



FX STRATEGY:

AUD Annotated Chart and Model Update

The AUD in August 2018

The AUD/USD fell to a new year to date low of 0.7179 in August as heightened China/Emerging Markets (EM) concerns and ongoing US-led trade tensions saw the currency break below 73 cents for the first time since January 2017. After beginning the month at 0.7428, the AUD/USD spent most of August below 0.7350, ending at 0.7192. In addition to overseas developments, a number of domestic events added to AUD/USD volatility, including the Government’s leadership spill. Nevertheless, despite some sharp falls, the AUD/USD traded in a range of 2.77 cents, the average range over the last 12 months.

The start of August saw the AUD/USD broadly supported by a stronger CNY as the PBoC increased reserve requirements and told local banks it was prepared to reintroduce its “countercyclical factor” – signs that the PBoC were worried that the CNY was being seen as a one way bet. In between these events, the RBA board meeting (no change) had little impact and the AUD/USD reached a monthly high of 0.7449 on August 9th.

Shortly after, a remarkably sharp depreciation in the TRY on August 10th rapidly dragged the AUD/USD lower to 0.7293, breaking below 73 cents amidst heightened EM currency risk. The AUD/USD reached a low of 0.7204 as the USD/CNY reached a high of 6.9, before a reversal in the Yuan and news of further US-China trade talks saw the AUD/USD recover to around 0.7350.

The currency remained around 0.7350, even as then Prime Minister Turnbull’s leadership woes came into focus on August 21st. Further political uncertainty saw the AUD/USD touch 0.7241 before rising back to 0.7338 on August 24th as Treasurer Morrison was chosen as PM, the PBoC confirmed it would reintroduce the “counter-cyclical factor” and Fed Chair Powell shared some dovish remarks.

The AUD/USD remained at around 0.7340 for about half a week, before news that Westpac had increased its standard mortgage variable rate by 14bp saw the market push out pricing for an RBA rate hike all the way to Q3-20, dragging the currency down in the process by 40 pips to 0.7303 on August 29th. Further knocks to the AUD/USD came from the US: Trump’s announcement that the next round of China tariffs (on \$200bn of goods) could start early in September along with the failure of US-Canada NAFTA negotiations, which saw the AUD/USD drop to 0.7179 in the last few trading hours of the month.

The NAB AUD Model

AUD continued to trade near the lower edge of our short term fair value model range in August (Chart 2). Our short term fair value (STFV) model estimate was little changed over the month, starting at 0.7525 and ending at 0.7550, with broadly offsetting influences (Chart 3). The overall impact of commodity prices was to add about a quarter of a cent to our STFV estimate but a further widening in the (negative) spread between 1-year interest rates knocked the STFV down by

Chart 1: AUD/USD in August

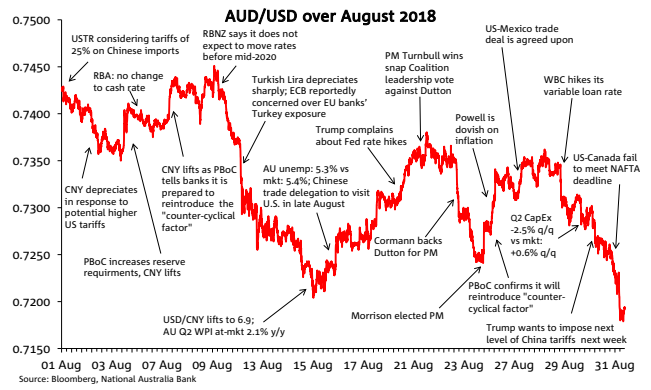


Chart 2: NAB’s AUD/USD short term fair value model

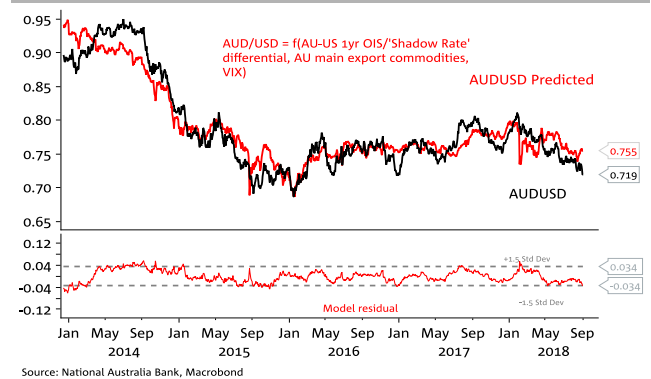
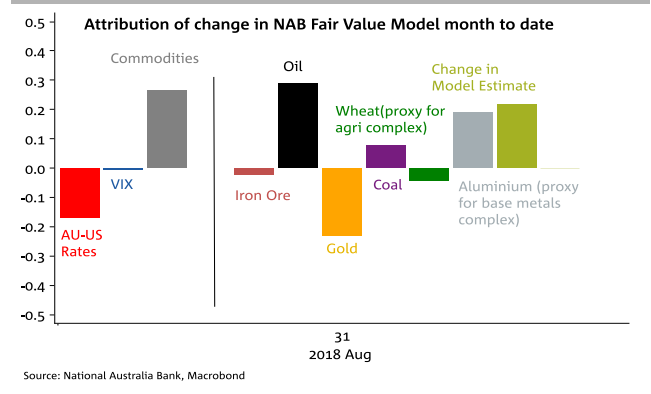


Chart 3: Drivers of change in NAB’s STFV model in Aug



about 15 pips. Risk sentiment as proxied by the VIX was virtually unchanged on the month, but it is the ongoing pressure on EM for which AUD has been increasingly highly correlated that is largely responsible for the underperformance of AUD vs. our model estimate. There are limited prospects of a recovery anytime soon given the likelihood of Trump intensifying his trade stoush with China in coming weeks.

CONTACT DETAILS

FX Strategy

Ray Attrill
Head of FX Strategy
+61 2 9237 1848
ray.attrill@nab.com.au

Rodrigo Catril
Senior FX Strategist
+61 2 9293 7109
rodrigo.h.catril@nab.com.au

Jason Wong
Senior Markets Strategist
+64 4 924 7652
jason_k_wong@bnz.co.nz

Christy Tan
Head of Markets Strategy/Research, Asia
+852 2822 5350
christy.tan@nabasia.com

Gavin Friend
Senior Markets Strategist
+44 207 710 1588
gavin.friend@eu.nabgroup.com

Markets Research

Peter Jolly
Global Head of Research
+61 2 9237 1406
peter.jolly@nab.com.au

Group Economics

Alan Oster
Chief Economist
+61 3 8634 2927
alan_oster@national.com.au

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