

Economic and market update

Economic Overview – as at 24th September 2026

Global markets

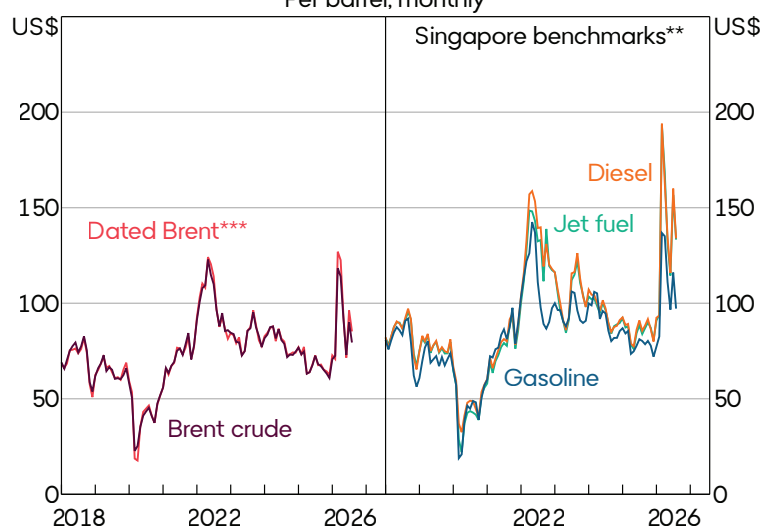
The rollercoaster ride of global market sentiment has continued as the lack of any meaningful diplomatic progress kept the oil price above US\$100 per barrel pushing bond yields up to multi-decade highs. A record high was seen for the price of US diesel last week. Equity markets reflected this pessimism with the Dow Jones Industrial Average recording its worst week since March. However this week has seen some signs of diplomacy with Iran's President Pezeshkian in the US and the two sides at least talking, so oil briefly dropped back below

\$100 and the Nasdaq Index actually rose to a fresh record high! The battle between confidence in AI investment versus the toll of higher energy prices continues, complicated by more central bank rate hikes.

The US 10-year bond yield has been a good barometer of this lack of progress in the Middle East conflict overlayed with relentless demand for capital as the private sector competes with public spending on defence, energy and infrastructure.

Oil and Refined Product Prices*

Per barrel, monthly



* The August 2026 observation for all series is as at 5 August.

** Front-month forward prices.

*** Dated Brent is the physical spot price for Brent crude.

Sources: Bloomberg; RBA.

The 10-year yield traded above 5.10% last night, its highest level since 2007 partly due to these factors, but also as the US Federal Reserve embarked on a new tightening cycle (taking the Fed Funds rate up to 3.875%). This rate hike was most obviously driven by higher inflation amid higher energy prices, but the latest [PMI](#) surveys of business activity saw much stronger demand and further risks to inflation, suggesting that last week's Fed hike will be followed by another in late October (unhelpfully for the US administration just before the mid-term elections!). There were reports overnight that the White House is considering a ban on diesel exports for three months, complicating trade conflicts including those between the US and Canada. However more positively Chinese President Xi is also in the US this week, so there are hopes that this summit with Trump will show progress around trade, AI cooperation and investment: hope springs eternal.

The PMI surveys for Europe were almost as strong as those in the US with manufacturing up to 52.7 (where 50 is neutral) and services up to 53.0, both suggesting that the euro-zone economy (while uneven and struggling with high oil prices) is showing resilience. However this does come with the implication that inflationary pressures intensified in September. As a result the ECB are expected to hike rates again to 2.75% in December, having unanimously voted to increase the official deposit rate to 2.5% earlier this month adding to the first hike in this cycle back in June. This is in clear contrast to the UK where PMI readings were lower, and similarly a different path for the Bank of England who voted 6/3 to keep the [Bank Rate](#) at 3.75%: but a November hike appears inevitable in the UK as mildly restrictive rates there are yet to temper inflation.

The Chinese economy continued its disappointing run of domestic data as consumption remains very weak (with retail sales growth slowing from 0.6% y/y in July to 0.4% in August) but still offsetting support from exports and associated industrial output. This theme of external demand – especially via high-tech manufacturing compensating for feeble domestic demand – is not a new one but like much of the Asian region the extent of tech investment continues to greatly exceed predictions. China has also coped better than expected with the high price of oil given how long the conflict has dragged on for, but from here further policy easing is expected.

In summary, as the latest [OECD](#) report notes, the global economy continues to weather successive storms admirably and is still expected to achieve around 3% growth this year, despite the Middle East conflict approaching its eighth month, and despite resulting inflation expected to remain higher for longer. Rising bond yields reflect strong demand for capital as well as concerns around fiscal sustainability, and there are ongoing concerns around the payoff of AI investment, but amid this uncertainty the extent of technology investment should bode well for productivity in the medium term, albeit with potentially extreme levels of disruption.

Domestic economy

The RBA monetary policy board have received a number of pieces of evidence recently that make a hike next week highly likely – many of these are consistent with the global themes discussed above, including energy prices and higher bond yields, but the most compelling evidence came with the July CPI report. This monthly series is still relatively new (refer chart below) but it is becoming more reliable, and based on recent trends appears to be well correlated to the traditional quarterly series, and indeed a leading indicator for the Q3 inflation report out on 28 October.

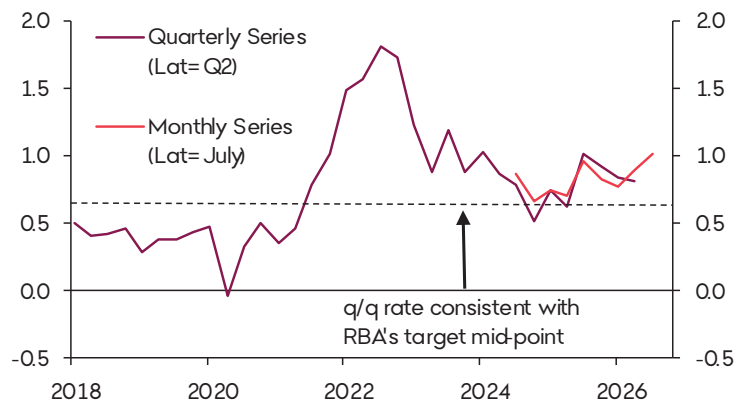
The most worrying aspects of the July CPI numbers included:

- Core inflation (the Trimmed Mean) rising to 3.62% y/y.
- For the month of July alone the TM rose by 0.49%, more than double the pace needed to achieve 2.5% core inflation.
- This unexpected jump was prior to the recent jump in oil/petrol prices, and prior to the full impact of new minimum wage/award wage increases delivered by the Fair Work Commission.

Subsequent interviews and speeches from the RBA have consistently highlighted this jump in underlying inflation as the most pressing challenge (ahead of labour markets and house prices), so to paraphrase Michele Bullock: the RBA have been warning of upside risks to inflation, and these have now materialised.

Trimmed Mean CPI

(Seas. Adj., % q/q)



Sources: ABS, LSEG, Capital Economics.

Our basecase scenario has, since May, predicted the most likely outcome for monetary policy to be a longer, more drawn out tightening cycle with little prospect of rate cuts in 2027. The market has now warmed to this scenario although admittedly we now expect (as does the market) that the next hike will be in September rather than November – but the majority of forecasters still predict cuts in the second half of 2027. For this to occur (as argued here for some months) we will either need a miraculous and speedy soft landing, or a relatively quick hard landing bordering on a recession that rids the economy of inflation and allows for cuts to soften the blow. Either way we would need core inflation to be close to 2.5%, which is a tall ask.

Another key factor for interest rates is jobs, and today's [August report](#) did see unemployment rise to 4.6% (matching our basecase expectations throughout the year) – the highest rate since 2021. This might suggest that the labour market is cooling at a faster pace than the RBA had expected, however the data was complicated by some changes in the survey methodology and also a sharp rise in the participation rate (a growing pool of people seeking work). Presumably, the RBA will still be of the view that we are slightly below the NAIRU 'full employment' rate that links back to inflationary risks, and they will have noted the underemployment rate fell to 6.2%.

Another consideration for policy rates is the ongoing disconnect between sentiment and activity – for households we still see rising (and actually accelerating) [discretionary](#) household spending at the same time that consumer confidence is well below neutral. This anomaly can be explained to some degree by resilient labour markets, but also is further evidence that a [neutral](#) RBA cash rate today is significantly higher than a year ago. Similarly, business confidence remains weak (in negative territory for the 6th consecutive month – the longest stretch since the GFC) but business investment and Capex intentions are very strong.

The other consideration for the RBA is the Australian Dollar, especially after the recent US Fed hike – the Aussie is still above 70 cents but this is a transmission mechanism that is part of their decision making. The basecase scenario below continues to lean to a weaker USD and stronger A\$, and while the trade-weighted index is very steady around 66, a firmer Aussie Dollar will help at the margin especially given the recent surge in imports, mainly linked to tech investment.

Interest Rate Outlook

The RBA will maintain a tightening bias for the rest of 2026 and probably for all of 2027, but the urgency of taking rates further into restrictive territory has risen in the wake of recent inflation data and as the oil price has again risen above US\$100 per barrel. As a result the pause in RBA rate hikes through winter appears to be behind us and a further tightening in policy is now most likely in September (bringing forward the hike previously forecast in our basecase scenario in November), as well as a further increase next year (potentially in February).

Economic Forecasts: basecase scenario

	2025			2026				2027			
% (actual, forecast)	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
GDP q/q	0.8	0.5	0.9	0.3	0.4	0.3	0.2	0.4	0.7	0.5	0.7
GDP y/y	1.9	2.1	2.6	2.5	2.1	1.9	1.2	1.3	1.6	1.8	2.3
Unemployment	4.3	4.4	4.1	4.3	4.4	4.6	4.8	5.0	5.2	5.3	5.4
CPI (q/q)	0.7	1.3	0.6	1.4	0.6	1.0	0.6	0.5	0.7	1.0	0.7
CPI (y/y)	2.1	3.2	3.6	4.1	3.9	3.6	3.6	2.7	2.8	2.8	2.9
CPI (core y/y)	2.7	3.0	3.4	3.5	3.6	3.7	3.3	3.2	3.0	3.0	3.0
RBA cash rate	3.85	3.60	3.60	4.10	4.35	4.60	4.60	4.85	4.85	4.85	4.85
AUD / USD	.658	.662	.668	.690	.692	.71	.73	.75	.77	.78	.79

Benchmark rates

	31/7/25	31/7/2026	31/8/2026	24/9/2026
90-day bills	3.68%	4.55%	4.50%	4.74%
3-year swap	3.34%	4.46%	4.64%	5.07%
5-year swap	3.69%	4.81%	4.93%	5.34%
AUD/USD	.6430	.7020	.7165	.7030
ASX 200	8 743	8 977	9 076	8 699
Credit Index (iTraxx- 5 yr)	68.7	70.8	68.3	69.6

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