Economics and Markets Research

FX Forecast Update

national australia bank

In this issue

USD – A more positive USD view 2
AUD – Once there was an uptrend…. 3
NZD – A flatter NZD/USD profile..... 4
JPY – To infinity and beyond?..... 5
CNY – Gradual appreciation to continue .. 6
EUR – Establishing a new, lower range..... 7
GBP – In search of the real Andy Burnham 8
Spot FX Forecasts 10

Upgraded post-war USD view; AUD vulnerable to 2027 RBA cuts

- The end of the Iran conflict (as far as the market is concerned) and rapidly retreating oil prices have done nothing to dent the USD's allure, supported by the Fed's hawkish tilt and a view of ongoing US economic exceptionalism.
- We have accordingly upgraded our USD views across the forecast horizon, though tempered by a prevailing NAB view of an extended period of unchanged Fed policy, contrasting with current money market pricing. What the Fed does or doesn't do is a crucial swing factor for the USD and if the Fed facts change, so too will our USD forecasts.
- Assuming the RBA is done tightening, AUD/USD will struggle to get back much above 0.70, and in 2027 on NAB's RBA view, could fall to as low as 0.65.
- We downgraded our NZD forecasts, with the currency now expected to be broadly flat over the coming quarters, trading roughly a 0.56-60 range.
- EUR/USD is establishing a new lower range, which we think will be bounded by 1.12-1.18. More clarity on the US rate outlook is the more likely driver of a break of this range – on either side.
- GBP has behaved better than feared as yet another PM prepares to take over, increase spending, taxes and possibly borrowing. Lack of policy detail and lower Gilt yields (following oil) have helped, but for how long?
- A resilient economy, rising inflation and a slow-moving BoJ means JPY is now seen weaker for longer. A gradual 2027 recovery is Fed and BoJ dependent.
- CNY slow and strategic appreciation to continue (no changes to forecast), seen supporting domestic demand and appeasing major trading partners.

Table 1: FX Forecasts (see p.10 for full forecast table)

Majors		Current	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28	Sep-28	Dec-28
AUD/USD	**New**	**0.692**	**0.69**	**0.70**	**0.70**	**0.69**	**0.68**	**0.67**	**0.68**	**0.69**	**0.70**	**0.70**
	Old		0.72	0.73	0.74	0.73	0.72	0.72	0.72	0.71	0.70	0.69
NZD/USD	**New**	**0.570**	**0.57**	**0.59**	**0.60**	**0.61**	**0.61**	**0.61**	**0.61**	**0.62**	**0.63**	**0.63**
	Old		0.61	0.63	0.64	0.63	0.63	0.63	0.63	0.62	0.62	0.61
AUD/NZD	**New**	**1.214**	**1.21**	**1.19**	**1.17**	**1.13**	**1.11**	**1.11**	**1.11**	**1.11**	**1.11**	**1.11**
	Old		1.18	1.16	1.15	1.15	1.14	1.14	1.14	1.14	1.14	1.14
EUR/USD	**New**	**1.143**	**1.14**	**1.15**	**1.16**	**1.15**	**1.15**	**1.15**	**1.14**	**1.14**	**1.14**	**1.14**
	Old		1.19	1.20	1.21	1.20	1.20	1.19	1.18	1.18	1.18	1.18
GBP/USD	**New**	**1.335**	**1.32**	**1.32**	**1.33**	**1.32**	**1.31**	**1.32**	**1.30**	**1.31**	**1.31**	**1.31**
	Old		1.34	1.33	1.36	1.35	1.35	1.35	1.36	1.36	1.36	1.36
USD/JPY	**New**	**161**	**163**	**161**	**158**	**155**	**153**	**151**	**150**	**148**	**146**	**145**
	Old		153	152	150	149	146	144	142	140	138	136
USD/CNY	**New**	**6.79**	**6.70**	**6.60**	**6.50**	**6.40**	**6.40**	**6.40**	**6.43**	**6.45**	**6.45**	**6.45**
			6.70	6.60	6.50	6.40	6.40	6.40	6.43	6.45	6.47	6.49

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USD – A more positive USD view

We are making a meaningful upward revision to our USD projections across all majors relative to our prior (April) update, having earlier been hesitant to make changes during the 'fog of war'. The key driver of the revisions is that the US economy is proving much more resilient than anticipated, keeping inflation elevated and prompting a hawkish pivot by the Fed. Yet to the extent this has not to date translated into a formal NAB view that the Fed will lift rates in coming months, our enthusiasm for lifting forecasts for the USD from prevailing levels is currently limited. Indeed, a failure by the Fed to act on current market pricing for tighter policy carries downside USD risk into year end and into 2027, such is the potency of Fed policy expectations in driving the USD upswing since May.

The case for upgrading our USD forecasts includes the following arguments:

- Citi's US economic surprise index recently reached its highest level since 2023, indicating that positive economic surprises have been widespread relative to consensus. The same cannot be said for other major economic regions, hence US economic exceptionalism is vividly on display (Chart 1). Comparison of latest PMI data, for June, paints a similar picture.

- After the US labour market data showed limited payroll growth through 2025 and a mildly rising trend in the unemployment rate, payrolls printed healthy gains in March through May. And while the lower than forecast May payrolls and downward revisions to the prior two months suggest some deceleration in job creation, the unemployment rate fell to 4.2% (vs a 4.5% peak last year) and still suggests an overall 'stable labour market situation (Chart 2).

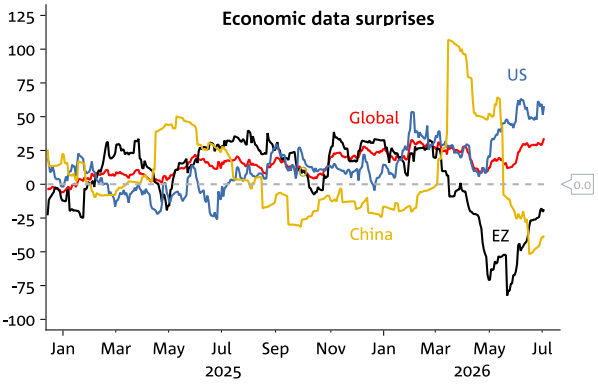
- Higher oil prices, past tariff impacts and robust growth have pushed inflation in the wrong direction. Importantly, the Fed's preferred core PCE deflator rose to 3.4% y/y in May, its highest level since late 2023 and clearly further away from target (Chart 3).

- Against this economic backdrop, there has been a significant repricing of Fed monetary policy expectations, from a series of rate cuts thought possible earlier in the year to a high chance of at least one rate hike year end. At the mid-June press FOMC, Fed Chair Warsh delivered an orthodox press conference, acknowledging that inflation has been running above target for more than five years and that, under his leadership, the committee will deliver price stability. The USD upswing since May has closely tracked the evolution of Fed policy expectations (Chart 4).

Any argument that the USD reverses course through the second half of the year and into 2027 would require US economic growth to soften including a weaker labour market and inflation pressures to ease substantially, prompting the market to materially revise Fed pricing.

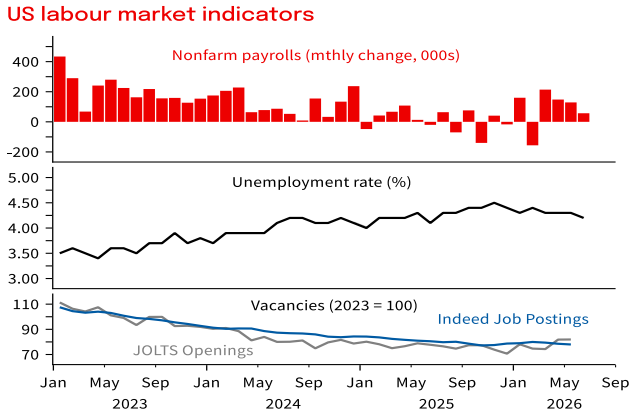
On the economy, one could point to consumer spending growth being lifted by large early-year tax refunds and strong (equity-related) wealth effects and that spending will weaken as softer income fundamentals come into play.

Chart 1: Economic surprises and US exceptionalism



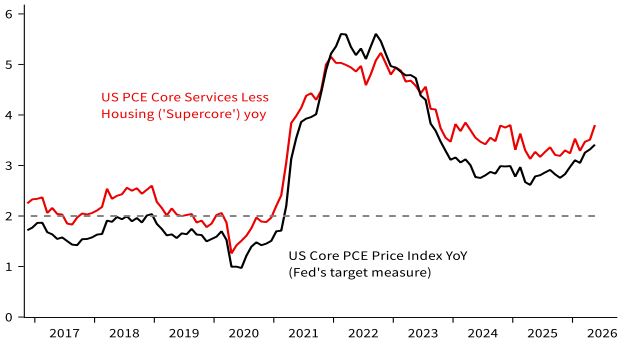
Source: National Australia Bank, Macrobond, Citi

Chart 2: US labour market stability



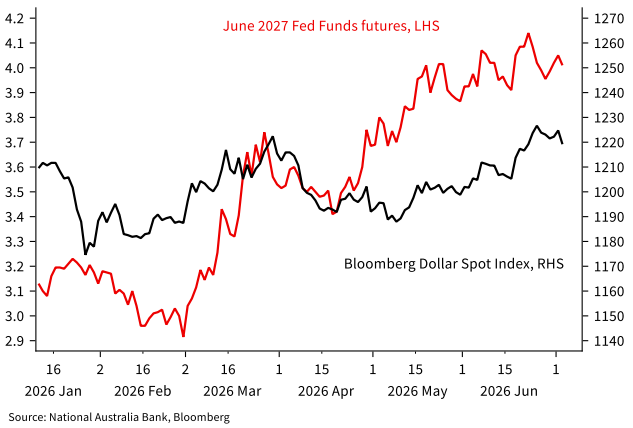
Source: National Australia Bank, U.S. Bureau of Labor Statistics (BLS), Indeed Hiring Lab, Macrobond

Chart 3: US inflation moves away from target



Source: National Australia Bank, Macrobond

Chart 4: June 27 Fed Funds rate vs USD



Source: National Australia Bank, Bloomberg

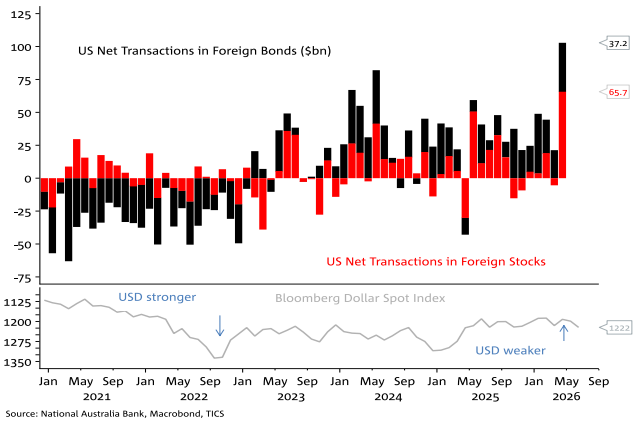
The housing market remains weak because of higher mortgage rates, and overall growth could be described as narrowly based, relying heavily on AI-related investment expenditure. On US growth relative to other major developed countries, lower oil prices, if sustained, is USD-negative from a terms of trade perspective while supportive for growth prospect of oil importing countries, potentially closing the gap in economic performance.

Since NAB does expect inflation to ease – driven by fading tariff impacts, moderate wage growth (particularly given solid productivity growth), weakness in housing rents and now, lower oil prices, we see the Fed staying on hold indefinitely. After all, those FOMC members who in June, thought higher rates later this year would be appropriate are likely to be mostly (or all) non-voters, while most voters believed policy could remain on hold.

That said, patience for high inflation – and looking through supply driven shocks – is clearly wearing thin, and any further upside inflation surprises from here – or just a failure to show moderation in short order - would probably trigger rate hikes. In this respect, we are sympathetic to an alternative view espoused by Treasury Secretary Bessent of a tap-on-the-brakes style policy adjustment as Alan Greenspan did in 1995. If enacted, policy could then ease later in 2027, bringing the USD down with it. But if so, up before down.

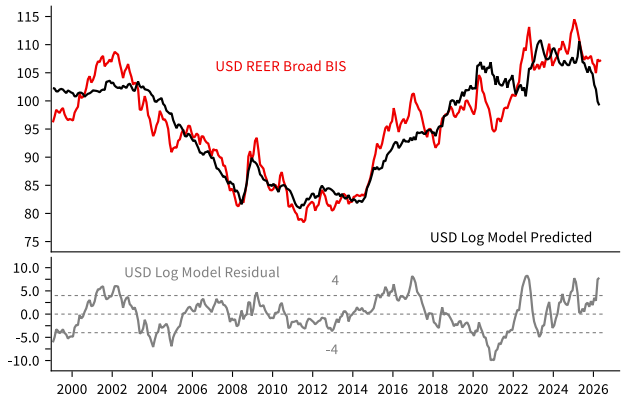
A new 'family fight' (in Warsh's words) is scheduled for four weeks' time (July 29 the outcome of which could be pivotal for USD performance in the second half of the year.

Chart 5: US investor (out) flows overseas



Source: National Australia Bank, Macrobond, TICS

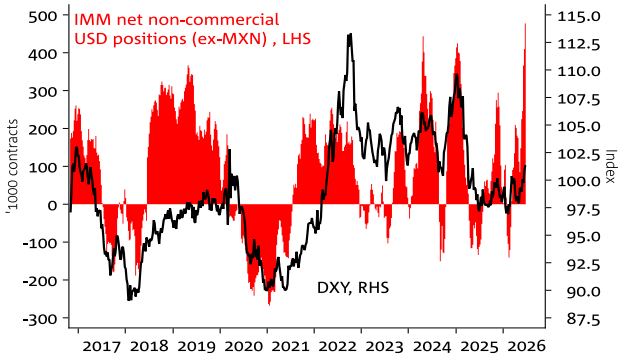
Chart 6: US capital (out) flows USD model



Source: National Australia Bank, BIS (The Bank for International Settlements), Bloomberg, Macrobond

Fed policy USD considerations aside, reasons not to get overly bullish on the USD in this forecast update includes: 1) US capital flows (TICS) data showing ongoing strong US outflows (a record in May) and which on our flows-based modelling shows a degree of USD overvaluation at current levels (Charts 5 & 6) and 2.) and net long futures market speculative positioning which is now back to extremes, if less so as a share of Open Interest (Chart 7).

Chart 7: USD speculative futures positioning



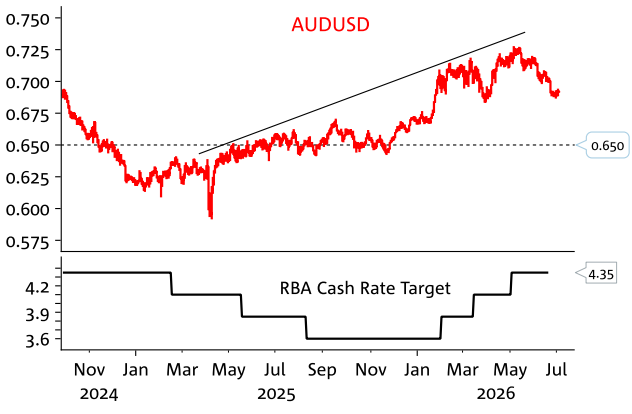
Source: National Australia Bank, Macrobond

AUD – Once there was an uptrend….

Even if it transpires that the Fed elects not to tighten policy in line with current market pricing and instead holds steady, this will still leave our prior forecast for AUD/USD breaching its May highs just shy of 0.73, and possibly extending to 0.75 this year, out of reach. For that to occur, at a minimum, it would require that the RBA is not done with its tightening cycle and that expectation of rates cuts in 2027 prove misplaced - both contrary to NAB's latest forecasts for no further tightening and 75bps of cuts in 2027.

Hence, we are shaving 3-4 cents off our AUD/USD forecasts across the forecast horizon. Spending time above 70c over coming months still looks likely with the AUD carry appeal and CNY strength supportive factors (see more below). But later in the year much will dependent on a reappraisal of Fed policy prospects, capable of spurring or taking some of the wind out of the USD's sails.

Chart 8: AUD/USD – where once there was an uptrend



Source: National Australia Bank, Macrobond

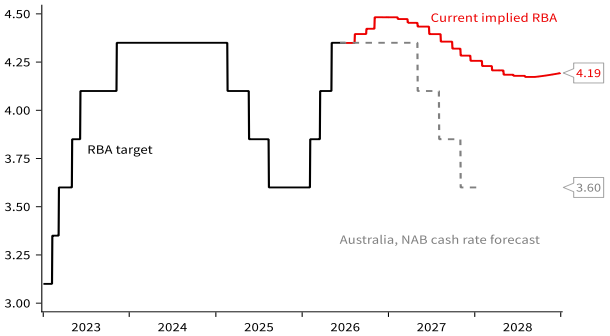
As per Char 8, the (jagged) AUD uptrend in place post April 2025 liberation day tariffs, marked by successive higher highs, has been receding into the rear-view mirror since

early May. The peak coincided with a peak in end-2026 RBA pricing, soon after the RBA first opined that it had 'space' to see how the 75bps of rate hikes to date played out. This also marked the peak in several AUD crosses, including AUD/EUR and AUDGBP, underscoring the dominant, though not exclusive, role played by monetary policy relativities, including expectations, in driving earlier AUD appreciation.

As for non-interest rate factors driving AUD, to the extent that oil (hence gas) and gold prices strength were supportive influence, both have recently turned into headwinds, although we would note that movements in Australia's terms of trade have proved a poor guide to AUD volatility for several years now.

Risk sentiment, as the other key driver of AUD has, outside the early/mid-June technology sector equity mini meltdown, held up well since May without doing the AUD any favours. We do nevertheless think that if risk sentiment holds up over the remainder of the northern hemisphere summer and the current low-FX volatility environment persists, AUD's carry attractions should mean it won't come to much harm in the next few months, both versus the USD and on most crosses,

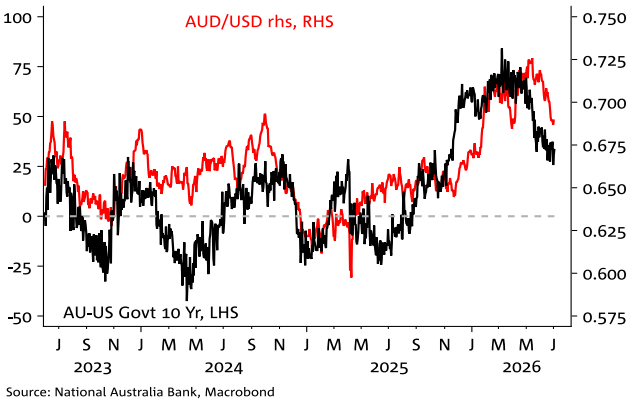
Chart 9: RBA expectations - NAB vs market pricing



Source: National Australia Bank, Macrobond

Looking into 2027, the primary driver of a now-bearish AUD/USD view is the NAB RBA call for 75bps worth of cuts to the Cash Rate starting in Q2 – in stark contrast to current market pricing (Chart 9). Our new point forecast for AUD/USD at end 2027 is 0.67, but this allows for it to trade down to at least 0.65 at some point in H2. In this respect and as per Chart 10, the compression seen to date in longer dates AU/US spreads, which has further to run on NAB's RBA view and in the absence of Fed rate cuts next year, looks ominous.

Chart 10: AUD/USD bs 10-year AU-US yield



Source: National Australia Bank, Macrobond

NZD – A flatter NZD/USD profile

We have downgraded our NZD forecasts, with the currency now expected to be broadly flat over the coming quarters, trading roughly within a 0.56-0.60 range. While the NZD is already at historically depressed levels, limiting the case for sustained further downside, the bar for a meaningful recovery has risen, against the backdrop of the points noted in the USD section.

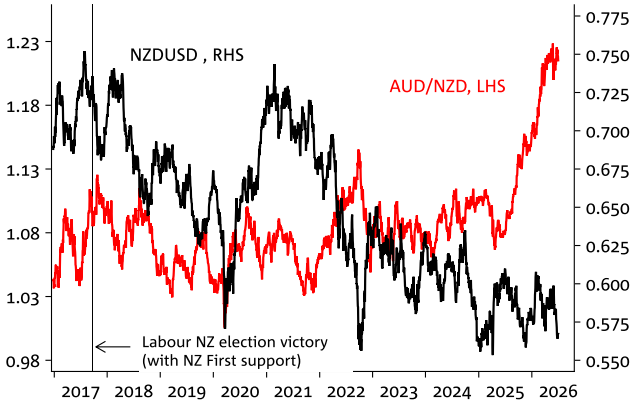
Simply, NZ's short-term interest rates remain too low. Even if the RBNZ lifts the OCR by 100bps, NZ's policy rate would still sit below those of the UK, US and Australia, a marked contrast to the pre-COVID period when NZ typically offered among the highest nominal and real interest rates in the developed-market group.

Our house view is that the OCR needs to rise significantly, with a projected move to 4% next year, but the RBNZ has so far shown limited urgency. We expect tightening to begin next week, but a delay until September remains a real risk. Any postponement would likely be a headwind for the NZD over the next couple of months, particularly if markets begin to see the RBNZ as repeatedly signalling future tightening without delivering it.

Domestic political uncertainty is another near-term consideration. With the general election four months away, a close race could weigh on sentiment toward the NZD, as occurred around the 2017 election. That experience showed how election uncertainty can hurt the currency in the short term, especially when the political outcome is unclear, although the longer-lasting impact is likely to be limited unless the policy outlook changes materially.

Overall, US resilience, Fed hawkishness and still-unfavourable NZ rate spreads argue for a flatter NZD/USD profile over coming months. A recovery later in the year remains possible, but it is likely to be slower than previously expected and dependent on clearer RBNZ tightening, less US exceptionalism and reduced election uncertainty. Our year-end target has been revised down from 0.63 to 0.59, implying a 0.57–0.61 range later this year, with the range nudging higher in 2027.

Chart 11: Political uncertainty can weigh on NZD



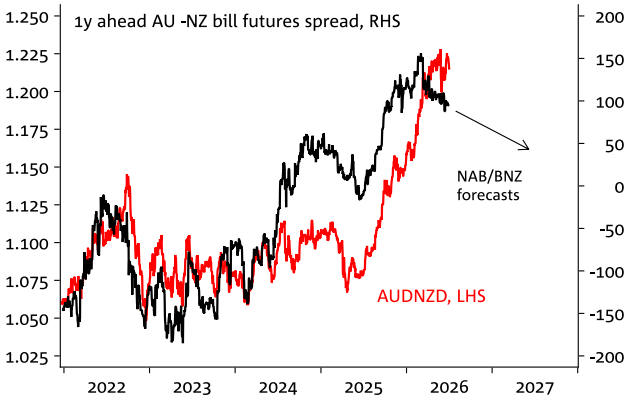
Source: National Australia Bank, Macrobond

AUD/NZD – 2027 forecasts downgraded

As noted in previous reports, we think the high in the AUD/NZD cross rate has probably been reached for this cycle. Convergence in NZ and Australian macroeconomic trends is a key driver. The key question is the pace of decline in the cross. The sharp decline, followed by recovery after the RBNZ's May MPS, showed that the material positive carry on any long AUD/NZD position remains a notable tailwind. We have moderated the pace of decline over the next few quarters, but our view that the RBA will cut three times from Q2 next year, the prospects for further decline in the cross improve thereafter.

Our year-end target for 2026 has been lifted to 1.19, while next year's target has been downgraded to 1.11. But that is about as low as it gets, meaning the cross rate is likely to sustain an above-average level, compared with the past decade, for some time to come. Overall, relative RBNZ and RBA policy changes over the next 18 months are expected to be a key swing factor.

Chart 12: RBA-RBNZ to drive AUD/USD down

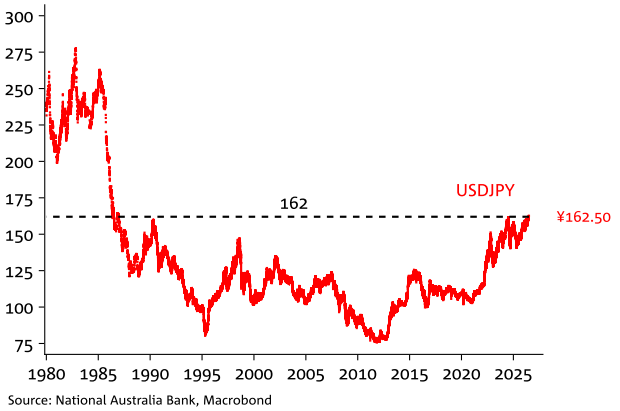


Source: National Australia Bank, Macrobond

JPY – To infinity and beyond?

USD/JPY reached a 40 year high of ¥162.84 this week, this notwithstanding oil prices declining back to pre-Iran conflict levels (Brent oil now at @~ $71).As the chart below illustrates, the 162 levels is historically important and from a technical perspective USD/JPY is now trading without major resistance to extend its recent rise.

Chart 13: 40-year high, where to now?



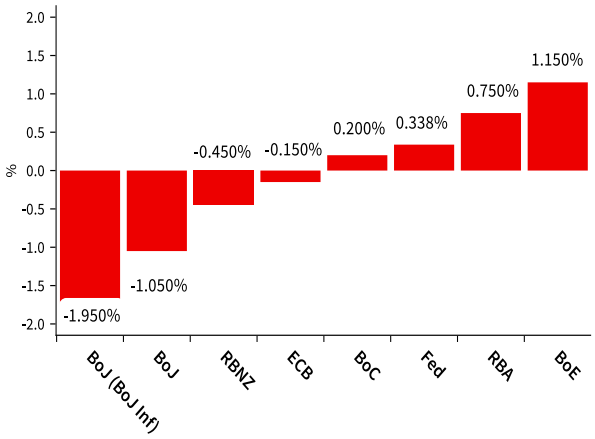
Source: National Australia Bank, Macrobond

In theory the decline in oil prices should be good news for currencies with energy dependent economies. Japan experienced a negative terms-of-trade shock from the Iran conflict, weaking the JPY but now that energy prices are easing, the JPY is not appreciating. So, what's going on?

For one, our sense is that other energy prices are not (yet) back to pre-conflict levels (JKM LNG now trades @$16, pre conflict it was ranging around $10), so the energy shock is easing but it still at play. But more importantly we think that the market has homed in on how inflationary pressures have played in different economies and how their respective central banks have reacted to these pressures.

This is where Japan and the BoJ stand out on as an outlier, not only in terms of where we are currently, but also in terms of how inflation is expected to evolve and how central banks are expected to react. Chart 14 below shows the current real cash rates for the BoJ and other majors alongside the RBA and RBNZ. The chart shows two versions of the BoJ real cash rate, one adjusts the nominal cash rate by the current Core CPI measure (Japan CPI ex Fresh Food and Energy, now @1.8YoY%), the other uses the BoJ Core CPI measure that corrects for institutional factors (now at 2.7%yoy).

Chart 14: CB's real cash rate. BoJ's super negative

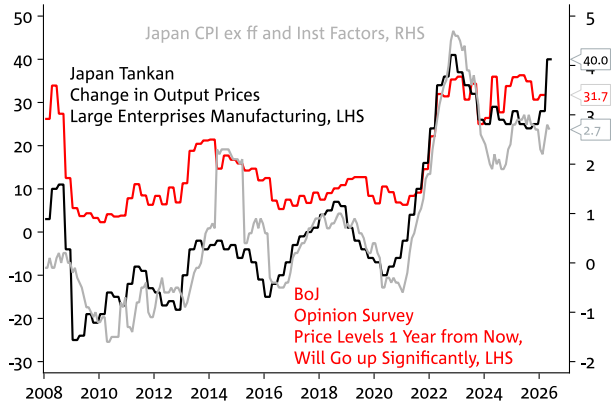


Source: National Australia Bank, Bloomberg, Macrobond

Real yields in Japan are extremely depressed and although the BoJ has been reducing the pace of JGB buying, it is still buying bonds, supressing yield along the JGB curve. We have written about these dynamics before, but the key point is that JPY weakness is the product of both ultra -easy monetary and fiscal policy. The JGB market is unable to reflect the true value of JGBs with JPY effectively working as a pressure release valve.

Meanwhile, activity readings show that Japan has been able to cope reasonably well from the Iran induced economic /inflationary shock. The Q2 Tankan survey is the latest piece of evidence corroborating this view. The Tankan was unexpectedly strong despite higher energy costs. Strong AI-related demand likely boosted confidence among large manufacturers, particularly in the technology sectors with a weaker JPY also supporting exporter earnings. Furthermore, the survey revealed output price index reached a record high, highlighting firms' growing willingness to pass on costs.

Chart 15: Japan inflation set to beat BoJ forecasts



Source: National Australia Bank, Macrobond

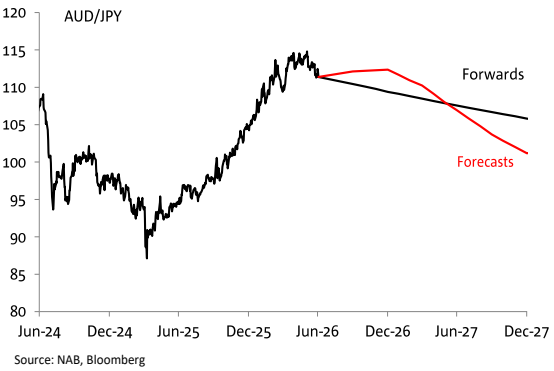
Japan's labour market remains tight, and PM Takaishi's expansionary agenda remains on track. Together all the above point to a demand-constrained economy with plenty of stimulus to keep it hot over coming quarters.

Our new USD/JPY forecasts reflect these dynamics alongside a central bank that remains committed to a very slow process of policy normalisation. We see the BoJ lifting the cash rate one more time this year (by 25bps to 1.25%) and twice next year. The Bank is set to remain behind the curve retaining downward pressure on JPY.

We now see USD/JPY in a ¥158 to ¥165 range over coming quarters (point forecasts above ¥160 over H2-26). intervention risk limits the upside, until later in the year JPY draws some support from another BOJ hike and if, as forecast, the Fed holds steady.

We see the pair's trading range shifting down over the turn of the year and 2027 (point forecast of ¥157.5 in Q2-27 and ¥155 by Dec-27), largely reflecting a BoJ normalising gradually alongside a broad USD decline weighed down by our expectations for an unwind of the ~40bps of Fed tightening currently priced in OIS curve.

Chart 16: AUD/JPY outlook



Source: NAB, Bloomberg

As for AUD/JPY, we still see the cross in a ¥110 to ¥115 range near term with our point forecast nudged a little bit higher from ¥110/12 to ¥112/14 over coming quarters. By the turn of the year and over 2027 AUD/JPY range is seen shifting lower to ¥112-¥108 in H1-27 and then ¥108-¥103 over H2-27 with RBA cuts and BoJ hikes the downward forces.

CNY – Gradual appreciation to continue

China's June PMI readings depicted an economy that remains in a slow-growth expansion rather than a strong recovery. Headline PMI readings are barely above 50 with strength in activity concentrated in high-tech and export-oriented sectors. Infrastructure activity also appears to be gaining traction, with civil engineering PMIs rebounding sharply and new orders returning to expansionary territory for the first time in almost a year, supported by government investment in strategic "six network" projects.

Nevertheless, the broader picture is less encouraging. The Chinese consumer remains on struggle street with retail sales unexpectedly contracting by 0.6% y/y in June, marking the weakest outcome since late 2022 and highlighting the fragility of household demand. The underlying problem appears less about a lack of policy support and more about persistent weakness in household balance sheets, labour market conditions and the property sector. Employment growth remains soft, limiting income confidence, while falling housing prices continue to weigh heavily on household wealth (real estate accounts for roughly 60% of household assets).

China's economy remains a combination of conflicting stories, where the external and AI/Tech sectors are booming while domestic demand (outside the AI sector) remains weak.

The good news from the Iran-US conflict is again good news and not so good news for China. Lower oil prices and easing geopolitical tensions is good news for global growth and Chinese exporters, but at the same time this good news reduces the urgency for policymakers to do more in support of households and hence domestic demand.

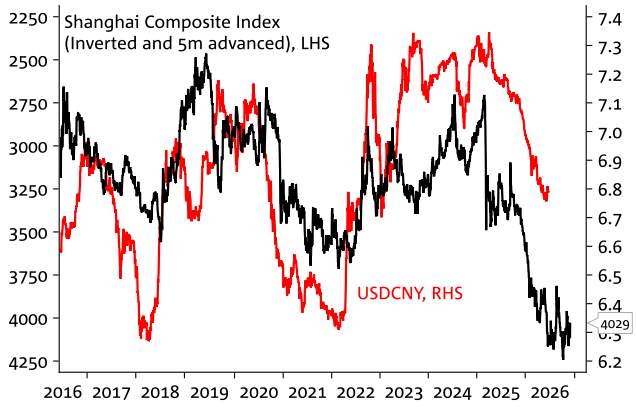
A key development for China has been the publication of an anonymous article in the influential Communist Party journal Qiushi, which appears to acknowledge many of the domestic demand concerns noted above. The article highlighted "deep-seated" challenges including weak employment, sluggish income growth, damaged household balance sheets and the ongoing property downturn. Importantly, it called for policies aimed at repairing household balance sheets, stabilising the housing market, improving social security and expanding employment opportunities.

Avid FX strategy readers would note that we have been here before; policymakers have been beating the drum for domestic support for quite some time but piecemeal actions to date have done little to improve the economic imbalance of strong industrial activity vs weak domestic demand (and new versus old economy).

Against this economic backdrop, the Yuan has been relatively resilient over the past month. The currency initially appreciated through early June as optimism surrounding China's technology sector, strong export flows and positive investor positioning supported Chinese assets. However, sentiment shifted following the Fed's June meeting,

triggering a reassessment on CNY's fortunes, the PBoC fixing signal no longer supported a stronger CNY with the USD also strengthening across the board.

Chart 17: Chinese equities lead CNY strength



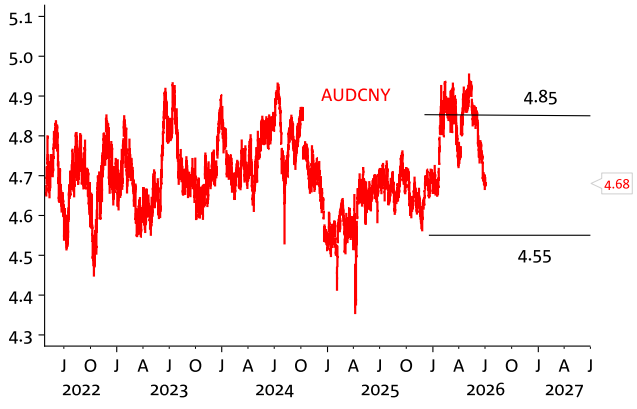
Source: National Australia Bank, Macrobond

In the past year CNY has appreciated by just over 5% and our expectations are for the currency to deliver a similar outcome over the coming 12 to 18 months. We have kept our USD/CNY forecasts unchanged with the pair seen ending this year at 6.60, then gradually declining towards 6.40 by the end of 2027. CNY is a managed currency, and our expectation is for the PBoC to guide the fix lower over the remainder of 2026 and 2027, reinforcing a message that China is an attractive place to invest with a stable currency.

The recent PBoC's decision to set its overnight reverse repo rate at 1.25%, below market expectations of 1.35%, was viewed by markets as a meaningful dovish signal. While officials are likely to characterise the move as a technical liquidity-management operation, the resulting 15bp gap between the overnight and 7-day reverse repo rate appears unusually wide and difficult to sustain.

The PBoC remains stuck between a rock and a hard place, concerns over the US-China yield differential and capital outflows limits the ability to ease policy, but the latest action is consistent with its strategy of (very) gradual and incremental easing aimed at supporting domestic demand. We retain our expectations for a 10bps cut to the 7d repo rate before year end.

Chart 18: AUDCNY shifting towards lower trading range



Source: National Australia Bank, Macrobond

Gradual PBoC easing is not CNY supportive, but it is supportive for flows into China with the equity market AI appeal seen as a CNY tailwind.

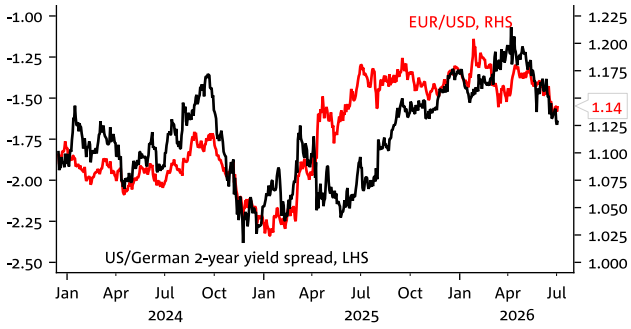
That said, the main driver for further gradual CNY appreciation is the positive impact in can have in providing an increase in purchasing power to households while at the same time it should help ease some of the angst from major trading partners specially Europe, who want to see a stronger CNY.

As for AUD/CNY, we see the cross gradually shifting towards a lower trading range of 4.85 to 4.55 over the next 6 months, before shifting lower again towards a 4.65 to 4.35 range. Our point forecast essentially see a pivot point around the 4.62 area for the remainder of 2026 moving down to 4.42 by mid-2027.

EUR – Establishing a new, lower range

In our last GFXS update on 10 June when EUR/USD had declined down through 1.16, the writing seemed to be on the wall with prior months' gains looking as good as it gets and where downside risks were building. The drivers for the USD's renewed run higher and EUR weakness have been on both sides – as they have for many currencies against the USD with a clear hawkish shift from the Fed and numerous idiosyncratic weaknesses across other currencies.

Chart 19: US-German 2-year spreads and EUR/USD



Source: National Australia Bank, Macrobond

For all the talk of Mario Draghi and Enrico Letta EU reforms and even displays of intervention from the former head of the ECB in upscaling efforts, while six major European countries talk of forging a two-speed Europe and fast-tracking reforms, the evidence has not matched the rhetoric.

Revised Q1 GDP growth in Europe saw an initial 0.1% q/q rise downgraded to a -0.2% decline due to an unexpected downward revision to Ireland's GDP from -2.1% to -12.1% thanks to volatile shifts in pharmaceutical trade related to Trumps 2024 tariffs. While that will reverse and we can say excluding Ireland EZ Q1 GDP looks reasonably healthy at 0.3% q/q, investors are in no mood for such detail, focusing for now on big-picture optics. In any case, we doubt the EZ can sustain that pace, with lower real incomes and recent services PMIs hobbled around 47, while the US cruises at/above 53.

The slide in oil prices back to pre-Iran conflict levels in the low $70s is already calming headline inflation in Europe, with preliminary June HICP coming in a 2.8% from 3.2% in

May and below consensus. Core and services measures are also lower. Naturally, the ECB like other central banks wants clarity, more data and evidence the pullback is sustainable, with second-round effect threats reduced. That will take more time, but the language from a majority of ECB officials speaking from its annual Portugal conference is the slide in oil prices compared to its Q3 forecast of $88 is encouraging.

Our forecast of second ECB rate hike in September remains for now, but we have long warned a second hike was dependent on events in the Middle East and may not be necessary. To be sure the ECB could still justify a rise to 2.5% given neutral policy settings, but if current oil prices hold, new forecasts in September will show HICP dropping back to target more quickly, negating the need to tighten policy again. Much could change either side here, but as we have said higher rates in a souring growth environment do little to support the EUR, while rates on hold doesn't really help – it's a lose - lose situation when the US is powering ahead.

We're revising down our EUR forecasts, now expecting the single currency to hold a broad 1.12-1.18 range over the forecast horizon and until there is greater clarity, most likely on the US rate side. Continued lower oil prices can assist a small recovery in the EUR, but to really challenge range highs we'd need to see a marked shift in Fed pricing back towards rate cuts, which regardless of the softer than forecast US June NFP, seems far off for the moment. A notable pick up in EZ reforms would greatly assist but again remains a distant prospect.

AUD/EUR forecast are little changed. Markets seem to agree with our sentiments that a second ECB rate hike may not be needed and have pushed full hike pricing back to March 2027. While we formally retain a second hike in our forecasts for September, it's fair to say it is under review. With RBA pricing less pronounced, the cross looks set to ease back through 0.60 in the coming months and where we see 0.58 at the end of 2027, aided by then by RBA rate cuts. Before then, we think the cross could recapture 0.61.

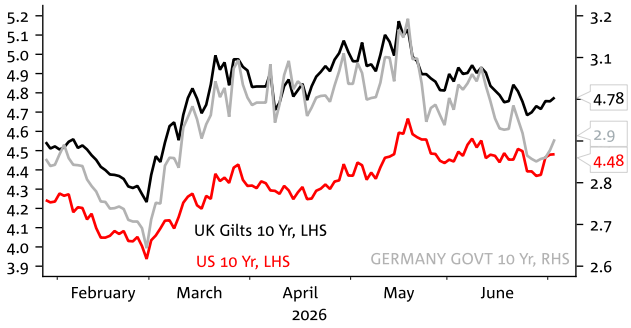
GBP – In search of the real Andy Burnham

Hat's off to Britain's soon-to-be Prime Minister Andy Burnham (to be the UK's seventh PM in 10-years) and his team. So far, they have managed to deftly navigate the pitfalls that can so easily bedevil incoming new administrations who do not take sufficient care with remarks on potential policy ideas and commitments. After some questionable comments on fiscal policy late in 2025 that Burnham has since refuted, he and his team have helped keep UK financial markets on side via a combination of stating the UK's current fiscal rules will remain in place, not providing any specific fiscal spending or budgetary proposals and keeping everyone guessing who will fill key Cabinet positions such as that of Chancellor.

UK bonds in particular are very sensitive to all this thanks to the UK's unenviable growing reputation for fiscal missteps and political instability. Stretched public finances have not been helped by a series of economic shocks, a lack of economic growth and no end of spending commitments. And yet just over two-weeks away from the likely Burnham takeover date of circa 18-20 July, where the new leadership is widely expected to increase spending, taxation and perhaps borrowing, UK government bonds have outperformed their peers by some margin.

UK 10-year yields have dropped 40bs from a 5.17% mid-May and post Iran conflict peak, while US 10s are down 21bps, Germany 10s down 29bps, while Australia 10-year yields are 30bps lower. At the short-end UK 2-year yields have slumped no less than 45bps against German 2s, down 25bps, Australia 3-year yields down 39bps and the US – where a more hawkish Fed has helped keep US front-end yield up and just 11bps off their post Iran conflict peak. Lower than forecast UK inflation, with the headline easing back to 2.8% has spurred estimates of a lower than previously thought peak around 3.25%, easing towards target in 2027. At the same time GBP has held up, with the trade-weighted index just 2.5% below a post-Brexit nine-year high.

Chart 20: UK 10-yr yields pullback the most as a US-Iran deal arrives



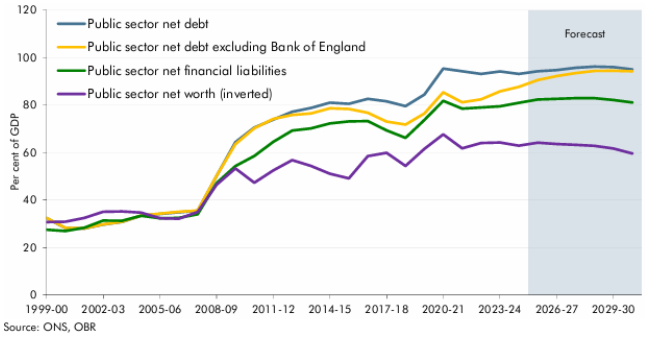
Source: National Australia Bank, Macrobond

The drop in yields has been beneficial to UK public finances, easing as it does the UK's bloated (£111bn or >8% of GDP) debt servicing costs. However, current FY outgoings are running above OBR forecasts. Outgoing Chancellor Rachel Reeves re-jigged things to provide more of a fiscal 'buffer' for unexpected events. The Iran damage is loosely estimated to have cut that headroom from circa £23bn to £13bn, but current PM Starmer's determination to pass the so-called Defence Investment Plan, has left Burnham with at least an additional £5bn to fund in the current FY and beyond.

The appearance of three prominent and well-respected economic advisors to Burnham in ex-Goldman Sachs chief economist Lord Jim O'Neill, former BoE chief economist Andy Halane and former head of the OBR Richard Hughes has meant any comments on the economy from Burnham have an additional veneer of respectability. We think it would be a mistake to assume everything from a fiscal or economic viewpoint from Burnham will have the blessing of these 'wise men,' and note media reports that among others, Peckham labour MP and economist Miatta Fahnbulleh, has Burnham's economic ear. Fahnbulleh is reported to be a proponent of universal basic income, free public transport, free basic energy and childcare, has a strong conviction for net zero policies and looks to wealth and land taxes and possibly higher capital gains levies. The extent to which any of these reports are correct and actually see the light of day will be important to the broader market reaction.

In his recent speech, Burnham embraced the idea of 'radical localism' via devolution of powers from Westminster to the regions, with a new 'No-10 for the North' located in Manchester. He talks passionately of taking water, transport, energy back into public ownership as well as spending up to £39bn on social housing. All of this will take time and money. It is here that his external economic advisors sound like they are looking for creative solutions to the fiscal rules – some fiscal re-plumbing - that might be able to persuade investors to lend more money for infrastructure projects that have decent returns or multipliers and where there may be a focus on net borrowing, taking in asset values rather than just liabilities.

Chart 21: Four measures of UK public sector balance sheet. Advisors are favouring the net worth measure



Source: ONS, OBR

Whether these efforts become policy and can work remains to seen. Communications strategy so far has been careful and could provide a small fillip to confidence or at least prevent fall-out. How long that lasts will depend on what actual policies emerge, who becomes Chancellor and what happens to growth, inflation, spending, taxes and public borrowing. We will update once more is known, but also remain aware of the potential for Burnham to call a General Election in the autumn. For now, we have modestly revised lower our GBP/USD forecasts to reflect the firmer USD and its prospects (see pages 2 & 3) and have lowered our EUR/GBP forecasts to reflect GBP's relative stability despite the political turbulence.

For AUD/GBP, while we temper our prior enthusiasm for the cross to rise to as high as 0.55 by late 2026, we do see gains to as high as 0.53 possible. As well as the aforementioned concerns that a Burnham-led government will fail to pull any meaningful growth/GBP supportive rabbits out of his hat, if at the same time the BoE does successfully resist the impulse to raise rates such that rates cut(s) could materialise in 2027 (as per NAB's view of two cuts) and potentially prior to an RBA easing cycle, AUD/GBP should be well supported.

Spot FX Forecasts

Majors		Current	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28	Sep-28	Dec-28
AUD/USD	New	0.692	0.69	0.70	0.70	0.69	0.68	0.67	0.68	0.69	0.70	0.70
	Old		0.72	0.73	0.74	0.73	0.72	0.72	0.72	0.71	0.70	0.69
NZD/USD	New	0.570	0.57	0.59	0.60	0.61	0.61	0.61	0.61	0.62	0.63	0.63
	Old		0.61	0.63	0.64	0.63	0.63	0.63	0.63	0.62	0.62	0.61
USD/JPY	New	161.1	162.5	160.5	157.5	155.0	152.5	151.0	150.0	148.0	146.0	145.0
	Old		153	152	150	149	146	144	142	140	138	136
EUR/USD	New	1.143	1.14	1.15	1.16	1.15	1.15	1.15	1.14	1.14	1.14	1.14
	Old		1.19	1.20	1.21	1.20	1.20	1.19	1.18	1.18	1.18	1.18
GBP/USD	New	1.335	1.32	1.32	1.33	1.32	1.31	1.32	1.30	1.31	1.31	1.31
	Old		1.34	1.33	1.36	1.35	1.35	1.35	1.36	1.36	1.36	1.36
USD/CHF	New	0.804	0.81	0.80	0.80	0.80	0.80	0.80	0.81	0.81	0.81	0.81
	Old		0.78	0.77	0.76	0.77	0.77	0.78	0.78	0.78	0.78	0.78
USD/CAD	New	1.42	1.40	1.39	1.38	1.36	1.35	1.34	1.34	1.34	1.34	1.34
	Old		1.36	1.35	1.34	1.35	1.37	1.37	1.36	1.36	1.36	1.36
USD/CNY	New	6.786	6.70	6.60	6.50	6.40	6.40	6.40	6.43	6.45	6.45	6.45
			6.70	6.60	6.50	6.40	6.40	6.40	6.43	6.45	6.47	6.49
USD (DXY)	New	100.86	101.2	100.4	99.5	99.7	99.5	99.2	99.9	99.6	99.5	99.4
	Old		95.0	94.5	93.5	94.0	93.9	94.2	94.4	94.3	94.1	93.9
AUD Cross Rates												
AUD/NZD	New	1.214	1.21	1.19	1.17	1.13	1.11	1.11	1.11	1.11	1.11	1.11
	Old		1.18	1.16	1.15	1.15	1.14	1.14	1.14	1.14	1.14	1.14
AUD/JPY	New	111.5	112	112	110	107	104	101	102	102	102	102
	Old		110	111	111	109	105	104	102	99	97	94
AUD/EUR	New	0.605	0.61	0.61	0.60	0.60	0.59	0.58	0.60	0.61	0.61	0.61
	Old		0.61	0.61	0.61	0.61	0.60	0.61	0.61	0.60	0.59	0.58
AUD/GBP	New	0.518	0.52	0.53	0.53	0.52	0.52	0.51	0.52	0.53	0.53	0.53
	Old		0.54	0.55	0.54	0.54	0.53	0.53	0.53	0.52	0.51	0.51
AUD/CHF	New	0.556	0.56	0.56	0.56	0.56	0.55	0.54	0.55	0.56	0.57	0.57
	Old		0.56	0.56	0.57	0.56	0.56	0.56	0.56	0.56	0.55	0.54
AUD/CAD	New	0.982	0.97	0.97	0.97	0.94	0.92	0.90	0.91	0.92	0.94	0.94
	Old		0.98	0.99	0.99	0.99	0.99	0.99	0.98	0.97	0.95	0.94
AUD/CNY	New	4.70	4.62	4.62	4.55	4.42	4.35	4.29	4.37	4.45	0.00	0.00
			4.82	4.82	4.81	4.67	4.61	4.61	4.63	4.58	4.53	4.48
NZD Cross Rates												
NZD/AUD	New	0.823	0.83	0.84	0.86	0.88	0.90	0.90	0.90	0.90	0.90	0.90
	Old		0.85	0.86	0.87	0.87	0.88	0.88	0.88	0.88	0.88	0.88
NZD/JPY	New	91.8	93	95	95	95	93	91	92	92	92	91
	Old		93	95	96	94	92	91	89	87	85	83
NZD/EUR	New	0.498	0.50	0.51	0.52	0.53	0.53	0.53	0.54	0.54	0.55	0.55
	Old		0.51	0.52	0.53	0.53	0.53	0.53	0.53	0.53	0.52	0.51
NZD/GBP	New	0.427	0.43	0.45	0.45	0.46	0.46	0.46	0.47	0.47	0.48	0.48
	Old		0.46	0.47	0.47	0.47	0.47	0.47	0.46	0.46	0.45	0.45
NZD/CHF	New	0.458	0.46	0.47	0.48	0.49	0.49	0.49	0.49	0.50	0.51	0.51
	Old		0.47	0.48	0.49	0.49	0.49	0.49	0.49	0.49	0.48	0.48
NZD/CAD	New	0.808	0.80	0.82	0.83	0.83	0.82	0.81	0.82	0.83	0.84	0.84
	Old		0.83	0.85	0.86	0.85	0.86	0.86	0.86	0.85	0.84	0.83
NZD/CNY	New	3.87	3.82	3.89	3.90	3.90	3.90	3.87	3.92	4.00	0.00	0.00
	Old		4.09	4.14	4.17	4.05	4.03	4.03	4.05	4.02	3.98	3.94

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