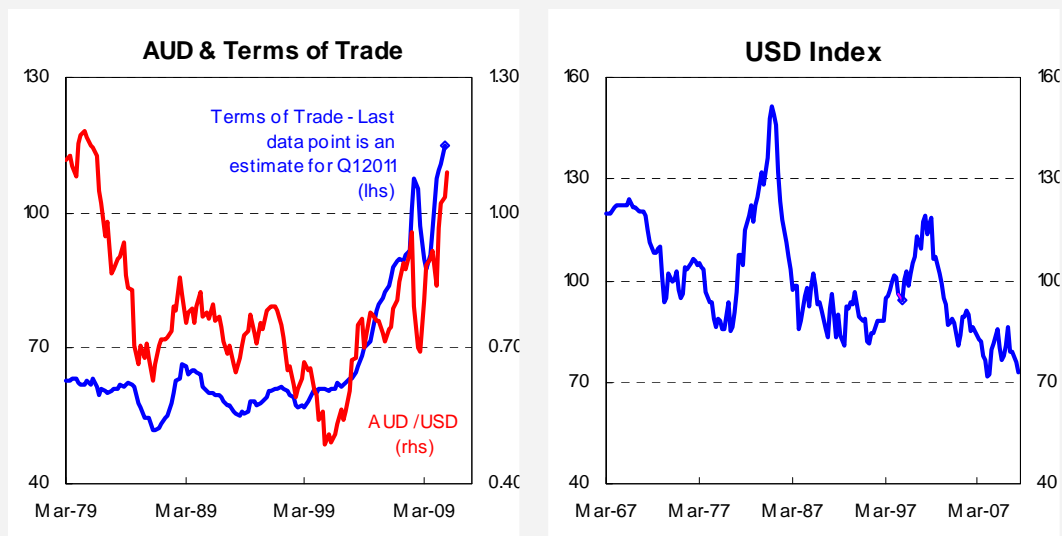


# AUSSIE DOLLAR OUTLOOK

Up, Up and Away

Thursday, 28 April 2011

- We now expect the Australian dollar to reach 1.1500 in the near term against the USD.
- The Australian dollar's positive relationship with the terms of trade suggests the AUD could aim for these new heights.
- The USD remains in a structural decline that has been in place since the 1980s.



The AUD has received fresh buying momentum, propelling it to above USD1.09 this morning. The recipe of a weak USD story, attractive local interest rates, high commodity prices, underlying momentum in the domestic economy and a rising terms of trade are propelling the AUD higher.

The AUD in the post-float era is in new territory. So examining the long-run relationship of the currency with the terms of trade might be useful. The terms of trade and the AUD/USD hold a close positive correlation. Last week, the Australian Bureau of Statistics released trade prices data for the March quarter. This data suggests that the terms of trade increased by an estimated 3.8% in the March quarter, taking the annual growth rate to near 20%. The further gains in the terms of trade means we would expect the AUD could scale as high as 1.15 in the first half of this year. Previously, we thought the high would be 1.11.

On a long-term basis, the AUD has structurally been in an uptrend since 2001 while the USD has been in a structural decline since 1985 (refer to the charts above). The AUD's structural uptrend has a lot to do with the rising terms of trade and the associated structural transformation of the Chinese economy.

The USD has continued to slide, and received fresh selling pressures overnight after the US Federal Reserve Chairman Bernanke said they would keep rates low for an extended time. The US quantitative easing program is also expected to end in June as planned. The combination of higher interest rates elsewhere in the world, slow US economic growth and a large US budget deficit is causing investors to shun the greenback. The recent declines in the USD are also helping the US export and manufacturing sector and therefore may be welcomed by the US administration. The old days of the "strong USD policy" appear to be over.

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