chinese property shares will help to erase recent concerns about a slowdown in Chinese growth and attempts by the Chinese authorities to dampen speculation in Chinese property.

Higher growth in China generally translates into improved prospects for Australia, which is already topping its G10 neighbors with its recovery from the recent slump.

This should certainly help the Aussie to shrug off new fears about Chinese banks, based on reports that one-fifth of the loans they have made to local councils are at risk.

Although some analysts reckon that the Aussie's recent rally has taken it back into overstretched territory, there still appears to be plenty room for a speculative run on the upside given that long positions in the futures market have recently been scaled back according to the most recent data from the Chicago Mercantile Exchange.

Early Wednesday, the Aussie had slipped back to $0.8964 by 0645 GMT from $0.9022 late Tuesday in New York, according to EBS.

The decline came despite an improvement in global risk sentiment, which helped the euro to rise to $1.3028 from $1.3006, while against the yen it was at Y114.71 from Y114.73. The dollar was also up at Y88.02 from Y87.97.

Although weak U.S. consumer confidence data initially dented sentiment, investors appear to be looking ahead to U.S. durable goods figures later in the day that are expected to show a 1.1% rise after a 0.6% fall.

This optimism is being shown in global equity markets, with most Asian indexes closing with gains of over 2.0%.

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 Reuters   USD/DJ
   Thomson   P/1066 or P/1074
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