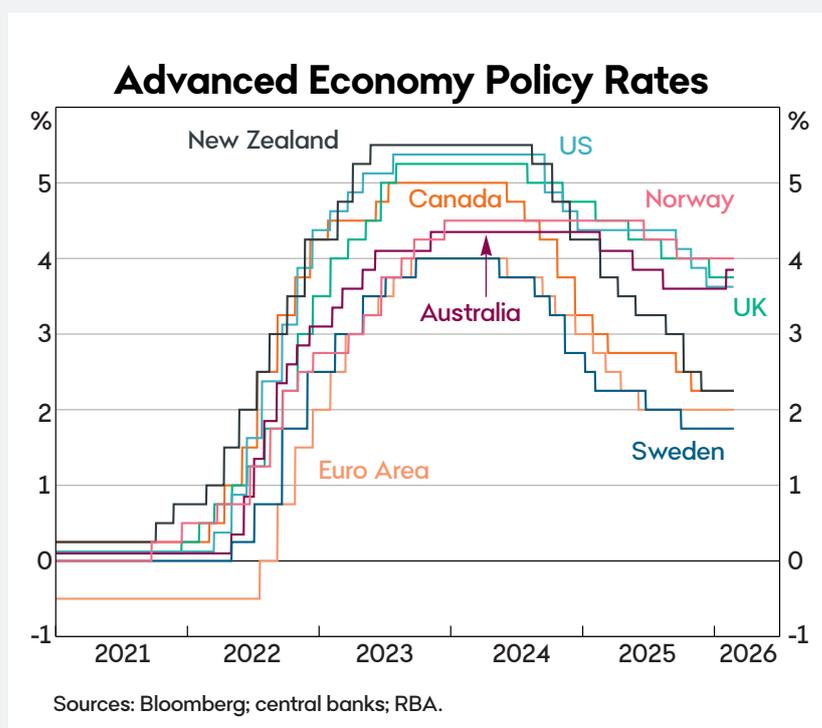


Economic and market update

Economic Overview – as at 20th March 2026

Global markets

The sudden escalation of military strikes in the Middle East and associated jump in energy prices has understandably had a significant impact on risk sentiment, asset valuations and central bank expectations. The reaction in the first few days after the conflict started was fairly muted as markets initially hoped the event could be brief, as was the case in last June's 'Twelve-Day War' US strikes on Iranian nuclear sites. However it soon became clear that this would be more lasting and the effective closure of the Strait of Hormuz saw a sharper rise in the oil price. As a result, stagflation risks have risen for a wide range of economies and many central banks (already nearing the end of easing cycles) are now considering if tighter policy may be needed.



The US Federal Reserve kept rates on hold this week as expected (at a mid-rate of 3.625 %) and left the door open for further cuts should conditions moderate but equally warned that they will need plenty of evidence that inflationary pressures have eased. Annual core PCE measures of inflation are running at 3.1% although the [updated Fed projections](#) see core inflation down to 2.7% by year end and 2.2% in 2027- and J. Powell in his press conference noted the 'standard learning that you look through energy shocks'. The impact of the Middle East conflict will depend on its duration (and how long the Strait of Hormuz remains closed) so the ability of the Fed to look through these inflationary consequences may be limited, however other US data has been on the weak side including jobs, consumer confidence, manufacturing and GDP (in Q4). The US avoided stagflation last year from tariffs, but an energy shock presents a larger test.

The ECB also held rates steady this week but are now considering when rate hikes may be needed, and Europe (along with Japan, Thailand, Korea and India) are most exposed to the oil shock being large net energy importers. The euro-zone economy was experiencing a tentative recovery as fiscal stimulus (especially on defence and infrastructure) lifted forecasts for growth, however the region will be impacted by the new conflict and the latest German ZEW [economic sentiment index](#) plunged from +58 to -1. Similarly, the Bank of England kept rates on hold having last month been widely expected to cut rates this month until this latest energy shock and its inflationary risks. This was the first unanimous BoE vote on rates for 4 years, and while rate cuts are still possible if the crisis passes quickly this outcome appears less likely every day. Yesterday's strikes on Qatar LNG facilities reportedly will impact export capacity for years to come, with around 17% of capacity impacted, so production is another risk to supply.

China appears better positioned than most economies to deal with the war in Iran due to stockpiling and also access to Russian oil, although the southern half of China is more exposed. China is considered a world-leader in green energy with significant progress this decade in wind, nuclear, solar and hydropower, so only roughly 20% of energy consumption comes from crude oil - however petrol and diesel prices have risen sharply for both households and factories. Ahead of the conflict, activity data in China (for January and February) saw their economy start the year on a strong footing, with a rebound in fixed asset investment (up 1.8% y/y vs the recent sharp contraction) and retail sales accelerating to 2.8% growth y/y. This rebound for the consumer compliments the reliable upswing in exports and associated industrial production, however the headwinds from higher energy prices will be a factor along with only modest levels of fiscal support outlined in the recent National People's Congress.

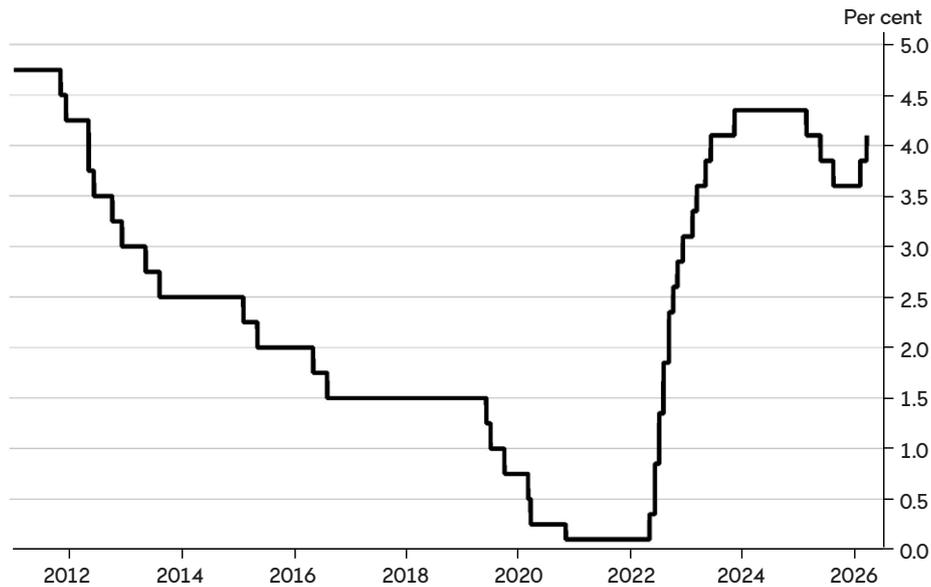
In summary, the Middle East conflict presents considerable uncertainty to the outlook and (while the global economy started 2026 in a resilient, constructive position) the conflict clearly adds to stagflation risks, at least in the short term. At

present markets appear more worried about the inflationary consequences than the risks to growth, but a more prolonged conflict (best measured by how long the Strait of Hormuz remains closed) will challenge economic growth given its implications for monetary policy on top of inflated prices. Global growth had been forecast to achieve 3.3% [this year](#) and similarly next, but an oil price above US\$120 for more than a month may see much deeper downgrades to growth, while a reopening of shipping routes within weeks could only see growth slow to 3.1%. Countries that are net energy exporters will be less exposed initially, but a lasting conflict will challenge all economies. New Zealand is an example of an economy most at risk to stagflation: GDP only rose 0.2% in 2025 but inflation is back above 3%. So while the RBNZ may prefer to keep cutting rates to rescue household consumption and private investment, the energy shock will probably require the exact opposite - and the NZ curve currently shows 2 hikes priced in by year end, and more in '27.

Domestic economy

The remarkable change in policy from an easing cycle last year to tighter monetary policy has been further cemented with the second RBA hike in as many months - six months ago the curve still reflected cuts below 3% but here we are with an official cash rate at 4.1%. The second rate hike was a much closer call with a 5-4 vote, and so our recent forecast of a May hike over March was at least considered - but ultimately the Monetary Policy Board opted for a more aggressive strategy, noting 'risks have tilted further to the upside, including to inflation expectations'. The subsequent press conference was fascinating, where Governor Bullock suggested that while the Middle East conflict added to upside risks to inflation, the rate hike was ostensibly a function of conditions prior to developments in the Middle East and not a direct consequence of them. She also didn't rule out a recession (not that one ever should) saying 'we don't want to have a recession, but if it's hard to get inflation down then you know we're going to have to deal with that possibly'.

RBA official cash rate (per cent)



Source: RBA

The risks of stagflation as outlined in the global markets section above does clearly apply to Australia, however like many regions the market's focus appears more-so on inflation than risks to growth. GDP growth rose to 2.6% in 2025 with Q4 growth of 0.8% and upward revisions to previous quarters, so this pleasing report card for last year including the recent pick-up in business investment does suggest momentum in our economy. However, the two sudden rate hikes and the reality of higher petrol and diesel prices will temper growth in 2026. How sharp the slowdown will be will depend on how much higher the RBA takes the cash rate and how sensitive the economy is to higher rates and prices. The latest curve shows around a 70% probability of another hike in May but more than fully priced by August - and despite having been behind the eight-ball on the two recent hikes I lean to a later hike rather than May. The futures market also points then to another hike in November to 4.6%, but this scenario would probably only occur should the oil shock worsen further and completely unanchor inflation expectations.

Since the RBA rate increase the data has been on the softer side with a sharp fall in consumer

confidence in the wake of the Middle East conflict (the second lowest read in the history of this survey) and an uptick in unemployment. The increase in unemployment to 4.3% was higher than consensus although the February labour report had some mixed signals, including

- Total employment rose by 49 k (s.a.) but this was all part-time (full time fell by 30k!).
- Total hours worked fell 0.2%, but the participation rate rose 0.2 to 66.9%.
- Trend measures actually saw unemployment fall from 4.3 to 4.2%, but from an upwardly revised previous level.

All in all, it's consistent with the RBA's characterisation of labour markets being tight (and below NAIRU 'full employment'), but perhaps not consistent with the comment from Tuesday that 'the labour market has tightened a little recently and capacity pressures are slightly greater than previously assessed'. Amid these somewhat ambiguous and fast-moving conditions the Aussie Dollar has consolidated above US 69.5c, and the basecase forecast below continue to favour the topside.

Interest Rate Outlook

The RBA has doubled down on the new policy cycle with consecutive rate hikes and remain concerned that the rebound in inflation is at risk of becoming more entrenched. The Middle East conflict and associated rises in energy prices adds to these risks. Another hike this year is very likely, with August the preferred estimate. Beyond this we still expect that the nominal neutral cash rate will continue to rise due to a range of factors (especially business investment competing with public spending) which would suggest mildly tighter policy settings into 2027, although tighter policy will constrain household spending in the short term.

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	0.6	0.6	0.6	0.6	0.7
GDP y/y	1.3	1.3	1.9	2.1	2.6	2.6	2.4	2.5	2.3	2.4	2.5
Unemployment	4.0	4.1	4.3	4.4	4.1	4.2	4.4	4.6	4.8	5.0	5.2
CPI (q/q)	0.2	0.9	0.7	1.3	0.6	1.1	1.2	1.0	0.6	0.7	0.7
CPI (y/y)	2.4	2.4	2.1	3.2	3.6	3.7	4.2	3.9	3.9	3.5	3.1
CPI (core y/y)	3.3	2.9	2.7	3.0	3.4	3.4	3.6	3.5	3.3	3.2	3.2
RBA cash rate	4.35	4.10	3.85	3.6	3.6	4.1	4.1	4.35	4.35	4.35	4.35
AUD / USD	.619	.625	.658	.662	.668	.71	.73	.74	.75	.76	.77

Benchmark rates

	31 / 1 / 25	31 / 1 / 2026	28 / 2 / 2026	20 / 3 / 2026
90-day bills	4.25%	3.85%	3.97%	4.29%
3-year swap	3.75%	4.27%	4.31%	4.68%
5-year swap	4.09%	4.60%	4.62%	4.94%
AUD/USD	.6160	.6965	.7055	.7080
ASX 200	8 532	8 869	9 086	8465
Credit Index (iTraxx- 5 yr)	66.9	66.7	66.6	80.2

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