

FX STRATEGY:

AUD Annotated Chart and Model Update



The AUD in April 2018

April was a month of two halves for AUD/USD. In the first half, better domestic data releases and conciliatory trade news from China boosted risk sentiment and helped the AUD/USD trade from just above 0.7650 to an intra-month high of 0.7813 on April 19th. Later in the month, the USD regained its mojo and despite risk-positive news the AUD began a decline of almost 3 cents, trading to an intra-month low of 0.7525 in the second last hour of the month, before closing April at 0.7530.

The AUD/USD began April on the back foot following China's plans to impose trade tariffs on US imports as a response to Washington's plans to impose tariffs on imported steel and aluminium from China. The RBA came and went leaving the cash rate unchanged for the 20th month in a row. Better than expected domestic retail sales data later boosted the AUD and then on April 9th, a conciliatory speech by President Xi helped alleviate fears of an escalating trade war. A few days later the AUD remained in the ascendency, further boosted by speculation the President Trump might be willing to re-enter the Trans-Pacific Partnership (TPP).

After trading to a monthly high of 0.7813 on April 19th, the AUD/USD embarked on a steady decline towards 0.7530, mainly driven by resurgence in the USD, amid better than expected US data releases, higher US Treasury yields and stretched short USD speculative positions. On April 19th, 10 year US Treasuries traded above their previous year to date high of 2.951% and a few days later they briefly traded above the 3%. Risk-positive news such as the historic meeting between North and South Korean leaders did little to arrest the AUD/USD decline with the pair ending the month at 0.7530, a level not seen since early December last year.

The NAB AUD Model

Our Short Term Fair Value (STFV) model estimate lifted by 2 cents in April to 0.7790, while spot fell by 1.5 cents to finish the month at 0.7530 (AUD/USD had started the month about one cent above STFV). While this has marked AUD/USD out as being on the edge of undervaluation (+/- 1 standard deviations around STFV), spot has typically needed to trade closer to 1.5 standard deviations away from STFV before flashing warning signs of a potential correction (Chart 2).

Moreover, the biggest contributor to the rise in the model valuation estimate in April was the sharp rise in aluminium prices, which acts as our proxy for all exchange-traded base metals. The outsized gains in aluminium vs. other metals was linked to new sanctions against Russia snaring Rusal, the world's 2nd biggest aluminium producer, producing an exaggerated STFV calculation. If we control for this, STFV at month-end is reduced to near 0.7700 from 0.7790. There were also positive contributions from risk sentiment (lower VIX) and other commodities, principally oil (Chart 3).

Chart 1: AUD/USD in April

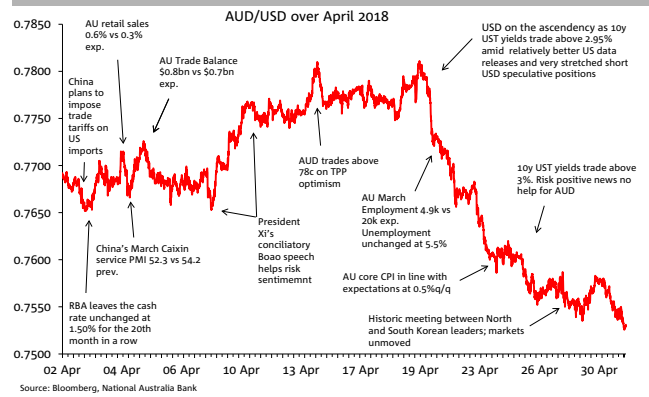


Chart 2: NAB's AUD/USD short term fair value model

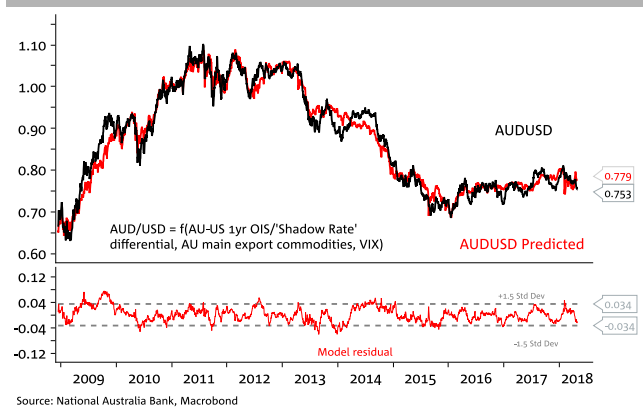
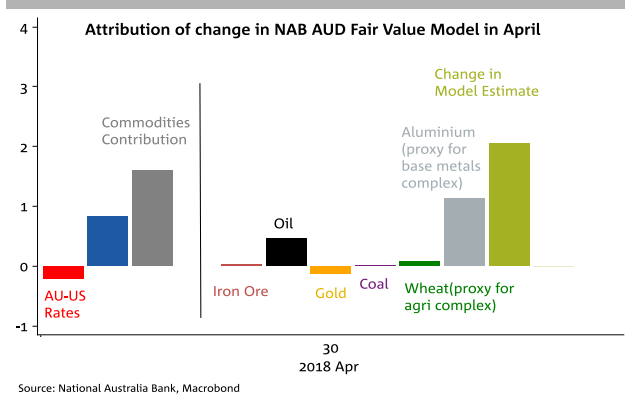


Chart 3: Drivers of change in NAB's STFV model in April



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