

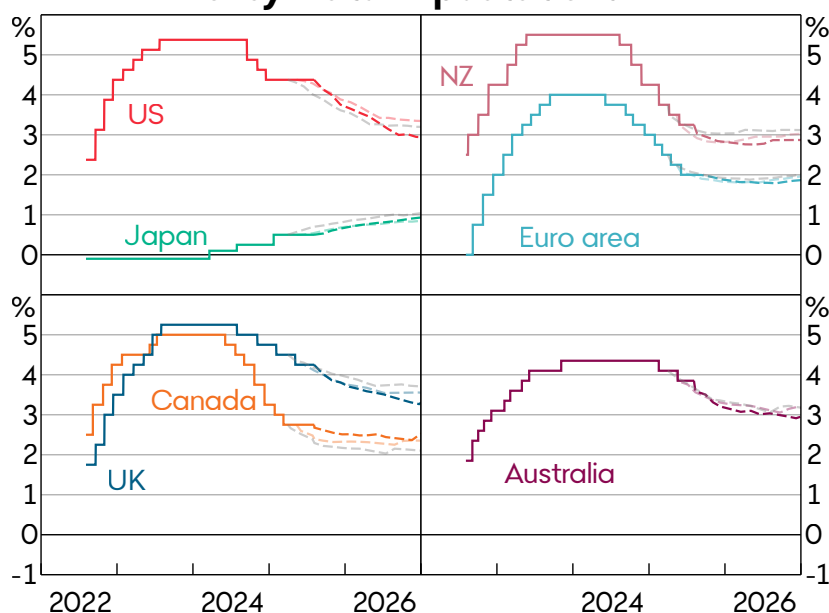
Economic and market update

Economic Overview – as at 21st August 2025

Global markets

Markets continue to grapple with the highly uncertain impending impact of US tariffs on individual economies, and also with constantly changing policy decisions (especially the size of tariffs by country and by sector). Overall sentiment appears a little brighter than a month ago and is certainly a lot more settled than four months ago when the US and China briefly had tariffs above 120% on each other; and the fact that easing cycles are continuing in most countries is helping equity markets along with lower bond yields and AI. In short, slower global growth is expected amid the trade tensions but a more severe global shock appears less likely and, thus far, trade markets have adjusted (avoiding supply chain issues, with evidence that trade is being diverted away from higher tariff routes).

Policy Rate Expectations*



* Darker dashed lines show expectations implied by current overnight index swap rates; lighter dashed lines show the same expectations as of 14 May 2025; grey dashed lines show expectations as of 2 April 2025.

Sources: Bloomberg; RBA.

The most notable change to expectations around central banks (refer chart above) has been seen in the US, where expectations that the Federal Reserve would be on hold for longer as tariffs added to US inflation were hit by the latest jobs data, where non-farm payrolls stalled in July and the previous two months were dramatically downgraded. This encouraged the market to fully price a September cut of at least 25bp, and a strong chance of another in December, also helped by the appointment of Stephen Miran (Trump's chief economist) to the Fed, replacing the retiring Adriana Kugler - but a September cut does appear at odds with the latest US inflation data. Core CPI in July rose 0.3% and core PPI was up 0.6% month-on-month, while Fed minutes overnight revealed the majority of voting members were more wary of upside risks to inflation than a weakening labour market - but the curve still shows two cuts almost fully priced by year-end. That market assessment will no doubt be heavily influenced by tomorrow's speech by Fed chair Powell at the annual Jackson Hole conference.

The European Central Bank may only have one more rate cut in this easing cycle (the deposit rate last lowered in June down to 2% from its peak at 4% last year) despite sluggish eurozone GDP growth of 0.1% in Q2, as conditions show resilience in the face of tariff uncertainty. Fiscal stimulus (especially from Germany) will remain a factor and the latest consumption data is encouraging. Annual inflation in the euro area was stable at 2.0% in July (and even lower in France at 0.9% and in Ireland at 1.6%), however the UK faces a very different environment, with CPI rising to its highest level in 18 months at 3.8%. The Bank of England cut rates earlier in August to 4.0% with a narrow 5-4 vote but UK GDP did grow by another 0.3% in Q2 on top of 0.7% in Q1, so lower rates may not be needed.

Japan remains in an entirely different cycle but are still facing challenges around the impact of tariffs as the BoJ try to lift their official rate above 0.5% (for the first time since the 90s). Japan's economy grew faster than expected in Q2 at 1.0% annualised, however auto exports are at risk and total exports fell 2.6% y/y in July. The BoJ are expected to keep rates on hold again on 19 September, but the majority of economists favour a hike later this year, possibly in October.

China's economic activity data for July was slightly weaker than hoped with soft consumer demand (retail sales growth slowed to 3.7% y/y and the property downturn deepened further) while industrial production decelerated to 5.7% growth.

Nevertheless, confidence that China will achieve its growth target around 5% is supported by exports growing at over 7% y/y despite much less exporting to the US, and the RBA voiced their optimism on China's short-term outlook in the Statement on Monetary Policy (key judgement [3.1 #1](#)). Additional policy support is expected, subject to trade developments.

The Reserve Bank of New Zealand cut rates by 25bp to 3.0%, and 2 voting members supported a 50bp cut as forecasts for NZ GDP growth were downgraded and unemployment (already at 5.2%) was forecast to rise further. From here two more 25bp cuts are likely, with non-tradables inflation expected to remain benign. The weaker NZD has weighed to a degree on the AUD/USD.

In summary, global growth is still expected to be sub-par this year and modest next, although a more severe trade-war shock scenario is not being priced into markets - helped by another 90-day extension of the tariff truce between the US and China. Equity markets continue to trade near record highs as AI benefits are being assigned a higher weighting than trade and geopolitical risks. The independence of the US Federal Reserve and its implications for bond markets remains a 'known unknown' ahead.

Domestic economy

Unlike the surprise 'on hold' RBA policy decision in July, the latest RBA cut in August was completely unsurprising (albeit ignoring any suggestion of a larger cut, even 35bp). The language from Governor Bullock was as expected: patient, cautious and measured amid uncertainty, with an unwavering commitment to keep inflation in check. The [forecasts](#) in the accompanying Statement on Monetary Policy (SOMP) included only mild tweaks to the previous edition back in May, including:

- Underlying inflation (measured by the Trimmed Mean) falling to 2.5% by the end of 2027
- Downgrades to productivity growth (from around 1% to only 0.7%)
- Slightly lower GDP growth ahead (mainly due to lower productivity) at 2.0% for FY26 and 27

The expectation of slower growth in productivity is understandable given the regular [misses](#) in their forecasts since 2016, and was timely given the Economic Reform/Productivity Roundtable in Canberra this week. The SOMP noted that some of the factors driving low productivity have also been seen overseas: declining competition

meaning less pressure to innovate and adopt new technologies, and regulatory barriers (including in the construction industry) - but also local factors such as our larger share in the services sector where productivity growth is more difficult to achieve. The RBA suggested that they don't see inflationary pressures arising from this underperformance vs other countries (as they expect lower productivity to have a commensurate drag on demand as it will on inhibiting supply). However, they reminded us that improved standards of living and higher real wages growth is very closely correlated to productivity growth (refer appendix) - so should be a universal common goal to all political parties and to both business groups and unions.

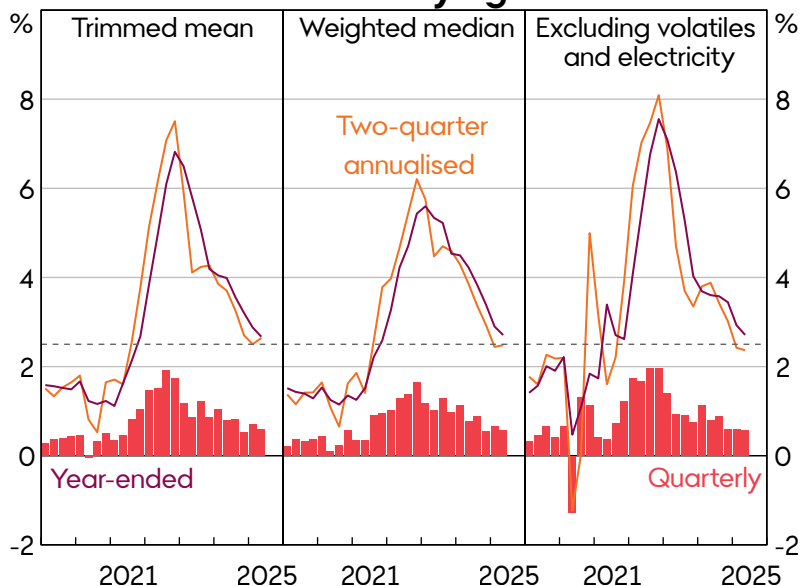
The actual success rate of the Economic Roundtables will be interesting to observe and will be vital for our sustainable development and international competitiveness, but meaningful tax reform is likely to only be seen in the medium term (presumably after the next Federal election), so short-term improvements in productivity will need to be driven by reducing bureaucracy and technology adoption. Much of this will probably come from AI irrespective of government policy, but there is a strong argument that governments will play a vital role in alignment of AI development to societal outcomes.

Recent data continues to show that underlying inflation is back at target (refer chart below) and the RBA is cautiously optimistic that it will remain so, as their forecasts indicate. The judgement from the SOMP that 'global trade developments will be mildly

disinflationary for Australia' is something we have argued here for the last few months and was one reason to support an earlier rate cut than August, but equally the lower risk of a global trade-war shock justifies their patient approach. The RBA are confident that labour markets (which they assess as displaying 'some' tightness) will remain relatively tight but sound a little more guarded about their confidence that inflation will remain benign.

Given the unemployment rate stabilised at 4.2% in July, after the jump in June and with forward looking indicators also looking steady, the RBA expect little movement in the jobless rate for the next two years, which is understandable in the short term but potentially ambitious for next year. Our basecase forecasts below continue to argue for an easing in tight labour markets supported anecdotally in both the public and private sector, and as seen in comparable economies around the world. Nevertheless what we have today is a perfect outcome from an RBA dual mandate perspective: full employment with all of the gains in jobs since the pandemic preserved, and core inflation exactly on target. The 'narrow path' referred to back in 2023 as the RBA tightened policy has ostensibly been navigated, and (especially if their forecasts for CPI and jobs prove correct) it is difficult to think of a better textbook example of monetary policy successfully dealing with an inflation shock. However productivity and housing affordability are separate challenges, in the hands of government policy rather than the RBA.

Measures of Underlying Inflation*



* Dashed line indicates midpoint of the inflation target.
Sources: ABS; RBA.

Interest Rate Outlook

The RBA (three cuts into their easing cycle) remain on the path back to a more neutral Official Cash Rate likely to continue via quarterly 25 bp cuts. While there is some uncertainty as to the precise level of 'neutral', two more cuts down to 3.1% remains our unchanged basecase scenario detailed below. The path beyond neutral is much more challenging to anticipate, with deeper cuts possible if trade tensions reemerge and conversely less cuts if labour markets tighten further, but the consensus view of a trough in the OCR next year appears most sensible. After this a tightening cycle in FY27 is likely.

Economic Forecasts: basecase scenario

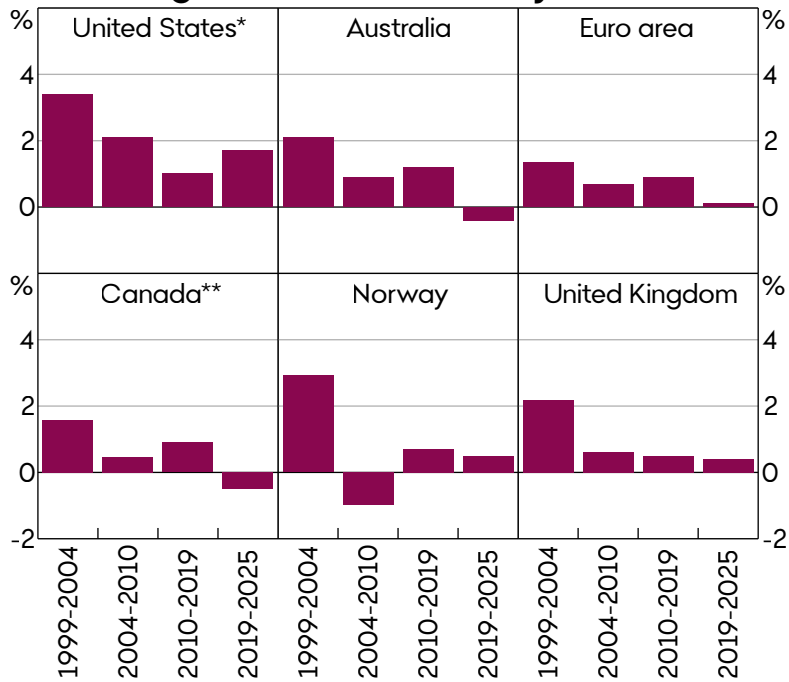
	2024			2025				2026			2027	
% (actual, forecast)	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q2
GDP q/q	0.2	0.3	0.6	0.2	0.5	0.5	0.5	0.5	0.7	0.6	0.6	0.9
GDP y/y	0.9	0.8	1.3	1.3	1.6	1.8	1.7	2.0	2.2	2.3	2.4	2.8
Unemployment	4.1	4.1	4.0	4.1	4.3	4.4	4.6	4.8	4.9	5.0	5.1	5.2
CPI (q/q)	1.0	0.2	0.2	0.9	0.7	0.9	0.5	0.6	0.7	0.9	0.7	0.7
CPI (y/y)	3.8	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)	4.0	3.6	3.3	2.9	2.7	2.6	2.7	2.7	2.7	2.8	2.9	3.0
RBA cash rate	4.35	4.35	4.35	4.10	3.85	3.6	3.35	3.1	3.1	3.1	3.1	3.6
AUD / USD	.667	.691	.619	.625	.658	.66	.68	.70	.725	.75	.76	.75

Benchmark rates

	30 / 6 / 24	30 / 6 / 2025	31 / 7 / 2025	21 / 8 / 2025
90-day bills	4.45%	3.60%	3.68%	3.57%
3-year swap	4.22%	3.21%	3.34%	3.30%
5-year swap	4.34%	3.60%	3.77%	3.70%
AUD/USD	.6680	.6580	.6495	.6425
ASX 200	7 768	8 542	8 639	9 019
Credit Index (iTraxx- 5 yr)	70.9	73.7	71.3	66.8

Appendix: Productivity

Average Labour Productivity Growth



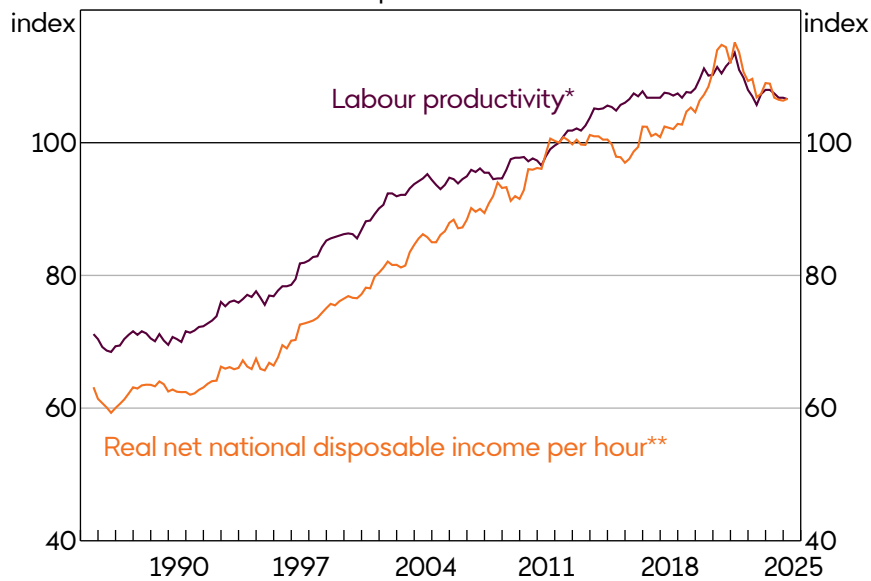
* Non-farm business sector.

** Business sector.

Sources: ABS; LSEG; RBA.

Productivity and Income

March quarter 2012 = 100



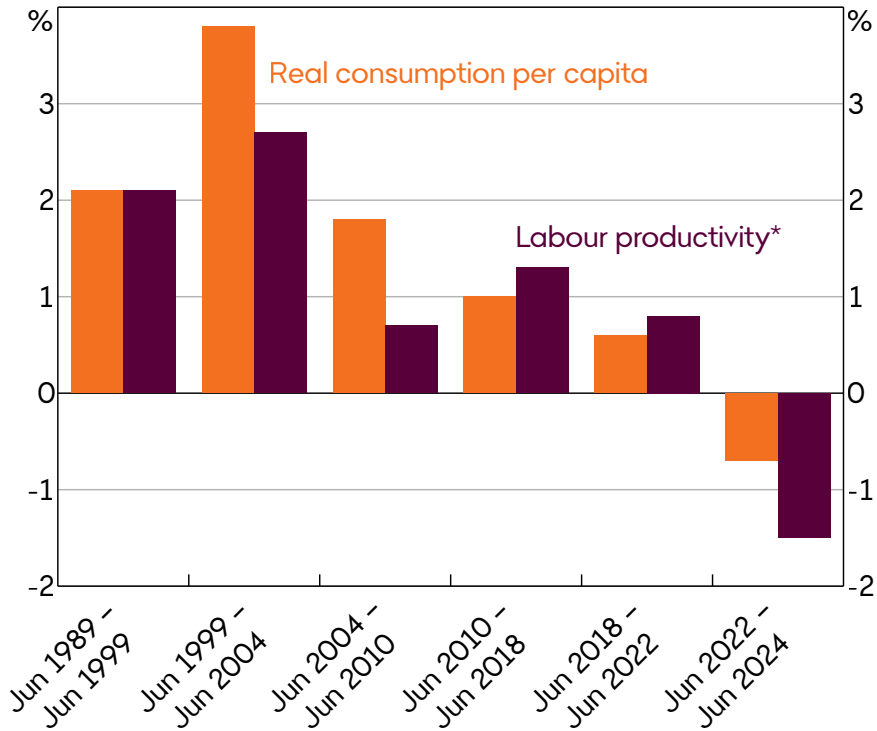
* Non-farm GDP per hour worked.

** Real GDP per hour adjusted for the purchasing power effects of changes to the terms of trade, depreciation of the capital stock and net income transfers to the rest of the world.

Sources: ABS; RBA.

Productivity and Consumption Growth

Average annual growth rates over productivity cycles



* Non-farm GDP per hour worked.

Sources: ABS; RBA.

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