December 2025

Economic and market update

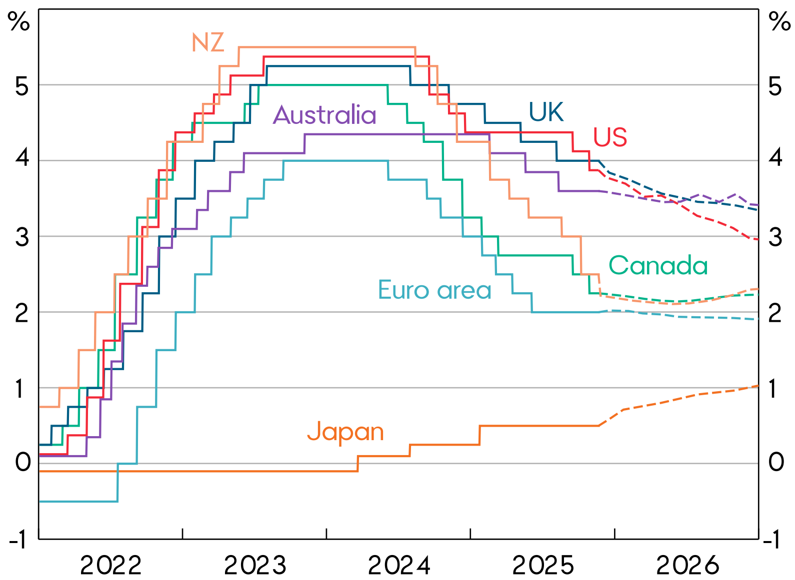
Economic Overview – as at 11th December 2025

Global markets

As we approach year-end most central banks have completed the bulk of their easing cycles and some are already hinting that the next move will probably be a hike, although timing on this new phase is likely to be highly variable and there are obvious exceptions (e.g. Japan). The US and UK are expected to experience a longer easing cycle in duration with fiscal policy and other unique factors at play, but further de-escalation in global trade tensions has removed more extreme downside scenarios to the outlook, and equity markets continue to power ahead riding the AI technology wave. As such the case for more aggressive policy easing has diminished.

The US Federal Reserve cut rates as expected last night by another 25bp (to a 3.5–3.75% band) although there were 3 dissenters with recent Trump appointee Stephen Miran voting for a 50bp cut, while two regional Fed Presidents voted for no change.

Central Bank Policy Rate Expectations*



*Dashed lines show expectations implied by overnight index swap rates as of 21 November 2025.
Sources: Bloomberg, RBA.

The Fed's 'dot-plot' forecasts show a median view of one more cut in 2026 and another in 2027, but there is a wide distribution of views on the policy and economic outlook (mirroring the dissent in the latest decision). In the press conference Chairman Powell sounded fairly neutral, stating "the fed funds rate is now within a broad range of estimates of its neutral value, and we are well positioned to wait and see how the economy evolves". Powell is expected to be replaced by Kevin Hassett (currently White House economic adviser) in May, so Hassett's comments are also relevant: he said yesterday that there is 'plenty of room' for further rate cuts, but insisted that he wouldn't bow to political pressure should he become the next Fed Chair. US data continues to play catch up after the government shutdown, but generally points to slightly weaker labour markets and mildly higher inflation - far less damaging than feared earlier in the year but still on the weak side.

The ECB gave a clear signal that the easing cycle is probably over as Elizabeth Schnabel said she was comfortable with market expectations that "the next move is going to be a hike, albeit not anytime soon". European data has continued to show resilience with German industrial production up 1.8% m/m in October and the euro-zone economy growing at better than expected 0.3% in Q3; so while a recent Reuters poll predicted the ECB on hold for all of 2026, the improvement in investor morale and rebound in investment appears well established.

The BOE are likely to deliver a pre-Christmas present with rate cuts likely to resume next week after the 5–4 slim majority decision to keep rates on hold at 4% in November. There are still lingering concerns on UK inflation but unemployment rose again to 5% and a bank report said household spending fell at its fastest pace in five years ahead of the 28 November budget.

The Bank of Japan (in contrast refer chart above) are expected to hike by 25bp on 19 December after recent hawkish comments from the BOJ and as the market continues to price in a steady path to 1–1.25%. Japan's economy contracted by around 0.6% in Q3 as the full brunt of US tariffs was felt, but new PM Takaichi's policy agenda is expected to drive an economic revival.

China's exports rebounded impressively in November after the surprise fall the previous month, with exports to the EU and a range of local destinations more than offsetting another fall in US shipments (down 29% y/y) despite recent tariff de-escalation between the world's two largest economies. The IMF revised its growth forecast yesterday for 2026 up to 4.5% (with this year's 5% target on track) and the recent Politburo meeting emphasised the importance of domestic demand, with more fiscal support and monetary easing needed but likely to be delivered.

In summary, global trade has proved remarkably resilient to US tariffs and other policy uncertainty, so the challenges driven by trade tensions and geopolitical complexities have only delivered short-term market disruptions, not more systemic dislocations that had been feared 6–8 months ago. Markets continue to be wary of the sustainability of fiscal support and government debt vis-à-vis bond markets in some countries (refer appendix for comparisons), but AI and emerging technologies continue to drive investment and the promise of accelerating growth and activity in the medium term.

Domestic economy

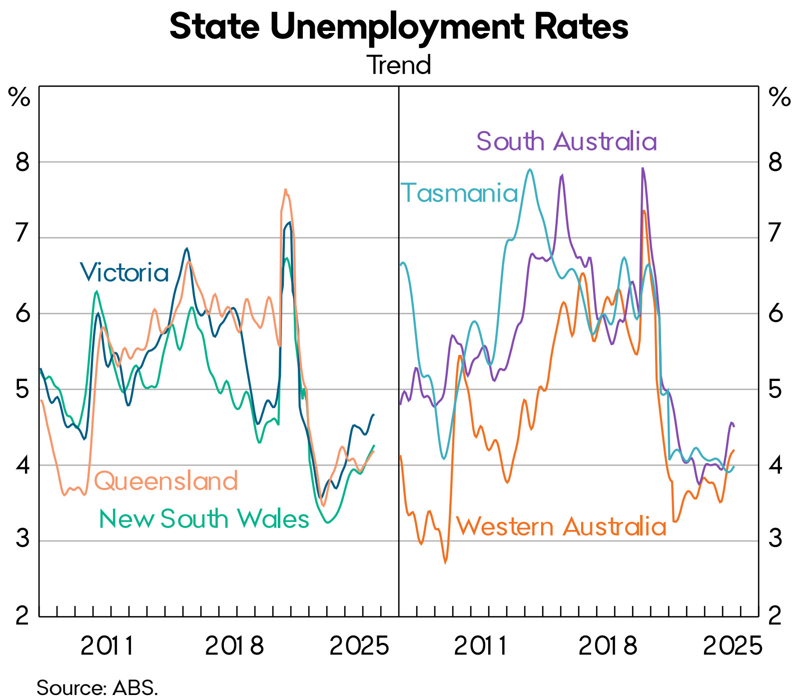
The third successive RBA 'rates on hold' decision on 9 December signalled a clear change in language from the Reserve Bank who dropped references to restrictive rates and any forward guidance such as maintaining the cash rate at current levels – so while remaining cautious there was a direct implication that hikes are possible next year. The markets have taken this very literally and have moved from pricing in a cut only 6 weeks ago to now pricing in two hikes in 2026! Bullock's comment that 'risks to inflation have tilted to the upside' are quite valid and do indeed open the door for a hike next year, but core inflation will need to deteriorate a little more before the RBA could be justified in this action. Our forecasts here have referred to hikes in 2027 and 2028 for some time (based more-so on a virtuous growth cycle than menacing inflation), but just holding rates at their current (slightly restrictive) rate and warning of upside risks should do the trick in capping core inflation no higher than 3.2% – time will tell.

At the start of the year our forecasts centred on a shallow easing cycle to around 3.5% but (as detailed in the global markets section) the mid-year trade tensions saw markets factor in deeper easing cycles, which were hard to ignore. The fact that trade de-escalation has removed the need for more urgent policy support is in most respects good news, but the proposition that the RBA need to hike rates within the next 6 months to combat inflation (as the curve currently implies) appears hasty.

The monthly CPI data for October is now a 'complete measure' rather than being referred to as an indicator, and it was alarming to see headline CPI jump to 3.8% (double the 1.9% rate seen in June). Less dramatically (but still above target) the Trimmed Mean rose to 3.3% from 3.2% the previous month and the 2.95% y/y rate in the Q3 report. The RBA have noted the new data series is still 'in transition' so will be far more persuaded by the next quarterly data out on 28 January, vs the November monthly numbers out on 7 January. The latest jump in CPI was driven primarily by housing, food and recreation subindices of the basket, some of which may prove to be temporary, but any rise in core inflation above 3.3% would indeed risk an RBA policy response. The basecase forecasts below don't show this outcome, but it is uncomfortably close.

One reason to expect rates on hold for all of 2026 rather than RBA rate hikes (prior to the hiking cycle already expected for 27/28 due to accelerating growth and output) is the likely steady weakening in labour markets, although today's numbers showed unemployment steady at 4.3% in November. The data had some inconsistencies between trend and 'seasonally adjusted' figures: e.g. the fall of 21k in employment s.a. versus a rise of 21k in trend terms, and the fall in full-time employment of 57k, together with a sharp rise in underemployment (from 5.7 to 6.2%) and a fall in the participation rate were concerning. Overall the data appeared consistent with a rates on hold outlook for the RBA but the next read on 22 January will be important for the February monetary policy meeting. Labour markets are still quite uneven by state (refer chart) with Victoria at 4.7% unemployment while Queensland continues to enjoy strong jobs growth.

The Aussie Dollar rebounded to around .6685 after the Fed cut in contrast to market expectations of RBA hikes although the jobs data took some of the wind out of the sails – the basecase forecasts below continue to factor in a weaker US Dollar although the progress has been slower than we had hoped a few months ago. Nevertheless the recent GDP data showed a pleasing pick-up in private sector demand as hoped, and private investment grew 2.9% in Q3, contributing 0.5% to GDP growth, the highest quarterly growth since early 2021. Business capex in machinery and equipment was a standout, attributed to major data centre investment. The AI investment boom has had a significant impact on equity markets, but the next phase of this to an uplift in productivity and output (while very difficult to draw a timeline on) provides considerable scope for optimism on growth in the years ahead – albeit with implications for the neutral cash-rate and for labour markets.



Interest Rate Outlook

The RBA have probably completed their easing cycle after the recent jump in inflation and with economic growth running up closer to potential growth. While the next tightening cycle is still more likely to be a 2027 and 2028 story, earlier hikes are possible if core inflation rises above 3.3%. Until then the RBA will probably maintain the current 'slightly restrictive' rate throughout 2026. The scenario for another cut requires a quick fall in CPI and a jump in unemployment.

Economic Forecasts: basecase scenario

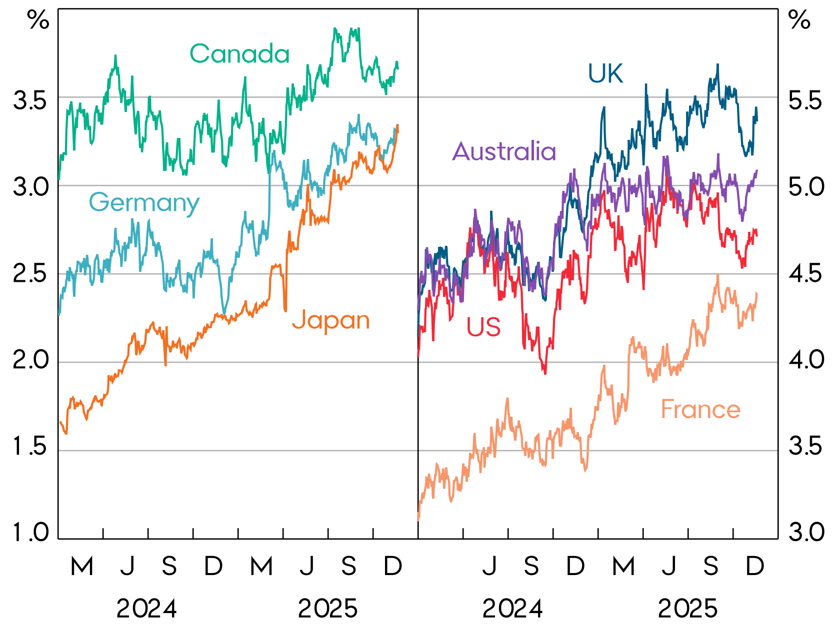
	2024		2025				2026				2027
% (actual, forecast)	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q2
GDP q/q	0.3	0.5	0.4	0.7	0.4	0.6	0.5	0.7	0.5	0.7	0.7
GDP y/y	0.8	1.3	1.4	1.8	2.1	2.1	2.2	2.2	2.3	2.4	2.6
Unemployment	4.1	4.0	4.1	4.3	4.5	4.5	4.7	4.9	5.0	5.1	5.4
CPI (q/q)	0.2	0.2	0.9	0.7	1.3	0.5	0.7	0.6	1.0	0.8	0.7
CPI (y/y)	2.8	2.4	2.4	2.1	3.2	3.4	3.2	3.1	2.8	3.1	3.2
CPI (core y/y)	3.6	3.3	2.9	2.7	3.0	3.1	3.1	3.1	2.9	3.0	3.2
RBA cash rate	4.35	4.35	4.10	3.85	3.6	3.6	3.6	3.6	3.6	3.6	4.0
AUD / USD	.691	.619	.625	.658	.662	.67	.69	.71	.72	.73	.75

Benchmark rates

	31 / 10 / 24	31 / 10 / 2025	28 / 11 / 2025	11 / 12 / 2025
90-day bills	4.39%	3.64%	3.67%	3.71%
3-year swap	4.04%	3.58%	3.85%	4.10%
5-year swap	4.27%	3.95%	4.25%	4.49%
AUD/USD	.6580	.6545	.6550	.6635
ASX 200	8 160	8 882	8 614	8 579
Credit Index (iTraxx- 5 yr)	65.4	65.9	71.5	63.8

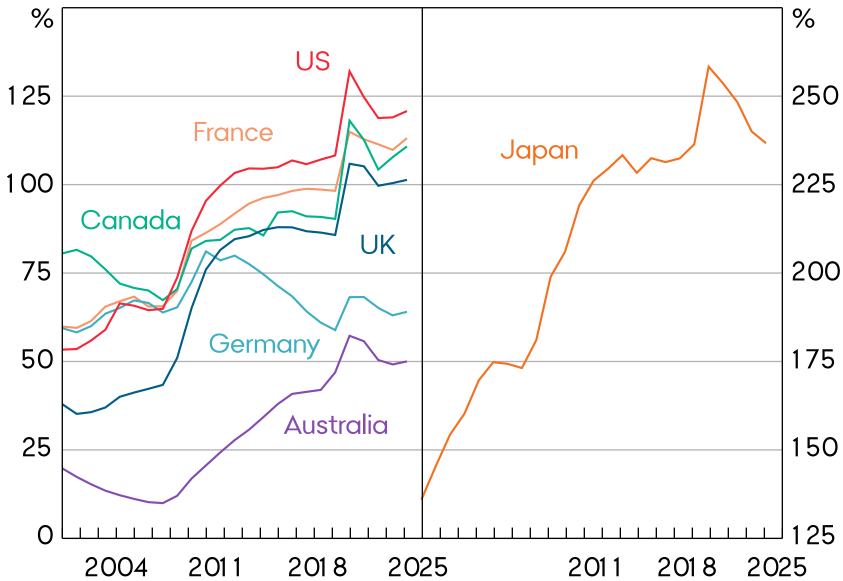
Appendix: Peer economy comparisons

30-year Government Bond Yields

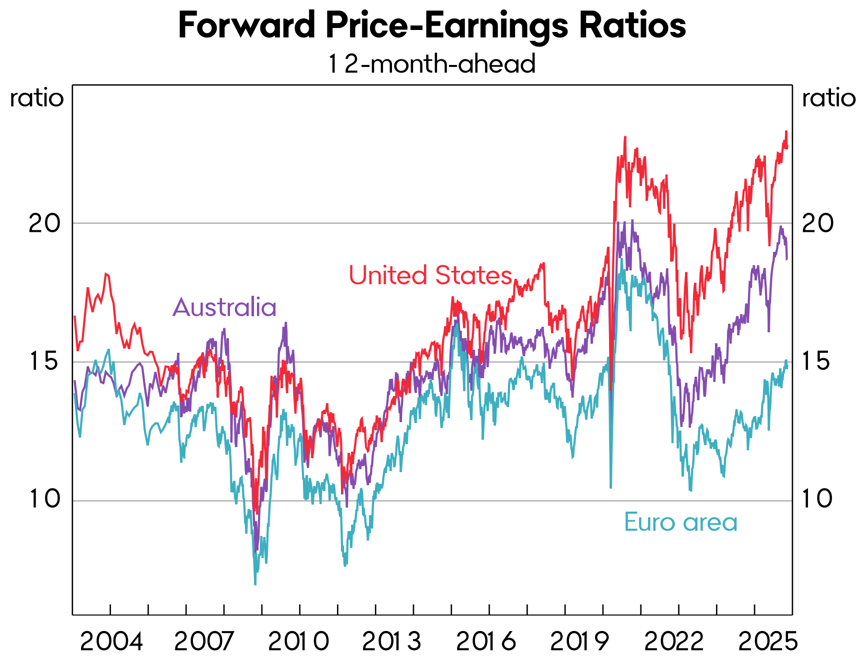


Source: Bloomberg, LSEG, RBA.

Advanced Economy Gross Debt-to-GDP



Source: IMF, RBA.



Sources: LSEG, RBA.