

Economic and market update

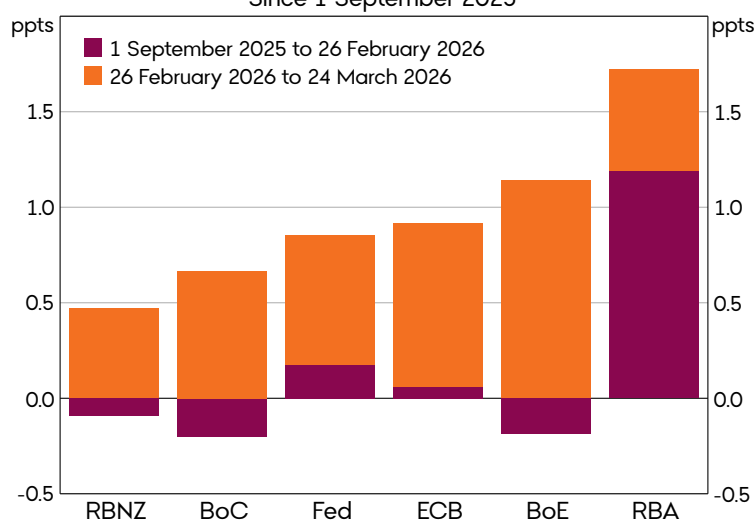
Economic Overview – as at 23rd April 2026

Global markets

The Middle East conflict has continued into week 8 with an extension to the ceasefire although disappointment that the Strait of Hormuz was only reopened for less than 24 hours before being closed again on Saturday 18 April. The Iranian announcement that the Strait was completely open was welcomed by markets with stock indices back at record highs and the oil price falling 10%, but when it became apparent that the US were maintaining their naval blockade of Iranian ports some of these gains were erased.

Stagflation risks remain in play until a permanent resumption of shipping routes is achieved, and central banks around the world continue to grapple with the policy implications. Some unwinding of last year's easing expectations was already in place (refer chart below) as downside scenarios from 2025 trade wars were pared back, however military wars and an associated energy crisis have very different implications, so far from easing rates further, the question is now how much tightening is necessary.

Change in end-2026 Policy Rate Expectations*
Since 1 September 2025



* Expected end-26 policy rate derived from overnight index swap rates.
Sources: Bloomberg; RBA.

Minutes from the March US Federal Reserve policy meeting showed some members were open to hikes to deal with the energy shock, but Fed chair nominee Kevin Warsh (at his Senate 'confirmation hearing') hinted a more dovish leaning, should he take the reins from Jay Powell next month as expected. Stagflation is as much a threat for the US as elsewhere, and consumer sentiment fell in the University of Michigan survey to a record low while inflation (based on the core PCE deflator) rose to 3.0% in February, ahead of the impact of higher oil prices. Admittedly US retail sales have been resilient as has the manufacturing sector, and equity markets have reclaimed all their losses from March to set fresh record highs this week, but the US economy will be tested in the short term, especially should the oil price remain above US\$100 per barrel.

Europe and the UK still appear more exposed than most regions to this fresh escalation in energy prices, having barely recovered from the full implications of the Russian invasion of Ukraine, requiring the European Central Bank to take rates down to their likely turning point of 2%. From here the rebound in inflation may see the ECB hike in Q3 depending on the duration of the conflict, in a classic stagflation scenario where growth is expected to slow (the IMF suggest down to 1.1%), but with the euro-Zone particularly sensitive to natural gas prices. CPI may quickly exceed 3%. In the UK the change in direction for rates is even more stark as the Bank of England were expected to cut rates this quarter below 3.75% - but now hikes are on the table as UK inflation is expected to reach 4%, double the policy target. Unemployment in the UK fell to 4.9% in the three months to February, but the trend has been higher and the outlook most challenging.

While Asia at face value is more exposed to the Middle East conflict as it gets a larger share of its oil directly via the Strait of Hormuz, the region has been resilient through March and April (evidenced by trade volumes) and its importance in supporting the AI investment boom is a helpful offset. China appears better equipped than its economic peers given its access to Russian oil and its strength in green technology (including EVs), but like every country will be tested by supply chain stress and patchy demand. China's Q1 GDP growth surprised on the upside to 5.0% annual growth, and given their recent difficulties with deflation the jump in energy prices has a different perspective - ahead of the latest disruptions from the Middle East conflict Chinese export growth rebounded to 15% y/y in March and retail sales, industrial production and fixed asset investment all recorded solid gains. Elsewhere in Asia the larger net-energy importers (including India, Japan, South Korea and Singapore)

all face challenges from an elevated oil price and lack of supply, but it has been interesting to see the Japanese Nikkei index reach 60 000 (yesterday) for the first time on record, suggesting markets are looking through short term impacts from the Middle East conflict.

In summary, the Middle East conflict continues to present significant risks to global growth and the latest **IMF** report has downgraded 2026 growth from 3.4 to 3.1%, but also has modelled moderate and severe downside scenarios dependent on the duration of the war. The best indicator of this severity remains how long the Strait of Hormuz remains closed for, which market barometers such as the price of oil and equity indices imply will be 'for a few more weeks, but not forever' - should this be the case there will still be ongoing disruptions and downside implications from the conflict this year, but a recovery into 2027 would remain viable. The US administration's motivation to end the conflict must be high given its sensitivity to equity markets, and with mid-term elections later this year (along with Trump's impending meeting with Chinese President Xi on May 14-15). Complications in achieving this outcome include Israel's ongoing occupation of southern Lebanon and US demands on Iran to fully abandon nuclear capabilities before the US blockade is lifted. Until then recession risks are elevated, although it's not at this stage the basecase scenario.

Domestic economy

The upcoming RBA Monetary Policy Board Meeting on 4-5 May and the Federal Budget the following week will be two of the most anticipated for some time, with markets pricing around a 70% probability of another hike in the cash rate to 4.35%. Three consecutive hikes to suddenly erase all of last year's cuts would be an extraordinary outcome given how benign inflation appeared **mid-last year** when CPI was 2.1% and core inflation 2.7%, but as these reports have discussed this year the primary drivers of this U-turn in official cash rates are:

- The stronger footing the global economy and the domestic economy started 2026 on, having avoided downside scenarios from US tariffs and trade wars last year;
- The low 'potential output' in our economy (estimated around 2% by the **RBA**) acting as a growth speed-limit, vs our rebound in GDP growth to 2.6%;
- The fact that the RBA only took our cash rate up to 4.35%, compared to 5-5.5% in the US, New Zealand, Canada and the UK

The February and March RBA hikes were delivered due to inflationary risks and capacity constraints ahead of the Middle East conflict, and so the additional price pressures that will obviously come by virtue of the war in Iran come at a difficult time for monetary and fiscal policy. Domestic demand will be substantially lower for a period, evidenced by the plunge in consumer confidence in the ANZ-Roy Morgan [survey](#) to its lowest level on record and the fall in business confidence in the March NAB survey to -29 (its second largest monthly fall on record). Falls of this magnitude bring back memories of similar uncertainty in the GFC and the onset of the pandemic, although such events have generally had V-shaped recoveries, over relatively short timelines.

For the RBA, who presumably will be significantly increasing their forecasts for headline inflation and decreasing GDP expectations in next month's Statement on Monetary Policy, the cash rate decision will reflect how worried they are about inflation expectations becoming unanchored, versus the risk of excessive tightening pushing the economy into recession. The collapse in sentiment due to higher energy prices and renewed cost-of-living pressures coinciding with two rate hikes, does offer the alternative for the RBA to simply warn of higher rates ahead but to pause in May awaiting more information on developments in the Middle East; and the fact that the March hike was a close call (a 5-4 vote) suggests that this vote may also be divided.

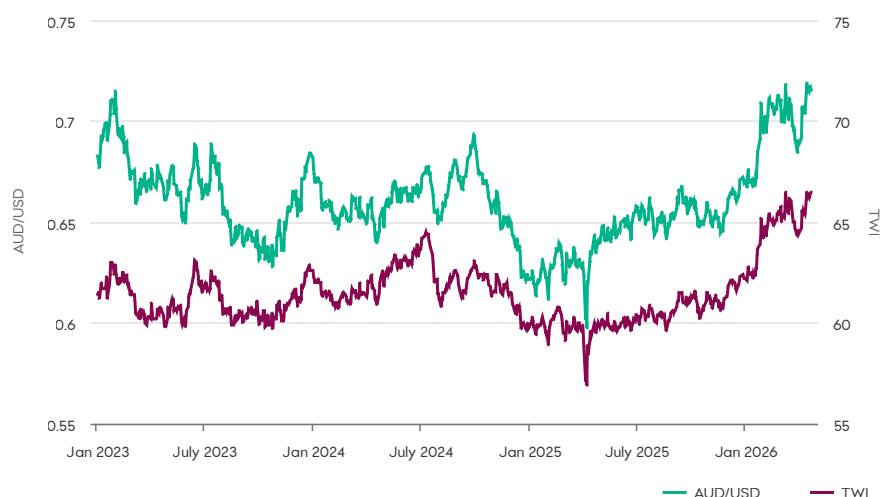
Another consideration for the RBA is the likely path ahead for labour markets, which have been consistently characterised as 'relatively tight' but are showing signs of easing. The March ABS data saw a rise from 4.1% to 4.3% unemployment, and the March ANZ-Indeed job ads also weakened (down over 3% m/m). As a result it is difficult to see employment trends picking up in the short term in these conditions, even prior to considering where

AI adoption might influence hiring intentions in the medium term. The basecase scenario outlined below continues to assume only a short-lived downturn due to the Middle East conflict (although with a fall in GDP growth to 1.5% in lieu of the latest sentiment survey data) but still a steady increase in the unemployment rate over the coming years - something the RBA and consensus is yet to predict. Downside scenarios would be more dramatic, much like the IMF 'severe downside' scenario covered in the Global Markets discussion above, which I'd suggest is still only roughly a 15-20% probability but at the mercy of the duration of the conflict and how high the oil price may rise.

The Aussie Dollar reached 72.2 US cents (a four-year high) on the announcement that the Strait of Hormuz had reopened, and only retraced a cent after this week's setbacks, so (again) markets appear to be leaning to a relatively short impasse as the most likely outcome. A strong exchange rate is another helpful guard against inflation (along with the 50% reduction in the fuel excise on petrol and diesel), but even so headline inflation in the Q1 data to be released next week will be elevated given automotive fuel is around 3.4% of the CPI basket.

The Federal Budget will be unveiled the week after the RBA policy decision, where fiscal policy will be tested to try to balance the expectations to provide some form of cost-of-living relief with the imperative to improve productivity, while also addressing issues such as generational inequality. There are likely to be announcements around housing including changes to the CGT discount (currently 50%) and presumably around energy prices (a windfall tax on gas exports?), and we have already heard of significant changes to the NDIS. The budget deficit is likely to again only be around 1 to 1.5% of GDP, but the alignment of fiscal to monetary policy remains a pressure point.

AUD/USD Exchange Rates and TWI



Sources: WM/Reuters; RBA

Interest Rate Outlook

The RBA will most likely continue their recent tightening cycle with markets pricing in roughly a 2 in 3 chance of a third successive rate hike on 5 May, although there are some good arguments for a more patient approach amid the Middle East conflict: albeit still with a hike to 4.35% by August and later to 4.6%. The path ahead for energy prices and how lasting their impact will be on inflation in Australia remains most uncertain and will be heavily influenced by how soon the Strait of Hormuz reopens sustainably. After this a plateau in rates is very likely, in the absence of the RBA overshooting the tightening cycle (a cash rate above 5% would risk a recession, implying a subsequent easing cycle - however our basecase scenario is for a softer landing).

Economic Forecasts: basecase scenario

	2024		2025			2026			2027		
% (actual, forecast)	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
GDP q/q	0.5	0.4	0.8	0.5	0.8	0.5	0.4	0.3	0.3	0.5	0.8
GDP y/y	1.3	1.3	1.9	2.1	2.6	2.6	2.2	2.0	1.5	1.5	1.9
Unemployment	4.0	4.1	4.3	4.4	4.1	4.3	4.5	4.7	4.9	5.1	5.3
CPI (q/q)	0.2	0.9	0.7	1.3	0.6	1.5	1.5	1.2	0.6	0.5	0.9
CPI (y/y)	2.4	2.4	2.1	3.2	3.6	4.1	4.9	4.8	4.8	3.8	3.2
CPI (core y/y)	3.3	2.9	2.7	3.0	3.4	3.4	3.7	3.7	3.6	3.5	3.2
RBA cash rate	4.35	4.10	3.85	3.60	3.60	4.10	4.10	4.35	4.35	4.60	4.60
AUD / USD	.619	.625	.658	.662	.668	.690	.73	.74	.75	.76	.77

Benchmark rates

	28 / 2 / 25	28 / 2 / 2026	31 / 3 / 2026	23 / 4 / 2026
90-day bills	4.12%	3.97%	4.31%	4.35%
3-year swap	3.73%	4.31%	4.65%	4.67%
5-year swap	4.07%	4.62%	4.91%	4.92%
AUD/USD	.6215	.7055	.6900	.7145
ASX 200	8 172	9 086	8482	8 772
Credit Index (iTraxx- 5 yr)	67.9	66.6	91.5	72.5

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