1 December 2017

FX STRATEGY:

AUD Annotated Chart and Model Update

The AUD in November 2017

AUD/USD traded in a 2 cents range during November and ended the month lower than where it started. The monthly high of 0.7728 was reached on the 3rd day of the month and the low of 0.7533 on the 21st. The currency range-traded in the first 10 days of November with a soft Australian retail sales report the highlight, then and despite the fact that the USD struggled to perform, the AUD/USD traded with a soft tone amid deterioration in risk sentiment and weaker domestic data. Later in the month the prospects of US tax reform was an additional factor that supported the USD.

The AUD/USD started November on the front foot boosted by an unchanged Fed and an FOMC Statement that left a slight dovish scent. These gains were swiftly erased after a disappointing Australian retail sales report (October 0% vs 0.4% exp.) and the currency continued to leak lower over the next couple of days. On the 7th of the month, the RBA stood pat, as widely expected, and the statement suggested the Bank is currently comfortably on hold with no signs of a rate rise over the coming months. Then, the AUD/USD came under renewed downwards pressure amid deterioration in risk appetite and a fairly mixed picture for commodities. A disappointing Q3 Australian wage growth index and news that the US House of Reps. passed their tax overhaul bill were additional sources of misery for the currency. Finally, on the 21st day of the month, the AUD/USD found some support following a speech by RBA Governor Lowe where he noted that 'if the economy continues to improve as expected, it is more likely that the next move in interest rates will be up, rather than down'.

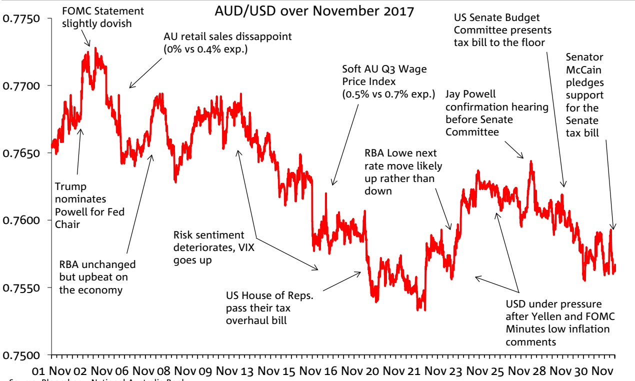
Late in the month a dovish take on both Yellen's conversation with ex BoE Governor King and Minutes from the FOMC November Meeting weighted on the USD with the move reversed on the last days of the month as the prospects of US tax reform improved with the Senate Budget committee delivering a bill for voting on the floor.

The NAB AUD Model

November saw a continuation of the detachment between the AUD/USD spot rate and our short term fair value (STFV) estimate. Spot declined one cent during month and our STFV stumbled just over half a cent over the same period. In the end, the picture is not that dissimilar from where we were at the end of October, AUD/USD is from a modelling perspective starting to look cheap, but because the model residual is still trading inside its 1.5 standard deviation range, we think the currency is still trading within its fair value range (i.e. just under +/- 4 cents). See Chart 2.

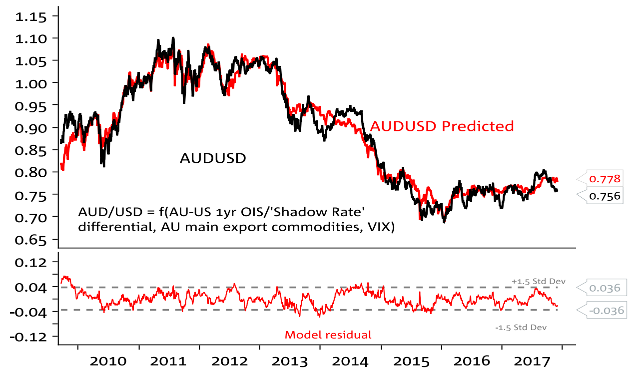
In November the narrowing of the AU-US OIS rate differential as well as increase in the VIX index (our measure of risk sentiment) from 10.28 to 11.28 contributed to the decline in STFV. Nevertheless, the big decline in Aluminium prices was the biggest downward force, only partially offset by the rise in other commodity prices during the month. See chart 3.

Chart 1: AUD/USD in November



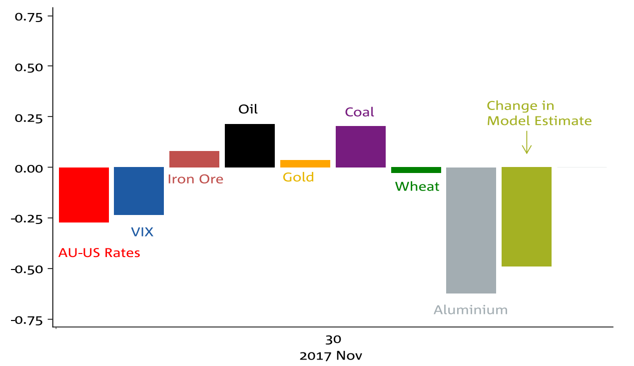
Source: Bloomberg, National Australia Bank

Chart 2: NAB's AUD/USD short term fair value model



Source: National Australia Bank, Macrobond

Chart 3: Drivers of change in NAB's STFV model



Source: National Australia Bank, Macrobond

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