June 2025

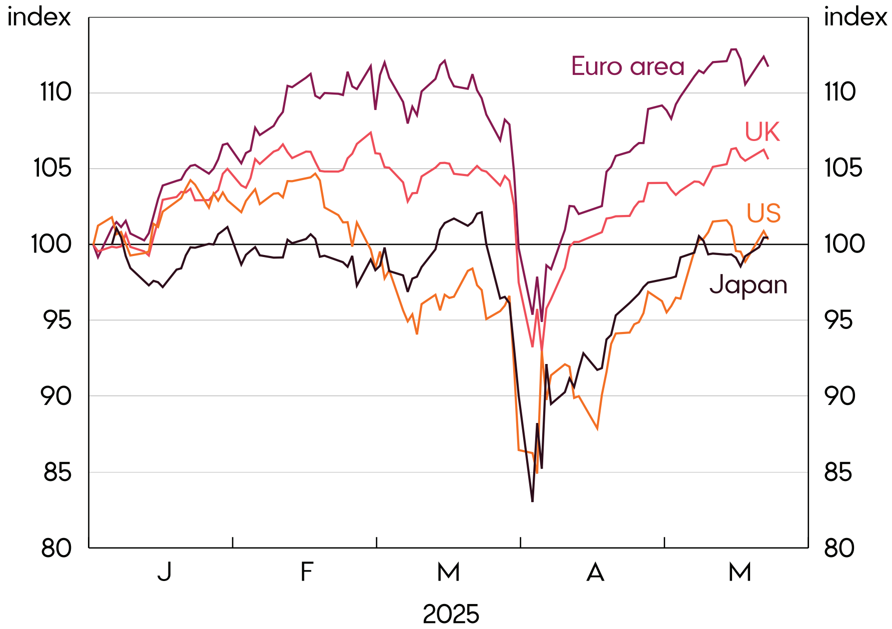
Economic and market update

Economic Overview – as at 22nd June 2025

Global markets

After the initial shock waves from the 'liberation day' tariffs had dissipated with deferrals and deals giving markets a sense of comfort, the latest escalation of conflicts in the Middle East has more recently seen oil prices surge higher. Equity prices had clawed back most of their losses since April, however the weekend news of direct US involvement in the Iran conflict will see at least some degree of renewed volatility in markets beyond energy prices, and this new dimension of uncertainty adds another layer of complexity to the outlook. The consequences of the US bombing of the Iranian nuclear sites is still being assessed by analysts, however today's comments that America 'does not seek war' with Iran may sooth markets to an extent, and the UN is urging to return to diplomacy.

Equity Prices*



*6 January = 100 for Japan; 2 January 2025 = 100 for US, Euro area and UK.
Sources: Bloomberg.

US stagflation risks remain elevated amid these developments, although there is more evidence of stagnation in the US economy than there is of a reigniting in inflation, with core CPI reading only 0.1% for May and 2.8% y/y. The Federal Reserve kept rates on hold at 4.375% this week and downgraded their estimates of US growth in 25/26, but lifted forecasts ahead for unemployment and inflation in anticipation of downstream impacts of tariffs - much to the disapproval of President Trump who again criticised the Fed for not cutting rates. Recent US data continues to print on the soft side with

- Retail sales fell 0.9% in May, their second successive monthly decrease;
- Housing starts dropped by 9.8% in May;
- Labour markets have weakened with downgrades to NFP employment growth;
- The most recent ISM manufacturing PMI survey was lower at 48.5 (where 50 is neutral).

Extreme geopolitical tensions and the prospect of a deeper conflict in the Middle East add to risks that the oil price may be higher for longer, as has been seen in similar periods of conflict in the region over the last five decades. The status of trade negotiations is also unclear after the White House indicated it will soon be issuing letters clarifying ongoing tariff rates, while the details of a US/China 'deal' remains opaque but appears more so a truce than a permanent outcome. At this stage China will maintain its 10% tariff on the US, while the US tariff will be 55% (the 10% baseline for all countries plus 20% for Chinese imports, over and above the pre-existing 25% tariff that was already in place).

Elsewhere Trump announced a trade 'deal' with the UK (removing some of the trade barriers including reduced tariffs on UK cars and steel) but the 10% levy on most UK goods exports remains in place. The Bank of England left rates on hold at 4.25% with a 6:3 vote suggesting more cuts are still coming as early as August, despite inflation rising to 3.4% in May. Meanwhile negotiations with the EU seem to have made little ground, and the EU appear unlikely to succeed in eliminating the 10% baseline. The ECB cut rates to 2% in June (as did Sweden), and 25bp cuts were also seen in Norway (to 4.25%), while the Swiss National Bank cut its official rate this week to zero!

The Bank of Japan kept rates on hold at 0.5% with the uncertainty around tariffs, developments in the Middle East and their implications for growth and inflation deferring the expected hikes that should ultimately take interest rates above 1%.

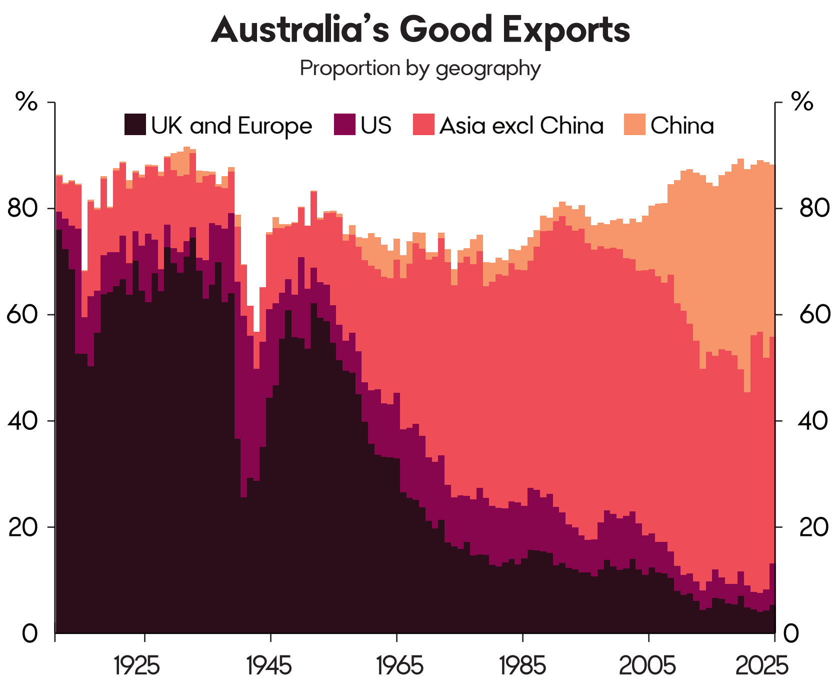
China's economic data for May remained a mixed bag with a welcome rise in retail sales (up 6.4% y/y from 5.1% annual growth in April) but industrial output slowing to 5.8% growth, and lending data showed a similar uneven picture: bank lending growth continued to decelerate but non-bank borrowing (driven by state-owned enterprises) kept broad credit growth steady. Further PBoC rate cuts and policy support are expected, to cushion the economy from the impact of the trade war. This should be sufficient to achieve an official growth rate of around 4.5% in 2025.

In summary, the drag on the global economy and on specific nations exposed to the US trade wars (including the US themselves) is still expected to be between 0.25 and 0.5% this year and next in GDP terms, and the escalation of conflicts in the middle east adds to stagflation risks. How much higher the oil price rises and for how long is impossible to anticipate, however sentiment is fragile.

Domestic economy

The RBA face an interesting dilemma leading into the July 7/8 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. At the time of writing the market still assigns an 80% probability to a July cut in the Official Cash Rate and has 40 basis points of cuts priced in by August. However, the observations below appear more consistent with at best a 2 in 3 chance of a July cut, although a cash rate down to 3.6% appears pretty much a done deal by the end of August.

RBA speeches since the May have reiterated the uncertainty and complexity that has driven volatile markets since March but also the growing confidence that upside risks to inflation have fallen. This is in part due to offshore uncertainty and trade tensions lowering growth expectations as detailed above in the global markets section, but the May RBA minutes also included the comment that members decided to 'move cautiously and predictably when withdrawing some of the current policy restriction'. So despite more evidence that we should be expecting the OCR to move to 'neutral', this comment could be interpreted as a leaning towards steady quarterly moves, in line with the first two cuts.



Sources: ABS; Owen Analytics; Pinkstone (1992); Vamplew (1987).

Labour markets remain relatively tight with the unemployment rate steady at 4.1% in May despite a small fall in total employment, while underemployment fell to 5.9% and hours worked increased 1.3%. This adds to the 'wait for August' RBA cut scenario, although easing job vacancies and a new cycle low in the employment index within the May nab business survey still point to a slightly higher unemployment rate ahead. Next week's monthly series for inflation in May will add further colour for the RBA in their deliberations.

Q1 GDP data on balance added to the case of a July cut however there were some one-off factors that contributed to the weak growth rate of 0.2% for the quarter and only 1.3% through the year. These included lower government spending and weather events, and net trade detracted 0.1% from growth. Recent trade data has been complicated by front loading of some exports in a range of countries ahead of expected tariffs, although as outlined in last month's report we are one of the least directly exposed countries. However our indirect exposures (e.g. via our largest trading partner China) is clear, and economic policy uncertainty is at a record level – refer appendix.

The savings ratio rose to 5.2% in the March quarter still suggesting that households are leaning to saving the recent improvement in disposable income rather than spending it, but this trade-off may quickly evolve as the RBA moves to less restrictive interest rates. Other data in the national accounts showed another disappointing outcome for productivity: flat for the quarter and still down 0.9% y/y. The recently announced Productivity Summit scheduled for August looms as the best opportunity for some time to address our dismal underperformance in this field – it deserves bipartisan support.

Population growth slowed in late 2024 and much of this has been driven by a fall in international student arrivals. If this faster deceleration in net migration continues, it could suggest lower inflation ahead and potentially a faster path to a neutral cash rate, although it will be a trade-off with growth. Meanwhile the Aussie Dollar has recaptured the 65 cent level leaving it in a much stronger technical position (matching the fundamental outlook), also helping the outlook for core inflation to remain below 3% sustainability for a longer period of time.

Interest Rate Outlook

The RBA (two cuts into their easing cycle) remain on the path back to a more neutral official cash rate likely to continue via quarterly 25 basis point cuts. The pace of cuts may increase should global conditions sharply deteriorate, which remains quite possible but is highly uncertain. The RBA has lowered its estimate of a neutral rate down closer to 3%, which coincides with our current forecast of a 3.1% terminal low although the market curve suggests the risk of an additional cut next year to 2.85%. The next cut is fully priced by 12 August but an earlier (8 July) cut is quite plausible.

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	0.7
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	2.6
Unemployment	4.1	4.1	4.0	4.1	4.3	4.5	4.7	5.0	5.2	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	.64	.66	.68	.70	.725	.75	.76	.75

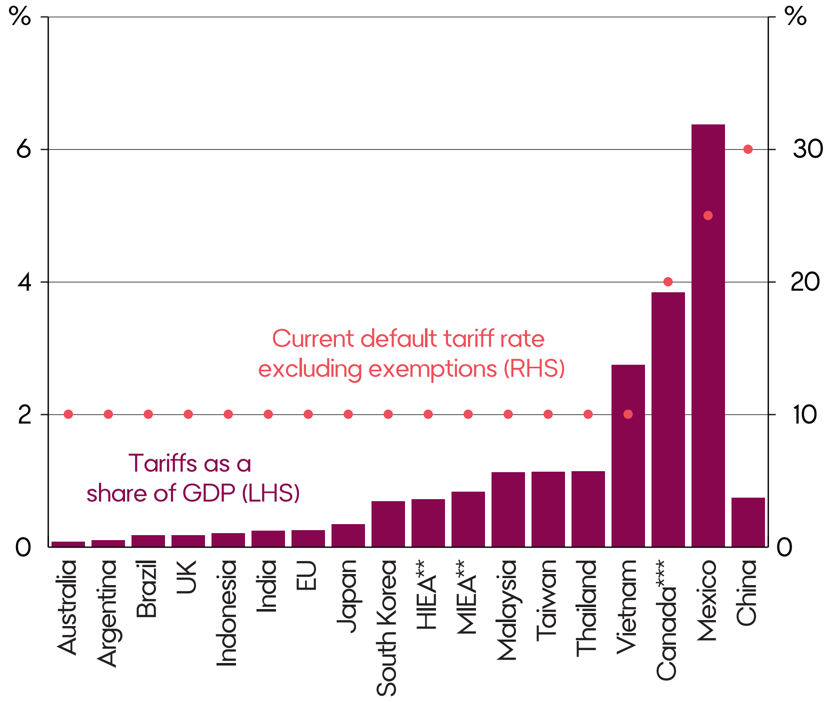
Benchmark rates

	30 / 4 / 24	30 / 4 / 2025	30 / 5 / 2025	20 / 6 / 2025
90-day bills	4.41%	3.90%	3.73%	3.69%
3-year swap	4.26%	3.22%	3.30%	3.27%
5-year swap	4.43%	3.58%	3.69%	3.66%
AUD/USD	.6470	.6405	.6435	.6485
ASX 200	7 664	8 126	8 435	8 506
Credit Index (iTraxx- 5 yr)	71.5	98.0	75.0	78.8

Appendix:
Australia's exposure to US trade and tariffs – direct and indirect

Direct Exposure to US Tariffs*

As at 15 May 2025



* Calculated as tariff rate multiplied by value of 2023 exports to the US divided by GDP in current US$; accounts for tariff pauses but not for exemptions, trade redirection, tax incidence or price changes.

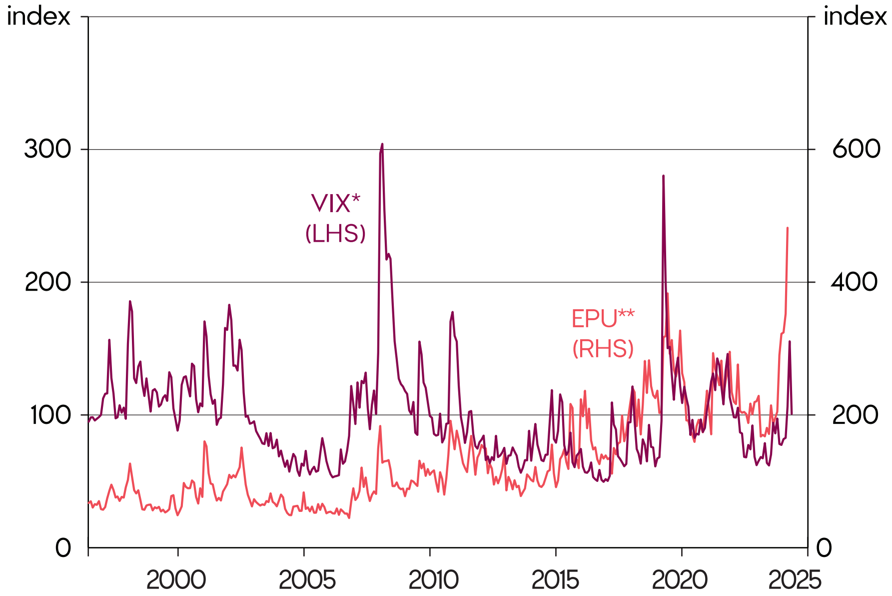
** Middle-income east Asia comprises Vietnam, Thailand, Malaysia, the Philippines and Indonesia; high-income east Asia comprises Hong Kong, Taiwan, Singapore and South Korea.

*** Reflects 10 per cent tariff on energy exports and 25 per cent tariff on all other exports.

Sources: OEC; RBA; UN Comtrade; World Bank.

Measures of Uncertainty

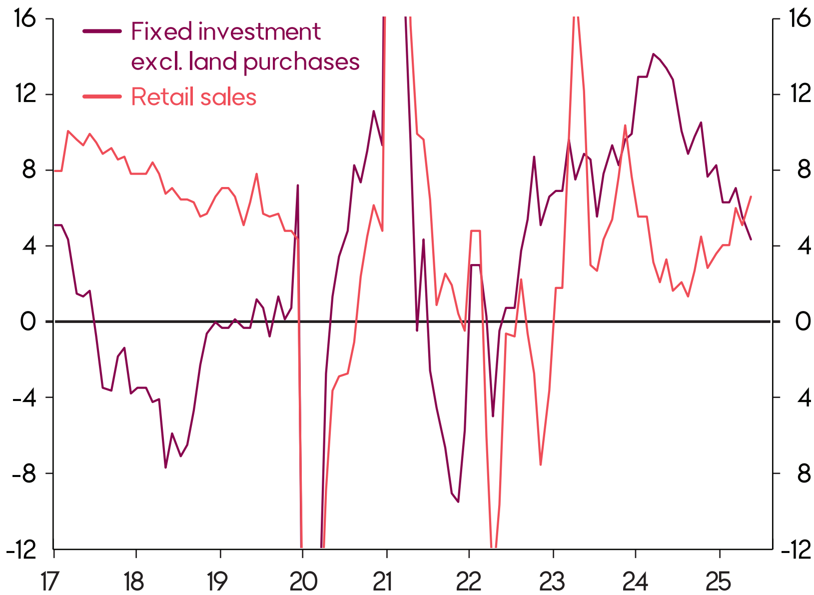
January 2010 = 100



* S&P 500: data up to May 2025;monthly average of daily data.
** Global economic policy uncertainty index from Davis (2016); data to March 2025.

Sources: Davis (2016); FRED; RBA.

Domestic Demand Indicators (real, % y/y)



Sources: Capital Economics.