



IS AUD A CORONAVIRUS SAFE HAVEN?

Agenda: Is AUD a Coronavirus safe haven?

- 5 Drivers model:
 - Global and Australian growth (or, more recently, Chinese growth and Australia's terms of trade);
 - Interest rate differentials;
 - Investor sentiment and technical
 - The relative strength of the US dollar.
-
- Investment Outlook



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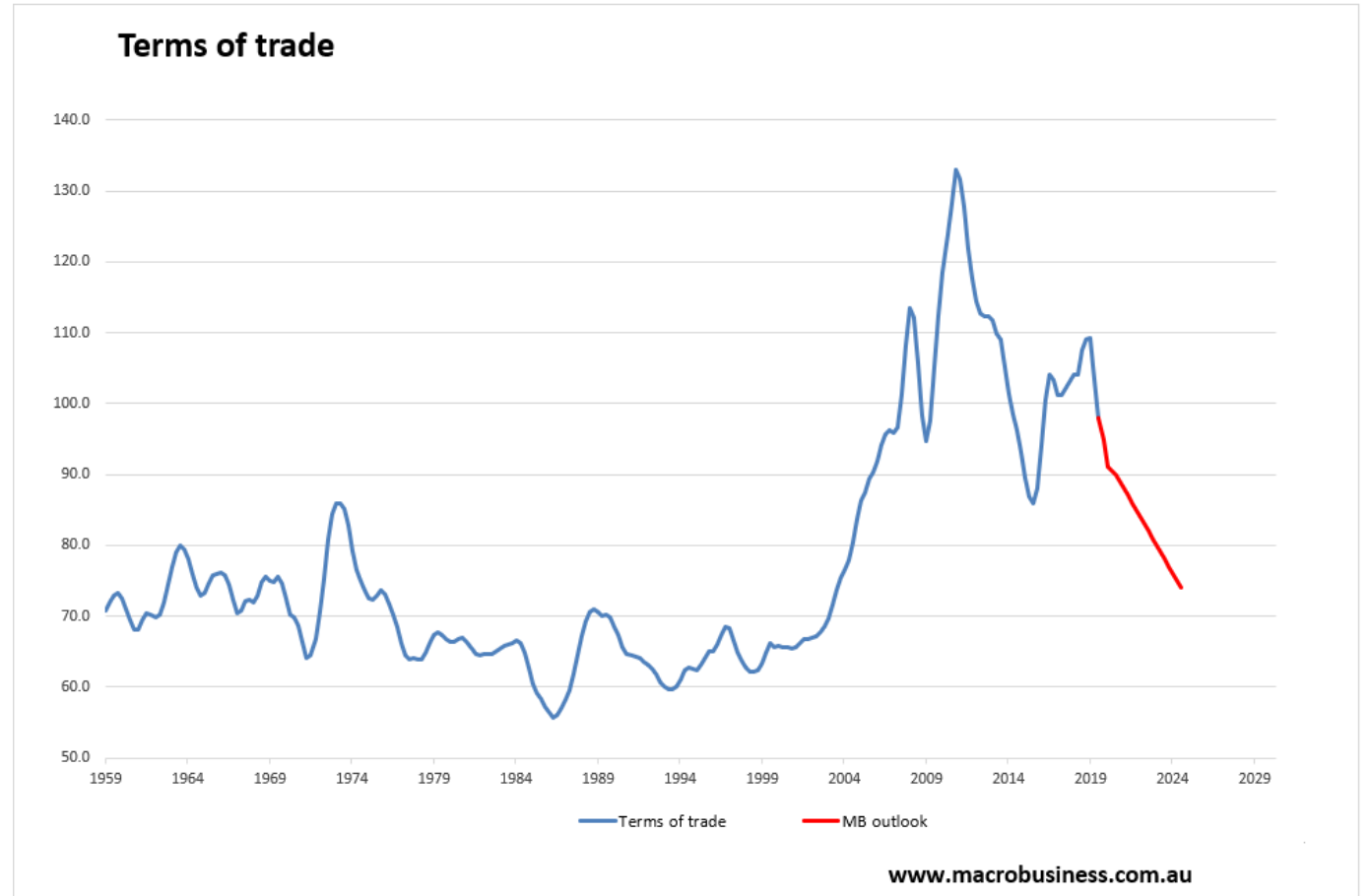
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Global & Australian Growth:

Global and Chinese growth & Australia's terms of trade

- Global growth crushed with weak rebound.
- Chinese recovery leading but to struggle and weaken medium term.
- Two coals getting belted
- Iron ore likely to slide lower on:
 1. weak Chinese property pipeline;
 2. big Chinese steel overhang;
 3. post-monsoon supply ramp up;
 4. longer term supply normalisation.
- Gold up but largely offset by base metals
- LNG crushed but direct offset in oil.

When we add education and tourism falls, the trade deficit will likely turn negative despite squashed consumer.



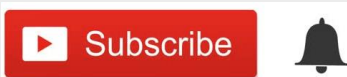
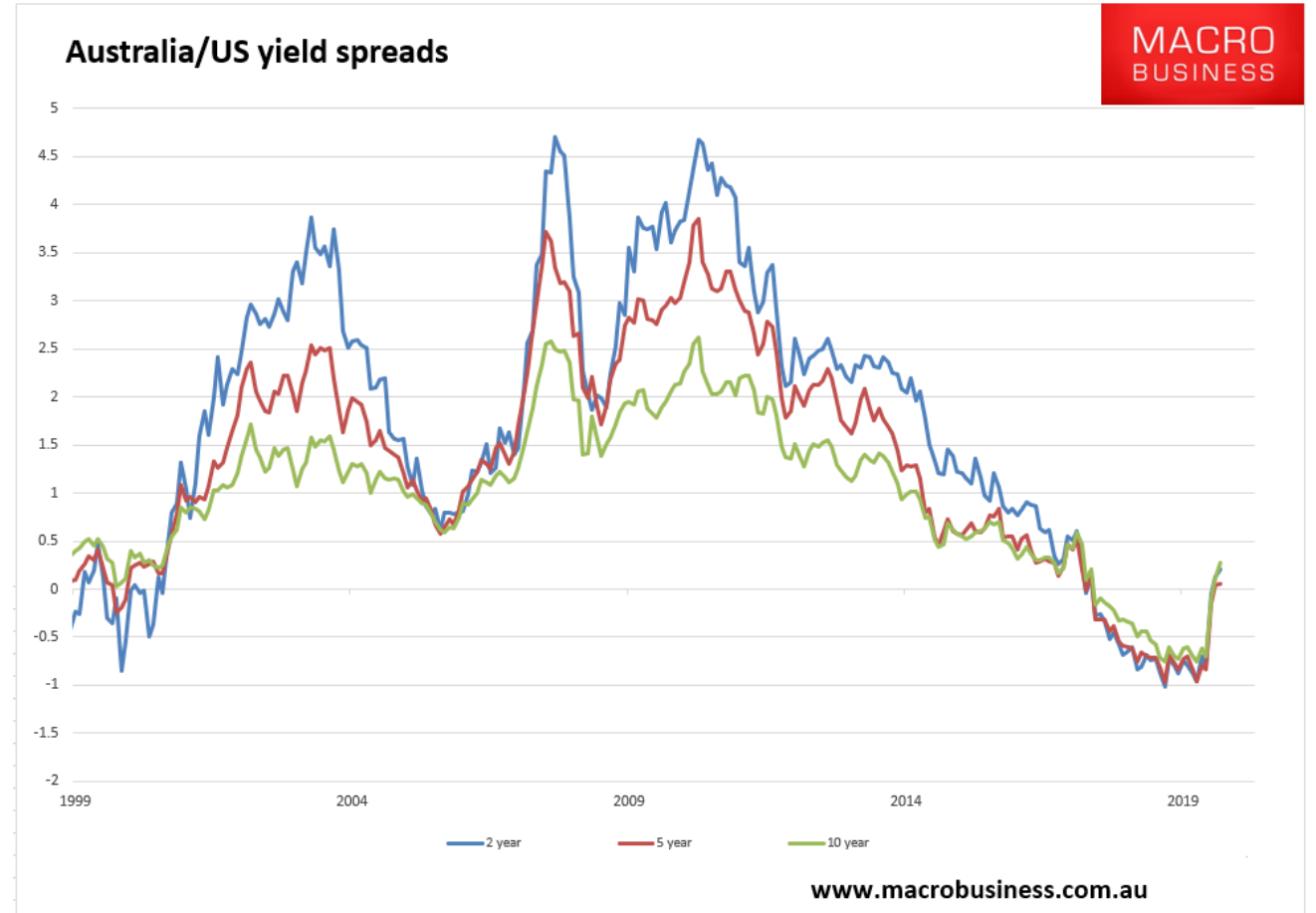
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Interest rate differentials:

- Spread has turned positive but not aggressively so.
- Australian rates low forever now.
- Neither US nor Australia to go negative but RBNZ might.
- QE is massive in US and tiny in Australia.
- But Australia likely to have more difficulty in banks as household debt under stress, SMEs buckle and immigration revival struggles politically and in market terms.



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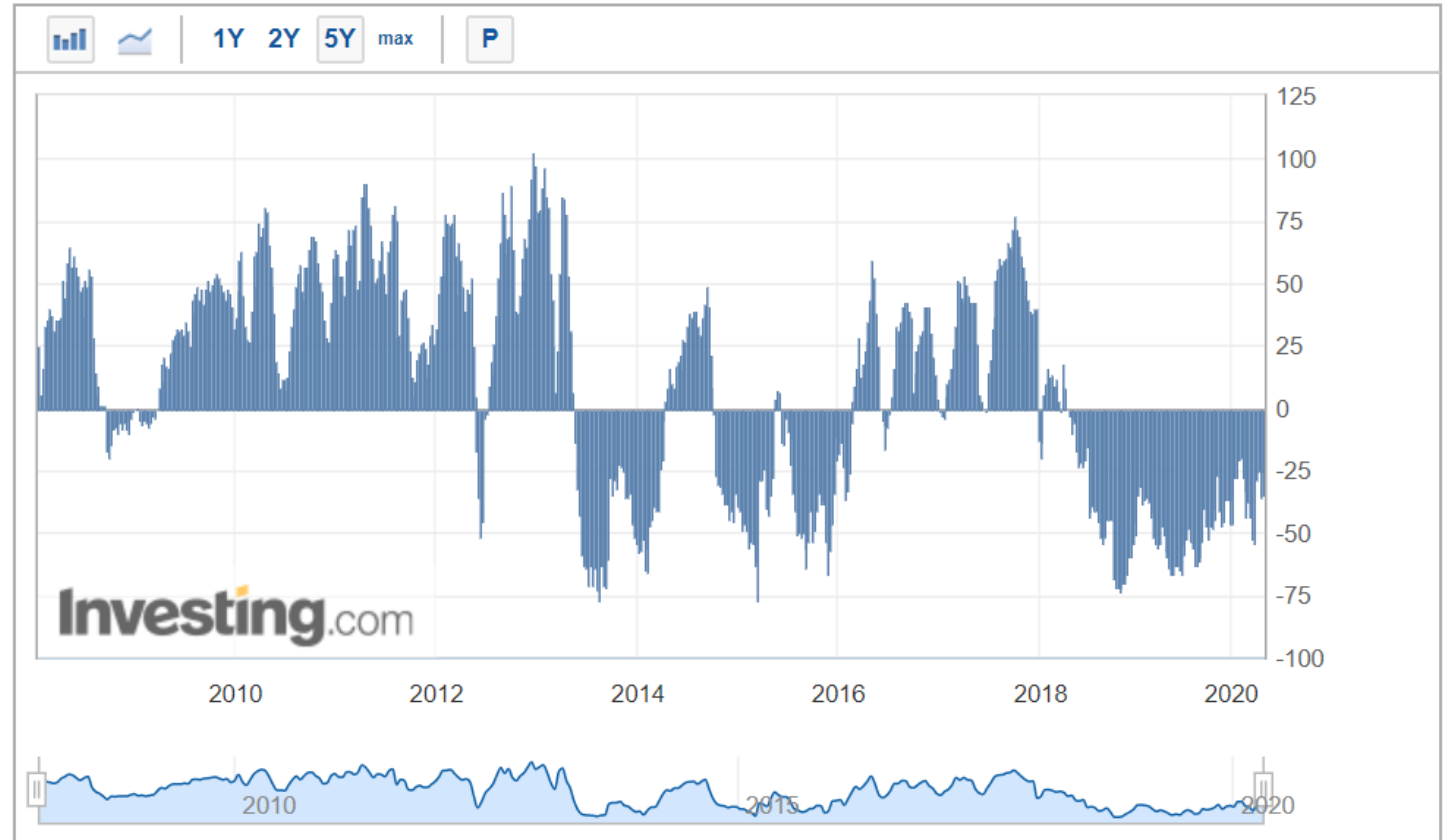
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Investor sentiment and technicals:

Senitment

- Market still moderately bearish on CFTC.
- But equities price action wildly bullish, tipping into forex.
- Trader: won't we just go back parity like we did post-GFC?



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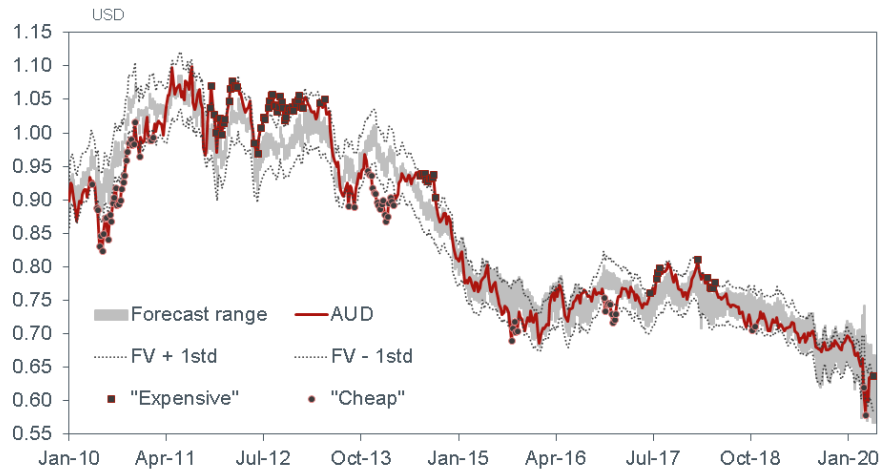
Investor sentiment and technicals:

Technicals

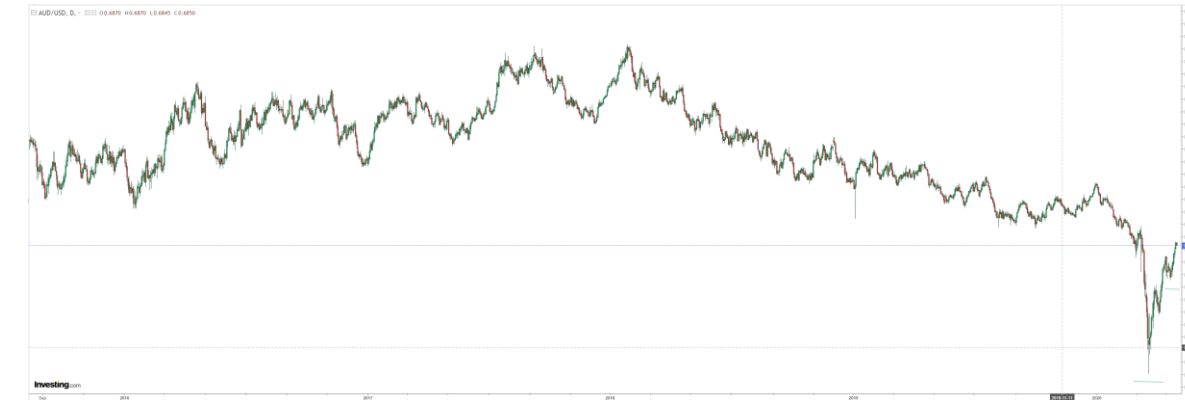
- Very bullish patterns with broken ascending triangle and cup and handle formation.
- But fair value blown away. AUD undershot, now overshooting.

A\$ 'fair value' midpoint drops to fresh 19yr low at 0.61

Meaning A\$ is expensive to fair value for first time since April 2018 as coal crunch is ignored



Source: Bloomberg, Westpac Strategy



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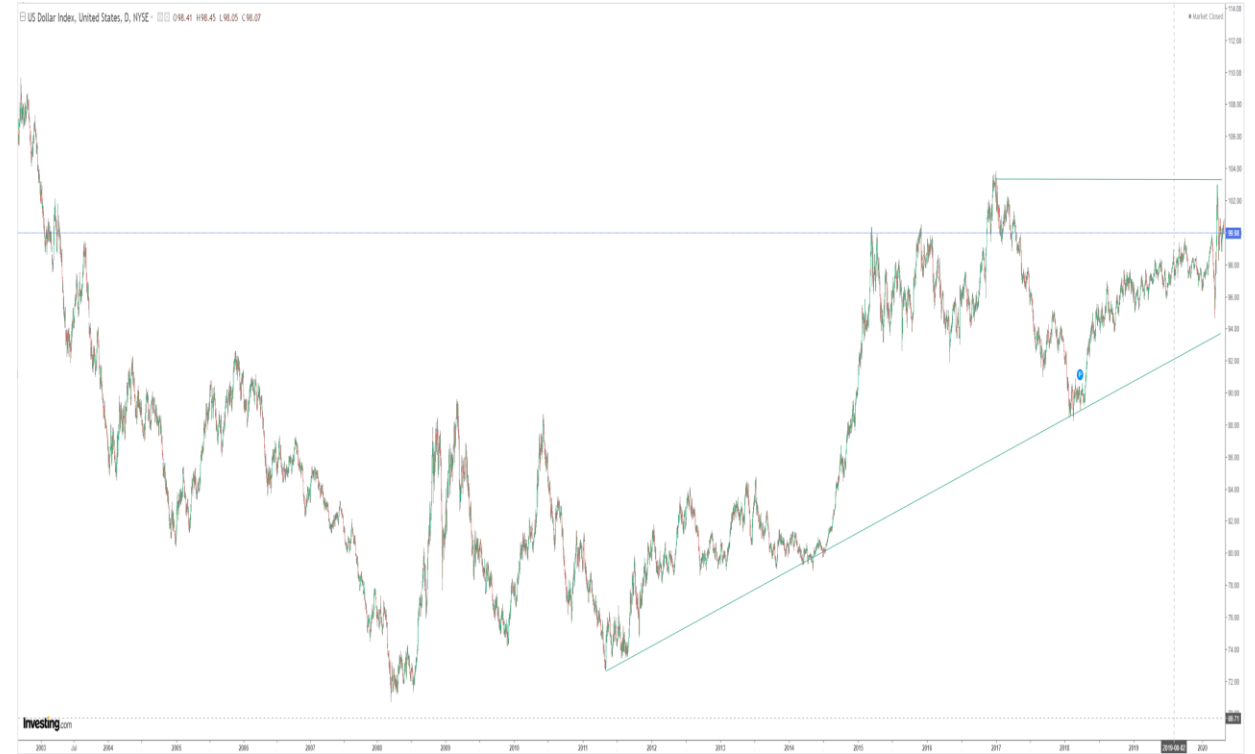
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The relative strength of the US Dollar:

Whither the beast?

- Safe haven played out as expected.
- Swiftens of policy response prevented super-spike.
- But still in demand as:
 1. Global bank stress has USD in demand despite swap-lines;
 2. EM stress still apparent despite Fed, more virus to come for them;
 3. Trade tariffs still in play as US/China fight over virus. Probably not in either's interests to see trade deal collapse.
 4. European fiscal stresses apparent and likely to intensify as country's heal. Italy?
 5. European banks to struggle more than US capital markets.
- But global recovery will see DXY fall.



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Five drivers summary

Short term bull, medium and long term bear

1. China-led global recovery bullish short term but not for long with bulks still to fall. Local growth recovery bullish short term given virus curve but big challenges ahead: Winter, immigration, housing, SMEs, banks. Not a GFC rerun. Likely return to twin deficits.
2. Credit spreads and QE bullish.
3. Sentiment bullish short term but valuation already a problem as bulks fall. If markets roll with crushed earnings then AUD to plunge again.
4. Technicals bullish short term.
5. US dollar bull market intact and bearish short term but will ease on global recovery so bullish medium term.

Outlook may be higher yet as risk assets overshoot. But into recovery, despite global growth firming, Australia will lag as income shock plays out, immigration constrains housing and consumer suffers from both. More fiscal will be needed yet government is talking up useless tax cuts.

Lower over the new cycle as Australian structural adjustment away from mining continues with Chinese Japanification, ex-globalisation etc.



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Investment Outlook:

Unemployment: Number one issue

Equities:

- How far will earnings fall / recover
- Consensus earnings useless. Five year average more helpful.
- -ve: Gearing changes, deglobalisation, increased redundancy, supply chain
- +ve: Reduced rent, travel, new efficiencies

Bonds:

- Inflation vs safety

AUD:

- Stimulus vs disruption



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