iPartners inFocus
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# All change please: the RBA shifts tack

- The RBA has changed tack and commenced lifting interest rates.
- Policymakers are trying to contain inflation, support growth and manage financial stability.
- With all the clarity of hindsight, the RBA misjudged the demand-supply balance in H2 2025.
- Fiscal policy has a role to play – but early indications for the May Budget are not encouraging.
- The inflation outlook may not be as dire as thought – but pencil in another rate rise for May 2026.
- This edition of inFocus looks at some implications for the economy, markets and Alternatives.

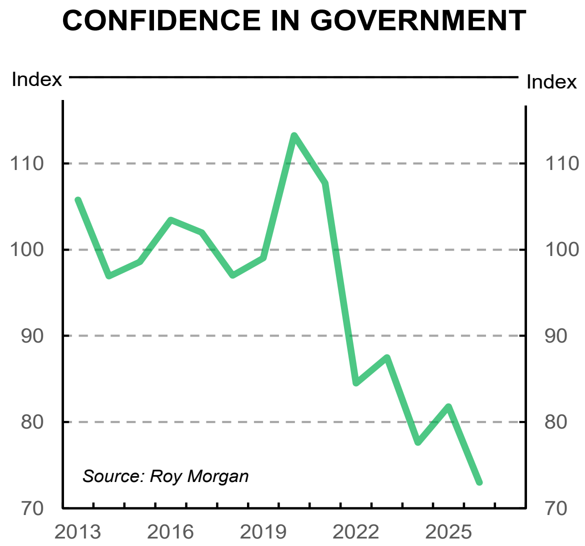
They say a week is a long time in politics. And I'm sure plenty of politicians will agree given recent gyrations.

We have stable government on paper. But a highly volatile and fragmented political landscape underneath. Debate continues over the cost-of-living, housing, migration and culture-war issues. The Coalition is fractured, minor parties are gaining ground, Culture-war flashpoints (hate-speech laws, national identity) are sharpening political rhetoric. Small wonder that voter trust in government is at an all-time low (Chart 1).

I'm also sure that economists will agree a couple of months is a long time in economics.

- Inflation was cooling for a while but then re-accelerated. Inflation at the end of 2025 remained stubbornly above the RBA's 2-3% target.
- The RBA pivoted from rate cuts to rate rises as a result.
- Financial markets backflipped and shifted from expecting 1-2 rate *cuts* in 2026 to now expecting a further 1-2 rate *rises* (Chart 2).
- Economic data was of the stop-start variety as spending patterns fluctuated.
- The geopolitical backdrop changes on an almost daily basis. The drivers are ongoing conflicts, strategic rivalries, bloc-based trade and tech-driven competition. All of which are reshaping international alliances and global stability.

Bottom line: policymakers are navigating a tricky balancing act between containing inflation, supporting growth and managing financial stability. Volatility is likely to continue in 2026. Investors need to be alert.

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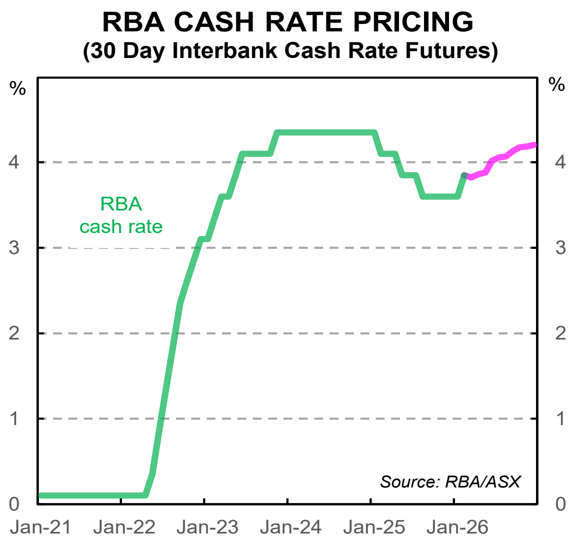



*Figure 2*

## The RBA in perspective

The bald facts are that the RBA *lifted* the cash rate by 25bpts to 3.85% at its 3 February Board meeting. The pivot follows 75bpts of rate *cuts* during 2025. It was the first rate rise since November 2023.

There are some interesting similarities and differences compared with earlier RBA cycles:

- The time at the cash rate trough matched the average and median experience of previous cycles (Chart 3).

But the quantum of easing was small compared with previous cycles. The peak-to-trough fall of 75bpts compares with an average cut of 125bpts in the first year of previous cycles (Chart 4).

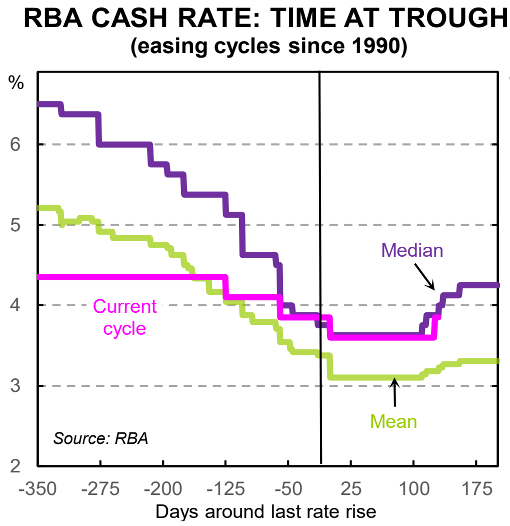



*Figure 3*

- This rate-rise cycle is starting from a point where the cash rate was arguably still on the *restrictive* side of the line. Other rate rise cycles since 1990 all started with monetary policy settings in *expansion* mode (Chart 5).
- Australia is leading the way. Australia normally lags the global monetary policy cycle. The RBA was one of the last to join the easing cycle in 2025. But it is one of the first to raise rates in 2026. Most of the major central banks are expected to remain on the sidelines in 2026 (Eurozone, Canada, Sweden). Or to cut further (US, UK, Norway). (Chart 6)

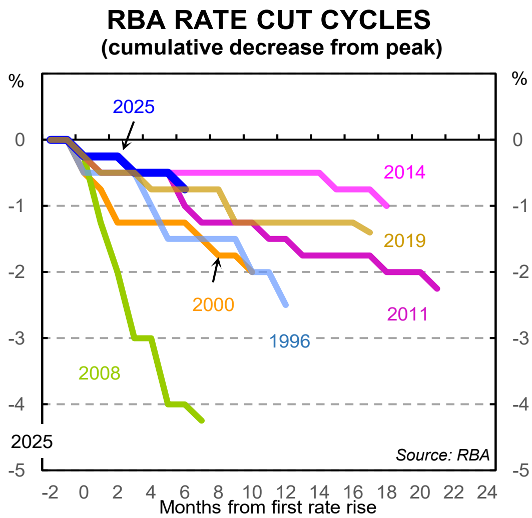
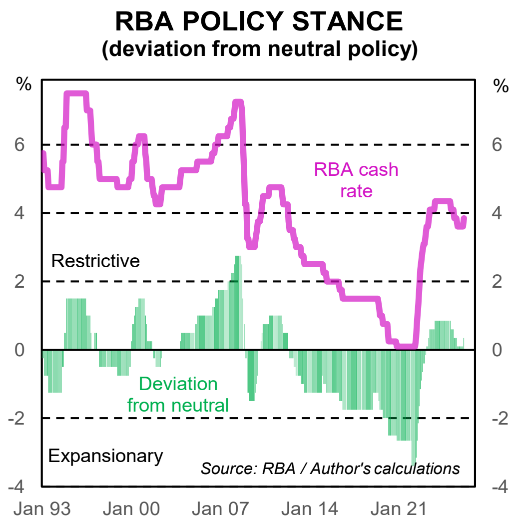



*Figure 4*

## The RBA changes tack

With all the clarity of hindsight, it's now clear that the RBA misjudged the balance between demand and supply in the economy during the second half of 2025.

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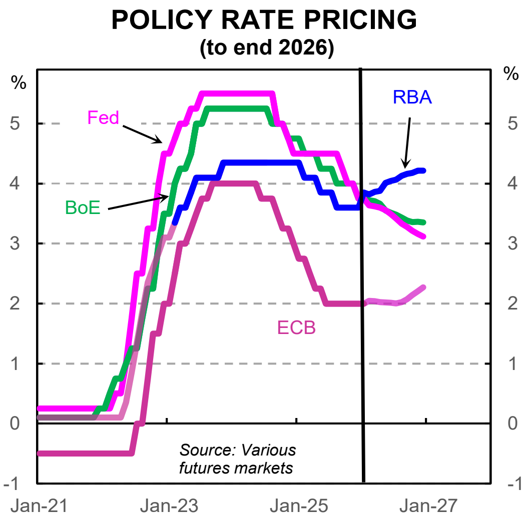



*Figure 6*

There was a nasty shock in the inflation readings showing the inflation rate was back above the top end of the 2-3% target range. There was some surprising strength in the labour market that meant the unemployment rate was falling rather than rising. And there was also some unexpected resilience in domestic spending and trading partner growth.

In central bank speak, the RBA had no option but to conclude that "stronger-than-expected demand in aggregate was pushing up against the ability of the economy to supply all of the goods and services being demanded".

Translated, this demand-supply mix means that RBA forecasts for the unemployment rate had to be revised down, wages growth revised up and inflation projections pushed higher (Chart 7).

The other change in RBA thinking relates to the time taken to get inflation back to target. The RBA has a target range of 2-3%. But Governor Bullock has elevated the midpoint of that range (or 2.5%) as her target. The RBA expected to get there by mid 2027 back in November (Chart 8). That success point has now been pushed back to mid 2028!

The policy conclusion was equally inescapable. And the RBA moved the cash rate higher in February.

Policy rate changes are a bit like cockroaches – there is never just the one! The "average" rate rise cycle involves 3 steps, cumulating to 1½% over the first 12 months (Chart 9).

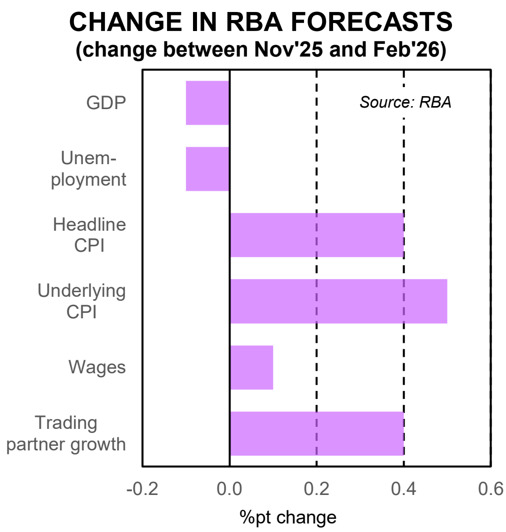
How the inflation story evolves from here is the key to how far and fast the RBA moves. There are reasons to think the inflation outlook is less threatening than the consensus perceives.

We know that the RBA remains uncertain whether the turn in inflation reflects temporary or permanent factors.

The last inFocus piece noted that one way to think about the upside inflation surprises is in terms of price flexibility. PinPoint Macro have subdivided the CPI into two, roughly equal, parts. The Flexible CPI reflects those items where prices change frequently and reflect underlying economic conditions. The Sticky CPI contains items where prices don't change very often and typically reflect longer-run inflation expectations.

The 2025 CPI surprises reflected a spike in the Flexible CPI (Chart 10). As such, underlying economic conditions favour an unwinding of that spike. And supports the case for seeing the inflation aberration as temporary.

There are other reasons for caution on upside inflation risks. One of these is the US tariff story that featured in much of the economic debate and market volatility in 2025.

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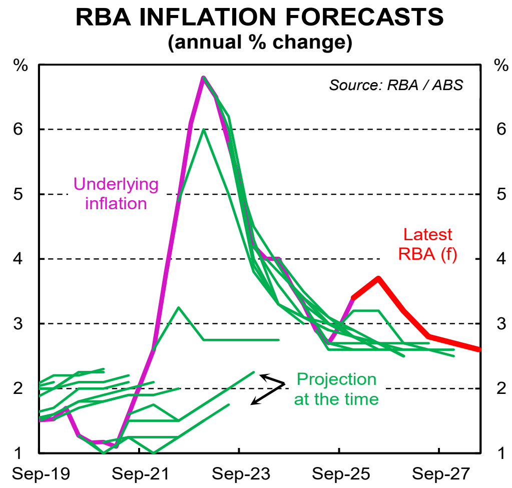


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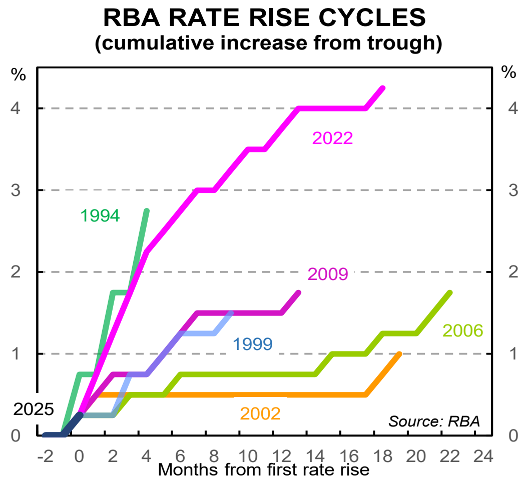


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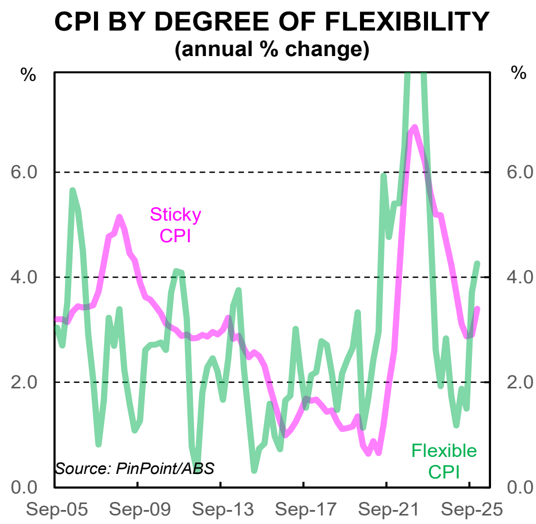



*Figure 10*

- Tariffs distort trade flows. Chinese exports to the US have fallen sharply (as in Trump 1.0). But *total* Chinese exports continue to grow at a decent pace (Chart 11). In other words, China has successfully diverted exports from the US to other countries. The diversion boosts domestic supply in those countries. One of the countries taking up the US slack is Australia.

- US tariffs are deflationary (outside the US). China is now "exporting" deflation to the rest of the world. Falling Chinese producer prices should flow through to the import prices paid by the advanced economies, ex the US (Chart 12).

And the AUD is helping as well. The exchange rate is an important transmission channel from the rest of the world into the Australian economy. A rising exchange rate is typically seen as tightening financial conditions (Chart 13). The Aussie is up by more than 8% against the USD and 5% in trade-weighted (TWI) basis since early November.

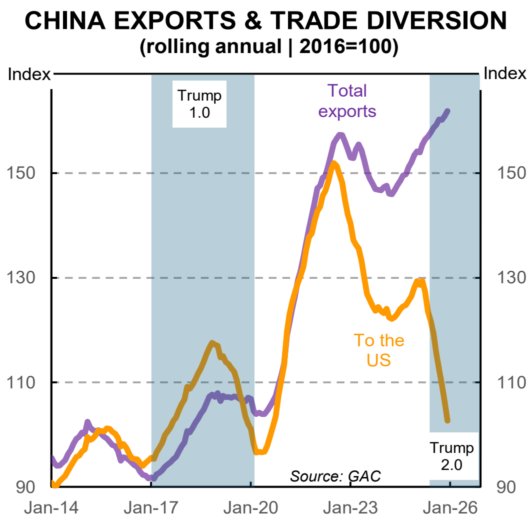
These considerations should limit the number of rate rises required. Especially given the earlier observation that this tightening cycle is starting from a point where policy is already restrictive.

Bottom line: pencil in the next 25bpt rate rise in for the May 2026 RBA Board meeting. And put a high probability of a follow up at the August meeting.

## The RBA, fiscal policy and "credibility"

The RBA talks endlessly about the importance of their 2-3% inflation target. They hint that 2.5% is the "new" 3%. They stress the importance of hanging on to recent job gains as part of their full-employment mandate. And they emphasise the importance of financial stability.

They are assisted in pursuing these objectives by being "independent". The RBA can set monetary policy without political interference.

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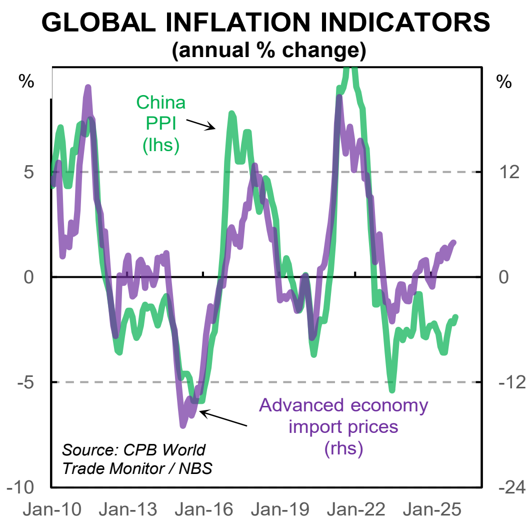


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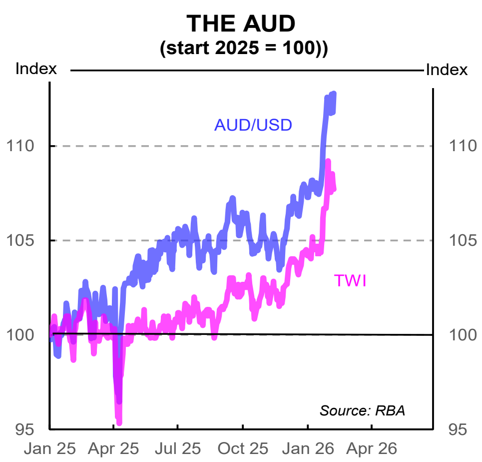



*Figure 13*

In plain English, politicians don't get to tell the RBA what to do. But the quid pro quo is that the RBA bends over backwards to avoid talking about fiscal policy – despite its importance for the economy more broadly.

This unwritten convention allows the Government to claim that public spending is not adding to the current inflation pressures. The unvarnished fact is that government spending as a share of the economy is the highest since WW2 (Chart 14). We can add to that inflation pressure the observation that public wages growth is accelerating and running well ahead of (slowing) private sector wages (Chart 15).

The fig leaf that the RBA has hidden behind is that they frame their discussion in terms of aggregate demand and supply.

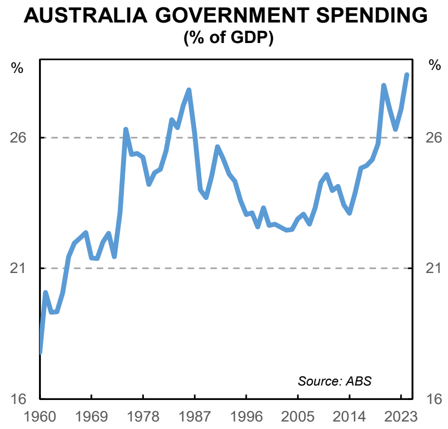
Aggregate demand, of course includes private and *public* spending. And the RBA Governor finally broke cover on this front at her recent Parliamentary appearance.

Governor Bullock noted: "Government spending is part of total spending and total aggregate demand in the economy, so it, along with private spending, contributes to aggregate demand. And so, to the extent that aggregate demand is above aggregate supply, which we think it is, that's contributing to inflation".

No room for doubt there! The Governor's comments also highlight the importance of the upcoming May Budget in framing the interest rate debate.

So will the Government shift fiscal policy in a way that will help the RBA? The early indications are not encouraging. The messaging seems to be about possible additional spending. Target areas are childcare, family support and housing – including building more houses and topping up first-home buyer support. Beyond that, the whispering is more about lifting tax revenue – such as "reviewing" the capital gains tax discount.

"Independence" typically only matters to central-bank-watchers and policy wonks. It's grabbing headlines at the moment because of the political pressures heaped on the US Federal Reserve and its Chairman (Jay Powell) to aggressively cut interest rates. Chairman Powell's term is up in May 2026. And debate about his replacement is adding to concerns.

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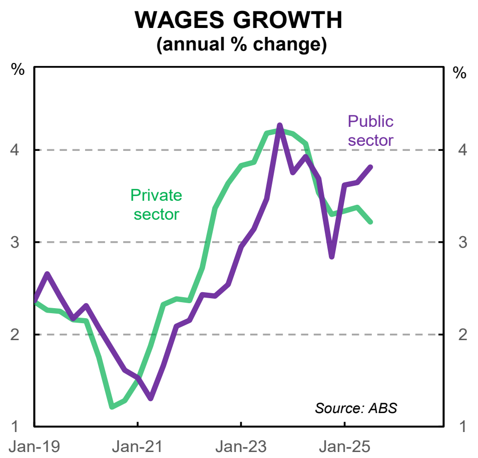


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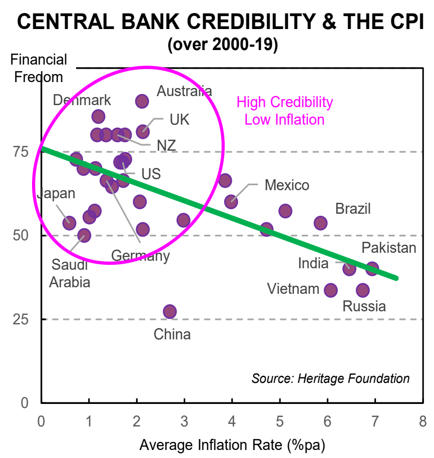



*Figure 16*

Credibility matters because countries with more independent and credible central banks:

- have lower average inflation rates; and
- have less volatile inflation.

The payoff for credibility is evident in Chart 16. The Heritage Foundation Index of Financial Freedom is a proxy for credibility. A high score means a more independent, efficient financial system with less government interference. Countries with high financial freedom typically have low average inflation rates (pink circled area on Chart 16).

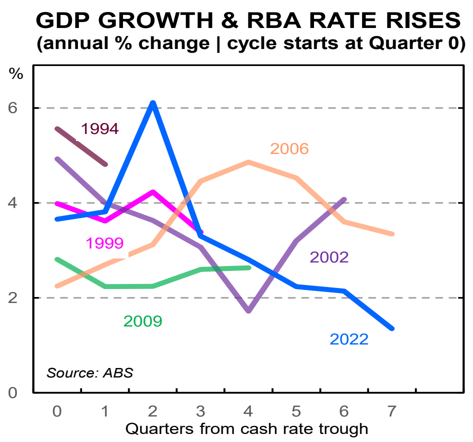
## What happens when the RBA lifts interest rates?

The RBA has commenced its 7th rate rise cycle since the "modern" policy ere began in 1990. So there is plenty of historical experience to tease out the impact of higher rates.

One of the lessons drummed into an economist early on in their careers is that the lag between changing interest rates and seeing an impact on the economy are "long and variable". And this is certainly the case:

- GDP growth does not slow immediately (Chart 17) and the unemployment rate often keeps falling (Chart 18).

Inflation rates often track sideways (Chart 19). The chart also shows the RBA typically acts in a pre-emptive manner. Most rate rise cycles start with inflation within or close to target.

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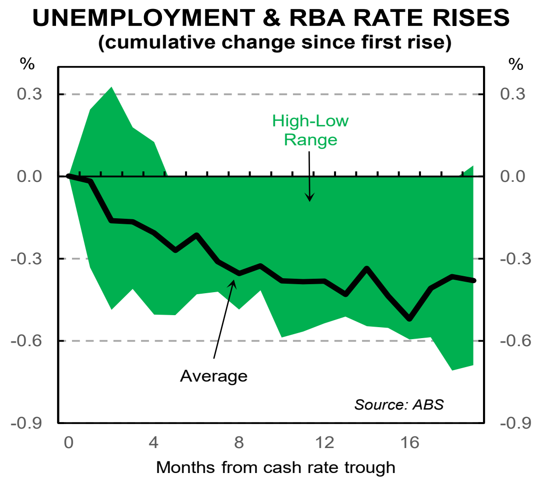


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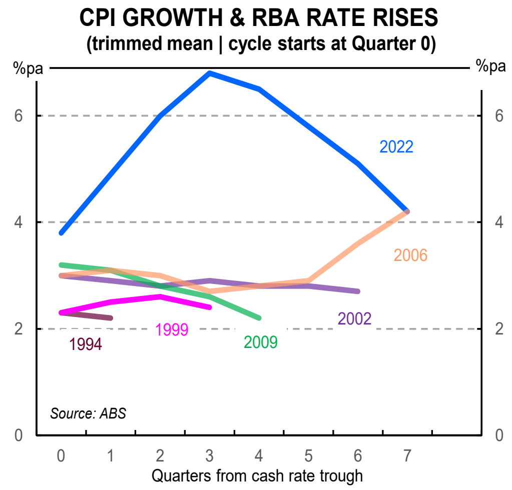


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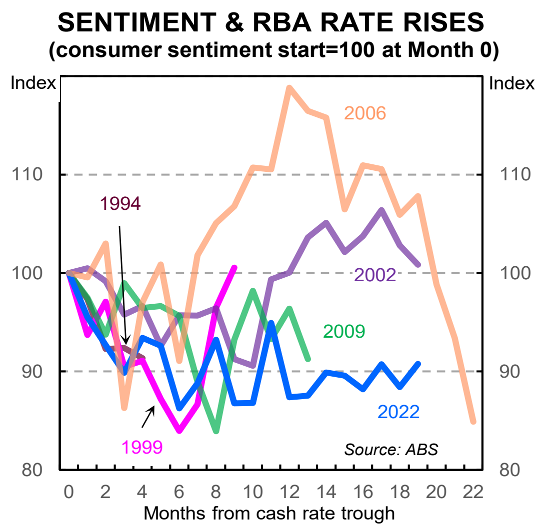


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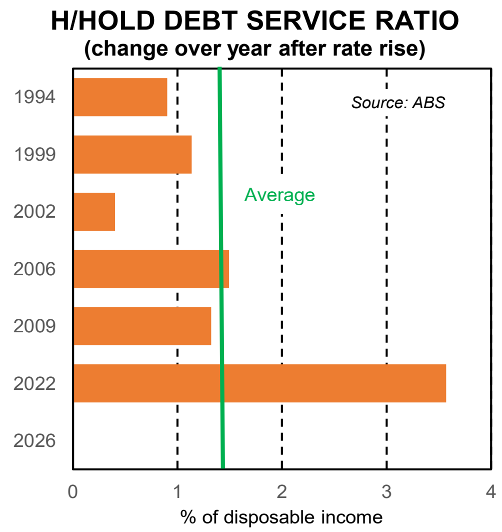



*Figure 21*

Beyond the real economy, sentiment measures and some monetary transmission channels are impacted more quickly:

• Consumer sentiment deteriorates (Chart 20). Business confidence eases back.

• Household debt servicing ratios typically lift quickly (Chart 21).

Financial market reaction is mixed:

• On average, bond yields rise initially. But the AUD and ASX-200 track sideways (Chart 22).

## A closer look at housing and the consumer

There is a general expectation that higher mortgage rates mean a cooling housing market. And the prospect of falling dwelling prices if the RBA squeezes too hard.

The historical response is pretty clear. Affordability and home-buyer sentiment fall immediately as mortgage rates lift. But dwelling prices take some time to respond.

The typical experience is that house prices keep rising in the aftermath of the first rate rise, albeit the pace of growth slows (Chart 23). The average price rise in the first year after a rate rise is 6%!

Genuine price falls are associated with extreme recessions (early 1980 and early 1990's) or financial shocks (the GFC in 2008, COVID in the early 2020's (Chart 23 again).

There are a number of housing drivers beyond interest rates that should help support prices. These include:

• the strength of housing demand given still strong population growth – the Australian population rose by 420,000 over the latest year;

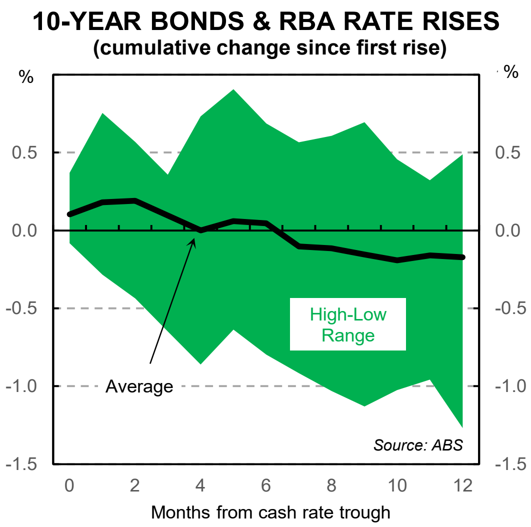
• the pent-up demand overhanging the housing market from the last few years of underbuilding;

• a weakening in housing supply as higher mortgage rates dampen new construction activity (Chart 24); and

• government schemes to help first-home buyers (where the benefits quickly get capitalised into prices).

The consensus among the major banks is that dwelling prices will grow by 5% in 2026, despite higher mortgage rates.

Consumer spending was one of the forces that pushed aggregate demand up against supply during 2025. And so contributed to the lift in inflation rates.

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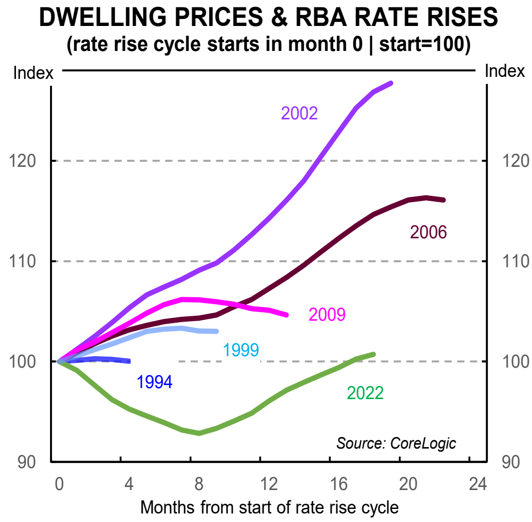


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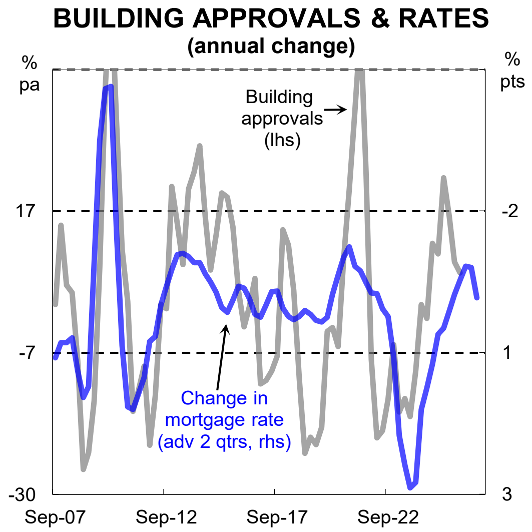



*Figure 24*

Consumer trends in 2026 will reflect the usual interplay of the *ability* to spend and the *appetite* to spend.

The checklist of indicators on the *ability* side of the spending equation are not as negative as a rising interest rate environment would suggest.

The major banks moved very quickly (as usual) to pass on the 25bpt rate rise to their home loan customers. Higher mortgage payments reduce disposable income. As noted earlier, the average rise in the household debt service ratio in the year after the first rate rise is 1½% (Chart 21).

But many households built up an interest-rate buffer during 2025 by not cutting their mortgage payments as interest rates fell. The Commonwealth Bank notes that only 10-14% of eligible home loan customers reduced their home loan repayments after the three rate cuts enacted in 2025. (Chart 25). Those that didn't cut repayments won't need to increase them either.

In addition, there are two (smallish) tax cuts to come in mid 2026 and 2027. And the expectation that dwelling prices will rise further in 2026 means household wealth will keep growing (Chart 26).

The checklist of indicators on the *appetite* side of the spending equation are more uniformly negative. Consumer sentiment typically falls as interest rates rise. And job security concerns typically intensify. Household buying intentions fall.

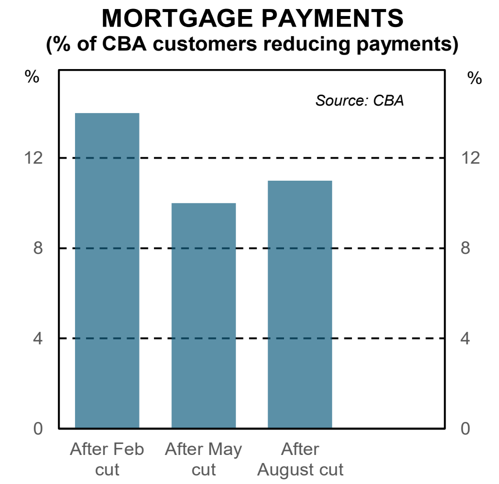
But there is an interesting wrinkle in the transmission. The unemployment rate has to rise to validate the lift in job fears and scare consumers into retrenching:

- During the Global Financial Crisis (GFC) job fears spiked to record highs as everyone thought they were going to lose their job (Chart 27). The reality was "bad". But nowhere near as bad as expected. Staring down the barrel of a gun and having it fail to fire had a weird double-negative impact on consumer sentiment. It improved rapidly. Consumers opened their wallets and Australia avoided recession.
- The experience during the Pandemic was quite different. The rise in unemployment far outstripped job fears (Chart 27) and consumer spending plunged.

Bottom line: watch the monthly labour market data for a guide to consumer spending. Ongoing labour market resilience and a low unemployment rate would be a positive sign.

## Alternatives in 2026

**What follows is general information. Any views or opinions expressed are solely those of the author. They do not represent financial advice.**

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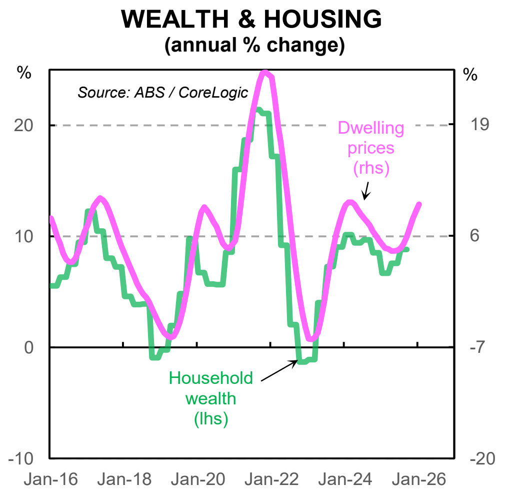


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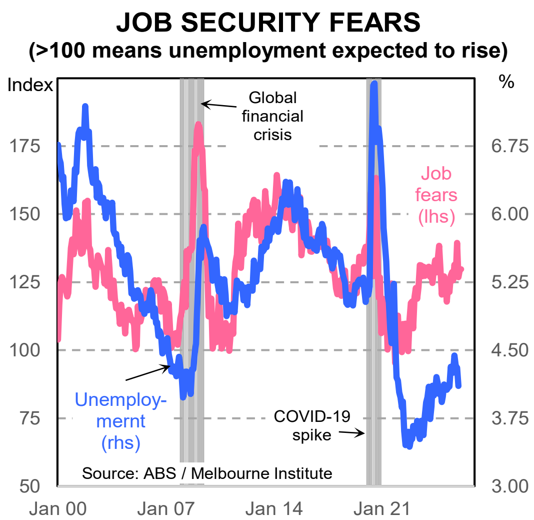



*Figure 27*

As noted earlier, the historical experience for major Australian asset markets as the RBA lifts rates involves higher bond yields and a sideway trend in the AUD and ASX-200.

But there are, of course, many nuances below the surface that investors might like to think about.

There is a wide range of equity outcomes on a sectoral basis as the RBA pushes rates higher. Sectors that historically outperform (or positive alpha) in the first year include Utilities, Consumer Staples and Healthcare. The major underperformers include Consumer Discretionary, Communications, Real Estate and IT (Table 1).

Table 1.

**Sectoral Alphas After First RBA Rise**

(Average Performance Relative to Broad Equity Market)

| | +1m | +2m | +3m | +6m | +9m | +12m |
|---|---|---|---|---|---|---|
| Utilities | -0.6 | 1.2 | 4.7 | 1.1 | 8.5 | 13.4 |
| Consumer Staples | 0.5 | 3.2 | 2.7 | 0.4 | 0.5 | 7.7 |
| Healthcare | -1.0 | -0.5 | -1.1 | -3.2 | 2.2 | 3.8 |
| Energy | -1.0 | 0.9 | 1.2 | -0.6 | -0.9 | 1.1 |
| Industrials | 0.3 | 0.7 | 2.3 | -1.6 | -2.4 | 0.8 |
| Materials | 0.0 | 1.5 | -2.1 | -2.5 | -0.4 | -0.2 |
| Financials | 0.0 | -1.5 | -0.1 | 0.5 | -0.5 | -1.3 |
| Consumer Discretionary | 1.7 | -1.0 | -1.8 | -1.8 | -3.2 | -3.4 |
| Communications | -0.7 | 1.1 | 2.3 | -5.1 | -4.1 | -7.0 |
| Real Estate | -5.2 | -5.9 | -4.0 | -10.0 | -4.3 | -7.5 |
| IT | -3.8 | -6.7 | -5.0 | -16.0 | -18.4 | -22.2 |

Red indicates underperforming benchmark | green indicates outperformance

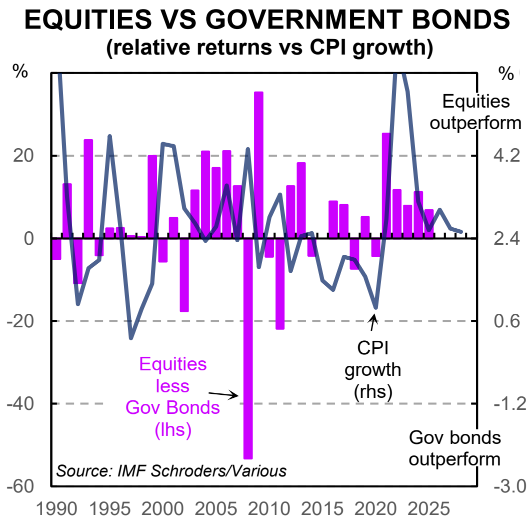
Source: PinPoint Macro Analytics, Macrobond, S&P Global

Higher bond yields following on from RBA rate rises are often a negative for the returns on real estate investment trusts (or REITS). Higher yields make government bond returns more attractive, with no property risk. High leverage means REIT borrowing costs rise.

Commercial real estate expectations have had a common theme in recent years. The consensus among industry experts has favoured Industrial outperforming Office and Retail. Industrial is helped by tight vacancies and strong rental growth.

Once we move beyond these *absolute* return outcomes following RBA interest rate rises, *relative* returns become more important.

Broader macroeconomic measures are often more useful as guides to relative returns. In an environment where inflation is of concern, expected CPI growth rates, for example, suggest an environment where Australian corporate bonds should outperform Australian government bonds (Chart 29).

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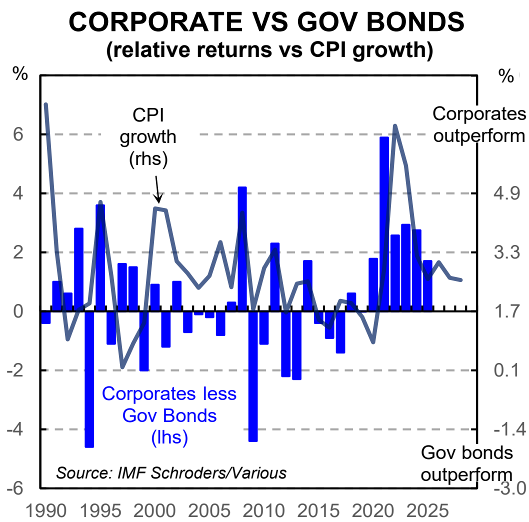



*Figure 29*

The implications of the expected inflation backdrop are less clear cut for equities vs Government bonds (Chart 28) and equities vs corporate bonds (Chart 30).

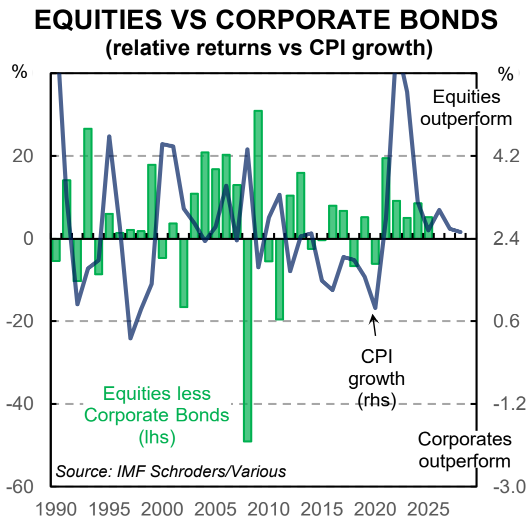



*Figure 30*

Drilling down further into the investment universe and global factors come more into play.

Forecasts for global GDP growth, for example, suggest speculative grade default rates should remain relatively low. (Chart 31). In turn, speculative grade bonds should outperform investment grade bonds (Chart 32).

The relative outperformance of emerging markets against the advanced economies should favour emerging market bonds over US Treasurys (Chart 33).

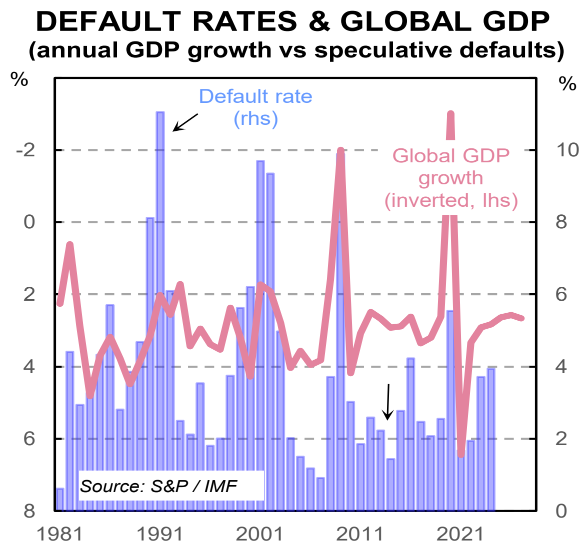
A look across the broader asset classes and their performance in 2025 also throws up some potential risks to watch. These signals are summarised in Table 2 and Table 3 on the next page.

- The ever-popular Bitcoin was finally dethroned from its top slot in 2025. A timely reminder, perhaps, that prices can fall as well as rise. And that financial market "bubbles" are sometimes real. Interestingly, many of the technical indicators that were signalling "overbought" are now in "oversold" territory.
- The Bitcoin experience is worth filing away for those investors in precious metals that have taken the top slot from Bitcoin.
- Beyond precious metals, equity markets were the star performers in 2025. The USD and Oil ended the year at the bottom of the list.
- A selection of thematic investments highlight some important longer-run themes.

Environmental concerns saw "clean energy" at the top of the return list in 2025. The huge global infrastructure task saw related investment funds near the top of the list. The aging population story means healthcare-related funds are moving up the return list.

- The one surprising outcome in 2025 is that AI-related funds fell short of the hype after a couple of years near the top of the return's rankings. It seems that some sort of re-evaluation is underway. And that has certainly weighed on the sector so far in 2026.

Meanwhile, I'm off to renew my term deposit!

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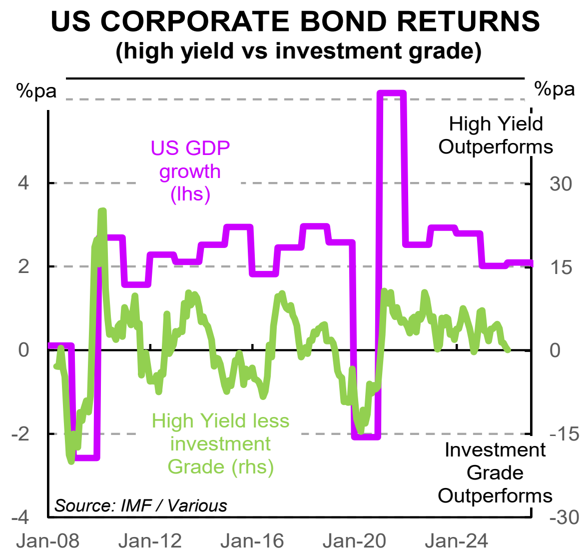


*Figure 32*

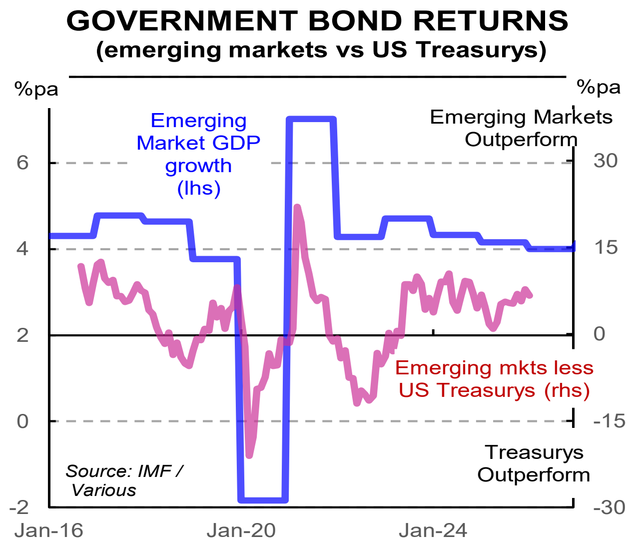


*Figure 33*

Table 2.

## Asset Classes Annual Performance Ranking

| Rank | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 YTD |
|---|---|---|---|---|---|---|---|
| 1 | Bitcoin 303 % | Bitcoin 59.7 % | Commodities (GSCPI) 26 % | Bitcoin 155 % | Bitcoin 121 % | Platinum 144 % | Gold 13 % |
| 2 | S&P 500 Growth 33 % | Oil 52.9 % | Oil 8.7 % | S&P 500 Growth 30 % | S&P 500 Growth 36 % | Gold 67 % | Oil 11 % |
| 3 | Gold 25 % | Commodities (GSCPI) 40.4 % | USD Index 7.8 % | S&P 500 26 % | Gold 26 % | EM Equities 34 % | Commodities (GSCPI) 8 % |
| 4 | S&P 500 18 % | S&P 500 Growth 32.0 % | Platinum 7.5 % | S&P 500 Value 22 % | S&P 500 25 % | S&P 500 Growth 22 % | EM Equities 7.3 % |
| 5 | EM Equities 18 % | S&P 500 28.7 % | Gold 0.44 % | Gold 15 % | S&P 500 Value 12 % | S&P 500 18 % | S&P 500 Value 4.8 % |
| 6 | Platinum 17 % | S&P 500 Value 24.9 % | S&P 500 Value -5.2 % | EM Equities 9.8 % | Commodities (GSCPI) 9.2 % | S&P 500 Value 13 % | S&P 500 1.4 % |
| 7 | US Fixed Income 6.9 % | USD Index 6.7 % | US Fixed Income -13 % | US Fixed Income 3.9 % | EM Equities 7.5 % | Commodities (GSCPI) 7.1 % | US Fixed Income 0.37 % |
| 8 | S&P 500 Value 1.4 % | US Fixed Income -1.3 % | S&P 500 -18 % | USD Index -2 % | USD Index 7 % | US Fixed Income 6.1 % | USD Index -0.7 % |
| 9 | USD Index -6.7 % | EM Equities -2.5 % | EM Equities -20 % | Platinum -3 % | US Fixed Income 0.38 % | Bitcoin -6.3 % | S&P 500 Growth -1.6 % |
| 10 | Oil -22 % | Gold -4.3 % | S&P 500 Growth -29 % | Commodities (GSCPI) -4.3 % | Oil -2.9 % | USD Index -9.4 % | Platinum -7.7 % |
| 11 | Commodities (GSCPI) -24 % | Platinum -10.2 % | Bitcoin -64 % | Oil -10 % | Platinum -8.7 % | Oil -19 % | Bitcoin -20 % |

Table 3.

## Annual Performance Ranking By Selected Theme

(Based on ETF Total Returns | USD)

| Rank | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026 YTD |
|---|---|---|---|---|---|---|---|
| 1 | Global Clean Energy 142 % | US Regional Banks 38.9 % | S&P GSCI Commodities 24 % | Global Robotics & AI 38 % | US Regional Banks 24 % | Global Clean Energy 42 % | US Regional Banks 14 % |
| 2 | Global Robotics & AI 53 % | S&P GSCI Commodities 38.8 % | Global Infrastructure -1.2 % | US High Yield Corporates 11 % | Global Infrastructure 15 % | MSCI EM Equities 34 % | Global Clean Energy 13 % |
| 3 | US Health Care 18 % | US Health Care 20.4 % | US Health Care -5.5 % | JP Morgan EM Bonds 10 % | Global Robotics & AI 13 % | Global Infrastructure 21 % | MSCI EM Equities 9.8 % |
| 4 | MSCI EM Equities 17 % | Global Infrastructure 11.6 % | Global Clean Energy -6.4 % | US Inv Grade Corporates 9 % | S&P GSCI Commodities 8.5 % | US Health Care 15 % | S&P GSCI Commodities 8.1 % |
| 5 | US Inv Grade Corporates 11 % | Global Robotics & AI 7.9 % | US High Yield Corporates -11 % | MSCI EM Equities 9 % | US High Yield Corporates 7.5 % | JP Morgan EM Bonds 14 % | Global Infrastructure 7.1 % |
| 6 | US Treasurys 6.9 % | US High Yield Corporates 3.7 % | US Green Bonds -13 % | Global Infrastructure 6.2 % | MSCI EM Equities 6.5 % | US Regional Banks 13 % | US Health Care 1.2 % |
| 7 | US Green Bonds 6.9 % | US Treasurys -1.3 % | US Treasurys -13 % | US Green Bonds 6.2 % | JP Morgan EM Bonds 4.8 % | Global Robotics & AI 13 % | JP Morgan EM Bonds 0.86 % |
| 8 | JP Morgan EM Bonds 5.4 % | US Inv Grade Corporates -1.8 % | US Inv Grade Corporates -18 % | US Treasurys 3.9 % | US Health Care 2.5 % | US High Yield Corporates 8.6 % | US High Yield Corporates 0.72 % |
| 9 | US High Yield Corporates 4.5 % | JP Morgan EM Bonds -2.5 % | JP Morgan EM Bonds -19 % | US Health Care 2.6 % | US Green Bonds 2.4 % | US Inv Grade Corporates 7.9 % | US Inv Grade Corporates 0.71 % |
| 10 | Global Infrastructure -6.5 % | US Green Bonds -2.8 % | MSCI EM Equities -21 % | S&P GSCI Commodities -5.5 % | US Inv Grade Corporates 0.48 % | US Green Bonds 7.3 % | US Green Bonds 0.5 % |
| 11 | US Regional Banks -7.6 % | MSCI EM Equities -3.6 % | US Regional Banks -21 % | US Regional Banks -8.5 % | US Treasurys 0.38 % | US Treasurys 6.1 % | US Treasurys 0.37 % |
| 90 | S&P GSCI Commodities -24 % | Global Clean Energy -24.6 % | Global Robotics & AI -42 % | Global Clean Energy -19 % | Global Clean Energy -26 % | S&P GSCI Commodities 5.9 % | Global Robotics & AI -0.59 % |

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