RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

August 2025

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Some graphs in this publication were generated using Mathematica.

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Contents

Overview

In Australia, inflationary pressures have eased as expected and both headline and underlying inflation are within the 2–3 per cent range. Labour market conditions have also eased a little, while private demand growth is recovering and public demand is continuing to support growth in economic activity. Risks to the outlook for global economic growth are skewed to the downside but the risk of a very damaging trade war has receded.

Supported by the assumed gradual removal of policy restrictiveness, the economy is judged to stay close to full employment over the forecast period and underlying inflation is projected to remain around the midpoint of the 2–3 per cent range. With momentum in the domestic economy gradually lifting, the risks to the outlook and inflation are judged to be broadly balanced.

The Monetary Policy Board judged that a further easing in monetary policy was appropriate, given that inflation has continued to moderate. However, the outlook remains uncertain, and the Board will be attentive to the data and the evolving assessment of risks.

Inflation remains in the 2–3 per cent range.

Underlying inflation has continued to ease towards the midpoint of the 2–3 per cent range. Monetary policy has worked to bring inflation down; the disinflation has been broadly based across expenditure categories in the CPI.

Headline inflation has declined in year-ended terms, as expected. Headline inflation has been below underlying inflation recently, largely reflecting lower fuel prices and the effect of temporary electricity rebates.

Labour market conditions have moved closer to full employment.

Labour market conditions have eased slightly but capacity constraints remain, though there is uncertainty around this assessment. The unemployment rate increased in the June quarter to 4.2 per cent as expected, while the participation rate and employment-to-population ratio remain around their levels in late 2024. Leading indicators, such as job advertisements and vacancies, have been little changed in recent months. Year-ended wages growth has eased from its highs, but unit labour costs growth remained elevated in the March quarter partly reflecting persistent weakness in productivity growth.

Private demand growth is recovering. Overall GDP growth was a little softer than expected in the March quarter due to a decline in public demand, but the pick-up in private domestic demand was stronger than forecast. Partial data for the June quarter suggest that household consumption is tracking in line with the May forecast.

Global growth has been steady but is expected to slow.

Global GDP growth appears to have been little affected by trade developments over the first half of the year, but policy uncertainty remains elevated. While recent announcements have seen US tariffs higher than expected in May, retaliation from other jurisdictions has been less than feared and global trade flows are adjusting. The pattern of Chinese exports has adjusted rapidly to higher US tariffs, with the decline in exports to the United States more than offset by higher exports to other countries. Recent international trade policy developments have had little discernible impact on the Australian economy to date. The risks of a very damaging trade war appear to have diminished somewhat, but risks to global growth remain skewed to the downside and a more material disruption to global trade cannot be ruled out.

Growth in Australia's major trading partners is nevertheless expected to slow from here. Higher tariffs and broader policy uncertainty are expected to affect global growth and inflation over the second half of 2025 and into 2026. This is particularly the case in the United States where there are signs the labour market is weakening. By contrast, Chinese GDP growth is expected to remain relatively resilient, in large part because of broad-based policy support by the authorities. The effect on the Australian economy is expected to be modest but is subject to a high degree of uncertainty.

The domestic economy is expected to come into balance.

Cash rate cuts have been passed on to households and businesses. Reductions in the cash rate in February and May have been passed through to deposit and lending rates, and financial conditions in Australia have eased. Market participants expect some further easing in the cash rate over the year ahead. While monetary policy has restricted the growth of domestic activity in recent years, the forecasts are consistent with monetary policy becoming less restrictive. The cash rate path assumed in the forecasts settles at around 3 per cent and the forecasts suggest that this path is consistent with sustaining balance in the economy, although this assessment is uncertain.

Domestic GDP growth is expected to pick up, but at a somewhat slower pace than forecast in May. Over 2025, the recovery in GDP growth is expected to occur more gradually than previously forecast because weaker-than-expected growth in public demand in early 2025 is not expected to be offset through the rest of the year. Private demand growth is forecast to be a bit stronger than it was over the past year, and to be the main driver of growth over the forecast period. GDP growth is expected to settle at a lower rate than previously forecast over the medium term, due to the lower outlook for productivity growth.

Labour market conditions are expected to ease a little to be close to full employment over the forecast period. The unemployment rate is forecast to be little changed, but employment growth is expected to ease from strong rates to be largely in line with population growth, while wages growth is expected to ease gradually before stabilising over 2026 and 2027.

Underlying inflation is projected to remain sustainably around the midpoint of the 2–3 per cent range. The outlook for underlying inflation remains similar to expectations in the May *Statement*. Headline inflation is expected to increase over the second half of 2025, mostly due to the scheduled unwinding of electricity rebates, before returning to around the midpoint of the target later in the forecast period. There are risks on both sides of the outlook for domestic inflation and activity.

The Monetary Policy Board decided to lower the cash rate target by 25 basis points to 3.60 per cent.

The Board judged that a further easing in monetary policy was appropriate, given that underlying inflation has continued to decline back towards the midpoint of the 2–3 per cent range and labour market conditions have eased slightly, as expected. The Board remains cautious about the outlook, particularly given the heightened level of uncertainty about both aggregate demand and potential supply, and that uncertainty in the world economy remains elevated. The Board noted that monetary policy is well placed to respond decisively to international developments if they were to have material implications for activity and inflation in Australia. The Board will be attentive to the data and the evolving assessment of risks and is focused on its mandate to deliver price stability and full employment.

Table: Output Growth, Unemployment and Inflation Forecasts[a]

Per cent

	Year-ended					
	June 2025	Dec 2025	June 2026	Dec 2026	June 2027	Dec 2027
GDP growth	1.6	1.7	2.0	2.1	2.0	2.0
(previous)	(1.8)	(2.1)	(2.2)	(2.2)	(2.2)	(n/a)
Unemployment rate[b]	4.2	4.3	4.3	4.3	4.3	4.3
(previous)	(4.2)	(4.3)	(4.3)	(4.3)	(4.3)	(n/a)
CPI inflation	2.1	3.0	3.1	2.9	2.6	2.5
(previous)	(2.1)	(3.0)	(3.1)	(2.9)	(2.6)	(n/a)
Trimmed mean inflation	2.7	2.6	2.6	2.6	2.6	2.5
(previous)	(2.6)	(2.6)	(2.6)	(2.6)	(2.6)	(n/a)

	Year-average					
	2024/25	2025	2025/26	2026	2026/27	2027
GDP growth	1.2	1.6	1.8	2.1	2.1	2.0
(previous)	(1.4)	(1.9)	(2.1)	(2.2)	(2.2)	(n/a)

	Assumptions[c]					
Cash rate (%)	4.0	3.4	3.1	2.9	3.0	3.1
Trade-weighted index (index)	59.7	60.2	60.2	60.2	60.2	60.2

(a) Forecasts finalised on 6 August. Shading indicates historical data.

(b) Average rate in the quarter.

(c) The forecasts incorporate several technical assumptions. The cash rate is assumed to move in line with expectations derived from financial market pricing as per 6 August and the daily exchange rate (TWI) is assumed to be unchanged from its level at 6 August 2025 going forward. See notes to Table 3.1: Detailed Forecast Table in Chapter 3: Outlook for other forecast assumptions.

Sources: ABS; LSEG; RBA.

Chapter 1
Financial Conditions

Summary

- **Financial conditions in Australia have eased since the May *Statement*.** The cash rate reduction in May has been passed through to deposit and lending rates, and market participants' expected path for the cash rate has declined. Also, equity risk premia have declined, spreads on corporate bonds have narrowed and household credit growth has picked up over recent months.
- **Pricing in international financial markets suggests that market participants are placing limited weight on risks to economic activity and inflation, including those arising from higher tariffs and geopolitical uncertainty.** Measures of long-term inflation expectations remain well anchored, and 10-year government bond yields in most advanced economies are within the range they have been trading in since 2023. Term premia have risen this year alongside higher expected growth of public debt in a few large economies. Measures of risk premia have declined to around historical lows; indeed, in Australia and some other advanced economies, equity prices have reached record highs and corporate bond spreads are low. However, financial conditions could tighten sharply if incoming data or news caused market participants to adopt a pessimistic outlook for economic activity and/or inflation.
- **Market participants expect policy rates in most advanced economies to decline over the rest of 2025.** In the United States, this reflects the expectation that policy will, on balance, be eased alongside a moderation in economic activity and a softening in the labour market, despite the likely inflationary impact of tariffs in the United States over the medium term. The market path for policy rates in many other advanced economies appears to partly reflect an expectation that tariffs will have an overall modest disinflationary impact due to their adverse effect on global growth. Market participants' expectations for near-term policy rates declined after the US tariff announcements in April. A number of central banks have signalled that they are waiting to learn more about the impact of tariffs on the economy before adjusting policy if necessary.
- **In Australia, market participants' expected path for the cash rate has declined since the May *Statement*.** The initial decline after the May policy decision was partially retraced after the cash rate was left unchanged in July, against market expectations. Domestic economic data overall were a little weaker than expected by market participants, which also contributed to the decline in the market path. A 25-basis point reduction in the cash rate at the August meeting is fully priced by markets, with an additional two further cuts expected by early next year. The market path for the cash rate is broadly in line with expectations of most market economists.
- **The Australian dollar has been little changed on a trade-weighted basis since the May *Statement*.** The stability of the Australian dollar is consistent with both commodity prices and government bond yield differentials having been little changed since then.

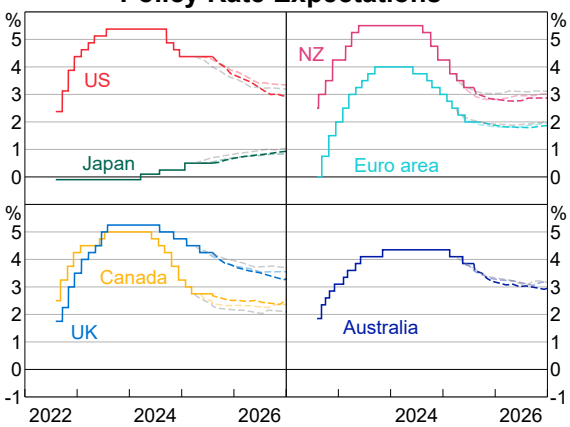
- **Household credit growth has increased to around the pace of growth in household disposable income.** The pick-up in credit growth is consistent with borrowers responding to lower interest rates and follows a period when household credit had declined, relative to household incomes, in response to restrictive monetary policy. Scheduled mortgage payments have eased as cash rate reductions have been passed through to lending rates. Business debt has grown at around its fastest pace since 2008 to be around pre-pandemic levels as a share of GDP.

1.1 Interest rate markets

Market participants expect policy rates in most large economies to decline further over the rest of this year.

Market pricing implies most advanced economy central banks are expected to ease policy by more than had been expected before the April tariff announcements (Graph 1.1). This is consistent with the view that tariffs are likely to have a modest disinflationary impact in most advanced economies due to an adverse impact of tariffs on global demand. Market expectations for the path of policy rates increased in the United States and Canada after the April announcements, where the impact of tariffs is likely to be inflationary. Nevertheless, market participants expect US monetary policy to become less restrictive alongside a moderation in economic activity and a softening in the labour market, the effects of which will tend to outweigh the inflationary impact of tariffs over the medium term. This expectation was supported by labour market data in August, which caused the expected US policy rate path to decline. In Canada, the higher market path for policy rates since April was supported by stronger-than-expected June labour market data. The market path in Japan increased after the announcement of a trade deal with the United States, which alleviated a significant downside risk to economic activity in Japan.

Graph 1.1
Policy Rate Expectations*



* Darker dashed lines show expectations implied by current overnight index swap rates; lighter dashed lines show the same expectations as of 14 May 2025; grey dashed lines show expectations as of 2 April 2025.

Sources: Bloomberg; RBA.

Since the May *Statement*, most central banks have adjusted policy rates in line with market participants' expectations. The US Federal Reserve (Fed) kept its policy rate on hold in June and July. At the July meeting, Chair Powell noted that trade policies had started to increase goods inflation and that it is uncertain whether the effects on overall inflation would be short lived or more persistent. However, two members of the Federal Open Market Committee voted to lower the policy rate by 25 basis points.

US policy rate expectations of further cuts in the second half of 2026 have also been influenced by speculation that Chair Powell will be replaced at the end of his term as chair in May 2026 by a candidate that favours a lower policy rate path.

The Bank of Canada and the Bank of England also left their policy rates unchanged, highlighting upside risks to inflation and downside risks to the labour market, respectively. By contrast, the European Central Bank (ECB) and Reserve Bank of New Zealand lowered their policy rates, as expected. Both highlighted continued progress on disinflation and downside risks to domestic and global growth associated with US trade policy as factors in their decision to lower rates.

Since May, the Bank of Japan (BoJ) has kept its policy rate unchanged and decided to slow the pace of quantitative tightening from April 2026. This means that the BoJ's bond portfolio will decline more slowly than previously planned. The decision was expected by markets and is designed to support stability in the Japanese Government bond market. This follows a significant rise in long-term yields in May, owing to factors including a decline in investor demand.

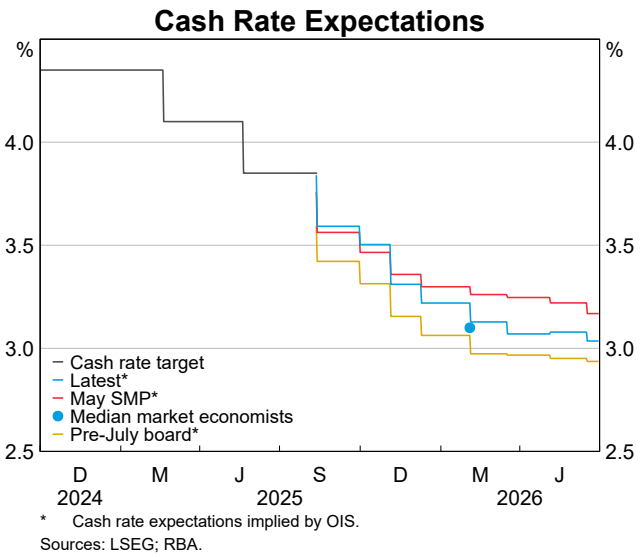
The People's Bank of China has maintained a moderately accommodative policy stance since May. It has noted that further monetary policy easing is constrained by bank profit margins, which are currently narrow and would be squeezed more if policy were eased further. The recent meeting of China's Politburo emphasised continuity of monetary and fiscal policy, with a focus on the implementation of already-announced policy to achieve the 5 per cent growth target.

A number of central banks have signalled that they are waiting to learn more about the impact of tariffs before adjusting policy if necessary. In the United States, Chair Powell has noted that, with inflation slightly above target and the economy at full employment, the current modestly restrictive stance of monetary policy leaves the Fed well-placed to respond as the impact of tariffs on inflation becomes clearer. The ECB Governing Council has noted that the environment remains exceptionally uncertain, especially because of trade disputes, and will adopt a data-dependent and meeting-by-meeting approach to determining the appropriate monetary policy stance.

In Australia, market participants' expected path for the cash rate has declined since the May *Statement*.

The near-term path for the cash rate implied by market pricing suggests the cash rate is expected to gradually decline to around 3.1 per cent by early 2026. The market path declined following RBA communications on the policy decision in May, although it partially retraced that after the cash rate was left unchanged in July whereas the market fully expected a 25-basis point cut. Domestic economic data that overall were a little weaker than expected by market participants also contributed to the decline in the market path since the May *Statement*. A 25-basis point reduction in the cash rate at the August meeting is fully priced in by markets and an additional two further cuts are expected by early next year (Graph 1.2). Most market economists' expectations for the cash rate are broadly consistent with the market path.

Graph 1.2



The forecasts provide the RBA's most comprehensive assessment of the economic outlook for a given cash rate path. In this *Statement's* baseline forecast, which is conditioned on the current market path for the cash rate, activity and the labour market are projected to move into balance, keeping inflation sustainably around the midpoint of the target range (see Chapter 3: Outlook). This is consistent with earlier restrictive monetary policy having worked to slow the growth of demand and with policy having become somewhat less restrictive since February. This easing of restrictiveness is evidenced in a number of measures of financial conditions, with household credit growth, for example, having increased to around the current pace of disposable income growth. This followed a sustained period of decline in the ratio of household credit to disposable income in response to the earlier rise in interest rates. This picture is also consistent with the fact that the cash rate had been above the range of model-based estimates of the neutral interest rate, but the current cash rate path now falls within that range. These models provide a complementary measure of the restrictiveness of policy, although they are subject to substantial uncertainty – around both the models and the estimates of the parameters within each model.

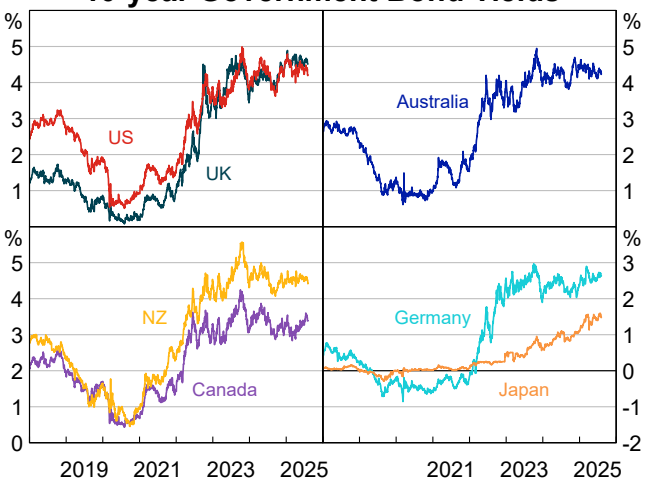
Ten-year government bond yields in most advanced economies are within the range they have been trading in since 2023, while 30-year yields have been trending higher.

Ten-year US Treasury yields have declined since the May *Statement* and by more than yields on other advanced economies' bonds (Graph 1.3). This decline was underpinned by a reduction in real yields alongside indicators suggesting a softening labour market amid higher trade barriers. Longer term inflation compensation has remained stable but shorter term inflation compensation has increased, based on measures derived from swaps (Graph 1.4). This is consistent with evidence that tariffs have to date had a modest inflationary impact in the United States and an expectation that inflation will be somewhat higher over the next year. Government bond yields in Australia have declined since the May *Statement*, also driven by a decline in real yields, with longer term inflation compensation remaining stable. By contrast, yields in Japan have increased somewhat alongside higher policy rate expectations and uncertainty about fiscal policy after the Japanese election in July.

Ten-year yields remain below their late-2023 peaks in most advanced economies, though term premia have risen alongside higher expected growth of public debt in a few large economies and further declines in the size of central bank balance sheets. Thirty-year government bond yields have risen more noticeably since the start of the year in many advanced economies. Nevertheless, term premia remain modest by historical standards, suggesting investors do not have material concerns about fiscal sustainability.

Graph 1.3

10-year Government Bond Yields

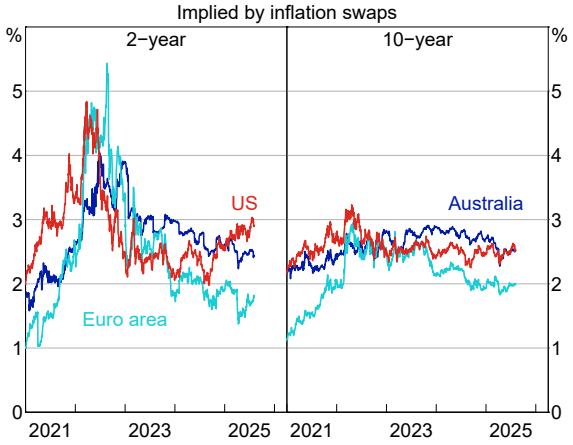


Source: Bloomberg.

Graph 1.4

Measures of Inflation Compensation

Implied by inflation swaps



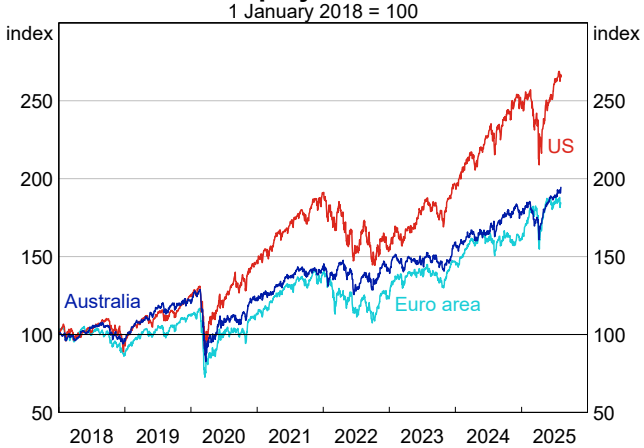
Source: Bloomberg.

1.2 Corporate funding markets

A range of other measures of financial conditions have eased in Australia and other economies since the May *Statement*.

In most advanced economies, equity prices have increased to near historical highs and equity risk premia have declined a little and are close to the historically low levels reached earlier in the year. Large technology companies have driven most of the increase in the S&P 500 since the May *Statement*, which reflects better than expected earnings and investor expectations about future returns rather than a broad-based improvement in the economic outlook . In Australia, equity prices remain elevated, after reaching a new peak in early August, with analysts' earnings forecasts for the ASX 200 little changed, and the equity risk premium around its lowest level since 2009 (Graph 1.5). The expected volatility of equity prices across most advanced economies, including Australia, remains below long-term averages.

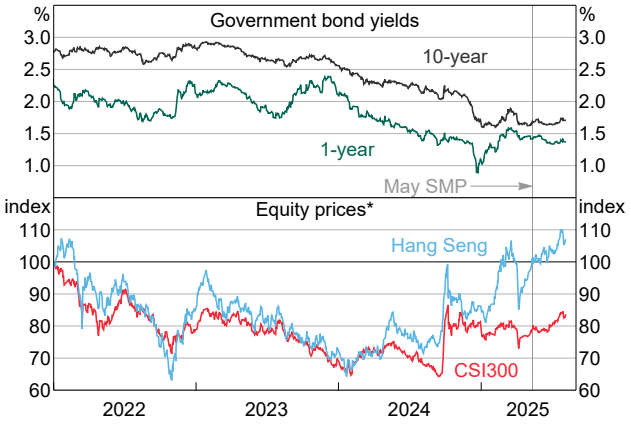
Graph 1.5
Equity Prices*
1 January 2018 = 100



* Total return basis.
Sources: Bloomberg; LSEG.

In China, equity prices are near their year-to-date highs, though well below previous peaks, driven by improved risk sentiment as trade negotiations with the United States progressed (Graph 1.6). The shift of local investors towards higher yielding assets has corresponded with a slight increase in Chinese Government bond yields from recent lows. Total credit demand remains weak, against the backdrop of historically low private sector credit growth in China.

Graph 1.6
China – Financial Markets

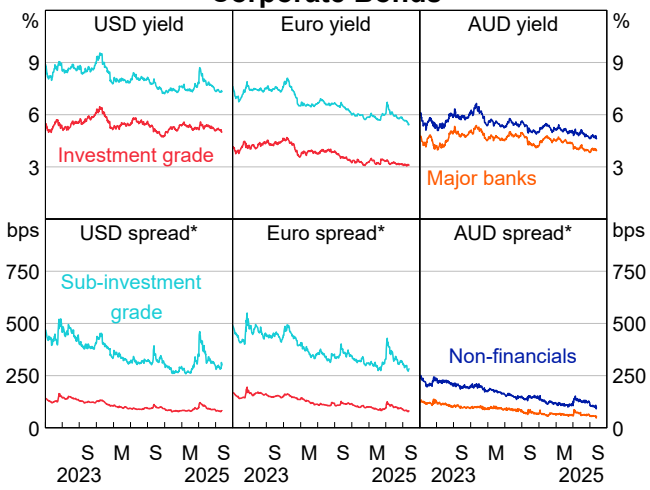


* January 2022 = 100.
Sources: Bloomberg; CEIC Data; RBA.

Corporate bond yields have declined in the United States, Europe and Australia, reflecting both the decline in government bond yields and a narrowing in spreads (Graph 1.7). Spreads on higher rated debt across advanced economies, and lower rated European debt, are back near the lows seen before the April episode of volatility.

Graph 1.7

Corporate Bonds



* Spread to equivalent maturity government bond yield.

Sources: Bloomberg; ICE Data used with permission; RBA.

Low risk premia suggest that market participants are not placing much weight on the potential for materially adverse outcomes for economic activity or inflation from evolving trade policies and geopolitical uncertainty, or that they are expecting such risks to be offset by fiscal stimulus or monetary policy. This is evidenced, for example, by the cost of hedging against negative tail risks to US equity prices being close to its long-term average despite the highly uncertain environment. Consequently, there is a risk that unexpected adverse outcomes could tighten financial conditions globally and in Australia – for example, by driving a significant decline in equity prices and/or a widening in corporate bond spreads.

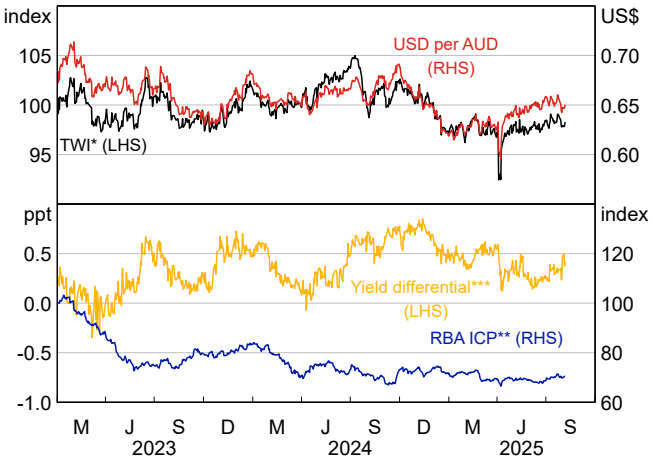
1.3 Foreign exchange markets

The Australian dollar trade-weighted index (TWI) remains around the bottom of the range observed over recent years.

The Australian dollar is little changed on a TWI basis and has appreciated slightly against the US dollar since the May *Statement* (Graph 1.8). The stability of the Australian dollar over this period is consistent with both overall commodity prices and the spread between Australian and other advanced economy bond yields having been little changed on average. Since the start of the year, however, the Australian dollar has appreciated noticeably against the US dollar, reflecting broad-based US dollar weakness (discussed below). The Australian dollar TWI has reacted broadly as expected to the reductions in the cash rate since the start of the year.

Graph 1.8

Australian Dollar



* Trade-weighted index; 31 December 2022 = 100.
** Index of Commodity Prices (USD terms); 31 December 2022 = 100.
*** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.
Source: Bloomberg; RBA.

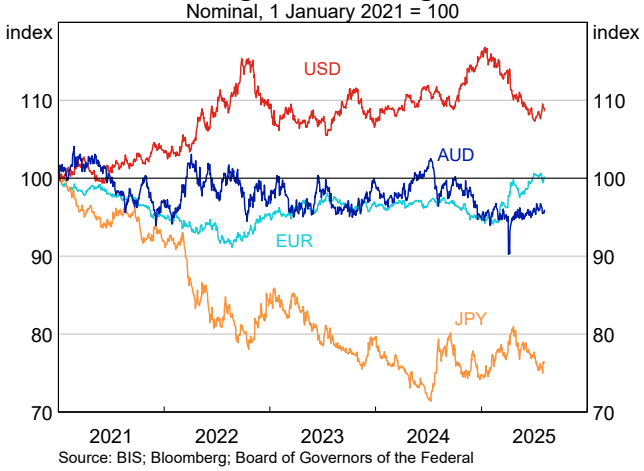
The US dollar TWI has depreciated a little further since the May *Statement*.

The depreciation of the US dollar TWI since May has been driven by a decline in US Government bond yields following data suggesting the US labour market is softening. The US dollar TWI is around 7 per cent lower than at the start of the year but remains around the average level seen over prior years (Graph 1.9). The depreciation since the start of the year has reflected concerns about US trade policies and their effects on the US economy. These factors have also supported the euro, which has appreciated markedly since the beginning of the year.

Graph 1.9

Trade-weighted Exchange Rates

Nominal, 1 January 2021 = 100



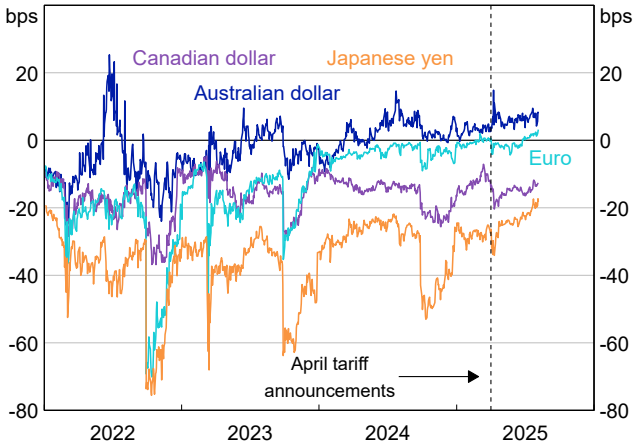
Source: BIS; Bloomberg; Board of Governors of the Federal Reserve System; RBA.

Some international investors have increased their currency hedges on US-dollar assets since the market volatility in April, which, at the margin, contributed to the US dollar weakness seen since the start of the year. Borrowing US dollars using FX and cross-currency swaps is one way that investors can hedge their US-dollar assets. However, FX swap basis – which represent the difference between the cost of borrowing non-US currencies using FX swaps and borrowing them in onshore markets – have remained stable in most major currencies, whereas it tends to fall if demand to borrow US dollars is high (Graph 1.10). This suggests that hedging-related changes in demand are likely to have been small.

Graph 1.10

Short Term FX Swap Basis*

Three-month tenor



* Interest rate to borrow each currency via FX swap against the US dollar (assuming US SOFR OIS rate) less domestic OIS rate. A lower basis implies a higher cost of borrowing US dollars via FX swap relative to onshore US rates.

Sources: Bloomberg; RBA.

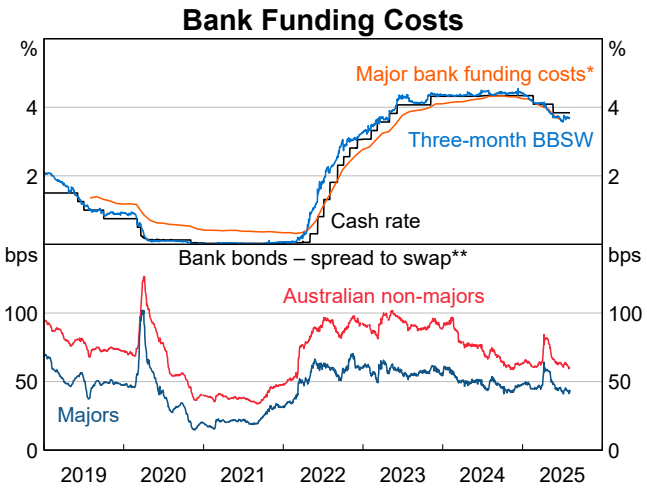
The Chinese renminbi has depreciated on a trade weighted basis since the May *Statement*, and is well below its historical peak in 2022. However, it has appreciated by around½ per cent against the US dollar. This partly reflects progress in US–China trade negotiations and Chinese authorities not leaning against the appreciation. Chinese authorities have also proposed incremental actions to increase financial openness. This has included an expansion of the quota for qualified local institutional investors to invest in overseas assets and a proposal to remove restrictions for foreign access to futures trading in local commodities markets. These developments, together with recent communication by policymakers, have pointed to an increased emphasis on longer term ambitions for greater use of the renminbi internationally.

1.4 Australian banks and credit markets

Bank funding costs have declined after the cash rate reduction in May and on expectations of further cash rate cuts.

The RBA's estimate of major bank funding costs has declined to around 70 basis points below its recent peak in 2024 (Graph 1.11). That partly reflects a fall in banks' deposit rates following the May cash rate reduction. It also reflects a decline in bank bill swap rates (BBSW) – to which much of banks' funding costs are linked – due to the actual and expected cash rate reductions. Spreads between bank bond yields and swap rates have also narrowed to around their lowest levels since 2022 as risk sentiment has improved, contributing slightly to lower wholesale funding costs for banks. The pace of bank bond issuance has been around its decade average after a brief pause in April.

Graph 1.11

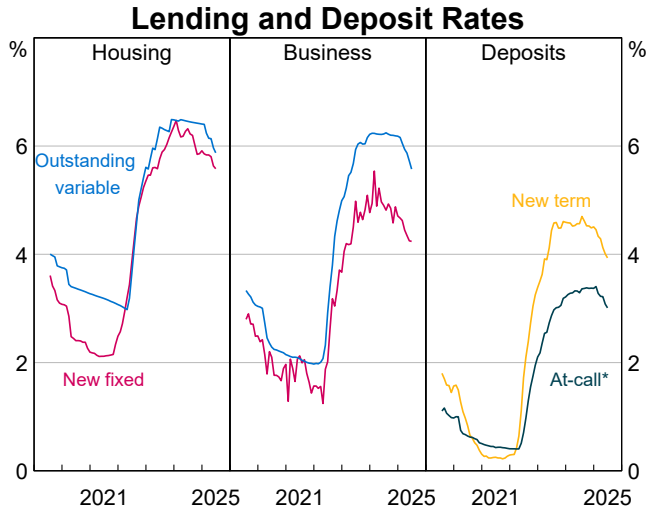


* RBA estimates of overall outstanding hedged debt and deposit costs for the major banks.
** Domestic secondary market; three-year target tenor.
Sources: APRA; ASX; Bloomberg; LSEG; major bank liaison; Private Placement Monitor; RBA.

Lenders have passed on the May cash rate reduction to lending and deposit rates.

Average new and outstanding variable mortgage rates declined by around 25 basis points over May and June (Graph 1.12). The average interest rate on new fixed-rate mortgages also decreased and is around 30 basis points lower than it was at the end of last year. Business lending rates have declined alongside declines in BBSW and the cash rate. Since the May *Statement*, banks have lowered rates on at-call and new term deposits by around 20 basis points up to June.

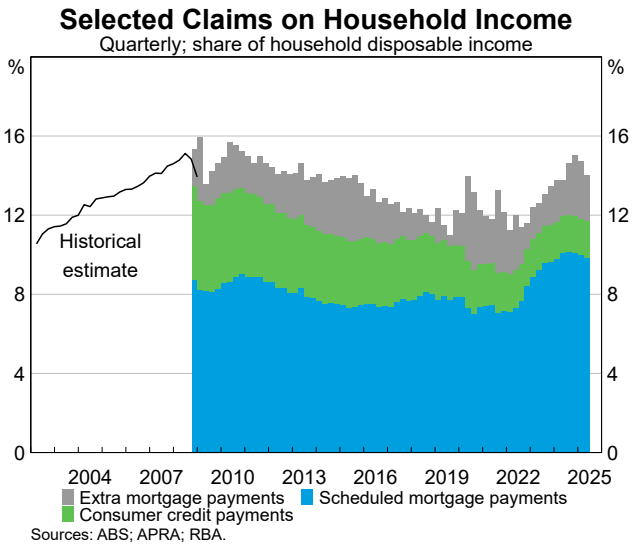
Graph 1.12



* Includes deposits in housing loan offset accounts.
Sources: APRA; RBA.

Scheduled mortgage payments decreased further in the June quarter (Graph 1.13). Total scheduled mortgage and consumer credit payments, as a per cent of household disposable income, have declined by around 30 basis points since their late-2024 peak. The flow of extra mortgage payments into offset accounts and redraw facilities has decreased but is still a little above its pre-pandemic average.

Graph 1.13

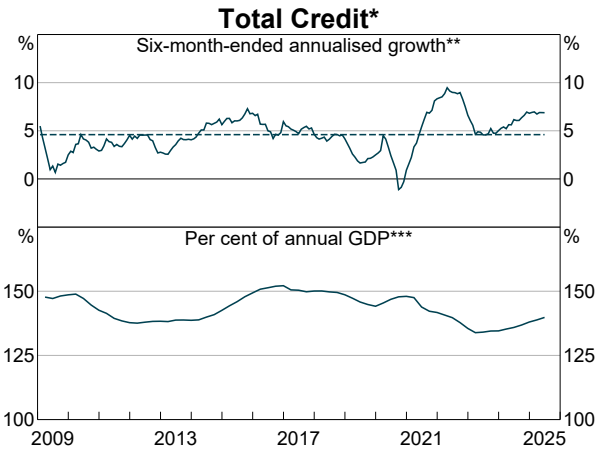


Sources: ABS; APRA; RBA.

The stock of total credit has increased relative to GDP since late 2023, though it remains below its pre-pandemic level.

Total credit growth has been stable in 2025 (Graph 1.14). Credit demand has been robust, particularly from businesses, and credit supply has been supported by strong competition for housing and business lending. Liaison information suggests that lending standards have not changed materially for housing and business lending over recent quarters, though some banks have eased terms for commercial property lending.

Graph 1.14



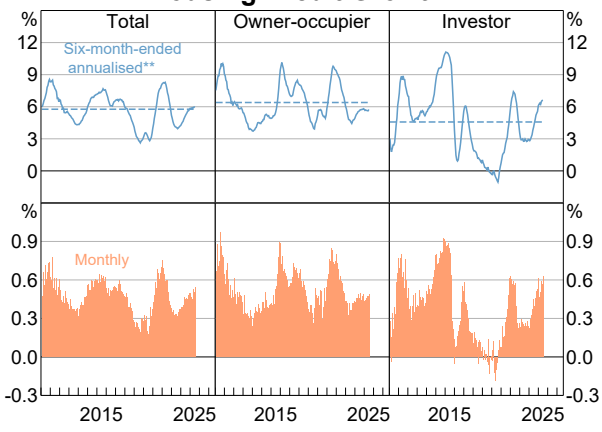
* Seasonally adjusted and break-adjusted; including securitisation. Includes housing, personal and business credit. Business credit excludes financial businesses from 2003 onwards.
** Dashed line is the average from 2009 onwards.
*** June quarter 2025 uses forecasts for GDP.

Sources: ABS; APRA; RBA.

Household credit growth increased modestly in the June quarter, to be broadly in line with the expected growth in household incomes.

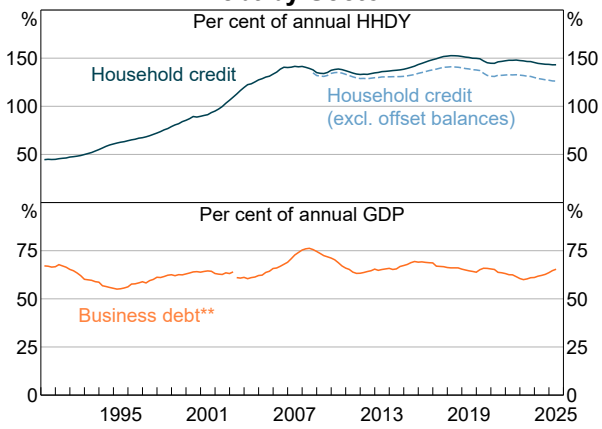
Housing credit growth has recently increased a little, to around its post-GFC average (Graph 1.15). The increase is consistent with borrowers responding to lower lending rates and expectations of stronger housing price growth, alongside the recent pick-up in actual housing price growth (see Chapter 2: Economic Conditions). In past episodes of policy easing, the response of housing credit growth to lower interest rates has varied materially in both timing and magnitude. The ratio of total household credit (including personal credit) to household disposable income looks to have stabilised in the June quarter, though net household indebtedness (which also accounts for growth in offset balances) is likely to have continued to decline (Graph 1.16).

Graph 1.15
Housing Credit Growth*



* Seasonally adjusted and break-adjusted.
** Dashed lines are the averages from 2009 onwards for each series.
Sources: ABS; APRA; RBA.

Graph 1.16
Debt by Sector*



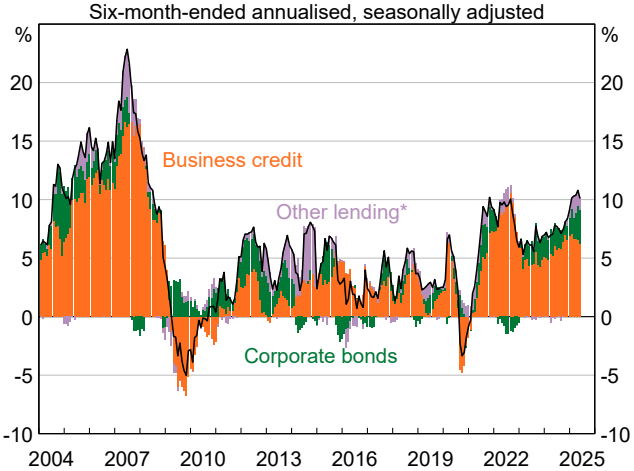
* Seasonally adjusted and break-adjusted; including securitisation. June quarter 2025 uses forecasts for household disposable income (HHDY) and GDP.
** Includes business credit, corporate bonds and other lending. Business credit excludes financial businesses from 2003 onwards.
Sources: ABS; APRA; RBA.

Growth in business debt has remained strong.

Growth in business debt has increased to around its fastest pace since 2008 in nominal terms, and to around pre-pandemic levels as a share of GDP (Graph 1.17). Growth has remained broadly based across industries. Bond issuance by non-financial corporations this year has been stronger relative to GDP than over most of the prior decade. There has so far been no evidence that overall demand or supply of business credit has softened materially in response to trade policy uncertainty.

Business debt growth has been supported by strong competition among lenders and favourable conditions in wholesale funding markets. Some Australian banks have noted in recent profit reports that they had increased their strategic focus on business lending, partly in response to low profit margins on mortgage lending. Competition from non-bank lenders has also been strong. These trends have likely made it easier and cheaper for some businesses to access credit, supporting their ability to manage cashflows, grow and invest. This suggests that credit supply has not been a material driver of flat private business investment over recent quarters (see Chapter 2: Economic Conditions). Historically there has been a weak relationship between aggregate private business investment and business debt growth.

Graph 1.17
Business Debt Growth
Six-month-ended annualised, seasonally adjusted



* Lending to large businesses by institutions that do not report to APRA.
Sources: APRA; Bloomberg; LSEG; RBA.

Chapter 2
Economic Conditions

Summary

- **As expected, underlying inflation has continued to ease towards the midpoint of the 2–3 per cent range.** Trimmed mean inflation declined to 2.7 per cent over the year to the June quarter, broadly in line with our May forecast. In quarterly terms, trimmed mean inflation eased to 0.6 per cent, down from 0.7 per cent in the March quarter. The easing over the past year has been broadly based across expenditure categories.
- **Headline inflation declined to 2.1 per cent in year-ended terms in the June quarter, broadly as expected in the May *Statement*.** Headline inflation was well below underlying inflation over the year to the June quarter, largely reflecting lower fuel prices and the effect of electricity rebates. The effect of electricity rebates on year-ended headline inflation will begin to reverse from late 2025.
- **Labour market conditions have eased a little since the May *Statement*, in line with our forecasts.** The unemployment rate increased to 4.3 per cent in the month of June and an average of 4.2 per cent in the June quarter. The participation rate and employment-to-population ratio remain around historic highs. Leading indicators, such as job advertisements and vacancies, have been little changed in recent months and point to stable conditions in the near term.
- **Overall, we assess that some tightness in labour market conditions remains, though there is considerable uncertainty around this assessment.** The ratio of job vacancies to unemployed workers is still somewhat elevated, firms continue to report some difficulty finding labour, and the underemployment rate and hours-based measure of labour underutilisation have been little changed recently at low levels. That said, the increase in the unemployment rate in June suggests that demand and supply in the labour market have moved closer to balance, though monthly outcomes can be volatile. The rate of job-switching remains fairly subdued, suggesting there may be only a little excess demand for labour.
- **Australian GDP growth in the March quarter was a little softer than anticipated, but the recovery in private demand was stronger than expected.** GDP growth picked up to 1.3 per cent in year-ended terms in the March quarter, driven by the recovery in private demand. Public demand declined unexpectedly. Dwelling investment was stronger than expected, and now shows a clearer upwards trend over the past year or so. Activity in the established housing market has picked up. Partial indicators received to date for the June quarter suggest that household consumption was broadly as expected in the May *Statement*.

- **Global GDP growth over the first half of the year was resilient to trade policy developments, and policy uncertainty has fallen back somewhat, though remains elevated.** While recently announced US tariff rates have been higher than expected in May, other jurisdictions have – as expected – generally not retaliated, and the range of likely trade policy outcomes appears to have narrowed. These developments, coupled with rapid adjustment in global trade flows, suggest that some of the more extreme downside risks around the impact of tariffs on global activity are less likely to materialise, though significant uncertainty remains. The effects of trade policy actions are expected to become more evident in global activity and inflation data over the remainder of the year, particularly in the United States – where there are signs the labour market is weakening. Some advanced economies have announced additional fiscal policy easing that will support near-term global growth.
- **Chinese GDP growth was resilient in the June quarter, supported by a rapid adjustment in the pattern of exports since higher US tariffs were introduced.** A decline in Chinese exports to the United States since the start of the year has been more than offset by higher exports to other countries. This has occurred without heavy discounting by Chinese exporters, with export prices having increased since the start of the year. Conditions in China's property market remain weak.
- **Recent international developments have so far had little discernible impact on the Australian economy.** Forward-looking indicators from consumer and business surveys have not fallen sharply as they did initially in other developed economies. Given the typical lags, any effects from increased uncertainty on consumption and business investment are expected to start showing up in the data in the second half of 2025 and into 2026, and even then these effects are expected to be modest and difficult to distinguish from other factors.

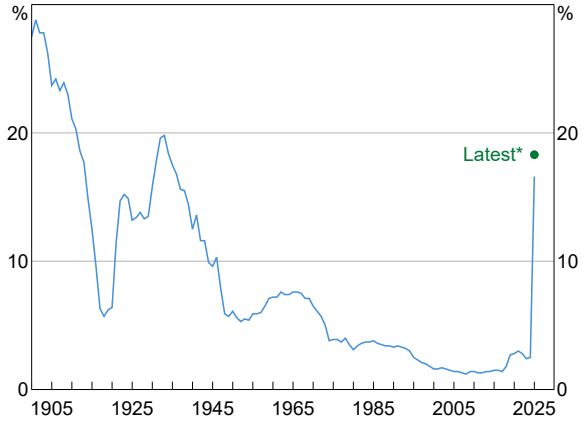
2.1 Global economic conditions

Trade policy uncertainty has declined somewhat since the May *Statement*, but remains elevated; announced US tariff rates are higher than in May's baseline case, though (as expected) retaliation has been limited.

The range of likely trade policy outcomes appears to have narrowed since April, which has contributed to some easing in measures of uncertainty and reduced concern among financial market participants about severe downside risks to the global economy materialising (see Chapter 1: Financial Conditions). Trade policy settings between the United States and China have been stable since the May *Statement*, and the United States has now reached agreements with many of its largest trading partners including the euro area, Japan, South Korea, the United Kingdom and Vietnam. Most bilateral agreements to date have included a US tariff rate of between 10 and 20 per cent, and the US administration has announced new tariff rates for countries without an agreement. So, while there continues to be uncertainty around the United States' future trade policy settings, with agreements yet to be reached or finalised with some key trading partners, there is now greater clarity about where the US effective tariff rate is likely to settle.

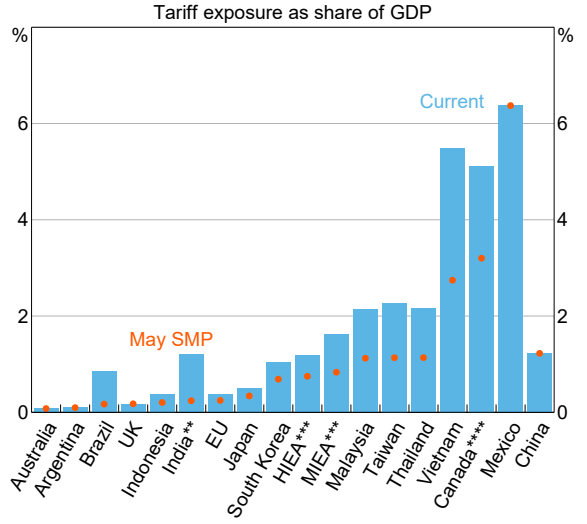
The US effective tariff rate is higher than expected at the time of the May Statement, with most agreed tariff rates being above the 10 per cent baseline that applied broadly in April (Graph 2.1). For countries that have reached an agreement with the United States since the May *Statement*, or for whom a new tariff rate has been announced, tariff rates have generally been somewhat higher than was expected in May, at between 15 and 20 per cent. The introduction of sectoral tariffs on copper and an increase in the previously announced steel and aluminium tariffs, is also contributing to a higher-than-expected US effective tariff rate. That said, in recent weeks some sectoral tariffs have been narrowed in scope or lowered on a country-specific basis. The tariff rate applying to Australia is unchanged at 10 per cent, which we assess will have a limited direct impact on the Australian economy (Graph 2.2).[1]

Graph 2.1
US – Average Effective Tariff Rate on Imports
Estimates by the Yale Budget Lab as at 1 August 2025



* Latest tariffs are on a 'real-time current policy' basis, where announced policies are assumed to continue across 2025.
Sources: RBA; Tax Foundation; The Budget Lab.

Graph 2.2
Direct Exposure to US Tariffs*
Tariff exposure as share of GDP



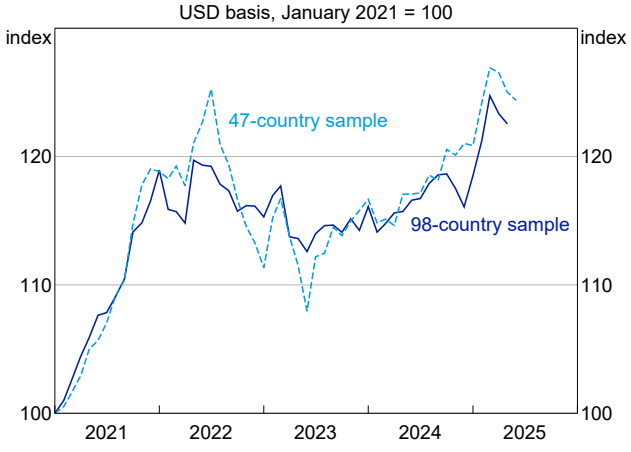
* Calculated as tariff rate multiplied by value of 2023 exports to the US divided by GDP in current US$; accounts for tariff pauses but not for exemptions, trade redirection, tax incidence, or price changes.
** Reflects a 50 per cent tariff rate, of which 25 per cent is currently scheduled to be implemented at a later date.
*** Middle-income east Asia comprises Vietnam, Thailand, Malaysia, the Philippines and Indonesia; high-income east Asia comprises Hong Kong, Taiwan, Singapore and South Korea.
**** Reflects 10 per cent tariff on energy exports and 35 per cent tariff on all other exports.
Sources: OEC; RBA; UN Comtrade; World Bank.

There has been limited retaliation from other countries so far in response to higher US tariff rates, as expected in May but in contrast with the 2018–2019 episode. Accordingly, while the effective US tariff rate is at its highest level since the 1930s, the global effective tariff rate has increased by much less – it is likely around its mid-2000s level.

Global trade remained resilient in the June quarter despite higher US tariffs and elevated uncertainty.

Higher US tariffs have affected some bilateral trade flows, but the impact on aggregate global trade flows has been limited so far (Graph 2.3). The ongoing resilience of global trade in the face of widespread US tariffs is largely due to rapid adjustments in global trading patterns and limited retaliation. US imports increased sharply in the first quarter of the year due to the front running of prospective US tariffs, but since then have only fallen back to 2024 levels. An increase in US imports from other east Asian economies has offset a decline in imports from China. Meanwhile, a decline in Chinese exports to the United States since the start of the year has been more than offset by an increase in exports to other countries, including higher exports to Europe and countries in east Asia (see Box A: How are Global Trading Patterns Adjusting to Changes in Trade Policy, and What Does It Mean for Australia?).

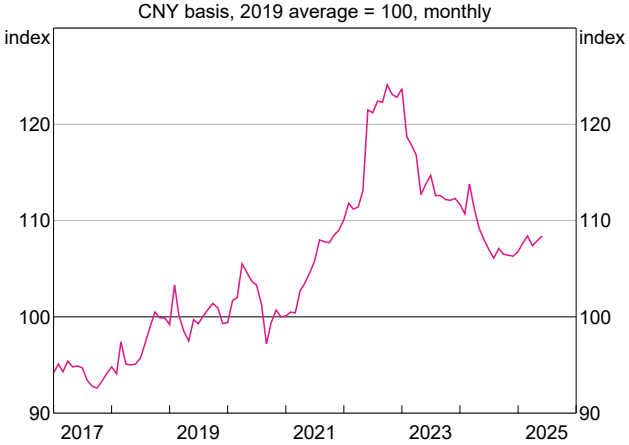
Graph 2.3
Global Merchandise Exports*
USD basis, January 2021 = 100



* Seasonally adjusted by the RBA.
Sources: CEIC Data; RBA.

Chinese export prices have increased slightly since the start of the year but have tracked in a narrow range since mid-2024 (Graph 2.4). Limited movement in export prices is consistent with there having been little change in total demand for Chinese exports, despite the decline in Chinese exports to the United States following the imposition of higher tariffs.

Graph 2.4
China – Merchandise Trade Export Prices*
CNY basis, 2019 average = 100, monthly



* Seasonally adjusted by the RBA.
Sources: CEIC Data; RBA.

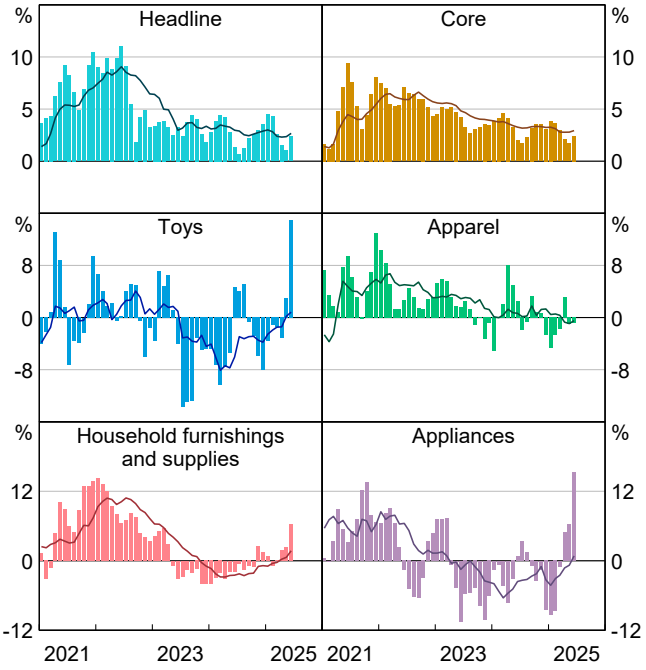
US economic activity was resilient over the first half of the year, with the effects of tariffs and elevated uncertainty expected to become more evident in the second half of the year.

The increase in US tariff rates has had a modest impact on US inflation to date, with pass-through expected to increase over the second half of 2025 and into 2026. Measures of US inflation rose in June, with signs of modest pass-through to core goods inflation, particularly in tariff-exposed components such as toys and appliances (Graph 2.5). Pass-through is expected to increase over the year ahead as the earlier build-up of inventories, accumulated ahead of tariffs taking effect, are drawn down and businesses buy from other, potentially higher cost, foreign and domestic producers. The Federal Reserve's Beige Book and regional Federal Reserve business surveys suggest that businesses are likely to substantially pass through higher tariff-related costs by the end of 2025. However, the extent and persistence of pass-through from higher tariffs to inflation remains uncertain and will depend on

a range of factors including future trade policy settings, the ability of firms to absorb tariff costs into margins amid strong corporate profitability, and the extent to which exporters are able to cross-subsidise US exports across other markets.

Graph 2.5

United States – CPI Inflation*

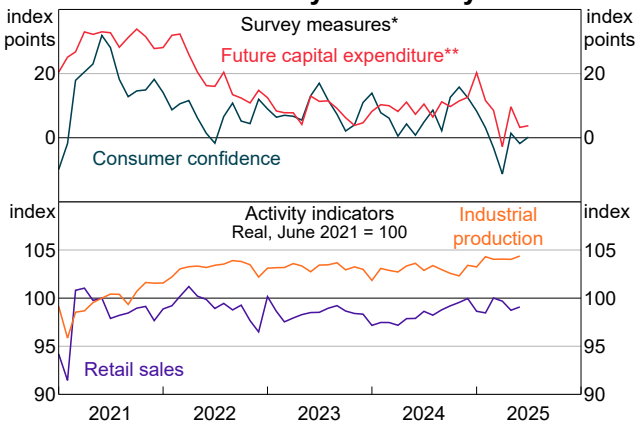


* Lines show year-ended, bars show three-month-ended annualised.
Sources: BLS; LSEG; RBA.

There is little sign that policy uncertainty weighed significantly on US activity in the first half of the year, although there are signs that activity is starting to slow gradually. While the effect of uncertainty on activity was expected to take time to become evident, the resilience of US activity suggests that more severe downside outcomes for US activity are somewhat less likely. GDP growth increased in the June quarter, though it was boosted by a fall in imports as earlier tariff front-loading unwound. Domestic demand continued to grow at a solid, albeit slower, pace. The level of retail sales in real terms has also been little changed overall for the year to date, despite some volatility due to earlier front-loading of purchases by households. Nevertheless, looking through the volatility related to tariff front-running, US GDP growth has started to ease in recent quarters, and while survey measures of US business investment intentions and consumer confidence have picked up from recent lows, they remain below pre-tariff levels (Graph 2.6). There have also been consistent reports since May in the US Federal Reserve's Beige Book that firms have deferred investment and hiring decisions. Recent data suggest a softening in the US labour market, with non-farm payrolls increasing by less than expected in July and earlier increases revised substantially lower. While the unemployment rate has been fairly stable at around 4.2 per cent in recent months, this has occurred alongside a gradual decline in the participation rate.

Graph 2.6

United States – Activity and Survey Indicators



* Deviation from long-run average.
** Average of Federal Reserve Banks' capital expenditure surveys.
Sources: Conference Board; LSEG; RBA.

The new US budget Act – the *One Big Beautiful Bill Act of 2025* – is expected to increase the federal government deficit over the next four years and, at the margin, support activity. The Act extends and expands existing tax cuts and increases funding for immigration enforcement and defence, while phasing out some government subsidies and implementing some spending cuts. Some key provisions of the Act had been widely anticipated by market economists, but it was overall viewed as providing a slightly larger near-term fiscal impulse, and implying a weaker long-term US fiscal position, than had been expected.

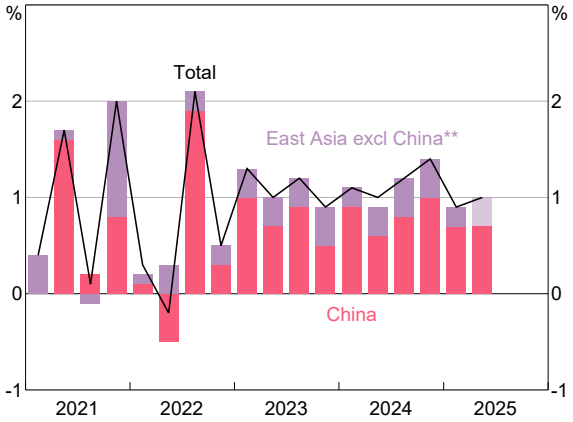
The additional fiscal impulse from the Act is expected to be substantially offset by the drag from tariffs via higher import prices. While tariff settings remain subject to ongoing trade negotiations between the United States and its trading partners, US tariff revenue has increased sharply, from an average of around $7 billion per month over 2024 to around $27 billion in June as the effective tariff rate has increased. These revenues are, however, small compared with the overall US fiscal deficit, which averaged close to $200 billion per month in 2024.

So far, changes in US trade policies appear to have had limited dampening effect on global activity, and little effect on global inflation – but that timing is broadly as expected, with a bigger impact anticipated in the second half of the year.

Domestic demand in the rest of the world has so far proven resilient to US tariffs and broader trade policy uncertainty. In advanced economies, retail sales have so far held up in real terms, despite measures of consumer sentiment remaining well below average. Business investment indicators have also remained resilient, and industrial production has been broadly stable over the year to date.

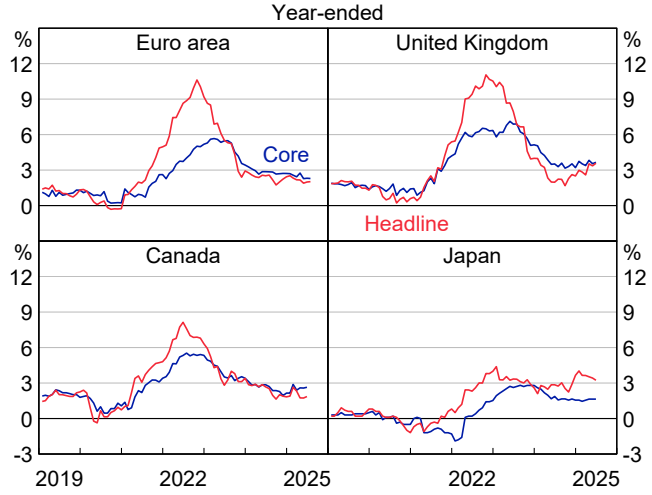
Across trade-exposed east Asian economies, activity and trade data have also been robust to US trade policy actions so far (Graph 2.7). Growth has moderated following the strong end to 2024 but has been steady over the first half of 2025. In China, which has been subject to the largest absolute tariff increase, and the most volatility in announced US tariff rates, external demand and domestic activity have been resilient, with GDP growth in the June quarter ticking down only slightly to 1.1 per cent, from 1.2 per cent in the March quarter. Fiscal policy in China has remained more supportive this year relative to last, and the authorities still have ample room in their budget for support to continue through the remainder of 2025.

Graph 2.7
East Asia GDP Growth*
Real, quarterly with contributions



* PPP-weighted.
** Forecast for June quarter 2025; includes Japan, South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Indonesia, Vietnam, Philippines and Thailand.
Sources: CEIC Data; Consensus Economics; LSEG; RBA.

Graph 2.8
Headline and Core Inflation
Year-ended



Sources: LSEG; RBA.

Core measures of inflation across advanced economies other than the United States remain at or slightly above central bank targets (Graph 2.8). Services inflation has been persistent and elevated, and there is some indication that goods price inflation has moderated across economies that have not imposed retaliatory tariffs against the United States. Inflation in the euro area has remained around target, as domestic price pressures have eased alongside slower wages growth; lower energy prices over the year have also put downwards pressure on headline inflation outcomes across most advanced economies. In Canada, retaliatory tariffs on the United States contributed to stronger durable goods prices in June, with notable increases in vehicle and furniture prices. While they were not considered the most likely outcomes in May, there was a possibility that higher tariffs could have caused global export prices either to have significantly declined by now as trade flows were redirected or to have increased due to supply chain disruptions; these risks have not materialised so far.

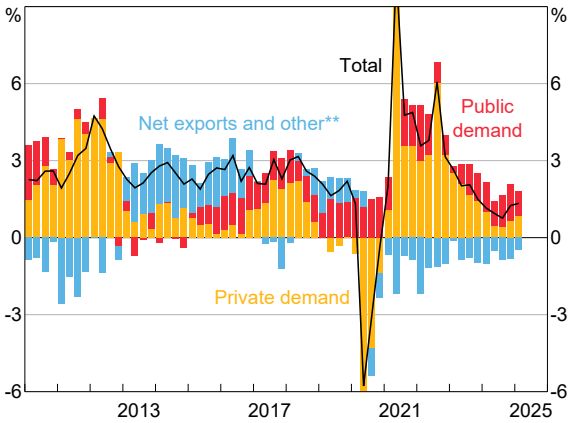
2.2 Domestic economic activity

GDP growth was slightly weaker than expected in the March quarter, driven by an unanticipated decline in public expenditure, but the recovery in private demand was stronger than expected.

GDP growth was 0.2 per cent in the March quarter. This was slightly below our expectations in May, as public demand declined in the quarter (against expectations for continued strong growth). However, private demand growth was a little stronger than expected in the quarter, driven by upside surprises for business and dwelling investment. Combined with this stronger-than-expected quarterly outcome, upwards revisions to historical data for household consumption and dwelling investment suggest that the recovery in the private sector up to the March quarter was stronger than previously expected (Graph 2.9).

Recent GDP outcomes have contributed to further progress in closing the economy-wide output gap. While year-ended GDP growth picked up to 1.3 per cent, this remains below our view of potential output growth (see Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth).

Graph 2.9
GDP Growth*
Year-ended with contributions



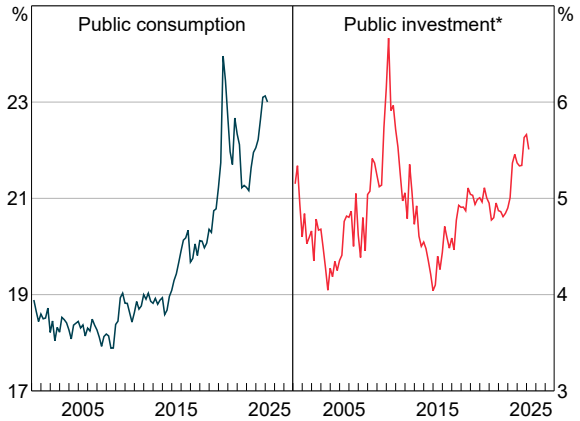
* Outliers during the COVID-19 pandemic have been truncated.
** Includes change in inventories and the statistical discrepancy.
Sources: ABS; RBA.

Natural disasters affecting parts of Queensland and New South Wales appear to have weighed on aggregate growth modestly in the March quarter. Household consumption growth in Queensland was only a little below the national average after accounting for changes in electricity subsidies. Declines in spending associated with Cyclone Alfred, in categories such as hotels, cafes and restaurants, were short-lived and largely offset by increases in other categories such as food. However, there appears to have been a more pronounced effect on the external sector, as resource production fell significantly in the quarter, partly in response to weather-related mine disruptions in Queensland and New South Wales.

Growth in public demand has eased a little in recent quarters.

Overall public demand declined a little in the March quarter and was weaker than expected. Public consumption was flat in the quarter, reflecting a reduction in electricity subsidies and a slowing in spending growth on other general government expenses and federal social benefits, including health and disability benefits. Nevertheless, public consumption continues to account for a larger share of GDP than it has for most of the period since the 1960s, outside of the emergency pandemic period (Graph 2.10).

Graph 2.10
Components of Public Demand
Share of nominal GDP



* Adjusted for second-hand asset transfers between the public and other sectors.
Sources: ABS; RBA.

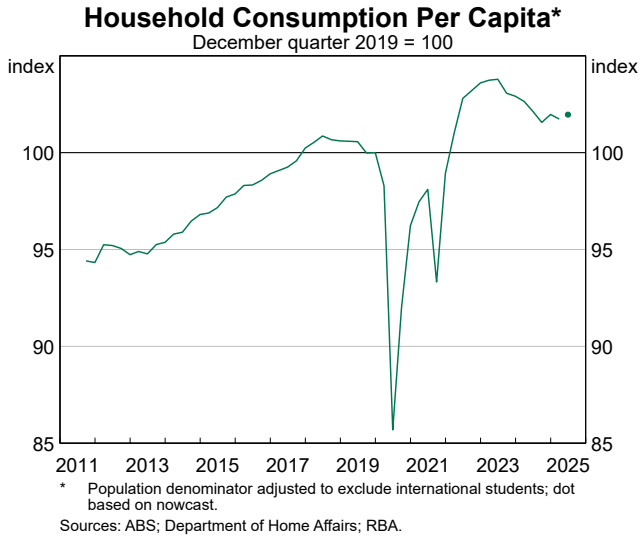
Government budgets imply continued growth in public consumption over the forecast period, albeit at lower rates than in the past couple of years as reforms to reduce the rate of increase of NDIS and aged care spending are assumed to take effect. All states and territories have released updated budgets since the May *Statement* and these have not materially changed our projections for future growth in public demand (see Chapter 3: Outlook).

The level of public investment has stabilised over the past year or so. New public investment declined in the March quarter, with the Australian Bureau of Statistics (ABS) noting that the decline reflected completions and delays in several major projects across energy, road, rail, health and education at the state level. In aggregate, state governments have revised down their projections for investment spending a little but continue to indicate large infrastructure pipelines over coming years.

Household consumption in the June quarter looks to have been broadly in line with the May *Statement* forecast. Over the past year, consumption has grown in line with population growth, leaving consumption per capita broadly flat.

Household consumption growth eased to 0.4 per cent in the March quarter, as expected. Year-ended growth was a touch stronger than expected at 0.7 per cent, due to an upward revision to the December quarter. Growth continued to be led by essential categories, although discretionary spending also increased over the year. Over the past year, overall household consumption has been growing in line with population growth, which has remained elevated: as a result, consumption has been little changed on a per capita basis (Graph 2.11). That is the case even after abstracting from a range of factors affecting measured growth in recent quarters – including changes to electricity subsidies, increases in promotional activity in the December quarter, and the effect of weather events.

Graph 2.11



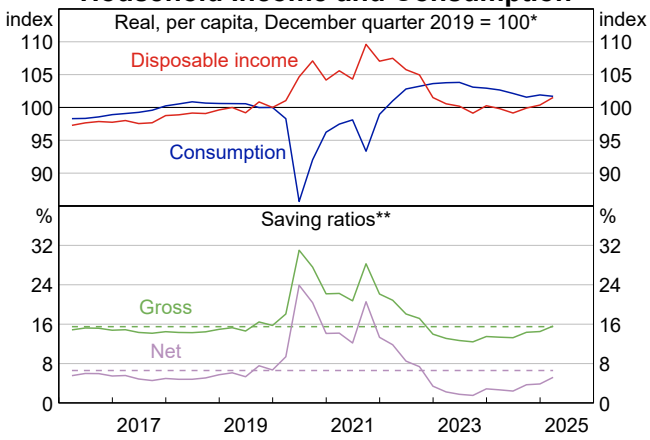
Timely indicators of household consumption for the June quarter to date have been in line with the assessment in the May *Statement*. Consumption growth is expected to pick up from the March quarter. Promotional activity around the end of the financial year supported growth in the quarter, and essential consumption is expected to continue contributing to growth, including through the unwinding of electricity subsidies. Overall, the recent data are consistent with retail liaison contacts continuing to report moderate growth since the start of this year (see Box B: Insights from Liaison). The expected June quarter outcome would be consistent with a small increase in household consumption per capita.

Real household incomes increased by 1.7 per cent over the year to the March quarter on a per capita basis; the household sector has largely used this higher income to increase saving (Graph 2.12). The household savings ratio increased in the March quarter to around its pre-pandemic average. While this was partly a continuation of a gradual increase over the preceding year and a half, there was also a temporary boost to income and saving in the March quarter from a large pick-up in social assistance and insurance transfers related to weather damage, which is expected to unwind in the June quarter. An increase in savings is consistent with an environment of higher interest rates, which increases the incentive to save. Nonetheless, the return of the saving ratio to its pre-pandemic average has occurred more quickly than expected, resulting in weaker consumption outcomes than were expected a year ago. The underlying cause of these

outcomes is difficult to determine but it could reflect an increase in precautionary savings motives as the persistence of weakness in real income growth has become more apparent over time.[2]

Graph 2.12

Household Income and Consumption



* Population denominator adjusted to exclude international students.
** Dashed lines represent ten-year average to the end of 2019.
Sources: ABS; Department of Home Affairs; RBA.

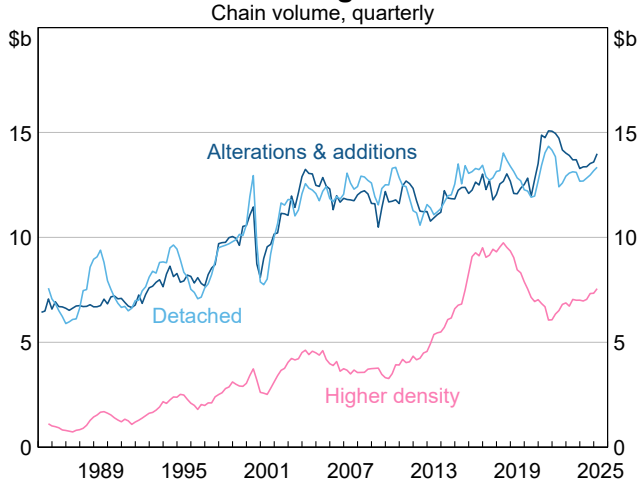
After easing over 2024, housing market conditions have begun to pick up.

Dwelling investment picked up in the March quarter and was stronger than expected in the May *Statement*. The pick-up was broadly based across high density dwellings, detached dwellings and alterations and additions (Graph 2.13). The overall upside surprise – combined with an upwards revision to previous data – points to a clearer upward trend in residential construction activity than previously observed. This upwards trend reflects construction work resulting from the pick-up in building approvals over the first half of 2024, which was in turn driven by easing cost inflation and build times, strong population growth, improved sentiment (as buyers believed the cash rate had peaked), and state-level housing initiatives for developers. Dwelling investment has also been supported recently by continued work on projects in the pipeline as capacity constraints have eased and trade labour availability has improved. Despite recent strength, dwelling investment and leading indicators such as building approvals remain low in per capita terms, and relative to underlying housing demand.

Graph 2.13

Private Dwelling Investment

Chain volume, quarterly



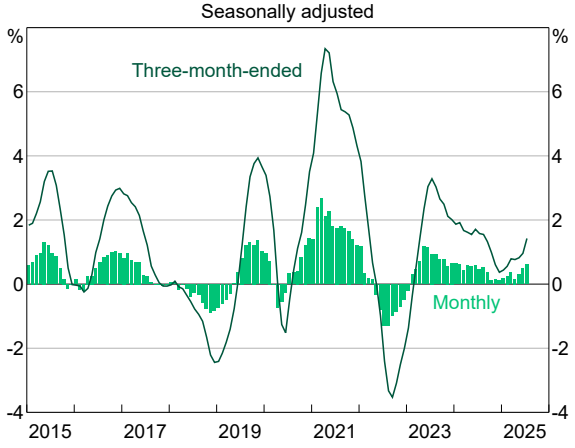
Sources: ABS; RBA.

Housing price growth and established housing market activity have picked up in recent months (Graph 2.14). After a period of subdued growth from the second half of 2024 into early 2025, housing price growth has been a bit stronger than expected in the May *Statement*, consistent with the modest pick-up in housing credit growth (see Chapter 1: Financial Conditions). Auction clearance rates, which can be a leading indicator for housing price growth, have trended a little higher since the start of the year to be slightly above historical averages. On-market supply remains tight, with total listings of homes for sale declining in Sydney and Melbourne in recent months and remaining on the lower end of recent historical ranges for other large capital cities.

Graph 2.14

Housing Price Growth

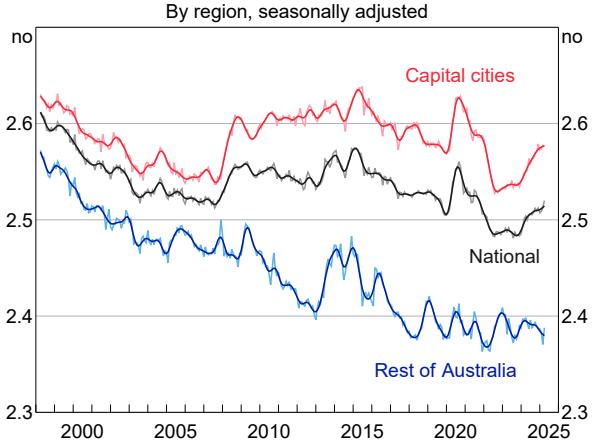
Seasonally adjusted



Sources: Cotality; RBA.

These developments collectively suggest that the established housing market is responding to the easing in monetary policy. So far, growth in housing prices since the first reduction in the cash rate in February has been within the range of historical experiences of previous easing phases. Future growth will depend on the evolution of other macroeconomic variables (notably the unemployment rate), how actual and expected monetary conditions evolve, and underlying demand and supply in the housing market. Building approvals are yet to respond noticeably to the recent cash rate cuts, although other leading indicators of supply such as enquiries for new homes have started to pick up. Underlying demand has continued to rise alongside continued growth in the population, although this has been partly offset by a pick-up in average household size, which has risen to pre-pandemic levels (Graph 2.15).

Graph 2.15
Average Household Size*
By region, seasonally adjusted

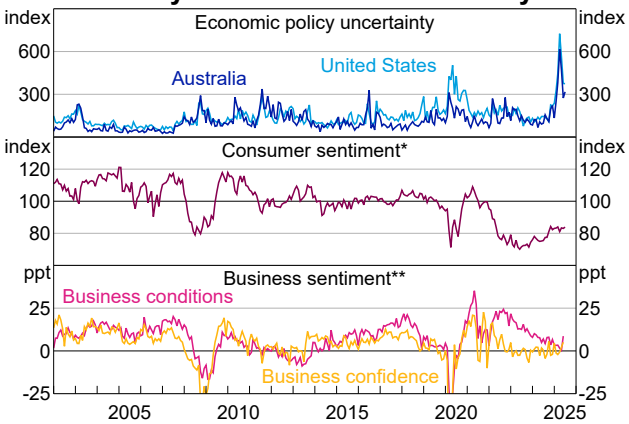


* Smoothed lines are 13-period Henderson trends.
Sources: ABS; RBA.

International developments appear to be having little effect on private activity in Australia so far, as had been expected at this stage, and forward-looking measures of sentiment so far show no signs of deteriorating on international news.

Timely readings of current conditions from consumer surveys suggest that global trade tensions have had little effect on consumer sentiment in Australia. Measures of public commentary about economic policy uncertainty – which increased sharply alongside recent global developments – have fallen back somewhat in both Australia and the United States from their peak in April (Graph 2.16). While there has been little recovery in consumer sentiment since the start of the year, survey responses continue to suggest that domestic issues – such as inflation and interest rates – are most salient for households.

Graph 2.16
Survey Indicators and Uncertainty



* Average since 1996 = 100; mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys.
** Net balance; outliers have been truncated.
Sources: ANZ–Roy Morgan; Baker, Bloom and Davis (2016); NAB; RBA; Westpac–Melbourne Institute.

Business surveys also continue to point to domestic factors shaping conditions more than international factors. Though surveyed business conditions have been mixed, conditions improved in the June month after a period of steady declines since mid-2022, which may be an early indication of business conditions stabilising, if not improving. Nominal capital expenditure intentions for the 2025/26 financial year were revised down in March and suggest there will be no growth in business investment over the year, compared with previous expectations for growth of around 3 per cent. As with consumers, domestic factors appear to be the primary driver of the business investment outlook, with few businesses calling out global factors at present. The May *Statement* forecasts for business investment assumed there would be a small effect from heightened global uncertainty from the second half of this year, but the evidence for such an effect is limited based on currently available data.

Global trade policy developments have also had few discernible effects on export volumes, as expected. While resource export volumes are estimated to have declined in the June quarter due to lower coal exports, this mostly reflects disruptions associated with weather events and lower demand from Asian markets due to milder weather conditions. Tariff announcements have caused some price volatility for key export commodities, but have generally not had a sustained effect, with other factors like global supply and Chinese demand being the more important drivers (see section 2.1 Global economic conditions). Looking forward, slowing global growth because of global trade policy developments will likely result in reduced demand for Australian exports. But the effect is more likely to come through export prices than volumes given that Australia's exports are dominated by resources for which Australia is a relatively low-cost producer, and in any case Chinese fiscal policy is expected to provide offsetting support. Other structural forces, like changes in global supply or declining use of fossil fuels in energy generation globally, are instead expected to drive trends in resource export volumes.

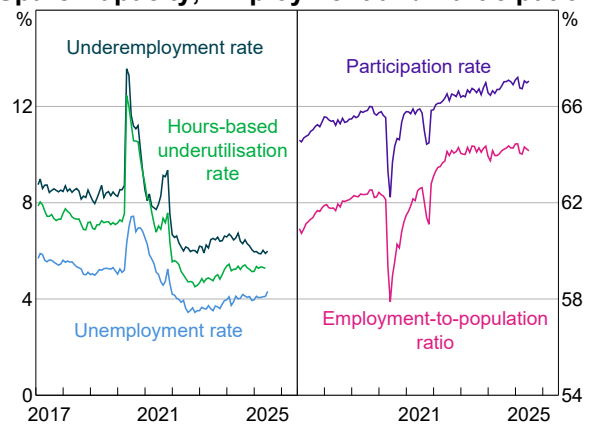
There is early evidence that global developments have had a modest effect on Australian imports. In particular, the value of goods imports from China increased sharply in the June quarter, broadly similar to other advanced economies. This could reflect some possible reorientation and redirection of Chinese trade flows. It is too early to observe clear evidence of whether changing trade flows have affected Australian import prices, although any effect on overall import prices is expected to be limited (see Box A: How are Global Trading Patterns Adjusting to Changes in Trade Policy, and What Does It Mean for Australia?).

2.3 Labour market and wages

Labour market conditions have eased a little in recent months and are evolving broadly as expected at the time of the May *Statement*.

The unemployment rate increased to 4.3 per cent in the month of June, its highest level since late 2021 (Graph 2.17). For the June quarter as a whole, the unemployment rate averaged 4.2 per cent, in line with our May *Statement* forecast. The increase in the unemployment rate in June was partly driven by a rise in the youth unemployment rate – a more cyclical measure – to 10.4 per cent. The medium-term unemployment rate also ticked up in June. Other measures of labour underutilisation have been broadly stable in recent months. The underemployment rate ticked up to be 6.0 per cent in June but has been little changed since late 2024. The hours-based underutilisation rate – a broader measure of spare capacity – has been little changed since the start of the year. The rate of layoffs, which began increasing in 2022, has stabilised over the past year at a relatively low level by historical standards. The rate of job-switching had been easing more rapidly than other labour market indicators, having fallen quite materially since its 2022 peak, but this measure has also stabilised since the start of the year.

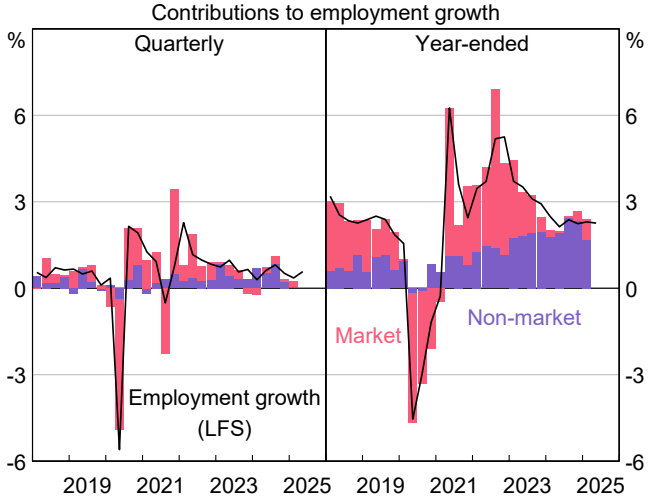
Graph 2.17
Spare Capacity, Employment and Participation



Sources: ABS; RBA.

Employment growth was solid in the June quarter despite the tick-up in unemployment. The 0.6 per cent increase in employment over the quarter was largely accounted for by strong gains in April, with momentum moderating in May and June. The non-market sector – which includes health care, education and public administration – has been the main driver of aggregate employment growth for some time (based on industry-level data to March quarter 2025), though employment growth in this sector has moderated from a rapid pace. Employment growth in the market sector picked up a little in year-ended terms in the March quarter, consistent with the gradual pick-up in GDP growth (Graph 2.18). The whole-economy employment-to-population ratio and participation rate were little changed in June, remaining around historical highs. The longer run trend of higher female participation and strong demand for labour in the non-market sector in recent years have continued to support recent participation rate outcomes.

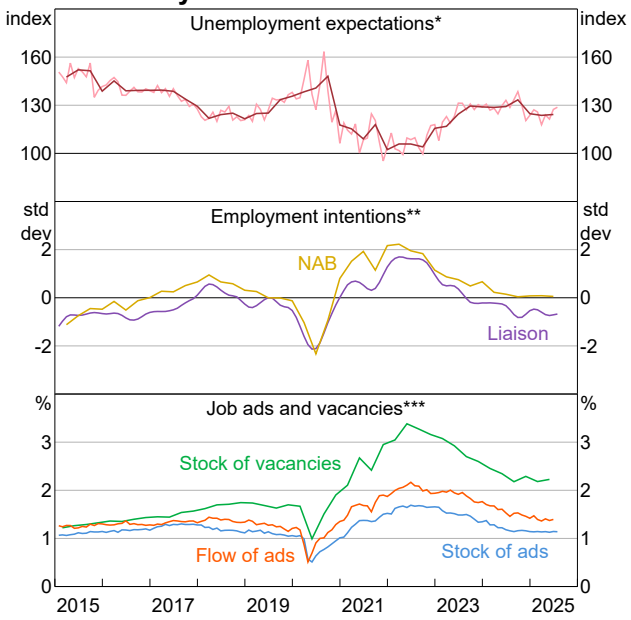
Graph 2.18
Market and Non-market Employment*
Contributions to employment growth



* Market and non-market employment shares are calculated using Labour Account data on main job holders by industry up to March quarter 2025.
Sources: ABS; RBA.

With the unemployment rate increasing somewhat and many other indicators stable, labour market conditions overall are judged to have eased a little recently – but leading indicators point to a stable near-term outlook. Measures of labour demand such as job advertisements and vacancies have mostly tracked sideways in recent months, and employment intentions from business surveys and the RBA's liaison program have been relatively stable (Graph 2.19). Households' unemployment expectations have also remained broadly unchanged since the start of the year.

Graph 2.19
Timely Labour Market Indicators

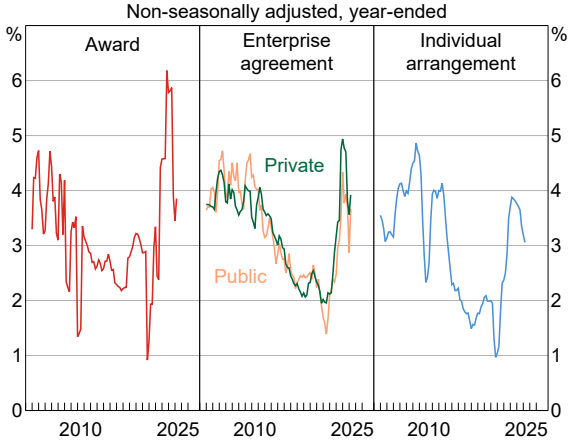


* Dark line shows quarter average.
** 12 months ahead; standard deviations from mean.
*** Per cent of labour force.
Sources: ABS; ANZ–Indeed; JSA; NAB; RBA; Westpac–Melbourne Institute.

As discussed in the May *Statement*, year-ended growth in nominal wages eased over the year to the March quarter.

The most recent Wage Price Index (WPI) data were released ahead of the May *Statement*. While wages growth had eased over the preceding year, it ticked up slightly to 3.4 per cent in the March quarter. This largely reflected administered increases to the wages of childcare and aged care workers. Looking through the effects of administered wage decisions, growth in the private sector WPI was little changed in the March quarter but was lower than a year earlier. Wages growth eased for workers paid under individual arrangements, whose wages tend to be the most reflective of conditions in the labour market (Graph 2.20). Public sector wages growth – which has been volatile recently – increased in the March quarter, supported by the certification of several large agreements.

Graph 2.20
Wages Growth by Pay-setting Method*
Non-seasonally adjusted, year-ended



* Excludes bonuses and commissions.
Sources: ABS; RBA.

In its annual wage review, the Fair Work Commission announced a 3.5 per cent increase to all modern award wages. The increase was effective from 1 July and directly affected the approximately 20 per cent of employees that are paid under a modern award, or about 10 per cent of the wage bill. A further 5 to 10 per cent of employees are estimated to be indirectly affected through agreements that are linked to the award rate. The wage increase has not materially affected the outlook for aggregate WPI growth (see Chapter 3: Outlook).

Unit labour costs growth remained high in the March quarter, largely because of persistent weakness in productivity growth.

Year-ended growth in the national accounts measure of average earnings (AENA) per hour increased slightly to 4.2 per cent in the March quarter. This was as expected in the May *Statement* and slightly above its historical average. AENA is a broader measure of labour earnings than the WPI and includes changes in bonuses, overtime and other payments, as well as the impact of workers moving to jobs with different levels of pay. This broader measure of earnings

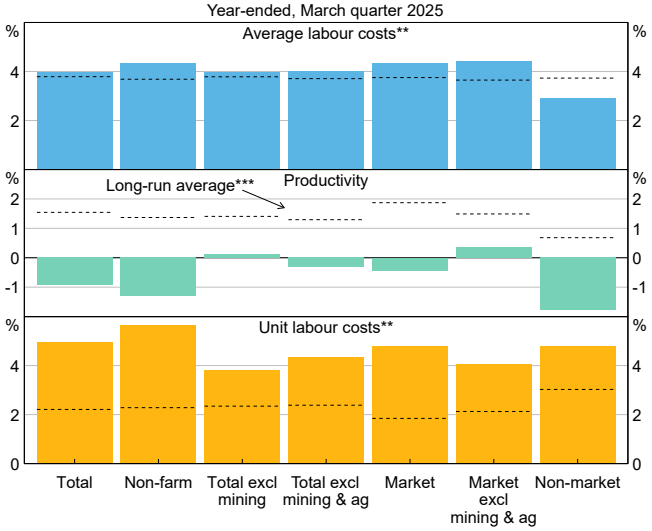
has continued to grow more strongly than the WPI, with the gap between growth in AENA and WPI slightly above its historical average.

Unit labour costs growth remained elevated in the March quarter, broadly as expected, owing to persistently weak productivity outcomes and slightly above-average growth in labour costs. Growth in non-farm unit labour costs picked up to 5.6 per cent over the year to the March quarter. Estimates of unit labour cost growth remain elevated even after excluding various industries (Graph 2.21). For example, growth in unit labour costs is above average when excluding the non-market sector, for which productivity is difficult to measure and which may have limited immediate impact on consumer prices. Over the forecast period, growth in unit labour costs is assumed to return to sustainable rates through a combination of a further easing in labour costs growth and an increase in productivity growth (see Chapter 3: Outlook).

Graph 2.21

Estimates of Growth in Labour Costs and Productivity*

Year-ended, March quarter 2025



* Industry split calculations are exclusive of gross value added (GVA) from ownership of dwellings; the farm sector and the agriculture industry are conceptually different, with the farm sector accounting for around 87 per cent of agriculture GVA.
** Industry splits assume the same ratio of employee to employer hours as in the non-farm economy.
*** Dashed lines represent the compound average annual growth rate from September quarter 1994 to December quarter 2019.
Sources: ABS; RBA.

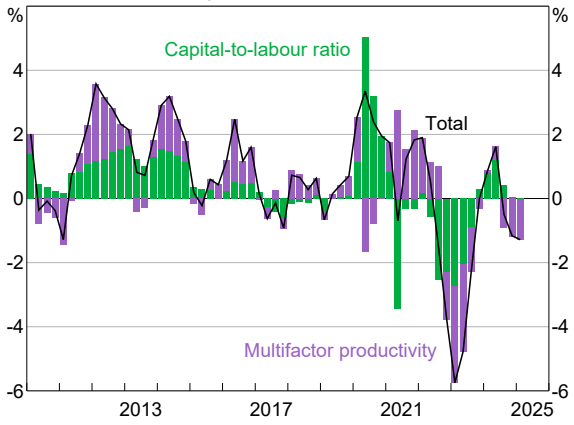
Productivity growth remains weak, weighing on the growth of the economy's supply capacity.

Non-farm labour productivity decreased by 1.3 per cent over the year to the March quarter, and labour productivity is around its 2016 level. Productivity growth in the market sector (excluding agriculture and mining) increased by 0.4 per cent over the year to March 2025. The earlier recovery in the stock of capital relative to the number of hours worked (the capital-to-labour ratio) has stalled in recent quarters. Multifactor productivity (MFP), which is the part of labour productivity growth not due to changes in the capital-to-labour ratio but reflecting how efficiently inputs are being used, remained very weak; MFP declined by 1.3 per cent over the year to the March quarter (Graph 2.22).[3]

Graph 2.22

Labour Productivity Growth

Non-farm, year-ended with contributions



Sources: ABS; RBA.

2.4 Assessment of spare capacity

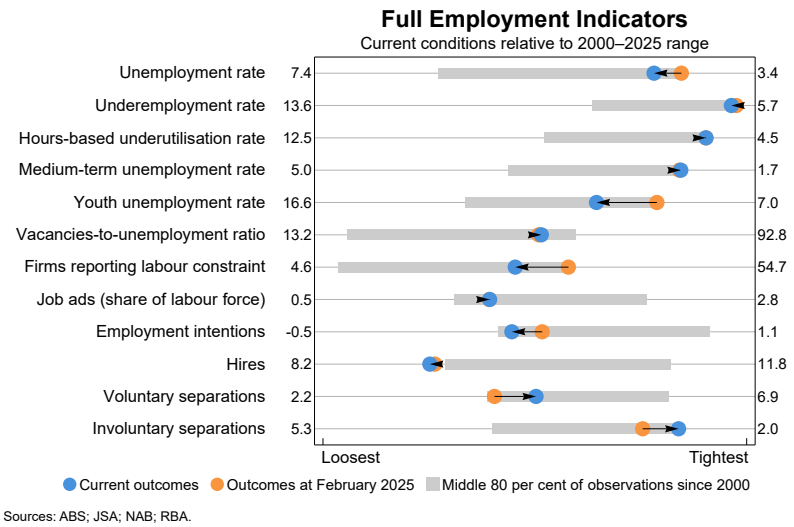
Overall, while conditions have eased a little recently, we assess that there remains some tightness in the labour market and some evidence of broader capacity pressures; as usual, this assessment is uncertain.

Some indicators suggest that labour market conditions have moved closer to balance recently, though overall we judge that some tightness remains. The unemployment rate has increased since the start of the year, reflecting underlying increases in medium-term and youth unemployment, and the share of firms reporting that labour is a significant constraint on output has declined a little recently (Graph 2.23). Nevertheless, unemployment is trending a little below our current estimate of its full employment level, the underemployment rate is little changed at around its historical low and the ratio of vacancies to unemployed workers and the share of firms reporting labour as a significant constraint on output remain above their long-run averages. Elevated growth in unit labour costs is also consistent with there being some tightness in the labour market, although this measure of labour costs, while comprehensive, is volatile and subject to considerable revision. Overall, these indicators suggest that labour market conditions have eased recently but that some tightness remains relative to full employment.

The rate of job-switching is around its long-run average, suggesting less tight labour market conditions. A decline in the rate of job-switching over recent years (notwithstanding a small pick-up recently) suggests that inter-firm competition to attract and retain staff may have eased. That in turn could indicate less upward pressure on wages – and less tightness in the labour market – than implied by other indicators. That possibility continues to be reflected in downwards judgements on our wages and inflation forecasts (see Key judgement #3 in Chapter 3: Outlook).

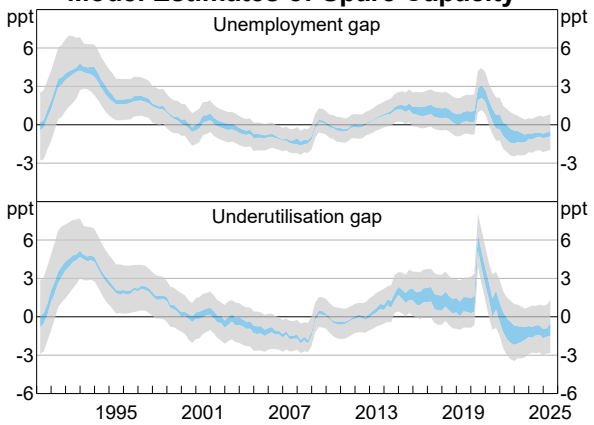
Model-based estimates continue to point to a somewhat tighter labour market than suggested by other indicators, though these estimates are imprecise. Model-based estimates of spare capacity in the labour market have remained broadly stable since mid-2024 (Graph 2.24). The estimates in our model suite vary widely, but each implies that the labour market is tighter than full employment – though there is substantial estimation uncertainty around each individual estimate.

Graph 2.23



Sources: ABS; JSA; NAB; RBA.

Graph 2.24
Model Estimates of Spare Capacity*

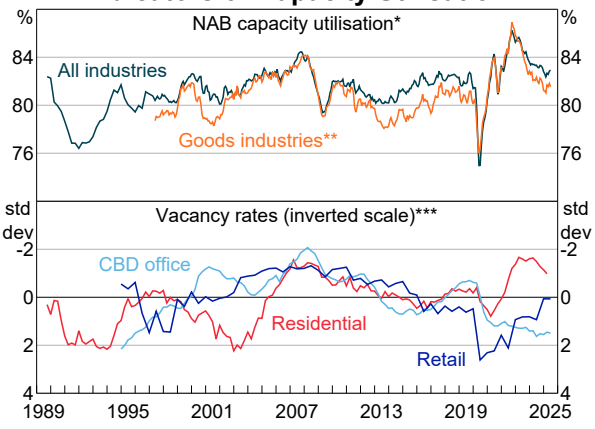


* Blue-shaded region shows illustrative range of central gap estimates from a selection of models; June quarter 2025 values are partial estimates; grey bands are the maximum and minimum two-standard-error confidence intervals from the selection of models.

Sources: ABS; RBA.

Indicators of broader capacity utilisation continue to suggest that some resources are being used intensively. The earlier easing in the NAB measure of capacity utilisation appears to have stalled since February and it remains above its historical average, suggesting businesses are still using their labour and capital resources at higher-than-normal rates to meet demand (Graph 2.25). Residential vacancies data show utilisation of the housing stock remains elevated, consistent with subdued growth in housing supply over recent years. Retail vacancies data suggest utilisation of retail property has returned to its historical average, supported by the return to office and growing demand from premium retailers for space as a result.

Graph 2.25
Indicators of Capacity Utilisation



* Quarterly data prior to May 1997, three-month moving average thereafter; excludes mining.

** Goods industries include manufacturing, construction, wholesale and retail.

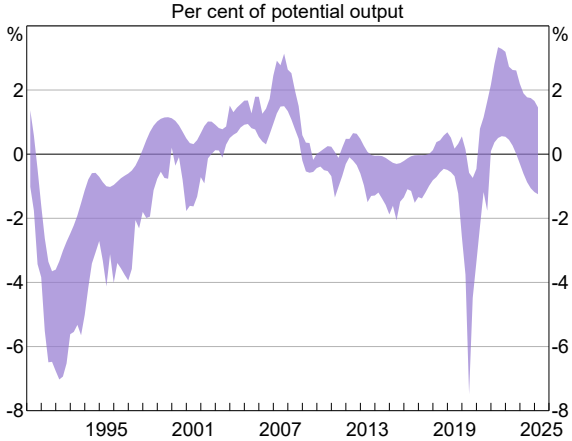
*** Series are standardised to measure the number of standard deviations each series is from its mean value; retail refers to regional retail centres.

Sources: ABS; JLL Research; NAB; RBA; REIA.

Taking survey evidence together with model-based estimates of the output gap, we assess that the output gap is small and positive, though there are material uncertainties around this assessment. The level of GDP in the March quarter remained higher than most model estimates of the level of potential output, suggesting that aggregate demand continued to exceed the capacity of the economy to supply goods and services sustainably (Graph 2.26). However, the individual model estimates vary widely, reflecting differences in how they interpret the data, and each is subject to significant estimation uncertainty.

The estimates suggest that the output gap continued to narrow in the March quarter. Weak productivity growth outcomes have continued to weigh on estimates of the current rate of potential output growth. We have revised down our medium-term assumptions for productivity growth and potential output growth, though this is assumed to have no implications for our assessment of the output gap (see Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth).

Graph 2.26
Model Estimates of Output Gap*



* Violet-shaded region shows illustrative range of central gap estimates from a selection of models encompassing different measures and definitions of the output gap; each estimate is subject to estimation uncertainty which is not shown in the graph, as well as revision due to data and model refinements.

Sources: ABS; OECD; RBA.

2.5 Inflation

The quarterly rate of underlying inflation eased further in the June quarter, broadly in line with expectations in the May *Statement*.

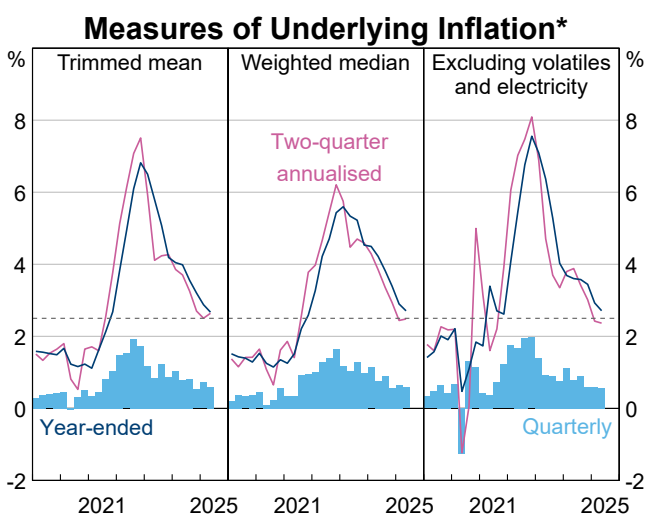
Trimmed mean inflation eased to 2.7 per cent over the year to the June quarter, from 2.9 per cent in the March quarter, broadly as expected in the May *Statement* (Graph 2.27). In quarterly terms, trimmed mean inflation eased to 0.6 per cent, from 0.7 per cent in the March quarter.

Some components experienced stronger-than-expected inflation in the June quarter. New dwelling inflation picked up alongside an increase in housing market activity; this follows declining prices over the previous two quarters and elevated discounting by builders. Consumer durables inflation has picked up in recent months, with some firms in liaison indicating that the depreciation of the exchange rate late last year is being passed through to consumer prices.

Offsetting these were downside surprises to domestic travel and some administered services, although these components tend to be volatile. Market services inflation continued to ease in year-ended terms, as expected in the May *Statement*. Non-labour cost pressures have continued to ease gradually in recent months. Downward pressure on some firms' margins may still be weighing on inflation at present, with some firms reporting in liaison that weak demand has limited their ability to pass increases in input costs to final prices.

Headline inflation eased to 2.1 per cent over the year to the June quarter, broadly as expected in the May *Statement*. Headline inflation was well below underlying inflation over the year to June, primarily reflecting large declines in electricity and fuel prices over the past year and the effect of federal and state government subsidies. Temporary changes to electricity rebates are estimated to have subtracted around 0.2 percentage points from headline inflation over the year to the June quarter. The unwinding of rebates, as scheduled, is expected to increase year-ended headline inflation from late 2025. Notwithstanding the recent volatility in global oil markets, oil price declines in early April resulted in lower fuel prices through April and May, subtracting around 0.1 percentage points from headline inflation in the June quarter.

Graph 2.27

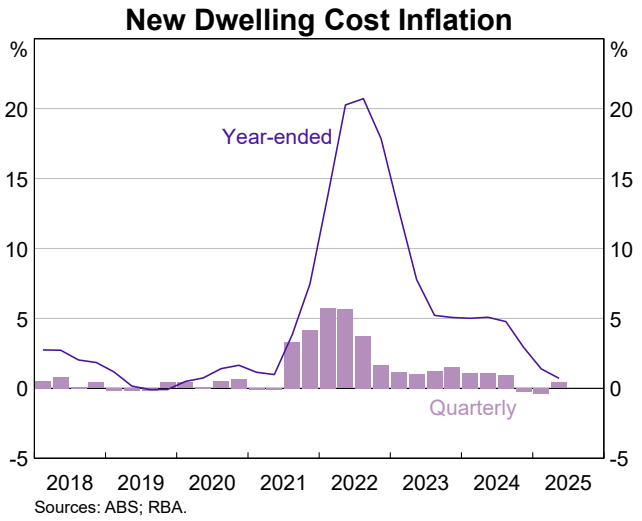


* Dashed line indicates midpoint of the inflation target.
Sources: ABS; RBA.

Housing inflation eased in the June quarter, but by less than expected in the May *Statement*.

New dwelling construction prices increased by 0.4 per cent in the June quarter, after declining over the previous two quarters (Graph 2.28). This was stronger than expected at the time of the May *Statement*. New dwelling inflation had been an important contributor to the moderation in underlying inflation over the past year, having eased to 0.7 per cent in year-ended terms from previously elevated growth rates. Information from liaison indicates that demand for building new houses has picked up in recent months alongside improved buyer sentiment. The availability of trade labour has improved a little further and growth in materials costs is a little below its historical average rate.

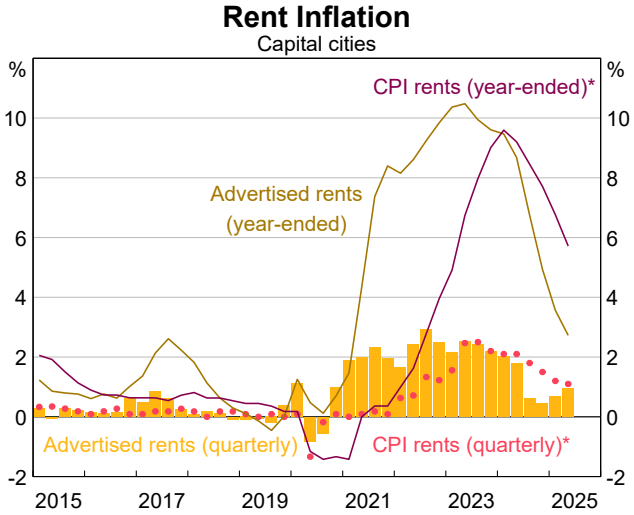
Graph 2.28



Sources: ABS; RBA.

CPI rent inflation eased to 4.5 per cent over the year to the June quarter, in line with expectations and consistent with the earlier slowing in advertised rents growth. Advertised rents growth has picked up in recent months in capital cities, suggesting that year-ended growth in advertised rents is unlikely to ease materially further in coming quarters (Graph 2.29).

Graph 2.29



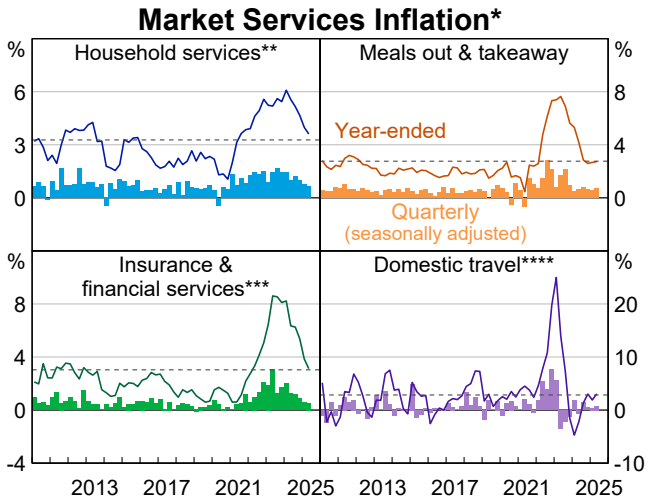
* Excludes effects of Commonwealth Rent Assistance from September quarter 2023 onwards.

Sources: ABS; Cotality; RBA.

Services inflation moderated further in the June quarter in year-ended terms.

Market services inflation (excluding domestic travel and telecommunications) eased to 3.1 per cent over the year to the June quarter, as expected, from 3.5 per cent in the March quarter. The disinflation in year-ended terms has been broadly based and has seen the rate of market services inflation decline to around its inflation-targeting average (Graph 2.30). Insurance inflation (excluding health insurance) has eased notably in recent quarters.

Graph 2.30



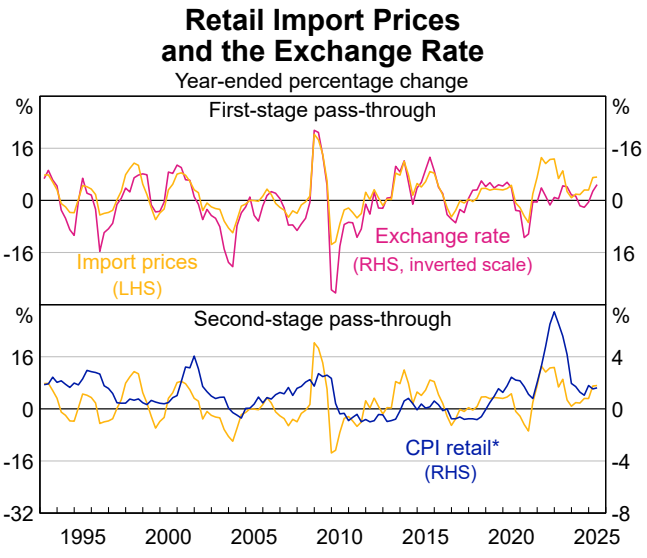
* Dashed lines show historical averages of year-ended inflation (June quarter 2001 onwards for insurance & financial services and March quarter 1993 onwards for all other components).
** Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services.
*** Excludes deposit & loans to June quarter of 2011.
**** Imputed using headline CPI in the June and September quarters of 2020 and September quarter of 2021.
Sources: ABS; RBA.

Inflation for goods and services with administered prices (excluding utilities) was broadly stable in year-ended terms. At 4.1 per cent in the June quarter, it was around its historical average. Cost-of-living policies continue to place downward pressure on the year-ended rate of administered price inflation.

Goods inflation has been broadly stable over the past year; it is too early to see any effects of recent international trade policy developments.

Retail goods inflation was broadly stable in the June quarter at 1.6 per cent in year-ended terms (Graph 2.31). Consumer durables inflation increased in the June quarter and was stronger than expected in the May *Statement*. Information from liaison suggests that stronger inflation in some components may reflect the pass-through from the depreciation of the exchange rate late last year. Global trade developments do not appear to be having a material impact on domestic prices in the data received to date (see Box A: How are Global Trading Patterns Adjusting to Changes in Trade Policy, and What Does It Mean for Australia?). Groceries inflation, excluding fruit and vegetables, slowed a little in the June quarter. Idiosyncratic factors have affected a handful of components, including eggs and confectionary.

Graph 2.31



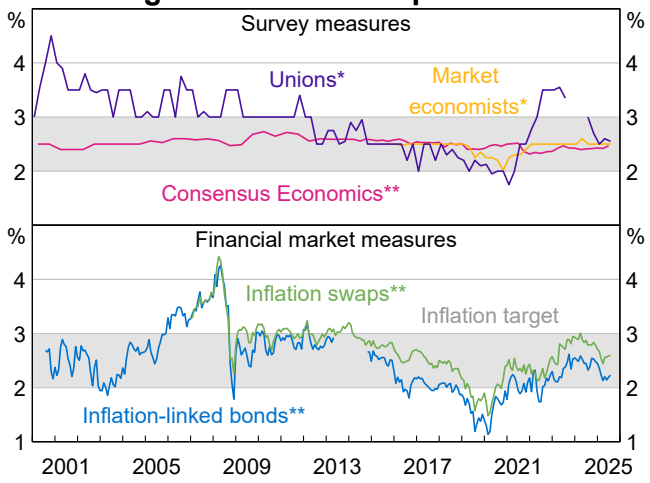
* Adjusted for the tax changes of 1999–2000.
Sources: ABS; RBA.

Inflation expectations remain consistent with achieving the inflation target.

Survey and financial market measures of long-term inflation expectations have declined from their mid-2022 peaks, consistent with declines in actual inflation. Financial market measures of inflation compensation declined earlier in the year, although this may have partially reflected market dynamics unrelated to fundamentals, and have been stable in recent months (Graph 2.32). Unions' long-term inflation expectations have also declined to be close to the mid-point of the inflation target range. Our assessment is that long-term inflation expectations remain anchored at the target.

Graph 2.32

Long-term Inflation Expectations



* Average over the next 5–10 years; data on union inflation expectations unavailable between November 2023 to May 2024.
** Average over the five years starting from five years ahead.

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

The monthly CPI will commence later this year.

The ABS has announced that it will start publishing the complete monthly CPI in November 2025, and will discontinue the monthly Indicator data at the same time. The ABS will also continue to publish quarterly seasonally adjusted data for at least 18 months, and the RBA plans to observe both the quarterly and monthly data for a period. More information on the RBA's approach will be provided in the November *Statement*, ahead of the first data release to be published later that month.

Endnotes

1 See RBA (2025), 'Box A: How Might Tariffs Affect Australian Trade?', *Statement on Monetary Policy*, May.

2 See RBA (2025), 'Box B: Consumption and Income Since the Pandemic', *Statement on Monetary Policy*, February.

3 For more information on the labour productivity decomposition, see RBA (undated), 'Productivity', Explainer.

Box A: How are Global Trading Patterns Adjusting to Changes in Trade Policy, and What Does It Mean for Australia?

Global trade volumes in aggregate have been notably resilient since the start of the year in the face of large increases in trade barriers imposed by the US administration and the responses of some of its trading partners. However, underlying the aggregate trade figures there have been some significant adjustments in country-to-country trade patterns. This Box examines how trading patterns, particularly for the United States and China, have been adjusting to trade policy developments, and the potential impact that could have on the prices of goods imported to Australia. Looking ahead, the extent to which aggregate trade flows remain resilient will depend on: the flexibility of global supply chains; the evolution of trade policy, including tariff rate differentials between exporting countries; the resilience of global GDP growth; and exchange rate movements.

Global trade patterns tend to adjust in a way that reduces the impact of trade barriers on economic activity and inflation.

The introduction of trade barriers can affect supply chains and global trade flows, as households and businesses in affected economies adjust to the changes in competitiveness. Some changes in trade flows may happen relatively quickly in response to tariff changes – for example, as importers switch to new suppliers for highly substitutable goods. Other aspects of the adjustment – for example, changes in the location of production for less substitutable goods – are likely to occur more gradually, if tariffs are sustained. Over time, these changes, along with adjustments in exchange rates, will tend to reduce the impact of higher trade barriers on overall economic activity and inflation.

This Box focuses on the *initial* adjustment in trade flows in response to recent trade policy developments, and how the global prices of Australia's goods imports might be affected. These changes in trade flows can come about in a number of ways. When a country raises its tariffs on some trading partners, that can encourage importers to source their goods from other countries ('trade diversion'), or it may prompt a switch to domestically produced goods where possible ('import substitution'). Alternatively, some goods may be imported via an intermediate country to avoid trade barriers ('transshipment') – though, subject to country-specific customs laws, it may not be possible to legally circumvent higher tariffs in this way. Exporters elsewhere that face lower demand due to the higher tariffs may also look for new markets in which to sell their products.

Adjustments in trade flows are likely to reduce the extent to which tariffs weigh on economic activity in the country imposing the tariff, while supporting export volumes and prices in other economies. Demand in the tariffing country will tend to shift towards trading partners less affected by any tariff increases, reducing the extent to which higher tariffs raise domestic prices (and reduce domestic purchasing power), compared with a situation in which there was no adjustment in trade flows. That in turn helps maintain demand for exports in other economies, and mitigates the impact of tariff increases on overall global demand and hence global prices (which is expected to be mildly disinflationary).[1]

Global trade has historically adjusted in this way following the introduction of trade barriers – for example, following the United Kingdom's departure from the European Union in 2016, and the tariffs imposed by the US administration in 2018–2019, particularly on China.[2] During the 2018–2019 episode, the decline in US imports from China was offset by an increase in US imports from other countries such as Vietnam, Taiwan and Mexico. China's total export volumes were also little changed over the period, suggesting that Chinese producers were able to find new markets.

There are signs that global trade patterns are adjusting in response to tariff policy changes.

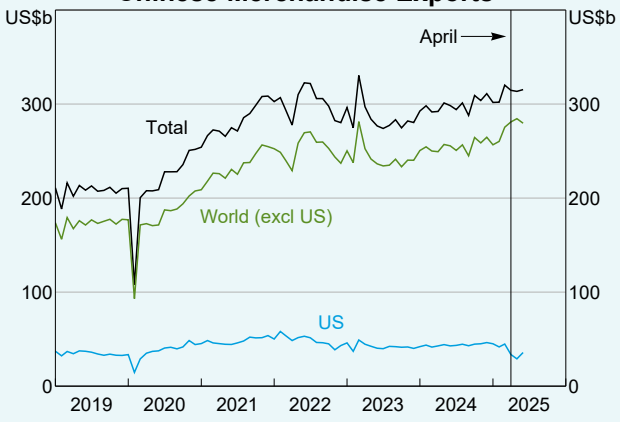
Bilateral trade data provide an early indication of how global trade flows are adjusting to recent US tariff changes. This Box focuses on the United States and China because increases in US tariffs on China have been among the largest so far, China is Australia's largest trading partner, and together these two economies accounted for more than one-fifth of global trade flows in 2024.

Chinese exports to the United States have declined but exports to other advanced economies and east Asia have increased, leaving total exports little changed (Graph A.1).

Similarly, after a surge in the March quarter in anticipation of higher tariffs, total US imports are little changed from 2024 levels despite a sharp fall in imports from China (Graph A.2). The share of US imports from China has declined and the share of imports from other economies – particularly Vietnam, Malaysia, Indonesia and Mexico – has increased. Changes in import shares from China in these economies can indicate whether the adjustment in US trade flows reflects trade diversion or transshipment; if transshipment was occurring on a large scale, we would expect to see an increase in the share of imports from China in these economies. So far this hasn't been observed, suggesting that the adjustment in trade flows in the United States is largely due to trade diversion. For example, the share of Vietnam's imports from China is broadly unchanged this year, while Vietnam's share of US imports has increased.

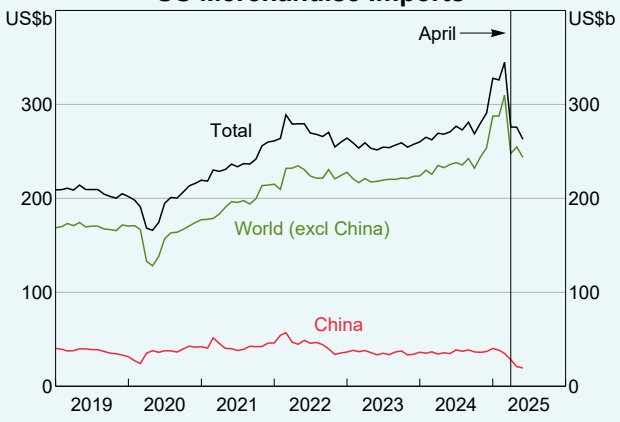
It will be important to monitor bilateral trade data closely over the months ahead to assess the persistence of these changes in global trade patterns in response to tariffs, particularly because the earlier frontloading of imports into the United States, and other temporary factors, add uncertainty to their interpretation.

Graph A.1
Chinese Merchandise Exports*



* Seasonally adjusted by the RBA.
Sources: CEIC Data; RBA.

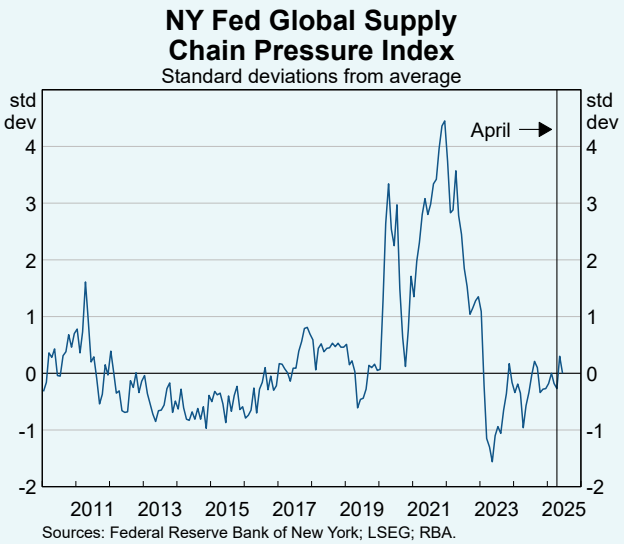
Graph A.2
US Merchandise Imports



Sources: LSEG; RBA.

There has been little evidence of global supply chain disruptions as trade flows have adjusted. Changing shipping patterns have led to ports in Vietnam recording high levels of both congestion and container ship departures in June. However, the risk of broader supply chain disruptions has so far not materialised, with indicators of global supply chain pressure little changed (Graph A.3).

Graph A.3



Sources: Federal Reserve Bank of New York; LSEG; RBA.

Around half of China's exports to the United States prior to tariff changes may be redirected relatively easily to other markets, with global demand and prices for those products likely to be little changed.

The scope for redirection of Chinese exports to markets outside of the United States is likely to vary across individual products. One way to assess the possibility for trade redirection across products is to look at the extent to which the United States and China rely on each other as purchaser and supplier of a given good. This is shown in Graph A.4, which is divided into four quadrants. The lower left quadrant shows products for which US imports from China comprise a low share of overall US imports of that good type, as well as being a low share of Chinese total exports of that good. This implies that the United States has other import options and China has other export options for these goods – making these goods readily substitutable across countries. The upper right quadrant shows the opposite, where US importers and Chinese exporters don't have other options, making them mutually dependent. The upper left quadrant shows goods where the United States has other import options, but Chinese exporters do not, while the lower right quadrant shows goods where the US mainly imports from China while China exports to many countries.

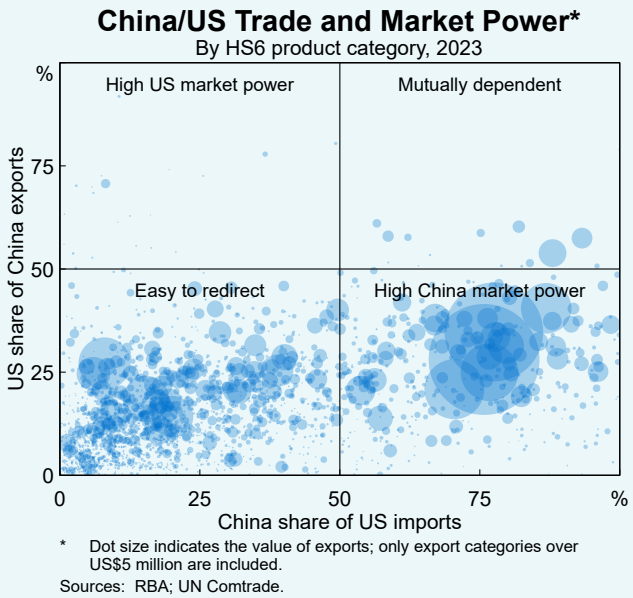
We estimate that around half of Chinese exports to the United States could relatively easily be redirected to other markets, because the United States is not a dominant source of demand for those products and China is not a dominant supplier. This includes products such as computer parts and modems. Downward pressure on Chinese export prices for these goods from lower US demand is likely to be limited, since this demand can be replaced by demand from other markets, while US demand is simultaneously higher for these goods sourced from other markets.

Most of the other products that China exports to the United States could be classified as belonging to the 'high China market power' quadrant (Graph A.4) – that is, the United States is largely reliant on imports from China for these products, while China is less reliant on the United States as a source of demand for these goods. For these products, it is likely that Chinese exporters could find alternative markets, since the United States accounts for less than half of demand for China's exports. However, because the United States relies on China as the major supplier, it is possible that importers will need to continue to purchase these products despite higher

tariffs, or that some products in this category will end up exempt from tariffs because they are deemed critical or essential (e.g. smartphones and computers, which fall under this category, have already been exempt from US tariffs).

Overall, this framework is consistent with there being considerable scope for global trade patterns to adjust to higher US tariffs on Chinese exports, as has been observed so far, helping to limit the negative impact on Chinese activity. That suggests Chinese and global trade will continue to be resilient to the large increase in US tariff rate differentials between China and the rest of the world.

Graph A.4



The effect of trade redirection and shifting global supply chains on the global prices of Australian imports is likely to be limited, though prices for some products could decline.

US exporters may eventually pass on increased costs due to tariffs on imported intermediate inputs to global customers, but the effects on Australia are expected to be limited. The increased costs of intermediate inputs as a share of overall costs is likely to be modest for most US exporters. Further, US imports only account for around 10 per cent of Australia's merchandise imports.

Chinese export prices have increased slightly since the start of the year (in both CNY and USD terms). That is consistent with trade redirection having ensured that there has been little reduction in total demand for Chinese exports so far, despite higher tariffs on Chinese exports to the United States. It is also consistent with the analysis above that, for many products, Chinese exports can be redirected relatively easily, without requiring significant declines in prices. Australian imports from China have risen sharply, but this has been partially offset by decreases in imports from other countries. Overall, Chinese export prices have been resilient. Some firms in the RBA's liaison program have reported isolated instances of discounting of imported products due to trade redirection, but in general businesses view the impact of tariffs and adjusting trade flows on imported prices as uncertain. Firms continue to note recent movements in the exchange rate as a much more important factor in imported costs.

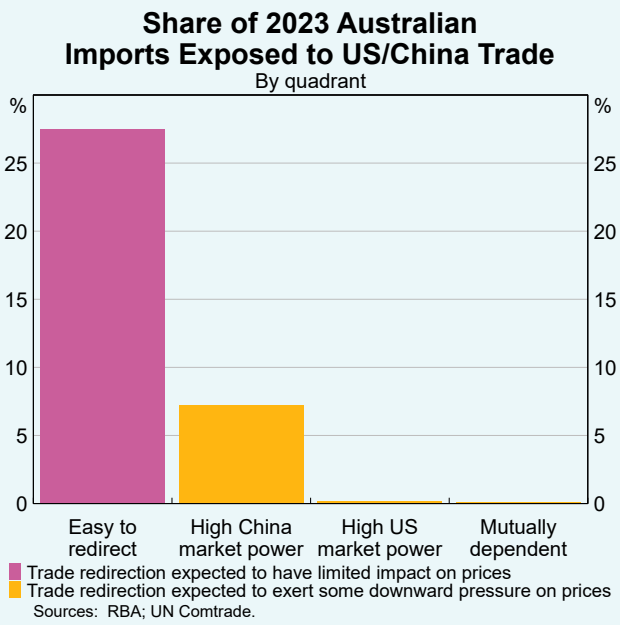
In aggregate, our assessment is that the effect of trade redirection from China on Australia's import prices is likely to be limited. We use the simplified framework above (Graph A.4), which divides products traded between China and the United States into four categories based on their scope for trade redirection, to illustrate the possible effect of trade redirection on prices for Australian imports based on the (value) share of each of these categories in Australia's imports. Higher tariffs are expected to be mildly disinflationary for the Australian economy, primarily due to weaker global demand, so trade redirection that supports global demand

in the face of tariffs should lead to a smaller disinflationary impact on Australian import prices. Indeed, Australia's imports are most exposed to products considered 'easy to redirect', where total demand and prices are expected to be little changed as trade flows adjust to tariffs (Graph A.5).

Some Australian imports could, however, experience some downward price pressure as global trade flows adjust to tariffs. Downward price pressures are likely to be largest for products where the United States has higher market power (top left quadrant of Graph A.4), because they will be most affected by the decline in US demand and least likely to benefit from tariff exemptions. The share of Australia's imports of these goods, which could experience the most acute price declines, was less than 1 per cent of total goods imports in 2023 (Graph A.5). These goods also have a small weight in Australia's Consumer Price Index.

Some downward price pressure is possible for goods in the remaining two quadrants of Graph A.4, but price declines particularly in the 'high China market power quadrant' are likely to be small because US demand has a smaller effect on the global price and US reliance on Chinese suppliers means that tariff exemptions are more likely. In total, around 7 per cent of Australia's imports are in categories that are more likely to experience some price declines due to trade diversion, but in most cases these price declines are likely to be small.

Graph A.5



Endnotes

1 The ultimate impact of changing trade patterns on global prices depends on the substitutability of goods across exporters and the extent to which the tariffing country turns to domestically produced goods. In cases where goods are less substitutable across markets, or the tariffing country turns to domestically produced goods rather than sourcing imports from a new market, changes in trade patterns could exert additional downward pressure on global export prices for those products.

2 See Wang M and SA Hannan (2023), 'Trade Diversion Effects from Global Tensions – Higher Than We Think', IMF Working Paper No 2023/234; Gutiérrez E, A Lacuesta and C Martín-Machuca (2024), 'Brexit: Trade Diversion due to Trade Policy Uncertainty', *Oxford Bulletin of Economics and Statistics*, 86, pp 1058–1088.

Box B: Insights from Liaison

This Box highlights key messages collected by teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 300 businesses, industry bodies, government agencies and community organisations from the beginning of May to early-August 2025.

Information from liaison suggests that business conditions have remained broadly stable over recent months. Firms generally report little effect on their operations from the large increases in US tariffs and the related policy uncertainty. They also report that demand continues to grow at a moderate pace, supported by ongoing modest growth in household consumption, a slight improvement in residential construction activity and a steady level of business investment. Headcount growth has slowed over the past year, and a large share of contacts expect their headcount to remain stable over the year ahead. Liaison contacts report that generally their cost pressures have eased a little. However, wage pressures have not moderated to the extent firms had expected. Contacts are focused on cutting costs, though they note that, for a variety of reasons, lifting productivity remains challenging. Firms expect their selling price growth to remain steady over the period ahead.

Overall sentiment among liaison firms has been little changed, despite elevated uncertainty around international trade policies.

Most firms report no significant impact from US tariff announcements and are much more focused on domestic conditions; a small number have adjusted their operations or delayed investments. Some firms have secured lower prices from Chinese suppliers, while others have seen their suppliers pass on the higher costs of trade disruption. Some firms have also taken action to mitigate risks to supply chains. Indirect effects – such as the potential for dampened consumer sentiment and impacts on export demand – are cited as concerns, but not ones with any material impact at this stage. Non-trade geopolitical conflicts have been discussed more frequently in liaison meetings, but most firms do not expect material effects on their operations that cannot be managed.

Consumer spending remains cautious, with a strong focus on value and price.

Firms report that consumers remain cautious in their spending, which they see as constraining a more pronounced lift in consumption growth, particularly for mid-tier retailers. Most retailers have reported ongoing moderate sales growth since the beginning of the year. Some non-food retailers have experienced stronger sales growth in recent months, driven by targeted discounting, promotional campaigns, and new product launches. Retail firms generally view the recent improvement as reflecting only a modest uplift in underlying retail demand. While price-sensitivity remains a recurrent theme, some retailers have noted consumers appear a little more willing to purchase higher priced offerings if they believe it presents good value. Domestic tourism contacts have noted that consumers are still choosing more affordable holiday options and spending less than usual on meals, tours and entertainment. Some community services organisations note some levelling off in demand for their services, although demand remains elevated given the high cost of living and housing.

Investment has been little changed, although residential builders have become a little more optimistic.

Firms generally expect the level of their investment to remain relatively steady over the year ahead. Firms with above-average investment intentions are focused on automation, digital transformation, data centres and progressing infrastructure projects. There is growing interest in the use of artificial intelligence (AI), though many firms say they are at an early stage and still trying to work out the most suitable use cases for their firm. Investment in office vehicles, industrial property and office space is expected to soften further. Some firms continue to cite high construction costs and subdued demand as constraints weighing on their investment intentions.

Residential building firms report that conditions have improved slightly. New detached home sales have trended higher over the past quarter, supported by lower interest rates and end-of-financial-year promotions. That said, home sales remain at low levels and firms expect that affordability constraints will limit the extent of recovery. Build times have continued to decline in some states as labour availability improves, alleviating sequencing issues such as coordination of tradespeople, with a growing number of firms reporting a return to pre-pandemic build times. High-density residential construction activity remains constrained by elevated costs relative to selling prices, although many luxury and mixed-use developments continue to be viable.

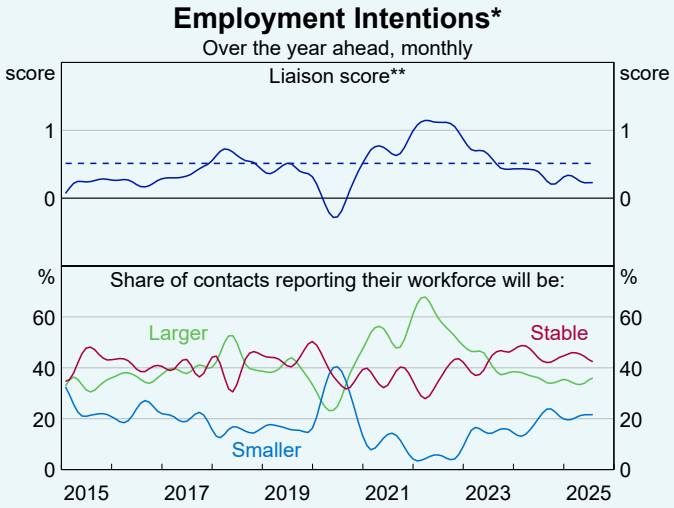
Contacts' changes in their staffing are consistent with moderating employment growth.

Over recent months fewer firms have been increasing their headcount. Many firms are keeping overall headcount steady and taking a 'wait and see' approach to hiring, though some have offset higher staff numbers in revenue-generating areas with reduced headcount elsewhere. A common theme is that firms are trying to do 'more with less' as part of a general focus on cost control.

Labour availability has improved, though many contacts still find it challenging to fill positions. Voluntary staff turnover has declined to more normal levels and recruitment activity has slowed, reflecting less job switching.

Firms in liaison expect employment growth to be below average over the year ahead, with a large share of contacts intending to keep employment levels stable (Graph B.1). Factors cited by firms include that there is little change in demand or production levels, that they are awaiting clearer demand signals before adjusting staffing numbers, or that they are looking to achieve more with their existing staff by improving processes or making greater use of technology.

Graph B.1



* Smoothed with a 13-month Henderson trend.
** Dashed line shows average since 2003; a score of 0 indicates no change.
Source: RBA.

Firms expect growth in their selling prices to remain around current levels in the year ahead.

Liaison suggests that wages growth has been little changed in recent months (Graph B.2); firms had expected some slowing in growth. Many firms overestimated the pace at which labour market conditions would ease and also underestimated the recent award rate outcomes. However, most firms still expect wages growth to be slower than the prior 12 months or stable over the year ahead.

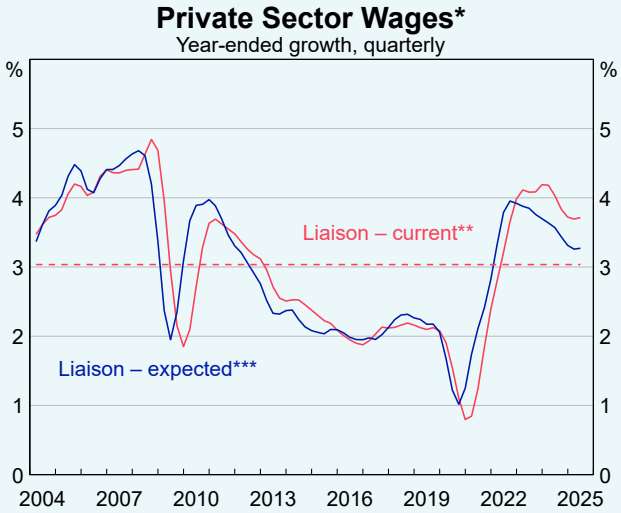
Firms report that increases in their non-labour costs have outpaced growth in their selling prices (and the CPI) for some time. However, firms' non-labour cost growth has eased a little in recent months and an increasing number of firms are saying that they expect their cost growth to converge with CPI inflation over the year ahead. Some firms are now reporting slower growth or even outright declines in insurance costs, following a couple of years of significant increases. In construction, growth in costs has also moderated compared with a year ago.

The share of firms that have reported their selling prices growing at above average rates has trended lower (Graph B.3). Retailers continue to use discounting to support sales volumes, but the share of firms reporting unchanged prices or price declines is still lower than average over the prior decade.

Firms expect growth in their selling prices to be steady over the year ahead. Many firms remain focused on margin improvement. Homebuilders have reported subdued price growth recently but expect their price growth to strengthen over the next 12 months as demand picks up and construction costs start to rise more quickly.

Agricultural firms expect that elevated demand and ongoing drought conditions will add to food price pressures. Drought conditions have become more severe in many parts of Australia over recent months, which firms report is weighing on the outlook for crop and livestock production. Demand for cereal and pasture hay for livestock has surged, which has led to a sharp increase in their price as inventories have run down; high yields of grain in other

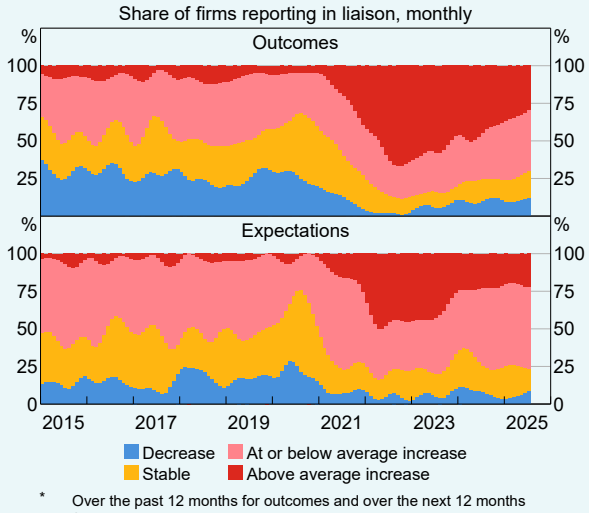
Graph B.2



* Long-run averages for current and expected wages growth are approximately the same.
** Trimmed mean; rescaled to have the same mean as the private sector WPI; seven-quarter Henderson trend; dashed line is the long-run average.
*** Derived from Likert scores of firms' wage expectations; rescaled to have the same mean as the private sector WPI; seven-quarter Henderson trend.

Sources: ABS; RBA.

Graph B.3



* Over the past 12 months for outcomes and over the next 12 months for expectations; smoothed with a 13-month Henderson trend; data to July 2025.

Source: RBA.

regions are somewhat offsetting these effects. Contacts report that dairy production has declined due to increased culling in response to drought conditions in Victoria and flooding in northern New South Wales, which may lead to higher dairy prices. Lower livestock supply and strong international demand is keeping beef and sheep prices elevated. Slightly offsetting these upwards pressures on dairy and meat prices, egg supply is expected to improve as affected farms recover from avian flu outbreaks.

Firms have found it challenging to lift productivity.

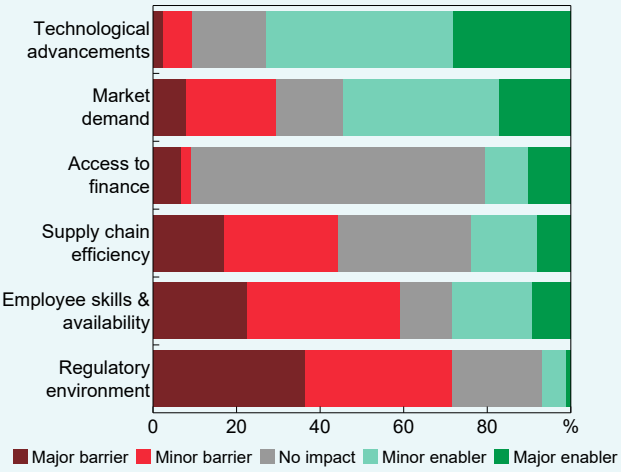
Contacts have reported in a survey on productivity that regulation and labour availability were key barriers to lifting their productivity growth over the past five years (Graph B.4).[1] Firms said that the complexity, cumulative volume and frequency of change in regulation has been hard to manage, particularly for smaller firms. The large share of firms identifying employee skills and availability as a barrier over the recent period cited the significant turnover in the labour market, much higher wage expectations and the inability to attract specific skills when needed as factors weighing on productivity.

Some firms that participated in the survey viewed technology as important for driving efficiencies and productivity gains, though some noted that not all technology enhances productivity. Many firms also flagged the ongoing fast pace of growth in software prices as a challenge to fully capturing productivity gains from new technology investments. Further, firms noted that more staff may be needed to facilitate the adoption of technology, particularly in the transition phase. Although there remains considerable uncertainty around the potential impacts of AI, most survey participants anticipated that such technologies will be labour saving in the future and that AI will facilitate a change in their workforce from lower to more highly skilled roles.

Graph B.4

Factors Impacting Productivity Growth

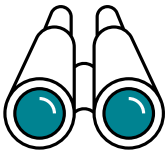
Compared with pre-pandemic



Source: RBA.

Endnotes

1 More detail on the survey results will be released in a forthcoming RBA *Bulletin* article.



Chapter 3
Outlook

Summary

- **GDP growth in Australia's major trading partners is expected to slow over the second half of 2025 and into 2026 as higher tariffs and broader policy uncertainty weigh on global activity.** This forecast is largely unchanged from the May *Statement* baseline forecast. The forecasts continue to embody a reasonably pronounced slowing in US GDP growth, and relatively resilient growth in China. We continue to expect that Chinese authorities will use fiscal and monetary stimulus to largely mitigate any adverse effects on economic activity from higher tariffs and the ongoing weakness in the Chinese property sector. We assess that the risks of a widespread and protracted trade war have diminished since May. Downside risks to global activity nevertheless remain, reflecting persistent uncertainty around the configuration of trade and other economic policies, and the extent to which tariffs affect global growth and inflation.
- **Domestically, supply and demand in the labour market – and the economy more broadly – are expected to be close to balance over the forecast period, and underlying inflation is expected to be around the midpoint of the 2–3 per cent range.** A key risk to this forecast relates to the uncertainty around our assessment of the balance between supply and demand. Other key risks relate to the extent of the recovery in domestic demand, and the extent to which global trade and other policy developments affect domestic growth and inflation.
- **GDP growth in Australia has been revised a little lower over most of the forecast period, partly as a result of our lower outlook for productivity growth.** The forecast pick-up in GDP growth over 2025 is now more gradual than expected in May, as weaker-than-expected growth in public demand in early 2025 is not expected to be offset through the rest of the year. We have also lowered our assumption for the medium-term (end of forecast period) rate of productivity growth as we assess that the persistent headwinds that have lowered productivity growth over recent decades are likely to continue over the next couple of years. This downgrade directly flows into our estimate of potential output growth and our forecast for GDP growth in 2026/2027. As growth in aggregate demand has been revised down in line with potential output, our assessment of future spare capacity and inflationary pressures has not changed in response to the productivity growth downgrade (see Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth).
- **Year-ended GDP growth is expected to continue to pick up over the next year to around its potential growth rate; private demand growth is forecast to be a bit stronger than it has been over the past year, with public demand continuing to support growth.** The forecasts are conditioned on market expectations for a cumulative 80 basis point easing in the cash rate over the next year. These and earlier reductions in the cash rate would likely support growth in private demand, which is expected to be the main driver of growth over the forecast period.

- **We judge that the economy will be close to full employment over the forecast period, though our models and some indicators point to the risk that some tightness in labour market conditions remains.** The unemployment rate is forecast to be little changed over the forecast period and unchanged from the baseline forecast in the May *Statement*. Estimates of full employment are very uncertain, so assessing capacity pressures in the labour market becomes difficult as the economy approaches balance. We will continue to refine our assessment of full employment as more data become available.
- **Underlying inflation is expected to be around the midpoint of the 2–3 per cent range over the forecast period**, based on the assumed path for the cash rate that incorporates some further gradual easing in policy. The outlook for underlying inflation remains consistent with expectations in the May *Statement*, alongside a stabilisation in labour market conditions.
- **Year-ended headline inflation is expected to increase over the second half of 2025 to be above 3 per cent, before returning to around the midpoint of the target range over the latter part of the forecast period.** This volatility is due to the unwinding of electricity rebates, which boosts inflation over 2025 and 2026.

3.1 Key judgements

A key assumption underpinning the current set of forecasts is that tariff policies remain largely unchanged from where they are currently. The other important judgements that have been considered and debated throughout the forecast process are discussed below.

Key judgement #1 – Australia's trading partner growth will slow modestly in 2025, then pick up in the second half of 2026 as the direct effects of higher tariffs and elevated uncertainty are expected to wane.

The forecast for GDP growth in Australia's major trading partners (MTP) is little changed from the baseline forecast in the May *Statement*. Consensus forecasts suggest that the slowing in overall major trading partner growth is expected to be relatively modest and short lived as the direct effects of higher tariffs dissipate and policy stimulus supports demand. We explore the downside risks to the global outlook in Key risk #1.

A key judgement underpinning our global outlook is that Chinese GDP growth will remain relatively resilient. Our forecast for 2025 is close to the Chinese authorities' growth target of 'around 5 per cent'. Growth in 2026 and 2027 is expected to be a little lower than in 2025, which is largely unchanged from our May forecast. We judge that Chinese authorities have largely ameliorated the impact of ongoing uncertainty effects on the Chinese economy by committing to the growth target and signalling a willingness to expand policy stimulus quickly if conditions deteriorate. Since May, Consensus forecasts for Chinese growth have been revised higher and are now similar to our projections, but there is a wide range that reflects different views on the impact of tariffs and the size and effectiveness of stimulus that may be used to offset this impact.

Key judgement #2 – Global trade developments will be mildly disinflationary for Australia.

Weaker growth in global demand from higher tariffs is expected to exert some downward pressure on global export prices and the prices of goods and services imported to Australia.[1] Growth in these prices is expected to remain weaker than at the start of the year when fewer trade barriers were in place. This is an unchanged assessment from the May *Statement*.

Our forecast is for weaker global export prices to only have a small effect on inflation in Australia. It is possible that an increased supply of imports to Australia – as trade is diverted away from higher tariff routes – exerts more downward pressure on import prices than forecast; however, our analysis of Australian imports exposed to US and China trade suggests that this is unlikely to be material (see Box A: How are Global Trading Patterns Adjusting to Changes in Trade Policy, and What Does It Mean for Australia?). Working in the other direction, the trade conflict could result in substantive supply chain issues, which could raise prices for some imports. Exchange rate movements will be a key determinant of how developments in global prices flow through to domestic prices.

We are yet to see clear evidence of the effect of global trade developments on prices and will continue to monitor developments closely.

Key judgement #3 – The economy will be close to full employment over the forecast period, though our models and some indicators point to a risk that some tightness in labour market conditions remains.

There is considerable uncertainty around our assessment of capacity pressures in the economy and this assessment becomes more uncertain when the economy is close to balance, as it is now. Recent quarterly prints of trimmed mean inflation are consistent with inflation tracking close to the midpoint of the 2–3 per cent range, which can suggest the labour market is close to full employment. However, there are some mixed signals from labour market indicators. The rate of job-switching – despite stabilising recently – has declined notably from its peak in 2022, which might indicate less upward pressure on wages growth and inflation than other indicators. By contrast, firms continue to report difficulties finding staff, the ratio of job vacancies to unemployed people remains elevated, the unemployment rate remains below model estimates of full employment and growth in unit labour costs has been high.

Our central forecasts for wages growth and inflation continue to incorporate some downward judgement to reflect the possibility that the economy and labour market are closer to balance than our models suggest. If there is some tightness in the labour market over the forecast period, this will be more inflationary than currently forecast (see Key risk #3). We will continue to refine our assessment of full employment as more data become available.

Key judgement #4 – The downward revision to the productivity outlook lowers potential output growth but does not have any implications for the inflation outlook.

Lowering our estimate of trend productivity growth lowers our estimate of the supply capacity of the economy over the next couple of years (see Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth). We have revised down our forecast for aggregate demand (GDP growth) in line with the downward revision to productivity growth. This is because we think households and businesses have already (implicitly) adjusted to persistently lower growth in productivity, incomes and revenues, and so plans for future consumption and investment are lower than we had assumed in our previous forecasts.

As we have revised down our forecasts for aggregate supply capacity and demand by the same magnitude, our assessment is that there is minimal effect on the inflation outlook – this is a key judgement. If productivity growth is lower than households and businesses implicitly expect, because they have not yet revised down their expectations for income growth, then demand could grow more quickly than our revised view of supply and create additional inflationary pressure. Conversely, if they expect slower growth of productivity and incomes than actually occurs (e.g. they implicitly take more signal from the weak productivity outcomes over recent years), spending could be weaker than expected over the forecast period, dampening inflationary pressure relative to what is forecast.

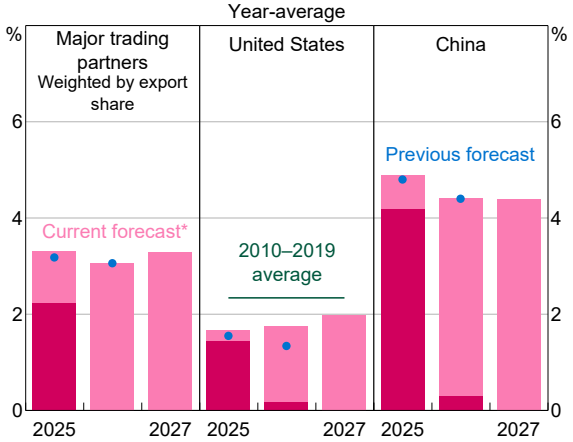
3.2 The global outlook

Major trading partner growth is expected to slow over the second half of 2025 and into 2026 as higher tariffs and uncertainty weigh on activity.

The outlook is little changed relative to the baseline forecast in the May *Statement*. Year-average MTP GDP growth is forecast to be 3.3 per cent in 2025, slowing modestly to 3.1 per cent in 2026; growth picks back up to 3.3 per cent in 2027, as the direct effects of higher tariffs wane and uncertainty is assumed to decline (Graph 3.1). While the likelihood of a severe 'trade war' scenario materialising appears to have diminished since the May *Statement*, the path of future trade policy remains unpredictable. It is plausible that global growth could be stronger than expected if the adverse effects on activity from higher tariffs are smaller than expected or if other policies are more stimulatory than currently forecast. However, we judge that the risks to global activity remain tilted to the downside (see Key risk #1).

Recent bilateral trade deals and the latest US administration announcements are for slightly higher tariff rates than those that underpin the forecasts. The US administration announced updated 'reciprocal' tariff rates of between 10 and 20 per cent for most of their trading partners, with significantly higher tariff rates remaining for India and China. Recently agreed separate trade deals include country-level tariff rates that are also higher than the 10–15 per cent currently assumed in our forecasts; however, some material reductions in the sectoral-level tariffs have also been announced. Consensus forecasters are yet to fully incorporate the estimated effect of these latest trade deals in their forecasts, but we judge that the change to MTP forecasts are likely to be small. Most Consensus forecasters assume that the US administration will set trade policy in a way that limits acutely adverse economic outcomes for the United States.

Graph 3.1
GDP Growth
Year-average



* Darker bar indicates the contribution to year-average growth from realised quarterly outcomes; 2025:Q1 latest data for most economies, 2025:Q2 latest for the United States and China.

Sources: ABS; CEIC Data; Consensus Economics; LSEG; RBA.

Consensus forecasters continue to expect quarterly growth in the United States to slow over the second half of 2025 as higher tariffs flow through to consumer prices and weigh on consumer spending. So far, the pass-through of higher tariffs to US inflation has been modest, but a range of survey data and recent liaison by the Federal Reserve suggests that businesses that are intending to pass on tariff costs expect to do so in the coming months.

Growth in many of Australia's other trading partners is also expected to moderate over the remainder of 2025 and into 2026 as higher US tariffs weigh on external demand. Growth is expected to pick up thereafter as a mixture of stimulatory fiscal policy (in some east Asian and European economies) and expected easing in monetary policy (as indicated by market pricing) in some major advanced economies provides support. Inflation in most advanced economies (excluding the United States) is largely expected to return to central bank targets over the next year or so; these forecasts are little changed compared with the May *Statement*.

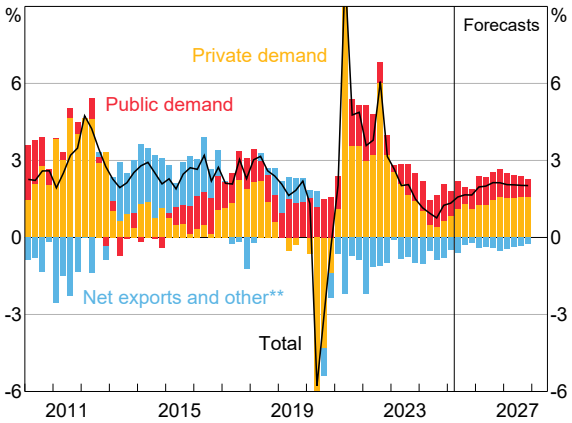
Growth in China is expected to remain relatively resilient, but to slow a little over 2026 before stabilising in 2027. The outlook for China's GDP growth in 2025 has been upwardly revised a little to 4.9 per cent. This reflects a slightly better-than-expected outcome for growth in the June quarter, and a revised assessment that higher tariffs and trade policy uncertainty will weigh less on trade and manufacturing investment in the near term than previously expected. Growth over 2026 is expected to moderate, before stabilising in 2027. The outlook for the real estate sector remains poor and is expected to remain a drag on growth for longer than expected compared with the May *Statement*. As noted in Key judgement #1, we expect that Chinese fiscal policy will be expansionary as authorities look to mitigate the effects of higher tariffs on the economy. The forecasts retain the trade policy settings that were assumed in the May *Statement* – that is, an average US tariff rate of around 50 per cent on Chinese imports and an average Chinese tariff rate of 30 per cent on US imports.

3.3 The domestic outlook

Australian GDP growth is expected to be a bit stronger over 2025 than over 2024, but to stabilise at a lower rate than was forecast in May because of lower assumed productivity growth.

Year-ended GDP growth in Australia is expected to pick up a little over 2025 as the modest recovery in private demand is sustained and public demand continues to support growth (Graph 3.2). The modest recovery in household consumption growth that began in late 2024 is expected to be sustained over the forecast period, underpinned by the recovery in real household incomes that began in mid-2024. The assumed easing in the cash rate (as implied by financial market pricing) will also provide a boost to private demand, particularly for interest-sensitive components such as dwelling investment. While measures of policy uncertainty related to tariff developments have eased in recent months, they remain elevated and are still assumed to weigh a little on domestic spending decisions over the next year.

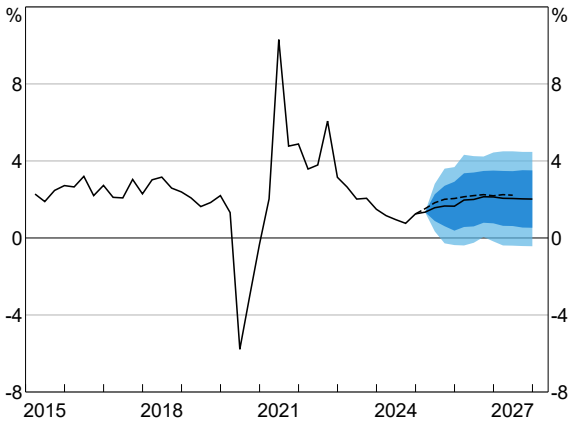
Graph 3.2
GDP Growth*
Year-ended with contributions



* Outliers during the COVID-19 pandemic have been truncated.
** Includes change in inventories and the statistical discrepancy.
Sources: ABS; RBA.

The forecast pick-up in year-ended GDP growth over 2025 is more gradual than was expected three months ago, mostly reflecting weaker-than-expected growth in public demand in the March quarter (Graph 3.3). Upward revisions to historical data for household consumption and dwelling investment suggest that the recovery underway in the private sector has been stronger than previously assessed. However, the expected pick-up in overall GDP growth over the remainder of the year is now expected to be less pronounced, primarily reflecting much weaker-than-expected growth in public demand in the March quarter of 2025 that is not expected to be offset in the rest of the year. Updated spending projections in government budgets released since May suggest that this recent period of weak public demand growth will be temporary; the outlook for quarterly growth in public demand beyond the March quarter of 2025 is broadly similar to the May forecasts.

Graph 3.3
GDP Growth 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.

Further out, GDP growth is expected to be lower than was previously anticipated, as a result of the downgrade to our productivity growth assumption. As detailed in Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth, and Key judgement #3, we have lowered our assumption for the rate of productivity growth that the economy returns to by the end of the forecast period. This lowers our estimate of growth in the economy's supply capacity – or potential output growth – at that horizon. We have also lowered the forecast for GDP growth in the latter part of the forecast period by the same magnitude (around 0.3 percentage points).

How does lower productivity growth affect the forecasts?

A persistently lower rate of productivity growth will weigh on growth in output, incomes and demand as the economy cannot produce as much as previously expected for a given set of inputs. This will weigh on most types of activity in the economy. For example, households will consume less than otherwise because their incomes are growing at a slower rate, while lower growth in incomes will weigh on tax revenue and therefore public spending.

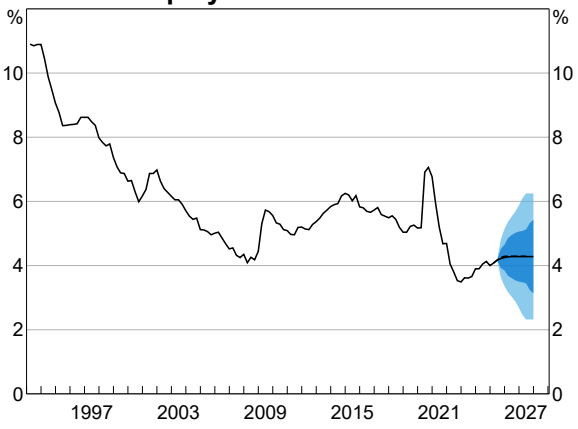
The size of the revision we have made across most of the components of growth is similar in size to the overall 0.3 percentage point revision to year-ended GDP growth, with a few exceptions. The revision to non-mining business investment is larger than the revision to GDP growth, as lower demand reduces the expected return on additional capital and therefore the incentive for firms to invest. The decline in growth in exports and mining investment is smaller than the decline in GDP growth as demand for exports is largely determined by global growth.

Productivity growth is a key driver of real wages growth in the long run; lower labour productivity growth weighs on growth in per capita income and wages. We have downwardly revised our forecast for the National Accounts' measure of average earnings per hour (AENA) in line with the productivity downgrade. However, the Wage Price Index (WPI) is a narrower measure of labour costs that abstracts from some of the effects of productivity growth; as a result, the WPI forecast has been revised lower by around half of the downgrade to productivity growth.

The labour market is not expected to ease much further.

The forecast for the unemployment rate is unchanged from the baseline forecast in the May *Statement* (Graph 3.4). In quarterly terms, the unemployment rate is forecast to be little changed and to stabilise at around 4.3 per cent over 2026 and 2027, as GDP growth stabilises at around growth in potential output. Leading indicators such as job ads and vacancies suggest little change to the near-term outlook for the unemployment rate.

Graph 3.4
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.

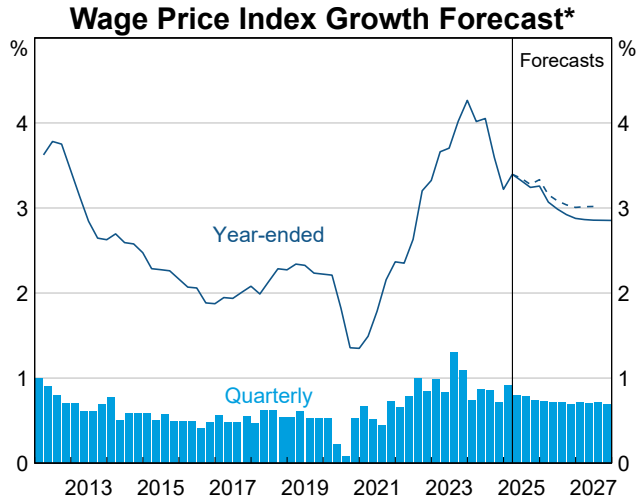
Employment growth is expected to ease over the forecast period from the very strong growth rates seen over recent years. Employment growth is forecast to slow to around the same pace as expected population growth, keeping the employment-to-population ratio fairly steady and close to record highs. This is largely consistent with the employment outlook in the May *Statement*. The forecast assumes a pick-up in market sector employment growth as private demand growth recovers, and a slowing in non-market sector employment growth from its very strong rates in recent years. Together, these suggest an expected slowing in flows of labour from the market sector into the non-market sector, particularly the health care industry.[2] The participation rate is expected to be broadly flat over the forecast period, though there is a possibility that it could continue to rise if the trend of increased participation by females continues.

Quarterly growth in nominal wages is expected to ease gradually over 2025 before stabilising.

The renewal of several large public sector agreements and announced administered decisions for several large awards are expected to support wages growth over the remainder of 2025, and may also contribute to increased quarterly volatility in the WPI. Overall wages growth is then expected to remain relatively steady over 2026 and 2027, consistent with the stability in labour market conditions. As has been the case since February, we have applied some downward judgement to the wages growth forecast to reflect the possibility that we are closer to full employment than our models would imply.

Nominal wages growth is expected to be slightly lower over the second half of the forecast period than was expected in the May *Statement*, reflecting the lower rate of trend labour productivity growth. Year-ended WPI growth is expected to stabilise at a little below 3 per cent by the September quarter of 2026 (Graph 3.5). The downgrade to trend productivity growth lowers the rate of long-term WPI growth that is consistent with the labour market being broadly balanced (see Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth).

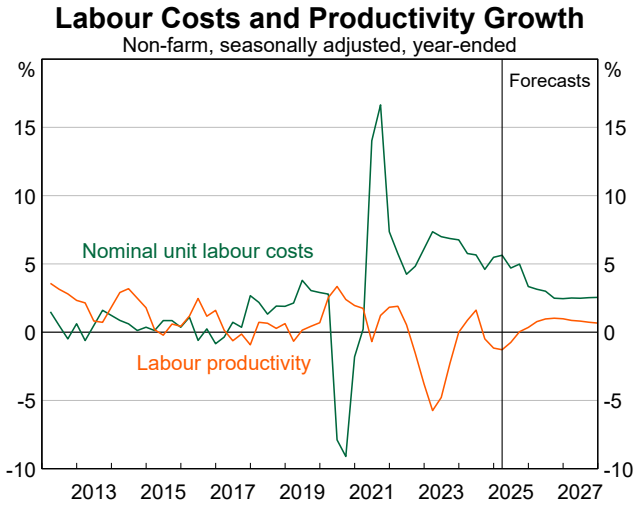
Graph 3.5



* Dashed line shows previous SMP forecast; seasonally adjusted.
Sources: ABS; RBA.

Growth in unit labour costs (ULCs) is expected to ease from late 2025 (Graph 3.6). Growth in nominal ULCs – the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes – has been elevated in recent years due to weak productivity growth. Growth in ULCs is expected to ease to a pace consistent with inflation at target, in line with easing growth in nominal wages and a projected pick-up in productivity growth. Our downward revision to the rate of productivity growth at the end of the forecast period is not expected to affect ULCs growth, as output and labour costs are affected proportionately. ULCs are expected to reach a rate broadly consistent with inflation being sustainably at the midpoint of the target range by the second half of 2026, in line with expectations in the May *Statement*.

Graph 3.6

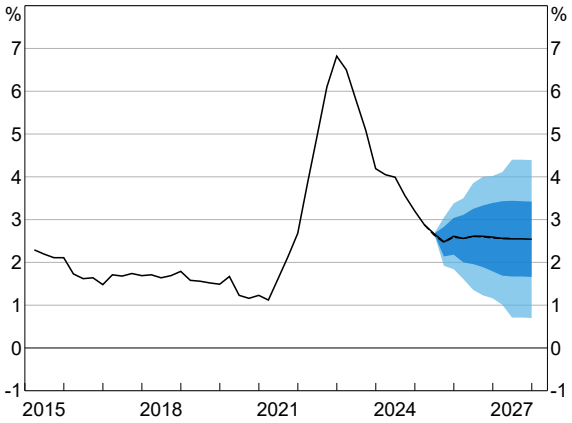


Sources: ABS; RBA.

Underlying inflation in year-ended terms is expected to remain within 2–3 per cent over the forecast period, and to settle at around the midpoint of that range.

Underlying inflation is expected to be around – or a little above – 21/2 per cent over much of the forecast period. The June quarter inflation data provided further confidence that there has been a broad-based easing in inflation over the past year, and the outlook remains largely unchanged relative to the May *Statement*. Trimmed mean inflation is expected to ease to around 21/2 per cent in the September quarter, and then to remain close to this rate for the remainder of the forecast period (Graph 3.7). Similarly, in quarterly terms, trimmed mean inflation is expected to stay close to its rate in the June quarter, consistent with the forecast stability in labour market conditions**.** As has been the case since February, we have applied some downward judgement to the inflation forecast to reflect the possibility that we are closer to full employment than our models would imply. Inflation expectations are assumed to remain consistent with achieving the inflation target over the long term.

Graph 3.7
Trimmed Mean Inflation Forecast*
Year-ended

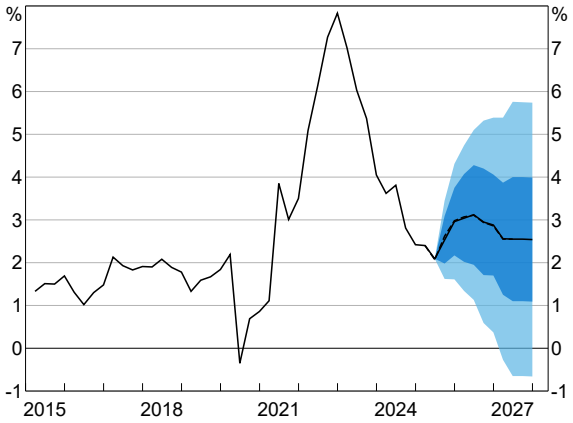


* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

Headline inflation is expected to increase over the second half of 2025 to be above 3 per cent, before returning to the midpoint of the target range later in the forecast period (Graph 3.8). The outlook for headline inflation is broadly unchanged from the May *Statement*. Volatility in the forecasts is due to the unwinding of cost-of-living relief measures, such as electricity rebates. The extension of the Energy Bill Relief Fund is due to expire by the end of 2025, which will see year-ended inflation around 3 per cent through most of 2026. Headline inflation is forecast to converge towards underlying inflation once the effects of this have passed. Because headline inflation can be affected by large swings in the prices of individual items, we will continue to pay close attention to underlying measures as an indicator of momentum in consumer price inflation.[3]

Graph 3.8
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.

Housing inflation is expected to pick up, to be slightly stronger than anticipated in the May *Statement*. New dwelling inflation is forecast to increase through 2025 and 2026 from current low rates, as dwelling investment increases alongside stronger demand for new housing. CPI rent inflation is expected to ease by a little less than expected in the May forecast, as near-term indicators of advertised rents suggest more strength in the rental market than previously assumed, which gradually passes through to the stock of rents as measured in the CPI.

The outlook for retail goods remains subject to considerable uncertainty due to international developments. We continue to judge that weaker global demand weighs a little on world export prices. This could result in slightly lower inflation for goods imported to Australia, which would have a small impact on domestic inflation over the forecast period, though exchange rate movements will also affect the domestic price of imported goods (see Key judgement #2).

3.4 Key risks to the outlook

Key risk #1 – Global growth may be weaker than forecast.

In the May *Statement*, the heightened level of global uncertainty and rapid pace at which international trade policies were evolving meant we thoroughly examined alternative scenarios around the path of future tariffs. Our 'trade war' and 'trade peace' scenarios are unchanged from the last *Statement*. While we assess that the risks of a 'trade war' scenario have diminished in recent months, we judge that the risks around the global outlook are still skewed to the downside. Possible adverse outcomes, abstracting from near-term trade policy negotiations, include:

- **The effect of tariffs on global activity and inflation remains uncertain and global forecasts may downwardly adjust as the effects become apparent in the data in the second half of the year.** For example, the forecasts embody a small negative impact on business investment in the United States due to elevated trade policy uncertainty, but there are a wide range of empirical estimates of the impact of uncertainty; it is also unclear how uncertainty will evolve going forward.
- **It is possible the effects of higher tariffs on the global economy are longer lasting than assumed.** As noted in section 3.2, MTP GDP growth is expected to pick up in the second half of 2026. However, businesses and households may delay spending decisions for much longer than currently assumed given the unpredictable nature of the global policy environment and heightened geopolitical concerns. Higher tariffs can also reduce productivity in affected economies via a misallocation of resources and less incentive to innovate, which would reduce supply capacity over the longer term.

Our judgement is that global trade policy developments will be modestly disinflationary for the global economy (and Australia). However, it is possible that there may be more inflationary pressures than we expect. For example, there may be a temporary surge in freight costs in the near term if exporters to the United States divert trade to other destinations. We will continue to refine our assessment as more information on possible trade diversion and the effects becomes available.

Key risk #2 – The period of subdued growth in domestic activity could be more persistent, or the recovery in activity could be stronger.

There is a risk that the ongoing recovery in domestic demand could be weaker than forecast, which would see a more pronounced easing in the labour market than currently anticipated. This could occur if households remain cautious and increase their saving rate further (as they have done over the past year) rather than spend more in response to the recovery in household incomes. Global policy uncertainty could also have a larger-than-expected effect on consumer spending and business investment, though there is little evidence of this to date. Growth in public demand could also turn out to be weaker than expected. There has been little change in public demand over the past six months; while state and federal budgets suggest this weakness is temporary, there may be a longer-than-expected delay in some public investment projects getting underway over the year ahead.

That said, the recovery we have forecast in GDP growth is relatively modest and could end up being stronger. Households have increased their rate of saving to around pre-pandemic averages and may become more confident to spend out of their higher incomes and wealth than we are anticipating. Furthermore, households and businesses might not adjust their behaviour in response to increased global uncertainty as has been assumed. Also, cost feasibility challenges in the construction sector – where potential developments are left on hold because construction costs are too high relative to selling prices – may turn out to be less binding than expected, leading to a more pronounced pick-up in dwelling investment in response to the assumed easing in monetary policy.

Key risk #3 – There may be more excess demand in the economy than judged.

Our forecasts are for inflationary pressures to remain relatively stable over the forecast period as the economy is judged to be close to balance. While the risk of weaker growth in domestic activity in Key risk #2 would dampen inflationary pressures, there are some plausible upside risks that might see inflation settle above the midpoint of the target range.

There may be more excess demand in the labour market than we have forecast. Since February, we have incorporated some downward judgement to our wages and inflation forecasts to reflect the possibility that labour market conditions are not as tight as we had assessed (see Key judgement #3). However, there is a risk that labour market conditions are tighter than implied by our forecasts, in which case inflation and wages growth would be higher than in our forecasts, all else equal. Alongside the signal from our suite of full-employment models, some other indicators continue to suggest that the labour market is still tight: the ratio of job vacancies to unemployed people remains somewhat elevated; an above-average share of firms report the availability of labour is a constraint; and growth in unit labour costs remains high. Further, while the rate of job-switching is currently low, it may pick up as market sector employment growth increases alongside a recovery in private demand.

The rate of growth in output prices across the broader economy may indicate more inflationary pressures than consumer price inflation. While measures of consumer price inflation have been within the 2–3 per cent range recently, broader measures of price growth throughout the economy have been notably higher, suggesting there are pockets of inflation in some parts of the economy. For example, after stripping out prices in the mining and agriculture industries, which are volatile, prices of domestically produced output increased by 4 per cent over the year to the March quarter (as measured by the price deflator for gross value added). Deviations between consumer and output prices can arise for several reasons, including due to the differing effects of exchange rate movements, the series capturing different sectors in the economy, component weights and the treatment of subsidies. Our baseline forecasts assume that growth in output prices will slow to be close to consumer price inflation; however, there is a risk that strength in output prices spills over into consumer prices, leading to inflation picking up to be closer to growth in output prices.

3.5 Detailed forecast information

Table 3.1 provides additional detail on forecasts of key macroeconomic. The forecast table from current and previous *Statements* can be viewed, and data from these tables downloaded, via the *Statement on Monetary Policy – Forecast Archive*.

Table 3.1: Detailed Forecast Table[a]
Percentage change through the four quarters to quarter shown, unless otherwise specified[b]

	Jun 2025	Dec 2025	Jun 2026	Dec 2026	Jun 2027	Dec 2027
Activity						
Gross domestic product	1.6	1.7	2.0	2.1	2.0	2.0
Household consumption	1.5	1.8	2.1	2.4	2.1	2.2
Dwelling investment	5.3	4.1	2.2	2.3	2.3	2.2
Business investment	0.6	0.3	0.6	2.0	2.6	2.7
Public demand	3.9	2.7	3.8	3.8	3.0	2.4
Gross national expenditure	2.1	2.0	2.4	2.7	2.5	2.3
Major trading partner (export-weighted) GDP	3.6	2.8	2.9	3.4	3.5	2.9
Trade						
Imports	1.0	2.3	3.8	4.2	3.8	3.1
Exports	–0.2	1.0	2.0	1.8	2.0	1.9
Terms of trade	–3.4	–3.3	0.1	0.8	–0.3	–0.5
Labour market						
Employment	2.3	1.6	1.4	1.4	1.4	1.4
Unemployment rate (quarterly, %)	4.2	4.3	4.3	4.3	4.3	4.3
Hours-based underutilisation rate (quarterly, %)	5.1	5.2	5.3	5.3	5.3	5.3
Income						
Wage Price Index	3.3	3.3	3.0	2.9	2.9	2.9
Nominal average earnings per hour (non-farm)	3.9	3.7	4.0	3.5	3.3	3.2
Real household disposable income	3.8	2.5	1.8	2.0	2.0	2.2
Inflation						
Consumer Price Index	2.1	3.0	3.1	2.9	2.6	2.5
Trimmed mean inflation	2.7	2.6	2.6	2.6	2.6	2.5
Assumptions						
Cash rate (%)[c]	4.0	3.4	3.1	2.9	3.0	3.1
Trade-weighted index (index)[d]	59.7	60.2	60.2	60.2	60.2	60.2
Brent crude oil price (US$/bbl)[e]	66.8	68.2	68.2	68.2	68.2	68.2
Estimated resident population[f]	1.6	1.6	1.3	1.3	1.2	1.2
Memo items						
Labour productivity[g]	–0.7	0.3	0.9	1.0	0.8	0.7
Household savings rate (%)[h]	4.7	4.7	4.5	4.5	4.4	4.5
Real Wage Price Index[i]	1.3	0.3	–0.1	0.0	0.3	0.3
Real average earnings per hour (non-farm)[i]	1.9	0.8	0.9	0.6	0.7	0.7

(a) Forecasts finalised on 6 August.

(b) Forecasts are rounded to the first decimal point. Shading indicates historical data.

(c) The cash rate is assumed to move in line with expectations derived from financial market pricing. Prior to the May 2024 *Statement*, the cash rate assumption also reflected information derived from surveys of professional economists. For more information, see A Change to the Cash Rate Assumption Method for the Forecasts.

(d) The daily exchange rate (TWI) is assumed to be unchanged at its current level going forward.

(e) Oil prices are assumed to remain constant at the current price over the current quarter. For the rest of the forecast period oil prices are expected to remain around the price implied by the six-month-forward rate.

(f) The population assumption draws on a range of sources, including partial indicators from the Australian Bureau of Statistics, migration policies, and estimates made by the Australian Government.

(g) GDP per hour worked (non-farm).

(h) Household savings ratio refers to the ratio of household saving (disposable income minus consumption) to household disposable income, net of depreciation.

(i) Real Wage Price Index and non-farm average earnings per hour worked are both deflated by Consumer Price Index.

Sources: ABS; Bloomberg; CEIC Data; Consensus Economics; LSEG; RBA.

Endnotes

1 See RBA (2025), 'Chapter 1: In Depth – Global Economy and Financial Markets', *Statement on Monetary Policy*, May.

2 See RBA (2025), 'Box C: Health Care Employment and its Impact on Broader Labour Market Conditions', *Statement on Monetary Policy*, February.

3 See RBA (2024), 'Box C: Headline and Underlying Inflation', *Statement on Monetary Policy*, August.

Chapter 4

In Depth – Drivers and Implications of Lower Productivity Growth

Summary

- **Productivity growth drives improvement in living standards.** Higher productivity means the economy can create more from a given set of resources, allowing people to produce and consume more of the goods and services they value or enjoy more leisure time.
- **Productivity growth has slowed in Australia over recent decades, as it has in many advanced economies.** There is evidence to suggest that this reflects persistent factors, including declining business dynamism and competition, slower technological diffusion in the economy and lower growth in the amount of capital per worker. In recent years, temporary factors in certain industries have also played a role.
- **Slower growth in productivity has weighed on supply capacity and observed demand in the economy.** Slower productivity growth has meant that the supply capacity of the economy is smaller than it otherwise would have been if productivity growth had been faster. And slower productivity growth has directly weighed on growth in wages, incomes and so household spending.
- **We expect productivity growth to remain subdued over the two-year forecast period.** While we expect the temporary factors to ease and enable some pick up in productivity growth from current very low levels, we have assessed that the persistent factors are likely to remain over our forecast period.
- **We have lowered our assumption for medium-term 'trend' labour productivity growth** – the average rate the economy returns to by the end of the two-year forecast period – to 0.7 per cent per annum (previously 1 per cent). The revised assumption is consistent with the average rate of annual (non-farm) labour productivity growth over the past 20 years. Nevertheless, significant uncertainty remains around the path for future productivity.
- **We have also lowered our expectations for growth in aggregate demand.** This is because lower productivity growth means slower growth in business revenues, household incomes and ultimately demand. Specifically, we have revised down our forecast for growth in aggregate demand in 2026/2027 by the same magnitude as growth in trend productivity and potential output.

- **There are no implications for our forecasts for inflation.** As we have revised down aggregate demand in line with potential output, the lower assumption for trend productivity growth in the future has not changed our assessment of the current and future balance between supply capacity and demand, and so inflationary pressure. This reflects an assumption that businesses and consumers have already adjusted to a lower productivity growth environment, and they expect lower growth in productivity, incomes and revenues to persist over the forecast period. As such, their plans for future consumption and investment are lower than we had assumed in our previous forecasts, but in line with our new lower assumption for productivity and potential output.
- **This is a key judgement.** Ultimately, how consumer and business (implicit) expectations for productivity growth, as captured by their expectations for income growth, compare with actual productivity outcomes will determine inflation. If productivity growth is lower than households and businesses expect, as they are yet to revise down their expectations for income growth, this could add inflationary pressure as growth in demand outstrips supply capacity. On the other hand, if productivity growth turns out to be higher than they expect – for example, having taken signal from the very slow productivity growth in recent years – growth in supply capacity could outstrip growth in demand and reduce inflationary pressures.

4.1 Why productivity growth matters

Productivity measures how much output the economy creates for a given quantity of inputs, such as capital, natural resources and labour.

Productivity growth occurs when the economy finds new and better ways of using its resources, including through discovering and investing in new technologies, shifting resources to better uses, and increasing the skills of its workforce.[1] So productivity growth is about working smarter, not harder, to produce more in the same amount of time with the same resources. Many of the biggest productivity improvements have come from things that have made work easier, like computers, robots and the internet.

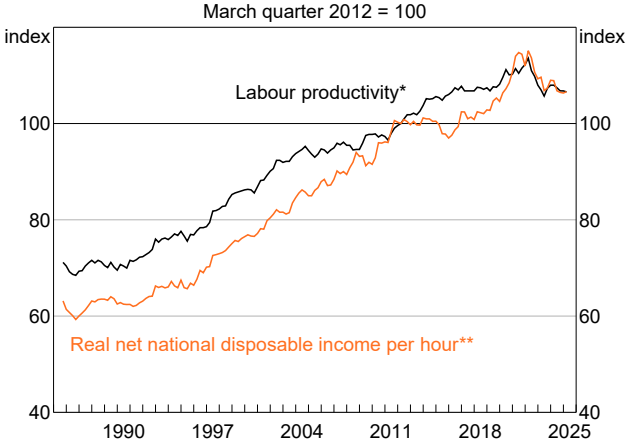
Productivity is a key determinant of the economy's supply capacity. As productivity increases, the economy can produce more goods and services for a given set of scarce resources (capital, natural resources and labour). So productivity growth expands the supply capacity of the economy – often referred to as potential output. It is therefore important for a central bank to understand productivity growth in assessing the balance of supply capacity and actual demand in the economy.

Productivity growth also contributes to demand. Productivity growth tends to support consumption and spending in the economy: when productivity and therefore incomes are growing more strongly, people can spend more and businesses have a greater incentive to invest.

As productivity growth allows us to create more from the same inputs, it makes us richer as a country and raises living standards.

Productivity is the key driver of growth in living standards over time. Productivity growth makes goods and services cheaper to produce and consume. In the 1960s the average worker needed to work for 10 minutes to afford a loaf of bread, but today it takes four minutes.[2] It also supports higher wages and incomes, as the overall economic pie is larger and workers can get paid more without raising costs for businesses. So productivity growth drives growth in per capita incomes over time (Graph 4.1).

Graph 4.1
Productivity and Income
March quarter 2012 = 100



* Non-farm GDP per hour worked.
** Real GDP per hour adjusted for the purchasing power effects of changes to the terms of trade, depreciation of the capital stock and net income transfers to the rest of the world.
Sources: ABS; RBA.

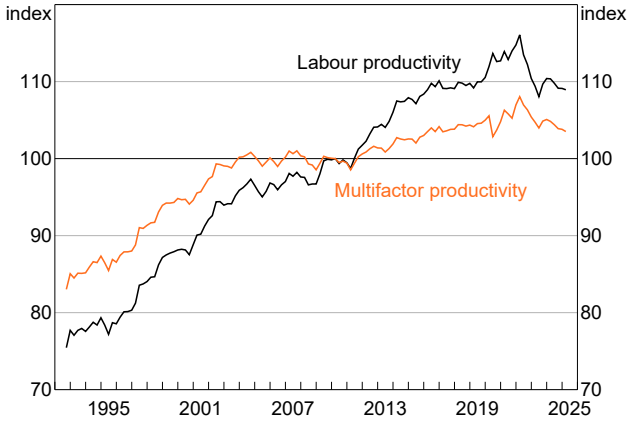
4.2 Productivity growth has slowed in Australia (and many other advanced economies)

Productivity growth has slowed in Australia, weighing on supply capacity, incomes and demand.

Looking through volatility in the data, growth in aggregate productivity has slowed over recent decades. Productivity growth has been volatile in recent years, reflecting pandemic-related factors such as lockdowns and supply chain disruptions.[3] Looking through this volatility though, growth in productivity has slowed over recent decades. For example, labour productivity (output per hour worked) currently sits around its 2016 level, whereas it grew very strongly from the mid-1990s to mid-2000s. The slowdown in labour productivity growth over recent decades reflects both:

- slower growth in the amount of capital (such as machinery, equipment and workspace) for each worker to use – known as 'capital deepening'
- slower growth in multifactor productivity (MFP), which captures improvements in technology and skills, and more generally how efficiently we are combining all the resources in the economy (Graph 4.2).

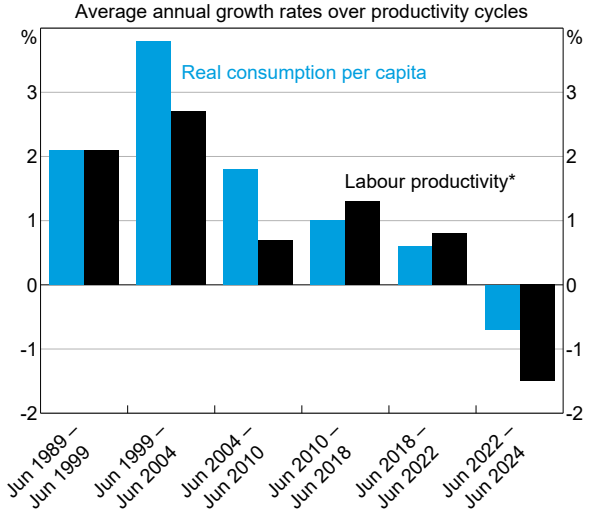
Graph 4.2
Productivity*
March quarter 2010 = 100



* Non-farm.
Sources: ABS; RBA.

Slower growth in economic capacity appears to have weighed on incomes and demand. Slower productivity growth has coincided with slower growth in incomes and as a result consumption (Graph 4.3). As such, it appears that wages, household incomes and spending have adjusted in response to the slower growth in the supply side of the economy.

Graph 4.3
Productivity and Consumption Growth
Average annual growth rates over productivity cycles

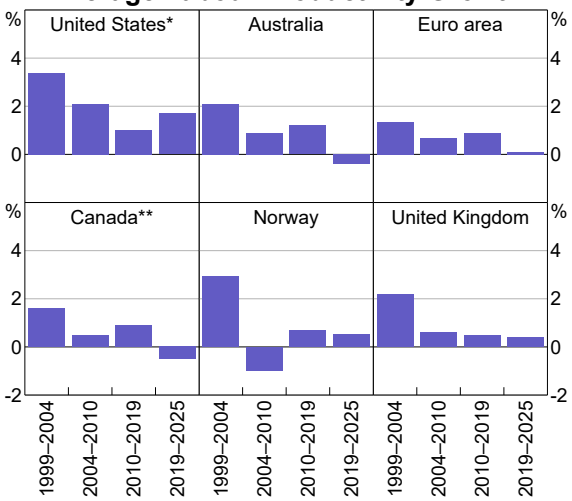


* Non-farm GDP per hour worked.
Sources: ABS; RBA.

Other countries have also experienced a slowdown in productivity growth over recent decades.

Productivity slowed over recent decades in many advanced economies. This continued into the post-pandemic era, with the United States being a notable exception (Graph 4.4). As a result of the slowdown, several central banks have revised down their assumptions around the medium-term outlook for trend productivity growth in recent years, including the Bank of England, Bank of Canada and Reserve Bank of New Zealand.

Graph 4.4
Average Labour Productivity Growth



* Non-farm business sector.
** Business sector.
Sources: ABS; LSEG; RBA.

The global slowdown in productivity growth reflects various persistent factors. The drivers of this productivity slowdown have been explored extensively in the economic literature, though it is still not fully understood. For Australia, some factors that have been found to be important, though may not account for the entire slowdown, include:

- declining business and labour market dynamism, with it now taking longer for inputs to move to higher productivity firms
- slower technological diffusion, with firms now taking longer to catch up to the global technological frontier
- declining competition, meaning there has been less pressure on firms to grow and improve, or exit
- regulatory barriers, including in the construction industry.[4]

Other potential explanations for the global slowdown in productivity growth include slowing growth in skills (human capital) in the labour force, declining trade integration, and measurement challenges.[5]

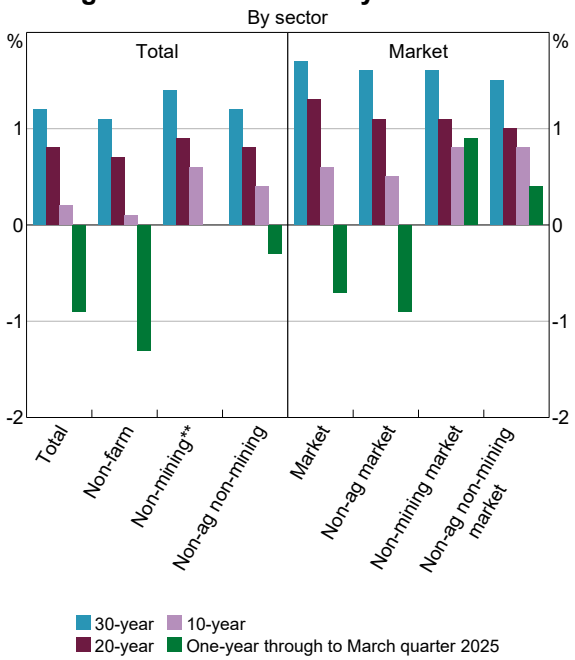
In Australia, the medium-term slowdown has been broadly based across sectors of the economy.

Some of the weakness in productivity growth over the past five or so years has reflected idiosyncratic, temporary factors in certain sectors. Namely:

- The non-market sector – which includes the health care, education and public administration industries – has grown as a share of the economy over recent years at a fairly rapid pace. Measured productivity (as defined in the National Accounts data) is low in these industries, and this has weighed on aggregate productivity.[6] We estimate that growth in this sector mechanically subtracted around 0.3 percentage points from aggregate labour productivity growth on average between 2017/2018 and 2023/2024, compared with subtracting 0.15 percentage points on average over the previous decade.[7]
- Productivity in the mining sector has also fallen sharply over recent years, declining by around 20 per cent over the past five or so years. Some have argued that this reflects attempts to take advantage of recent high prices by tapping potentially less productive resource deposits by using additional labour, rather than additional capital investment. Similar dynamics were evident in previous commodity cycles.[8]

Even abstracting from these potentially temporary factors, productivity growth has slowed. For example, growth in the market sector excluding agriculture and mining has slowed notably over recent decades (Graph 4.5). As such, the slowdown in productivity appears to be a broad-based and persistent trend, rather than reflecting potentially temporary idiosyncratic outcomes in a few industries alone.

Graph 4.5
Average Annual Productivity Growth Rates*
By sector



* Quarterly chain volume gross value added (GVA) data and quarterly labour accounts data used to derive; the farm sector and agriculture industry are conceptually different, with the farm sector accounting for around 87 per cent of agriculture industry GVA.

** Non-mining productivity grew by 0 per cent in the year to March quarter 2025.

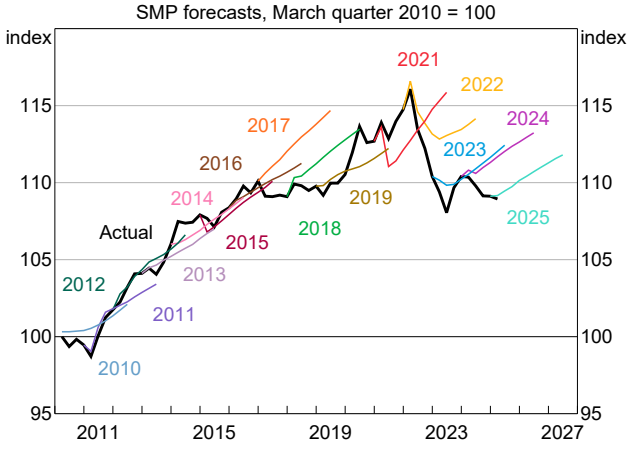
Sources: ABS; RBA.

4.3 We are downgrading our productivity growth assumption

Consistently weaker-than-expected productivity growth has led us to revise down our productivity assumption.

For some time, our forecasts have implicitly assumed that productivity growth was temporarily weak and would gradually return to, and be sustained at, higher historical growth rates. More often than not, this has not eventuated, resulting in the RBA's implied productivity forecasts consistently overestimating the actual outcomes (Graph 4.6). In recent years, our GDP growth forecasts have also been weaker than forecast, while unemployment and inflation outcomes have been broadly in line with forecasts.[9] This is consistent with labour productivity undershooting our forecasts: as labour productivity is the ratio of output to labour inputs, if output undershoots but labour inputs are in line with forecasts, labour productivity must undershoot.

Graph 4.6
Productivity*
SMP forecasts, March quarter 2010 = 100



* Non-farm GDP per hour worked; May SMP forecasts; May 2020 SMP omitted.
Sources: ABS; RBA.

In recognition that some of the lower productivity growth in recent decades is attributable to persistent factors, we are downgrading our medium-term trend productivity growth assumption. We now assume that productivity growth will return to 0.7 per cent by the end of the forecast period, rather than 1.0 per cent. The new assumption equates to the 20-year average growth rate for non-farm labour productivity.

We continue to assume that some of the recent weakness reflects temporary factors, and that productivity growth will pick up as they abate, but to a lower rate. In particular, we assume that the recent falls in mining sector productivity come to an end, and that the rate of output growth in the non-market sector returns to around its historical average. The unwinding of these temporary factors accounts for around half of the rebound. We also assume that the rest of the economy returns to longer run average productivity growth rates, having slowed over the past decade: one-year and 10-year average annual growth rates for the non-farm non-mining market sector are currently 0.4 per cent and 0.6 per cent, respectively, compared with a 20-year average of around 1.1 per cent.[10] With these new assumptions, our forecasts for productivity in the very near term are largely unchanged, but are noticeably lower at the end of the forecast period.

The downgrade brings our assumptions in line with other Australian policy institutions. The new assumption is broadly in line with NSW Treasury's recently revised long-term growth assumption of 0.8 per cent.[11]

The downgrade balances the risks around our productivity assumption, but significant uncertainty remains.

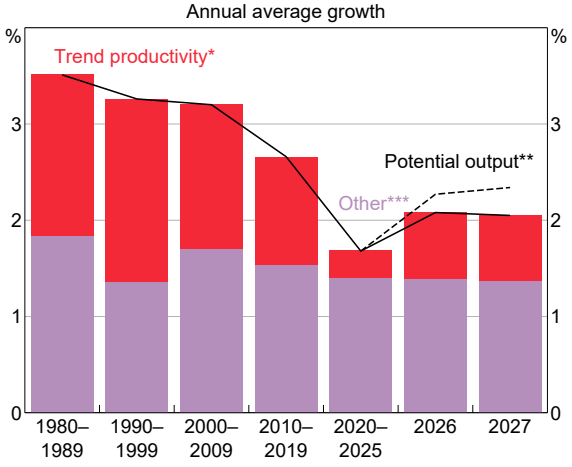
Assessing future productivity outcomes is extremely difficult and uncertain. There is a risk that our new trend productivity assumption remains too optimistic. Temporary, sectoral factors may not abate as assumed, or productivity growth in the rest of the economy could return to the very low rates observed over the five or so years leading up to the pandemic when there was almost no growth. However, there is also scope for some (transitory) boost to productivity growth if some of the temporary factors not only stop detracting but unwind, or if the fundamental drivers of productivity become more favourable, such as faster adoption of technologies like AI or increased economic dynamism.

4.4 Implications of the downgrade for our forecasts and assessment of spare capacity

Slower productivity growth means slower growth in the supply capacity of the economy in the future, and slower long-term growth in wages.

We have revised down our assessment of the rate of growth in potential output at the end of the forecast period from 21/4 per cent to around 2 per cent (Graph 4.7). By way of comparison, the median estimate of potential output from a survey of market economists is around 21/4 per cent.

Graph 4.7
Potential Output Components
Annual average growth



* Using the average of the three models in the potential output model suite (SMOG-PPE, Joint-stars and Production Function model).
** The dashed line is potential output growth from May SMP.
*** Other contributions from population, participation and average hours growth.
Source: RBA.

Productivity growth underpins long-term growth in real wages. Productivity growth is the key driver of real wages growth in the long run as it allows for wages to increase without the (real) costs faced by firms rising. So while real wages can grow more quickly than productivity for a period without this necessarily driving up inflation, over time productivity growth underpins real wages growth. As such, we assess that the rate of wages growth over the long term that is consistent with inflation at the target and the labour market at full employment is equal to the midpoint of the inflation target plus productivity growth.

Slower productivity growth implies that the rate of wages growth that can be achieved over the long run without generating inflationary pressure is lower. When measured using Average Earnings in the National Accounts (AENA), our assessment of long-term wages growth consistent with full employment and inflation at target falls from 3.5 per cent to 3.2 per cent due to the productivity downgrade. When measured using the Wage Price Index (WPI) – which abstracts from some growth in wages that reflects productivity growth (e.g. workers moving to higher productivity, higher wage sectors) and so is less affected – our assessment is that it drops from 3.0 per cent to around 2.9 per cent.[12] This does not suggest that wages growth above these levels will necessarily drive up inflation. But these rates remain a useful indicator of what wages growth would look like on average in the long run when the economy is at full employment.

The implications for inflation depend on how economic activity adjusts to lower productivity growth.

The implications of the downgrade for our view of inflation depend on what we assume about business and consumer expectations for productivity and income growth. Namely:

- If we assume that business and consumers implicitly share our expectation of persistent, moderately lower productivity growth, they will also expect weaker growth in revenues and household incomes (including wages). As such their planned investment and consumption will be lower than we have been assuming until now, but will be in line with our new lower expectation for growth in the economy's supply capacity. So, our assessment of the balance of supply and demand, and therefore inflation, would be unchanged.
- If we assume that households or businesses haven't yet adjusted to the lower productivity environment, this would mean that demand will grow more quickly than our revised view of supply, so our assessment would be that there will be additional inflationary pressure.

- If we assume that households and businesses have taken signal from the recent very weak productivity and income growth, and implicitly expect productivity growth to remain very low rather than picking up towards 0.7 per cent, demand would grow more slowly than our revised view of growth in supply, so our assessment would be that there would be less inflationary pressures.

Businesses and households do not need to explicitly think about productivity to make these adjustments. Instead, they may experience the effects of productivity growth in their daily lives – through slower growth in wages, incomes and profits – and use these past outcomes to shape their expectations and behaviour in the future.

The productivity downgrade does not change the inflation outlook, as we assume the economy adjusts quickly.

We assume that growth in demand in the medium term will be lower than previously forecast and in line with the lower growth in supply capacity, and so by assumption there are no implications for inflation. Forecasts for annual GDP growth at the end of the forecast period have been lowered by 0.3 percentage points to reflect the lower productivity growth assumption (see Chapter 3: Outlook). As such, we now assess that there is less scope for the rate of growth in activity to pick up going forwards. Forecasts for wages growth have also been lowered, consistent with the longer run relationship between productivity and real wages. The assumption that demand slows in line with supply capacity represents a two-sided risk to our inflation forecast; expectations for productivity and income growth could ultimately sit above or below our forecast for productivity and actual productivity outcomes.

Our assessments of the neutral interest rate and labour market tightness are unaffected. The productivity downgrade has no implications for our assessment of the NAIRU and full employment, so our assessment of labour market tightness remains unchanged. Our forecasts for activity and potential output growth have been revised down together so our assessment of the evolution of the output gap is unaffected, while our current assessment of the output gap already accounts for past low productivity growth. While in theory lower productivity growth would imply a lower neutral interest rate, in practice our model estimates of the neutral interest rate derive from the observed data, which already reflect the historical slowdown in productivity, and so are unaffected by the change in our forecast assumption.

Endnotes

1 For more details around the concept and measurement of productivity, see RBA (2025), 'Productivity', Explainer.

2 For more information and a broader discussion of the importance of productivity, see Productivity Commission (2025), 'Growth Mindset: How to Boost Australia's Productivity: 5 Productivity Inquiries', Australian Government; Plumb M (2025), 'Why Productivity Matters', Speech at the Australian Business Economists Annual Forecasting Conference, Sydney, 27 February.

3 For a detailed discussion, see Productivity Commission (2025), 'Productivity Before and After COVID-19', Research paper, Australian Government; Bruno A, J Dunphy and F Georgiakakis (2023), 'Recent Trends in Australian Productivity', RBA *Bulletin*, September; Bruno A, J Hambur and L Wang (2025), 'A (Closer to) Real Time Labour Quality Index', RBA *Bulletin*, July.

4 On dynamism, see Hambur J and D Andrews (2023), 'Doing Less, with Less: Capital Misallocation, Investment and the Productivity Slowdown in Australia', RBA Research Discussion Paper No 2023-03; Andrews D and D Hansell (2021), 'Productivity-Enhancing Labour Reallocation in Australia', *Economic Record*, 97(317), pp 157–169. On technology diffusion, see Andrews D, C Criscuolo and P Gal (2016), 'The Best versus the Rest: The Global Productivity Slowdown, Divergence across Firms and the Role of Public Policy', OECD Productivity Working Paper No 5; Andrews D, J Hambur, D Hansell and A Wheeler (2022), 'Reaching for the Stars: Australian Firms and the Global Productivity Frontier', Treasury Working Paper No 2022-01. On competition, see Hambur J (2023), 'Product Market Competition and its Implications for the Australian Economy', *Economic Record*, 99(324), pp 32–57. On construction sector regulation, see Productivity Commission (2025), 'Housing Construction Productivity: Can We Fix It?', Commission research paper, Australian Government. On occupational entry regulations, see Bowman J, J Hambur and M Markovski (2024), 'Examining the Macroeconomic Costs of Occupational Entry Regulations', RBA Research Discussion Paper No 2024-06.

5 On slowing human capital accumulation, see OECD (2024), 'From Decline to Revival: Policies to Unlock Human Capital and Productivity', OECD Economics Department Working Paper No 1827. On trade, see Goldin I, P Koutroumpis, F Lafond and J Winkler (2024), 'Why is Productivity Slowing Down?', *Journal of Economic Literature*, 62(1), pp 196–268. Note that it has been argued that mismeasurement is unlikely to account for the slowdown globally and in Australia. See Syverson C (2017), 'Challenges to Mismeasurement Explanations for the US Productivity Slowdown', *Journal of Economic Perspectives*, 31(2), pp 165–186; Burnell D and M Elsnari (2020), 'Does Measurement of Digital Activities Explain Productivity Slowdown? The Case for Australia', Institut National de la Statistique et des Etudes Economiques (INSEE), 517-518-5, pp 123–137. For a broader discussion of the slowdown and its causes, see Duretto M, O Majeed and J Hambur (2022), 'Overview: Understanding Productivity in Australia and the Global Slowdown', Treasury Working Paper No 2022-05.

6 Measurement of productivity in these sectors is difficult, due to a lack of market prices and difficulty capturing the quality of the output. For example, healthcare sector productivity growth in the National Accounts only captures changes in the inputs (e.g. number of days in hospital), but not improvements in the quality of the outputs (i.e. health outcomes). Alternative measures of non-market productivity that try to overcome these issues often find higher non-market output and productivity growth: see Cornell-Farrow S (2019), 'Improving Measures of School Education Output and Productivity in Queensland', QPC Staff Research Paper, July; Luo Q (2020), 'Hospital Output Measures in the Australian National Accounts: Experimental Estimates, 2004-05 to 2017-18', ABS Research Paper, September; Burnell D and Q Luo (2021), 'Experimental Capital Service Indexes for Non-market Industries', ABS Research Paper, July; Nguyen BH and V Zelenyuk (2021), 'Aggregate Efficiency of Industry and its Groups: The Case of Queensland Public Hospitals', *Empirical Economics*, 60, pp 2795–2836; Productivity Commission (2024), 'Advances in Measuring Healthcare Productivity', Research paper, April.

7 For further discussion, see Plumb, n 2.

8 See, for example, Productivity Commission (2023), 'PC Productivity Insights', *Bulletin*, July; D'Arcy P and L Gustafsson (2012), 'Australia's Productivity Performance and Real Incomes', RBA *Bulletin*, June.

9 See, for example, RBA (2024), 'Box D: Annual Review of the Forecasts', *Statement on Monetary Policy*, November.

10 Growth in market sector productivity was boosted by a large reallocation of resources to more productive industries at the start of the pandemic. This is likely to be a one-off boost, and so the gap between the recent underlying growth trend and the longer run average may be even larger.

11 See NSW Government (2025), 'Budget Paper No.1 – NSW Budget 2025–26', June.

12 The rate of long-term AENA growth consistent with full employment and inflation at target is assessed to be the middle of the target band plus productivity, as this means that, with inflation at 2.5 per cent, the real unit labour costs faced by firms will be constant as will the labour share of income in the economy. It is harder to assess this level in terms of WPI, as WPI tracks wages growth for a fixed basket of jobs, while some of the productivity growth in the economy could reflect shifts in the basket of jobs (e.g. sectoral changes). Estimates suggest that, on average over history, around half of growth in (trend) productivity is captured in the WPI.