

Weekly Economic Update



18 September 2026

"Inflation is too high". This blunt phrase could have been uttered by Michele Bullock but, actually, it was freshly-minted chair of the US Federal Reserve Kevin Warsh, who said this on Wednesday when raising interest rates for the first time since 2023. The Fed's unanimous board decision follows recent hikes by the ECB, the RBNZ and the BoJ.

Until recently, the RBA stood alone in tightening monetary policy, outside the persistent hikers in Tokyo. Other central banks joining the fray builds momentum for even higher interest rates, and greases the wheels for further local rate hikes, too. Before, the RBA hiking in isolation risked the AUD shooting up and damaging our export competitiveness.

Futures markets price an 80% chance of a quarter point rate hike by the RBA later this month - two such hikes are fully priced by the end of the year. That sounds about right given that inflation here remains stubbornly elevated, the labour market is resilient and Canberra's money hose continues to gush, most recently via (even) more industry support to buttress at-risk unionised jobs.

The bond markets have been influential in shifting reluctant central banks off the fence. The spike in yields in recent months (yields in the US pierced 5% for the first time since before the GFC) reflects not only ballooning public debt and persistent budget deficits, but fears central banks were letting inflation get away unchecked. Those fears will calm now, but the fiscal pressures remain.

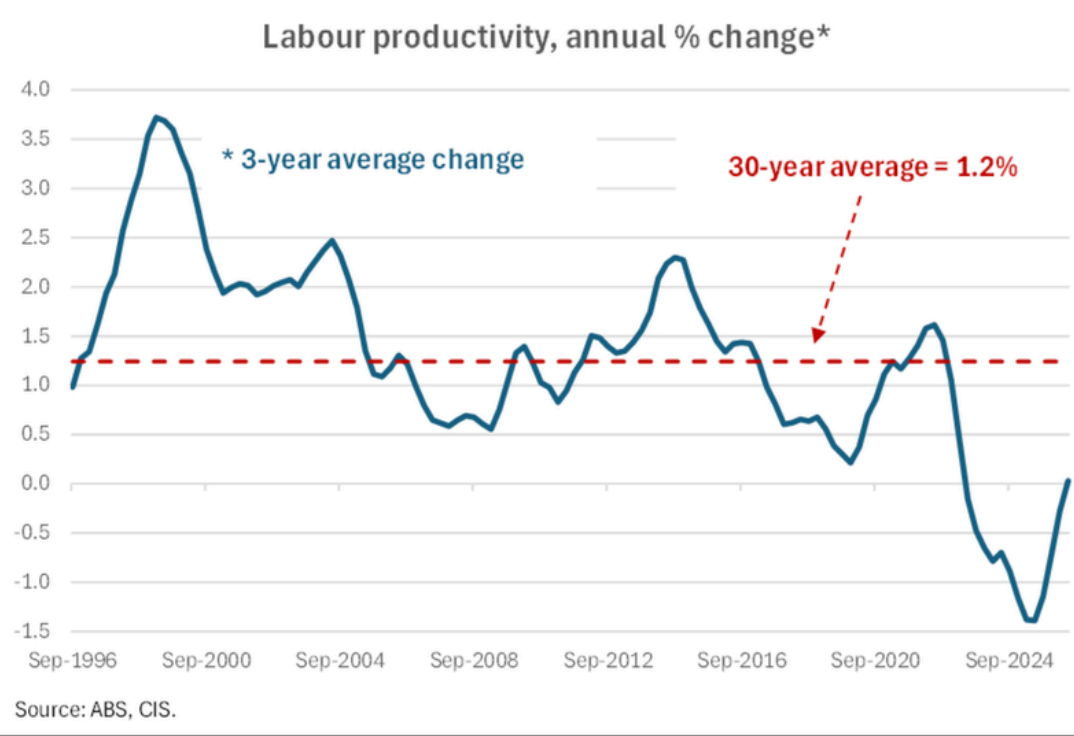
For Australia, the bond market sell off means higher interest costs on our \$1 trillion of federal public debt. We have favourable debt metrics relative to others as a share of GDP, but there is no sign of genuine fiscal restraint here. Interest costs already are the fastest growing line item in the federal budget and the yawning gap over other spending measures now will widen.

It will be interesting to see what the Treasury says about this in Monday's Intergenerational Report (IGR), if anything. The five-yearly snapshot of public finances will include a long run estimate of productivity growth, currently tracking along dismally at ... zero. Media leaks suggest the long run IGR assumption will stay at 1.2% (the 30-year average - *see chart over the page*). But that's fantasy given recent trends and because current policies mostly drag on productivity.

The main policy news this week (outside more panicked retreats on the contentious investment tax changes) was the federal government's belated efforts to curb migration. The published data showed that net overseas migration slowed ahead of these changes, but bolder action is needed if the needle is to move. Farmers and others reliant on seasonal labour are furious - they will struggle to find the temporary workers they need.

Meanwhile, the rate at which the local housing market is bleeding out appears to have slowed. Auction clearance rates picked up last weekend in the second week of the spring selling season. That's great, but the heightened uncertainty created by housing tax changes persists. And pessimism likely will deepen if the RBA taps the brakes again as expected. This downturn still has further to run.

Finally, there was more bad news from the Middle East. The alternative seaborne exit path for crude oil via the Red Sea all but closed last weekend following attacks by Houthi rebels. A crucial pipeline through Saudi Arabia also was damaged. Crude oil prices spiked well above US\$100 per barrel as a result, so petrol prices here are rising again. See above on inflation and RBA rate hikes.



Stephen Walters
Chief Economist,
Optimal Economics

Call us:
+61 499 976 196

Email:
stephenwalters@optimaleconomics.com.au

Website:
<https://optimaleconomics.com.au/>