Mizuho Brief: AUD

Economics & Strategy | Asia ex-Japan

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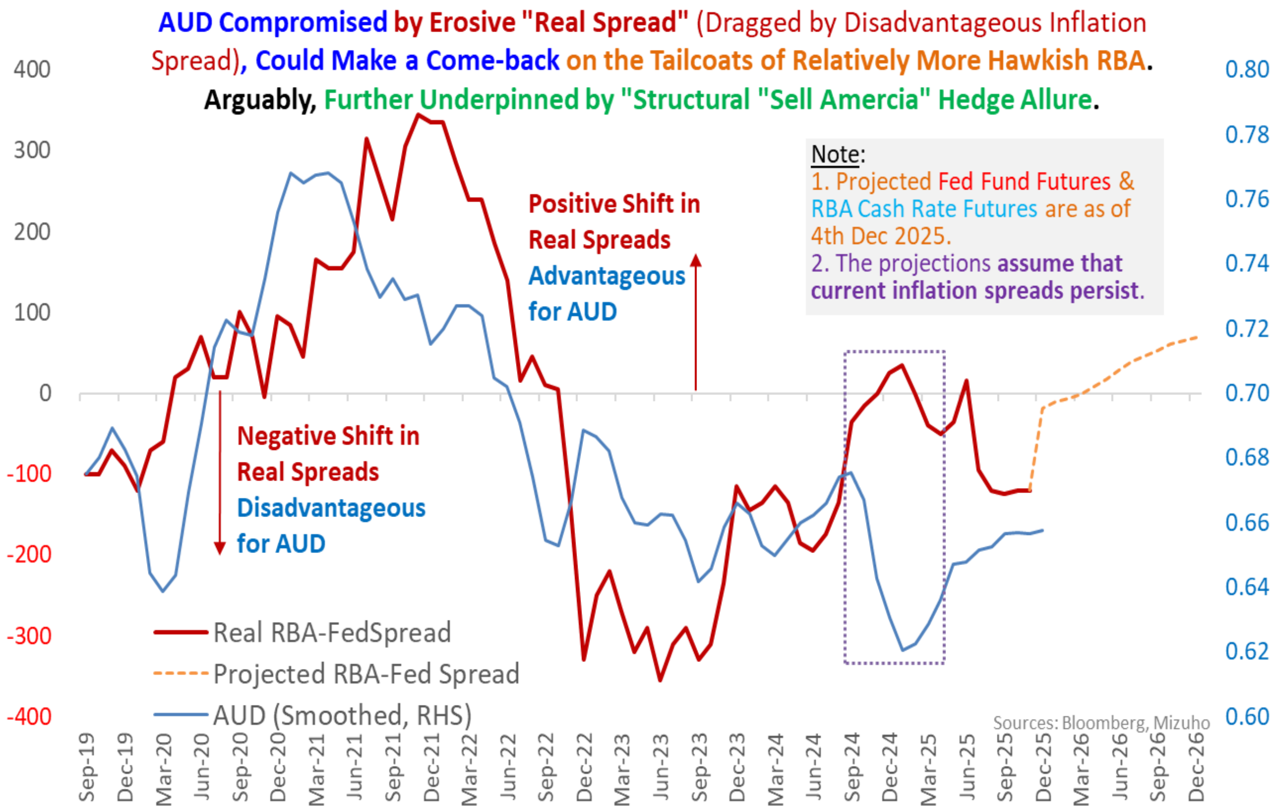
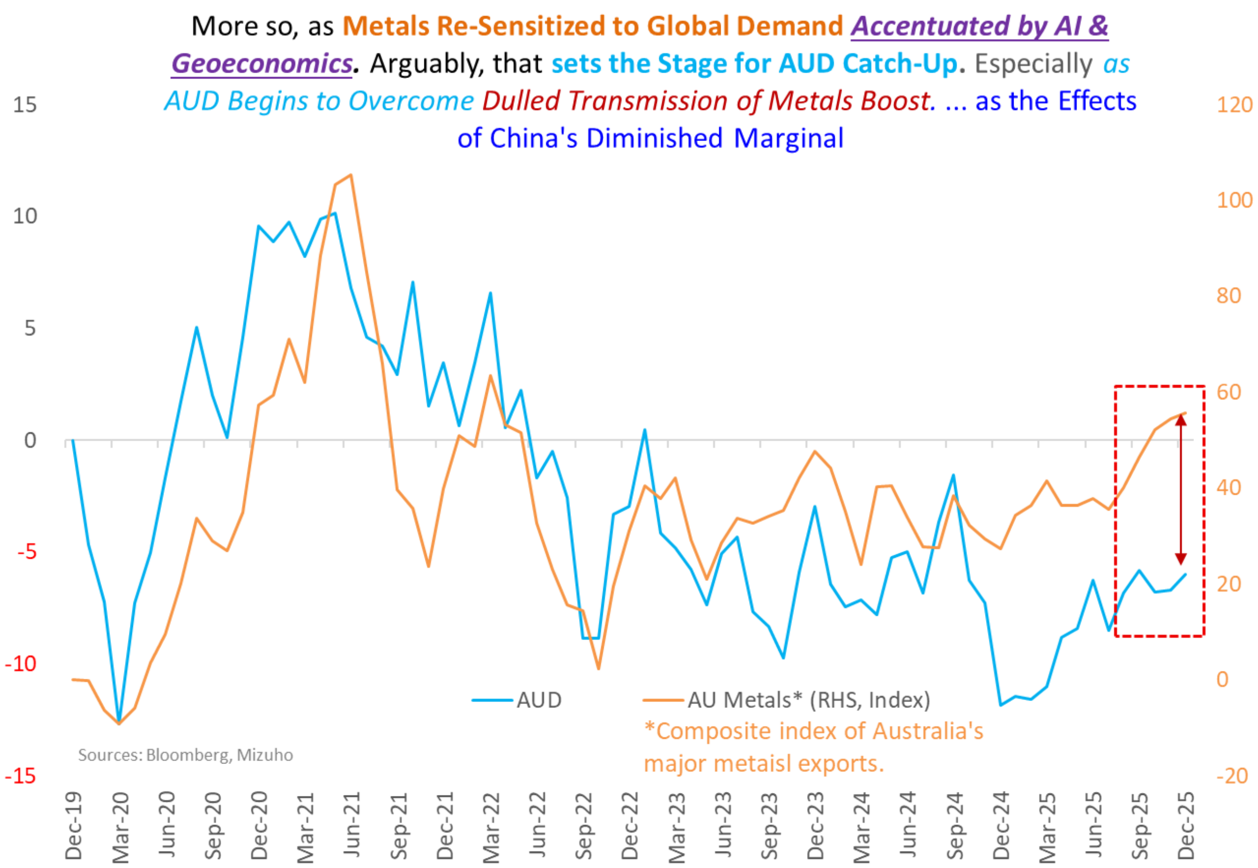
AUD: Cyclical & Structural Stars Aligning?

In a Nutshell:

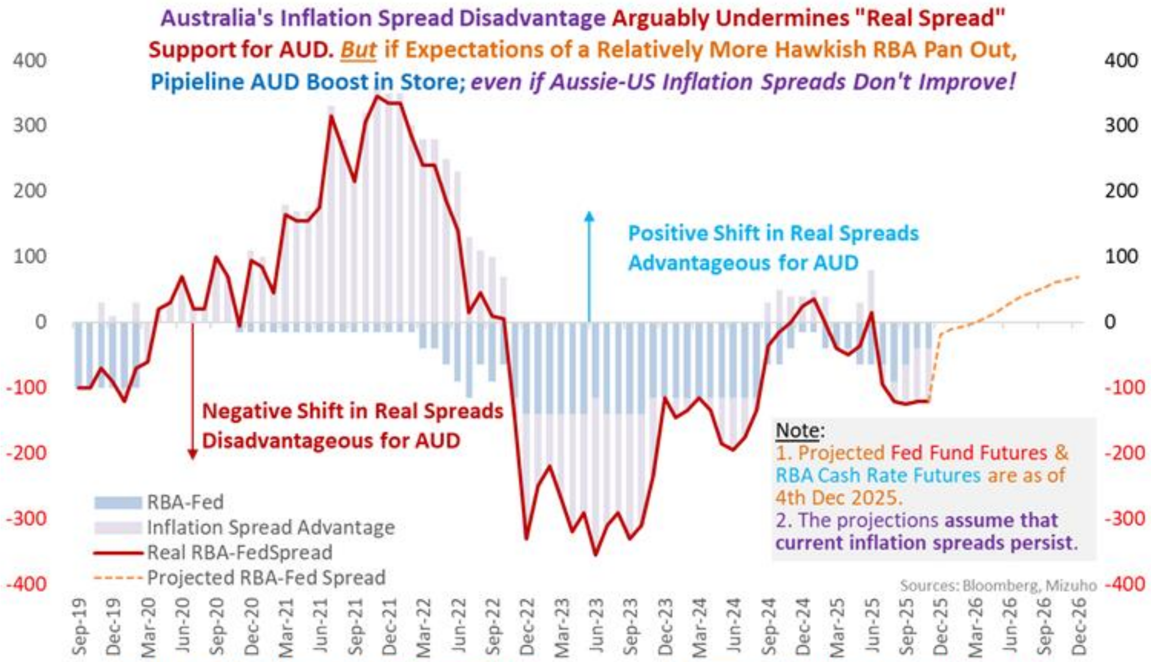
- Seemingly Counter-intuitive AUD Out-performance: ***Despite the OECD flagging a moderation in global growth*** into 2026 (from 3.2% to 2.9%), **AUD may counter-intuitively be positioned for out-performance ahead**.
- Not Passively Premised on Softer USD: This is **not exclusively premised** on our view of a modestly **softer USD**. Point being, **AUD is arguably primed to out-pace**, not passively piggy-back, **tailwinds from USD pullback**.
- As Cyclical & Structural Stars Align: Notably, our constructive AUD view is built **on a confluence of cyclical and structural shine *aligning the stars for durable AUD boost***.
  - Hawkish Divergence: AUD's **leg-up** may initially **be led by (relatively) hawkish RBA divergence, *offsetting disadvantages inflation spread dynamics***. *More so if the Fed turns more aggressively dovish.*
  - Structural "Sell America" Hedge: Beyond cyclical policy fillip, **AUD is set to be more durably underpinned by structural demand for AUD-denominated reserve assets**, as a key hedge to "Sell America". Arguably, this will be *accentuated as relative AUD carry turns favourable.*
  - Commodity Super-cycle: Moreover, AUD is also likely to be underpinned by a **constructive commodity super-cycle** that is **underpinned by** *late-stage monetary largesse spill-over* and **further amplified by a conspiracy of** *AI infrastructure build-out* and *race for geoeconomic resource security*.
- China May Dampen, Not Decimate: Admittedly, **China's property market crash** casts a **long shadow on AUD**. ***But*** China's marginal commodity demand hit is ***already priced into AUD level shifts***. Hence, **China risks merely dampen upside beta on bullish AUD cues**, *not decimate pick-up prospects.*
- Risks & Attendant Volatility a Feature, Not Bug: To be sure, ***despite the bullish out-performance case,*** **innate AUD vulnerabilities to "risk off" and adverse demand shocks remain prominent**. So, **inherent cyclical/headline risk volatility *through structural support*, is a feature, not bug**.
- What Could Go Wrong: There are obvious, non-negligible **risks to the AUD out-performance view.** A prominent source of AUD pain **wider "risk off" spill-over from AI correction**, entailing a *double whammy of "risk off"* and *knee-jerk commodity slump.* **Unforeseen geoeconomic threats** and/or **monetary policy flip-flops also feature** in the litany of risks.

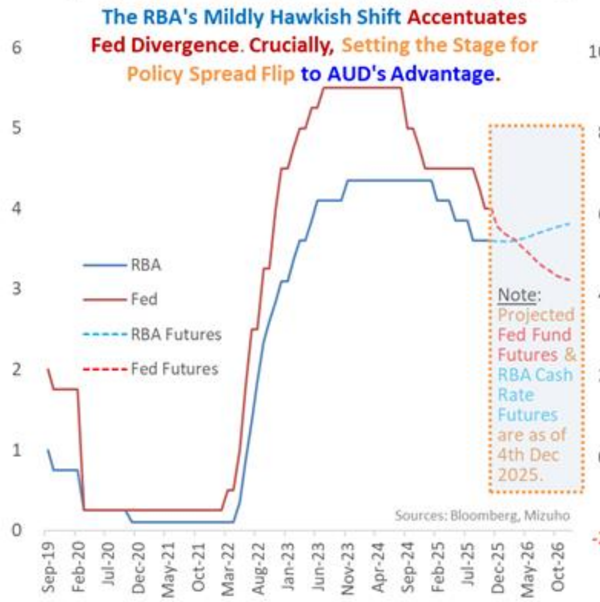


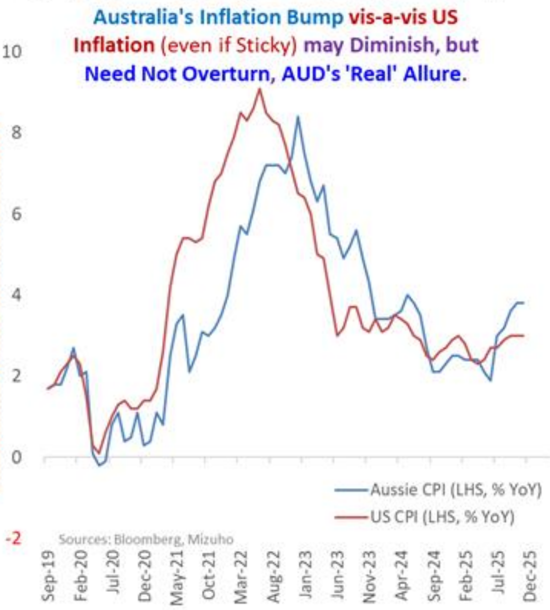


"The probability lies in that direction" – **Sherlock Holmes**

1. The Cyclical (Real Rates) Case
    a. A **relatively hawkish RBA** is the **most prominent** (cyclical) **policy trigger for AUD out-performance**.
    b. To be sure, the catalyst for more emphatic AUD pick-up may be from a more aggressively dovish Fed rather than RBA hawks doubling down.
    c. Notably, **a distinctly more disadvantageous inflation spread for AUD in recent months is likely to plateau**, hence, *priming the AUD for accentuated upside from more emphatic RBA-Fed divergence* ahead.
    d. Crucially, ***AUD is not over-reliant on cyclically more constructive real rates***. So, ***even if RBA hawks are be tempered further out, AUD need not be devastated***.







2. The Structural "Sell America" Hedge – accentuated by in-coming "Carry" Boost
    a. A **key AUD backstop**, if not **incrementally binding support**, is its **obvious allure as a hedge against structural "Sell America", USD debasement fears**.

b. Point being, **AUD's USD hedge proposition** is **outstanding given the fast shrinking universe of 'AAA' assets.** And its *allure enhanced by* its *existing SDR inclusion* and *Gold proxy properties.*

c. To be sure, this is ***not expected to be a tectonic bullish shift for AUD valuations*** in the short-term (as AUD remains *a hedge not wholesale substitute* for USD) and the "*Sell America" theme will only play out over a much longer horizon between ebbs and flows.*

d. *Nonetheless,* **as the Fed cuts aggressively**, the *"carry" tide turns more constructive for AUD* will arguably *amplify marginal re-allocation to AUD's noticeable benefit.* ¥

e. *As a corollary, this means that AUD out*-performance is *necessarily not solely reliant on a softer USD outlook*.

3. The Commodity Boost – Both Catch-Up & Super-cycle

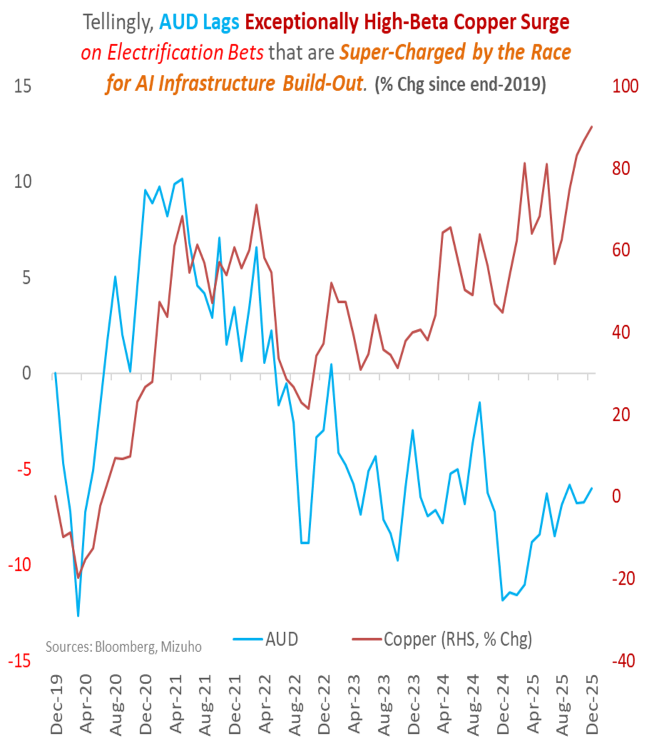
a. Crucially, the **making of a commodity Supercycle** getting underway also promises to be **naturally constructive for AUD**.

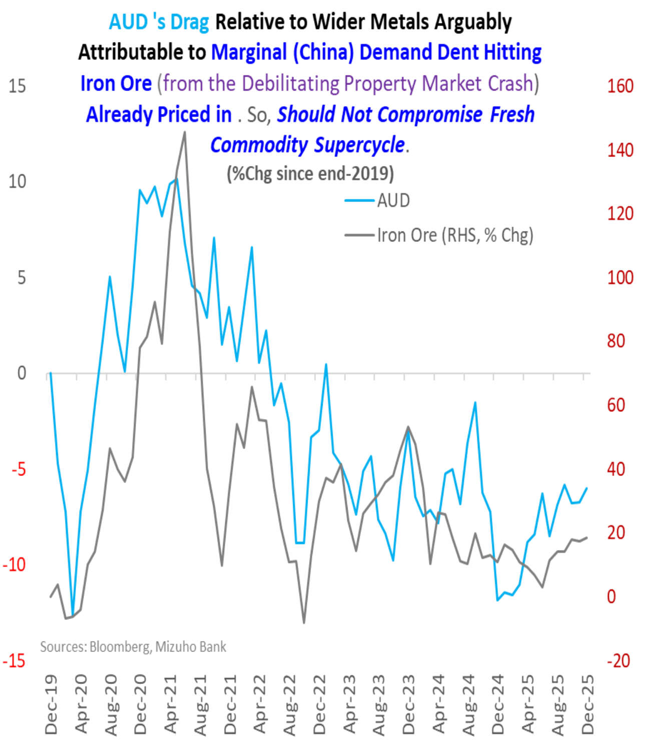
b. Not only do **commodities typically tend to do well after monetary largesse**, but this "monetary effect" may be ***more pronounced as real asset gain even more allure*** amid broader concerns "Sell America" and attendant debasement risks.

c. What's more, the **AI infrastructure build-out race** *amplified by geopolitical rivalries* is **likely to bolster the commodity (and consequent AUD) boost** – **led by*, but not limited to,* copper**.

d. Taking place against a wider backdrop of *geoeconomic clamour for resource* and *energy security*, the *commodity up-cycle may be amplified.*

e. **Ahead of structural commodity build-up for AUD**, there is still *room for two cyclical legs to boost AUD.* First, **Copper's catch-up** *on drawndown inventories* and alongside that, **AUD's catch-up** *to Copper's loftier valuation cues.*





4. China is a Bullish Beta-Dampener, Not Party-Pooper
   a. **China's dimming domestic demand** outlook with **risks of gathering headwinds** raise a ***fair doubt, curbing overly-bullish AUD views.***
   b. Fact is, following China's property market crash, **AUD's upside beta to Chinese demand has been dampened**.
   c. Even so, the pertinent point is that the AUD re-pricing (lower) on China's property market travails is mostly behind us.
   d. Crucially, the China property market overhang **merely checks upside AUD sensitivity**. And in turn, **dampening amplitude of AUD upside, *not decimate bullish fresh triggers***.

5. Volatility & Cyclical Undulations Embedded into (Not Eliminated From) Structural Upside
   a. Notably, this phase of **conspiring cyclical and structural boost for AUD** *while somewhat more broad-based,* is **no less susceptible to inherent volatility**.
   b. Point being, scope for inherent volatility in the AUD is in no way diminished, possibly even potentially exacerbated as;
      i. the cyclical elements such as monetary divergence remain fluid;
      ii. the commodity Supercycle far more uncertain **as colliding geoeconomic threats** and **AI unknowns may amplify swings**, and;
      iii. the "Sell America" hedge allure remains non-linear, and possibly pro-cyclical, retrenching AUD on accentuated commodity-/risk-induced downside.
   c. The upshot is that **volatility is embedded**, *sometimes enhanced,* **within this peculiar cyclical-structural AUD boost**.

6. What Could Go Wrong?
   a. By definition, the number of moving parts involving hard-to-predict geoeconomic variables and AI transformation are **replete with risks to the bullish AUD view**.
   b. A more ***accentuated AI correction*** is top of the list, as the **generalized "risk off"** is ***amplified by*** *potential* ***knock-on bearish commodity shocks*** to acute AUD pain.
   c. Wider **geoeconomic threats** and **monetary policy flip-flips** also **feature in the litany of interruptions to AUD's cyclical and structural stars aligning**.