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An Economic Update

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In brief

At the June meeting, the Monetary Policy Board left the cash rate unchanged at 4.35%. Why?

Prior to the Middle East conflict, inflation was too high. Elevated fuel prices have added to this

Increase in capacity pressures since mid 2025 → pick-up in inflation

Middle East conflict directly lifted petrol, diesel and jet fuel prices, and have had knock-on effects through global supply chains

Financial markets expect further increase in the cash rate

Monetary policy board responded to inflationary pressures by raising the cash rate in February, March and May

Further increase expected by the end of 2026

GDP growth expected to slow, elevated inflation and higher interest rates

As demand growth slows demand set to come back into line with sustainable supply, inflation expected to return to target

Unpredictable global environment and domestic conditions means the economic outlook is uncertain

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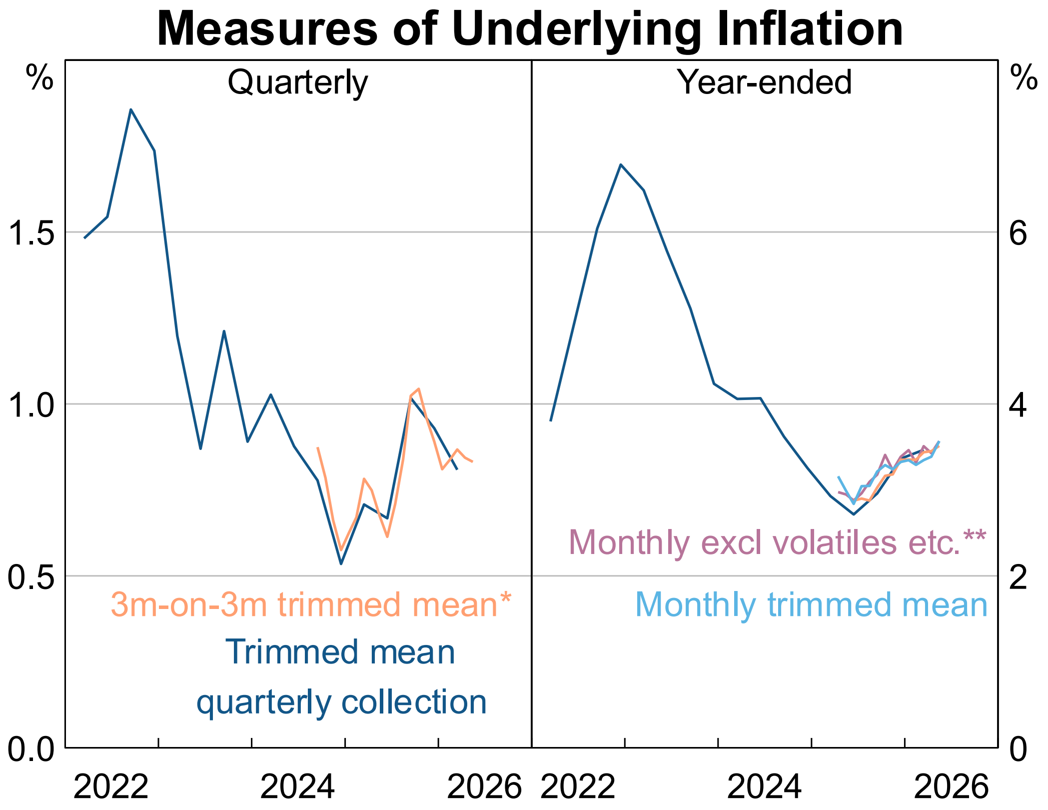
Prior to the Middle East conflict, inflation was too high



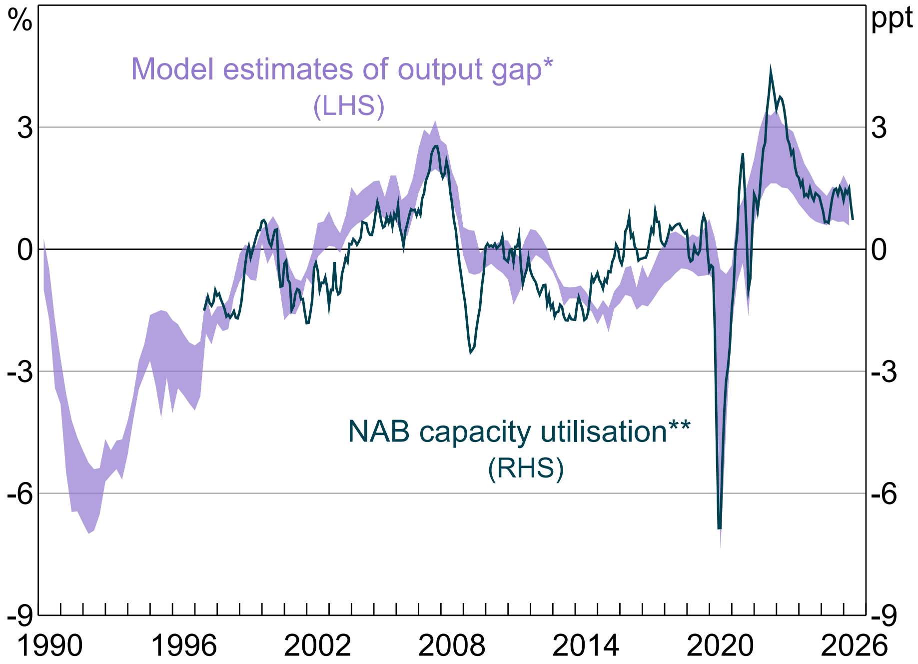
* Calculated based on the distribution of three-month-on-three-month price changes.

** Monthly CPI excluding volatiles, holiday travel and electricity.

Sources: ABS; RBA.

The economy was operating above its sustainable level

Estimates of Capacity Utilisation



* Per cent of potential output; violet-shaded region shows an illustrative range of central gap estimates from a selection of RBA internal models, encompassing different measures and definitions of the output gap.

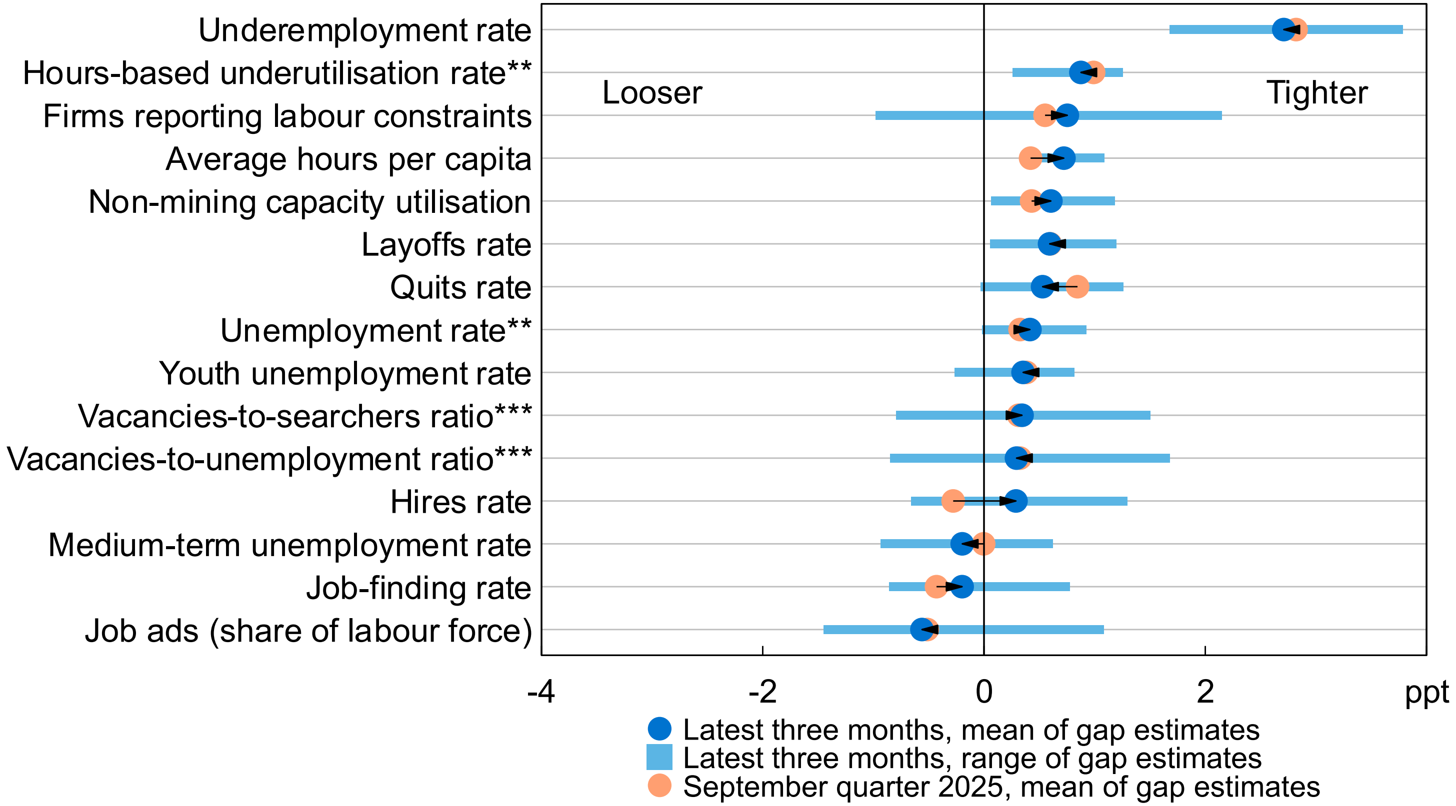
** Three-month moving average deviation from the long-run average capacity utilisation rate; the long-run average is calculated from March 1997 onwards; excludes mining; weighted by industry using share of gross fixed capital formation.

Sources: ABS; NAB; RBA.

Labour market conditions still on the tight side

Indicators of Labour Market Tightness*

Gap between current conditions and estimated trends



* Indicators scaled to the units of the unemployment rate.

** Range includes model-based estimates.

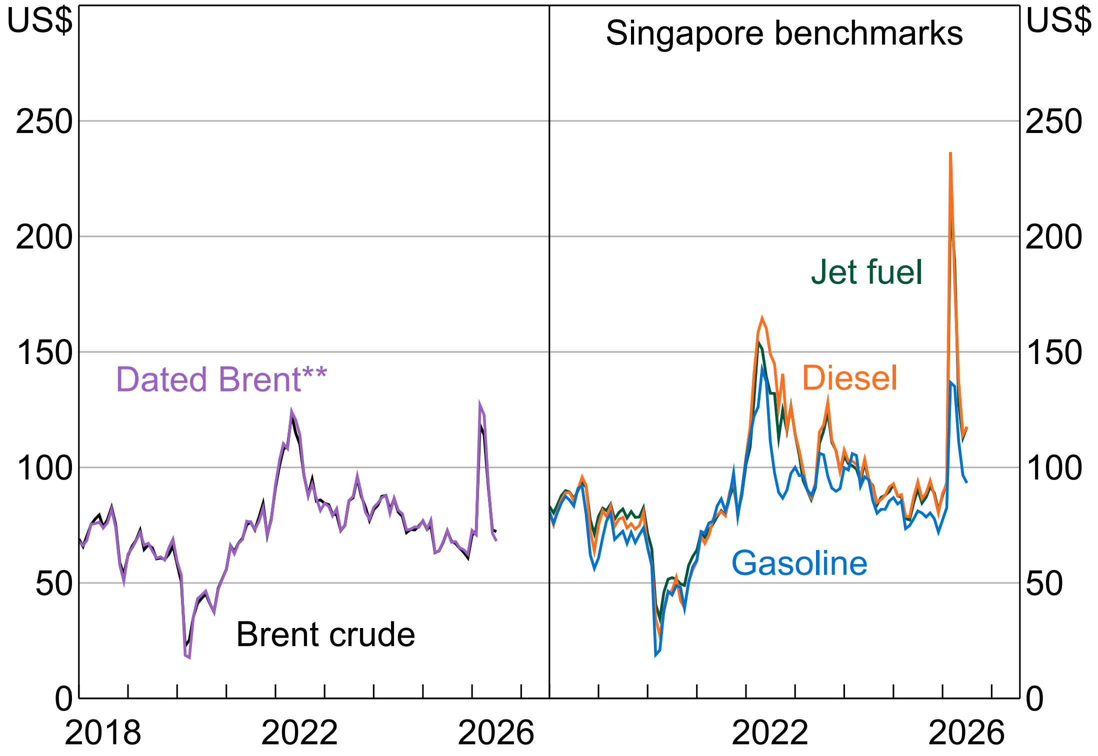
*** Log.

Sources: ABS; ANZ–Indeed; NAB; RBA.

Oil prices have eased in recent weeks following the announcement of a peace agreement between the US and Iran

Oil and Refined Product Prices*

Per barrel, monthly



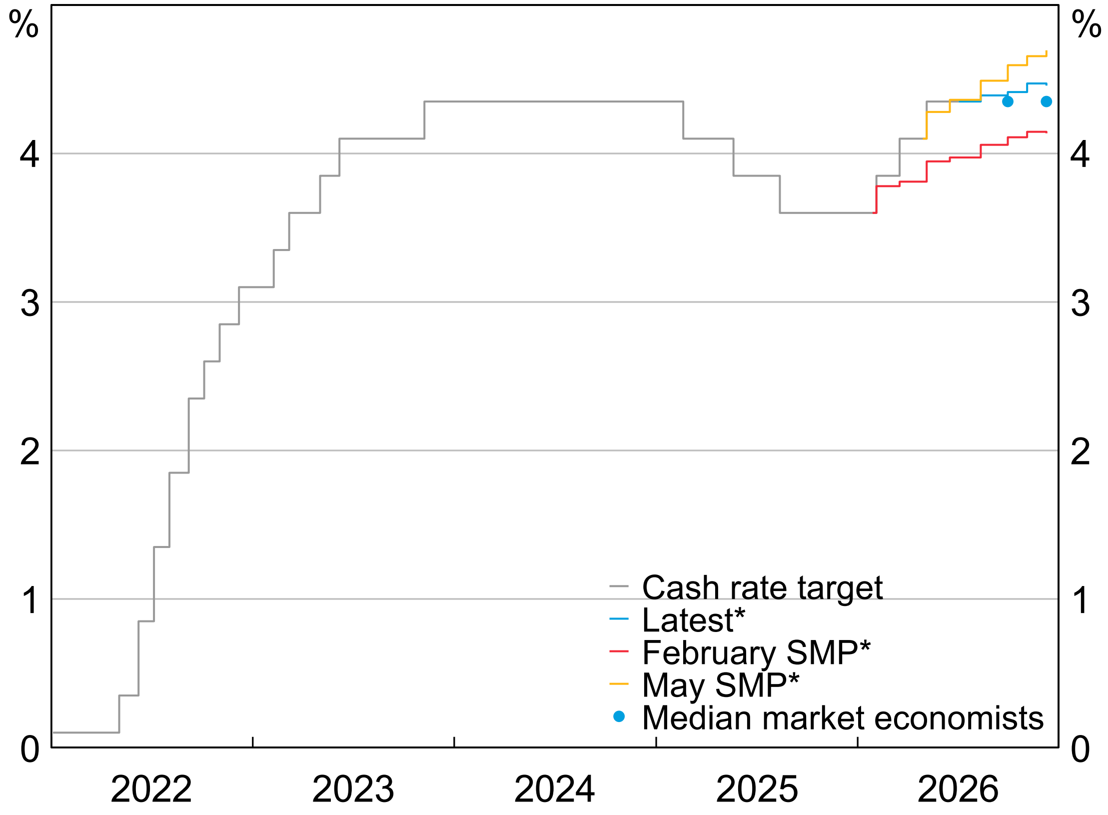
* The July 2026 observation for all series is as at 3 July.

** Dated Brent is the physical spot price for Brent crude.

Sources: Bloomberg; RBA.

Market expectations for the cash rate have increased this year

Cash Rate Expectations



* Cash rate expectations implied by overnight index swap rates.

Sources: LSEG; RBA.

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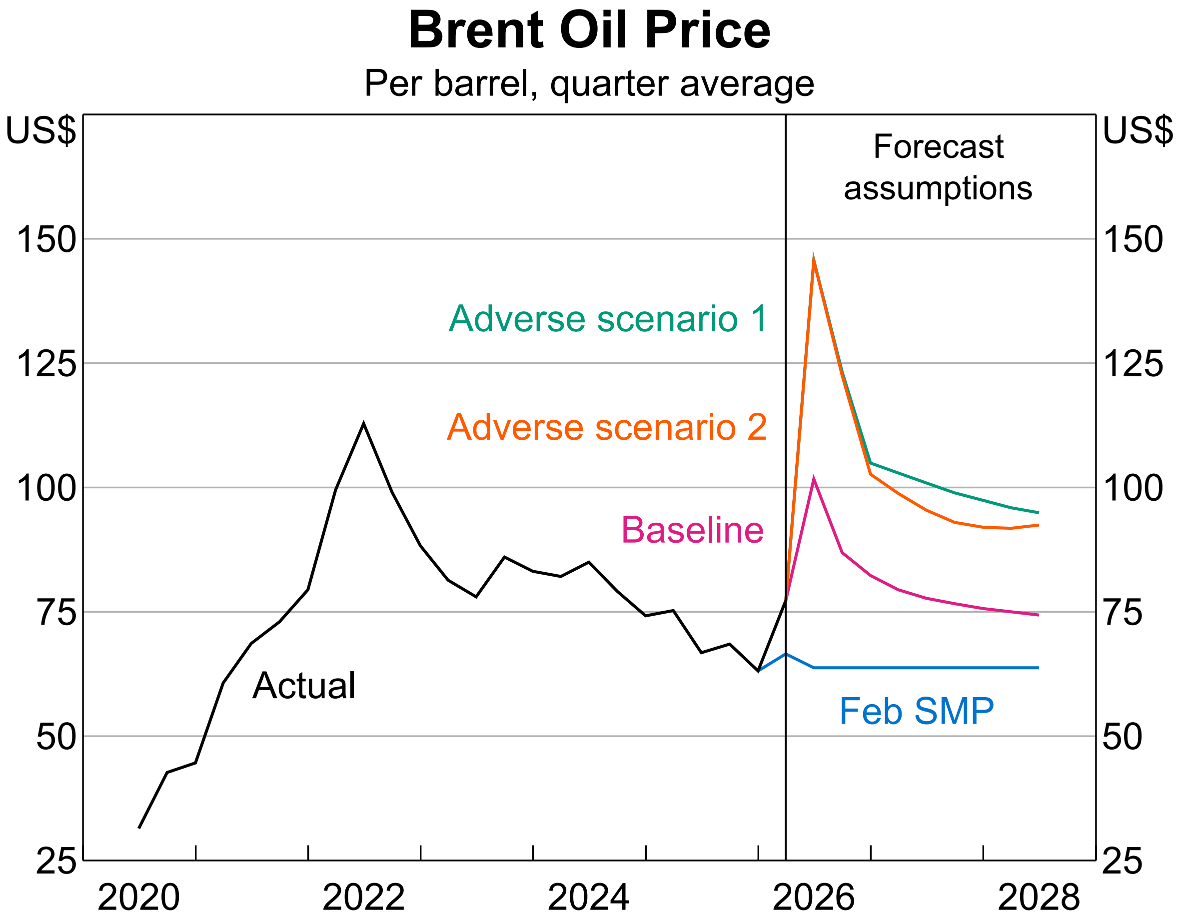
The baseline forecast (at the time of the May SMP) assumed that the worst of the disruptions to global energy supply would be resolved in 2026



Sources: Bloomberg; RBA.

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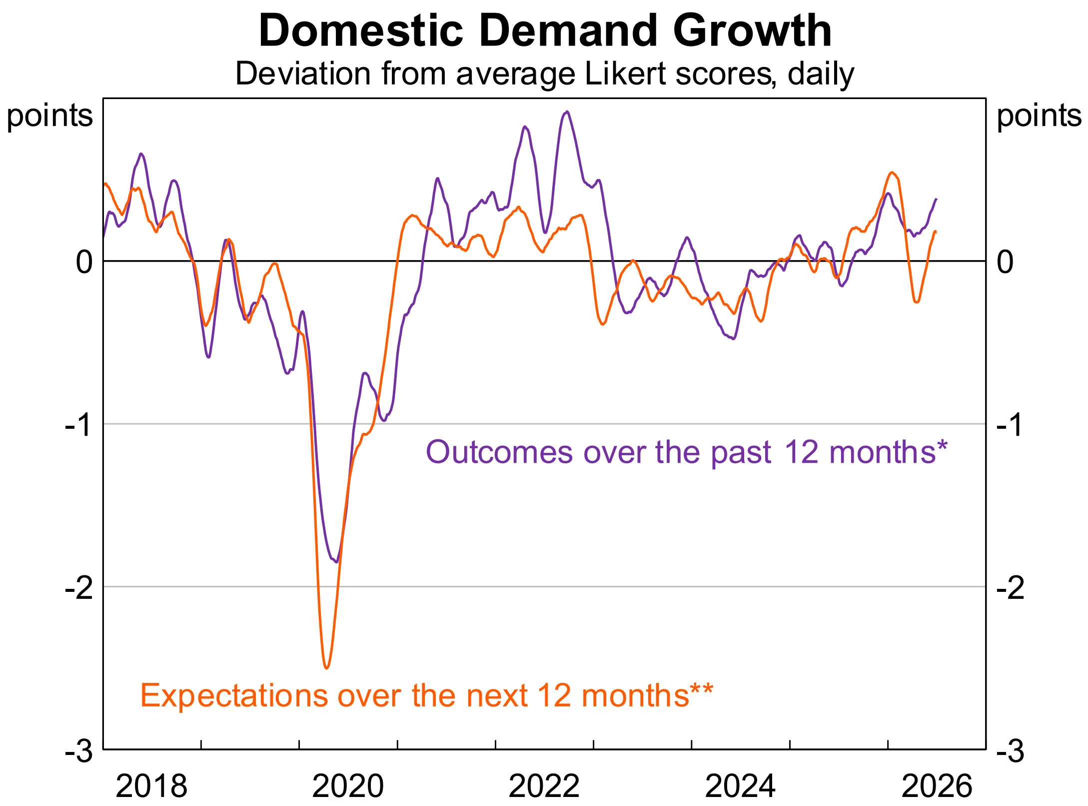
Liaison contacts have been reporting positive demand conditions to date, but the outlook for activity has slowed over recent months

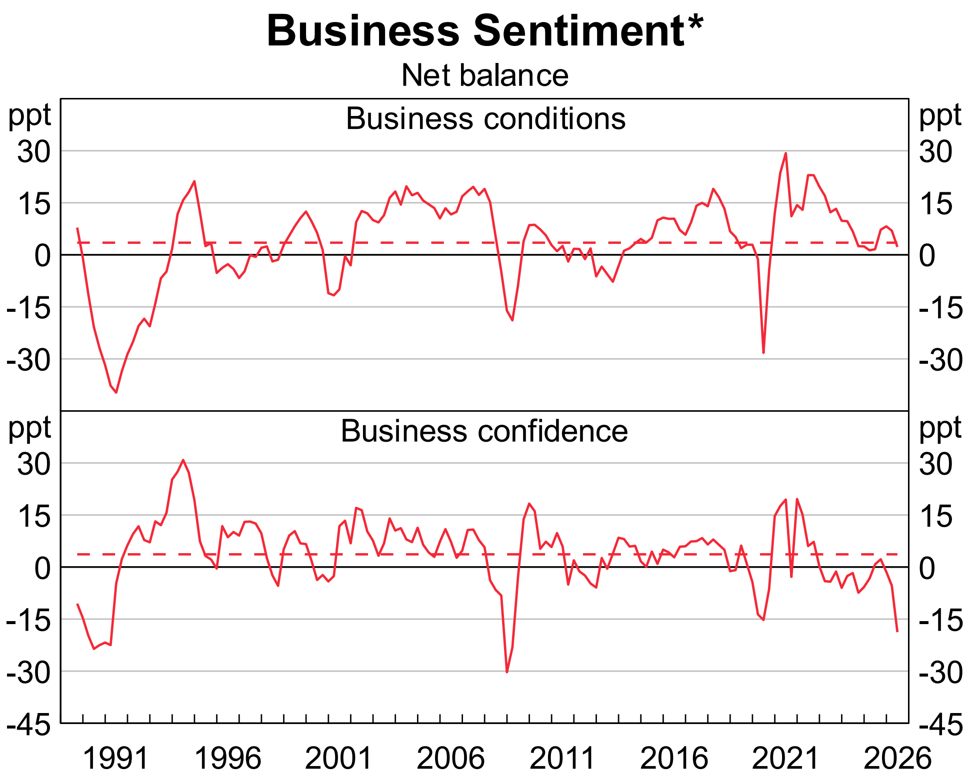


* Outcomes over the 12 months before each observation; smoothed with a 60-day linear-weighted average.

** Expectations over the 12 months after each observation; smoothed with a 60-day linear-weighted average.

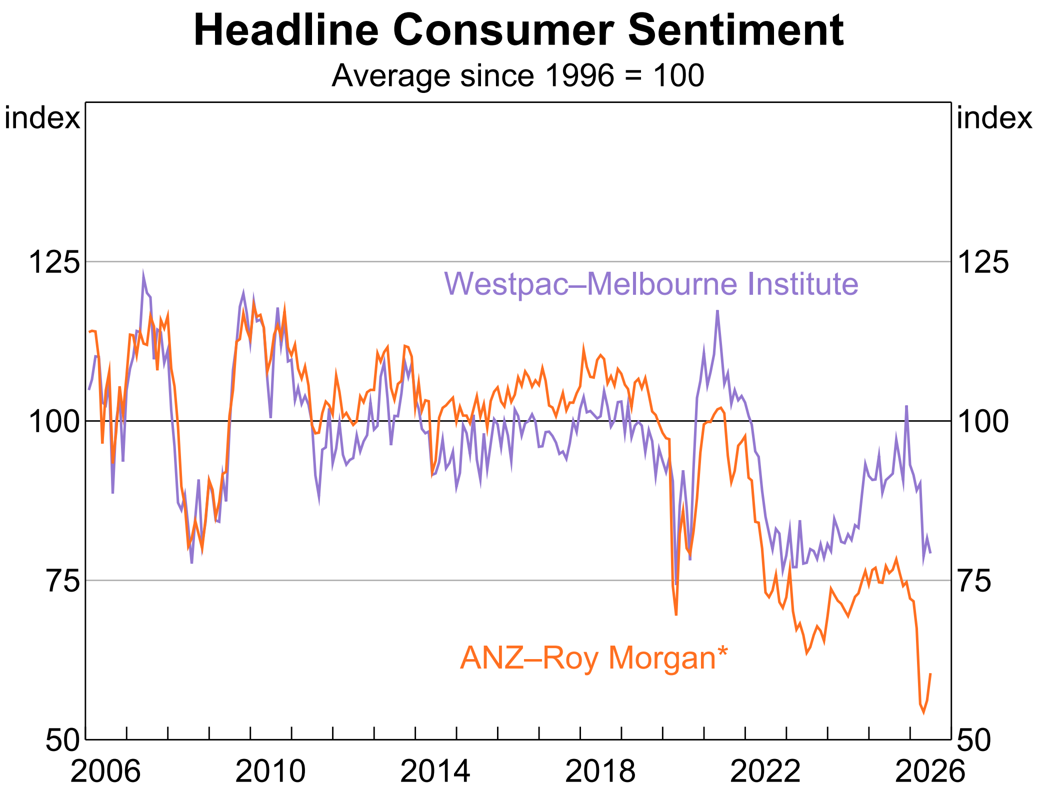
Source: RBA.

Consumer and business sentiment declined notably in March and April, and has only partially recovered



* Quarterly survey; dashed lines represent the long-term average of each series from 1989 onwards.

Sources: NAB; RBA.



* Rescaled to have the same average as the Westpac–Melbourne Institute index since 1996.

Sources: ANZ–Roy Morgan; RBA; Westpac–Melbourne Institute.

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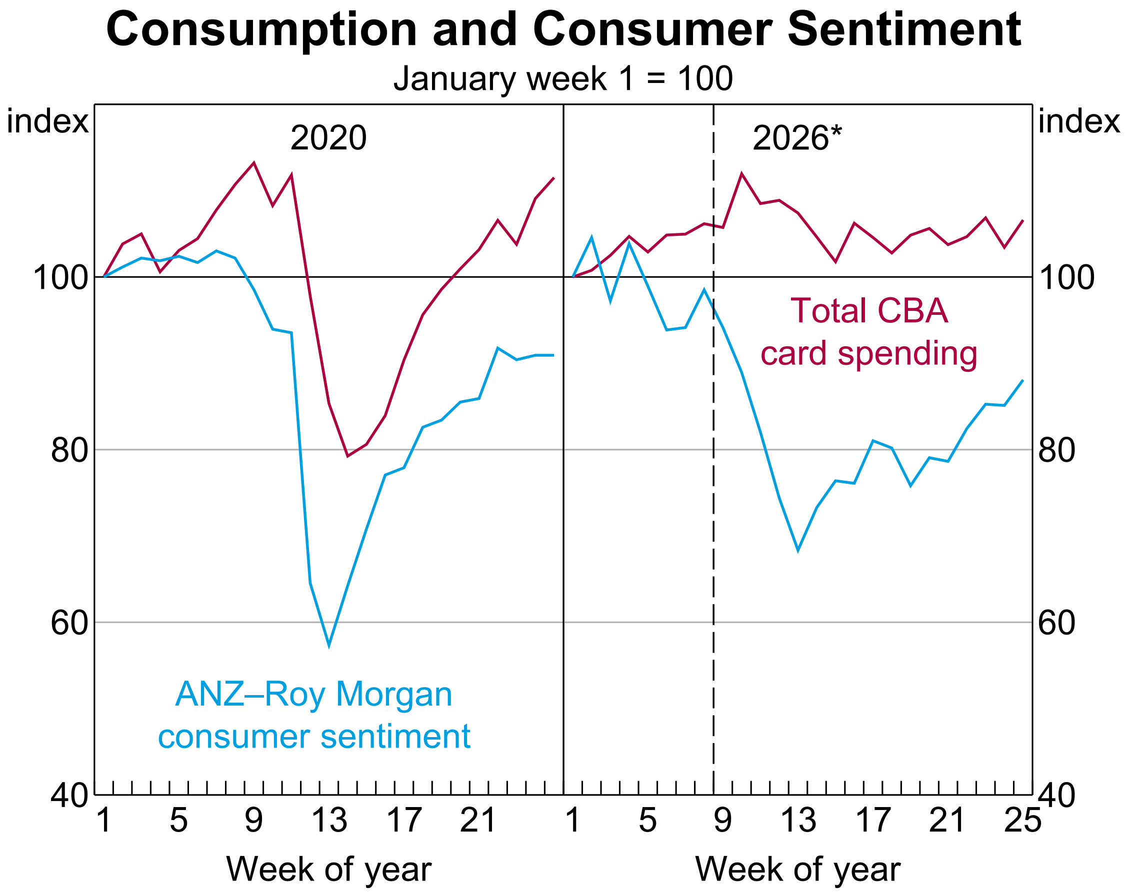
There is little evidence that consumers have noticeably reduced non-petrol spending to date



* Dashed line shows the start of the Middle East conflict.
Sources: ANZ–Roy Morgan; CBA; RBA.

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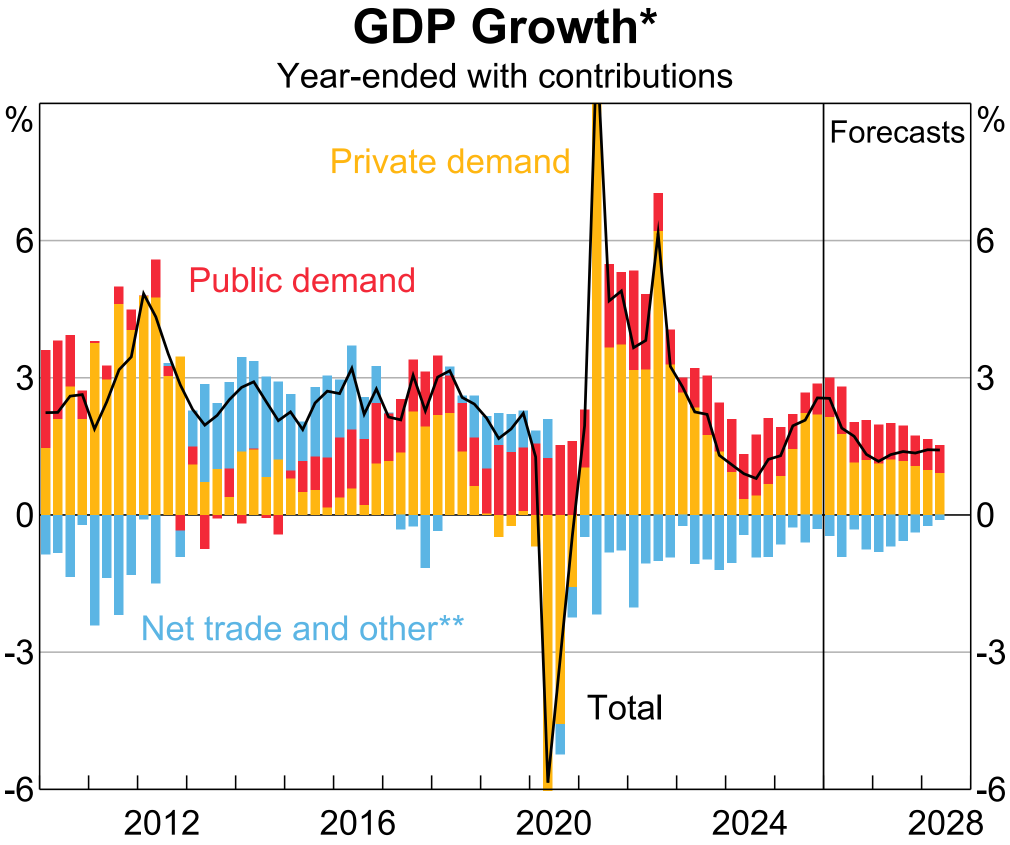
GDP growth expected to slow to below-trend pace, reflecting higher interest rates and cost of living

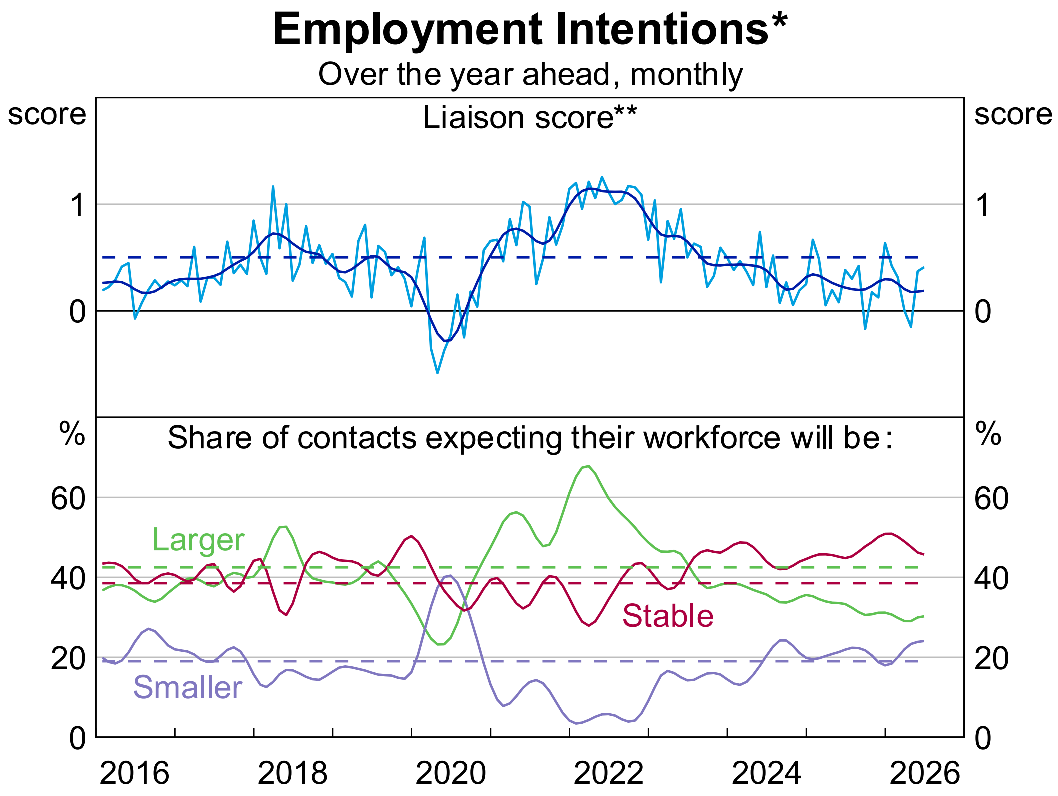


* Outliers during the COVID-19 pandemic have been truncated.

** Includes change in inventories and the statistical discrepancy.

Sources: ABS; RBA.

Hiring intentions have recently moved lower, consistent with softer demand momentum



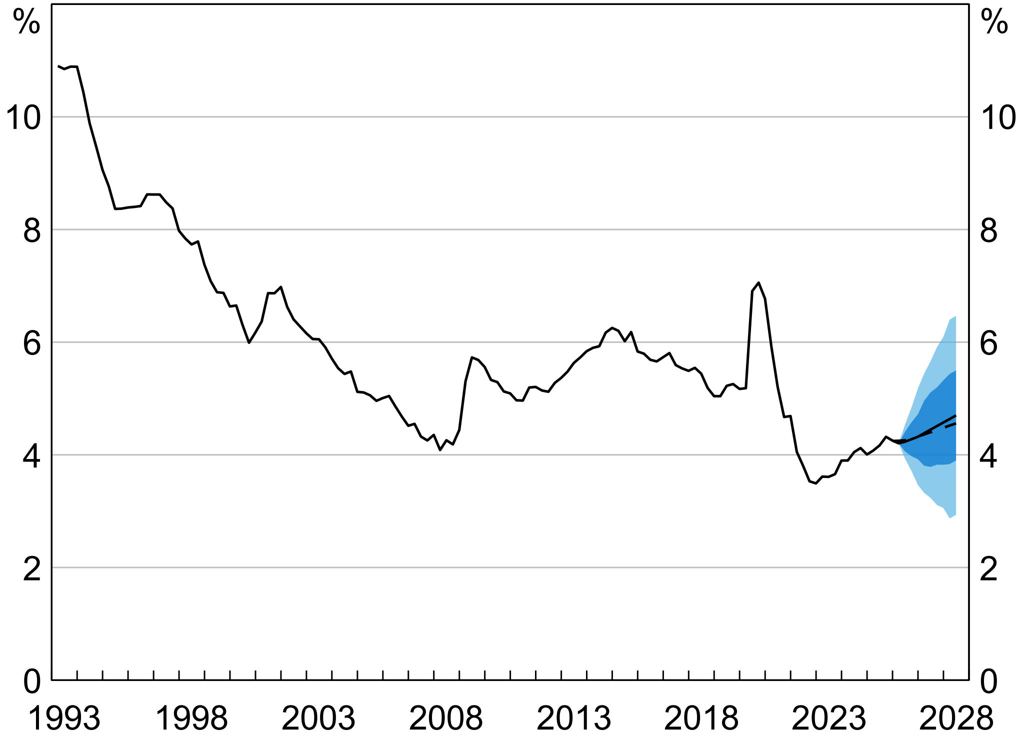
* Dark blue solid line in the top panel and all solid lines in the bottom panel are 13-month Henderson trends, with the long-run series averages since 2003 shown as dashed lines.

** A score of 0 indicates no change.

Source: RBA.

The tightness in the labour market is expected to ease over the forecast period

Unemployment Rate Forecast*

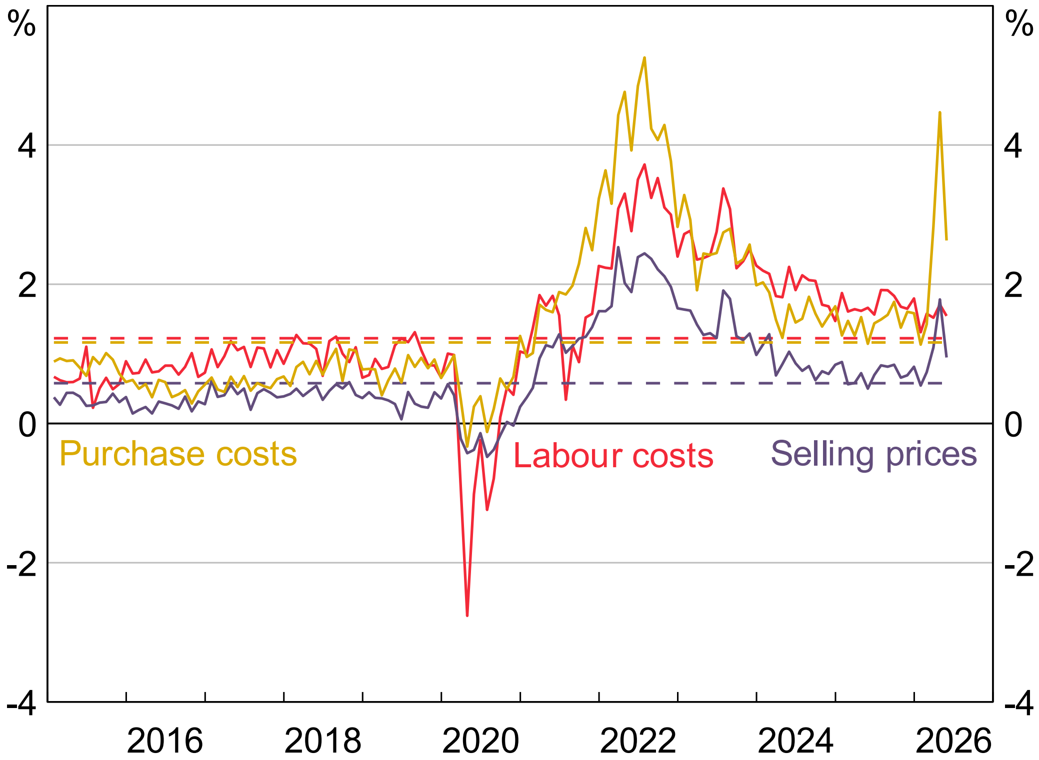


* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Higher business costs still putting upward pressure on final prices

Costs and Prices – NAB Survey*



* Average of respondent's monthly per cent changes at a quarterly rate; dashed lines represent the long-term average of each series from 1997 onwards.

Sources: NAB; RBA.

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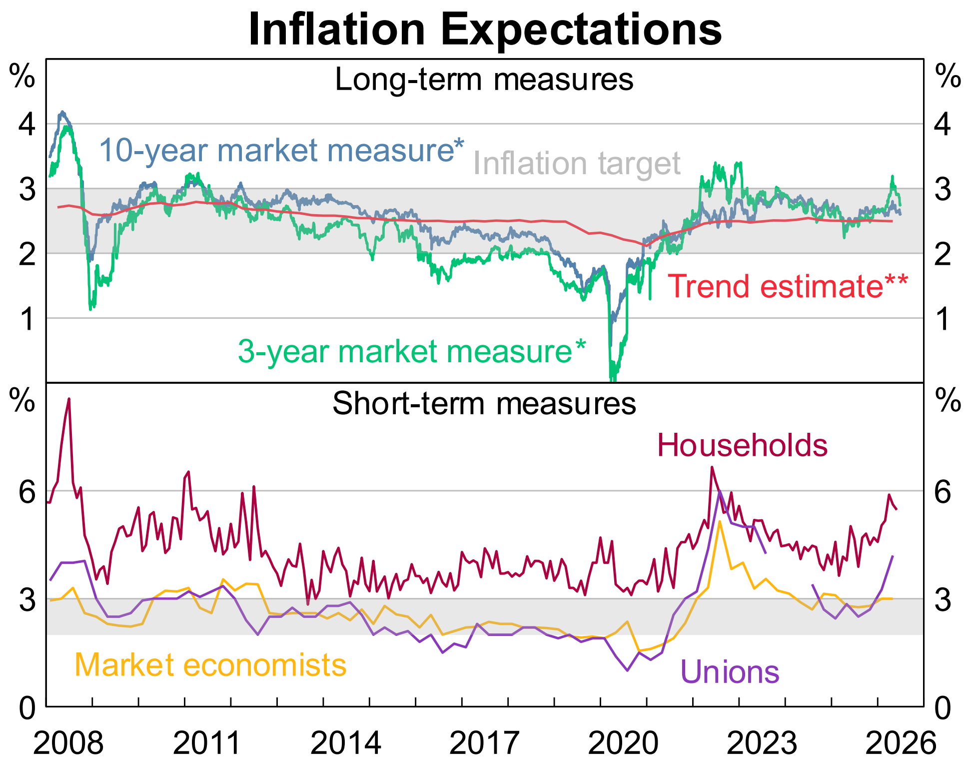
Longer term inflation expectations have remained near the inflation target, while short-term inflation expectations have risen this year



* Inflation expectations implied by swaps pricing.

** The long-term trend estimate is used to inflate real neutral rate estimates to nominal neutral rate estimates.

Sources: Australian Council of Trade Unions; Bloomberg; Employment Research Australia; Melbourne Institute; RBA; Workplace Research Centre.

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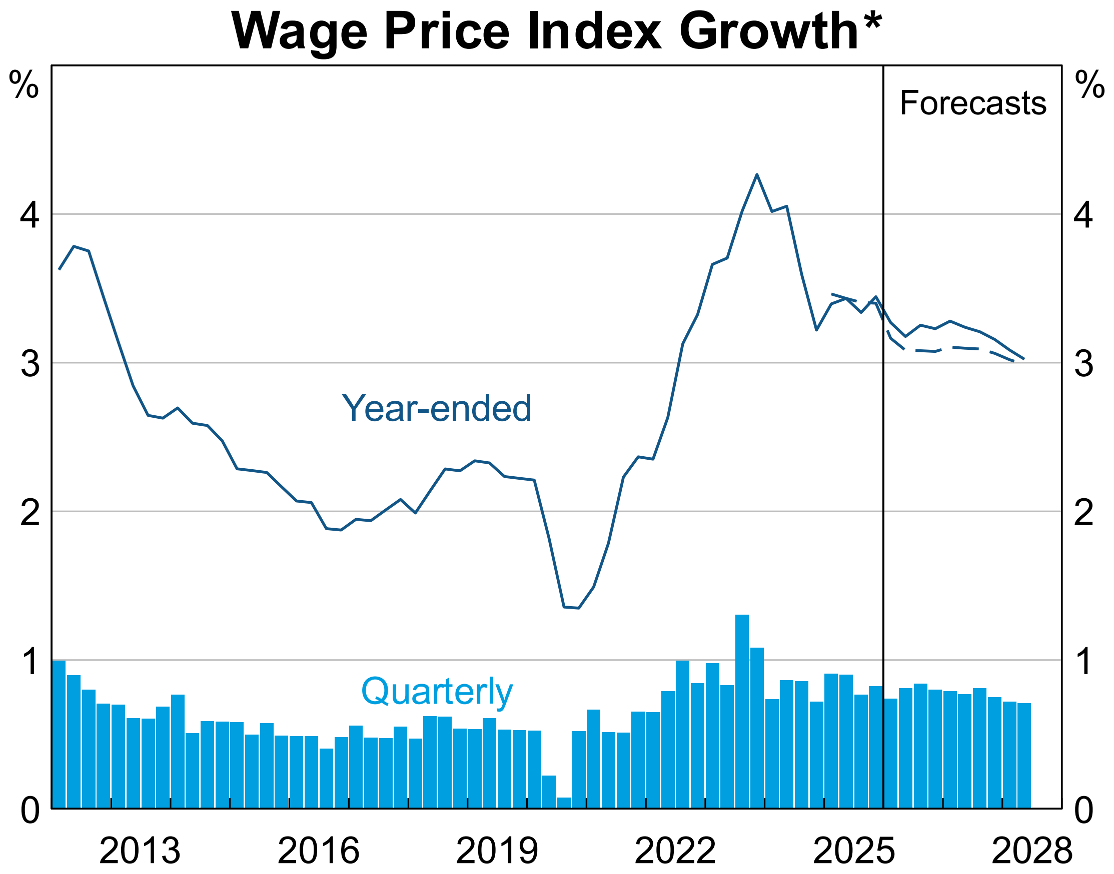
Wages growth is expected to be stronger in the near term, reflecting the higher outlook for inflation



* Dashed line shows previous SMP forecast; seasonally adjusted.

Sources: ABS; RBA.

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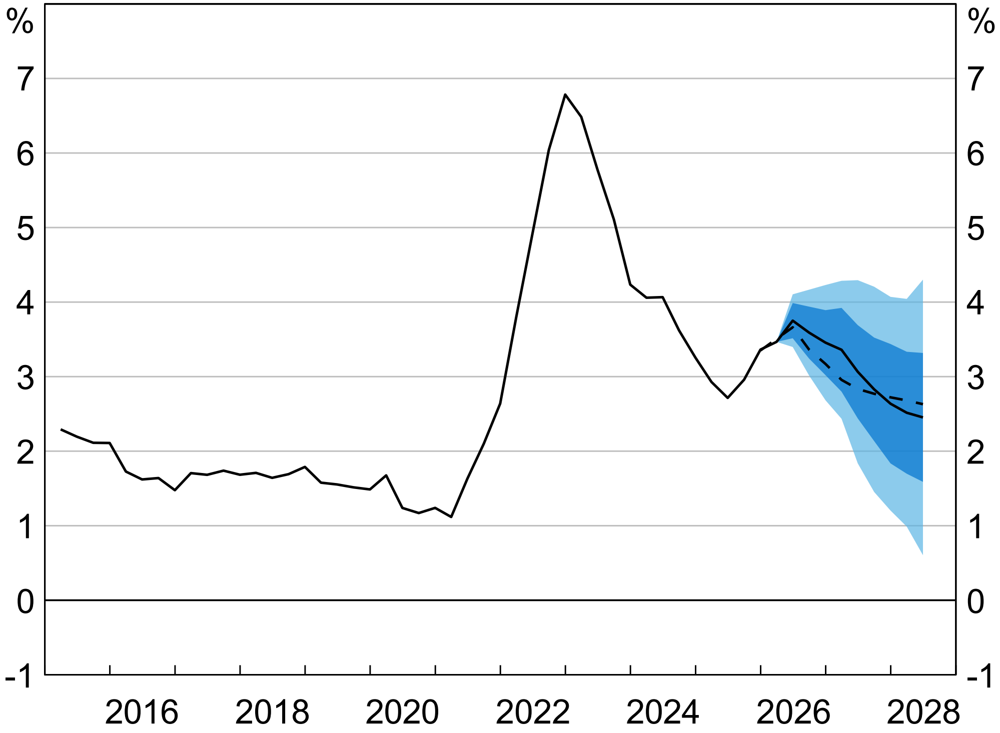
Trimmed mean inflation is now expected to remain above 3 per cent until mid-2027, before easing to 2.5 per cent by early 2028

Trimmed Mean Inflation Forecast*

Year-ended



* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

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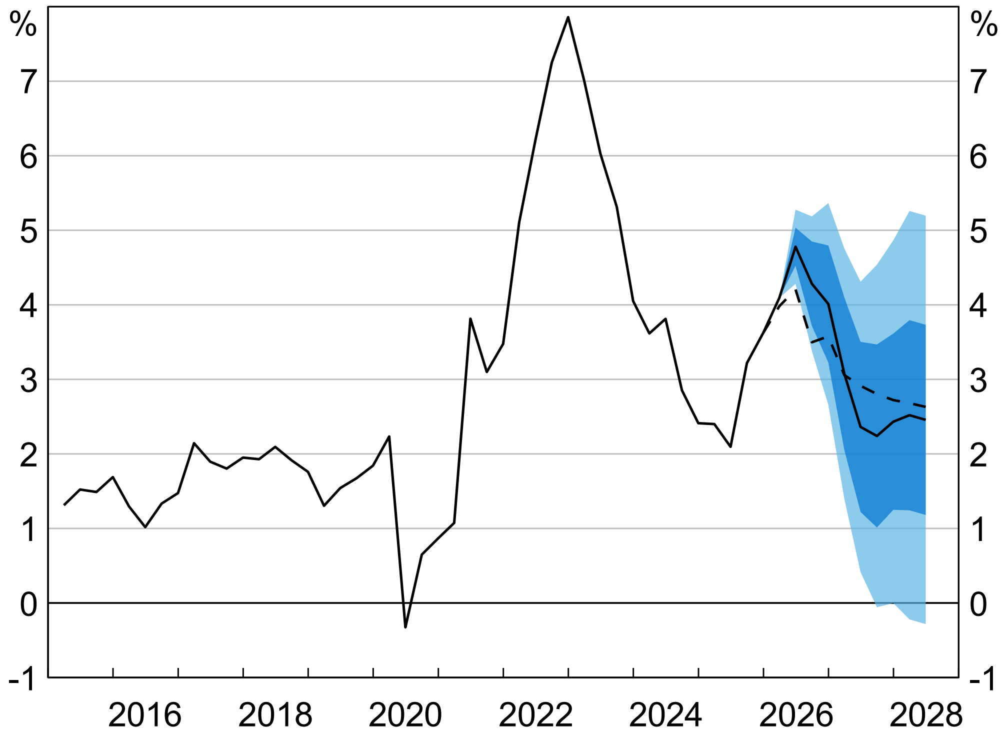
The outlook for headline inflation was expected to be materially higher due to higher fuel prices; recent data suggests a lower peak

Headline Inflation Forecast*

Year-ended



* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Q&A