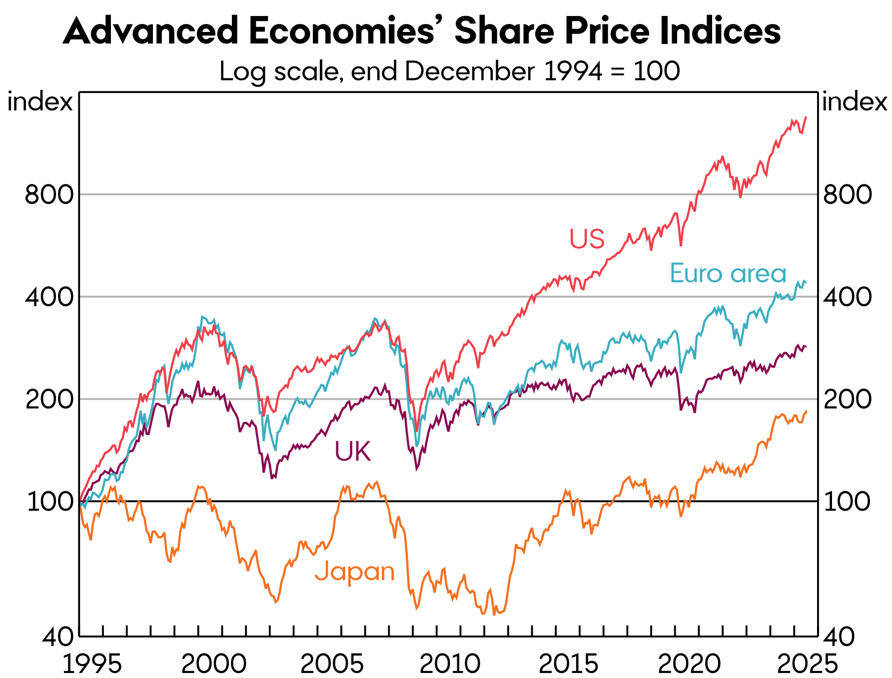
July
2025

Economic and market update

Economic Overview – as at 17th July 2025

Global markets

Just over three months on from the initial Liberation Day tariffs the levels of economic policy and geopolitical uncertainty are as elevated as ever, however stock markets have recaptured the initial sizeable losses from April and are mostly back at fresh record highs. The sources of optimism remain primarily driven by technology (most notably AI - evidenced by Nvidia becoming the first ever company with market capitalisation of US$4 Tn) and little evidence yet of tariffs lifting inflation, together with relentless fiscal support. How these factors will offset the challenges of the trade war that is reshaping the global landscape, and how ongoing negotiations and 'deals' between the US and its trade partners will evolve, are two crucial questions that will likely keep market volatility elevated for some time.



Sources: Bloomberg; RBA.

The size of US tariffs by country and by sector is very difficult to keep up to date (especially the status of negotiations), however various publicly available trackers are helpful in monitoring developments. The latest news has generally surprised on the high side in terms of the quantum of the tariffs (25% for Japan and South Korea, and 30% for Mexico and the EU) although some of these appear to be interim, but there is risk that the minimum 10% baseline (that currently applies to Australia) might be heading to 15 or 20%. This uncertainty continues to weigh on US business sentiment, economic activity levels and the outlook for labour markets, although the impact on inflation has thus far been inconclusive: US June core CPI rose 0.23% m/m and 2.9% y/y. All of this has encouraged Fed speakers to echo a 'wait and see' approach and to be 'actively patient', much to the disappointment of President Trump who has stated on social media that 'Our Fed rate is at least 3% too high' and has actively criticised Fed Chair Jerome Powell for keeping rates on hold at 4.325%. Rumours of Powell being sacked have added to volatility in bond markets for obvious reasons but he remains in the chair.

The consequences of Trump replacing Powell with an obedient dove would be far reaching for bond markets and confidence in US price stability, given the risks to US inflation amid tariffs on top of fiscal stimulus after the 'tax and spending bill' was signed into law, together with other policies such as deportations of illegal immigrants and defence spending. Meanwhile, risks linger of higher energy prices by virtue of ongoing conflicts in Ukraine and the Middle East, although OPEC has committed to increasing oil production and the ceasefire between Israel and Iran is currently intact, so Brent Crude is trading below US$70 per barrel. Irrespective, the independence of the Fed remains paramount and any doubts in its ability to manage inflation sustainably would surely undermine the US Dollar.

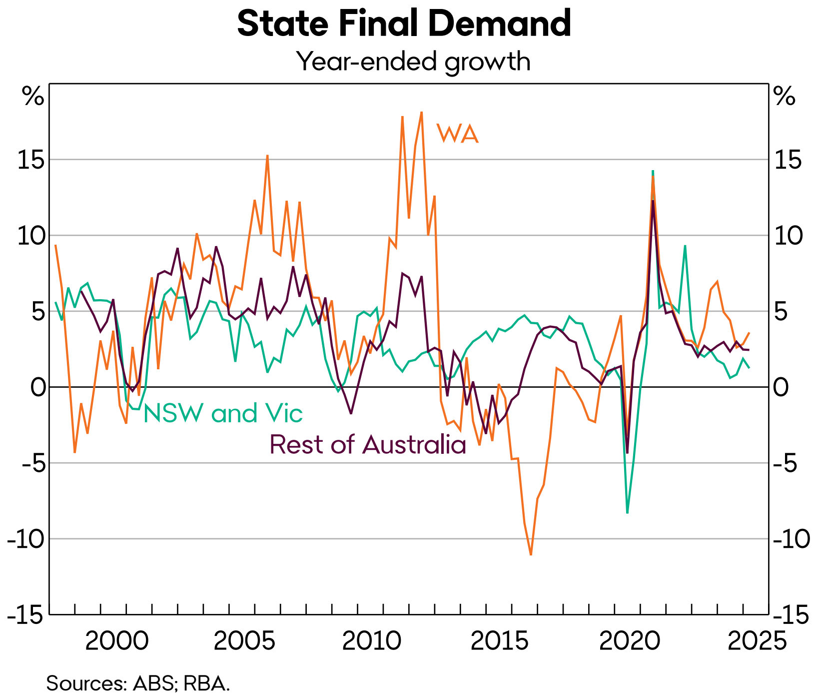
The chart above shows European and UK stock indices also at record highs, so markets are similarly looking through the immediate consequences of US tariffs on North Atlantic economies and are comfortable that official interest rates can maintain their path to less restrictive levels driving sustainable growth. This is understandable for the EU with CPI at 1.9% and underlying inflation at 2.3%, and the 30% US tariff rate (effective August 1) adding to the case for more rate cuts below the current deposit rate of 2.0% - but the UK is less straightforward. UK core CPI rose to 3.7% y/y in June, although markets still rate an August cut an 85% probability, while S&P warned this week that the inability of Britain's government to make inroads to budget repair 'underscores the UK government's very limited budgetary room for manoeuvre'. The official UK interest rate is still 4.25%.

China's economic data for June once again showed a mixed picture with official GDP growth resilient at 1.1% for Q2 and 5.2% y/y (refer appendix), but independent measures point to more modest growth. Consensus for economic growth in China in 2025 has converged to around 4.5%. The pleasing aspects of the June activity data came from export-led demand and industrial output, with Industrial Production rising to 6.8% growth y/y. However retail sales slowed to 4.8% growth (matching the lending growth data in the charts below) and other measures of domestic demand disappointed. This, together with weak real estate investment, points to challenges ahead amid trade tensions, so more policy support will be required to hit targets; but trade in the Asian region should hold up well.

In summary, policy uncertainty driven by US tariffs and their inconsistent and unpredictable consequences have been shrugged off in deference to more positive scenarios for stocks and risk sentiment (but not as confidently for bond markets). This resilient optimism has merit in the context of AI and emerging technologies driving broader growth beyond technology companies, and aligns to the view that the short to medium term outlook lies in the (virtual) hands of AI, not trade wars. How equitably and socially progressive this growth and wealth is distributed lies with government oversight.

Domestic economy

As discussed in last month's' report the RBA faced an interesting dilemma leading into the 7/8 July monetary policy board meeting: continue the easing cycle in line with their dovish tone from the May meeting, or wait until August to see where the Q2 inflation data lands and more time to see how the global backdrop is evolving. Our report last month suggested at best a 2 in 3 chance of a July cut (although the cash rate down to 3.6% pretty much a done deal by August), but after some more benign monthly inflation data and weak retail sales numbers, markets priced in a July cut as a 98% probability. Hence it came as a surprise to all (including your author) that the RBA displayed so much patience and continued their trend of aligning cuts to the quarterly Statements on Monetary Policy.



For the first time the RBA Monetary Policy Board published its (unattributed) votes which revealed a 6 to 3 majority vote: so presumably Governor Bullock and her deputy Andrew Hauser favoured 'on hold' and had the job of convincing the other 7 voting members to do the same, with a 4 in 7 success rate. Today's jobs data perhaps vindicates those three who wanted to cut rates in July, given the increase in unemployment from 4.1% to 4.3% for June, further confirming the much lower risks today vs three months ago that underlying inflation (which is below target at 2.4% based on the latest monthly CPI indicator) might rise back above 3% after the RBA take the cash rate down to more neutral levels.

The June jobs report showed only 2k new jobs added (all part time) and a 0.9% fall in total hours worked, while underemployment rose by 0.1 to 6.0%. The jump in unemployment to 4.3% leaves us with the highest national rate since November 2021, although there may have been some statistical noise in this report due to sample rotations. WA and Queensland continue to see lower levels of unemployment at 4.1% than Victoria (4.6%) and NSW and SA at 4.4%, while Tasmania and the territories are in the 3's. Similarly, other metrics of economic activity are stronger for WA and QLD than the rest of Australia (refer chart below) with population flows and the resources cycle driving demand.

Consumer confidence remains below trend but slowly recovering with the disappointment of no RBA cut in July capping gains in the W-MI Consumer Sentiment Index to 0.6% (up to 93.1), but further gains likely ahead as inflation moderates and as household disposable income benefits from this and further rate cuts. Business confidence rose for the second consecutive month by 3 points to +5 in June, while business conditions rose to +9. By state the improvements were most pronounced in QLD and Tasmania, but by industry the improvements were more consistent.

This all aligns to the (arguably) understated reality for the domestic economy that our greatest economic foe, **inflation**, is now at bay. It is understandable that this welcome outcome isn't capturing headlines while we see the unpredictable and somewhat chaotic news from overseas around trade wars, military conflicts and weather-related disruptions, but inflation is generally the largest risk to any economy, so its containment here is worthy of celebration. Households and businesses alike should gradually see the improvement in conditions assuming CPI remains in the 2's. As for the direct and indirect risks from trade wars and US tariffs, RBA research and speeches on this topic suggest we will be less adversely impacted than almost anywhere in the world, but that these local impacts may be quite unevenly distributed by sector and by location. China (refer above and appendix) will be a critical part of this path ahead for the domestic economy. The implications for the Aussie Dollar are similarly very difficult to extrapolate (e.g. a lower exchange rate will be part of the solution should the trade wars hit us more than expected), but the basecase forecasts below continue to show a gradual weakening in the US dollar, so an uptrend for the AUD/ USD as previously outlined.

Interest Rate Outlook

The RBA (two cuts into their easing cycle) remain on the path back to a more neutral cash rate likely to continue via quarterly 25 basis point cuts. The August cut appears close to a done deal, assuming Q2 core CPI to be released on 30 July remains around 0.7%, with the main uncertainty now the size of the cut in August: likely to be 25bp to 3.6%, with some speculation it may be 50bp (and 35bp the most sensible compromise, but at odds with Bullock's messaging of 'policy consistency'). Beyond this cut the basecase forecasts below continue to show quarterly cuts to a 'neutral' 3.1% - then higher in FY27.

Economic Forecasts: basecase scenario

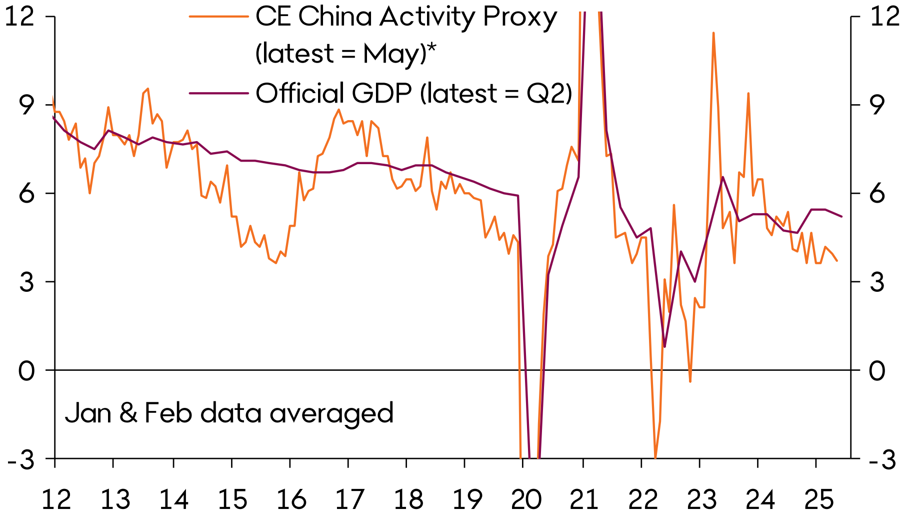
	2024			2025				2026				2027
% (actual, forecast)	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q2
GDP q/q	0.2	0.3	0.6	0.2	0.5	0.5	0.5	0.5	0.7	0.6	0.7	0.9
GDP y/y	0.9	0.8	1.3	1.3	1.6	1.8	1.7	2.0	2.2	2.3	2.5	3.0
Unemployment	4.1	4.1	4.0	4.1	4.3	4.5	4.7	4.9	5.1	5.2	5.1	5.0
CPI (q/q)	1.0	0.2	0.2	0.9	0.9	0.9	0.6	0.6	0.7	0.9	0.7	0.7
CPI (y/y)	3.8	2.8	2.4	2.4	2.2	2.9	3.3	3.0	2.8	2.8	2.9	2.9
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

	31 / 5 / 24	30 / 5 / 2025	30 / 6 / 2025	17 / 7 / 2025
90-day bills	4.35%	3.73%	3.60%	3.71%
3-year swap	4.25%	3.30%	3.21%	3.37%
5-year swap	4.41%	3.69%	3.61%	3.77%
AUD/USD	.6655	.6435	.6580	.6495
ASX 200	7 702	8 435	8 542	8 629
Credit Index (iTraxx- 5 yr)	65.5	75.0	73.7	71.3

Appendix: Chinese economic indicators

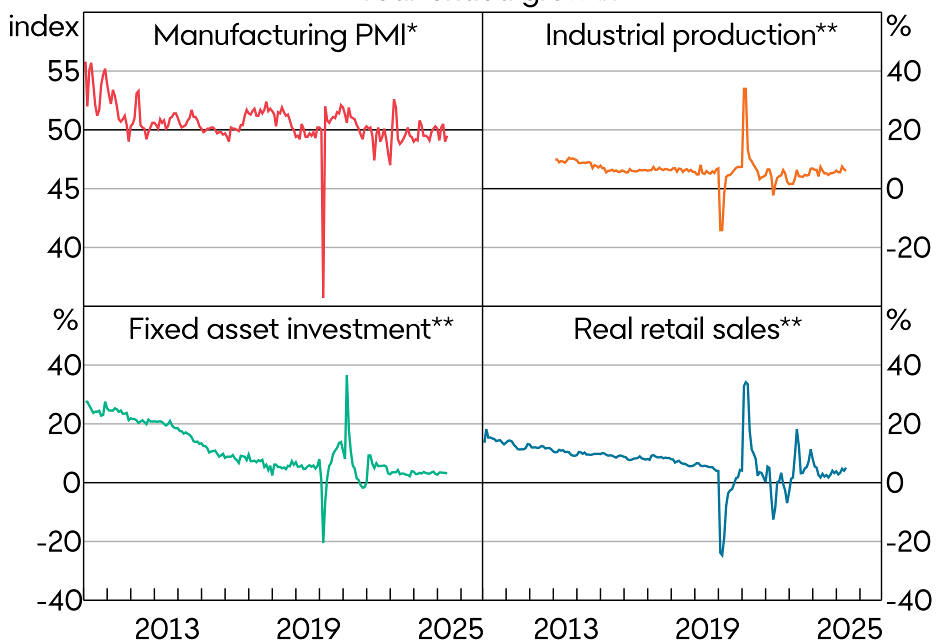
CE China Activity Proxy & Official GDP (%y/y)



Sources: CEIC, Capital Economics

China – Activity Indicators

Year-ended growth

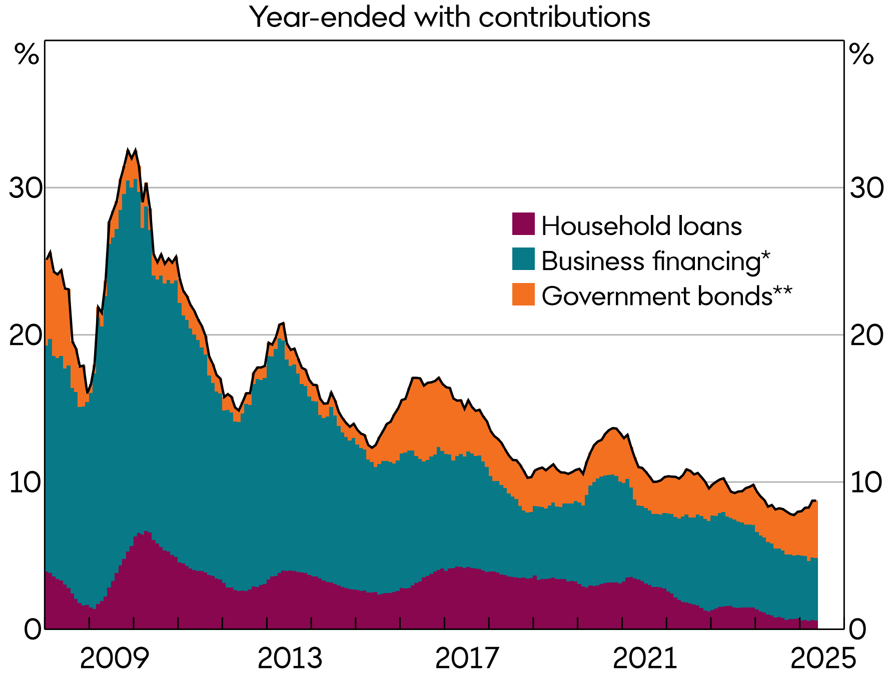


* Diffusion index; official measure.

** Seasonally adjusted by the RBA.

Sources: CEIC Data; RBA.

China – Total Social Financing Growth



* Sum of business loans, securities financing and off-balance sheet financing.

** Net government bond issuance includes local government bond issuance to pay off debt previously classified as business financing, and uses RBA estimates prior to 2016.

Sources: CEIC Data; RBA.