

## FX Insight

# AUD - More Room For Upside Than Down

### AUD Is Almost Done With Bears

AUD has been hammered by a number of factors including weaker base metals in particular iron ore, higher volatility, a brief bout of USD strength in Feb-Mar, fading RBA rate hike calls as well as the China-US trade spat. The antipode weakened approximately 6% against the USD from its high this year and was last seen around 0.7750. With much of the weakened iron ore and steel demand from China likely somewhat priced, AUDUSD might be close to its bottom at 0.76-figure and we see more risks to the upside from here.

### Still Eye The Same Old Factors

Iron ore came off pretty sharply in Feb, around 20% from its highs that month and prices of the base metals tracks the Caixin PMI-mfg pretty well, underscoring the accuracy of the survey in predicting demand and price. OLS regression shows that 1% change in iron ore price could lead to a 0.085% change in AUDUSD. We look towards the data release for the next cues in AUD. In fact, a likely mean reversion in the iron ore price could mean recovery in the antipode. In addition, we like to look past the present jitters that have been too fixated on concerns such as trade wars and focus on the current healthy fundamentals of the global and domestic economy. In an environment of USD downtrend, AUDUSD could still head above 0.80 within this half of the year. Our fast-tracking fair value model of AUD puts its fair value at around 0.85 vs. the USD.

### Technical Indicators Warn of Upside Risks

Against the USD, AUD risks breaking out of its descending wedge to head towards 0.7890 with a break of the 100-DMA at 0.7788. We do not rule out another dip before the breakout though. AUDSGD is testing the upper bound of the downward sloping trend channel and a convincing break there could open the way towards 1.0320. Eyes on MAS decision tomorrow. AUDMYR is almost done with its double top formation and looks about to head higher to 3.0850 before 3.1259.

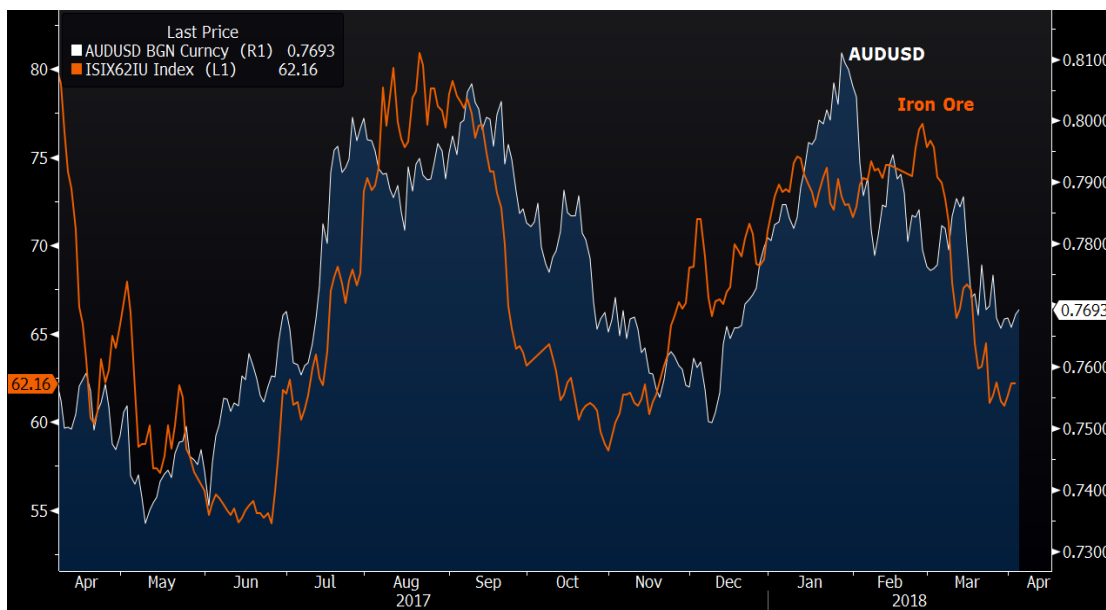
#### Analysts

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

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

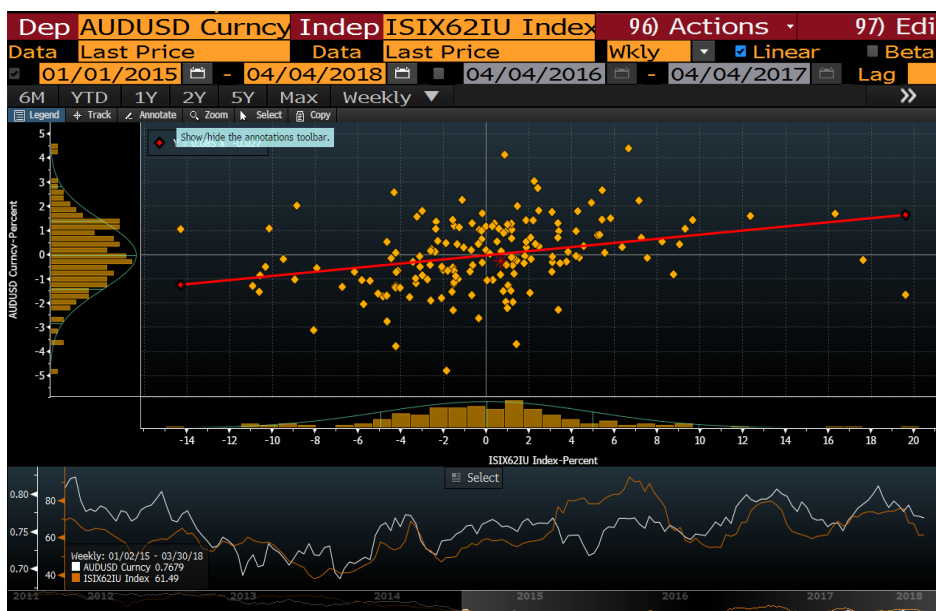
Christopher Wong  
(65) 6320 1347  
wongkl@maybank.com.sg

Leslie Tang  
(65) 6320 1378  
leslietang@maybank.com.sg

**Chart 1: Iron Ore Has Been a Key Drag on AUDUSD**

Source: Bloomberg, Maybank FX Research

AUD depreciated around 6.1% against the USD since its Jan high. The plunge in Feb was due to the strength of the USD and a surge in volatility that reduced risk appetite. The antipode remained under pressure for most of Mar due to the sharp fall in iron ore and now this pair hovers around 0.7750, around 100 pips off its recent low.

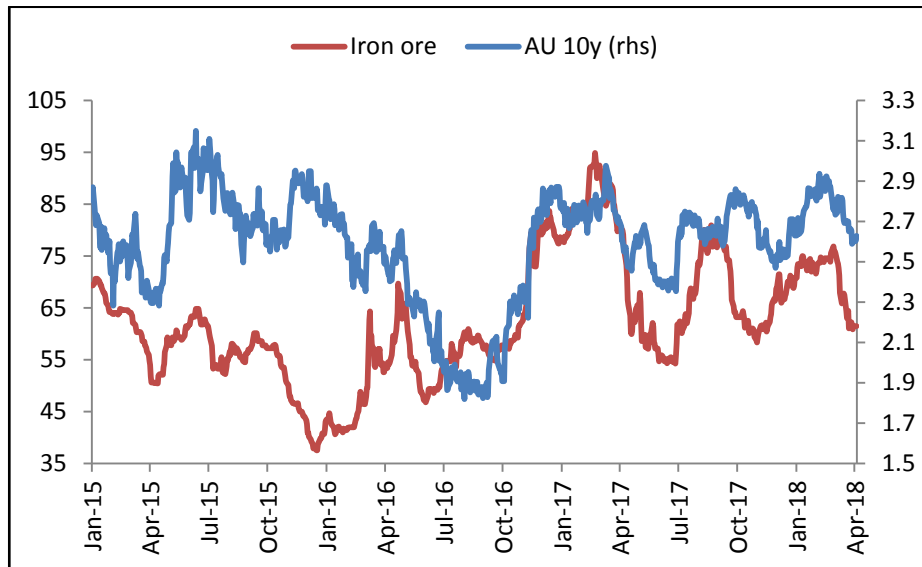
**Chart 1: A 1% fall in iron ore could see a 0.085% fall in AUD**

Source: Bloomberg, Maybank FX Research & Strategy

Iron ore matters a lot to the outlook of the AUD. Our ordinary least squares (OLS) regression reveals that a 1% decline in iron ore prices (iron ore spot price index 62% fine ore) could result in a depreciation of 0.085% in the AUD against the USD. To be clear, the iron ore mining contributed 0.1 ppt to 4Q GDP of Australia last year, offsetting the other sectors that have detracted from the headline including manufacturing, agriculture and equipment. Hence, the recent all in

iron ore soured the growth prospect of the Australian economy and even triggered a flattening in the sovereign yield curve. The Australian 10y yield came off in tandem with the iron ore prices as shown in Chart 3. This strongly suggests that the behaviour of iron ore affects the perception of the economy by fixed income traders and we think it is overdone.

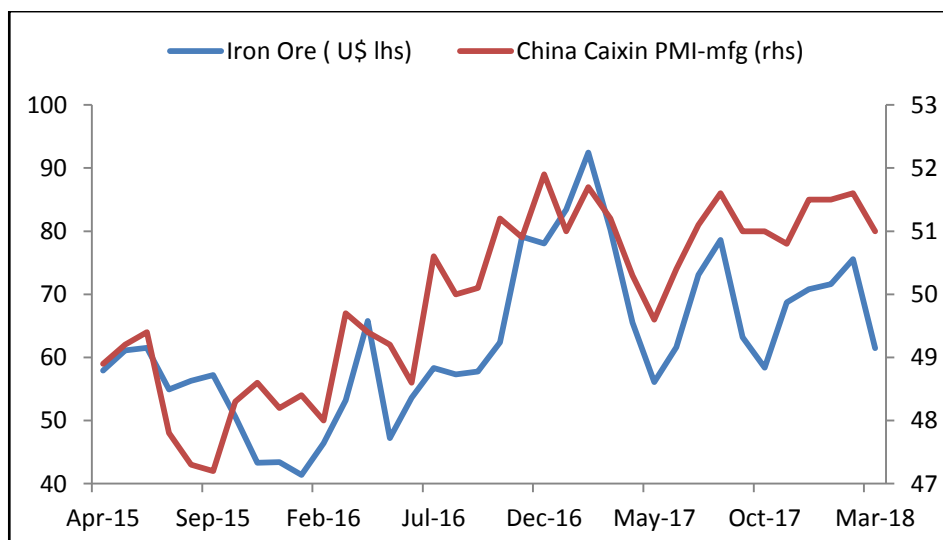
**Chart 3: The Fall in Iron Ore Drags the Australian 10y yields Lower**



Source: Bloomberg, Maybank FX Research & Strategy

Much of the iron ore price fall was anticipated with only the question of timing. It was no secret that China's fight for blue sky saw a withdrawal of iron ore mining rights in the last quarter of 2017. Low profitability of the industry also saw a shut-down of 40% of the country's iron mines. Industrial profitability tumbled at the turn of the year for most of Chinese firms. That said industrial profits had since stabilized in the first two months of the year. China's Caixin PMI-mfg came in at 51.0 for Mar vs. previous 51.6. Any stabilization in the mfg index could lend support to the iron ore prices. In addition, mean reversion from its recent sharp decline in the iron ore could mean a recovery in AUD as well.

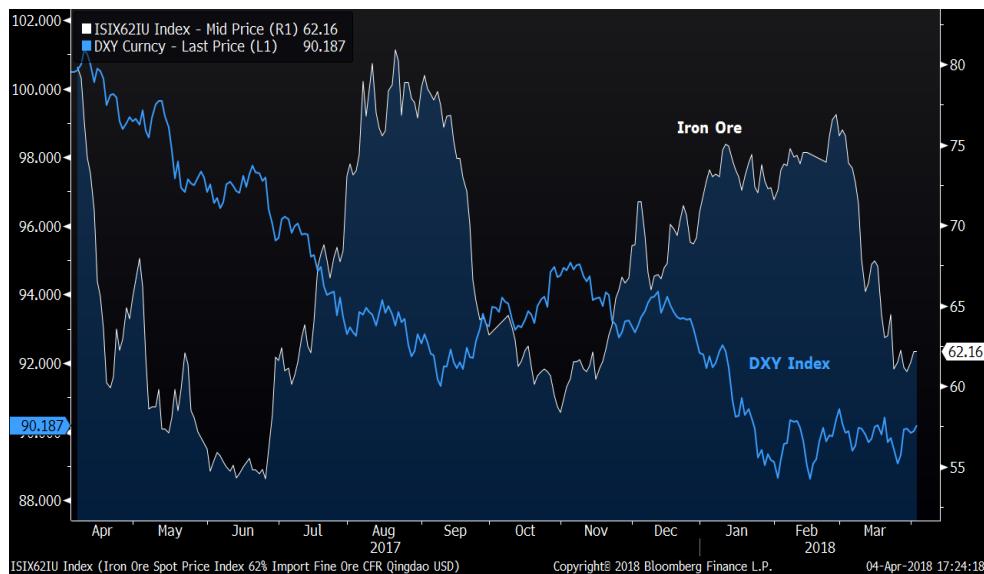
**Chart 4 (Monthly): Iron ore Moves With China Caixin PMI-mfg**



Source: Bloomberg, Maybank FX Research & Strategy

We continue to eye this release for cues on the AUD.

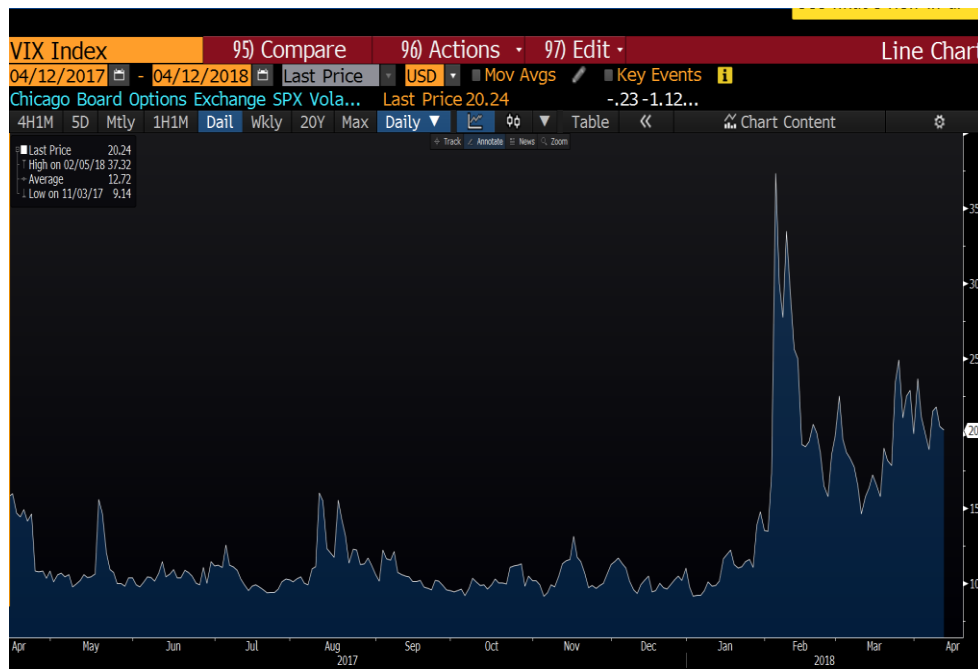
**Chart 5 (Daily): The Iron Ore Decline Seems to be Decelerating In The Absence of USD Strength**



Source: Bloomberg

Apart from external demand out of China, the iron ore prices were likely also partially affected by the USD. So iron ore prices have a better chance of stabilizing in the absence of USD resurgence.

**Chart 6 VIX Index: Volatility has been elevated for a while**

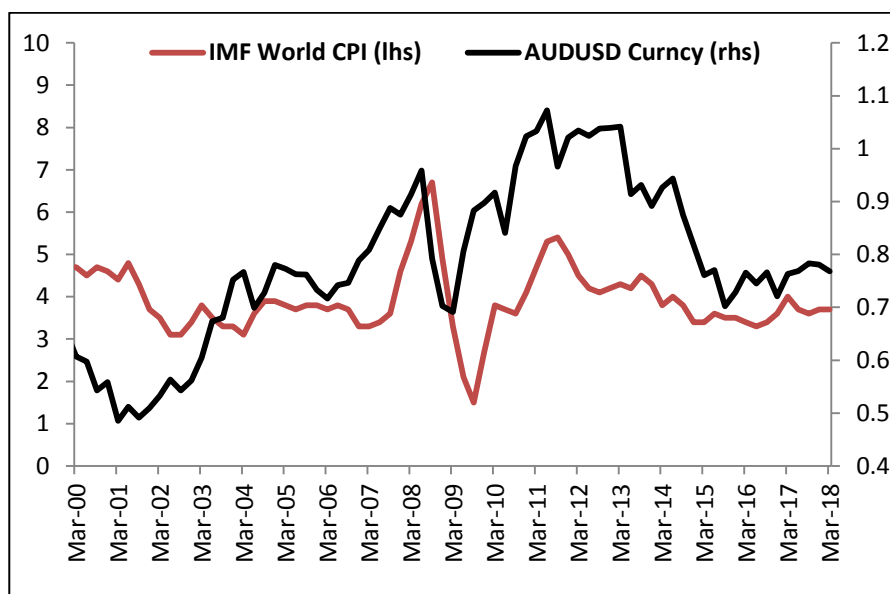


Source: Bloomberg

Keep in mind that the VIX index has been rather elevated around the 20-level. Ever since the trade war concerns started, equity markets have remained rather volatile. Appetite for risk currencies such as AUD has also been weak. However, if we look past the current environment that had been too focused on the trade

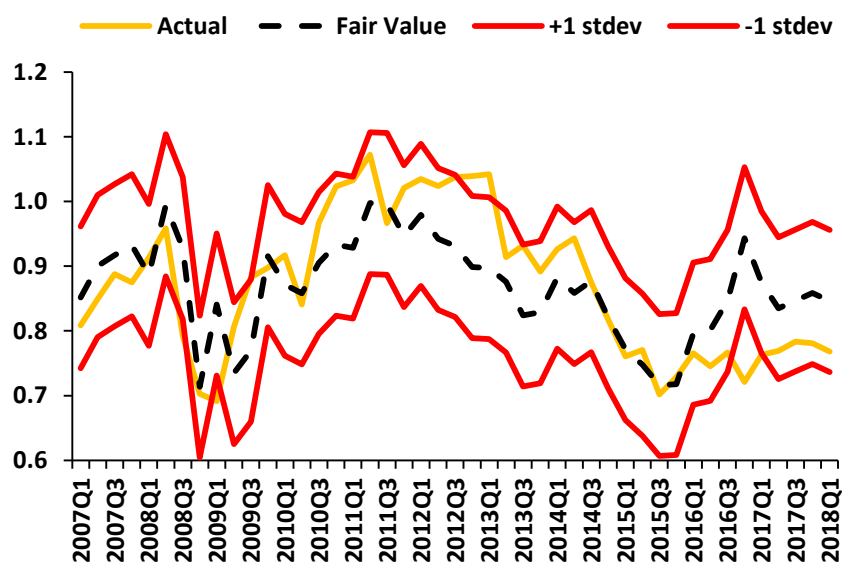
war (that could be over before we know it), global growth is still sustained. Australia's own fundamentals are still rather decent with hiring still keeping momentum, wage growth troughed, capacity utilization has been high, net exports growth is even expected to recover from its contraction in 4Q 2017 according to RBA. In addition, inflation seems to be on the uptick and AUD, as a pro-cyclical currency, tends to head higher in an environment of modestly rising price pressure. We keep to our view that AUDUSD could head higher above the 0.80-figure in this half of the year.

**Chart 7 AUD Could Be lifted By A Modestly Inflationary Environment.**



Source: Bloomberg, Maybank FX Research & Strategy

**Chart 8: Fast-Tracking Model Projects AUDUSD to be around 0.85**



Source: Maybank FX Research & Strategy Estimates, CEIC, Bloomberg

Our fast-tracking model for AUD puts its fair value at 0.85 against the USD. This model takes into consideration real yield differential vs. that of the UST, current account differential and reflation.

## Technical Charts

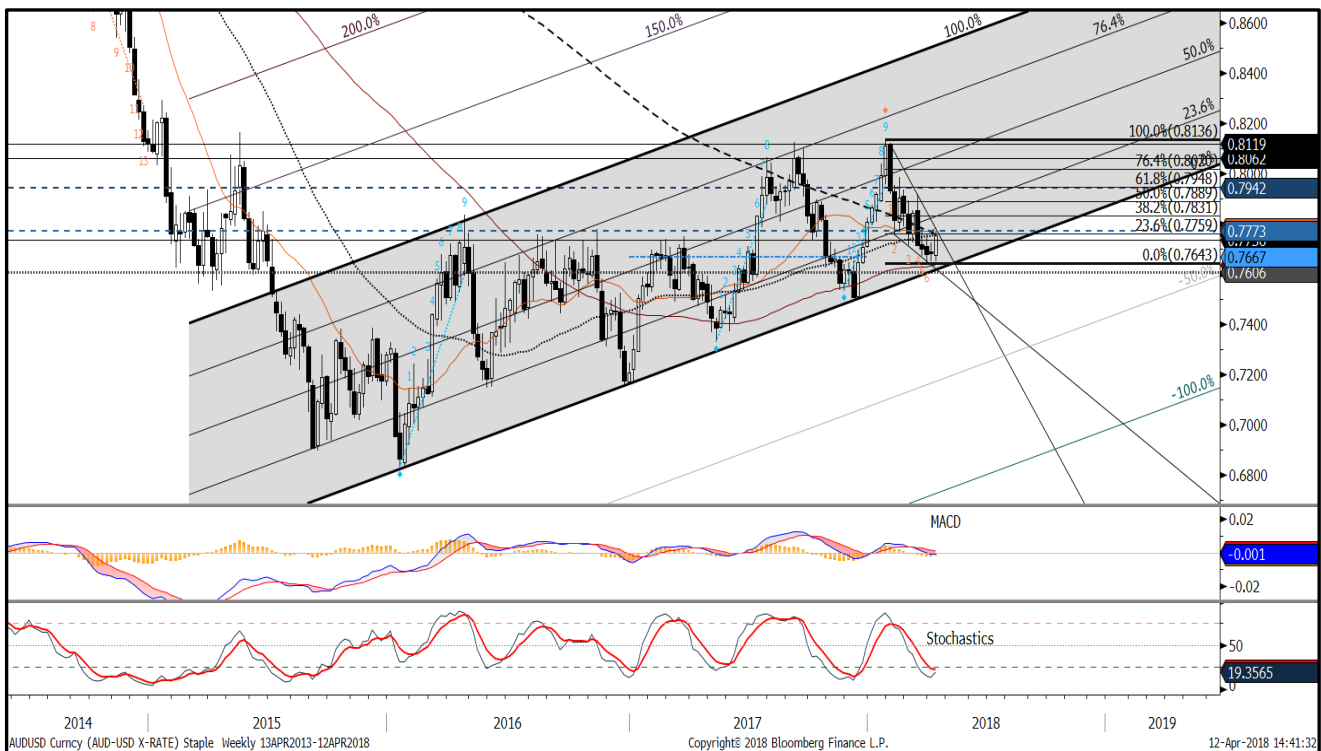
### AUDUSD (Daily): Descending Wedge Is a Bullish Formation



Source: Bloomberg, Maybank FX Research & Strategy

A descending wedge seems to have formed with the price action seen since the start of the year. As we have stated before (perhaps since Feb monthly), 0.76 remains a strong support that we eye. A break of the 0.7788- resistance, marked by the 100-DMA could be a bullish signal and a breakout of the descending wedge towards 0.7830 or even 0.7890 (50% Fibonacci retracement of the Jan-Mar sell off). That said, we do not rule out another dip towards the bottom of the descending wedge before a breakout. Support is seen at 0.77 before 0.7640. Eye critical level around 0.7788.

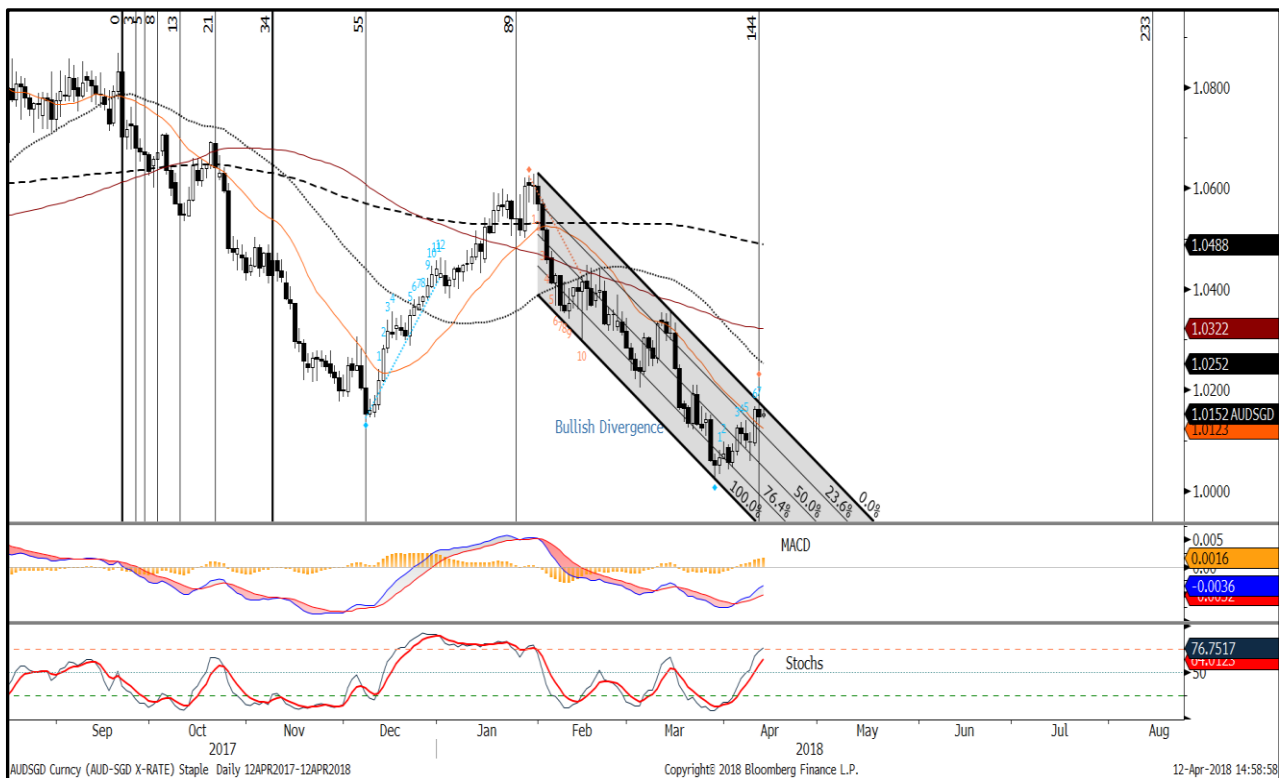
### AUDUSD (Weekly): Stochs Turning From Oversold Levels



Source: Bloomberg, Maybank FX Research & Strategy

It is clear on the weekly chart that the double top formation seems to have run its course. The long-term upward sloping trend channel was tested recently at its lower bounds and AUDUSD saw a strong rebound thereafter. Stochs are also turning from its oversold conditions. The last time it turned, AUDUSD rallied from 0.75 to 0.81. We continue to see risk of AUDUSD breaking above the 0.80-figure in this quarter.

### AUDSGD (Daily): Testing The Upperbound



Source: Bloomberg, Maybank FX Research & Strategy

The recent AUD rally lifted this AUDSGD cross towards the upper bound of the downward sloping trend channel. The Fibonacci time zone suggests that the downmove might have ended and we might be looking into the next leg up. This next leg up could be stronger and last longer, eye period 233 on the charts. However, another signal to confirm this would be a breakout of the downward sloping trend channel, preferably a move above 1.0200. Should MAS fail to move tomorrow (not our house view), this could nudge this cross towards the 1.0200-level. 50% retracement of the Jan-Mar sell off would see the AUDSGD around 1.0320. There are also other positive AUD triggers that could bring prices higher including a revival of risk sentiments.



### AUDMYR (Weekly): Moving on From its Double Top...



Source: Bloomberg, Maybank FX Research & Strategy

AUDMYR seems to have completed its double top formation and its next move may be northbound. We look for price moves to meet resistance around 3.0520 (76.4% Fibonacci retracement of the 2016-2017 rally). We also see a bullish divergence of the MACD forest with price moves as indicated by the blue line on the chart above. 200-DMA at 3.0850 marks the next resistance level before 3.1260.

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Published by:



Malayan Banking Berhad  
(Incorporated in Malaysia)

Saktiandi Supaat  
Head, FX Research  
saktiandi@maybank.com.sg  
(+65) 63201379

Christopher Wong  
Senior FX Strategist  
wongkl@maybank.com.sg  
(+65) 63201347

Fiona Lim  
Senior FX Strategist  
Fionalim@maybank.com.sg  
(+65) 63201374

Leslie Tang  
Senior FX Strategist  
leslietang@maybank.com.sg  
(+65) 63201378