

Economic and market update

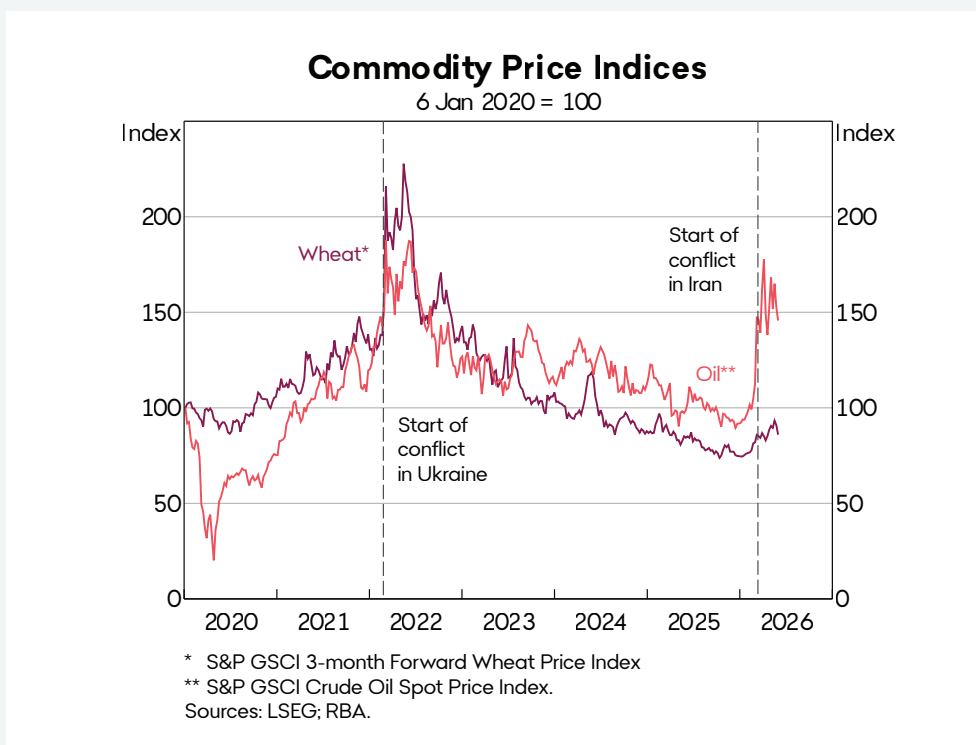
Economic Overview – as at 18th June 2026

Global markets

The long awaited agreement on a 'peace deal' between the US and Iran has at face value been delivered and, whilst only a 60-day interim step, has sufficient substance to convince markets that the oil price has peaked and that global inflationary risks should slowly recede. The fact that the MOU has officially been signed and allows a 60 day period of toll-free passage through the Strait of Hormuz does appear to be a major breakthrough. However, there remain complications given the recent Israeli attacks on southern Lebanon, and also around mines in the Strait (and what happens after 60 days). Nevertheless the price of oil (Brent) is back below

US\$80 per barrel and other energy and commodity prices should steadily benefit from the deal.

The first FOMC decision for new US Fed chair Kevin Warsh was predictably 'no change' with the Fed funds target rate band remaining at 3.5–3.75%, but the language was markedly different from his predecessor both in its brevity and its avoidance of forward guidance. Warsh has long been critical of the Fed being too precise with its forecasts as well as not being happy with the size of the Fed's balance sheet, so he has initiated five 'task forces' including communications, data sources



and productivity (especially in the context of the impending impact of AI). Despite this leaning to less definitive forward guidance the market did interpret his short statement as unambiguously hawkish, so a hike as soon as the next meeting (in 6 weeks) is being priced into the curve, and only one voting member still expects a cut [this year](#). As a result, despite the above developments on the Middle East conflict (which would have been expected to see downward pressure on the US Dollar) the prospect of higher US rates has seen the greenback appreciate and stock markets have reacted with caution – albeit are still near record highs. Inflation in the US has risen due to the oil crisis and the FOMC median projection is for core PCE inflation to average 3.3% in Q4, while labour markets and retail activity have remained resilient – all suggesting that rate hikes are likely (although their timing is very challenging to predict).

The European Central Bank raised rates last week by 25 basis points taking the benchmark deposit rate from 2 to 2.25%, the first hike in the new cycle (ending the easing cycle that had seen rates [halve](#) from 4%). While the market had expected this hike in response to rising inflation, the outlook from here is less clear in the wake of the signing of the US-Iran MOU, however euro-zone headline inflation at 3.2% in May and core inflation is clearly above target at 2.5%. The ECB increased its forecast for inflation to average 3% this year and 2.3% next, while revising down growth – but the peace deal in the Middle East clearly reduces stagflation risks. In the UK the Bank of England are expected to keep rates on hold at 3.75% tonight, but like other major central banks, easing cycles appear to be behind us.

The Bank of Japan increased rates by 25bp to 1% this week, their highest level in 31 years! Another hike is expected by year end as the economy powers ahead, with the Nikkei stock index at 71,000 (not just a record high, but up 85% y/y) and the consensus opinion is that (after two decades of deflation) Japan is finally in a 'normal' inflationary cycle. The Yen remains very weak (above 160 versus the US Dollar) which is helpful for exports especially amid the AI and data-centre related demand for semiconductors and non-ferrous metals.

China's activity data for May continued the trend of underwhelming economic growth but assuming some degree of policy response the official growth rate for 2026 should still achieve around 4.5–5%. Export demand especially from the AI-engine room of [east Asia](#) is expected to offset weak domestic demand, and the contrast between robust manufacturing and industrial production versus retail sales (actually falling 0.6% y/y) is stark.

Complications via the Middle East conflict and US tariffs are [headwinds](#) but policy is expected to be supportive.

In summary, global stagflation risks appear less elevated after the signing of the US-Iran MOU, and the prospect of 60 days of 'toll-free shipping' through the Strait of Hormuz. How lasting the peace agreement is and what global trade looks like by year-end remain obvious unknowns, but assuming the oil price remains back near current levels, presumably the global economy will start to resemble its appearance prior to the conflict. Stock markets certainly appear to be leaning to this more positive [interpretation](#) although the higher interest rate outlook (especially in the US) could challenge the remarkable bull-market and its relentless confidence in where high tech is taking us.

Domestic economy

The RBA kept the official cash rate at 4.35% this week as universally expected and while there were no surprises in the [statement](#) or Michele Bullock's press conference there were numerous reminders that the tightening bias remains firmly in place. Examples of this reality included:

"The latest data show that headline and underlying inflation are still too high";

"Global oil supply issues will take some time to resolve, maintaining upward pressure on global energy prices and inflation"; and

"the Board is focused on its mandate to deliver price stability and full employment. It will do what it considers necessary to achieve that outcome, including increasing the cash rate target further if required."

Clearly the subsequent developments in the Middle East would be welcome news for the RBA given their focus on ensuring that high inflation doesn't become entrenched, but the market's recent repricing of cash rate assumptions for next year is perplexing. A majority of economists are now forecasting at least one rate cut next year, and the curve now only suggests around a 50% probability of another hike this year, while one cut next year is [implied](#).

There are a few problems with this assumption of lower rates next year – will underlying inflation be sufficiently benign by then to allow an easing in RBA policy? Will the Monetary Policy Board come to the conclusion that the economy actually needs more accommodative rates? And will model estimates of a 'neutral cash rate' stop increasing between now and then, having steadily risen [since 2021](#)?

The April inflation data released in late May did see headline CPI fall from 4.6 to 4.2%, however underlying inflation measured by the trimmed mean rose from 3.3 to 3.4%, and RBA forecasts don't show the inflation target of 2.5% reached until [2028](#). To what degree these forecasts will be adjusted lower when we read the August SOMP in less than 6 weeks will be intriguing (assuming the oil price is still moderating then as [assumed](#)); but second order price impacts from higher energy prices generally take time to emerge, and the government halving of the fuel excise is due to end on June 30. The May data to be released next week will likely see core inflation print at around 3.5%, further justifying the RBA comments listed above.

Beyond inflation and whether or not the RBA will have the luxury of being able to cut rates next year, the question remains just how much policy support the economy will need. Prior to the Middle East conflict the economy was growing at 2.5% while our productive capacity was estimated to be only 2% – GDP growth remains at 2.5%, however Q1 only contributed 0.3% to this annual pace. Forecasts for the balance of 2026 are for much slower growth in the wake of the three RBA hikes and with cost of living pressures acutely higher, so by year end the growth rate is expected to be only around 1–1.5%.

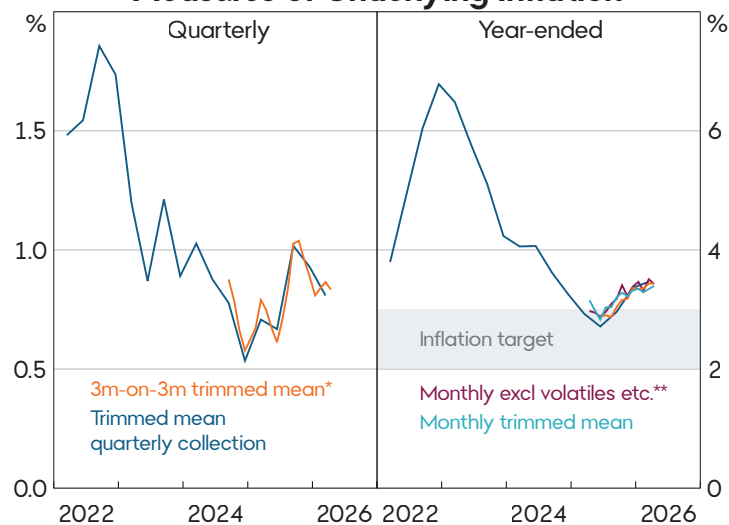
Consumer confidence has plummeted to near-record lows and the federal budget with its range of tax changes has added to a mood of pessimism. However household spending is yet to decline, and we heard today of some backdowns on the tax reforms (after 'consultation') – so the extent of the impending slowdown is a key variable. It is quite

possible that by the time core inflation is back closer to target, the broader drivers of economic growth – business investment (with 'machinery and equipment investment' having seen its largest rise in [30 years](#)), relatively tight labour markets, and the outperformance of our major trading partners – are driving a brisk recovery from the current economic slowdown.

The outlook for residential property is another source of pessimism, but still with mixed signals. As the appendix outlines, the auction clearance rate was already falling in capital cities ahead of the federal budget with its changes to negative gearing and CGT, so prices are expected to flatten in most regions and falls are already widespread in Sydney and Melbourne. How this all translates to broader household demand and business investment (and for how long) may end up having more [political](#) consequences than economic. Some of the more extreme forecasts of median dwelling prices falling 15% appear exaggerated – but property appreciation will clearly be far more moderate ahead, and housing turnover is expected to be much slower. The balance of supply (refer chart 3 in the appendix) and demand (e.g. via [population growth](#)) will evolve.

In summary the slowdown in the economy is likely to accelerate in Q2 and Q3, however an outright recession is still unlikely in the absence of the Middle East conflict reigniting. The RBA may well remain on hold at a cash rate of 4.35% for some time now, but the basecase scenario below still shows another hike in November amid stubborn inflation, and no cuts in 2027.

Measures of Underlying Inflation



* Calculated based on the distribution of three-month-on-three-month price changes.
 ** Monthly CPI excluding volatiles, holiday travel and electricity.
 Sources: ABS; RBA.

Interest Rate Outlook

The RBA will likely continue their pause for rate hikes in August but will maintain a tightening bias for the rest of 2026 and probably into 2027. The need to tighten rates any further will be at the mercy of inflation data and conversely any evidence of constrained supply improving (e.g. via labour and housing markets). Other relevant data will be household spending vs consumer sentiment, and evidence of whether the recent surge in business investment remains in place.

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	0.4	0.2	0.4	0.5	0.8	0.6	0.6
GDP y/y	2.0	2.1	2.5	2.5	1.9	1.8	1.3	1.3	1.9	2.3	2.5
Unemployment	4.3	4.4	4.1	4.3	4.5	4.7	4.9	5.1	5.3	5.4	5.5
CPI (q/q)	0.7	1.3	0.6	1.4	1.2	0.9	0.5	0.5	0.7	0.9	0.7
CPI (y/y)	2.1	3.2	3.6	4.1	4.5	4.1	4.0	3.1	2.6	2.6	2.8
CPI (core y/y)	2.7	3.0	3.4	3.5	3.7	3.7	3.5	3.4	3.0	3.0	3.0
RBA cash rate	3.85	3.60	3.60	4.35	4.35	4.35	4.60	4.60	4.60	4.60	4.60
AUD / USD	.658	.662	.668	.690	.71	.73	.75	.76	.77	.78	.79

Benchmark rates

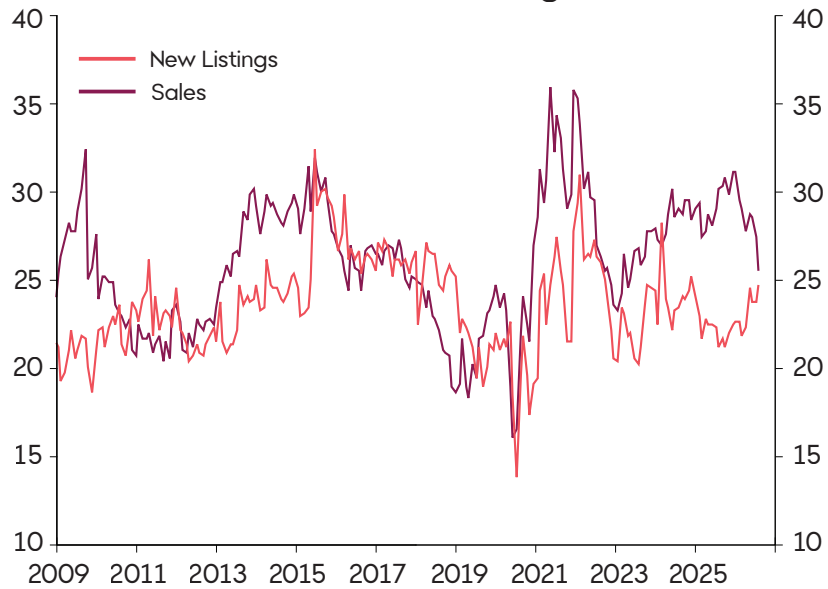
	30/4/25	30/4/2026	29/5/2026	18/6/2026
90-day bills	4.13%	4.37 %	4.46%	4.47%
3-year swap	3.22%	4.76 %	4.49%	4.42%
5-year swap	3.59%	4.98 %	4.78%	4.70%
AUD/USD	.6405	.7205	.7185	.7010
ASX 200	8 126	8 666	8 732	8 911
Credit Index (iTraxx- 5 yr)	82.9	75.5	72.5	68.8

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Appendix:

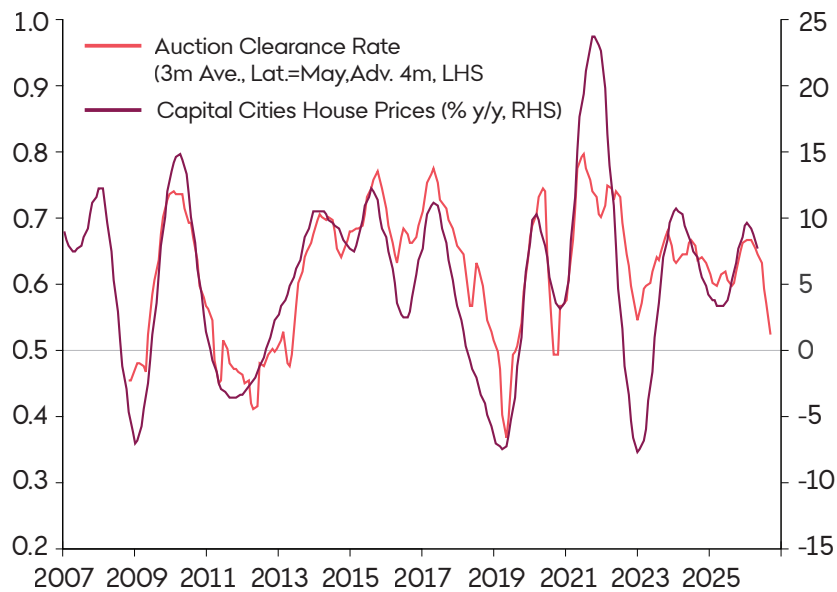
Residential property markets.

Chart 1 – Sales & New Listings (SA, 000s)



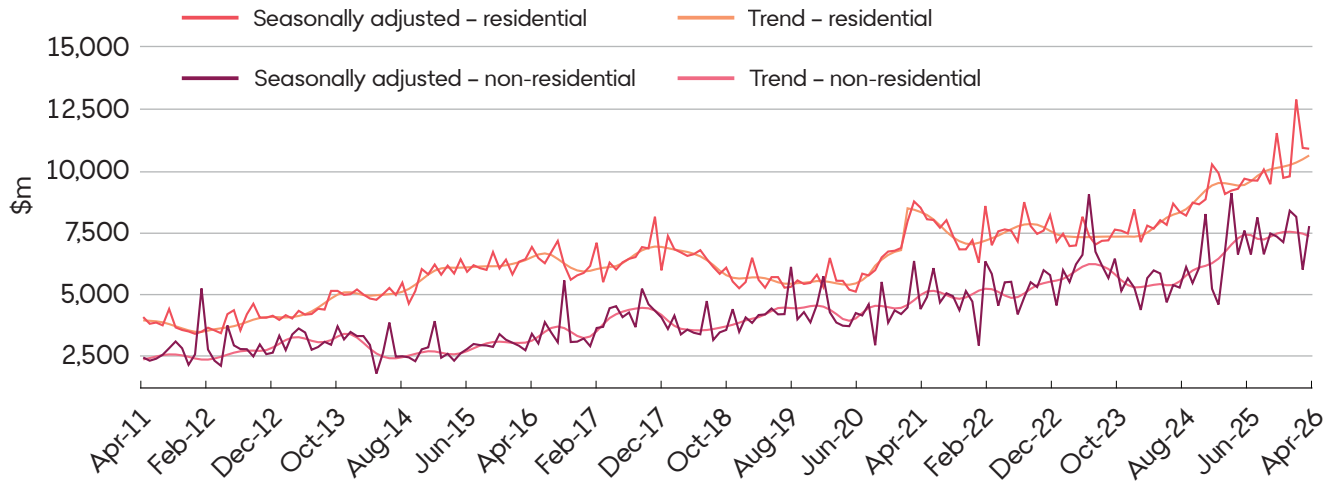
Sources: Cotality, ABS, Capital Economics.

Chart 2 – Auction Clearance Rate & House Prices



Sources: Cotality, ABS, RBA, Capital Economics.

Chart 3 – Value of building approved (a), by building type



a. Trend break added to 'Total residential' trend series for September 2020 and February 2021.
Sources: ABS, Building Approvals, Australia April 2026.