2026: Rinse and repeat?

By Tim Toohey, Head of Macro & Strategy

the 2026 outlook macro

In our 2025 outlook we concluded that the Reserve Bank of Australian (RBA) was too optimistic on Australia's economic growth outlook and that market expectations for just one rate cut in 2025 were too conservative.

At the time, we suggested that economic growth would average 1.8% in 2025, which is now the RBA's estimate for the 2025 year (down from their 2.2% estimate made in November 2024), which combined with our analysis that the RBA had overestimated the inflation outlook, suggested to us that 100bps of rate cuts in 2025 would be more likely.

In the end, the RBA delivered 75bps of cuts, with rising asset prices and a utility subsidy-distorted September quarter CPI print working against a late 2025 rate cut. While our forecasts for the economy proved mostly accurate, for much of 2025 it has seemed that asset class forecasts might prove more elusive.

Our asset views were to be long equities and credit into mid-2025 before rebalancing towards bonds in the back half of the year. 'Liberation Day' tariff announcements in April created sufficient disruption to extend the equities rally into 3Q25, however, at the time of writing equities have since given back all of their 2H25 gains, relative to modest positive gains in bonds over the same period.

In general, our broad asset class recommendation also appears to have been mostly correct, however, the rationale for the recommendation was little more satisfying. We suggested that loose US financial conditions would fuel EPS upgrades in the US, before President Trump's policies ultimately weigh on future growth expectations into year end, and that seems like a fair description of how the year panned out.

The past is prologue, and it serves as a useful segue into the 2026 outlook. Any forecast requires a healthy portion of luck, however as we close out 2025 it does appear that the damage done to the US economy from tariffs, the retreat from institutional norms and the combination of poor employment growth and lack of progress in addressing cost of living pressures has weighed on Trump's political polls. Financial markets and voters are now beginning to contemplate what a post-Trump world will look like.

Yet, any transition away from Trump is unlikely to be seamless and we expect mid-term elections in late 2026 will be highly contested. Voter suppression tactics are likely and it is more probable than not that financial markets will be unable to look through the distraction.

The 'good news' is that Federal Reserve Chair Powell's replacement will undoubtedly be a 'Dove' and it is our expectation that a further 100bps of Fed easing before the end of 2026 will be comfortably achieved. The 'bad news' is that because Trump seems to have no intention to pay down Federal debt with the tariff revenue, longer dated yields may remain stubbornly high. That is, the Fed can keep cutting, but little relief will pass through to mortgage holders since bond holders will demand compensation via higher term premia.

This leaves the US economy primed to under deliver on lofty expectations. The consensus view is that the US manages to deliver a similar pace of economic growth in 2026 as it did in 2025 – around 2% – and that the combination of strong fiscal spending, likely lower Fed interest rates and an AI investment boom will sustain economic growth.

Our view is that the fiscal spending is primarily aimed at extending taxation breaks for the rich rather than driving a significant new economic growth impetus. Interest rate cuts are also more likely to skew to 2H26 rather than the first half and even if bond yields do follow the Fed funds rate lower, the fact that US household cash deposits are now equal to US household debt suggests the economic boost from lower interest rates is mitigated by lower interest income receipts.

That is, the power of the Fed to alter aggregate demand is rapidly diminishing. Finally, while the AI investment boom will inevitably happen, the lessons from prior investment booms – Australia's LNG boom being a recent case in point – is that they are inflationary, take longer to complete than expected, are import intensive and create regulatory and social friction that can diminish broader economic benefits.

In many ways, we remain underwhelmed by the state of the US economy. Housing investment is falling at its fastest pace since 2008, consumption growth is heavy skewed to wealthy households and business investment ex-AI investment is in decline. We think it is more likely that the US will undershoot consensus expectations in 2026 and expand at a pace closer to 1.5%.

On the other side of the Atlantic, the Europeans are still in search of an economic cycle. Output and production data have stagnated yet again, despite the ECB's 235bps of easing since mid-2024. Some modest earnings recovery can be expected in 2026, albeit financial markets have long been priced for such an outcome. In contrast, emerging market economies, excluding LatAM, are expanding solidly, driven in part, by excess global liquidity and China's fiscal and monetary stimulus and this still appears the most durable region for economic growth and asset returns in 2026.

Australia: Recovery underway, but it will feel a whole lot better in 2026

We are as positive on the Australian economic outlook as we have been since our 2020 call for a sharp V-shaped recovery post COVID. This cycle will feel very different compared to 2020 recovery. It is clear to us that it will be a slow-moving recovery, building on the base of the one that commenced in 2025, but we believe it will also be a more durable recovery. Importantly, we expect that private demand growth will continue to take the baton from the public sector to deliver a more inclusive economic climate.

Supportive major trading partner growth sets a tailwind for the Australian economic recovery into 2026. Filling out the sails of the recovery are loosening financial conditions, strong household cashflow growth, solid household wealth growth and early signs of a return of housing equity withdrawals which all contribute to the consumer being the prime driver of economic growth in 2026 and 2027. The amplifier of the economic cycle is the housing sector. A recovery in housing approvals is currently transitioning to improved construction output growth. In concert with record undersupply of housing, lower mortgage rates, government subsidies, regulatory changes to expedite approvals, and labour rotating back from public construction work to the housing sector should all help propel the housing construction cycle through 2026.

It is important to also recognise that some headwinds to economic growth are simultaneously abating. Not least, population growth has normalised from rapid growth towards something that now approximates an equilibrium pace. With the transition to a more sustainable population growth behind us, the drag this imposed on economic growth has receded.

While 2025 was also a year of political uncertainty, the incumbent government now appears well entrenched. Policy certainty is an underrated ingredient in fuelling economic growth and Australia should stand like a beacon in this regard in 2026. In that vein, we are expecting private sector investor to provide positive contributions to economic growth in 2026, however, this could be a source of better-than-anticipated economic growth relative to our forecast.

Perhaps our most out-of-consensus forecast is that we expect the RBA to cut interest rates by 75bps in 2026, commencing in May. The rationale is that: (i) inflation is likely to be a bit below the RBA's current forecast track, (ii) a rising Australian dollar will inevitably tighten financial conditions, particularly as the Fed expedites its own easing, and (ii) we expect productivity to post a solid cyclical rebound through 2026.

All of this suggests to us that the easing cycle in Australia is FAR from complete.

We expect Australia's economic growth to average 2.25% in 2026 and 2.5% in 2027. We expect 10-year bonds to finish 2026 at 4.0% and the A$/US$ to finish 2026 at 73c.

Tactical positioning: Strong EM, Strong Australia

We expect that 2026 may well feel a lot like an echo of 2025.

A weaker US$, a steeper yield curve and long EM trade appear likely to be the dominant themes again in 2026. The key difference is that the gloss is coming off the 'Trump-trade'. Backing tariff winners, crypto, financial deregulation and all things AI/Tech may well feel so 2025 by mid-2026.

We are loath to make economic and asset class recommendations based on the likely outcome of US mid-term elections, but we suspect that Trump will become more disruptive for financial markets as the mid-term election approaches. There may be more alpha available in positioning for the unwinding of the 'Trump trade' and positioning for a post-Trump world.

We expect a bumpy but positive ride for equities in 2026, with a total return of +9% for the US, +12% for EM, and +10% for Australia.

Within rates, we expect yield curve steepening to be in vogue in 1H26 in anticipation of a dovish Fed and stubbornly high government debt in the US.

We favour commodities, with metals and energy likely to outperform gold. We are cautious on private credit and within public credit we remain more constructive on IG.

In short, in 2026 Australia should prove an increasingly attractive destination for foreign capital seeking to capitalise on EM resilience, a rising A$, effective monetary stimulus, stable fiscal finances, and Australia's solid demand growth trajectory.

Contact us

If you require further information, please contact your relevant Business Development Manager.

2026 may well feel a lot like an echo of 2025

that is not up to date. No part of this material may, without the Yarra Capital Management Group's prior written consent be copied, photocopied, duplicated, adapted, linked to or used to create derivative works in any form by any means.

YFM manages the Fund and will receive fees as set out in the PDS. To the extent that any content set out in this document discusses market activity, macroeconomic views, industry or sector trends, such statements should be construed as general advice only. Any references to specific securities are not intended to be a recommendation to buy, sell, or hold such securities. Past performance is not an indication of, and does not guarantee, future performance. Information about the Fund, including the relevant PDS, should not be construed as an offer to any jurisdiction other than in Australia. With the exception of some Funds that may be offered in New Zealand from time to time (as disclosed in the relevant PDS), we will not accept applications from any person who is not resident in Australia or New Zealand. The Fund is not intended to be sold to any US Persons as defined in Regulation S of the US federal securities laws and has not been registered under the U.S. Securities Act of 1933, as amended.

References to indices, benchmarks or other measures of relative market performance over a specified period of time are provided for your information only and do not imply that the portfolio will achieve similar results. Holdings may change by the time you receive this report. Future portfolio holdings may not be profitable. The information should not be deemed representative of future characteristics for the strategy. There can be no assurance that any targets stated in this document can be achieved. Please be advised that any targets shown are subject to change at any time and are current as of the date of this document only. Targets are objectives and should not be construed as providing any assurance or guarantee as to the results that may be realized in the future from investments in any asset or asset class described herein. If any of the assumptions used do not prove to be true, results may vary substantially. These targets are being shown for informational purposes only.