Trade Idea – Foreign Exchange
Uncertainty to weigh on the Aussie
8th July 2016

AUD supported by buoyant commodity prices

- After falling to seven year lows at the start of the year, the AUD has exhibited remarkable strength, rebounding 6.4% on a trade weighted basis since the 15th January. The rally has been almost entirely driven by a bounce in the price of bulk commodities (such as steel, coal and iron ore – see Figure 1) from record lows, which has improved conditions for Australia’s vast resource sector. Positive momentum in the AUD has been enough to offset headwinds from political instability and a surprise interest rate cut by the Reserve Bank of Australia (RBA), but we believe this is about to change. In coming months, we see uncertainty linked to the recent federal election process and fragility in the recent rise in bulk commodity prices as presenting real risks to the downside for the AUD. Furthermore, should Q2 inflation data due on the 27th July disappoint, the RBA could be forced on a more accommodative monetary path than is currently expected, which could be the catalyst for a move lower in the AUD. We believe shorting the AUD/USD currency pair is the best way to express this view, as the US Dollar is likely to retain strength from its allure as a safe haven during this period of elevated geopolitical risk.

![Figure 1: Commodity rebound buoys AUD](image)

Tight election race raises questions over fiscal stability

- Australia has had turbulent political history, having had five Prime Ministers (PMs) since 2007 as a result of re-elections and internal political party upheavals. The most recent federal vote, held last Saturday, was a rare “double dissolution” election, which entails the re-election of both the Australian lower house (House of Representatives) and the upper house (Senate). The incumbent PM, Malcolm Turnbull, demanded the vote following a series of disagreements earlier in the year between the two houses over labour reforms (specifically union conduct in the construction industry). Initial poll counts suggest that a slim majority could be achieved by the ruling party but a hung parliament also remains a real possibility, adding to uncertainty. A key upshot of the recent vote is that credit rating agencies have released warnings that a deterioration of the political situation in Australia could jeopardise the nation’s prized AAA credit rating. A downgrade would risk increasing borrowing costs and could cause damage to broader market confidence. With the final result of the election likely to take weeks to emerge and the likelihood

*All figures quoted are sourced from Bloomberg unless stated otherwise.
of a fractured parliament increasing, the nation is in a state of limbo and uncertainty over the outcome is likely to weigh on the AUD in coming weeks.

Figure 2: Speculative activity still elevated

Speculation drives commodity prices

- The recent ascent in bulk commodity prices has lent support to the AUD but looks largely speculatively driven, having coincided with a jump in retail activity in China. While steps taken by authorities to curb commodity speculation have largely been successful, trading volumes remain elevated compared to historical levels (see Figure 2), making prices vulnerable to a correction in the near future. Should manufacturing data out of China continue to disappoint we could see the AUD fall as commodity prices see recent gains reversed.

Investors wishing to express the investment views outlined above may consider using the following ETF Securities ETPs:

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<th>Currency ETPs</th>
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ETF Securities

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- **ETF 5x Short AUD Long EUR (AUE5)**

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