

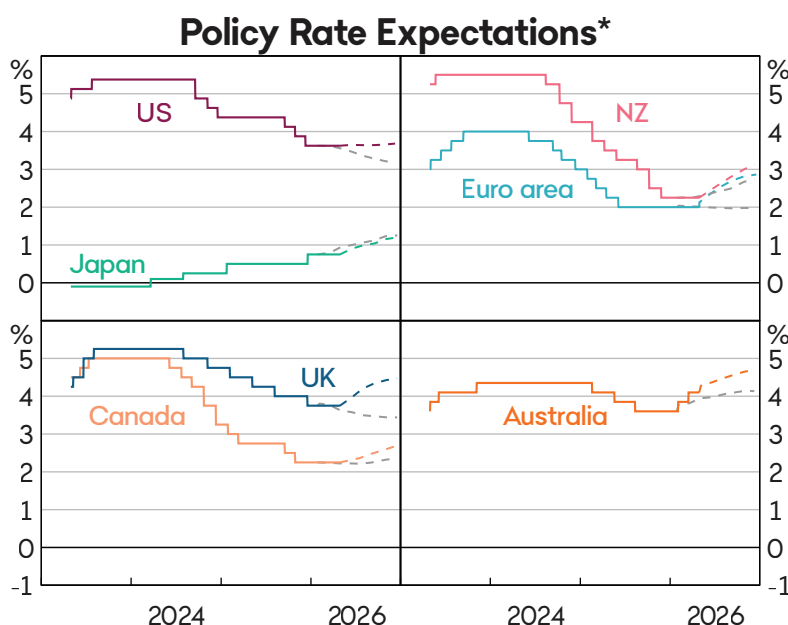
Economic and market update

Economic Overview – as at 22nd May 2026

Global markets

The lack of progress on peace negotiations in the Middle East continues to frustrate markets with bond yields pushing higher and oil prices remaining elevated, although stock markets continue to look through these risks to the medium term AI-supported outlook. Donald Trump's much anticipated summit in China with President Xi failed to deliver a meaningful resolution around the Strait of Hormuz (or anything else beyond cementing the existing trade truce), but more recent news that

the US and Iran were 'in the final stages' of talks, together with reports that three tankers passed through the Strait, buoyed sentiment. As discussed here in the last few months the clearest signal that the energy crisis has passed its peak will be shipping data (as opposed to claims from either side that a peace deal has been agreed), but irrespective most central banks continue to warn of imminent inflationary risks and policy tightening ahead.



* Coloured dashed lines show expectations implied by current overnight index swap rates; grey dashed lines show the same expectations as of 28 January 2026.

Sources: Bloomberg; RBA.

Kevin Warsh takes the reins today of the US Federal Reserve promising to lead a 'reform agenda' but with policy in as challenging an environment as could be imagined. The energy crisis has pushed US inflation up to 3.5% (with core CPI up to 2.8% y/y in April from 2.6% in the previous month) and the yield curve is now implying that the next move in [US rates](#) is more likely to be up than down. The minutes from the late-April FOMC meeting (Jerome Powell's last as Fed chair) were particularly hawkish although a hike seems unlikely unless oil prices move even higher and look likely to do so for longer, while the broader US economy appears resilient with payrolls growth holding up better than expected, although retail sales are a little softer. The productivity uplift from AI adoption on top of technology investment and the 'AI buildout' are offsetting weaker consumption and very low consumer sentiment. Meanwhile US equities go from strength to strength, with the broad S&P500 reaching 7500 for the first time (up 30% y/y).

Conditions in Europe and the UK remain even more challenging with the eurozone Composite PMI falling to a two and a half year low of 47.5 as domestic and export demand wanes and with labour markets declining. Similarly UK PMIs were weaker in May including the Services index down to 47.9, its lowest since early 2021. However in a classic stagflation example, the ECB and Bank of England won't be able to support these economies with rate cuts as inflation in the EU has just risen to 3.0%. Similarly in the UK, while CPI fell from 3.3 to 2.8% in April, this is expected to be a temporary reprieve complicated by government energy price caps.

China's activity data for April was much slower than expected with a deceleration in industrial production to 4.1% y/y and retail sales barely growing at 0.2% y/y (its lowest level since the pandemic), although there were a few one offs contributing to this beyond the global headwinds. Weather related disruptions and a scaling back of some subsidy programs were a factor in these numbers, as administrators (having front-loaded support in Q1) try to achieve a more balanced sustainable pace of growth, but also as weaker property markets weighed on activity. China's economy grew by 1.3% in the March quarter driven by a rebound in [investment](#), and with a lower dependence on gulf oil and LNG, confidence has risen that it can hit its 5% target.

In summary, the Middle East conflict remains the key variable in the short term although Australia's major trading partners have seen some outperformance thanks to AI-related investment, and [inflationary pressures](#) have been more problematic in the US and Europe. Most 'advanced economy' central banks have ended easing cycles and are

considering the need to tighten policy, with the primary outliers being Japan (who continue to edge rates higher at a glacial pace to 1%) and the two early movers/hikers in 2026: Norway and Australia.

Domestic economy

The Federal Budget added another dimension to the already complex domestic outlook, with the details in the budget discussed [here](#). The budget still needs to get through parliament and the fierce debate around implications for SMEs, start-ups and indeed for younger savers may see some amendments and negotiations around the details for CGT and the 30% tax floor. Given the aim of the tax changes is to help aspiring homeowners into the market, there is for example an option to make the CGT discount change only for existing dwellings (in the same way that the negative gearing changes were specifically limited to existing housing, not any other assets e.g. shares).

As for the implications of these policies on house prices, consumer sentiment and business investment, time will tell – but most analysts have reduced their forecasts for dwelling value growth this year and next. Nevertheless, bold structural reform remains an imperative for Australia's economy, to lift flagging productivity – the question is whether it can be achieved without considering changes to GST, and the role that emerging technologies play in lifting productivity and therefore our '[potential output](#)' above the current 2% growth speed limit.

Beyond policy reform some of the key questions for Australia's economy are:

- How large will the hit be to our economy (especially for labour markets and growth) from the oil shock, and the 3 rate hikes delivered thus far?
- How resilient will households and businesses be to this global shock?
- How much further does the RBA need to hike rates to get comfortable with inflation?

Answers to these questions will be heavily dependent on the duration of the Middle East conflict, and there does appear some confidence that this may be resolved over the coming weeks, but the latest consumer sentiment and household spending data appear at odds. Consumer confidence plunged to record lows in the wake of the first 2 RBA hikes and the sudden energy crisis, and has only marginally picked up in the latest [report](#) – but as the latest RBA Statement on Monetary Policy [notes](#), household consumption is yet to slow.

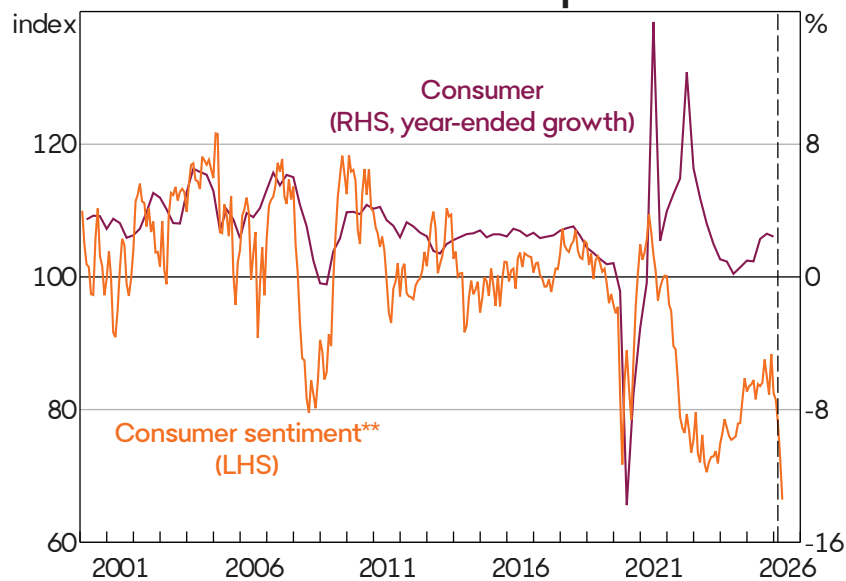
There is a widespread expectation that discretionary spending will sharply slow from current levels, but until it does the RBA will be concerned that higher prices are being tolerated and thus translate to 'unanchored inflation expectations', which will keep the pressure on cash rates. The RBA presented their baseline forecast in the SOMP as well as some adverse scenarios detailed in the appendix dependent on the path ahead for oil, and thus for inflation.

The latest jobs [data](#) was materially weaker than expected (although in line with our forecasts, which have been more pessimistic than consensus) and at face value take the pressure off the RBA hiking rates in June. The basecase forecast below have another hike in November, and beyond developments around inflation (especially via the Middle East conflict) labour markets will be a key determinant for the timing of the next RBA hike, if indeed further policy tightening is required.

Other factors relevant for the official cash rate remain the Aussie Dollar (still trading between 69.8 and 72.8 cents, with risks to the upside – which is helpful for inflation) and housing markets which, as detailed above, now may see less price appreciation, although debate rages around rental prices via the proposed policies.

Beyond the oil shock the question will then be what the 'next cycle' looks like, assuming the dust settles on the Middle East conflict in the coming months. Presumably, the focus will quickly be back on the technology investment boom, although geopolitics will likely have overlap with this theme, along with concerns around government debt and bond markets.

Consumer Sentiment and Household Consumption*



* Dashed line shows the start of the Middle East conflict

** Average since 1996 = 100; mean of Westpac–Malbourne Institute and ANZ–Roy Morgan surveys.

Sources: ABS; ANZ–Roy Morgan; RBA; Westpac–Melbourne Institute.

Interest Rate Outlook

The RBA will very likely pause their tightening cycle in June before considering another hike in August. Our basecase forecast has the next hike in November, but this is at the mercy of oil prices. The path ahead for energy prices and how lasting their impact will be on inflation here remains most uncertain and will be heavily influenced by how soon the Strait of Hormuz reopens. After this a plateau in rates is very likely, in the absence of the RBA overshooting the tightening cycle (a cash rate above 5% would risk a recession, implying a subsequent easing cycle) – however the basecase scenario outlined below remains for a mildly softer landing.

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	0.4	0.2	0.2	0.5	0.8
GDP y/y	1.3	1.3	1.9	2.1	2.6	2.6	2.2	1.9	1.3	1.3	1.7
Unemployment	4.0	4.1	4.3	4.4	4.1	4.3	4.5	4.7	4.9	5.1	5.3
CPI (q/q)	0.2	0.9	0.7	1.3	0.6	1.4	1.5	1.2	0.6	0.5	0.9
CPI (y/y)	2.4	2.4	2.1	3.2	3.6	4.1	4.9	4.8	4.8	3.8	3.2
CPI (core y/y)	3.3	2.9	2.7	3.0	3.4	3.5	3.7	3.7	3.6	3.5	3.2
RBA cash rate	4.35	4.10	3.85	3.60	3.60	4.10	4.10	4.35	4.35	4.60	4.60
AUD / USD	.619	.625	.658	.662	.668	.690	.73	.74	.75	.76	.77

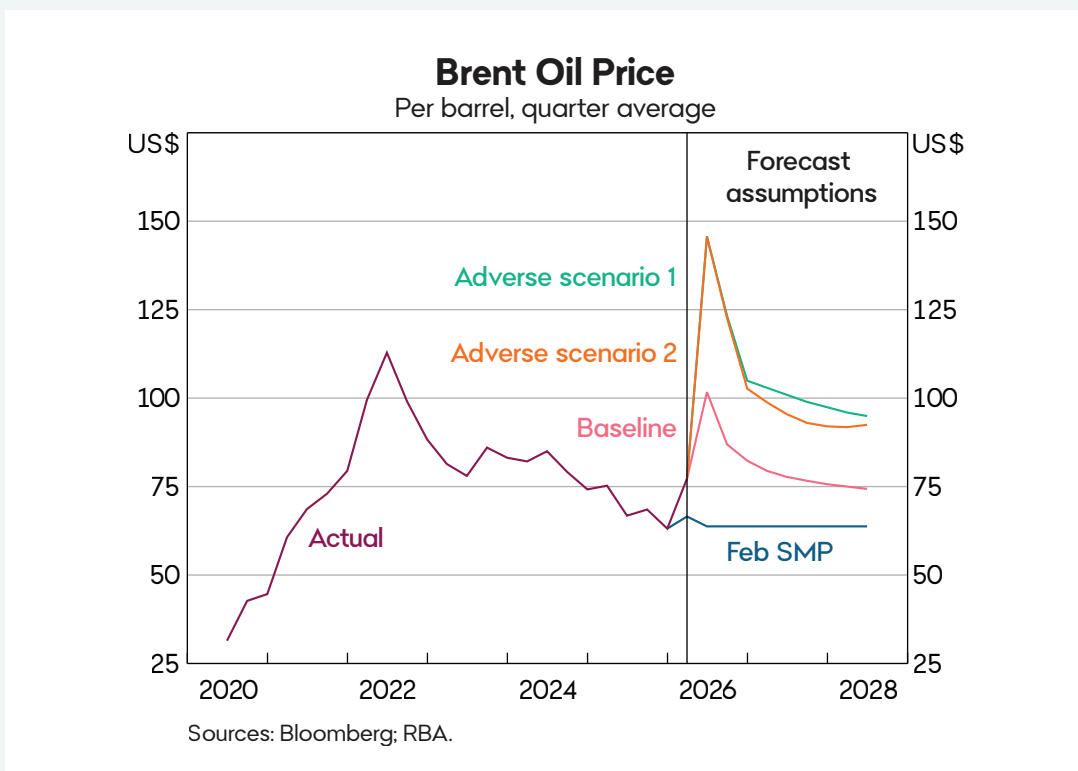
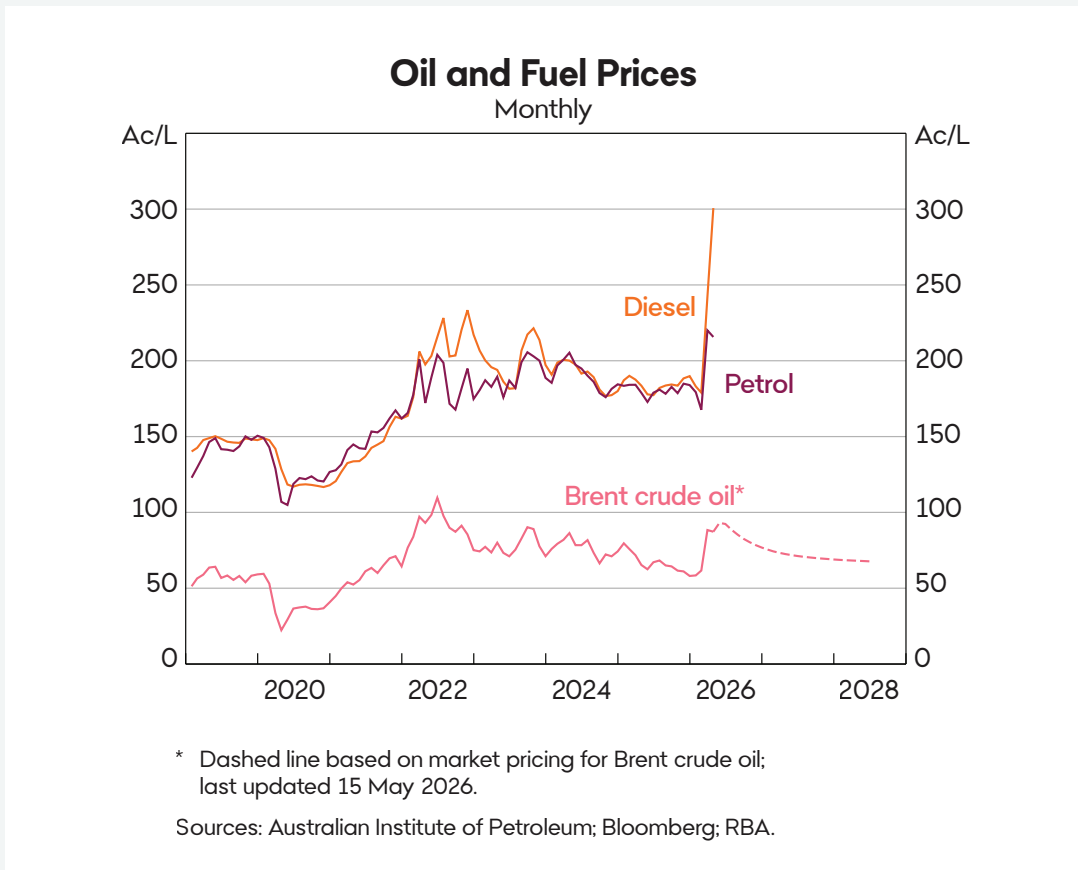
Benchmark rates

	31 / 3 / 25	31 / 3 / 2026	30 / 4 / 2026	22 / 5 / 2026
90-day bills	4.13%	4.31%	4.37%	4.43
3-year swap	3.65%	4.65%	4.76%	4.56
5-year swap	3.99%	4.93%	4.98%	4.81
AUD/USD	.6250	.6900	.7205	.7125
ASX 200	7843	8482	8666	8657
Credit Index (iTraxx- 5 yr)	82.9	91.5	75.5	76.0

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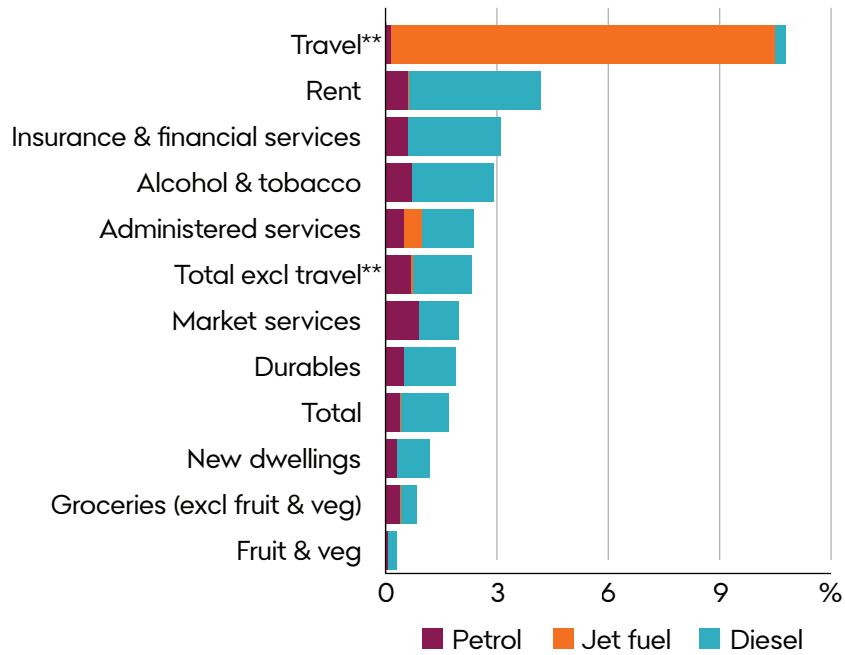
Appendix:

The oil shock and its impact on Australian inflation



Indirect Domestic Fuel Intensity of CPI*

Fuel share of final prices 2023/24



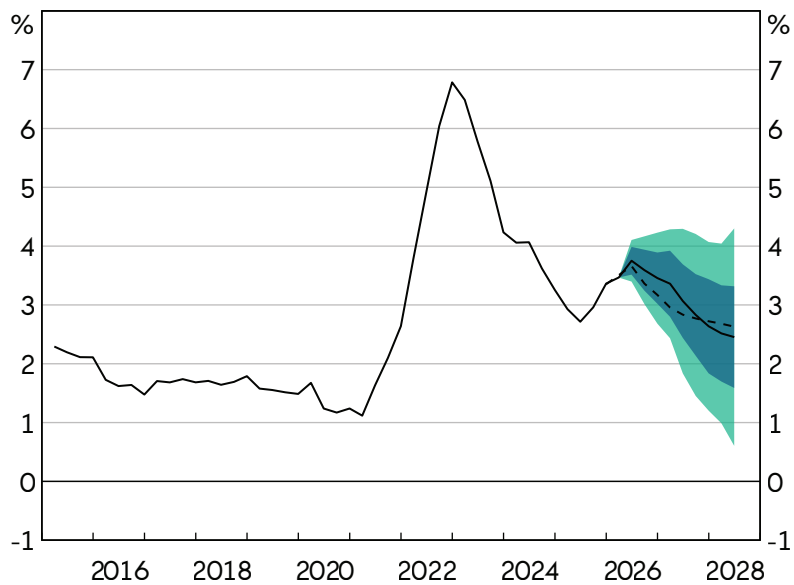
* Share of fuel in domestic production and distribution, calculated from input-output tables; totals exclude fuel used directly by consumers via the automotive fuel expenditure class.

** Travel represents the domestic and international holiday travel and accommodation expenditure classes, which includes fuel usage by airlines but not usage of fuel by consumers for passenger vehicles.

Sources: ABS; RBA.

Trimmed Mean Inflation Forecast*

Year-ended



* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in green.

Sources: ABS; RBA.