April
2025

Economic and market update

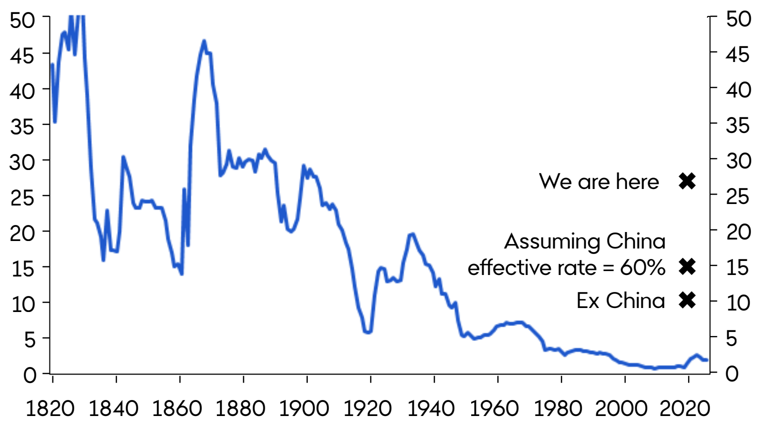
Economic Overview – as at 16th April 2025

Global markets

To say the outlook is highly uncertain and fast moving is probably an understatement, given the pace of policy changes on US tariffs and the unevenness of their distribution and responses from countries around the world. The summary below will attempt to capture recent key events and their implications, but these observations may date very quickly. What may not change in the short term is

- The focus for most central banks is quickly moving from inflation to protecting growth.
- The world's two largest economies (the US and China, who together comprise around 45% of global GDP) have reached a trade impasse, so trade between the two will be decimated.
- The impact on other countries will be highly variable and is extremely challenging to anticipate, but tail risks appear to be skewed to the downside.

Chart 1: Effective Tariff Rate (%)



Sources: Census Bureau. Capital Economics.

The US economy may be one of the easiest to assess given how clearly history shows us that tariffs are bad for everyone, but worst for the country imposing them. There is widespread consensus (certainly outside the White House) that US economic growth will be much slower this year, and that inflation will rise as a direct consequence of tariffs. The initial 'reciprocal tariffs' which (far from being a reciprocal of existing tariffs imposed by other countries on the US) turned out to be defined by the size of US trade deficits with those countries, divided by 'total exports to the US'. This was really just a measure of imbalances of imports and exports - and even more curiously in the case of Australia (with whom the US have a trade surplus) was assigned an arbitrary 10%.

This formula imposed large tariffs on countries that don't import much from the US (even after the initial ratio was halved), including 34% for China (on top of the previous arbitrary 20%), 26% for India and 24% for Japan. After the market's initial reaction (i.e. shock and sudden fears of a global recession) the Trump administration then deferred the larger tariffs (except for China) for 90 days but maintained a 10% minimum - which gave markets a brief reprieve but hasn't greatly changed the probability assigned to a US recession this year - around 55-60 %. Recent US data has been consistent with this outlook, including:

- The Empire State manufacturing survey was -8 in April, with the 'business conditions' subindex falling to -7.4, its lowest level since 2001, while 'prices paid and received' rose.
- The University of Michigan survey for April similarly showed consumer sentiment plunged but price expectations spiked higher.
- The New York Fed inflation survey (1- year consumer expectations) rose to 3.6% from 3.1%.
- The Bank of America global fund manager survey revealed that (a 30-year high) 82% of respondents expect the global economy to weaken, and 42% rate a recession 'likely'.

The chart on the previous page shows a current average US tariff rate in the mid 20's, but this may fall to closer to 15% subject to further exemptions - we have already learned that a wide range of electronic goods and parts (e.g. iPhone components) have been given a reprieve, albeit with uncertainty for how long. Markets continue to grapple with which countries may achieve exemptions by negotiation but are also dealing with the prospect of additional tariffs e.g. for pharmaceuticals. Even at 15% this effective tariff rate will be the highest since the 1930s - tariffs were the hallmark of the great depression.

The US administration believe the tariffs will generate roughly US$1 trillion in revenue and that another trillion can be saved via 'DOGE', thereby balancing the budget deficit, but markets are understandingly sceptical of the benefits of tariffs as a sustainable fiscal strategy. Furthermore, part of the strategy is for tariffs to encourage domestic manufacturing back in the US, so it is difficult to reconcile wholesale exemptions to the tariffs without undermining this perceived incentive to reignite local manufacturing.

Canada and Mexico were initially dealt a blanket 25% US tariff, but this was removed for 'USMCA compliant goods'- around 40% of imports from Canda and 50% from Mexico - although universal tariffs on steel, aluminium and car imports complicate these exemptions. The Canadian election on 28 April will be a good test case of attitudes towards the US with new PM Mark Carney gaining popularity as trade wars intensified - but the Bank of Canada is likely to keep rates unchanged at 2.75% for now.

The European Union were delivered a 20% tariff (vs 31% for Switzerland but only 10% for the UK), however hopes for any reduction for the EU via a 'deal' appeared to be misplaced after US talks broke down, while US VP Vance sounded more positive about the UK: "We're working very hard with Keir Starmer's government". The European Central Bank are expected to cut rates by another 25bp on 17 April and again in June, down to 2%. Recent data from the region has been reasonable but predates the 'reciprocal tariffs', and consensus now leans to an H2 technical recession for the EU.

The Chinese economy continues to respond to a range of policy measures, with export growth accelerating 12.4% in March (front-running the tariffs) and bank lending growth also picked up in March, taking broad credit growth to a year-high. Q1 GDP growth held steady at 5.4%, while retail sales growth jumped impressively to 5.9% y/y. The expansionary fiscal stance adopted at the recent NPC should be supportive as will be likely further monetary policy easing and targeted policy support - but the 145% US tariff (matched by a retaliatory 125% Chinese tariff on US imports) is extreme to say the least. Economic growth in China will probably struggle to exceed 3.5% this year as a result, and while some rollback of tariffs is likely the trade relationship with the US may be permanently impaired.

In summary, while some of the larger US tariffs have been deferred for 90 days and may to some extent be negotiated away, the reality of the two largest economies in the world (the US being 27% of global GDP and China around 18%) no longer effectively trading with each other will have global consequences. This may not ultimately resemble the GFC or the pandemic with a classic V-shape but could have some comparisons with the Asia crisis of 1997 and/or the European debt crisis of 2011. The impact of the US tariffs on lower growth ahead appears more likely than on reigniting inflation; other than potentially in the US itself where consumers will be directly exposed to higher prices. The price of gold (at a fresh record high around US$3300/oz) underscores many of these concerns.

Domestic economy

The minutes from the April RBA policy meeting revealed a discussion broadly as expected given how definitive the February rate cut message was - that the RBA had initiated the easing cycle thanks to progress with core inflation, but didn't share the market's enthusiasm for a string of cuts ahead, so a cut in April wasn't an option. Subsequent events suggest the markets were right to price in more cuts, given the 'reciprocal tariffs' detailed above, and in particular the uncertainty this poses for our major trading partners, especially China. As a result, markets are now factoring in the official cash rate being lowered to 2.85% by December, before the yield curve tilts slightly higher in 2026. Indeed the first cut expected in May could be as much as 50bp based on market pricing, although a more appealing scenario would be a 35bp cut to 3.75% and then another 25bp in July or August to an even 3.5%. The next meeting (19/20 May) will no doubt spend more time debating downside risks to growth and the 'full employment' part of the RBA's mandate, and less on inflation.

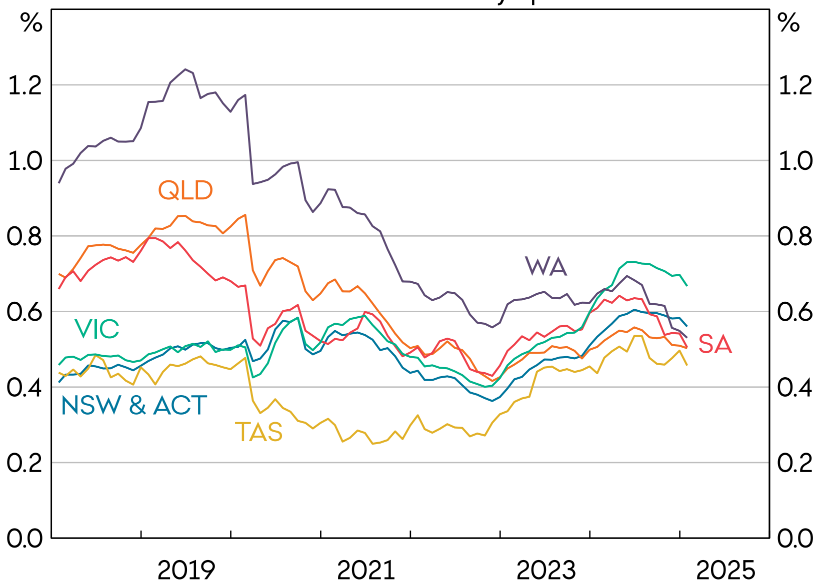
Core CPI is likely to be 0.6% for Q1 in the quarterly data to be released on 30 April, consistent with the monthly indicator for February where the Trimmed Mean was 2.7%. Moreover the prospect of lower demand ahead from overseas as the trade wars bite, together with severe volatility on financial markets potentially deferring investment decisions locally, adds to downside risks for CPI, although there is still the school of thought that US tariffs could see inflation imported from overseas. The recent dip in the Aussie Dollar to US 59.1 cents added to some of these concerns, but the subsequent bounce to 63.5 and benign levels of inflation with our major trading partners, together with global recession fears and stock market volatility makes a May RBA cut almost certain.

One of the key unknows is the impact tariffs will have on business confidence and consumer sentiment, and similarly the risk that labour markets could weaken soon as hiring intentions are deferred. The household sector has been through a severe inflation shock, but real household income is recovering (refer appendix) which has seen an uplift in consumer sentiment - until the recent trade news and market unrest. Meanwhile the housing market has been resilient with dwelling prices back rising again in Q1, and arrears rates (while uneven) are improving and generally lower than in 2019.

The Federal election is another source of uncertainty with the 3 May outcome set to shape housing markets, tax rates and energy policies. Historically consumer and business sentiment have enjoyed uplifts after elections are completed (at least for a while) although a minority government or hung parliament may inhibit policy reform ahead.

Arrears Rates by State

Share of borrowers 90+ days past due*



* Variable-rate owner-occupier loans. Arrears rates in 2020 are affected by large changes in the composition of loans in the dataset due to the introduction of the Term Funding Facility. Earliest observation January 2016. Latest observation January 2025.

Sources: RBA; Securitisation System.

Interest Rate Outlook

The RBA should cut rates on 20 May by at least 25 basis points, with the depth of the unfolding easing cycle now linked to the vulnerability of the global economy in the wake of much larger than expected US tariffs rolled out in April. Even after some tariffs were deferred 90 days, the baseline of 10% for all countries is punitive and the escalation with China suggests global growth will be lower than previously expected - so for the RBA the focus moves from inflation to maintaining jobs and growth. Quarterly cuts to around 3.1% now appear likely, but this outlook and associated forecasts are made in a VUCA world.

Economic Forecasts: basecase scenario

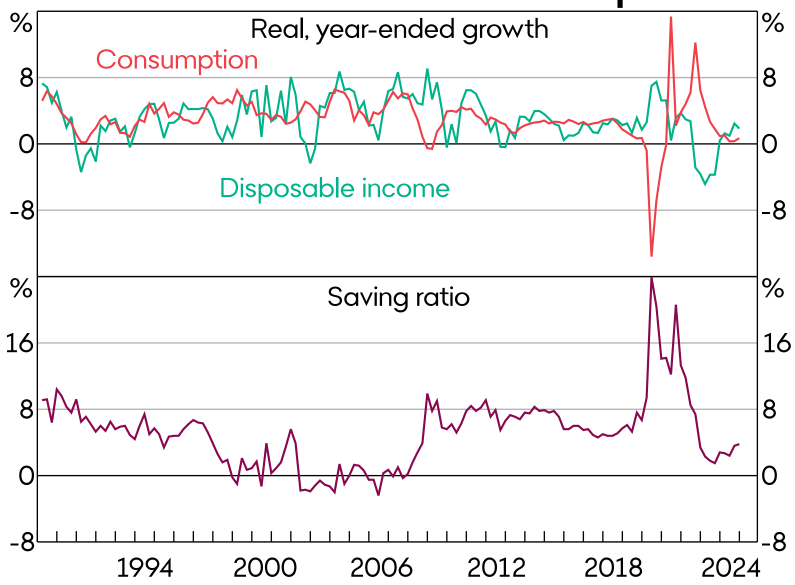
	2024				2025				2026	
% (actual, forecast)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
GDP q/q	0.2	0.2	0.3	0.6	0.5	0.5	0.5	0.5	0.5	0.7
GDP y/y	1.1	1.0	0.8	1.3	1.6	1.9	2.1	2.0	2.0	2.2
Unemployment	3.9	4.1	4.1	4.0	4.2	4.4	4.6	4.8	5.0	5.2
CPI (q/q)	1.0	1.0	0.2	0.2	0.8	0.9	1.0	0.6	0.6	0.7
CPI (y/y)	3.6	3.8	2.8	2.4	2.2	2.1	2.9	3.3	3.1	2.9
CPI (core y/y)	4.0	4.0	3.5	3.2	2.8	2.7	2.6	2.9	3.0	3.0
RBA cash rate	4.35	4.35	4.35	4.35	4.10	3.85	3.60	3.35	3.10	3.10
AUD / USD	.6515	.667	.691	.619	.625	.625	.65	.675	.70	.725

Benchmark rates

	29 / 2 / 24	28 / 2 / 2025	31 / 3 / 2025	16 / 4 / 2025
90-day bills	4.34%	4.15%	4.13%	4.00%
3-year swap	3.90%	3.73%	3.65%	3.29%
5-year swap	4.12%	4.00%	3.95%	3.73%
AUD/USD	.6445	.6210	.6250	.6350
ASX 200	7 699	8 305	7 843	7 762
Credit Index (iTraxx- 5 yr)	64.3	62.8	82.9	98.0

Appendix: Household Sector

Household Income and Consumption*

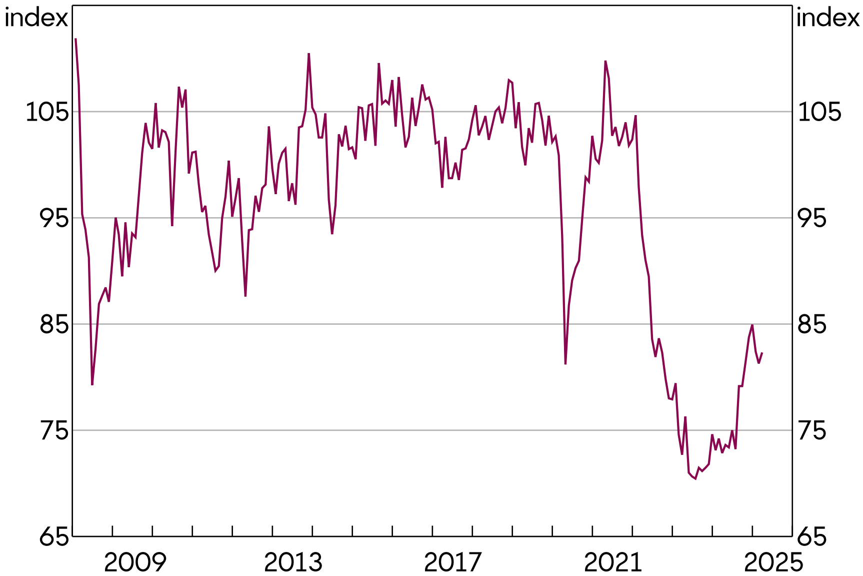


* Household sector includes unincorporated enterprises; disposable income is after tax and interest payments; saving ratio is net of depreciation.

Sources: ABS; RBA.

Consumer Sentiment*

Average since 1980 = 100

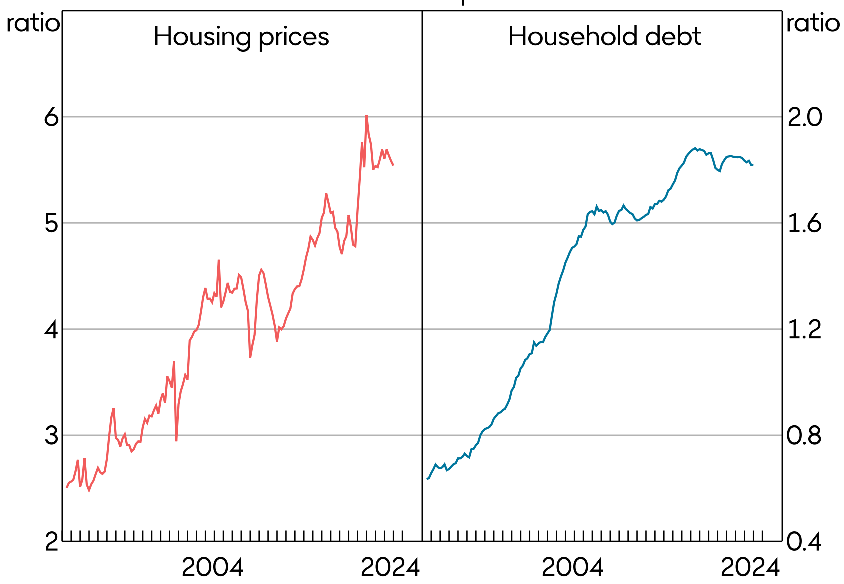


* Average of the ANZ-Roy Morgan and Westpac-Melbourne Institute consumer sentiment measure of respondents' perceptions of their personal finances relative to the previous year; ANZ-Roy Morgan index rescaled to have the same average as the Westpac-Melbourne Institute index since 1996.

Sources: ANZ-Roy Morgan; RBA; Westpac and Melbourne Institute.

Housing Prices and Household Debt*

Ratio to household disposable income

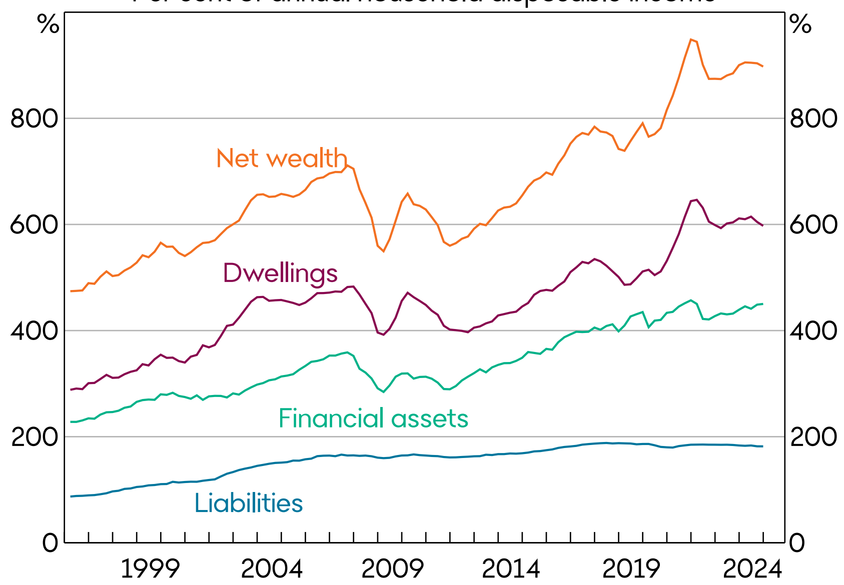


* Household disposable income is after tax, before the deduction of interest payments, and includes income of unincorporated enterprises.

Sources: ABS; CoreLogic; RBA.

Household Wealth and Liabilities*

Per cent of annual household disposable income



* Household disposable income is after tax, before the deduction of interest payments, and includes income of unincorporated enterprises.

Sources: ABS; RBA.