January 2026

Economic and market update

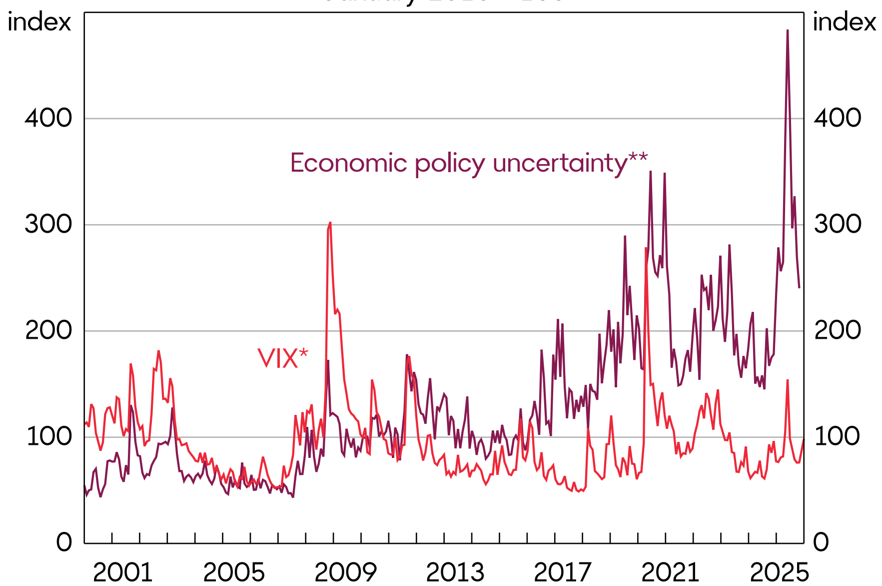
Economic Overview – as at 22nd January 2026

Global markets

Having noted the deescalation of geopolitical tensions into year-end and the pleasing ability of most countries to reroute trade in lieu of US tariffs, 2026 has started with several shocks after recent events in Venezuela, Iran and most recently (somewhat comically) around Greenland. Economic policy uncertainty was lower but still elevated at year-end; it may now rebound to an extent, depending on how the extraordinary demands of President Trump on Greenland's sovereignty play out. As others have noted, best to take Trump's rhetoric seriously but not always literally. Nevertheless, risk appetite took a hit after tariffs were used as a threat to Europe apparently to avoid military action: the VIX index spiked to 20 and gold to fresh record highs – however a softening in Trump's language overnight has been welcomed by markets.

Measures of Uncertainty

January 2010 = 100



*S&P 500; data up to November 2025; monthly average of daily data.

**Global economic policy uncertainty index from Davis (2016); data to September 2025.

Source: CBOE; CEIC Data; RBA.

These events and tensions may primarily have political (over economic) consequences and may quickly deescalate (surely the US won't actually invade a fellow NATO country), but they match the rapid changes to 'rules-based world order' as noted by Canadian PM Mark Carney in his Davos WEF speech: "We're in a rupture, not a transition...the old order is not coming back". Beyond stock market jitters US treasury yields jumped on these economic risks, with bonds already under pressure after US federal prosecutors opened a criminal inquiry into Fed chair Jerome Powell – testing the market's perception of central bank independence. The US ten-year yield jumped to 4.3% prior to Trump stating 'a framework is agreed' on Greenland with NATO.

Beyond political developments (including the impending Supreme Court judgement on the legality of the Trump administration using tariffs at all), US economic data continues to paint the picture of slightly elevated inflation (around 2.8% for the core PCE), below trend employment growth (with unemployment likely to remain around 4.5%) and GDP growth in the 2's. Two Fed cuts (most likely in June and September) should support consumer spending, which has been challenged by the recent government shutdown and sluggish housing and jobs markets.

Japanese bonds are also in focus but for different reasons – new PM Takaichi's snap election call came with a pledge to suspend the 8% sales tax on food, giving the market another reason to question fiscal sustainability. Ten-year JGBs rose to 2.34% (the highest level since 1997) while 30-year bond yields rose to 3.85%, a record high. The combination of this sell-off in bonds with events in Europe (including a Danish pension fund selling $100m in US Treasuries) sets the scene for a troubled start to the year for global bond markets, and renewed focus on debt.

China landed exactly on GDP target for 2025 (based on official data) at 5.0% growth, so beyond any scepticism of the accuracy of this number there is agreement that strong exports and industrial production offset very weak Chinese consumer activity. Another sharp fall in fixed investment in December was accompanied by weak retail sales and housing markets, but the export-led jump in industrial output clearly offset the lack of domestic demand. So while 5% growth no doubt overstates the health of the economy, the new record goods trade surplus (US $1.2 Tn- over 1% of global GDP) and AI-related investment ahead suggest momentum can be maintained. Further PBoC policy support is still expected, and the latest credit growth numbers were 'less slow than expected', so IMF forecasts of 4.5% growth in 2026 seem reasonable.

In summary, despite volatility on bond and stock markets amid fresh geopolitical unease, the global economy ended 2025 (despite all its trade and political turmoil) with resilient growth around 3.3% and a similar pace expected in 2026. The same familiar themes of AI and other technologies driving investment and productivity are dominating forecasts, offsetting trade headwinds and keeping markets in this unique environment of gold and other safe haven assets at record highs, at the same time that stock markets reach fresh record peaks. The outlook for geopolitics is as uncertain as ever which may continue to drive unease in stock and bond markets, but technology optimists are keeping bubbles at bay for now and the anticipated productivity boom ahead is difficult to ignore.

Domestic economy

The RBA Monetary Policy Board face a very challenging environment for the 2–3 February meeting: clear evidence that core inflation has picked up in the last few months and that the economy is facing capacity constraints, but only three rate cuts into the easing cycle an official cash rate still above neutral in contrast to peer economies. The timing of this decision will also be difficult in the wake of recent devastating weather-related events and amid highly uncertain global conditions (refer section above), but there is no doubt that the RBA will emphasise their commitment to achieving low and stable inflation, and delivering on their dual-mandate.

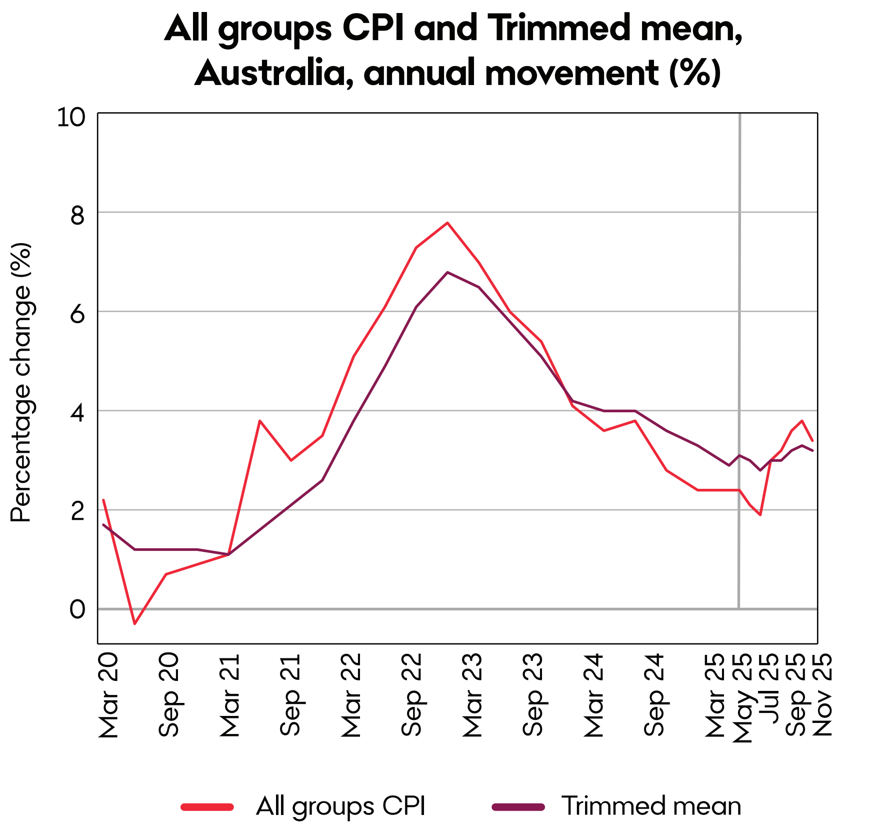
The latest jobs data only added to the recent chorus of opinion that the RBA may need to hike rates in February (and thereby exit the shallowest easing cycle in its history) with a large rise in employment in December taking the unemployment rate back down to 4.1% from its recent peak at 4.4% in September. Underemployment also fell to 5.9% (from 6.2%) and other details all appeared strong – perhaps the only caveat on the data was the sample rotation (potentially adding some noise). However with the RBA recently characterising labour markets as 'a little tight, but modest easing expected' and given their forecasts had unemployment at 4.4% for December and staying there for the next two years, this data will be difficult to ignore. As per the basecase forecasts below I continue to warn of downside risks to labour markets, but confess that the latest data does nothing to support this opinion. The impact of AI is all ahead of us.

Other indicators of growing price-pressures include household spending which was strong in November but may ease off in the wake of Black Friday sales and with consumer confidence falling sharply in the latest survey. Indeed the sudden expectation that (far from cutting rates any further) the RBA may hike rates soon is clearly seen in these surveys of sentiment, so to an extent will do the job of discouraging consumer demand. Nevertheless, the wealth effect of strong asset prices (property, super etc) and resilient labour markets are evident in retail sales.

The monthly CPI data for November took some pressure off the RBA with the fall in headline CPI from 3.8 to 3.4% and more importantly the Trimmed Mean falling from 3.3 to 3.2%, but the Q4 numbers will be critical for the outlook and for the decision on 3 February.

Headline CPI is expected to rise to around 3.5% at year-end, but the crucial number will be the Trimmed Mean – and should this land at 0.7 or 0.8 for Q4 (so 3.2–3.3% y/y) it would still give the RBA the option to keep rates on hold, but warn of the risk of impending hikes and thereby put the economy on notice. This approach would essentially translate to 'inflation has risen, so we need to keep rates at their current restrictive level' as opposed to the groundswell of opinion that the RBA need to make rates even more restrictive. All eyes on next week's data .

The Aussie Dollar reacted to today's jobs data and the higher probability of an imminent RBA hike by leaping above US 68c for the first time since October '24, also supported by the ongoing negativity on the US dollar that has been evident throughout 2025. Risks of more dramatic 'de-dollarisation' may be overstated, and it is difficult to image a world where the US Dollar isn't the primary reserve currency, but recent trends are interesting and the rise in gold a sign of uncertainty ahead. The basecase forecasts below continue to anticipate a stronger A$ ahead, and this may be understating the upside if the cash rate moves higher ahead of our timeline.



a. Annual movements prior to April 2025 are calculated by comparing each quarter to the same quarter in the previous year. From April 2025 these movements are calculated by comparing each month to the same month in the previous year.

Source: Australian Bureau of Statistics, Consumer Price Index, Australia, November 2025.

Interest Rate Outlook

The RBA have very likely 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. Scenarios for another cut include a quick fall in core CPI or (more likely) a shock offshore.

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	4.4	4.1	4.4	4.6	4.8	5.0	5.4
CPI (q/q)	0.2	0.2	0.9	0.7	1.3	0.6	0.8	0.6	1.0	0.8	0.7
CPI (y/y)	2.8	2.4	2.4	2.1	3.2	3.5	3.4	3.3	3.0	3.2	3.2
CPI (core y/y)	3.6	3.3	2.9	2.7	3.0	3.2	3.2	3.1	2.9	3.1	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	4.1
AUD / USD	.691	.619	.625	.658	.662	.668	.69	.71	.72	.73	.75

Benchmark rates

	29 / 11 / 24	28 / 11 / 2025	31 / 12 / 2025	22 / 1 / 2026
90-day bills	4.43%	3.67%	3.74%	3.73%
3-year swap	3.92%	3.85%	4.10%	4.20%
5-year swap	4.15%	4.25%	4.49%	4.55%
AUD/USD	.6520	.6550	.6675	.6805
ASX 200	8 436	8 614	8 714	8 846
Credit Index (iTraxx- 5 yr)	66.1	71.5	63.8	66.7