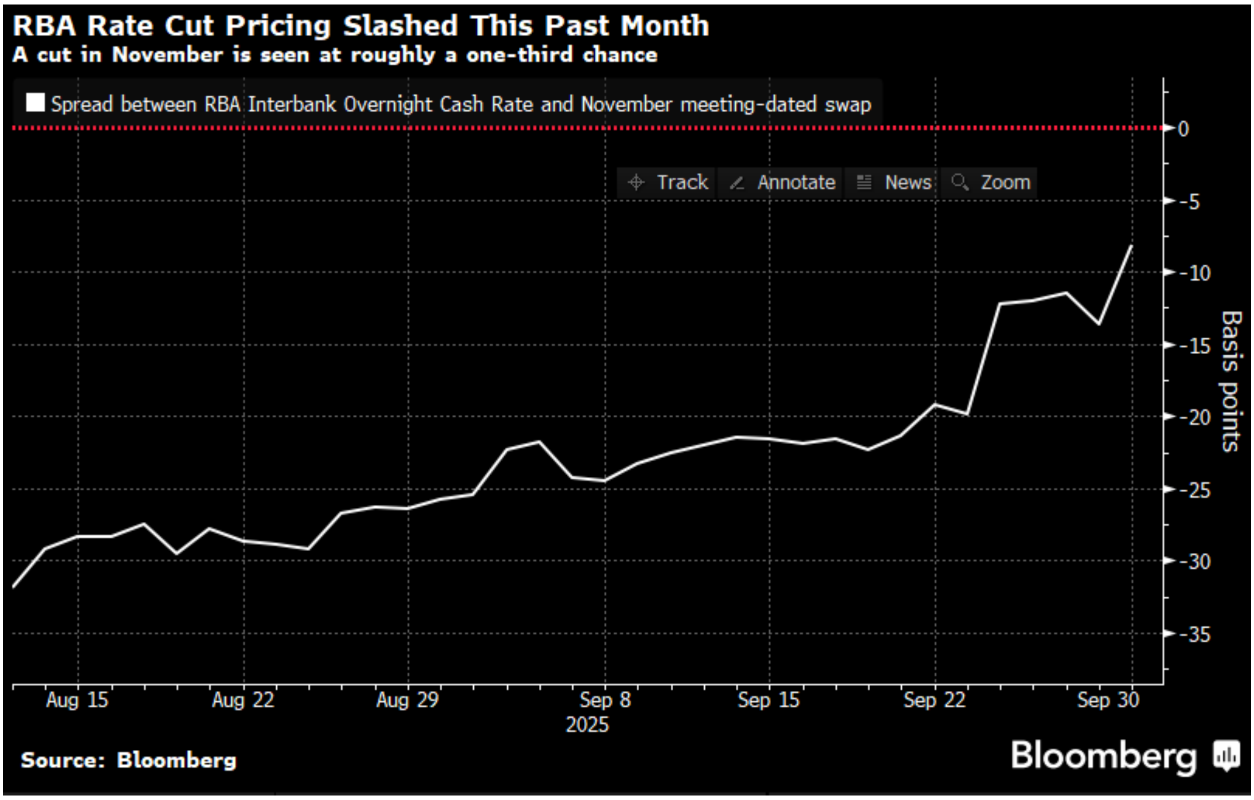
01 October 2025

RBA rates on hold - important not to forget about floaters within portfolios

The RBA has left rates on hold, amidst rising inflation and rising electricity costs. The RBA's rhetoric marked a clear move tilting a more hawkish position prior to the Q3 CPI print due in October 2025. This move reflects the stronger-than-expected monthly CPI for August 2025, primarily in housing and market services, and robust growth in consumption and housing. The RBA governor Michelle Bullock noted inflation persistence and a tight labour market which gives the RBA policy optionality going forward.

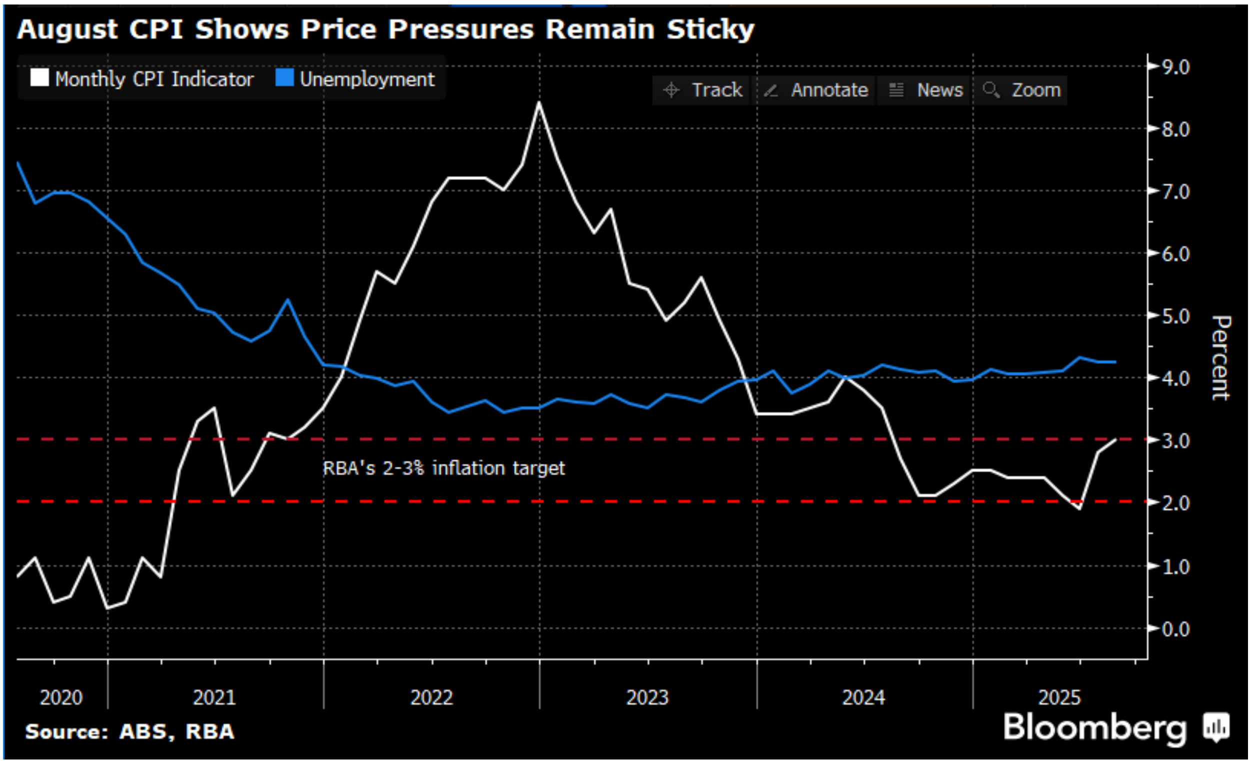
Markets have repriced quickly, with only one cash rate cut forecasted by May 2026 and a one in three chance of a rate cut at the November 2025 meeting. The monthly CPI series showed annual headline inflation of 3% and trimmed mean at 2.6%.



The RBA governor Michelle Bullock noted that there have already been three interest rate cuts since the start of 2025, and the full impact of these cuts is yet to come. She also signalled patience on further interest rate cuts. This means that risks are building of a longer period with rates on hold. The RBA's pause comes after the FED lowered rates this month for the first time since December. Money market pricing implies two more FED rate cuts by the end of 2025. This implies that there should be divergence in short-term yields between Australian (3y) and the US (2y) respectively. On the international front, uncertainty is elevated with the outlook clouded by the Trump Administration's protectionist policies, heightened geopolitical tension and a slowdown in Chinese demand.

If we are indeed near the end of the RBA rate cutting cycle, then it makes sense to have an allocation of floating rate exposure within portfolios. Absent any unforeseen market shock, there is unlikely to be a cash rate cut anytime soon and the market tends to agree. Thus, it would make sense to maintain a balance between fixed rate and floating rate exposure. We had previous proposed a skew towards fixed rate over floating but are now advocating a balance as the fixed rate market already reflects the anticipated rate cuts, and there's not a lot more to be gained by going fixed rate from a capital gain perspective (aside from locking-in higher outright yields). Indeed, if the market is pricing one cash rate cut by May 2026 and only one rate cut is delivered, then yields will likely remain the same, all-else-equal, as the RBA cuts rates. Looking at this from a different perspective, it means that floating rate bonds, even if the RBA only cuts rate once, still offer comparably good value to fixed rate bonds.

We have had two floating rate bond issues recently, AMP IG Tier 2 FRN +190 and Judo HY Tier 2 FRN +215, which allow clients to build up their allocation in floating rate bonds. An IAM sales representative can also provide other floating rate bond opportunities that may work for you.



It's also important to consider what part of the curve your fixed rate exposure is as the RBA expectations around the cash rate tend to impact the Australian (3y-7y). Longer-end bond yields (10y and plus) tend to be impacted by long-term borrowing requirements and less about central bank expectations. Thus, we see more volatility in duration in the longer-end (10y and plus) part of the curve relative to 3-7y where we would advise investors to position their fixed rate exposure.

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