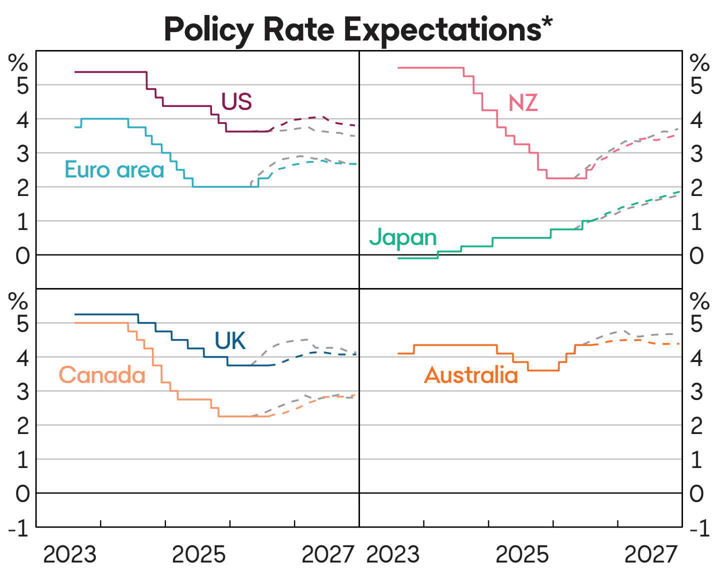
Economic and market update

Economic Overview – as at 20th August 2026

Global markets

The disconnect between the lack of any diplomatic progress in the Middle East (pushing Brent crude back above US$90 per barrel) and rampant equity markets has continued, best explained by relentless investment in AI build-out, and also by observations that higher energy prices haven't been as damaging to the global economy as feared back in Autumn. Central banks have generally viewed these developments as evidence that the recent easing cycle is over, but other than Australia most have simply stopped cutting rates rather than starting to increase them. Oil prices appear likely to remain elevated for some time which is constraining growth and adding to inflationary risks, but outright stagflation (fortunately) hasn't yet arisen.

The US FOMC minutes from their latest meeting have kept the door open for a September hike and 'many participants assessed that policy tightening would likely be necessary if inflation did not decline'. However Fed chair Warsh appears to be on the patient side, and recent US data has been softer (including a fall in non-farm payrolls for September and a fairly benign CPI read). Three of the twelve voting members did vote for a hike in July, but the bigger news for US rates came overnight with



* Coloured dashed lines show expectations implied by current overnight index swap rates; grey dashed lines show the same expectations as of 29 April 2026.

Sources: Bloomberg; RBA.

US Treasury announcing a doubling of their debt buyback operations of 10 to 30-year securities. This helped yields to rally by around 10 basis points, after the US 30-year had been trading as high as 5.22%, its highest level in 25 years. This may provide just a short-term reprieve rather than remedying structural challenges such as high US debt, together with the surge in private sector demand (refer appendix), but is a significant move. Nevertheless the inflationary risks in the US economy clearly remain at the mercy of geopolitical developments.

Recent economic indicators from Europe have been a little stronger with growth of 0.4% in Q2 for the Eurozone although some underperformance from Germany and Italy, while ECB President Lagarde sounded optimistic: "We already have many of the ingredients for longer-term growth". July inflation for the EZ stands at 2.9%, so further rate hikes are expected but like everywhere the pace of these will be subject to energy supply and second-order inflationary effects. UK CPI is also at 2.9% but the Bank of England are in a tougher position with their cash rate higher at 3.75% and yet to start hiking rates, while caught between the prospect of cooling labour markets, but less confidence that inflation will moderate in the months ahead.

The Chinese economy experienced a larger slowdown in July than expected although not all of that is being attributed to the Middle East conflict, with some of the weakness related to typhoon disruptions. GDP growth has slowed again to 4.3% and while trade data remains strong the domestic demand side of the equation is very weak, with retail sales slowing further to only 0.6% y/y growth and fixed asset investment down 6.7% y/y. Markets still expect a policy response to help achieve growth targets, and this may mark the low ebb of the cycle with AI related and hi-tech manufacturing booming, so the timing of any additional fiscal support will be important to monitor.

In summary, the competing forces of elevated energy prices versus the acceleration of AI and tech-investment are dominant, but at this stage consistent with our forecast of global growth achieving just over 3% in 2026. As the RBA noted in last week's Statement on Monetary Policy, 'the boost from AI-related investment has outweighed the negative effects of the Middle East conflict' in many economies. Upside and downside scenarios are easy to envisage, but the most compelling attribute of the last few months has been the ability of most economies to cope with the oil-crisis and to demonstrate resilience, much like the manner in which the world coped with US tariffs last year. Equity markets still appear stretched, but as previously outlined here this is just the AI build-out stage: the diffusion of this technology will probably be the more transformative phase for economies and markets.

Domestic economy

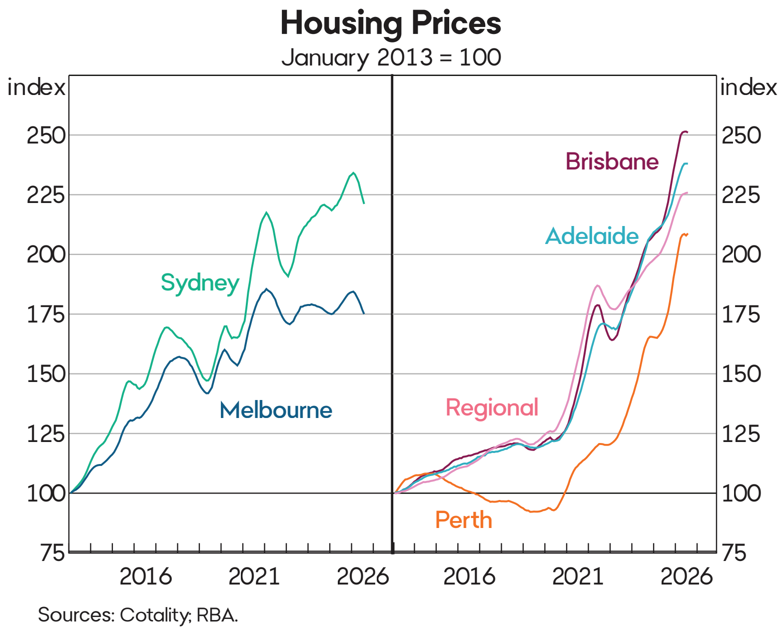
The August RBA Monetary Policy decision and Statement have maintained the tightening bias while extending the pause in rate-hikes, and the yield curve is now much flatter, however still (like our unchanged forecasts) leaning towards one more hike. The SOMP asserted that inflation risks remain skewed to the upside, and Governor Michele Bullock was assertive in her press conference that "the board is thinking very hard about when to raise rates", but the updated forecasts did show CPI and core inflation both back down to 2.6% by the end of 2027.

The uncertainty amid competing forces detailed above for global markets (high energy prices vs relentless AI investment) are just as relevant here (refer appendix) but there are additional complications for Australia. These include our capacity constraints which are more acute than in peer economies, and (further details below) the recent downturn in residential property markets. The RBA assess our 'potential output' at only around 2% with some improvement expected over the coming years, presumably enhanced by tech investment and AI adoption, but until this improves the cash rate is likely to be held in restrictive territory. The latest jobs data slightly muddied the waters with respect to capacity pressures in labour markets, where we saw in July (seasonally adjusted).

- A fall in employed people of 15,800
- A 0.1% increase in the unemployment rate to 4.5%
- A 0.2% fall in the participation rate and a 0.6% fall in total hours worked

Admittedly the rise in the unemployment rate was only from 4.43% to 4.46%, but the recent decline in job advertisements and anecdotal evidence of businesses managing labour costs do appear consistent with an ongoing decline in employment, in line with our basecase scenario forecasts below.

The broadening downturn in Australia's housing market is even more challenging for the RBA to interpret – will the wealth effect of this new cycle see a material fall in discretionary spending taking the pressure off the need for tighter policy, or is this simply a welcome correction in an unsustainable uptrend? Bullock was blunt in saying "housing is not the main game", and there is a strong argument that investors moving away from this asset class to others will ultimately be helpful for productivity, but the decline in dwelling values will continue to gain plenty of media attention.



The Q2 inflation data released late last month was slightly more benign than expected with headline CPI falling from 4.0% to 3.8% and, more importantly, underlying inflation unchanged at 3.6% – so the run rate of 0.8% per quarter for the Trimmed Mean doesn't appear alarmingly above the target of around 0.6%, but there is no tolerance for any deviation from the RBA. This is understandable given elevated energy prices and in particular Australia's high exposure to diesel, in combination with relatively tight labour markets and weak productivity growth. Perhaps the simplest way to sum up the outlook for interest rates is 'rates on hold with the risk of one more hike around year-end'. Other considerations include:

- The strength of our major trading partners (refer appendix)
- The continued (but slow) upswing in the Aussie Dollar
- Any further easing in labour markets

Interest Rate Outlook

The RBA will maintain a tightening bias for the rest of 2026 and probably for the bulk of 2027 but will likely continue their pause on rate hikes in September. Another rate rise is expected later in the financial year (perhaps in November) as core inflation remains stubbornly above target, and an easing cycle is unlikely until core inflation is back below 3%, or in the event of a harder landing next year, resulting in recession-like conditions. Elevated oil prices add to recession risks, but this is still assessed as only roughly a 15–20% probability this financial year.

Economic Forecasts: basecase scenario

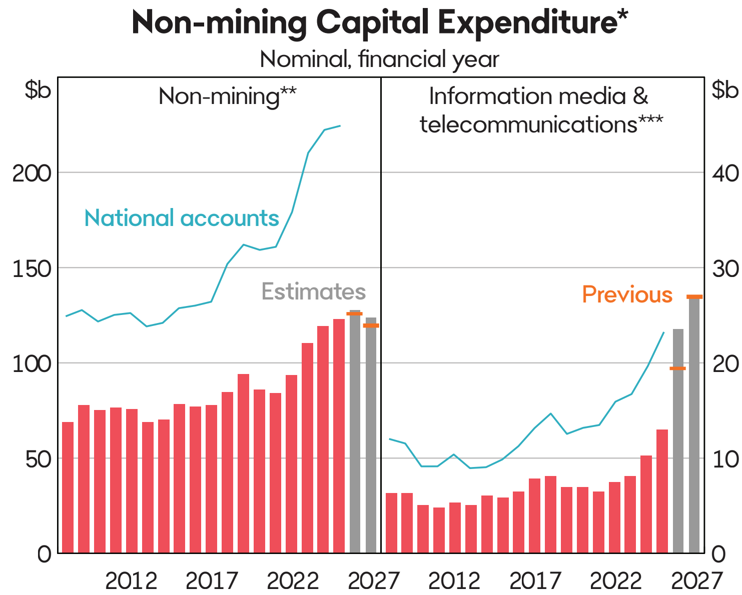
	2025			2026				2027			
% (actual, forecast)	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP q/q	1.0	0.4	0.9	0.3	0.3	0.3	0.3	0.4	0.6	0.6	0.7
GDP y/y	2.0	2.1	2.5	2.5	1.8	1.8	1.2	1.3	1.6	1.9	2.3
Unemployment	4.3	4.4	4.1	4.3	4.4	4.6	4.8	5.0	5.2	5.3	5.4
CPI (q/q)	0.7	1.3	0.6	1.4	0.6	1.0	0.5	0.5	0.7	0.9	0.7
CPI (y/y)	2.1	3.2	3.6	4.1	3.9	4.2	4.1	3.2	2.7	2.6	2.8
CPI (core y/y)	2.7	3.0	3.4	3.5	3.6	3.7	3.5	3.4	3.0	3.0	3.0
RBA cash rate	3.85	3.60	3.60	4.10	4.35	4.35	4.60	4.60	4.60	4.60	4.60
AUD / USD	.658	.662	.668	.690	.692	.72	.74	.76	.77	.78	.79

Benchmark rates

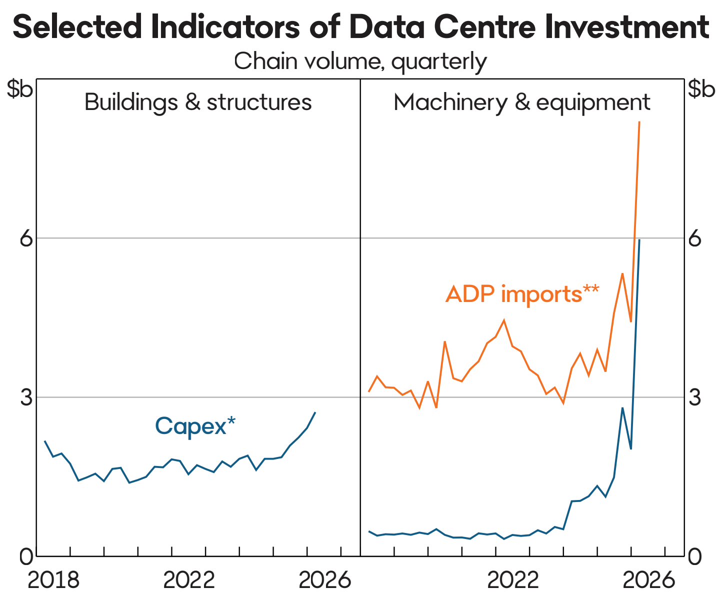
	30/6/25	30/6/2026	31/7/2026	20/8/2026
90-day bills	3.60%	4.67%	4.50%	4.50%
3-year swap	3.21%	4.32%	4.46%	4.55%
5-year swap	3.55%	4.63%	4.81%	4.85%
AUD/USD	.6580	.6920	.7015	.7120
ASX 200	8 542	8 986	8 977	9 068
Credit Index (iTraxx- 5 yr)	73.7	67.5	70.8	68.3

Appendix:

AI and related technology investment: domestic and international



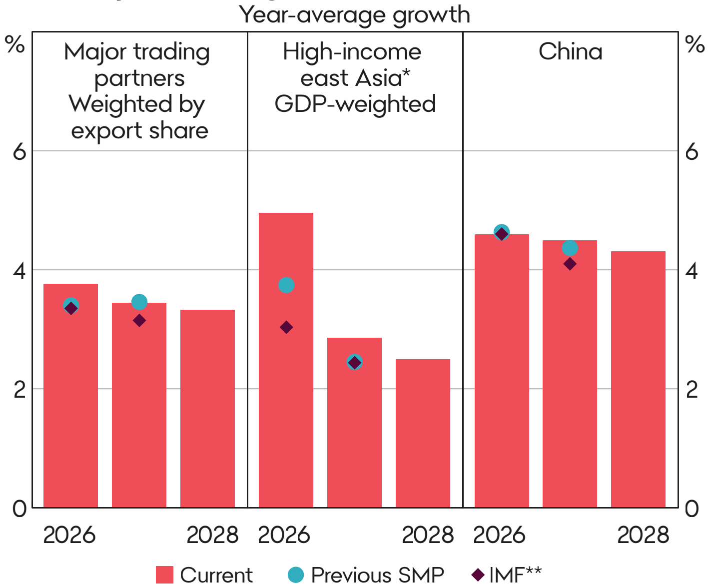
* Estimates are firms' expected capital expenditure, adjusted for historical average difference between expected and realised spending.
** Excluding the information media & telecommunications industry.
*** Includes data centres.
Sources: ABS; RBA.



* Data for the information media & telecommunications industry in the Private New Capital Expenditure Survey.
** Total Australian imports of automated data processing equipment for data centres and other industries.
Sources: ABS; RBA.

Major Trading Partner GDP Forecasts

Year-average growth



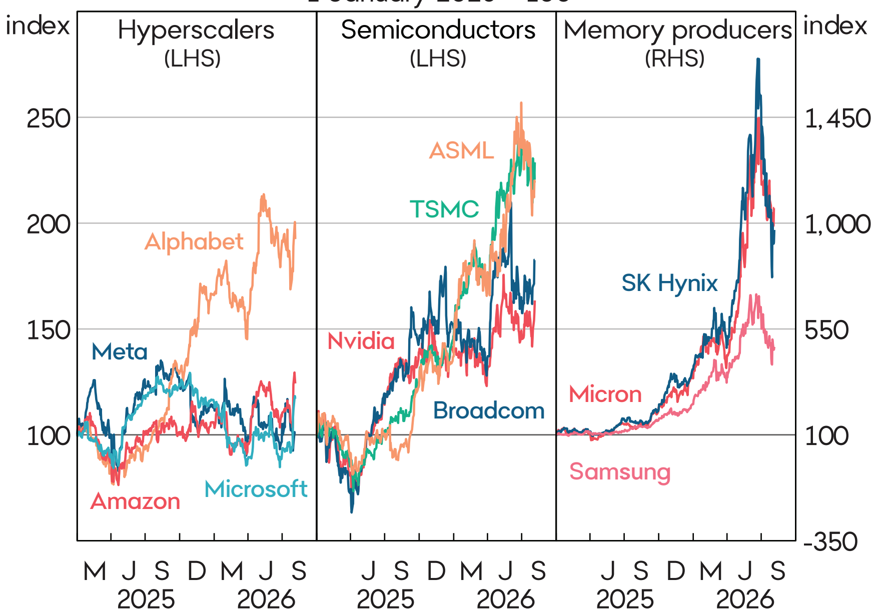
* High-income east Asia is a GDP-weighted average of South Korea, Taiwan, Hong Kong and Singapore.

** IMF forecasts from the July 2026 WEO Update for China and the April 2026 WEO for major trading partners and high-income east Asia.

Sources: ABS; CEIC Data; Consensus Economics; IMF; LSEG; RBA.

AI-Related Equity Prices*

1 January 2025 = 100



* Equity prices are on a total returns basis.

Sources: LSEG; RBA.