FX Insight

AUD - Stimulus to the Rescue But Fear Overwhelms

Analysts

Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Tan Yanxi
(65) 6320 1378
tanyx@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

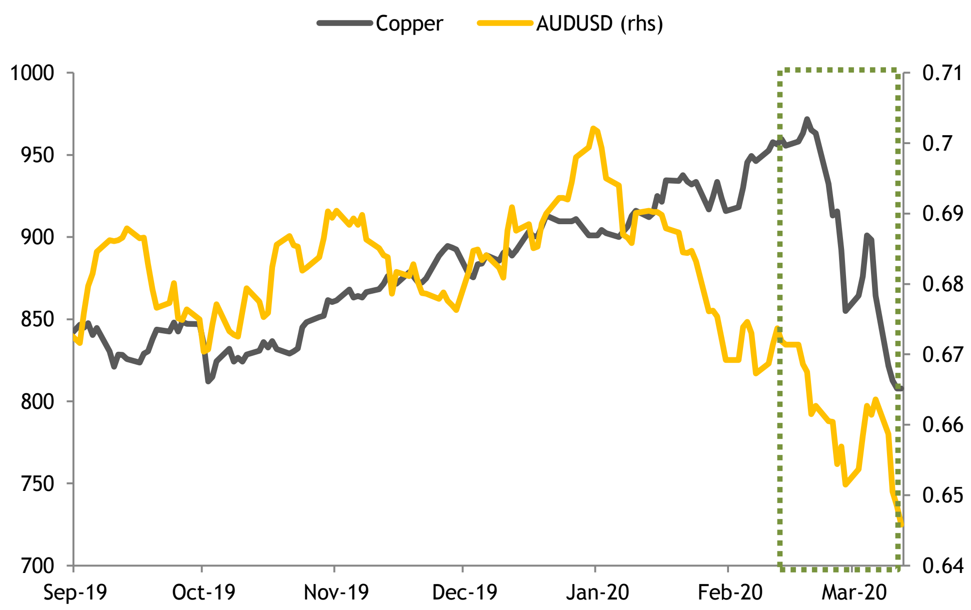
Joint Stimulus but Fear Keeps Risk Leashed

PM Scott Morrison announced a A$17.6bn package to support economic growth in the face of the COVID-19 pandemic. The package includes A$1.3bn to protect the jobs of 120,000 apprentices and one-off cash payments to welfare recipients and lower-income households. A $6.7bn is also allocated to support the cash flow of SMEs in paying wages.

This package amounts to 1.2% of GDP and Treasurer Frydenberg said that models projects a gain of 1.5ppt to GDP for 2Q2020 from the stimulus. The package was announced after RBA lowered cash target rate by 25bps last Tue and RBA Deputy Governor Debelle gave a hint of unconventional monetary policy being considered yesterday. The potential for RBA to start yield curve control (YCC) could keep short-term interests low for business. That could also mean that AUD would still underperform in the near-term. However, we anticipate RBA to be cautious in the use of YCC and AUD dips could be concomitantly shallow.

We downgrade our 2Q forecast for AUD to 0.64, not ruling out potential for AUDUSD to weaken towards 0.63, given the spread of the COVID-19 that has worsen beyond our initial assumptions and the slower than expected recovery in China's production level that could spur RBA to cut cash target rate to its effective lower bound in Apr and then proceed to use YCC thereafter. We still look for a modest recovery in 2H but the use of the YCC could mean a slower recovery in the AUDUSD and we look for the pair to end the year around 0.66.

The Fall in Copper Prices (proxy of activity) Drags the AUDUSD Lower



Source: Bloomberg, Maybank FX Research & Strategy

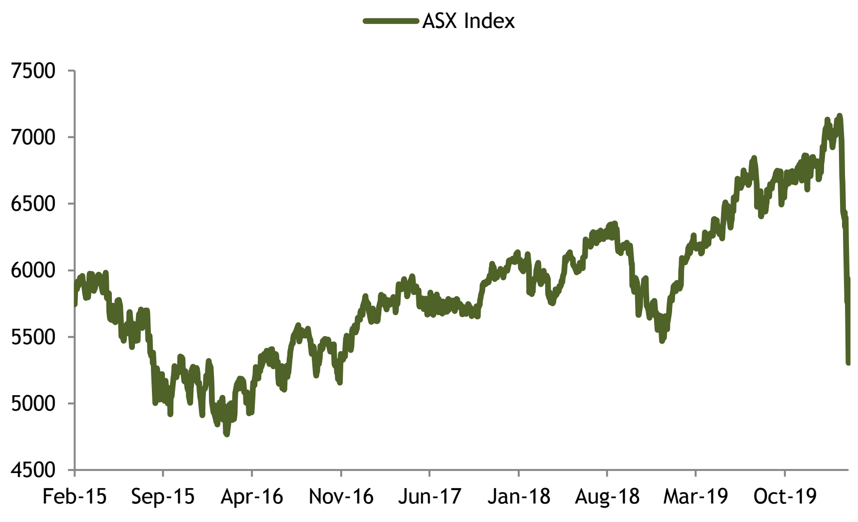
Fiscal Stimulus and Rate Cuts are no Comfort in the Face of Uncertainty

More than once, top officials such as PM Morrison had warned that economic impact of the COVID-19 outbreak could be worse than the Global Financial Crisis, setting the stage for the stimulus package and abandoning their quest for a budget surplus year. He also stressed that measures will be both "scaleable and temporary to enable a fiscal exit strategy". Here is a key list of measures announced this morning.

- Tax-free payments of up to A$25,000 for firm with revenues < $50mn
- Wage subsidies of A$7000 to small businesses each quarter for each apprentice hired.
- Instant tax write-off program to support 3.5mn businesses with revenue >A$500mn buy assets worth up to A$150K.
- A one-off A$750 payment to welfare recipients including job seekers, households receiving family benefits and pensioners.
- A $1bn fund to support tourism operators and some China-exposed exporters.

Despite the stimulus package and the assurance by RBA to do more, the uncertainty of the duration of COVID-19 and concomitant economic damage were amplified by WHO's declaration that the outbreak has become a pandemic. Calls for more social distancing (by Opposition Labor) could further weigh on consumer spending and business confidence in the near-term, triggering further risk-off sentiments.

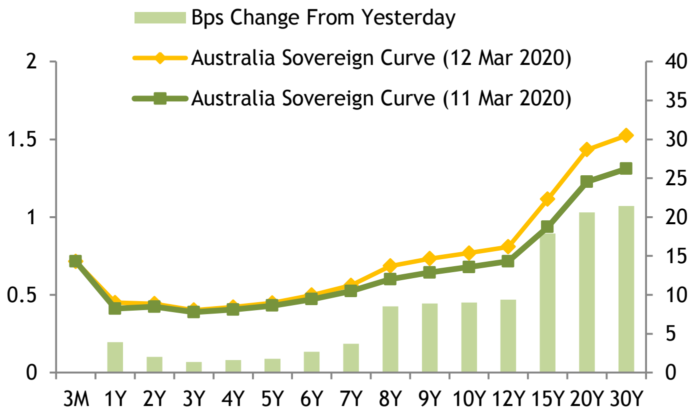
ASX is Down >25% from the Year High



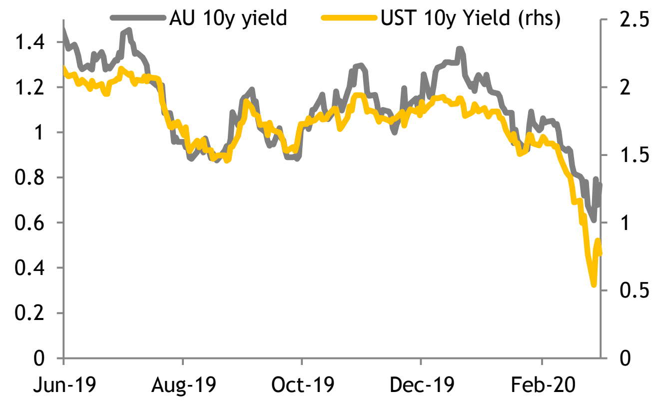
Source: Maybank FX Research & Strategy, Bloomberg

ASX clocked a loss of >7% today and the index had dropped more than 25% from its high this year. Bonds did not get much relief either. 10y yield rose around 9 bps (see chart below). The announcement of the fiscal package by the PM might have triggered some unwinding of aggressive rate cut bets as Australian sovereign curve shifted higher, also guided by the upmove in the UST yields.

Australia's Rates Rise across tenors Today



AU Rates Tend to Take the Cue from the USTs



Source: Maybank FX Research & Strategy, Bloomberg

AUDUSD had been rather soft since the start of the year and its prospects have been further dimmed by its exposure to China's slowing growth and supply shocks.

Our findings in a recent study on COVID-19 effects revealed that while Australia does not rank very high on vulnerability to contagion risks given its low population density, moderate air connectivity and low confirmed cases relative to other countries as of 17 Feb, Australia is quite vulnerable to macro exposure to China. 27%

Risk Scoring Matrix (2): Quantifying Growth Concerns *Distilling the COVID-19 Effects*

	Growth Concerns					
Country/ Currency	Tourism: China Visitors' Share	Tourism: Receipts as % of GDP	Supply Chain: Intermediate Goods From China (% of GDP)*	Supply Chain: Intermediate Goods To China (% of GDP)*	Exposure to China's Domestic Demand (% of GDP)*	Risk Score
USD	13.5%	1.2%	1.4%	0.7%	1.2%	8
EUR	6.0%	1.6%	1.0%	1.2%	1.7%	8
JPY	26.9%	0.9%	1.7%	2.2%	2.6%	14
CHF	5.3%	3.0%	1.4%	1.8%	2.4%	12
GBP	3.2%	1.1%	1.0%	0.6%	1.2%	6
CAD	3.4%	1.2%	1.8%	1.8%	1.7%	10
AUD	26.7%	2.3%	2.1%	5.2%	4.9%	29
NZD	14.8%	3.0%	1.9%	2.8%	4.2%	22
SGD	14.5%	5.5%	2.8%	9.1%	7.8%	44
MYR	14.6%	5.8%	9.1%	12.7%	8.5%	60
IDR	13.5%	1.8%	2.4%	2.1%	2.5%	15
INR	2.7%	1.1%	2.3%	0.9%	1.1%	7
THB	27.8%	11.5%	7.7%	7.9%	7.0%	72
KRW	43.9%	1.1%	6.0%	10.5%	6.9%	45
TWD	24.4%	4.3%	5.5%	19.4%	13.0%	78
PHP	17.6%	2.3%	3.2%	5.0%	3.9%	25

Source: CEIC, Bloomberg, OECD-TiVA Database, Maybank FX Research & Strategy Estimates
Note: Scaling is achieved via indexing the largest value in each indicator at 100. Tourism and supply chain sub-scores are computed before averaging with scores for exposure to Chinese domestic demand. Tourism data are as of 2018; estimate for EU is average of Germany & France's.
* Computed by OECD by decomposing the actual input of each country in the production of goods & services consumed worldwide. Latest data point is 2015 due to complexity of calculations.

The travel ban on China is especially damaging to Australia's education and tourism sectors. Around 27% of tourist arrivals come from China and tourist receipts make up 2.3% of total GDP. There is also significant supply chain disruption for Australia as well with intermediate goods from China making up 2.1% of GDP while intermediate goods to China makes up 5.2% of GDP.

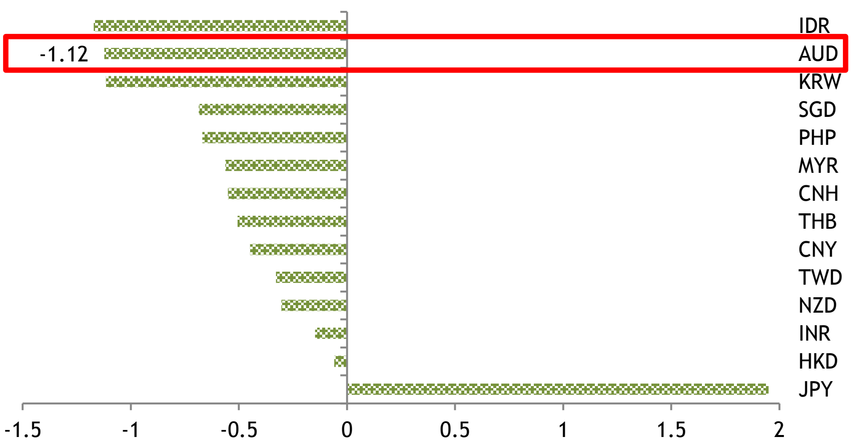
As a result of the travel ban and the rising infections at home, the government is now forced into taking action to ensure demand is supported (by putting cash into the hands of the welfare recipients), businesses are buttressed to keep their workers and the allowance for tax-free payments could help SMES in their cash flow as foot traffic slows. Should the crises extend longer than expected, the government has assured of more support. RBA may also start to use unconventional monetary policy tools.

Yield Curve Control the Preferred Choice of RBA

RBA Debelle gave one of the strongest signals that the central bank could delve into unconventional monetary policy on 11 Mar. He mentioned that the government bonds as a way to keep short-term financing rates low for businesses. In a QnA session, he said that unconventional policy would focus on price rather than quantity, suggesting that the tool of choice beyond cash target rate at 0.25% (also known as the effective lower bound) could be the yield curve control (YCC) that BoJ has been using since Sep 2016. The cash target rate is currently at 0.50%.

In a speech last Nov, RBA Lowe even spoke about considering the potential for utilizing these tools. Governor Lowe might have hinted about the use of YCC then when he highlighted on the use of unconventional monetary policy to lower risk-free interest rates along the yield curve via (1) direct price impact of buying government bonds and (2) signaling effect by ensuring that market players continue to expect RBA to keep cash rate low for an extended period of time. He also noted that asset purchase is a bigger step for the central bank than interest rate cuts and would help in circumstances like "stressed market conditions".

% Change VS. the USD (11-12 Mar 2020)

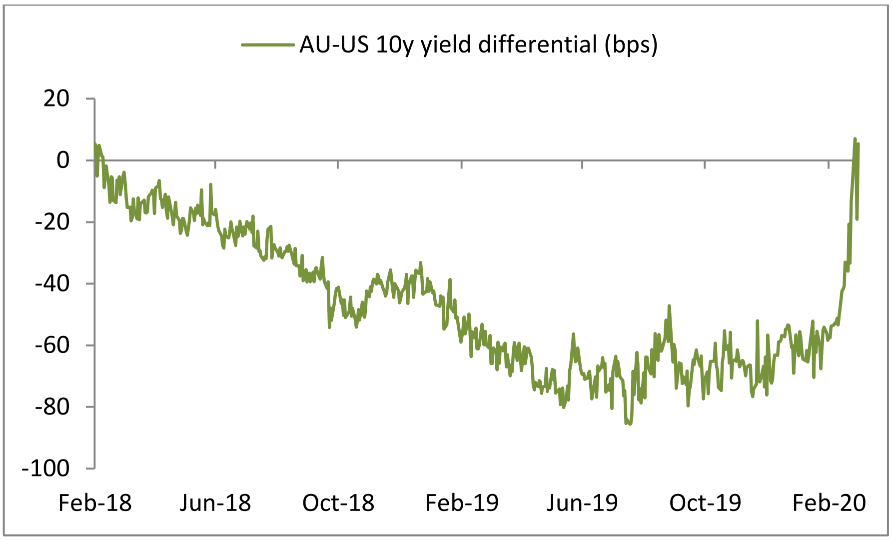


Source: Maybank FX Research and Strategy, Bloomberg

AUDUSD weakened considerably (down -1.1% vs. the USD in the past two sessions) in spite of stimulus package announcement. The pair was weighed by the poor risk appetite and broad USD recovery. An announcement of the use of YCC would also be AUD-negative. However, the extent of the decline really depends on where RBA prefers the front end of the risk-free curve to be. Market players have long been speculating on the inevitable of the use of unconventional monetary policy tools. We anticipate the start to be cautious as the central bank had always been mindful of household indebtedness. AUD dips may also be shallow if RBA is perceived to be less aggressive than other DM central banks.

In addition, the premium that UST had over Australian government bonds have been largely erased in the sharp moves over the past few sessions. In other words, AU-US 10y yield differential had been negative since early 2018 and that discount has been completely erased in a matter of days. This could mean that the decline in the AUD may slow if the US data continues to soften, COVID-19 infection gains a lot more traction in the US and the Fed is concomitantly forced to be more aggressive vs. RBA.

AU-US 10y Yield Differential has Completely Been Erased



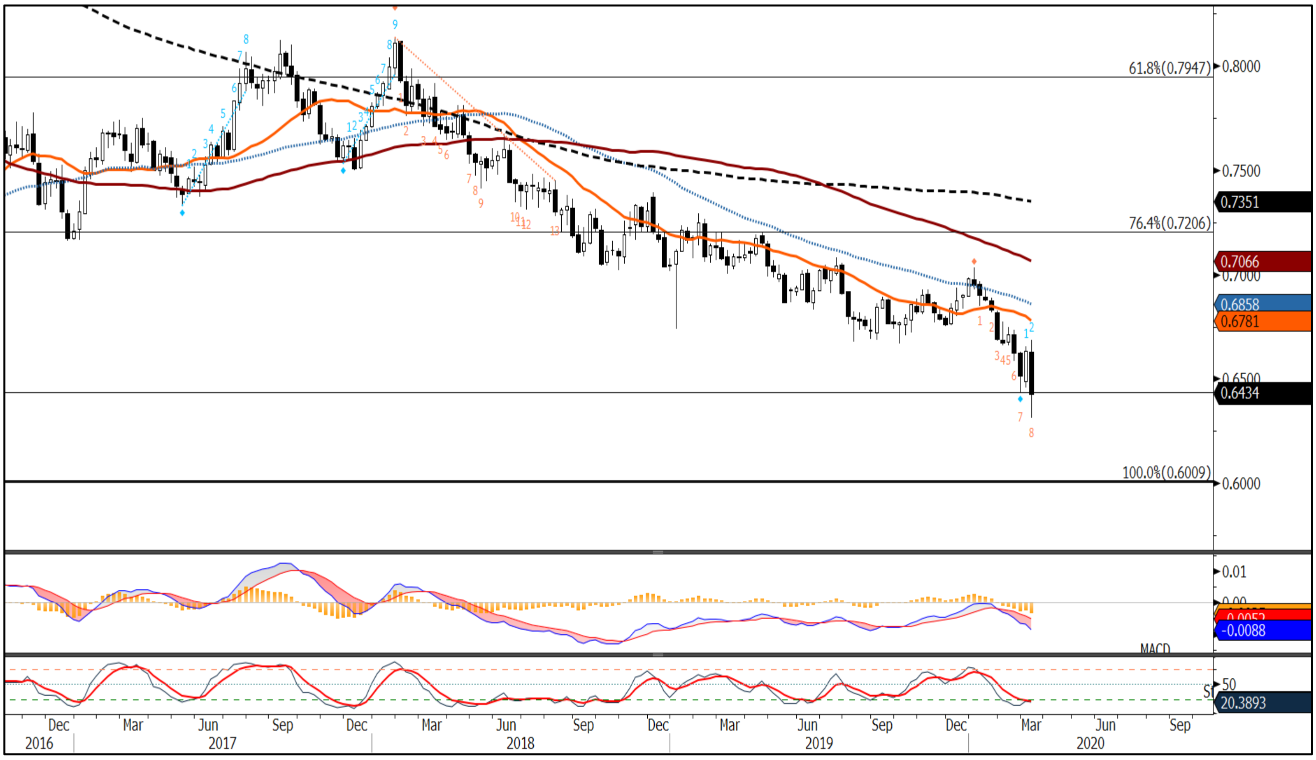
Source: Maybank FX Research & Strategy, Bloomberg

Nonetheless, we downgrade our AUDUSD forecast to 0.64 for 2Q given the spread of the COVID-19 that has worsen beyond our initial assumptions and the slower than expected recovery in China's production level that could spur RBA to cut cash target rate to its effective lower bound in Apr and then proceeding to use YCC thereafter. We still look for a modest recovery but the use of the YCC could mean a slower recovery in the AUDUSD and we look for the pair to end the year around 0.66.

Forecast	2Q 2020	3Q 2020	4Q 2020
AUDUSD	0.64 (0.67)	0.65 (0.68)	0.66 (0.68)

Previous Forecasts in Parenthesis

AUDUSD (Weekly) - Price action is bearish but Stochastics suggest Overstretched Condition



Based on the weekly AUDUSD chart above, the AUDUSD price action has been very bearish with the week poised to end on a engulfing bearish candle stick. Bias suggests that downmove may not be done with next support seen around 0.6313 (recent low) before 0.6225 and then at 0.6009 (2008 low). Stochastics look stretched even though downside bias remains. We do not rule out rebounds and choppier price action. Resistance at 0.6480 (23.6% Fibonacci retracement of the Jan-Mar fall) before the next at 0.6560 (38.2% fibo, 21-dma).

DISCLAIMER

Published by:

Maybank

Malayan Banking Berhad
(Incorporated in Malaysia)

Saktiandi Supaat	Christopher Wong	Fiona Lim	Yanxi Tan
Head, FX Research	Senior FX Strategist	Senior FX Strategist	FX Strategist
saktiandi@maybank.com.sg	wongkl@maybank.com.sg	Fionalim@maybank.com.sg	tanyx@maybank.com.sg
(+65) 63201379	(+65) 63201347	(+65) 63201374	(+65) 63201378