Back From Down Under

• The AUD faces numerous barriers
• But China's momentum is coming to the rescue
• Positioning may favor the short-term bull case

There is a positive case to be made for a continued near-term appreciation of the AUD, but it is perhaps worth highlighting the multitude of issues posing a risk to its sustainability in order to truly appreciate the fact that the currency has posted any gains at all this past month.

Firstly, by virtue of its status as a commodity currency, the recent run of downbeat economic projections has hardly stood in its favor. Notably, the IMF believes the global economy will grow by 3.3% this year – the slowest expansion since 2016 – having clipped 0.2% points from its outlook in January.

It's against such a backdrop that the RBA has, for the first time this cycle, alluded to rate cuts having abandoned the suggestion that the 'next move in rates will be up' earlier in the year. Across the curve, Australia's negative yield spreads over US equivalents continue to trade deeply in territory that hasn't been seen in decades.

We would even point to the inflation-induced slump in the NZD as an additional consideration. There is no question of causality, but the fact is that since 2000, the two currencies have put in the same daily, directional performance against the USD 75% of the time. And on the days they did not, the

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average divergence was a scant 0.03% points.

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On Tuesday, we noted the staggering levels of support required to keep China’s economy going forward and highlighted the growing longer-term risks of such largesse.

However, amid the uncertainty surrounding the efficacy of these latest measures, we suggested that yesterday’s batch of data could well have a marked influence on prevailing sentiment. And this appears to be what has happened.

Adding to modest improvements in PMIs and solid home price data, yesterday’s GDP, industrial production and retail sales all promoted the idea that the multitude of measures implemented year-to-date are now bearing fruit.

And indeed, it is due to these very measures that China was among the few economies receiving an upgrade in the IMF’s growth projections for this year.

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As a result of the data, the CNH gained 0.4% - a top 10 move this year – and along went the AUD for the ride.

There can be no expectation for the nine-year old, 84%
daily inverse correlation between USD/CNH and AUD/USD to hold on a day-to-day basis; but the fact that AUD has gained 1.6% since tentative optimism began to lift the CNH (by 0.8%) at the end of last month is hard to ignore.

Of course, Chinese fundamentals only mean so much to the performance of the CNH/CNY. But if Steve Mnuchin’s claim that he has struck one of “the strongest currency agreements we have reached” bears out in any final deal between the US and China, then there becomes the realistic prospect that Chinese economic momentum will be reflected in the CNH, and by extension the AUD’s performance.

One final point, and indeed, one that's integral to the short-term bullish view, is positioning. CFTC data show that non-commercial accounts are sitting on the largest short position in the AUD since last November – and the bulk of these positions have accumulated since the start of March, in which time the AUD has modestly appreciated.

So, the multitude of risks hanging over the currency cannot be ignored, certainly, but for the time being at least, the AUD is on a roll thanks to growing optimism over the Chinese economy and momentum could yet prove to be problematic for the doubters.

Please direct questions or comments to:

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