October 2025

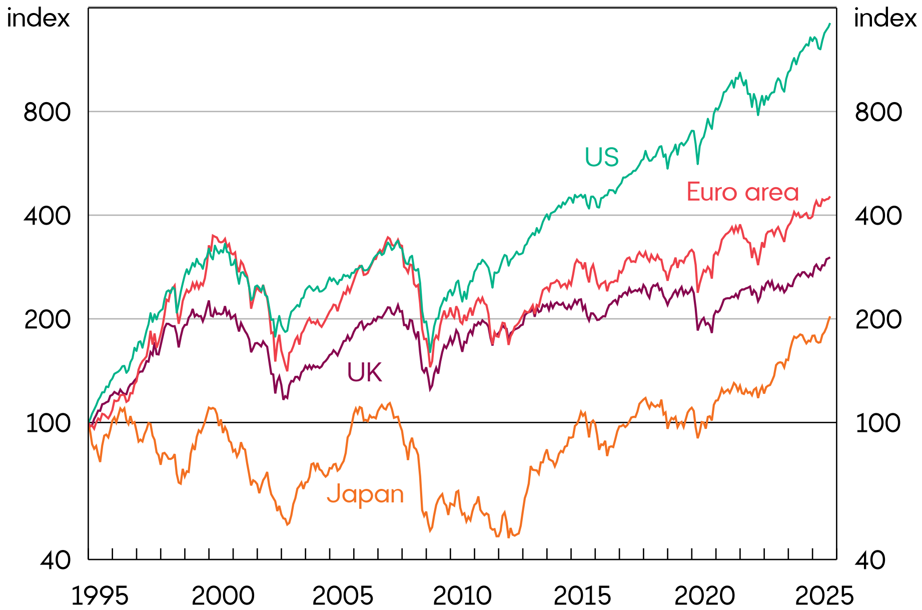
Economic and market update

Economic Overview – as at 23rd October 2025

Global markets

Stock markets in advanced economies are generally at or near record highs, but investors have received a few reminders in the last fortnight that it's never one-way traffic. A sudden deterioration in the US-China trade relationship (more details below), ongoing geopolitical fracturing and some remarkable volatility in the price of gold (down 9% in two days, having just risen 32% in two months) have been some of the key events. Even so, the recent record highs for stocks haven't been limited just to US tech stocks and are being seen in a range of countries (refer chart) which appears to reflect more confidence that extreme trade-related scenarios feared back in April won't eventuate, and that valuations 'priced for perfection' can be justified. Most central banks continue to lower rates as inflation moderates but also in some locations as labour markets indicate need for policy support.

Advanced Economies' Share Price Indices
Log scale, end December 1994 = 100



Source: Bloomberg; RBA.

The escalation in tensions between the US and China due to 'export controls on Chinese rare-earths' prompted a threat from Donald Trump to add 100% to the existing (roughly) 40% tariff rate, but his fairly quick back-down has soothed markets to some extent. The trade truce between the US and China had been a key factor in risk-on sentiment over the last month, but some muscle flexing from both sides ahead of the proposed meeting of Presidents Trump and Xi on the sidelines of the APEC summit in South Korea in a fortnight has complicated the outlook. Overnight reports that the US administration is considering plans to restrict exports of US software to China add further uncertainty, although Trump quipped 'I think we'll end up with a very strong trade deal...both of us will be happy'.

The US government shutdown due to their impasse on funding (in particular around immigration policy) is now more than three weeks old so there has been no official economic data from the various Bureaus, including the latest jobs data. The Bureau of Labor Statistics will be making an exception and publishing the September CPI data tomorrow (required for a range of purposes) so this will be helpful for the FOMC meeting next week when the Federal Reserve are expected to cut the Fed Funds rate by another 25bp to just below 4%. In the absence of official data independent private-sector reports point to mixed conditions for businesses, households and labor markets, but recent Fed comments suggest a cut in October and December (to a mid-rate of 3.625%) is likely. Core inflation in the US is still expected to rise back above 3% as the lagged impact of tariffs permeates the economy. This continues to present risks for US bonds but bond yields are back below 4% as weak economic and jobs growth is in focus together with recent concerns on some loan portfolios (in the auto sector).

Underlying inflation in the euro-zone was steady in September at 2.4% and is expected to ease marginally this month pointing to the ECB on hold next week at 2%. This may prove to be the low-point in European rates, while in the UK core inflation was slightly lower than expected at 3.5%; there are now 18bp of cuts priced in from the BoE by year end (from the current official rate of 4%).

Japan has a new Prime Minister (Sanae Takaichi, their first ever female PM) who faces the challenge of supporting households from cost pressures while committing to her flagged 'responsible proactive fiscal policy'; all coinciding with US tariffs and trade tensions. Takaichi is meeting with Trump next week where defence spending is expected to be topical, but markets have welcomed the new PM with the Nikkei reaching fresh record highs near 50 000 (the 'Liberation Day' low was 30 793!).

China's economic activity data for September showed more signs of slower domestic demand but resilient export markets. Headline GDP growth slowed to 4.8% y/y in Q3 from 5.2% y/y in Q2, and the outcomes for retail sales (slowing to just 3% growth) and Fixed Asset Investment (-0.5% y/y) were disappointing, suggesting that authorities may need to take proactive measures to support consumers. House prices fell last month at their fastest pace in over 12 months, all of which will no doubt have been in focus at the 4th Plenum (feeding into recommendations for the new Five-Year-Plan for 2026-2030). All a fascinating background to recent tensions to US-China trade relations.

In summary, market volatility is likely to remain elevated as policy uncertainty (political and trade) interplays with fast-moving monetary and fiscal policy developments, and also coincides with the sharp rise in investment in AI and other emerging technologies. How quickly these investments drive an uplift in output and productivity has a wide range of views (stock markets are pricing in earlier and lasting pay-offs, probably with good reason), but perceptions of this timeline will no doubt be prone to significant swings. Most central banks are on the path to more neutral official interest rates but some (e.g. Canada and New Zealand) are pressing on to expansionary levels.

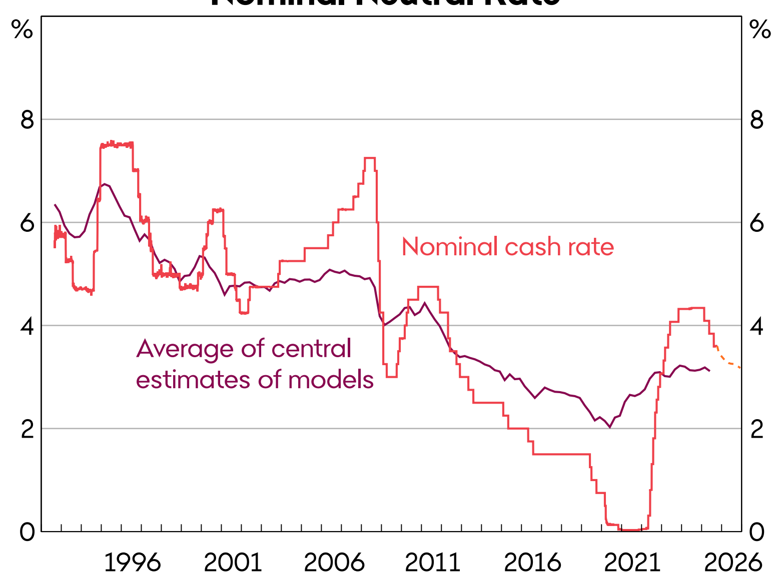
Domestic economy

The RBA 'rates on hold' decision on 30 September was not a surprise to anyone however their apparent removal of an explicit easing bias (or at least omitting clear references to further imminent cuts) did have an impact on market pricing. Back in July the Overnight Index Swap curve implied a move well below 3% for the official cash rate, but (after the latest monthly CPI indicator and the more dovish sounding RBA rhetoric) market pricing was back to just one more cut from here - until a few more curve balls muddied the waters, as detailed below.

The monthly CPI indicator for August rose to 3.0% annual inflation with a few one-off factors (especially electricity rebates) complicating the data, while the RBA's preferred measure of core inflation (the Trimmed Mean) actually fell to 2.6%, so the market reaction was initially subdued. However closer inspection of some key attributes of the rise in prices, especially market services and housing costs revealed a risk that inflation may have already achieved most of its moderation. The observation from the RBA minutes that the monthly data 'pointed to stronger-than-expected outcomes in the September quarter' shows the Monetary Policy Board are concerned that the full Q3 numbers (to be released next week) could print on the high side. As such, while our base-case scenario forecasts below still show a cut on 4 November to 3.35% there is clearly a risk that the CPI data ahead of that decision encourages the RBA to wait until next year before the next cut. Should the Q3 Trimmed Mean only be 0.7% then a 'Cup-Day cut' remains on track, while a 0.8% read will make the decision a much closer call. A quarterly TM of 0.9% or higher probably rules out the cut altogether, so this data to be released on 29 October will be critical. It is noteworthy that the RBA has clearly preferred to rely on the full quarterly CPI data than its younger monthly data sibling, but the October monthly CPI to be released on 26 November will be the first release of the complete Monthly CPI, no longer merely 'an indicator'.

Just when markets and a range of forecasters were giving up on the November cut (unlike your author) the September jobs data released last week suggested the path to a neutral cash rate was still needed with some urgency, as the unemployment rate rose to 4.5%, its highest level since November 2021. In trend terms the jobless rate remained at 4.3% but given the RBA's own forecasts don't predict unemployment rising above 4.3% for another 2 years, this outcome is significant. Our forecasts have been an outlier to the market (and the RBA) looking for unemployment to reach 4.6% by year-end, and this remains one of the reasons we still expect the RBA to take the cash-rate to 'neutral' in November. As for exactly what a neutral rate is, the chart below from the RBA and their recent speech on the topic suggest around 3.25% as the median estimate.

Nominal Neutral Rate*



* Nominal neutral rates are defined using trend inflation expectations. Dashed lines show cash rate expectations implied by OIS as at 13 October 2025.

Sources: LSEG; RBA.

It is worth noting that the Reserve Bank of New Zealand recently cut rates by 50bp to 2.5% which sparked some curiosity as to why the RBA sounded so comfortable with the current policy rate when others (including the US, NZ and Canada) are still cutting rates, however GDP in NZ is currently contracting 1.1% y/y, compared to our 1.8% real growth rate.

Other factors of note for our economy include the ongoing rise in residential property prices (up another 0.8% nationally in September and 2.2% in the quarter), the rise in business confidence and conditions in the latest survey to 'above the long-term average', and also the receding risks of US tariffs adversely impacting our economy. On the trade outlook, the risk of US-China trade relations deteriorating further (as detailed in the global markets section above) has resurfaced, however the meeting this week between PM Albanese and President Trump with a US$8.5 bn 'rare earths deal' was perfect timing with the latest focus on Chinese production of critical minerals. The reassurance of commitment to the AUKUS pact was also of significance, adding to the pipeline of investment projects via the public and private sectors, across defence, infrastructure and construction, energy transition and AI. Indeed this list is a key component to the medium-term forecasts below for the cash-rate to 'only' fall to neutral, and not to join NZ in going to expansionary territory - and potentially for a tightening cycle in FY27, especially as the nominal neutral cash rate may rise materially by then. The main scenarios for deeper cuts below 3% in contrast to this view lie in the potential for:

- Labour markets to weaken faster than consensus (our forecasts have been the most pessimistic amongst economists on this front, but even they don't see unemployment above 2019 levels for some years);
- A worsening in global conditions (probably driven by US tariffs) - which markets continue to discount;
- Even slower progress with respect to Australia's productivity growth - refer appendix- which continues to risk a rebound for inflation and stagnant 'standards of living'- but which will presumably be solved to an extent by AI and other technological advances, even if Canberra fails to shift the dial on productivity.

On this last point, a recent RBA speech on this topic explored the link between productivity and interest rates, where Sarah Hunter noted that productivity determines the economy's 'sustainable speed limit', and that recent lack of productivity growth risks the economy hitting capacity constraints and makes it harder for the RBA to keep inflation under control. As such, the path ahead for official rates will depend on remedying this roadblock, and the role that AI plays in helping Australian firms to adopt new technologies and to better equip their workforces will surely be crucial. Its implications more broadly for the structure of the workforce is even more challenging to anticipate, as are the implications for the economy's potential output and growth profile ahead.

Interest Rate Outlook

The RBA (three cuts into their easing cycle) remain on the path back to a more neutral Official Cash Rate, still expected to continue via quarterly 25 bp cuts. While there is some uncertainty as to the precise level of 'neutral', another cut to 3.35% (expected in November) would be very close to this level, while the case for deeper cuts has receded further suggesting a shallow trough for rates next year around 3.1 to 3.35%. After this a tightening cycle in FY27 is likely as growth accelerates.

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	0.6	0.3	0.6	0.5	0.6	0.5	0.7	0.6	0.6	0.7
GDP y/y	0.8	1.3	1.4	1.8	2.0	2.0	2.2	2.3	2.4	2.4	2.6
Unemployment	4.1	4.0	4.1	4.3	4.4	4.6	4.8	4.9	5.0	5.1	5.2
CPI (q/q)	0.2	0.2	0.9	0.7	0.9	0.5	0.6	0.7	0.9	0.7	0.7
CPI (y/y)	2.8	2.4	2.4	2.1	2.7	3.0	3.0	2.7	2.7	2.9	3.0
CPI (core y/y)	3.6	3.3	2.9	2.7	2.7	2.8	2.8	2.7	2.8	2.9	3.0
RBA cash rate	4.35	4.35	4.10	3.85	3.6	3.35	3.35	3.35	3.35	3.35	3.6
AUD / USD	.691	.619	.625	.658	.662	.68	.70	.72	.74	.76	.75

Benchmark rates

	30 / 8 / 24	31 / 8 / 2025	30 / 9 / 2025	23 / 10 / 2025
90-day bills	4.39%	3.57%	3.59%	3.50%
3-year swap	3.60%	3.31%	3.51%	3.35%
5-year swap	3.80%	3.70%	3.88%	3.73%
AUD/USD	.6770	.6540	.6615	.6485
ASX 200	8 092	8 973	8 849	9 035
Credit Index (iTraxx- 5 yr)	61.4	66.8	65.8	71.5

Appendix: Productivity

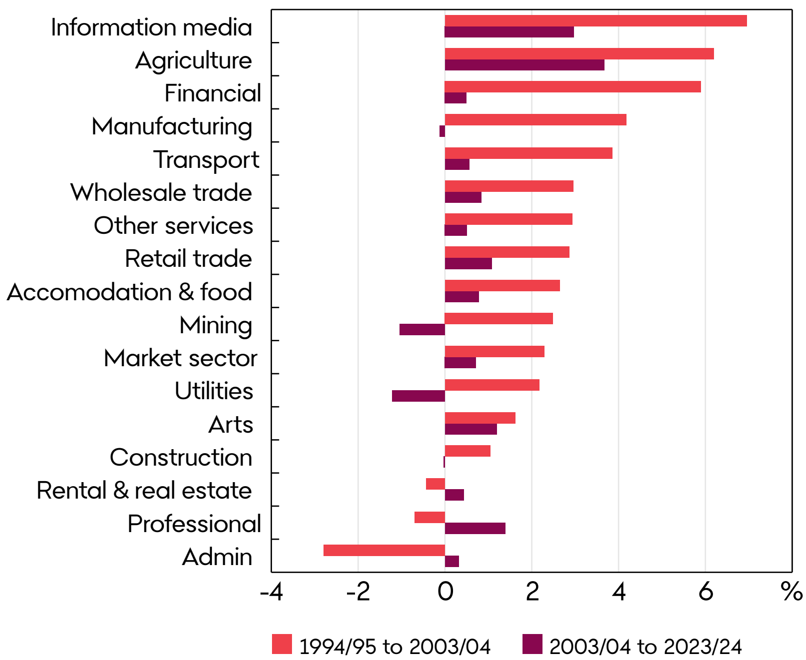
Productivity and Income

March quarter 2012 = 100

* Non-farm GDP per hour worked.
** Real GDP per hour adjusted for the purchasing power effects of changes to the terms of trade, depreciation of the captial stock and net icome transfers to the rest of the world.

Sources: ABS; RBA.

Average Labour Productivity Growth



Source: ABS; RBA.

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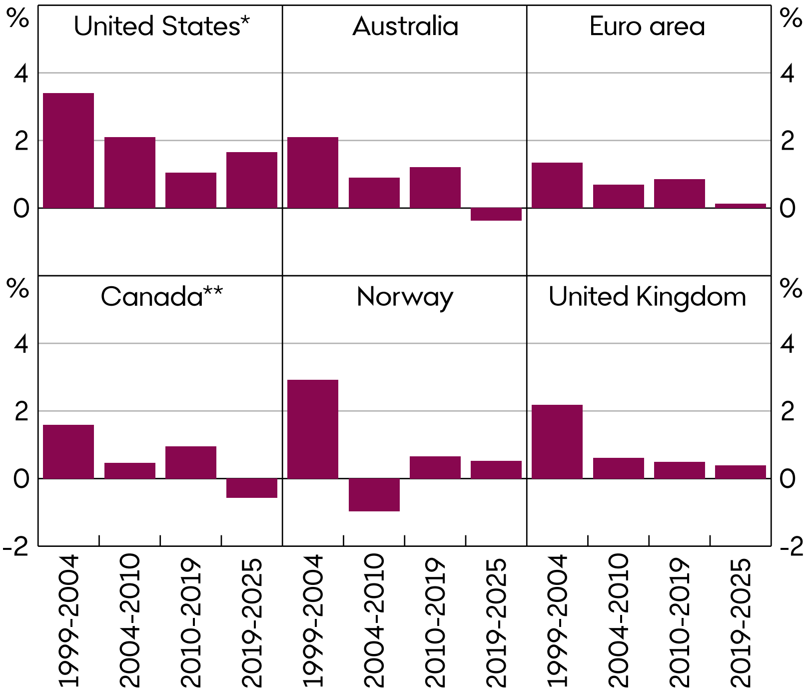

* Non-farm business sector
** Business sector

Source: ABS; LSEG; RBA.