

## A materially bigger and more persistent shock

Westpac Economics

- Longer Middle East disruption lifts peak prices for oil and gas, lengthens recovery. Infrastructure damage exacerbates the shock. Brent oil now expected to peak at an average \$120/bbl in Q2 and Japanese LNG prices at \$26mmbtu.
- Australian CPI inflation now expected to peak at 5.4%yr in June quarter, and even higher on the monthly series, despite the announced cut to fuel excise. Trimmed mean inflation peaks around 4% in 2026 H2. Food prices a particular concern through to 2028, but broader pass-through to non-energy prices also an issue.
- RBA now expected to hike rates three times (May, June, August), revised up from one more (in May) previously. Peak cash rate now 4.85%, above previous peak.
- Supply shock and tight monetary policy drag on demand, especially consumption and other interest-sensitive sectors. GDP growth forecast to trough at 1%yr in 2027; unemployment rate peaks at 5% end-2026.

### Energy situation

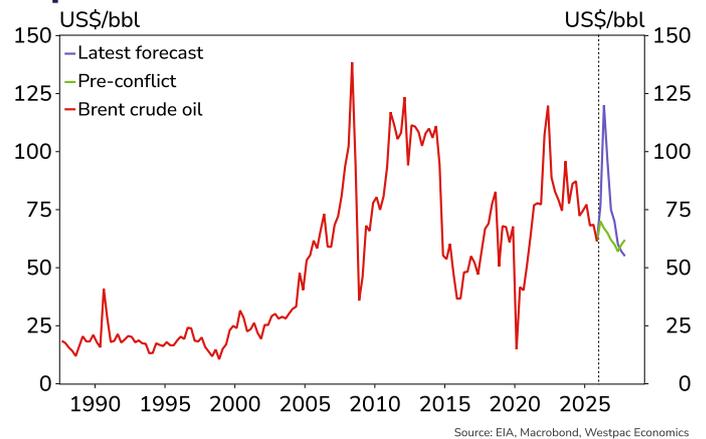
As previously highlighted, the key risk to our previous central case view (released on [March 17](#)) was that the Middle East conflict would prove to be more prolonged than assumed. With the conflict now entering its fifth week, it has become increasingly clear that the US/Israel–Iran confrontation is likely to result in a longer-lasting disruption to energy production in the Middle East and shipping through the Strait of Hormuz. We have therefore revised our baseline assumptions.

Specifically, we now assume the Strait of Hormuz remains effectively closed until the end of April, a total of eight weeks, and takes longer to reopen fully. This compares with our earlier assumption of a one-month disruption followed by a relatively rapid normalisation.

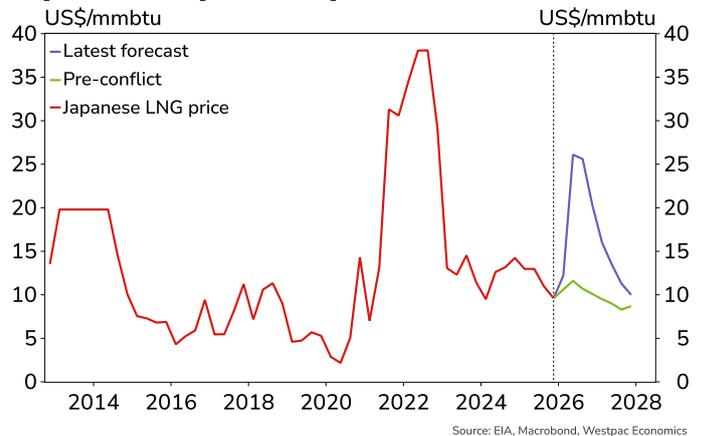
The slower recovery reflects several factors. Recent shipping traffic through the Strait has been limited to countries Iran deems friendly to it. Insurance premiums are expected to remain elevated given the risk of further attacks by regional factions. Shipping companies will also require time to re-establish vessel rotations and contractual delivery arrangements across energy and upstream industrial inputs.

As a result, we now assume traffic through the Strait reaches only around 20% of normal levels in May. Traffic is expected to continue to improve thereafter, although capacity is not expected to return to normal levels until end 2026.

### Oil price scenarios



### Japanese LNG price comparison



The extension of the conflict and slower normalisation will lead to more ‘shut-ins’ (temporary stops in production due to storage capacity limits) among smaller Gulf producers. Coupled with some oil infrastructure damage, we now project this to see a shortfall in global oil production of around 6mb/d on average in Q2. This assumes Saudi Arabia and the UAE continue to divert exports via operational pipelines to partially bypass the Strait, with an available capacity at around 1.6–5.5 mbpd, alongside the release of IEA emergency stockpiles.

Risks around this path remain clearly skewed to the downside, particularly if there is more damage to port and energy infrastructure and/or shipping via the Red Sea is also impacted

<sup>1</sup> The use of ABS input-output tables assumes production processes, consumption patterns and preferences remain fixed. If an energy shock is prolonged, businesses and households may respond to relative price changes, altering the CPI impacts estimated here. This needs to be weighed against the fact that the analysis is confined to domestic production and excludes energy embedded in imported final consumption goods, such as fuel or motor vehicles. As a result, the estimates should be interpreted as capturing domestic cost-pass-through channels rather than the full exposure of the CPI basket to global energy prices.

now that Yemen's Houthi rebels have entered the conflict. This would represent a sharp escalation, but it could also see a faster resolution as it would bring more Gulf state countries into the fray against Iran.

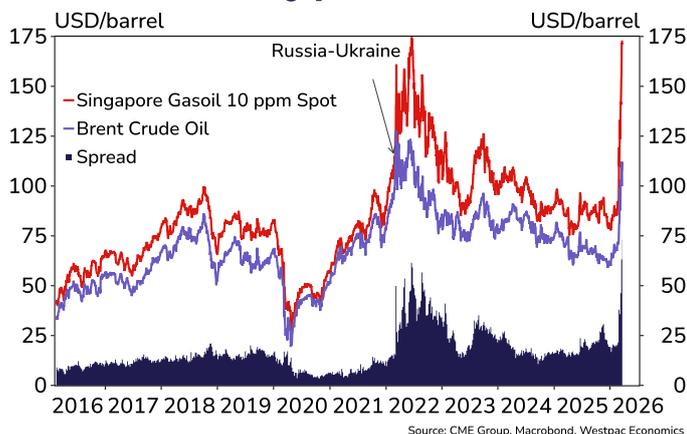
Overall, the changes to our baseline assumptions imply a materially bigger and more persistent energy price shock than previously assumed.

Consequently, we now expect Brent crude oil prices to average around US\$120/bbl in Q2, compared with US\$90 previously. Prices are expected to remain elevated for longer, reflecting both ongoing physical disruptions and a sustained risk premium linked to security and insurance costs. Under our revised base case, oil prices ease only to around US\$75/bbl in Q4, still US\$13 above our pre conflict baseline, and do not converge back to pre conflict levels of around US\$60/bbl until Q2 2027.

The impact on gas markets is even larger than for crude oil. LNG exports from the Middle East, particularly Qatar, have no viable alternative route that bypasses the Strait, leaving supply highly exposed to an extended disruption. Moreover, Qatar's Ras Laffan LNG plant has suffered extensive damage halting production, with reports that it will potentially take up to five years to fully repair. As a result, Japanese LNG prices have surged above US\$20mmbtu in recent weeks and are currently trading US\$10 above pre-conflict levels. We forecast further increases as supply tightens to a quarterly average price of around US\$26mmbtu over the next few quarters. Prices are projected to remain elevated even after oil markets begin to stabilise.

We have also made greater allowance for wider refinery margins than our previous forecasts. Disruptions to crude supply, combined with tight refined product inventories in Asia, have driven a sharp widening in the spread between Brent crude and Singapore Gas10, the key benchmark for Australian petrol and diesel prices. The spread has recently surged to around US\$70/bbl, exceeding levels seen following Russia's invasion of Ukraine. Given the importance of refined product availability and logistics, we expect margins to remain elevated even as the conflict eases, materially amplifying the pass through from higher crude prices to domestic fuel costs.

## Brent Crude oil vs Singapore Gasoline 10



## More acute pressures on supply chains

Given the prolonged closure, we now also assume supply chain pressures are more acute and persistent. Container freight rates have risen by 20% since the start of the conflict, reflecting longer shipping routes, higher fuel costs, insurance surcharges and booking constraints. While freight rates are still lower than the peaks in 2025 and significantly below the extraordinary peaks of 2021–22, Iran is reportedly extracting additional charges from non-hostile vessels negotiating passage through the Strait, further increasing transit costs even where shipping through the Strait is allowed.

The Middle East is also a key upstream supplier of industrial inputs, including fertilisers, chemicals, polymers and metals. Around 33% of global fertiliser trade, particularly urea and ammonia, transits the Strait. Disruptions are already pushing up prices for these inputs, with Egyptian urea prices, a global indicator for fertiliser prices, particularly nitrogen fertilisers, reaching its highest level in more than three years. That said, at around US\$475/t, it is still significantly below its record of \$1050 following Russia's invasion of Ukraine.

Globally, manufacturing PMIs show a sharp re-acceleration in input cost growth, with energy, freight and intermediate goods cited as key drivers, alongside some lengthening in supplier delivery times. In Australia, the PMI manufacturing input price measure has risen to its highest level since August 2023.

However, while supply chain pressures are rising and are expected to remain elevated beyond the end of the conflict, they are expected to remain materially below the peak levels experienced in 2021–22. The port congestion, post-COVID reopening surge in demand and broad-based shortages that were features in this episode remain absent. The appreciation of the Australian dollar, both against the US dollar and on a trade weighted basis, will also provide a partial offset to imported cost pressures, reducing the local currency impact of higher global input prices. In contrast, the AUD/USD cross fell by 9% around during the 2022 episode, amplifying the rise in import costs.

Accordingly, while price pressures are rising, particularly for energy-intensive inputs such as fertilisers and aluminium, the impact on producer prices and the flow through to headline and core inflation is expected to be smaller than during the 2022 cost of living crisis.

## Inflation impact

Both the Oxford Economics model and our bottom-up forecasts imply that higher energy, freight and upstream input costs are expected to lift headline inflation materially over 2026. The direct impact comes firstly through fuel and transport-related components before it broadens as higher distribution and input costs are passed on to a wider range of consumer prices.

Reacting to this, the Australian Government announced that from April 1, the fuel excise tax will be cut in half, reducing the pump price of petrol and diesel by 26¢/litre. We are now expecting headline CPI to peak at 5.4%yr in Q2 2026, up from 4.1% previously, with monthly inflation likely to be even higher breaking through 6%yr around April or May.

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Fuel inflation is expected to contribute 1.1ppt to the headline figure by the June quarter with national weekly average petrol and diesel prices projected to peak at around \$2.65/litre and \$3.25/litre in early April – they would have both been much higher through April and into May were it not for the cut in the fuel excise. The excise only applies to fuels used on Australian roads and is not applied to fuel sold for farming, mining, other industrial purposes, including aviation and shipping.

Higher energy, freight and fertiliser costs are expected to flow through to agricultural prices and food prices with a lag. The pass-through is unlikely to be uniform across products; more energy-intensive production will see greater pass-through, along with products where production elsewhere in the world is constrained. At first glance, winter crops such as wheat would appear to come under pressures, but for now strong global supply balances will keep these prices contained and the risks of large price increases sit more in 2027. At this stage we have food price inflation of more than 4%yr by end 2026 and into the first half of 2028.

We have allowed for larger spillovers into services prices and wages than previously, based on early firm announcements as well as the higher profile for fuel prices. Higher fuel costs are feeding directly into transport prices, including airfares, with Qantas already announcing a 5% price increases in response to higher jet fuel costs. More broadly, higher transport and input costs will mechanically lift prices for items such as eating out and even new home construction, adding to core inflation pressures even as weaker real disposable income growth signals some limited scope for costs to be fully passed on.

We expect the Trimmed mean inflation to peak at around 4.0%yr by end 2026 and remain above 3%yr in 2027. That said, a key risk is that memories of the last global supply shock mean businesses react pre-emptively to increases in prices, something we are already hearing anecdotally. This time around, businesses could also be readier to pass on any actual cost increases to consumers. Indeed, there have already been calls from some Australian businesses to implement a fuel surcharge including the Australian Restaurant and Cafe Association proposing a 5% charge. Again, we see these spillovers as likely to be smaller than in 2022, when demand was recovering strongly, policy was expansionary and a wider range of supply chains were disrupted. They will, however, contribute to a slower normalisation in underlying inflation.

## RBA response

We have changed our forecast for the RBA cash rate, adding in two more hikes, in June and August, on top of the increase we were already forecasting for May. The cash rate is now expected to peak at 4.85%, significantly above the previous peak of 4.35%. With trimmed mean inflation sitting around 4% in the second half of this year and only slowly declining thereafter, the Monetary Policy Board (MPB) will want policy to be clearly restrictive to keep inflation expectations anchored. It will be dismayed at the recent examples of rapid pass-through of energy costs to other prices, and

Despite the weaker economic outlook and potential undershoot of the inflation target implied by these revised forecasts, we think the RBA will be slow to reverse this policy

tightening and risks getting behind the curve in coming years. We push out the date for rate cuts and pencil in four rate cuts, one per quarter in February, May, August and November 2028. We have low conviction about the exact timing.

The main rationales for the slower reversal are that Australia already had relatively limited spare capacity at the point the conflict broke out, and that pre-emptive pass-through by firms could keep underlying inflation high into 2027. We also note that the RBA is likely to have something of a “once bitten, twice shy” approach even as inflation declines towards the 2–3% target range. Inflation kicked up shortly after it cut rates last year, and the MPB would want to avoid a repeat of the backtracking that induced.

## GDP impact

The combination of a deeper energy shock globally and higher path for inflation and interest rates locally points to a more pronounced and prolonged slowdown in the Australian economy than we forecast in mid-March. The combination will place particularly intense strains on the household sector. We now expect real consumption growth to slow to just 1.2%yr in 2026, implying a renewed period of decline in per capita terms.

Higher borrowing and input costs will also weigh on other interest-sensitive parts of the economy, particularly dwelling construction and business investment in construction-related industries, including new commercial buildings.

Taken together, these forces are expected to see real GDP growth slow to just 1% in 2027 and remain subdued at 1.6% in 2027. With population growth running at 1.6%yr, activity is set to contract in per capita terms in 2026, holding flat in 2027. Beyond that, anticipated rate cuts in 2028 should mean that monetary policy no longer prevents a recovery in growth. With energy supply assumed to have recovered by then, demand growth can rebound to 2.8% over 2028, though there will still be considerable spare capacity at that point.

Australia’s labour market is also expected to experience a more pronounced and extended weakening. The combination of slower employment growth and a slightly higher participation rate sees the unemployment rate rise from 4.3% currently to a peak of 5% by year end, holding near these levels through 2027. That additional slack will, in turn, accentuate the moderation in inflation expected to come through as energy price related pressures subside in 2028.

# Economic & financial forecasts

## Interest rate forecasts

Australia	Latest (30 Mar)	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28
Cash	4.10	4.60	4.85	4.85	4.85	4.85	4.85	4.85	4.60	4.35
90 Day BBSW	4.32	4.80	4.90	4.90	4.95	4.95	4.95	4.80	4.55	4.30
3 Year Swap	4.70	4.80	4.75	4.70	4.65	4.60	4.50	4.40	4.30	4.20
3 Year Bond	4.72	4.80	4.75	4.70	4.65	4.60	4.50	4.40	4.30	4.20
10 Year Bond	5.08	5.05	5.05	5.05	5.05	5.05	5.00	4.95	4.90	4.90
10 Year Spread to US (bps)	68	65	65	60	55	50	40	30	20	15
<b>United States</b>										
Fed Funds	3.625	3.625	3.625	3.625	3.625	3.625	3.625	3.625	3.625	3.625
US 10 Year Bond	4.40	4.40	4.40	4.45	4.50	4.55	4.60	4.65	4.70	4.75

## Exchange rate forecasts

	Latest (30 Mar)	Jun-26	Sep-26	Dec-26	Mar-27	Jun-27	Sep-27	Dec-27	Mar-28	Jun-28
AUD/USD	0.6861	0.72	0.72	0.73	0.73	0.74	0.74	0.74	0.73	0.73
NZD/USD	0.5739	0.59	0.61	0.62	0.64	0.66	0.67	0.67	0.67	0.665
USD/JPY	159.72	156	155	154	152	150	148	146	144	142
EUR/USD	1.1506	1.17	1.18	1.19	1.20	1.21	1.22	1.22	1.22	1.22
GBP/USD	1.3254	1.35	1.36	1.37	1.38	1.39	1.40	1.41	1.41	1.41
USD/CNY	6.9103	6.85	6.80	6.70	6.60	6.50	6.45	6.40	6.35	6.35
AUD/NZD	1.1958	1.22	1.18	1.18	1.14	1.12	1.11	1.10	1.10	1.10

## Australian economic forecasts

	2025		2026		2027				Calendar years			
% Change	Q3	Q4	Q1f	Q2f	Q3f	Q4f	Q1f	Q2f	2025	2026f	2027f	2028f
GDP %qtr	0.5	0.8	0.5	0.2	0.1	0.2	0.3	0.4	-	-	-	-
%yr end	2.1	2.6	2.6	1.9	1.6	1.0	0.9	1.1	2.6	1.0	1.6	2.8
Unemployment rate %	4.3	4.3	4.2	4.3	4.6	4.9	5.0	4.9	4.3	4.9	4.9	4.5
Wages (WPI) %qtr	0.8	0.8	0.8	0.8	0.8	0.8	0.7	0.8	-	-	-	-
%yr end	3.3	3.4	3.3	3.2	3.2	3.2	3.2	3.2	3.4	3.2	3.0	3.4
CPI Headline %qtr	1.3	0.6	1.5	1.9	0.9	0.3	0.5	0.6	-	-	-	-
%yr end	3.2	3.6	4.2	5.4	5.0	4.6	3.6	2.3	3.6	4.6	2.4	2.4
CPI Trimmed Mean %qtr	1.0	0.9	0.9	1.0	1.0	0.9	0.8	0.7	-	-	-	-
%yr end	3.0	3.4	3.5	3.9	4.0	4.0	3.8	3.5	3.4	4.0	3.0	2.5

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