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FX Focus: Can the Australian Dollar Keep Pace?

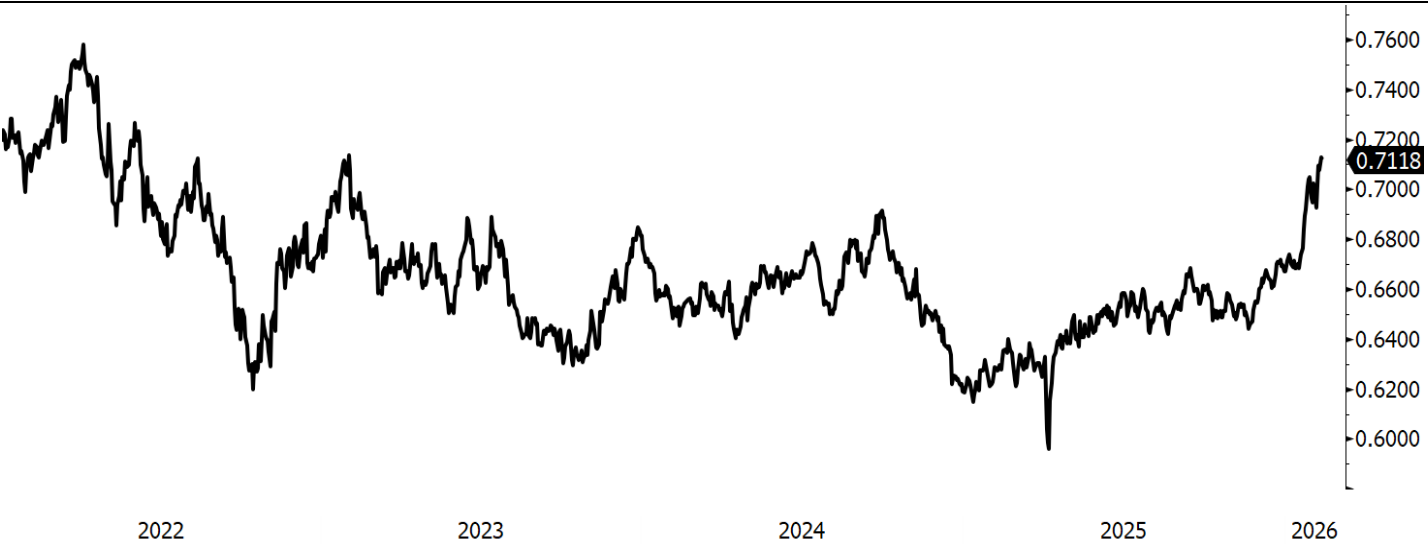
Australia's strong fundamentals are forcing the Reserve Bank of Australia (RBA) to go against a global easing cycle. A tight labor market, positive business sentiment with investment intentions running above their longer-term average, and solid consumer spending has resulted in a 25 basis point rate hike to 3.85% this month, the first time it has tightened since November 2023. This is likely to be followed by another 25 bps hike in March. This sentiment has supported the swift rally in AUDUSD to levels last seen in early 2023. The Aussie (AUD) has also benefitted from U.S. Federal Reserve rate cuts, Australia's resilient terms of trade and its high correlation with a strong Chinese Renminbi (RMB). However, AUD's support from such a diverse base also poses some question marks about its ability to sustain these gains later this year.

- Critically, Australia's private demand growth has strengthened more than expected, driven by both household spending and investments. The RBA's policy-making body said that "some of the increase in inflation reflects greater capacity pressures. As a result, the Board considers inflation is likely to remain above target for some time."
- This likely means that the RBA's previous upside risk scenario for activity is now the base case. The central bank said in February that some of the pressures driving Australia's inflation higher in recent quarters are unlikely to be temporary. RBA Governor Bullock added that it would take a major change in Australian data for the central bank to change tack in coming months.
- The RBA's turn to outrightly hawkish has supported a swift rally in AUDUSD to a high of ~0.7150 in early February 2026, up ~15.5% since the start of 2025 and to a level last seen in early 2023. AUD's gains have also been more broad-based within the G10 FX space, strengthening against its commodity peers (NZD & CAD), the euro bloc (EUR, GBP & CHF) and its Asian counterparts (RMB, JPY and SGD).
- However, the RBA's willingness to tighten among its cohort of G10 advanced central banks, apart from the Bank of Japan, has not been the only tailwind for the currency. Fed rate cuts, favorable terms of trade, and its correlation to the RMB are also helping. But can this strength be sustained in 2026?
- Australia's terms of trade are primarily driven by commodity exports to China, in particular iron ore. But iron ore prices recently slipped below USD100 per ton for the first time since August for two reasons:
 1. temporarily slowing demand from China ahead of the Lunar New Year this month.
 2. Concerns amid signs of a well-supplied market reflected in higher Chinese inventory.
- Meanwhile, the gains in RMB continue but with USDCNY now down below 6.95, further gains may slow as China attempts to shore up its weak domestic recovery with a stronger export-driven model. As for RBA rates driving AUD higher, investors are reminded that the Australian economy responds relatively quickly to rates given the leverage in the housing market. Once the rising trend in inflation expectations stabilizes, the RBA may also reverse its current front-loaded tightening to bring rates back to neutral in 2027, potentially making the current RBA tightening cycle a short-lived event.
- For AUDUSD to sustain further gains, markets would need to see several factors playing out together, including:
 1. Further Fed rate cuts against more RBA hikes to flip RBA–Fed rate differentials to positive and incentivize Australian investors to adjust FX hedge ratios on around USD1.1 trillion in USD-denominated investments.
 2. Resilience in Australia's terms of trade driven by commodity exports
 3. The RMB to continue strengthening
- Further gains in AUD above 0.7200 may be more difficult to sustain but Australia's solid fundamentals and the likelihood of back-to-back rate hikes suggest a higher 0.65 – 0.72 AUDUSD range in the first half of the year but with a possible re-adjustment lower later on in 2026.

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FIGURE 2: AUDUSD’s test of a ~0.7150 high in early February 2026 was last seen in early 2023



Source: Bloomberg, February 6, 2026. **Past performance is no guarantee of future results.** Real results may vary.

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