

AUD fate shifting as China may consider targeting Aussie coal

Reports that China is considering limiting Australian coal imports - as diplomatic tensions between the two countries rise - doesn't bode well for AUD. If such speculation materialises, the fall for the currency may be quite significant



China coal

Coal getting caught in the crossfire?

Since the first skirmish between Australia and China as the former called for an investigation on the origins of Covid-19 last month, markets have feared the diplomatic fall-out would trigger economic retaliation. Recent [news flow suggests](#) such fears, and AUD's shield to trade tensions is creaking.

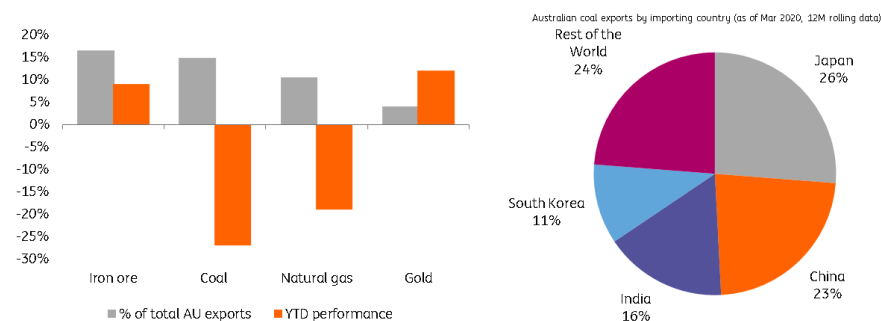
Unlike barley and beef, coal is Australia's second-biggest export, and China is the second-largest buyer

After imposing tariffs on Australian barley and beef in addition to an import ban, reports that

China is targeting [Australian coal have intensified](#). Despite no official confirmation from Chinese authorities, speculation and media reports about a possible import ban on coal has been enough to trigger a drop in AUD.

Unlike barley and beef, coal is Australia’s second-biggest export (figure 1), and China is the second-largest buyer of Australian coal. The consequences for the Australian mining industry would be quite severe at a time when the Australian economy faces its first major economic downturn in 30 years.

Fig. 1 & 2 - Australia's dependency on China's coal demand



Source: DFAT, Bloomberg, ING

AUD: Facing large downside risk

Barring today’s correction in AUD, so far the currency has proven to be not too sensitive to the rising tensions, thanks to the attractive fundamentals. These include a [supportive commodity backdrop](#) - thanks to iron ore’s performance, low Covid-19 contagion, a large fiscal stimulus and not a very dovish central bank, of course relatively speaking.

A Chinese ban on Australian coal is mere speculation thus far, but should this prospect materialise, AUD’s recent resilience suggests the fall may be quite significant.

In particular, it will likely fuel concerns that China will end up targeting other key Australian exports, such as iron ore, which is likely to have a much more substantial economic impact on Australia or even LNG ([whose prices are already under pressure](#)).

[How the resilience of iron ore prices provide a solid fundamental for AUD](#)

A fully-fledged Australia-China trade war (which includes duties/bans on coal and iron ore) can, in our view, send AUD/USD back to the 0.60 area.

For now, the risk of this happening should be enough to prompt AUD to lag its procyclical peers.

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