1 February 2018

FX STRATEGY:

AUD Annotated Chart and Model Update

The AUD in January 2018

AUD/USD started 2018 in the same manner it ended 2017.The currency strengthened in January, trading in a 3.4 cents range during the month and ending at 0.8055, 2.5 cents higher relative to where it started. The monthly high of 0.8134 was reached on the 27th and the low of 0.7796 was recorded early in the month, on the 2nd.

Broad USD weakness was the main theme during the month, a pattern that was already evident in December. USD weakness gathered momentum in January despite solid US data prints. The greenback was seemingly overwhelmed by global economic data releases favouring the view that the ongoing broad based global recovery is now being led by Europe and EM. So while the rates differential favoured the USD with US rates moving up at a faster pace than most major economies and Australian rates, the flow away from the US was the overriding force. So against this risk positive backdrop the AUD steadily moved higher during the month trading and then sustaining a move above the 80c mark for the first time since September last year.

Solid US data releases such as the ISM manufacturing print early in the month and then a stronger than expected CPI half way through the month did little to prevent the USD from weakening. The break of key technical levels for USD indices in the latter part of the month was an additional downward force while the US government shut down followed by stop-gap funding measures also didn't help the USD cause. US Treasury Secretary Mnuchin declared preference for a weaker USD upon arrival in Davos was a source of volatility too and despite refutations by Trump and Mnuchin himself, the market was left with a bad taste in its mouth re US administration ambitions for the dollar.

Domestic data releases didn't have much influence, though some support came from stronger than expected retail sales and AUD took a minor hit on weaker than expected Q4 CPI.

The NAB AUD Model

The AUD/USD spot rate spent much of January moving up, from about 1.5 cents below our Short Term Fair Value estimate (STFV) to 1.5 cents above (Chart 1).

US dollar weakness has gone hand in hand with further commodity price gains (led by oil and gold) which have acted to boost STFV. Offset have come from a move up in US short term rates (1 year OIS rates in our model) alongside a small decline in Australian equivalent rates – the latter occurring mostly in the wake of the slightly weaker than expected Q4 CPI data released on the last day of January. We also saw a negative model impact from the deterioration in risk sentiment towards the end of the month, reflected in the VIX moving up from 11 to above 15 before easing back slightly right at month-end.

The combined effect of these drivers pulled STFV down by about ¾ cent while spot itself rose by just ½ a cent. Even so AUD remained inside its fair value range (Chart 3).

Chart 1: AUD/USD in January

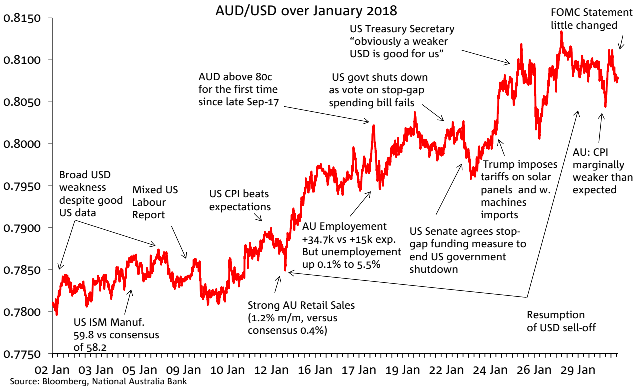


Chart 2: NAB's AUD/USD short term fair value model

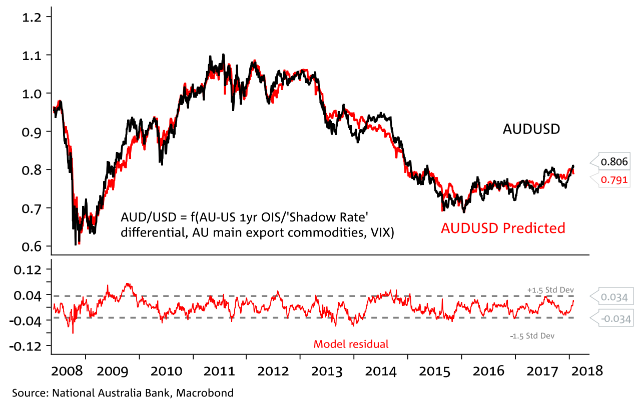
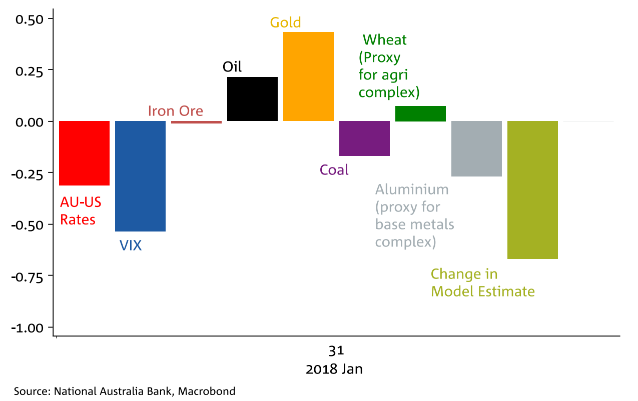


Chart 3: Drivers of change in NAB's STFV model



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