Trade Idea – Foreign Exchange

Aussie to turn lower

16th September 2016

Oversupply to push iron ore prices lower

- In our last piece on the AUD we outlined a case for the currency to maintain its upward momentum, emphasising the importance of rising commodity prices in supporting its rally (see Aussie rally intact) and the longer term risks associated with this dynamic. In the interim, sentiment towards Australia’s primary export, iron ore, has taken a marked turn, falling 7% to a two month low ($56/tonne). Over coming months it looks increasingly likely that iron ore prices will resume their decline, as news of increased supply on the international market continues to compound bearish sentiment. With the Reserve Bank of Australia (RBA) looking increasingly neutral and recent manufacturing data falling for the first time in a year, the AUD looks likely to succumb to downward pressure from falling export prices. A fall in the AUD/USD could be catalysed by a hawkish outcome to the US Federal Reserve’s (Fed) monetary policy meeting next week, as the currency pair has recently exhibited sensitivity to rhetoric from Fed speakers.

- The world’s largest producers of iron ore Vale, BHP Billiton and Rio Tinto have all recently committed to maintaining production at strong levels in coming years. Together these firms are responsible for approximately three quarters of the global seaborne market, making their contribution significant for the price of the mineral on the international stage. The Australian Department of Industry, Science and Innovation, in its June 2016 resource outlook, predicted that Australian and Brazilian exports of iron ore will grow on average by 6.7% and 5.5% per year respectively to 2017, compounding supply issues in an already over-supplied market. Representatives from BHP Billiton have also recently revealed that they expect the iron ore price to fall from current levels which sit at the top of their expected range due to a “well-telegraphed” influx of cheap supply from major producers. This makes the prospects for iron ore and AUD increasingly bearish in the months ahead.

*Figure 1: Iron exports to grow

![Figure 1: Iron exports to grow](source: World Steel Association; Department of Industry, Innovation and Science (2016), ETF Securities, F=Full year forecast from the Resources and Energy Quarterly June 2016)

Tide turning

- The AUD/USD currency pair has produced a number of bearish signals in recent weeks, breaking key support levels and accumulating downward momentum. The AUD/USD has also been negatively impacted by recent hawkish rhetoric from members of the Federal Open Market Committee (FOMC), falling following speeches from Dudley, Fisher and Rosengren.

*All figures quoted are sourced from Bloomberg unless stated otherwise.
Should the Fed deliver a message of further tightening at its meeting next week we could see the AUD/USD fall beyond the low from the 28th July of 0.7421 to its 200 DMA (daily moving average) of 0.7398.

**RBA maintains a neutral stance on upbeat outlook**

- The RBA has increasingly projected signs that it remains satisfied with current economic conditions and intends to maintain a neutral monetary policy stance. A recent speech by Assistant Governor Chris Kent provided an upbeat assessment of the Australian economy, flagging “abatement of two substantial headwinds”, namely the decline in mining capex and a fall in the nation’s terms of trade. The speech complemented strong trade data from China in providing an improved outlook for the Australian economy, thus reducing the case for further rate reductions in 2016.

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  - ETFS 3x Short AUD Long USD (SAU3)

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