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FX Focus: AUD – Stars aligning for a brighter future

FIGURE 1: FX Forecasts

Forecast (May 2025)	Spot	0-3m	6-12m	Long-term
AUDUSD	0.6525	0.6400	0.6800	0.6800

Source: Citi Wealth Investments as of May 2025.

Following a short-lived drop below the key 0.6000 level in early April, AUDUSD has not looked back as the stars have slowly aligned for a better future. Admittedly, Australia's domestic outlook has weakened even before global trade war began with Q1'2025 GDP data released earlier in June showing weaker-than-consensus real activity growth, expanding by just +0.2% against RBA's implied forecast of +0.4%. The result was also weaker than the Q4'2024 rise of +0.6% and means yearly growth remains at a below trend 1.3% and raises doubt about RBA's 1.8% YoY forecast for Q2 GDP growth as households and businesses appear more cautious because of global developments.

Such doubts have seen Australian rates markets discounting 3 additional 25bp RBA rate cuts to the end of 2025 commencing in July for a 3.1% terminal rate which if realized, would see the Bank lowering rates by a total of 125bp in its easing cycle. The RBA minutes of the May meeting also indicated that the Board discussed merits of a 50bp cut though opted for 25bp instead because it wanted to be cautious and predictable when removing policy restriction.

However, since March, rate differentials have played a lesser role in driving FX sentiment. For AUD, it is the external outlook that has mattered more in driving sentiment for the rest of 2025. With a third of all goods exported from Australia going to China, the outlook for Chinese growth is especially relevant to AUD's performance. In particular, the recent sharp de-escalation in US – China trade tensions raises AUDUSD's medium-term upside potential for 2 reasons:

1. A US – China trade deal that is now expected to be more favorable to China than expected earlier should allow Chinese policymakers to focus more on a domestic recovery via fiscal and monetary stimulus. Indeed, China's planned augmented fiscal deficit of nearly USD2trn (10% of China's GDP and 2.2% higher than in 2024) is already a designed fiscal boost meant to promote domestic growth to counter the disinflationary headwinds from tariffs even as US – China trade tensions recede.
2. China may be able to accommodate some RMB strength against USD as a quid pro quo to lowering tariffs by the US in any trade deal as it focuses more on reviving domestic growth. A stronger RMB in turn, is likely to flow onto AUD sentiment given the high level of correlation between the two currencies.

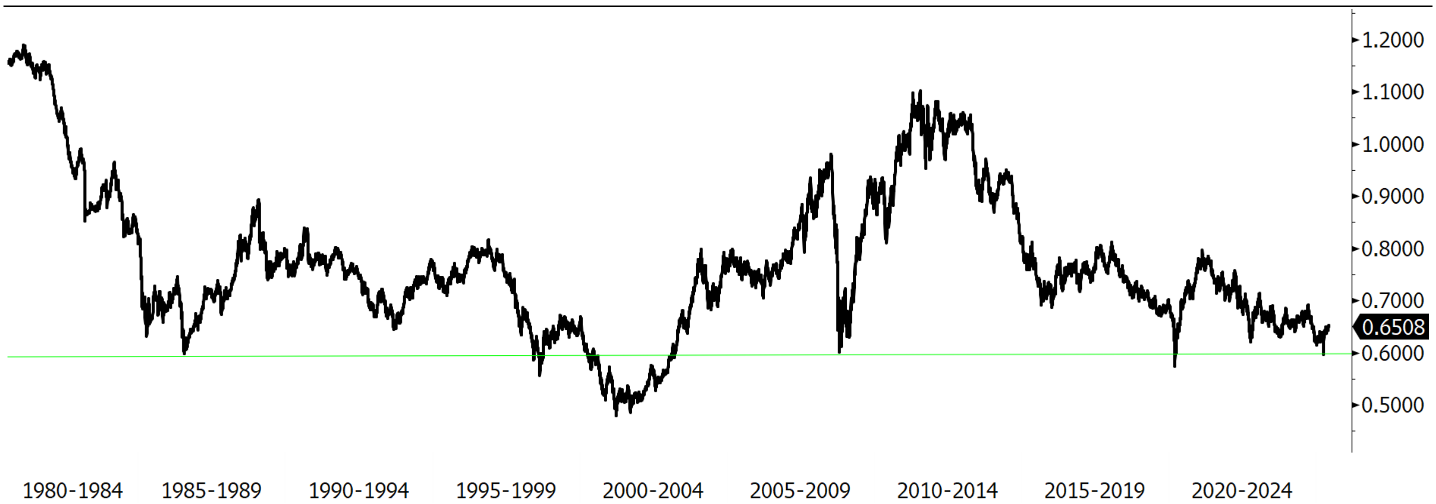
The China premium discounted into AUD was very large by historical standards earlier when AUDUSD tested the 0.6000 level in early April which explains why the dip below was rather short-lived. Since then, the China premium has significantly diminished as AUDUSD strengthens past 0.6500. This might slow AUD's upside momentum unless the RMB strengthens further. Ultimately, China may be able to potentially accommodate RMB strengthening to the 6.80 – 7.00 area versus USD that currently represents the stronger end of PBoC's allowable FX trading band for the currency if the domestic recovery accelerates. This in turn could potentially drive AUDUSD higher towards the 0.68-0.70 level.

Also adding to AUD's resilience against USD are the several headwinds now facing USD including:

1. Markets continuing to downgrade US exceptionalism
2. Reduced investor capital flows into US as Europe, Japan and China lower their recycling of current account surpluses to the US on reduced trade flows
3. Rising US fiscal deficit concerns - undermining USD's safe haven status
4. Extended trade and tariff uncertainty due to US judicial intervention
5. Talk of a possible currency accord between the US and Asia EM and Japan to weaken USD
6. A more sanguine ECB about EUR's recent elevation
7. A slowing US economy potentially bringing forward Fed rate cuts to the table

Of course, there are risks to AUD's resilience if a US – China trade deal fails to materialize when markets appear to be positioning for a significant lowering of trade tensions between the two superpowers. On the other hand, with investors currently positioned short USD and having discounted a lot of bad news for the US, any news of a major trade deal may trigger some short covering in USD on reduced trade uncertainty. However, such moves are likely to be tactical in nature allowing investors to buy AUD at cheaper levels with the 0.6000 level likely proving a solid floor for the pair.

FIGURE 2: AUDUSD has hit the major 0.6000 support level only 5 times since 1980 and on 4 of those occasions the move down has been very short lived



Source: Bloomberg, June 11, 2025.

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