

# Weekly Economic Update



OPTIMAL  
ECONOMICS

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Last week's contentious federal budget has not survived contact with the real world. As more details are revealed (or discovered), influential dissenters have emerged alongside a dwindling number of cheerleaders. While some budget measures no doubt sounded good in theory and in focus groups, many carry unintended consequences. The debate over equity and fairness rages on, but the budget has added ambiguity to an already uncertain investment environment.

The budget's initial impact showed up in weaker home auctions. Uncertainty about tax arrangements saw fewer than half the homes offered for auction in Sydney last weekend sell. The number of auctions also was lower. House prices were falling in Sydney and Melbourne before the budget, but auction clearance rates as weak as this suggest house price declines could accelerate.

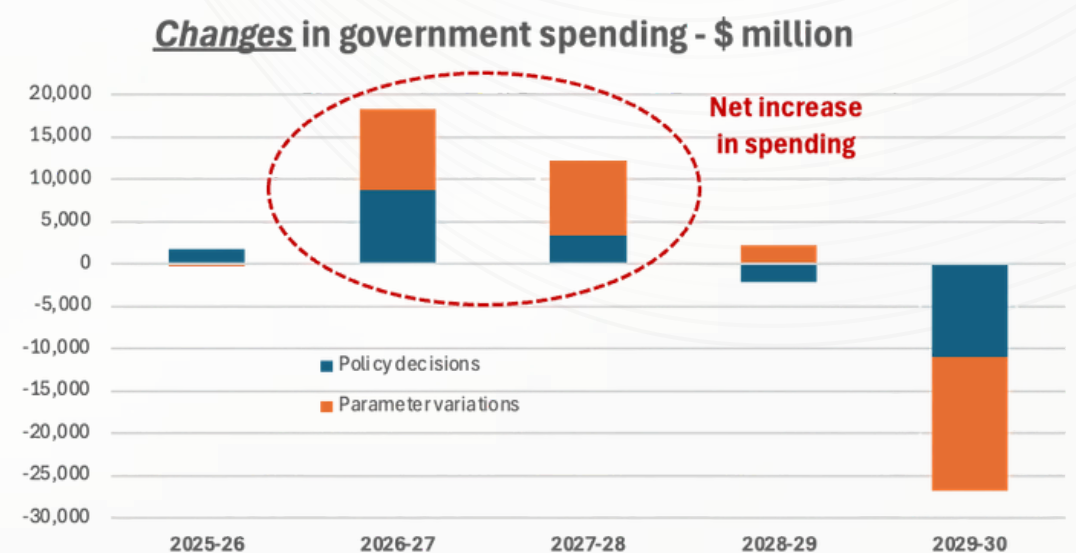
Opinion polls suggest the budget is all but "friendless" in key demographics, including among the youngsters it was supposed to help. But the results of this week's WMI Consumer Sentiment survey were more welcoming. The May confidence survey, partly collected after the budget was released, showed a small rise in the headline index. But, overall, consumers remain "deeply pessimistic", according to Westpac.

Reserve Bank officials are weighing the impact of budget decisions. On Tuesday, minutes of the last board meeting, at which officials raised the cash rate by an 8 to 1 vote, revealed that members now believe they have "space" to see how the Iran war evolves and how households and businesses respond.

And now, how the budget lands. The reference to "space" implies the RBA may pause from here, especially since monetary policy now is "restrictive".

A key complication is that fiscal policy is anything but restrictive. The so-called "table of truth" in last week's budget (page 98 of BP 1 for the nerds) shows that policy decisions and parameter variations will unleash another \$18 billion in additional government spending in 2026-27 and another \$12 billion in 2027-28 (see chart below). This after the RBA Governor asked governments to refrain from additional stimulus given elevated inflation.

Unrelated to the budget, Thursday's jobs report for April was a shocker. Employment fell for the first time this year (down nearly 19,000 positions) and the unemployment rate rose to 4.5%. Economists had forecast a decent gain in jobs last month and a flat jobless rate at 4.3%. It looks like the long-awaited weakening in the labour market has arrived.



Source: Budget Papers, Optimal Economics.

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Overseas, China's monthly data-dump revealed a two-speed economy. Exports are booming, but indicators of domestic activity are shrivelling. Fixed asset investment unexpectedly fell in April and growth in both industrial production and retail spending fell short of expectations. Recall that the world's second largest economy takes 30% of Australia's goods exports.

Finally, in financial markets, the interest rate on Australian government bonds has risen to a 15-year high above 5%, partly reflecting investor concerns about our growing debt pile. While bond yields have risen pretty much everywhere in response to the war in the Middle East, investors are demanding a premium return to hold Australian government bonds, which the market now perceives as riskier.



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