



FX STRATEGY:

AUD Annotated Chart and Model Update

The AUD in December 2017

AUD/USD traded in a 3.2 cents range during December and ended 2017 at 0.7809, 6 cents higher relative to where it started the year and 2.4 cents higher relative to its level at the start of the month. The monthly high of 0.7822 was reached late in December, on the 29th, and the low of 0.7502 was recorded relatively early on the 8th. While domestic data releases were a supporting factor for the AUD/USD during December, USD weakness and strong commodity prices, after an initial dip early in the month, were the main factors behind the currency gains in December. In fact, after the NZD which was up 3% in December, the AUD was the second best performing G10 currency in the month, up 2.69%.

The AUD/USD started December on a positive note boosted by USD weakness amid tax reform uncertainty and news reports speculating on Russia's intervention in US politics. Also early in December, Australia's retail sales figures for October surprised on the upside (+0.5% mom vs 0.3% exp.) and although the RBA left the cash rate unchanged as expected, the statement was interpreted as slightly more positive on the economic outlook. Soon after commodities came under pressure led by a 4% drop in copper, dragging the AUD lower, but this period proved to be short lived. Then the USD came under pressure following a combo of softer US core CPI data and a dovish hike from the Fed. Mid-way through the month, the AUD got an additional uplift from Australia's November Labour Force report which revealed another strong employment print (+61.6k vs 16k exp.).

Later in the month, reports of an imminent and eventual passing of US Tax Bill by the US Congress provided little support to the USD while a broad based rally in commodities boosted the AUD and other commodity linked currencies.

The NAB AUD Model

The AUD/USD spot rate increased almost 2.5 cents in December and our short term fair value (STFV) estimate climbed 2 cents over the same period. Late in November our model suggested the AUD/USD was starting to look cheap, albeit not at an extreme. A month later some of that cheapness has been eroded with the model residual ending the year at 1.7 cents, well inside the currency's fair value range (i.e. 1.5 standard deviation or just under +/- 4 cents, see Chart 2).

In December the small narrowing of the AU-US OIS rate differential was the only (minor) downward force on the STFV estimate while commodities and risk sentiment (VIX index) were a source of support. Of note, the increase in aluminium prices (up over 10% in the month) was the biggest contributor to the 2 cents rise in the STFV estimate during the month. See chart 3.

Chart 1: AUD/USD in December

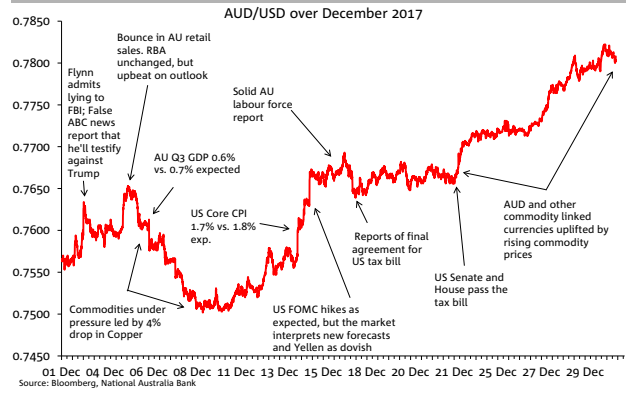


Chart 2: NAB's AUD/USD short term fair value model

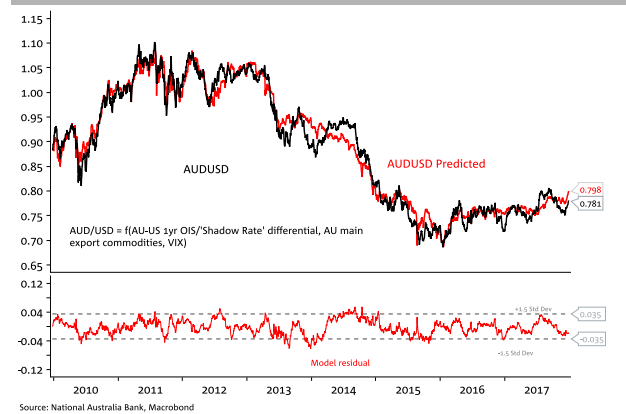
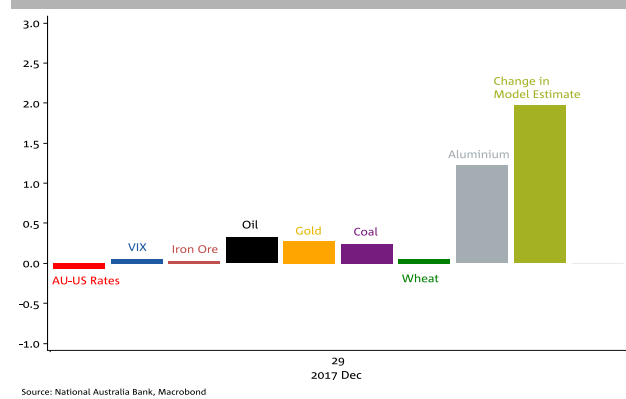


Chart 3: Drivers of change in NAB's STFV model



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