

Mid-year Economic & Equity Market Outlook

Australian Equities

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Economic Outlook

Following the onslaught of tariffs, Ausbil went into the 'war room' on April 2nd to map out and navigate economic and investment strategy. As a result, we implemented a risk management framework based on scenario analysis. We did the same successfully during the Pandemic.

Within our base case scenario, our key assumption is that the Trump administration will negotiate on a bilateral basis with willing countries to adjust their respective tariff levels lower, toward the minimum 10% level, with the Fed cutting by up 50 to 75 basis points. For completeness, our bear case assumes that higher tariffs remain with little downward negotiation (this is not our view), and central banks are late to cut rates to offset the growth impact, leading to a shallow technical recession. Our bull case assumes new bilateral negotiations result in effective tariffs falling below the 10% average, with multiple rate cuts from the Fed totalling more than 75bps, with the US economy achieving 2.5% year-average growth in calendar 2025, and a faster decline in the rate of core inflation to target. Our 'bull case' scenario has been ascribed a 20% probability by Ausbil, the 'bear case' a 15% probability, and our 'base case' scenario a 65% probability.

Subsequent developments from our updated scenario analysis have validated our base case assumptions and conclusions, with follow-up tariff relief announcements from President Trump, and seventy-five countries currently in bilateral negotiations with the US, markedly subduing market volatility, and seeing a return in market confidence, reflected in the outperformance of global equity markets.

Australian Economic Outlook

Our outlook for Australian growth remains unchanged (at an average of 2.5% for calendar year 2025), given that Australia is in a strong position in having a trade surplus with the US (meaning that we buy more from them than we sell to them). The driver of activity sees growth being handed from the public to the private sector, where the trough in private demand was set in the September quarter of 2024.

The March quarter's core measure of trimmed mean inflation saw the 6-month annualised rate at the mid-point of the RBA's target range of 2 to 3%. Ausbil has been saying for some time that an ongoing improvement in the inflation dynamics should provide an opening for the RBA to consider adjusting rates to a lower cycle terminal level. Building on an improving inflation profile, Australia will benefit from China's deflationary wave of finished export goods seeking new alternative markets to the US tariff wall. The deflation from imported goods will give additional flexibility for rate cuts of up to 50 basis points and more if required on worsening global macro-economic conditions.



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The unemployment rate is projected to remain in the low 4% range as labour supply and demand move into balance. This will be a remarkable achievement in holding on to a 50-year broad-based gain in employment conditions. Putting this in context, we have experienced close to a sustained 2% fall in the unemployment rate from the pre-pandemic 5-year average of 5.7%. Importantly, nominal wages are projected to stabilise at 3.5%, consistent with the core inflation target.

We export A\$560 billion worth of goods and services and, based on past experience, Australia is expected to be insulated from tariffs. The material risk of A\$214 billion in direct exports to China is in resource raw material commodities which will be required as an input in additional Chinese stimulus measures. Fortunately, we continue to benefit from our growing export exposure of A\$258 billion to the Indo-Pacific region of fourteen countries (which excludes China). This region is experiencing robust real growth rates in the range of 5% to 6%.

Structural underlying demand for resources, a relatively stable interest rate differential and forecast limited impact from tariffs should collectively underpin the Australian dollar, anchoring it at around AUD/USD 65 cents in 2025, with an upward bias heading into 2026.

The tariff shock is baking in more global rate cuts, which will be stimulative and supportive of real activity. We believe that Trump's tariffs are about negotiation, and that countries that seek to co-operate with the US will be able to mitigate the negative impact on their economies and for global growth. Based on our scenario analysis we will be cross-checking the latest information against our checklist of macro and financial variables. and we will make any necessary adjustments as events unfold.

Australian Equity Market Outlook

The first half of calendar 2025 was volatile, with escalation in Middle East tensions that saw Israel and Iran trade missile bombardments, and the US target Iran's nuclear facilities. This was an escalation of the ongoing war in Gaza between Israel and Hamas, which has also seen activity in the Straits of Hormuz from the Iranian-backed Houthis, threatening to restrict shipping, and importantly, oil. A ceasefire of sorts was negotiated before month end and the markets closed in positive territory. We are still in the tariff pause period and markets remain hopeful, even though the Fed held rates steady at their June meeting.

As a result of tariffs and tensions, we witnessed high volatility with major market moves the size of which we have not seen since the Global Financial Crisis in 2008/09. June has seen further steps towards negotiated outcomes with Europe and China. Markets have continued to respond positively, and with tariffs currently on hold, they ended the quarter well.

Ausbil's view of the US economy is that tariffs will have a downward drag on growth in the near term, before growth begins to build again at the end of 2025 and into 2026. We think the chance of a US recession is less than the market is ascribing because considerations such as tax cuts, deregulation, lower oil prices, lower core inflation and lower interest rates will help offset some growth drag from tariffs. With the quantum of monetary tightening undertaken by global central banks in 2022 and 2023, monetary authorities have significant room to stimulate should this be needed.

Ausbil is seeing opportunities in equities that are relatively shielded from, or are beneficiaries of, the new US tariff policy. While tariffs have caused a potential major shake-up in global trade, Ausbil expects Australian growth to be relatively unchanged and expect Australian companies to generate earnings growth in excess of consensus expectation of +6.1% in FY26 (S&P/ASX 300). Underpinning our outlook for equities are a number of structural drivers that are offering opportunities. These include an increased commitment to military spending globally (as the US withdrawal of support for Ukraine and others has sparked an upward shift in defence spending); increased investment in infrastructure to accommodate the growth in AI; ongoing investment to secure independent energy security; and the increase in demand for electricity over carbon-based energy.

Consensus estimates for the S&P/ASX 300 Index forecast EPS growth at -4.0% for FY25 and +6.1% for FY26. The market is now offering PE valuations of 20.2x and 19.1x for FY25 and FY26 respectively, with a dividend yield of 3.2% for FY25.

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