RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

August 2026

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Contents

Overview

Inflation remained elevated in the June quarter, against the backdrop of ongoing domestic capacity pressures and some effect from higher input costs due to the Middle East conflict. Capacity pressures and the labour market have eased a little as growth in domestic demand looks to have moderated. That said, the economy is still operating with capacity constraints: growth in the economy's supply potential remains constrained by weak productivity growth, and the labour market is still judged to be a little tight.

Monetary policy is judged to be somewhat restrictive, which is expected to help bring the economy into better balance. But that process will take some time, reflecting the normal lags in transmission. The easing in domestic capacity pressures and conflict-related cost pressures is expected to result in inflation declining to the midpoint of the 2–3 per cent target range by early 2028. The key risks to the inflation outlook are: the potential for global oil and non-energy price pressures to be higher than expected; faster and more fulsome pass-through of these global shocks into Australia's economy; and the risk of more persistent domestic capacity pressures. However, larger or more persistent negative effects of the Middle East conflict, or a greater-than-expected deterioration in housing market conditions could pose downside risks to the inflation outlook. On balance, the staff judge the risk to the inflation outlook to be skewed to the upside.

The Monetary Policy Board decided it was appropriate to leave the cash rate target unchanged at 4.35 per cent. The Board noted that inflation is likely to remain high for some time and that there are upside risks to this projection. The Board remains focused on ensuring that high inflation does not become embedded and will continue to do what it considers necessary to bring inflation sustainably back to target.

Oil prices have been volatile but growth in Australia's major trading partners has remained resilient, supported by strong AI-related activity.

The Middle East conflict has continued to disrupt energy production and shipping in the region and contributed to high and volatile global prices for oil and other key commodities. Higher energy prices have contributed to higher producer and consumer price inflation in many economies recently. Strong demand for AI-related goods has also added to producer price inflation in some economies.

GDP growth in Australia's major trading partners has continued to be stronger than expected, with support from AI-related investment outweighing the adverse effects of the Middle East conflict in some key trading partners. However, significant uncertainty remains, particularly around the resolution of the Middle East conflict and US trade policy.

Growth in domestic demand looks to have moderated broadly as expected …

In Australia, GDP grew by 2.5 per cent over the year to the March quarter. Private demand remained the main driver of growth over the year, underpinned by continued growth in consumption and elevated levels of business investment. The strong growth in business investment was largely driven by investment in data centres.

More recently, partial data suggest that consumption growth moderated only modestly in the June quarter, as expected in the May *Statement*. This is a more resilient picture than that suggested by consumer sentiment, which remains very weak.

… while housing market conditions have eased considerably.

Housing price growth and activity in the established housing market in Australia have eased by more than assumed in the May *Statement*. Housing prices nationally have declined by 1.6 per cent from their peak in March and auction clearance rates have fallen. This follows a long period of very strong growth in housing prices and reflects the combined effect of cash rate increases, tax changes announced in the federal budget, and weaker sentiment.

Capacity pressures remain, despite easing a little further …

The moderation in the growth of aggregate demand in Australia is helping to bring the overall level of potential supply and demand back into balance, but we assess that some capacity pressures remain, based on a range of survey- and model-based indicators.

Labour market conditions have eased by a little more than expected, with the unemployment rate increasing over recent months to 4.4 per cent. However, labour market conditions are still assessed to remain a little tighter than full employment. This is consistent with growth in unit labour costs remaining elevated at 3.3 per cent over the year to the March quarter. There are also reports from liaison that many firms still note some labour market tightness, particularly in relation to difficulty in sourcing staff with appropriate skills and experience.

… and inflation remains high.

Both headline and underlying inflation remained elevated in Australia. Headline inflation declined slightly to 3.9 per cent in year-ended terms in the June quarter, and was materially weaker than expected, largely driven by lower retail fuel and travel prices. However, trimmed mean inflation remained high at 3.6 per cent over the year, only slightly below expectations, reflecting ongoing economy-wide capacity pressures and the pass-through of higher costs as a result of the Middle East conflict.

Financial conditions appear to be somewhat restrictive, which will help to ease domestic capacity pressures.

The cash rate increases earlier in the year have tightened financial conditions in Australia, with banks passing through these increases to deposit and lending rates. Most of this has already flowed through to higher scheduled mortgage payments, which are relatively high as a share of household disposable income. Demand for new housing loans has eased, but business credit growth remains strong. Despite depreciating since the May *Statement*, the Australian dollar remains higher than at the start of the year, consistent with the tightening in monetary policy in Australia compared with other economies. Overall, financial conditions appear to be somewhat restrictive.

Market participants are now pricing in about a 50 per cent chance of a cash rate increase by the end of the year. Financial markets participants expect that many advanced economy central banks will also tighten policy in response to domestic inflationary pressures and possible second-round effects of the Middle East conflict.

The outlook for major trading partner growth has been revised up and headline inflation across many economies is expected to remain above central banks' inflation targets into 2027.

The near-term outlook for growth in Australia's major trading partners has been revised up a little, owing to stronger-than-expected demand from the AI investment boom. Across many advanced economies, headline inflation is expected to remain above target into 2027 owing to elevated energy prices and, in some instances, strong AI-related demand. Risks to global inflation are judged to be skewed to the upside.

Domestic GDP growth is expected to ease over 2026 and remain below potential growth in coming years.

GDP growth in Australia is expected to be subdued this year. This reflects a combination of factors, including weaker growth in real household disposable income, softer conditions in the housing market and the increases in the cash rate earlier in the year. Partly offsetting these factors is the anticipated continued strength in business investment, which is expected to be driven by data centre investment. The slowing in demand is expected to help bring the economy into balance in 2027, a little earlier than anticipated in May. As some of the headwinds start to ease, growth is expected to recover gradually over the remainder of the forecast period.

Labour market conditions are expected to ease gradually and labour cost growth is expected to moderate from an elevated level.

Consistent with the anticipated slowing in GDP growth, conditions in the labour market are expected to ease gradually over the forecast period. The unemployment rate is projected to increase further to reach 4.8 per cent by end-2028, while employment growth remains positive. Unit labour cost growth is expected to remain elevated in the near term, moderating gradually later in the forecast period.

Growth in the potential supply of the economy is expected to remain weak.

Growth in potential output is expected to be a little above 2 per cent in 2027 and 2028. That is materially weaker than averages over past decades, reflecting our assumption (adopted in the August 2025 *Statement*) that the medium-term rate of trend productivity growth is 0.7 per cent per annum. Recent productivity outcomes have been substantially lower than this, but productivity growth is assumed to pick up over the forecast period to this rate.

Inflation is expected to remain elevated in the near term and ease back to target only gradually, reaching 2½ per cent by early 2028.

Both headline and trimmed mean inflation are expected to remain elevated in the near term due to ongoing domestic capacity pressures and the pass-through of conflict-related cost pressures. As these capacity and cost pressures subside, inflation is expected to decline to the midpoint of the 2–3 per cent range in 2028.

The risks to inflation are judged to be skewed to the upside.

Several domestic and global factors pose upside risks to the inflation outlook. Globally, a material escalation in the Middle East conflict could increase oil and related prices further. If domestic capacity pressures and elevated short-term inflation expectations persist, this raises the likelihood of greater pass-through to broader consumer price inflation. Stronger-than-expected growth in AI and related technology prices may flow through to upstream producer prices and consumer prices, while a larger indirect effect could operate by exacerbating current capacity pressures, for example, through higher growth in construction demand for data centres that could push up costs elsewhere in the construction sector.

However, capacity pressures in the domestic economy and the labour market could ease sooner than forecast. In part, this could be the result of a larger or more persistent negative effect of the Middle East conflict, or a greater-than-expected deterioration in housing market conditions.

The Monetary Policy Board decided to leave the cash rate target unchanged at 4.35 per cent.

Inflation is likely to remain high for some time and there are upside risks. The Board remains focused on ensuring that high inflation does not become embedded. To achieve this, growth in aggregate demand needs to remain subdued to reduce capacity pressures and bring inflation back to target. With monetary policy judged to be somewhat restrictive, the Board decided to leave the cash rate target unchanged while it assesses how the economy is evolving. The Board has noted that it will continue to do what it considers necessary to bring inflation sustainably back to target.

Table: Output Growth, Unemployment and Inflation Forecasts[(a)]
Per cent

	Year-ended					
	June 2026	Dec 2026	June 2027	Dec 2027	June 2028	Dec 2028
GDP growth	1.9	1.4	1.5	1.6	1.6	1.8
(previous)	(1.9)	(1.3)	(1.3)	(1.4)	(1.4)	(n/a)
Unemployment rate[(b)]	4.4	4.5	4.6	4.7	4.8	4.8
(previous)	(4.2)	(4.3)	(4.4)	(4.6)	(4.7)	(n/a)
CPI inflation	3.9	3.6	2.8	2.6	2.4	2.4
(previous)	(4.8)	(4.0)	(2.4)	(2.4)	(2.5)	(n/a)
Trimmed mean inflation	3.6	3.3	3.0	2.6	2.4	2.4
(previous)	(3.8)	(3.5)	(3.1)	(2.6)	(2.5)	(n/a)
	Year-average					
	2025/26	2026	2026/27	2027	2027/28	2028
GDP growth	2.2	1.9	1.5	1.5	1.6	1.7
(previous)	(2.3)	(1.9)	(1.4)	(1.3)	(1.4)	(n/a)
	Assumptions[(c)]					
Cash rate (%)	4.3	4.4	4.5	4.5	4.4	4.4
Trade-weighted index (index)	66.1	65.3	65.3	65.3	65.3	65.3

(a) Forecasts finalised on 5 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 5 August and the daily exchange rate (TWI) is assumed to be unchanged from its level at 5 August 2026 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

- **The cash rate increases from earlier in the year have tightened financial conditions.** Banks have passed on the three cash rate increases to deposit and lending rates. Scheduled mortgage payments have increased relative to household disposable income to be close to their 2024 peak. The Australian dollar is higher than at the start of the year, consistent with policy tightening more than in other advanced economies. Some measures of financial conditions have eased since May. In particular, the market path for the cash rate has declined, which has also contributed to a depreciation of the Australian dollar.
- **Financial conditions appear to be somewhat restrictive.** The cash rate is at the top of the range of central estimates of neutral both from our models and from market economists. Conditions in the established housing market have softened by more than expected and housing prices have declined over recent months, reflecting the effects of cash rate increases and tax changes announced in the federal budget and after a long period of very strong growth. Demand for new housing loans has declined noticeably. Even so, funding remains readily available for banks, households and businesses, supported by low risk premia in financial markets.
- **Expectations for further cash rate increases have receded.** While global oil prices have been volatile, a decline in prices since the time of the May *Statement* and some weaker-than-expected domestic data have contributed to a shift lower in the market path for the cash rate. Market participants are now pricing in about half a chance of a cash rate increase by the end of the year and see very little chance of an increase in August.
- **Lower energy prices since the May *Statement* have also reduced expectations for policy tightening in some other advanced economies, though markets still expect many peer central banks to raise rates before the end of the year.** Several central banks have already raised policy rates in 2026, reflecting a mix of domestic factors and the inflationary effects of the Middle East conflict. In the United States, resilient activity and persistent inflation have contributed to a higher expected policy rate path over recent months.
- **Government bond yields have increased further in some advanced economies but are slightly lower in Australia.** The increase in the United States has been driven by a rise in real yields, alongside higher policy rate expectations. In Australia, bond yields are a little lower than their level at the time of the May *Statement* and have declined relative to most other advanced economy markets. Inflation compensation has eased in most economies, including Australia, as oil prices are below their earlier peak.

- **Risk premia remain low in advanced economy corporate funding markets.** Equity prices have generally risen since the previous *Statement*. In Australia, this has occurred despite a small decrease in corporate earnings expectations over this period, while equity prices in many other markets have been supported by strong corporate earnings growth. However, equity prices of some foreign AI-related companies have become increasingly volatile as investors have reassessed valuations and the prospective returns from data centre investment, resulting in very large declines in Korean and Taiwanese equity markets. Equity prices have received some additional support as investors became less concerned that the Middle East conflict will materially disrupt the global economy and have been resilient overall even as the conflict re-escalated. Corporate bond spreads have tightened a little in some markets and are low compared with historical averages.
- **The Australian dollar has depreciated on a trade-weighted (TWI) basis since the May *Statement* but remains around 5 per cent higher than at the start of the year.** The depreciation of late has been underpinned by a narrowing in yield differentials between Australia and other advanced economies and declines in some commodity prices. The nominal TWI remains broadly consistent with estimates of its long-run equilibrium level.

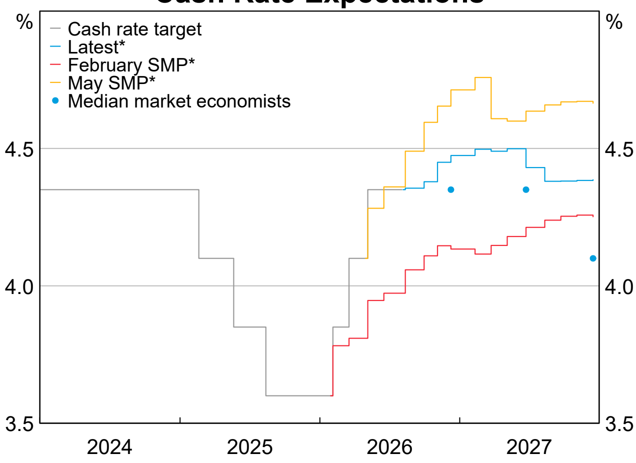
1.1 Interest rate markets

The market path for the cash rate has declined since the May *Statement*.

Market participants are pricing in around ½ a rate hike by the end of 2026, down from a projected 1½ increases at the time of the May *Statement* (Graph 1.1). Pricing implies almost no expectation among market participants that an increase will occur in August. The decline in the market path since the May *Statement* reflects lower global oil prices and some weaker-than-expected domestic data. Developments in the Middle East conflict and the associated moves in global oil prices contributed to some volatility in the market path over this period. Most market economists tracked by staff expect the cash rate to remain unchanged over the next year and around two-thirds expect at least one reduction in the cash rate by the end of 2027. However, a small minority continue to expect a further increase in the cash rate this year.

Graph 1.1

Cash Rate Expectations



* Cash rate expectations implied by overnight index swap rates.

Sources: LSEG; RBA.

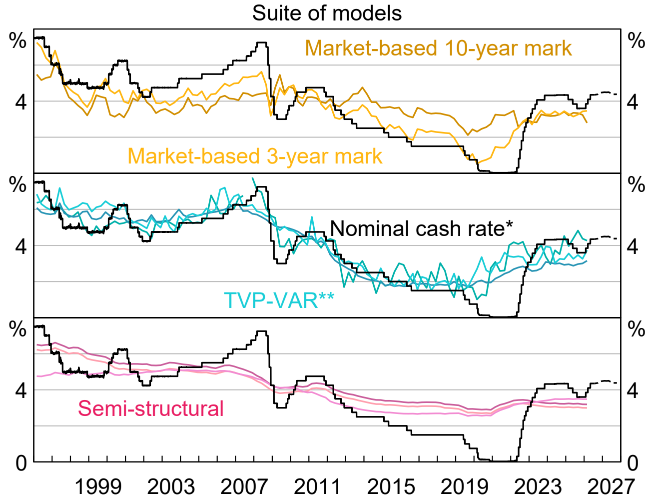
Financial conditions in Australia appear somewhat restrictive.

The cash rate is at the top of the range of model-based central estimates of neutral (Graph 1.2).[1] Other indicators also suggest that financial conditions are somewhat restrictive, such as conditions in the established housing market and housing credit growth (discussed below), the observed slowing in the growth of aggregate demand and the easing in labour market conditions (see Chapter 2: Economic Conditions). However, this judgement remains uncertain. The range of central estimates of neutral across models is wide, and each central estimate is imprecise. Spreads between lending rates and the cash rate also remain low by historical standards, reflecting low risk premia, favourable funding conditions and strong competition in lending markets (discussed below). These trends contribute to financial conditions being less restrictive than they otherwise would be for a given level of the cash rate and may not be well captured in some model estimates of neutral.

Graph 1.2

Nominal Neutral Rate

Suite of models



* Dashed line shows cash rate expectations implied by overnight index swap rates.

** Time-varying parameter vector autoregression models (TVP-VAR).

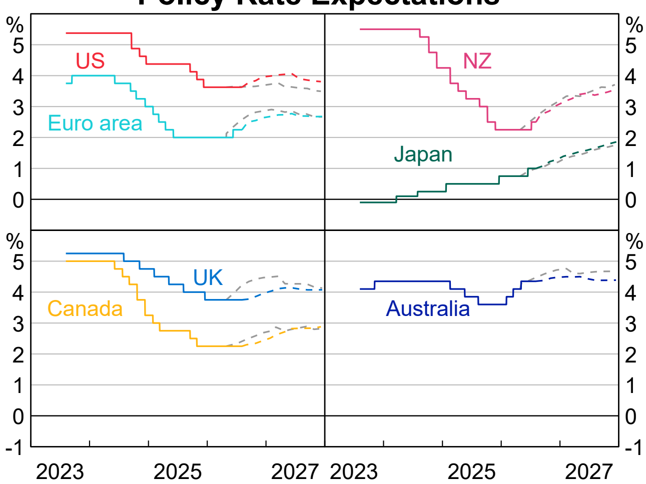
Sources: LSEG; RBA.

Expectations for the US policy rate have risen further and while expectations for rate rises by some peer central banks have eased, markets still expect many of them to also tighten policy in the months ahead.

In the United States, resilient economic activity and persistent inflation have supported expectations of tighter monetary policy (Graph 1.3). US growth remains resilient, supported by strong data centre investment and household consumption, while the labour market continues to show signs of stabilisation. Inflation has moderated from its peak earlier this year but remains elevated. Recent communications from US Federal Reserve (Fed) Chair Warsh and other officials have emphasised upside risks to price stability. Even so, the Fed left its policy rate unchanged at its July meeting and Chair Warsh emphasised that higher bond yields had tightened financial conditions. His remarks were generally interpreted as reducing the likelihood of a near-term rate increase and also led to increased uncertainty about the Fed's reaction function. Markets nevertheless continue to price at least one increase in the federal funds rate this year.

Graph 1.3

Policy Rate Expectations*



* Coloured dashed lines show expectations implied by current overnight index swap rates; grey dashed lines show the same expectations as of 29 April 2026.

Sources: Bloomberg; RBA.

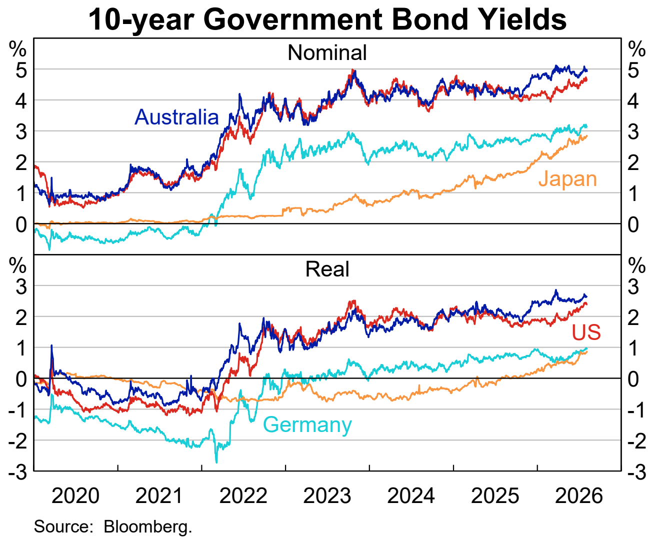
Several advanced economy central banks have increased policy rates this year, driven by a mix of domestic factors and inflationary pressures associated with the conflict in the Middle East. The European Central Bank explicitly linked its June decision to the conflict, citing more persistent inflationary pressures and the risk of broader pass-through of higher energy prices. The Bank of Japan and Reserve Bank of New Zealand also raised policy rates from relatively low levels, with their decisions to bring policy to a more neutral stance following assessments that upside risks to inflation outweighed concerns about growth. Other central banks that have left their policy rates unchanged have generally indicated that tighter policy may be required if broader inflationary pressures emerge from conflict in the Middle East (while noting there has been little evidence of this to date). Expectations for policy tightening have generally eased since early May, but most central banks are still expected to raise policy rates before the end of this year. Policy rate expectations for many economies initially fell on earlier signs of a resolution to the conflict in the Middle East and an easing in oil prices but rose following its re-escalation.

Meanwhile, Chinese authorities have kept policy rates unchanged and maintained a 'moderately accommodative' monetary policy stance, amid persistently low inflation and weak private sector demand for credit.

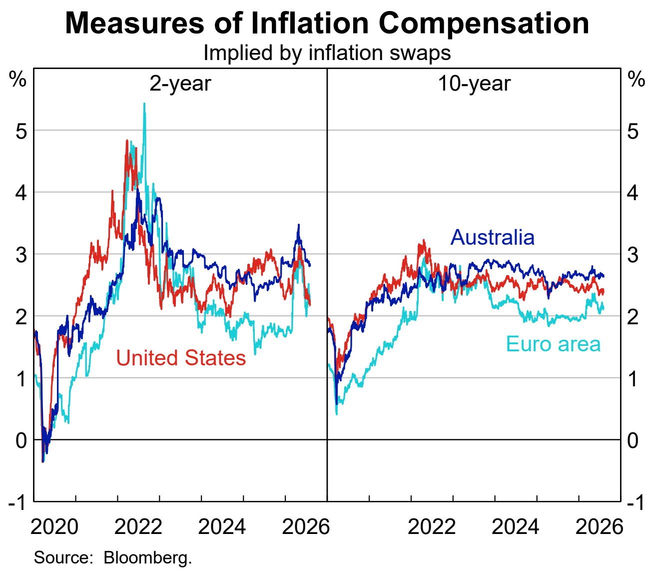
Government bond yields have increased in some advanced economies but are slightly lower in Australia since May.

Since the previous *Statement*, government bond yields have increased in the United States and Japan but are slightly lower in Australia. In the United States, yields have risen by around 20 basis points driven by higher real yields, particularly at the shorter end. This reflected expectations for tighter monetary policy and lower inflation compensation. Longer term real yields have also increased, possibly reflecting fiscal concerns and expectations that strong AI-related investment will support growth and raise equilibrium real interest rates (Graph 1.4; Graph 1.5). The rise in nominal Japanese government bond yields has similarly reflected higher real yields, amid heightened concerns about fiscal sustainability. By contrast, government bond yields in Australia are slightly lower since the May *Statement* alongside a decline in the market path for the cash rate and lower inflation compensation at the shorter end. Shorter term measures of inflation compensation in most markets remain well below their peaks seen earlier in the year, driven by the decline in oil prices, while longer term measures remain well anchored.

Graph 1.4



Graph 1.5

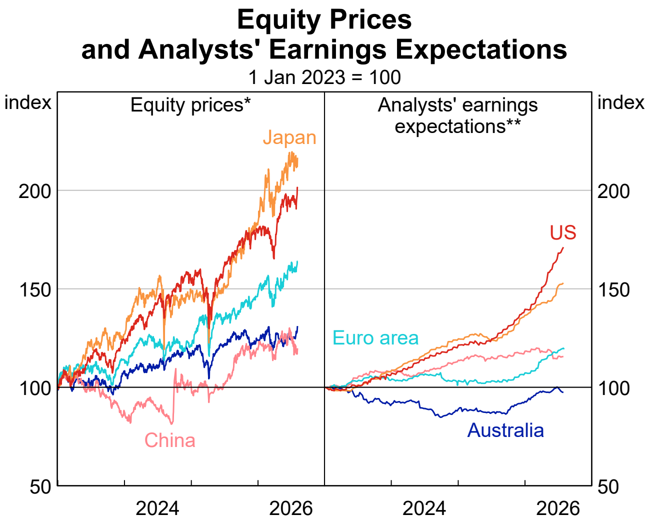


1.2 Corporate funding markets

Global risk premia remain low, despite recent volatility in equity prices of AI-related companies.

Global equity prices remain around or above their pre-conflict levels, supported by strong corporate earnings and expectations that the conflict will have limited effects on global economic activity (Graph 1.6). Gains in financial firms have buoyed non-AI equity indices in the United States and supported gains in European markets. Equity prices in Japan have also increased further over the period.

Graph 1.6



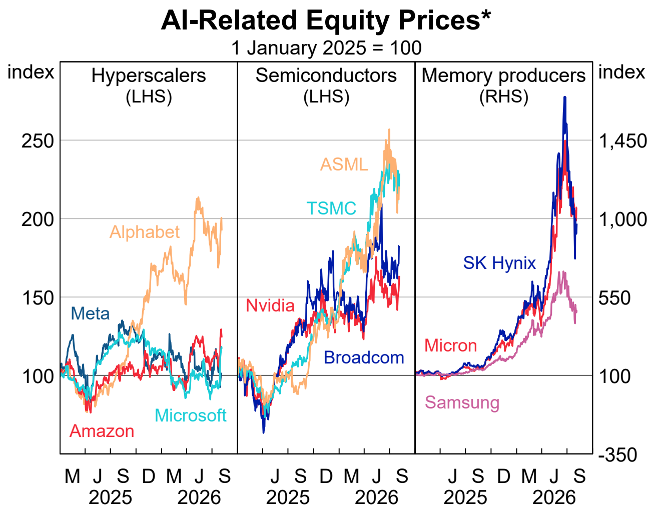
* Series is of equity prices returns, rather than total (dividend-adjusted) returns, as price returns are more closely linked to expected future earnings. However, price returns will tend to understate the overall return from investing in Australian equities relative to other markets, given Australian firms typically pay out a greater share of earnings as dividends.

** 12-month forward earnings per share.

Sources: Bloomberg; LSEG; RBA.

AI-related equities have become very volatile (Graph 1.7). In the United States, semiconductor firms and so-called hyperscalers (large cloud-computing companies investing heavily in AI infrastructure) have become sensitive to news about data centre investment plans, financing conditions and the outlook for earnings growth. Equity prices have been particularly volatile in South Korea and Taiwan, reflecting both the large weight of semiconductor and memory companies in those markets and their strong earlier gains. In South Korea, the volatility has been amplified by leveraged retail investors (which has since been curtailed by regulators), while Chinese technology-related equities have also fallen.

Graph 1.7



* Equity prices are on a total returns basis.

Sources: LSEG; RBA.

Australian equity prices have increased since the May *Statement* to be back around their pre-conflict levels, despite expected earnings having been revised down slightly. Easing concerns about the economic effects of the Middle East conflict and the slightly lower expected policy path have supported a recovery in consumer-facing equity prices over recent months. Australian banks' share prices have also increased to be only a little below the highs reached earlier in the year, despite expectations of slower household credit growth (discussed below) and the announcement of additional loan provisions by some banks. The underperformance of Australian equities over recent years is consistent with subdued earnings expectations for Australian companies, in contrast to the significant upgrades seen in many other markets. More recently, some of this divergence has reflected the limited exposure of Australian companies to the global AI supply chain.

Risk premia in global bond and equity markets remain low. This suggests that investors expect the economic impact of the Middle East conflict to be limited and that they remain confident in the long-term returns from AI investment, despite the recent volatility in that sector. This is in line with the resilience in earnings forecasts to date. While some corporate bond spreads have widened slightly amid a substantial increase in issuance by AI-related firms, they have declined in aggregate and remain low overall. However, a more material reassessment of the economic viability of AI-related investment, or of the economic effects of the Middle East conflict, could lead to a broader weakening in risk sentiment that could spill over to Australian markets.

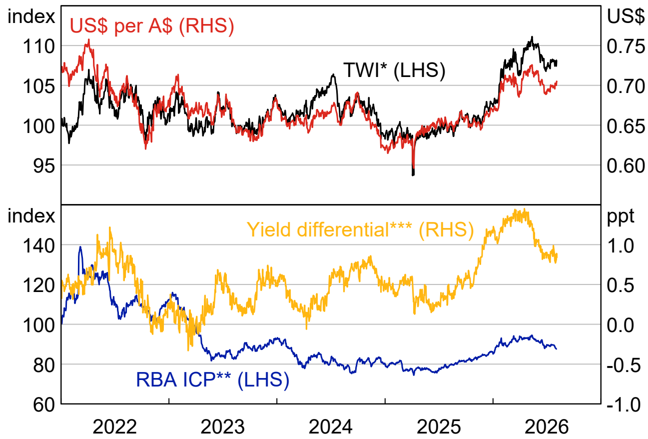
1.3 Foreign exchange markets

The Australian dollar has depreciated since the May *Statement*, reflecting lower yield differentials between Australia and other advanced economies and a decline in commodity prices. Even so, the exchange rate remains around 5 per cent higher than at the start of the year.

The Australian dollar TWI has depreciated 1.2 per cent since the May *Statement*, underpinned by a narrowing in yield differentials (Graph 1.8). Rising government bond yields internationally – particularly in the United States – and a decline in Australian monetary policy expectations have contributed to a narrowing of Australia's interest rate differentials with other advanced economies. Together with declines in some commodity prices, such as iron ore, this has more than offset support for the Australian dollar from generally resilient risk sentiment in global markets. Despite the recent depreciation, the TWI is 5 per cent higher than it was at the start of the year. The nominal TWI remains broadly consistent with model estimates of its long-run equilibrium level.

Graph 1.8

Australian Dollar



* Trade-weighted index; 01 January 2022 = 100.
** Index of Commodity Prices (USD terms); 01 January 2022 = 100.
*** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.
Sources: Bloomberg; RBA; Yieldbroker.

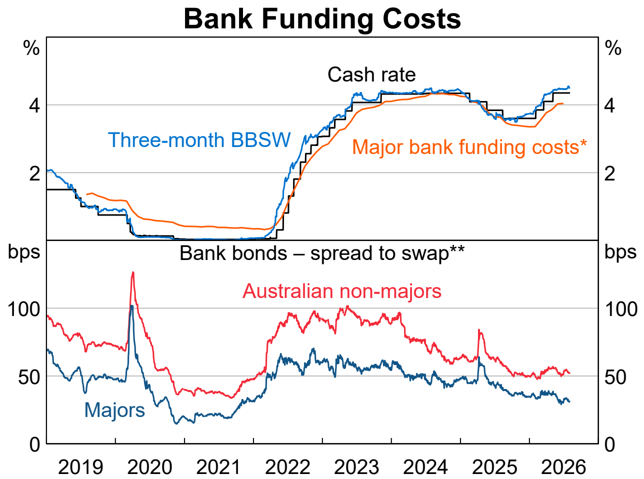
The Japanese yen has been supported recently by coordinated intervention by the Japanese Ministry of Finance and the US Treasury. This follows several market interventions earlier in the year by Japanese officials. Intervention occurred to support the yen and counter 'excessive volatility and disorderly movements in Japanese yen in recent months'. Market commentators have suggested that the US Treasury intervention reflects concerns that without US support, Japanese officials may have had to sell greater amounts of US Treasury securities to fund intervention. The US portion of the coordinated intervention was funded out of its official reserve assets, most likely through the sale of euros.

1.4 Australian banks and credit markets

Banks' funding costs and lending rates have increased since the beginning of the year, in line with the standard transmission of monetary policy.

Banks' funding costs have increased alongside the cash rate since the start of the year. Since the May *Statement*, major banks' funding costs are estimated to have increased by 18 basis points as the higher cash rate has flowed through to deposit and wholesale debt rates (Graph 1.9). Spreads between bank bond yields and swap rates have remained close to their lowest levels since 2022. Bank bond issuance so far this year has been around its decade average (relative to GDP).

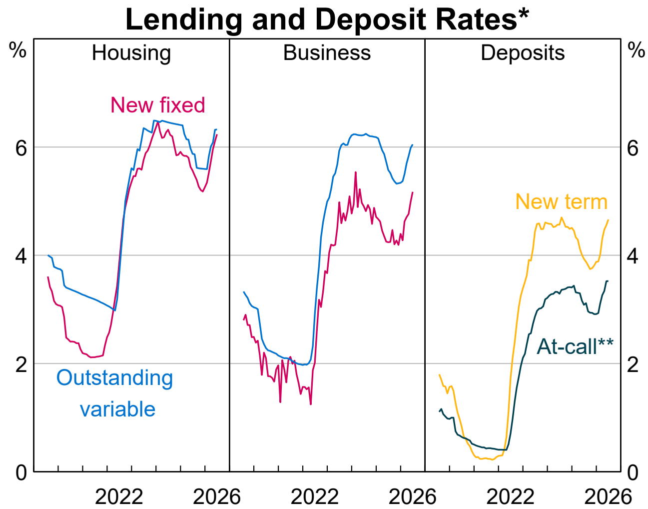
Graph 1.9



* 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 recent cash rate increases to mortgage and business lending rates. Variable business rates have increased alongside increases in bank bill swap rates (BBSW) and the cash rate this year (Graph 1.10). Variable mortgage rates increased by nearly 75 basis points between January and June. Since June, some lenders have reduced advertised variable mortgage rates for select products, with cuts as large as 20–30 basis points for a few small lenders. These reductions are consistent with continued strong competition and could reflect efforts to maintain market share amid an expected slowdown in housing credit growth (see below). The extent to which these changes will affect aggregate paid mortgage rates remains unclear. Some lenders also reduced advertised fixed mortgage rates in June and July.

Graph 1.10



* Latest observation is June 2026.
** Includes deposits in housing loan offset accounts.
Sources: APRA; RBA.

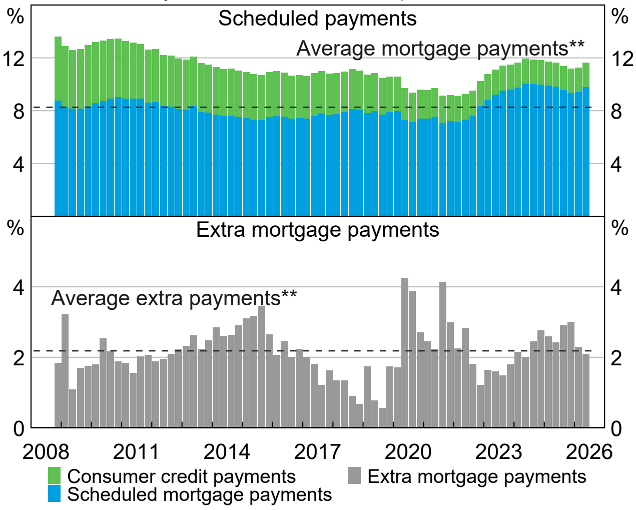
Previous cash rate increases have flowed through to higher scheduled mortgage payments.

Scheduled mortgage and consumer credit payments increased to just under 12 per cent of household disposable income in the June quarter, to be close to their 2024 peak (Graph 1.11). Cash rate increases can take around three months to flow through to scheduled mortgage payments because of minimum notice periods for higher repayments and differences in borrowers' repayment cycles. Accordingly, scheduled mortgage payments are expected to rise a little further over coming months as the May cash rate increase continues to flow through.

Graph 1.11

Selected Claims on Household Income*

Quarterly; share of household disposable income



* June quarter 2026 data are based on forecasts for household disposable income. Seasonally adjusted and break-adjusted.

** Post-2008 average.

Sources: ABS; APRA; RBA.

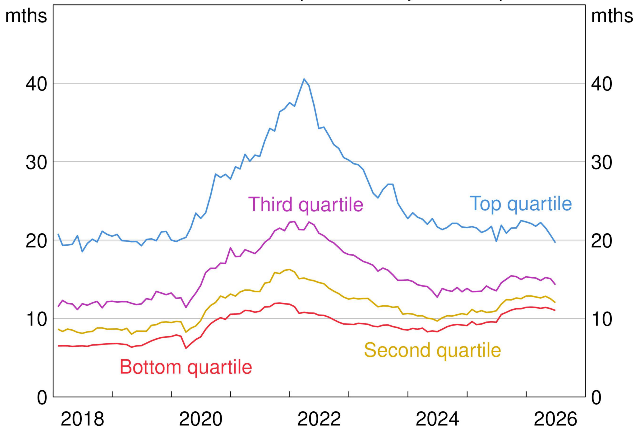
Extra mortgage payments into offset and redraw accounts declined a little to be around their long-run average in the June quarter. Flows into these accounts have been a bit weaker in 2026 compared with 2025. While higher rates have provided a stronger incentive to save, some households may have chosen to save less in these accounts (or even to draw down on balances) to support consumption and/or to meet increases in scheduled (minimum required) payments. Indeed, borrowers who left actual mortgage payments unchanged as the cash rate declined over 2025 would generally not have seen higher actual mortgage payments as interest rates increased over 2026 (as their actual payments were still at or above the minimum required). However, a larger share of these payments would have been absorbed by higher interest charges over 2026, mechanically contributing to weaker inflows into redraw accounts relative to 2025.

Even so, strong flows into mortgage offset and redraw accounts over recent years mean that many borrowers have sizeable buffers. For example, data to June suggest that a median borrower in even the lowest income quartile could meet almost one year's worth of scheduled mortgage repayments by drawing on funds in offset and redraw accounts (Graph 1.12). This is up from nine months before the pandemic, despite minimum scheduled mortgage repayments for the median borrower in the lowest income quartile having increased by almost 50 per cent since then.

Graph 1.12

Median Mortgage Prepayments*

Variable-rate owner-occupier loans, by income quartile



* Number of months that prepayments (offset and redraw balances) can cover minimum scheduled mortgage payments. Income quartiles based on the distribution of variable-rate owner-occupier borrower incomes. Income quartile upper bounds for June 2026 are $120,000 for the bottom quartile, $177,000 for the second quartile and $255,000 for the third quartile. Earliest observation January 2018. Latest observation June 2026.

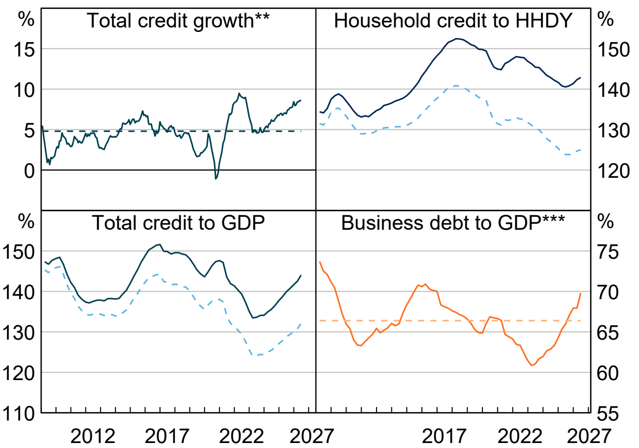
Sources: ABS; RBA; Securitisation System.

Total credit growth remained above average in June but is expected to weaken over coming months.

Total credit grew by 8.6 per cent in six-month-ended annualised terms in June, reflecting strength in lending to both the household and business sectors (Graph 1.13). Total credit growth has been relatively stable over the year to date but is expected to ease over coming months as declines in housing prices flow through to housing credit growth (which typically occurs with around a three-month lag). Household credit has continued to grow above its long-run average recently, and the ratio of household credit to disposable income has increased a little since mid-2025 after several years of declines. The ratio of business debt to GDP has risen significantly in recent years, and over the past year has increased to above its post-global financial crisis (GFC) average. Business debt growth has been supported by both favourable supply conditions – with ongoing strong competition between bank and non-bank lenders – and robust demand (see below).

Graph 1.13

Debt by Sector*



* Seasonally adjusted and break-adjusted; including securitisation. June quarter 2026 figures based on forecast for household disposable income (HHDY) and gross domestic product (GDP). Dashed lines in panels 2 and 3 are net of offsets.

** Six-month-ended annualised. Dashed line is the average from 2009 onwards.

*** Includes business credit, corporate bonds and other lending. Dashed line is the average from 2009 onwards.

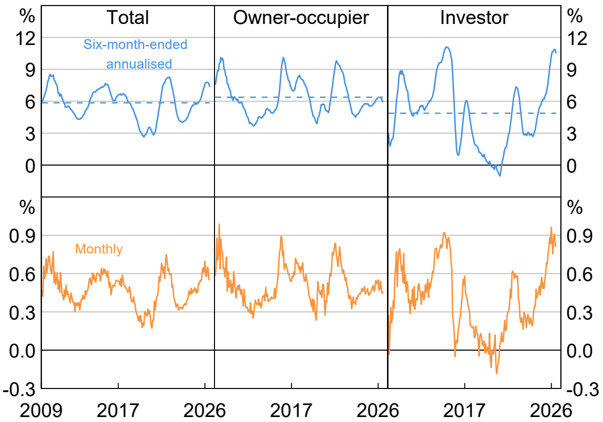
Sources: ABS; APRA; Bloomberg; LSEG; RBA.

Housing credit growth has eased and is expected to slow further in the period ahead.

Housing credit growth remains above its post-GFC average but has eased by around 0.5 percentage points in six-month-ended annualised terms since the May *Statement*, reflecting modest declines in credit growth to both owner-occupiers and investors (Graph 1.14). There has been a sharp decline in new housing loan commitments over recent months, driven by investors (Graph 1.15). The decline in new housing commitments reflects the combined impact of the easing in established housing market conditions, increases in interest rates and recently announced tax changes for property investors (related to negative gearing and capital gains tax). This is expected to flow through to a further slowing in housing credit growth in the months ahead.

Graph 1.14

Housing Credit Growth*



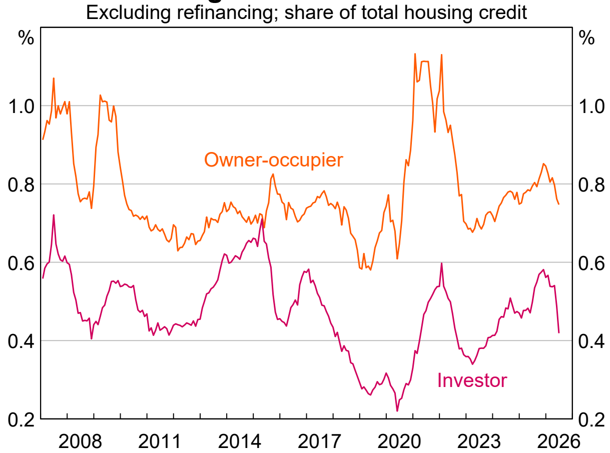
* Seasonally adjusted and break-adjusted; including securitisation. Dashed lines are the averages from 2009 onwards.

Sources: ABS; APRA; RBA.

Graph 1.15

Housing Loan Commitments*

Excluding refinancing; share of total housing credit



* Monthly data, seasonally adjusted and break-adjusted. Latest observation is June 2026.

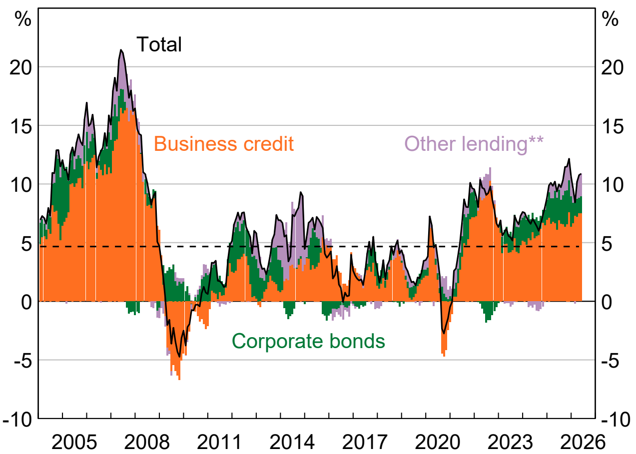
Source: ABS; APRA; RBA.

Growth in business debt remains strong and relatively broad-based across industries.

Business debt growth remains above its post-GFC average, but a little lower than its peak late last year (Graph 1.16). The strength in business debt growth has been broadly based across industries, with the industrials and real estate sectors contributing strongly to the recent growth. Growth in syndicated lending, which is a subset of business debt, has increased since the start of this year following a few large deals to build data centres and supporting infrastructure; syndicated lending has been an important source of debt funding for Australian companies establishing or operating data centres (see Chapter 3: Outlook for a discussion of data centre investment). Business credit growth remains close to its fastest pace since 2022, alongside strong competition in the business lending market. Corporate bond issuance has been steady, with year-to-date issuance from non-financial corporations around its decade average as a share of GDP.

Graph 1.16

Business Debt Growth*



* Six-month annualised, seasonally adjusted. Dashed line is average since 2009.

** Lending to large businesses by institutions that do not report to APRA.

Sources: APRA; Bloomberg; LSEG; RBA.

Endnote

1 Since the May *Statement* staff have re-estimated the market-based neutral rate model. The central estimates from the market-based model shifted a bit lower as a result.

Chapter 2
Economic Conditions

Summary

- **Consumer price inflation in Australia remains elevated**, reflecting both global cost pressures associated with the Middle East conflict and ongoing domestic capacity pressures. Historically weak productivity growth continues to constrain the capacity of the Australian economy to supply goods and services. Domestic demand growth looks to have moderated in the first half of the year, labour market conditions have eased a little and the housing market has softened. These developments are consistent with financial conditions being somewhat restrictive and the Middle East conflict having had a limited impact on overall domestic activity so far.
- **The ongoing Middle East conflict has continued to disrupt energy production and shipping in the region, contributing to high global prices for oil, liquefied natural gas and other commodities.** Global commodity prices have been volatile since May. The sharp increases in oil and some other commodity prices following the start of the conflict were largely unwound in June, after the United States and Iran signed a memorandum of understanding to cease hostilities and reopen the Strait of Hormuz, and as global supply chains adjusted. However, some prices increased again in July as the conflict re-escalated. Crude oil prices are currently below where they were at the time of the May *Statement*, although global inventories of oil and oil products are much lower than at the start of the conflict, suggesting upside risks to energy prices if supply disruptions continue.
- **GDP growth in Australia's major trading partners has been stronger than expected over the past year or so, and that has continued recently as the boost from AI-related investment has outweighed the negative effects of the Middle East conflict.** Surging global demand for AI-enabling products has recently contributed to strong growth in investment in many economies and in exports in some of Australia's Asian trading partners. In addition, trade policy developments since early 2025 have been less of a drag on growth than expected as trade flows have reoriented. However, significant uncertainty remains around both the resolution of the Middle East conflict and US trade policy. While GDP growth in China has slowed recently and growth in domestic demand remains subdued, the authorities have announced renewed support for infrastructure investment.
- **Higher energy prices have driven increases in producer and consumer price inflation in many economies over recent months, with strong demand for AI-related goods adding to producer price inflation in some economies.** However, the impact of upstream cost pressures on non-energy consumer prices has been limited so far; core measures of inflation remain broadly unchanged from prior to the conflict, though are above central banks' targets in several advanced economies.

- **In Australia, overall demand growth appears to have moderated, broadly as expected in May, and recent data support our May judgement that the impact on activity of the earlier spike in fuel prices will be relatively contained.** GDP grew by 2.5 per cent over the year to the March quarter, in line with our May forecast. Recent data suggest that underlying momentum in household consumption is easing only gradually, as expected, despite consumer sentiment remaining very weak. Business investment increased very strongly in the March quarter, and by more than expected, driven by growth in data centre fit-outs (though much of this equipment is imported). More recently, surveyed business conditions have declined only modestly, and the ABS measure of investment intentions has been revised a little higher, even though business confidence remains low. By contrast, conditions in the established housing market have eased by more than anticipated and housing prices have declined by 1.6 per cent from their peak in March. This easing reflects the combined effect of cash rate increases, tax changes announced in the federal budget and the broader economic environment.
- **Slower demand growth is helping to bring potential supply and demand back into balance, but we assess that some capacity pressures remain.** Labour market conditions have eased by a little more than expected in recent months. The unemployment rate was 4.4 per cent in June; this is still below our estimate of the rate consistent with full employment, suggesting that labour market conditions remain a little tight. Leading indicators are consistent with labour market conditions being stable in the near term or easing gradually. Wages growth was steady in early 2026, as expected, while broader measures of labour costs were a little weaker than expected.
- **Headline and underlying inflation remained well above target in the June quarter.** Headline inflation eased slightly to 3.9 per cent, against expectations of an increase, as retail fuel and travel prices were softer than expected. Fuel prices faced by Australian households and businesses declined over May and June but increased again in recent weeks as oil prices rose and the temporary reduction in fuel excise ended. Trimmed mean inflation remained elevated in the June quarter, increasing to 3.6 per cent, though this was a little softer than expected. The strength in underlying inflation reflects both broad capacity pressures and the pass-through of cost increases related to the Middle East conflict. In May we judged that conflict-related costs would flow through to underlying inflation relatively quickly, owing to existing capacity pressures and elevated short-term inflation expectations. Recent data and liaison suggest that these higher input costs have contributed to price increases for new dwellings, but evidence of pass-through across the rest of the CPI basket is limited; overall they look to have contributed a little less to underlying inflation than was assumed in May.
- **Short-term inflation expectations remain elevated, although most measures have eased back from the high level reached soon after the start of the Middle East conflict.** Most long-term measures remain consistent with achieving the inflation target.

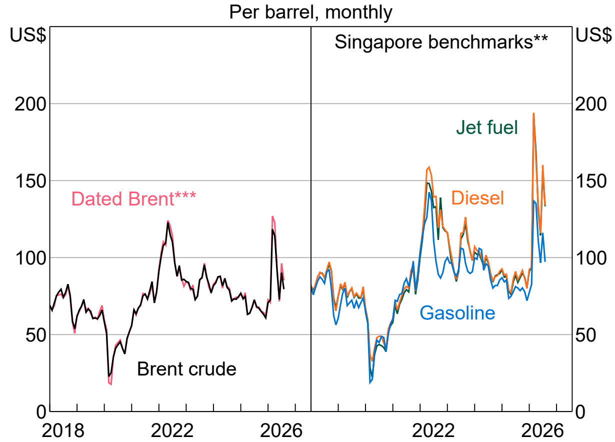
2.1 Commodity price developments related to the Middle East conflict

Global energy commodity prices have been volatile in recent months, reflecting developments in the Middle East that have affected exports of oil and liquefied natural gas (LNG) from the region.

Energy prices have been volatile in recent months and remain higher than their pre-conflict levels.

The price of Brent crude oil is currently around US$80 per barrel, lower than at the time of the May *Statement* but around 10 per cent above pre-conflict levels (Graph 2.1). Prices declined in June after the United States and Iran signed a memorandum of understanding that led to a partial recovery of shipping through the Strait of Hormuz, but have been volatile since then as the conflict re-escalated at times. Oil futures prices are currently broadly in line with the baseline assumption underpinning the May *Statement* forecasts (see Chapter 3: Outlook). Since the start of the conflict, inventories and strategic reserves of crude oil and oil products have been drawn down to partially offset the disruptions to Middle Eastern supplies. That has helped moderate some of the rise in oil prices but has also left the global economy with smaller buffers to withstand continued supply disruptions. Global oil demand also declined, particularly in China, where oil imports fell by around 40 per cent over the year to June, reflecting export restrictions and lower demand for transportation fuels, petrochemical feedstocks and stockpiling.

Graph 2.1
Oil and Refined Product Prices*
Per barrel, monthly



* The August 2026 observation for all series is as at 5 August.
** Front-month forward prices.
*** Dated Brent is the physical spot price for Brent crude.
Sources: Bloomberg; RBA.

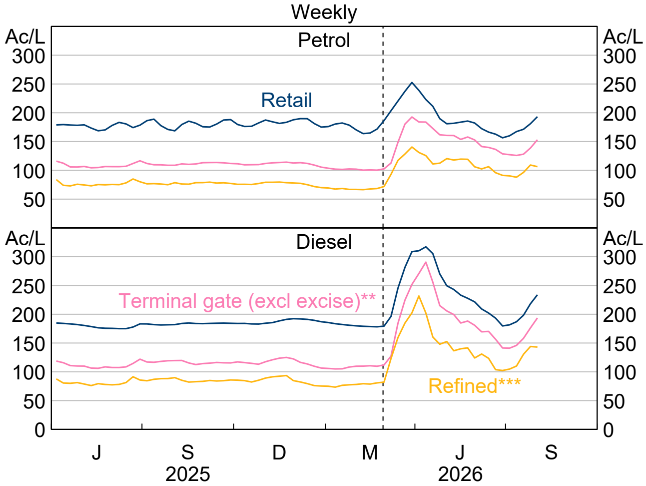
The prices of Asian refined oil products, which are the majority of Australia's imports, have also declined since the May *Statement*, though by somewhat less than crude oil prices as global refinery output remains constrained. Since the May *Statement*, Singaporean price benchmarks have fallen by around 30 per cent for gasoline and around 15 per cent for diesel and jet fuel. Global refining activity has been constrained by damage to refineries in the Middle East and Russia, and reduced throughput in China in part due to export restrictions. Demand for fuel has also been resilient, particularly in the northern hemisphere, where fuel usage for driving and flying are highest during summer. Together, these factors have put upward pressure on fuel prices relative to crude oil prices and led to a drawdown in global refined product inventories. Continued drawdowns present an upside risk to fuel prices, especially if global inventories approach minimum operational levels (though estimates of these thresholds are highly uncertain).

Retail fuel prices in Australia eased in May and June but have increased in recent weeks. Petrol and diesel prices are above their pre-conflict levels (Graph 2.2). The declines in petrol and diesel prices in May and June were larger than previously assumed, reflecting lower-than-expected retail margins (for petrol) and wholesale margins (for diesel).[1] The more recent increase in fuel prices in part reflects the rise in regional benchmark prices for refined fuel and in part the ending of the temporary reduction in fuel excise. However, the timing of this latter effect shifted slightly from what was assumed in the May forecasts, with the temporary cut partly unwinding in July and partly in August, rather than unwinding fully in July.

Graph 2.2

Fuel Prices*

Weekly



* Dashed line shows the start of the Middle East conflict.
** Average prices of fuel sold at fuel terminals to bulk customers.
*** Benchmark prices set by regional exporters for refined fuels.
Sources: Australian Institute of Petroleum; Bloomberg; LSEG; RBA.

Domestic reserves for all fuel types are higher than in recent years, with around 39 days of consumption cover for diesel, 34 days for jet fuel, and 43 days for petrol. Reporting by the Australian Government indicates that fuel imports in August are expected to remain broadly similar to June and July. The .5 billion Fuel and Fertiliser Security Facility announced by the Government has supported fuel imports in recent months by providing financial support to importers.

Movements in the prices of other commodities affected by the conflict have been mixed since the May *Statement*, as expectations for a normalisation in trade grew, but actual trade flows remained below pre-conflict levels. For the short window while the Strait was reopened, exporters prioritised crude oil flows in order to release storage capacity and restart oil production; exports of refined products have been more limited and markets have remained tight. Asian LNG prices and European natural gas prices have risen by around 20 and 18 per cent respectively, on restocking demand in Europe ahead of winter and concerns over future supply availability. Thermal coal prices are little changed and remain above pre-conflict levels. Fertiliser prices have generally eased as concerns about shortages have abated, but the pass-through to agricultural commodity prices has been uneven with mixed price moves since the May *Statement*. Aluminium prices have also declined reflecting expectations that Middle Eastern supply will recover.

2.2 Global economic conditions

Economic growth in Australia's major trading partners (MTPs) has been resilient recently as the ongoing boom in global AI-related investment has more than offset the negative impacts of the Middle East conflict. For some east Asian trading partners, surging global demand for AI-enabling products like semiconductors has contributed to stronger-than-expected growth in both GDP and traded goods prices. Growth in advanced economies more broadly has also been resilient over the past year despite disruptions to global energy supplies and trade policy developments. In China, growth weakened in the June quarter, as consumption and investment growth slowed and net exports contributed little.

Producer price inflation has increased sharply in many economies, driven by higher energy prices and, in some cases, higher prices for AI-enabling inputs. Headline consumer price inflation has also increased due to higher fuel prices. Core consumer price inflation is generally little changed from before the conflict, but upstream price pressures, if sustained, are likely to pass through to non-energy consumer prices over time.

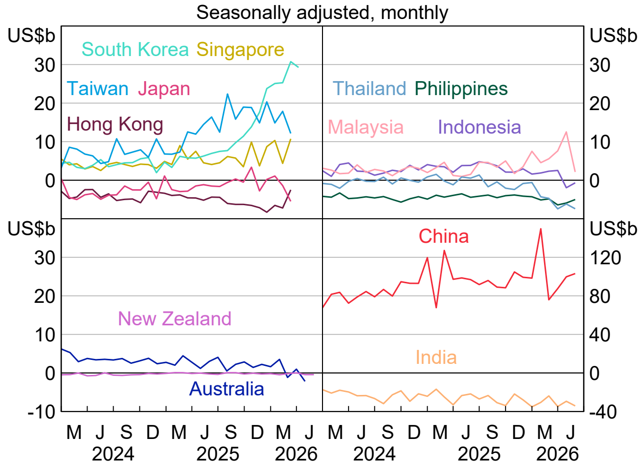
The global AI investment boom continues to drive stronger-than-expected economic growth in some of Australia's Asian trading partners.

Surging global demand for AI-enabling products has driven booming exports for some Asian economies, more than offsetting the negative impacts of higher energy prices on GDP growth. Robust growth in global AI-related investment has supported industrial production and export growth in the March and June quarters in trading partners that are integrated into supply chains for computer servers and semiconductors (Graph 2.3). Export values have continued to grow strongly in recent months for economies like South Korea and Taiwan, although growth in export prices has been stronger than growth in volumes as capacity constraints bind in parts of these supply chains. Some manufacturers plan to expand their productive capacity through higher capital spending, while governments in Japan and South Korea have announced medium-term plans to increase public investment in both AI-related and other industries. By contrast, Asian trading partners less integrated into AI supply chains, such as Thailand, have experienced some deterioration in their goods trade balances and terms of trade since the start of the Middle East conflict due to higher energy import prices.

Graph 2.3

Merchandise Goods Trade Balance

Seasonally adjusted, monthly



Sources: CEIC Data; RBA.

Economic activity has been resilient in advanced economies more broadly, despite the disruptions to global energy markets. Euro area GDP growth was stronger than expected in the June quarter; abstracting from volatility in Irish data, growth was broadly consistent with estimates of potential growth. Even though US GDP growth in the June quarter was a little weaker than expected and below estimates of potential, domestic final demand growth was much stronger, driven by household consumption and business investment, including data centre construction. US consumption growth has been resilient despite the increase in energy prices as households have smoothed through the decline in real incomes, supported by higher-than-usual tax refunds in April.

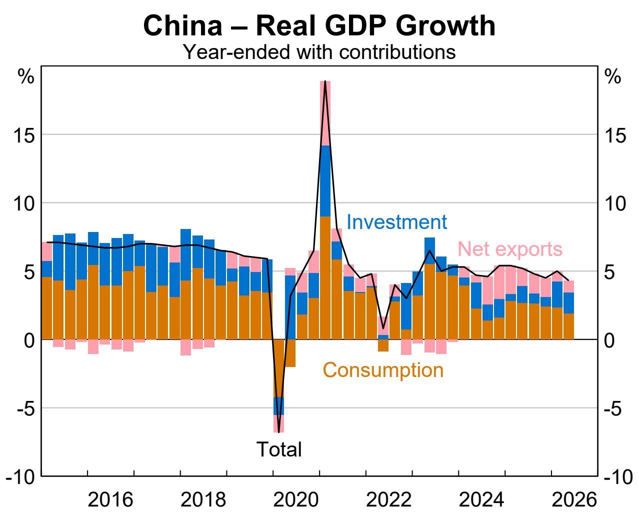
Recent weeks have seen another round of developments in US trade policy, but the direct implications of these changes are judged to be limited. The temporary 10 per cent global tariff rate implemented by the US administration in February lapsed on 24 July and the administration has implemented new tariffs for 60 of its trading partners, including China, the European Union and Australia.

These changes leave the average effective tariff rate on exports to the United States broadly unchanged. The US administration announced it would not renew the United States–Mexico–Canada trade agreement (USMCA) for an additional 16-year term; it will instead be reviewed on an annual basis until 2036. The administration also announced a new 50 per cent tariff on a range of Canadian goods.

GDP growth in China slowed in the June quarter, with weakness in domestic demand persisting.

The Chinese economy grew by 0.9 per cent in the June quarter, slowing from the stronger-than-expected 1.3 per cent increase in the March quarter (Graph 2.4). Structural imbalances between strong domestic supply and weak domestic demand continued, with household consumption remaining subdued in the quarter, despite sustained income growth. Investment also slowed, alongside a reported temporary pullback in support from authorities for infrastructure investment and continued declines in real estate investment. Activity in the real estate sector has remained weak with continued declines also observed in sales and starts. The impact of the Middle East conflict on China's economy has so far been mostly contained to higher producer prices, with limited evidence of broader effects on domestic activity – consistent with China's relatively low dependence on oil and LNG, and large strategic reserves.

Graph 2.4



Sources: CEIC Data; RBA.

Authorities in China have indicated renewed support for infrastructure investment this year. The recent meeting of China's Politburo in late July pledged continued policy support for the economy, with an emphasis on accelerating fiscal spending on already-announced infrastructure projects through the rest of the year. Authorities also announced plans earlier this year to invest around RMB7 trillion in the 'Six Networks' initiatives in 2026, as part of the 15th Five-Year Plan, with projects spanning water, energy, computing, communications, logistics and urban pipeline infrastructure.

The recent strong growth in Chinese trade paused in the June quarter, with both exports and imports estimated to have weakened and net trade making almost no contribution to GDP growth. Nevertheless, export volumes of some higher value-added goods, such as electric vehicles and ships, have increased considerably since the start of the year. Chinese imports of advanced AI-related goods have also grown strongly, including for use as intermediate inputs to production, as domestic production capacity is concentrated at the less advanced end of the supply chain.

Iron ore prices have declined by 15 per cent since the May *Statement*, alongside reported weakness in Chinese steel demand and increased seaborne supply. Recent weakness in activity and investment growth in China has weighed on steel demand. Low steel mill profitability has also encouraged production cuts and unseasonal stoppages for maintenance. Consistent with this, Chinese port inventories of iron ore rose in June and remain at historically high levels as supply has outpaced demand. Shipments from the Simandou iron ore project in Guinea – one of the world's largest high-grade deposits – have also increased significantly faster than expected, contributing to the rise in seaborne supply alongside continued strength in supply from Australia and Brazil.

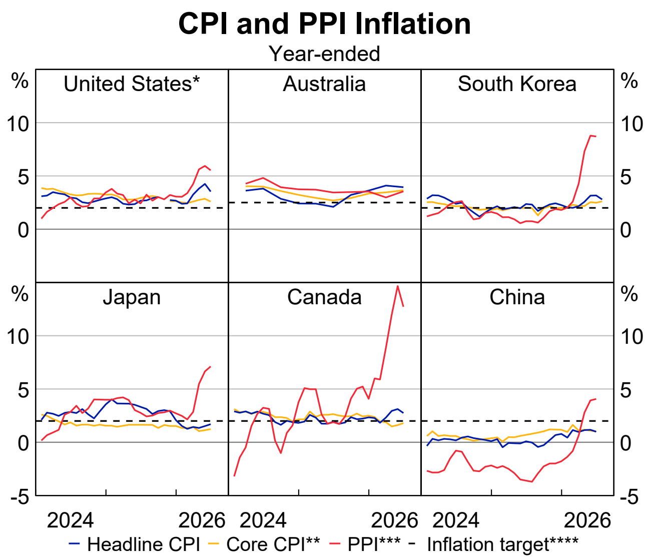
Higher prices for energy and, in some economies, AI-enabling inputs have pushed up producer prices globally – but pass-through to core consumer price inflation has been limited so far.

Higher energy prices have raised headline consumer and producer price inflation in most economies, although the effects have varied across countries, largely reflecting differences in policy responses (such as price controls, subsidies and tax cuts) and the domestic energy mix. Headline producer prices have generally responded more rapidly and by significantly more than consumer prices so far. While consumer and producer price inflation moderated in June in some economies – such as the United States and the United Kingdom – as fuel prices eased, inflation is likely to rise again given recent movements in oil prices.

Strong demand growth, particularly for AI-related goods, has also raised producer price inflation in some economies, although effects on consumer prices have been more limited to date. For some east Asian economies like South Korea, producer price inflation began to pick up before the Middle East conflict as bottlenecks emerged in AI-related supply chains. Surging demand for AI-enabling products has contributed to price increases for some consumer electronics and software but this has had limited impact on consumer price inflation in most economies so far. In China, producer price inflation remains around multi-year highs following the sharp increase in commodity prices, although the impact of higher energy prices has already begun to dissipate, with producer price inflation broadly stable in June.

Core consumer price inflation has been broadly stable since the start of the conflict in many economies, although it remains above levels consistent with central bank targets in several advanced economies (Graph 2.5). Sustained or renewed upstream cost pressures could contribute to a broadening of inflationary pressures to core goods and services prices over time. By contrast, Chinese consumer price inflation remains well below the official inflation target of 2 per cent as the structural imbalance between domestic demand and supply in China's economy persists.

Graph 2.5



* Headline and core CPI data not available for October 2025.
** Trimmed mean CPI used for Australia, core CPI for others.
*** Industrial producer price index used for Canada, total PPI for others.
**** Central bank inflation target or midpoint of central bank target range; PCE inflation target for the United States, CPI inflation for others.

Sources: ABS; CEIC Data; LSEG; RBA.

2.3 Domestic economic activity

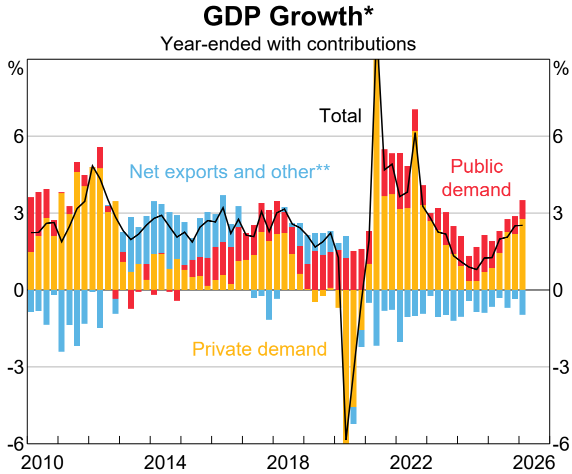
The May *Statement* forecasts assumed that GDP growth would ease in early 2026, following above-trend growth in late 2025, as some of the factors supporting growth (including strong growth in income and wealth) waned. Households and businesses were, in aggregate, in a solid financial position and it was assumed that the observed weak outcomes for consumer and business sentiment would not weigh materially on economic outcomes. However, a sharper pullback in household spending and business investment, owing to weak sentiment, was judged to be a key risk to the outlook.

Recent data, while mixed, remain broadly consistent with the May forecasts. GDP growth in the March quarter, which largely reflected economic conditions prior to the Middle East conflict, was broadly as expected. More recently, household spending growth looks to have eased only modestly, as anticipated, despite consumer sentiment remaining very weak. The established housing market has slowed by more than expected. By contrast, business investment in the March quarter was stronger than anticipated and investment intentions, as measured by the ABS, were revised up despite weak business sentiment. Recent state and federal budgets have not materially altered our view of the outlook for public demand.

Year-ended GDP growth remained solid in the March quarter.

GDP increased by 0.3 per cent in the quarter to be 2.5 per cent higher over the year, broadly in line with our expectations in the May *Statement*. Private demand remained the main driver of growth over the year, underpinned by solid consumption and elevated levels of business investment (Graph 2.6). This reflected the earlier strong growth in household incomes and wealth, the easing in financial conditions internationally and domestically over much of 2025, and ongoing structural changes in the economy, including investment in data centres and renewable energy infrastructure. Given the usual lags in transmission, the easing in monetary policy in 2025 is likely to have supported activity in the March quarter, particularly for dwelling investment and consumption.

Graph 2.6

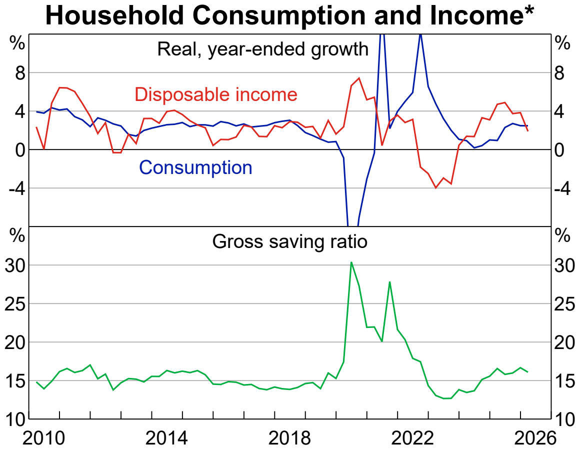


* Outliers during the COVID-19 pandemic have been truncated.
** Includes change in inventories and the statistical discrepancy.
Sources: ABS; RBA.

Household spending growth looks to have eased only modestly since the start of the year, as expected, despite very weak consumer sentiment.

Recent data support the assessment in the May *Statement* that underlying momentum in household consumption had started to ease prior to the Middle East conflict. This is consistent with an easing in real household income growth since mid-2025, following an earlier period of strong growth. Consumption grew by 0.5 per cent in the March quarter to be 2.5 per cent higher over the year, as expected (Graph 2.7). The unwinding of electricity subsidies shifted spending from public consumption to household consumption and so contributed 0.3 percentage points to year-ended growth. Retail spending declined as expected following promotional activity in the December quarter, but we assess that this had only a modest effect on consumption growth.

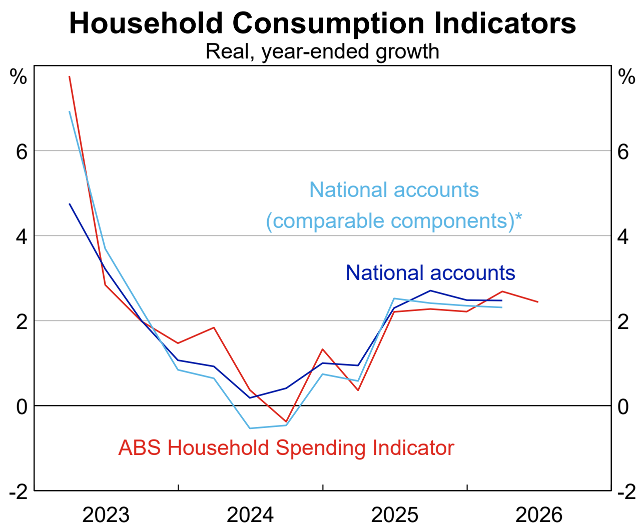
Graph 2.7



* Outliers during the COVID-19 pandemic have been truncated.
Sources: ABS; RBA.

Liaison and other timely indicators point to household spending growth continuing to ease only modestly in the June quarter, broadly as expected (Graph 2.8). This is consistent with the fundamentals for households remaining solid; household incomes are expected to have continued growing (albeit at a slower pace) and balance sheets remain in good shape for most households. Spending indicators have been volatile month-to-month – particularly transport spending, which has been directly affected by price changes related to the Middle East conflict. Overall, domestic spending growth according to the ABS Household Spending Indicator was resilient in the June quarter, increasing by 0.7 per cent in real terms, supported by strength in discretionary spending (including electric vehicle purchases). This is broadly consistent with consumer-facing contacts in the liaison program continuing to report moderate spending growth, with conditions since March a little softer than earlier in the year. However, there was a notable decline in international travel in the June quarter, which likely weighed on Australians' spending overseas and therefore household consumption.

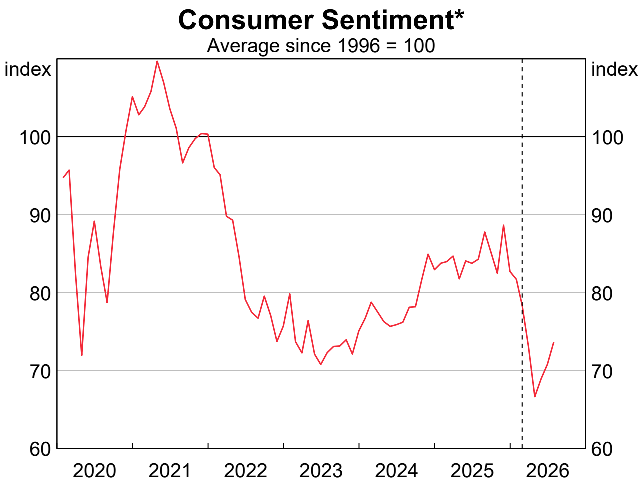
Graph 2.8



* This series excludes national accounts household consumption components not included in the ABS Household Spending Indicator.
Sources: ABS; RBA.

Consumer sentiment has remained very weak in the past three months, though it has increased from its trough in April (Graph 2.9). The weakness in sentiment likely reflects a number of factors, including the Middle East conflict, recent cash rate increases, cost-of-living pressures and a softening housing market. However, past analysis has found limited evidence that consumer sentiment is an independent driver of household consumption (over and above fundamental drivers such as household income and wealth, which remain consistent with modest growth in consumption).

Graph 2.9



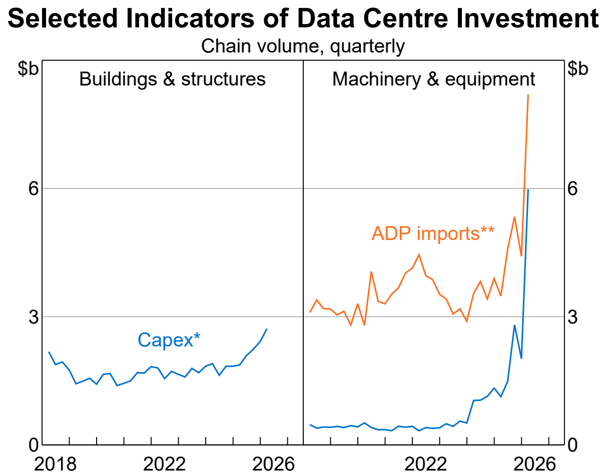
* Mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys; dashed line shows the start of the Middle East conflict.

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

Business investment has grown strongly over the past year, particularly for data centres, and firms' investment plans have generally been revised up despite weak business confidence.

Business investment increased by 10.4 per cent over the year to the March quarter, a much stronger rate of growth than expected. Investment was 5.7 per cent higher in the quarter, relative to expectations for a small decline. This strength was driven most prominently by data centre fit-outs, continuing the very strong growth recorded since mid-2025 (Graph 2.10). Much of this spending was on imported machinery and equipment, which limited the boost to GDP.

Graph 2.10



* Data for the information media & telecommunications industry in the Private New Capital Expenditure Survey.

** Total Australian imports of automated data processing equipment for data centres and other industries.

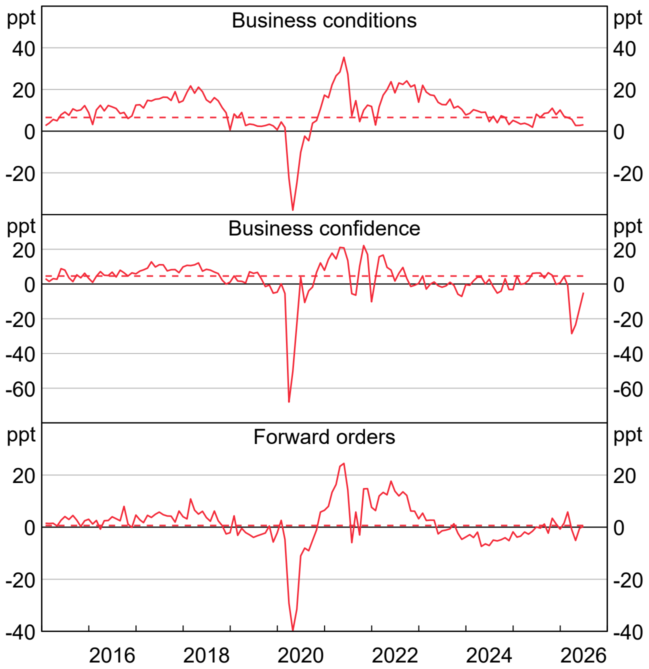
Sources: ABS; RBA.

Surveyed business conditions have declined only modestly over recent months, and forward orders are currently around their average level (Graph 2.11). These measures tend to map more closely to activity than does business confidence (an indicator of forward-looking sentiment). Despite improving for the third consecutive month, business confidence remained negative in June; it is lowest in the transport industry, likely due to its exposure to uncertainty and higher input costs associated with the Middle East conflict.

Graph 2.11

Business Sentiment and Forward Orders*

Net balance



* Dashed lines represent the long-term average of each series from 1997 onwards.

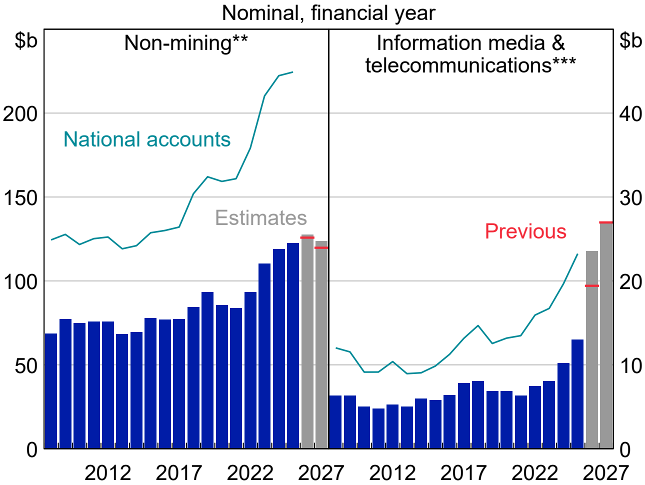
Sources: NAB; RBA.

Despite low business confidence, nominal capital expenditure intentions suggest the level of business investment will remain high, supported by investment in data centres. Capital expenditure intentions for 2026/27 – surveyed by the ABS in April and May – point to continued near-term growth in nominal business investment. This is being driven by strong growth in capital expenditure intentions for data centres (Graph 2.12). The scale and spillovers from this investment are uncertain but are expected to support investment in electricity and water infrastructure, reflecting government expectations that developers contribute to the infrastructure needed to accommodate new capacity. The outlook for other industries' capital expenditure intentions is more mixed, and there remains a risk that investment plans could be downgraded if uncertainty and weak business sentiment were to persist for some time.

Graph 2.12

Non-mining Capital Expenditure*

Nominal, financial year



* Estimates are firms' expected capital expenditure, adjusted for historical average difference between expected and realised spending.

** Excluding the information media & telecommunications industry.

*** Includes data centres.

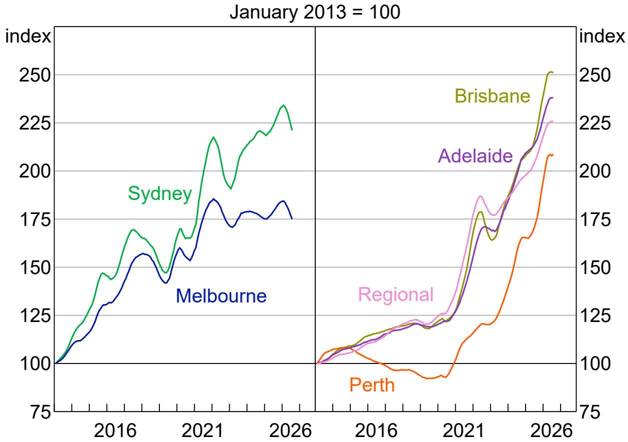
Sources: ABS; RBA.

Conditions in the established housing market have eased by more than expected.

Dwelling investment continued to grow as expected in the March quarter, to be 3.5 per cent higher over the year. Strong dwelling investment growth has contributed to rising capacity pressures in the construction sector since the second half of last year, after an easing over the preceding couple of years. Residential building approvals continued to increase in the March quarter, as there is typically a lag between increases in the cash rate and housing construction activity.

More timely data show that housing price growth and activity in the established housing market have eased by more than assumed in the May forecasts. Average housing prices have declined by 1.6 per cent from their peak in March (Graph 2.13). Sydney and Melbourne prices have declined by the most, though price declines have become increasingly broad-based. Auction clearance rates have continued to fall and are below their long-run averages, while measures of housing market sentiment have declined.

Graph 2.13
Housing Prices
January 2013 = 100



Sources: Cotality; RBA.

The easing in the housing market reflects a combination of the changed outlook for the cash rate in late 2025, actual cash rate increases in the first half of 2026, the broader economic environment and announced tax changes for property investors. The softening in sentiment and housing price growth started soon after policy rate expectations began to increase late last year, and momentum has slowed following increases in the cash rate. More recently, federal government policy changes have likely contributed to the easing in housing market sentiment, particularly among investors (see Chapter 1: Financial Conditions). Modelling from a range of external commentators suggests that the tax policy changes could reduce housing prices by 0–5 per cent in the long run. The recent easing in prices comes after a period of significant increases; housing prices are around 5 per cent higher than a year ago and are around 50 per cent higher since the start of the pandemic.

Recent budgets have not materially changed our view of the outlook for public demand and the fiscal stance.

Public demand was weaker than expected in the March quarter, growing by 0.1 per cent in the quarter and 2.5 per cent over the year. This reflected a decline in public consumption, which fell by 0.2 per cent in the quarter, driven by the end of the National Energy Bill Relief scheme and softer-than-expected spending on health-related programs (including Medicare, PBS and the NDIS). Public investment increased by 1.1 per cent in the quarter, broadly in line with expectations, reflecting continued strength in defence and state and local government investment.

All states and territories have released updated budgets since the May *Statement*, but these have not materially changed our view of the outlook for public demand (see Chapter 3: Outlook).

These budgets imply a smaller consolidated underlying budget deficit for 2025/26 than previously expected, but the outlook for the deficit beyond that is little changed. Estimates of the fiscal balance provide a broader indication than public demand of how fiscal policy may be affecting aggregate demand, as they incorporate a wider range of government spending as well as taxes and transfers. The smaller deficit for 2025/26 is primarily driven by higher federal government tax receipts as well as higher tax receipts and royalties for Queensland. Beyond the current financial year, upward revisions to projected receipts were broadly offset by higher projected spending, leaving the deficit little changed. The consolidated budget balance is projected to remain in deficit but narrow over the forecast period.

2.4 Labour market and wages

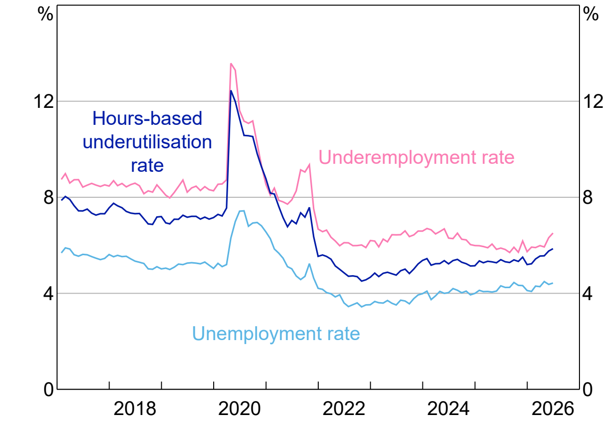
Labour market conditions have eased a little recently and the unemployment rate in the June quarter was higher than anticipated in May. Part of this easing appears to have been caused by subdued hiring in the early stages of the Middle East conflict, perhaps reflecting firms taking a 'wait-and-see' approach amid heightened uncertainty. Strong employment growth in June and a pick-up in employment intentions reported in the RBA's liaison program suggest that some of this caution may have since unwound. Timely indicators of labour demand, such as vacancies and job advertisements, are consistent with labour market conditions being stable in the near term or easing only gradually. Taking all of these measures into account, we continue to assess that labour market conditions remain a little tight (see section 2.6: Assessment of spare capacity). Wages growth was stable in early 2026, though growth in broader measures of labour costs were weaker than expected.

Labour market conditions have eased by a little more than expected in recent months.

The unemployment rate was unchanged at 4.4 per cent between the months of May and June (Graph 2.14). For the June quarter as a whole, the unemployment rate averaged 4.4 per cent, above our May *Statement* forecast of 4.2 per cent. The underemployment rate increased to 6.5 per cent in June, reaching its highest level since August 2024, although it remains low by historical standards. The hours-based underutilisation rate – a broader measure of spare capacity – has also increased in recent months.[2]

Graph 2.14

Labour Underutilisation



Sources: ABS; RBA.

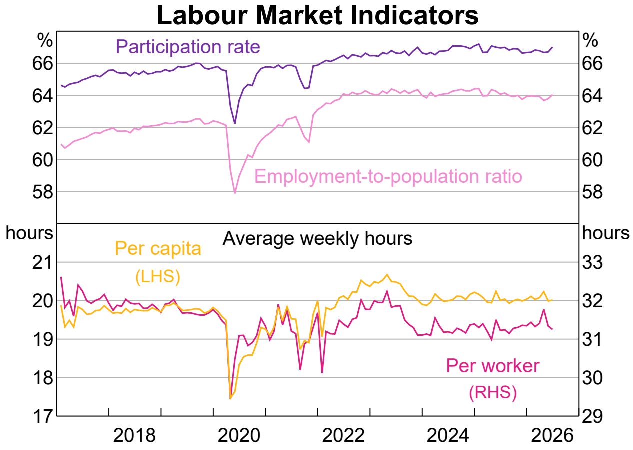
The employment-to-population ratio declined over the quarter, while the participation rate was broadly unchanged (Graph 2.15). In the June quarter, the employment-to-population ratio was 63.8 per cent, weaker than we expected in May. This reflects broadly flat employment through April and May, when the outlook was particularly uncertain, followed by strong employment growth in the month of June.

The participation rate remained at 66.8 per cent, which was in line with our expectations, although this was largely due to a strong pick-up in the month of June, which may partly reflect monthly volatility.

The participation rate remains around historically high levels, supported by long-run trends such as higher female participation as well as ongoing cost-of-living pressures, possibly partly offset by the greater difficulty for the unemployed of finding a job over the past year.

Graph 2.15

Labour Market Indicators



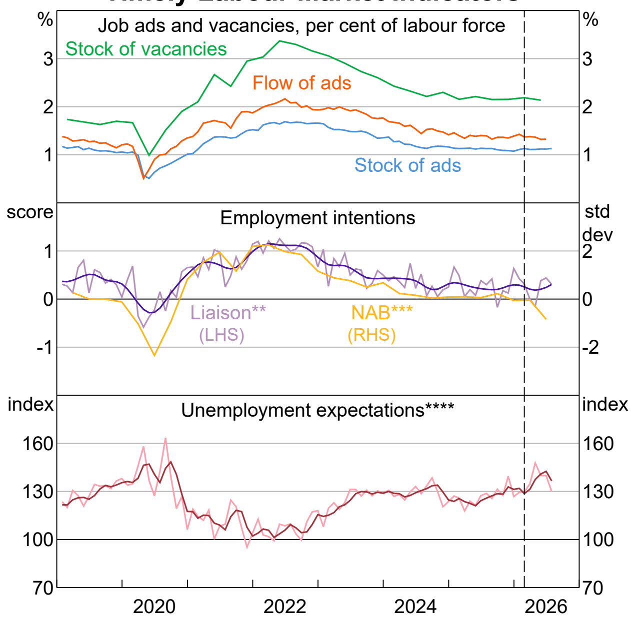
Sources: ABS; RBA.

After rising sharply in April, average hours per worker and per capita have since declined, with both measures now around their levels at the beginning of the year (Graph 2.15). The increase in hours worked earlier in the year may have reflected workers increasing their labour supply in response to cost-of-living pressures and heightened uncertainty related to the Middle East conflict. It may have also reflected firms meeting demand by increasing hours for existing staff rather than hiring additional workers in the early stages of the conflict (with the subsequent decline due to a resumption of hiring, consistent with strong employment growth in June). Alternatively, these movements may reflect monthly volatility.

Leading indicators are consistent with labour market conditions being stable or easing only gradually in the near term. Job advertisements and vacancies have been broadly stable over recent months (Graph 2.16). While employment intentions from business surveys fell over the quarter, the measure from the RBA's liaison program recovered after a slowing in April which some firms linked to uncertainty related to the Middle East conflict. Households' unemployment expectations ticked down in May and June, unwinding the large uptick in April. Taken together, these data suggest that there may have been some 'wait-and-see' behaviour in firms' hiring decisions that has since unwound.

Graph 2.16

Timely Labour Market Indicators*



* Dashed line shows the start of the Middle East conflict.
** Score of 0 indicates a firm has reported no change; dark line shows Henderson trend.
*** 12 months ahead; standard deviations from mean.
**** Dark line shows three-month moving average.
Sources: ABS; ANZ–Indeed; JSA; NAB; RBA; Westpac–Melbourne Institute.

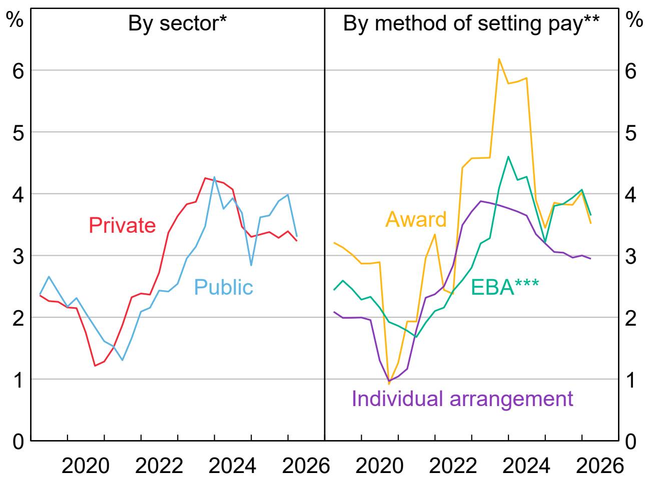
Aggregate wages growth remained stable through to the March quarter 2026, as expected in May, although broader measures of labour income growth eased by more than expected.

The wage price index (WPI) increased by 3.3 per cent over the year to the March quarter, as expected in May. Private sector WPI growth remained steady at 0.8 per cent in the quarter and 3.2 per cent over the year, as expected. Wages growth for workers on individual arrangements – which tends to be most responsive to current labour market conditions – eased slightly to 2.9 per cent over the year. Public sector WPI growth slowed to 0.5 per cent in the quarter, and 3.3 per cent in year-ended terms, reflecting a smaller-than-average number of public sector wage increases in the quarter (Graph 2.17).

Graph 2.17

Wages Growth

Year-ended



* Seasonally adjusted.
** Non-seasonally adjusted.
*** Enterprise bargaining agreement.
Source: ABS.

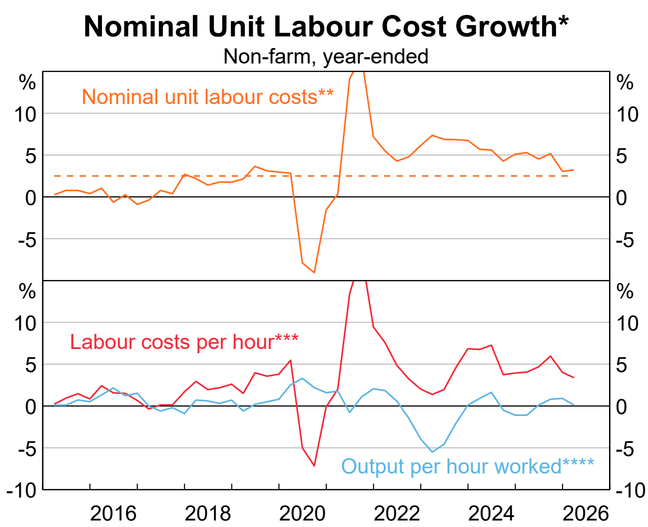
In its annual wage review, the Fair Work Commission (FWC) announced a 4.75 per cent increase to all modern award wages. This increase took effect from 1 July and directly affected the approximately 20 per cent of employees that are paid under a modern award, constituting about 10 per cent of the wage bill. A further 5 to 10 per cent of employees are estimated to be indirectly affected through agreements linked to the award rate. The increase to award wages was slightly higher than assumed in May. The annual wage review and other one-off administered decisions made by the FWC are together expected to contribute directly to a modest pick-up in wages growth over the year ahead (see Chapter 3: Outlook). Beyond this direct effect, some firms have reported in liaison that the FWC decision and recent elevated CPI outcomes have featured in bargaining discussions for workers that are not covered by awards.

Growth in the national accounts' measure of average earnings (AENA) continued to ease in the March quarter. AENA growth was weaker than expected, easing to 3.4 per cent in year-ended terms, in part due to strength in total hours worked. AENA tends to be a more volatile measure of labour costs than WPI and so provides a noisier read on wage pressures arising from conditions in the labour market.

Growth in unit labour costs has fallen over the past year, notwithstanding a small increase in year-ended growth in the March quarter.

Unit labour costs (ULCs) grew by 3.3 per cent over the year to the March quarter, a little weaker than expected. Growth in ULCs has fallen over the past year, alongside the easing in average earnings growth. However, growth remains above the rate consistent with inflation being sustainably at the midpoint of the target band (Graph 2.18), consistent with still-tight labour market conditions, largely because of weak productivity outcomes (see next section).

Graph 2.18



* Outliers during the COVID-19 pandemic have been truncated.
** Dashed line shown at 2.5 per cent, the rate of nominal unit labour cost growth likely to be consistent with inflation being sustainably at target.
*** Compensation of employees plus payroll taxes less employment subsidies, divided by employee hours worked.
**** Includes self-employed.
Sources: ABS; RBA.

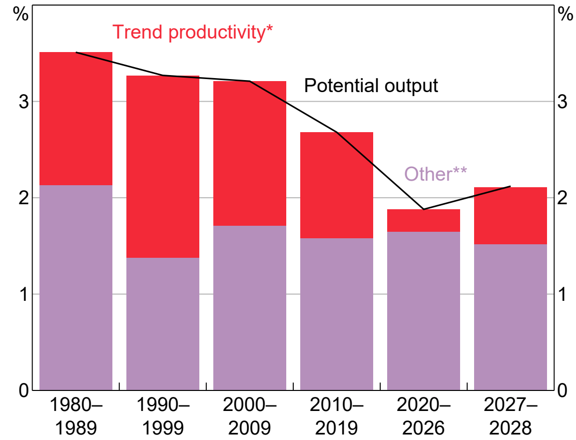
2.5 Potential supply

Potential supply growth has slowed in recent years, reflecting a prolonged period of weak labour productivity growth.

Productivity growth has been very weak in recent years, such that the level of labour productivity is slightly lower than it was prior to the pandemic. This pattern of weak productivity growth has continued recently. Non-farm labour productivity grew by just 0.1 per cent over the year to the March quarter, weaker than expected in May, and fell by 0.6 per cent in the quarter. Productivity in the market sector excluding agriculture grew by 0.2 per cent over the year to the March quarter, while productivity in the non-market sector was unchanged.

Slower productivity growth has contributed to a decline in potential output growth compared with previous decades. Our estimate of the medium-term trend rate of productivity growth remains at 0.7 per cent per year, which is lower than in the past.[3] As a result, the growth rate of the economy's potential supply (or potential output) – that is, its capacity to produce goods and services without generating inflationary pressures – is also lower than previously (Graph 2.19). This helps explain why there is evidence of capacity pressures in the economy despite the relatively subdued average rate of GDP growth (particularly on a per capita basis) over recent years.

Graph 2.19
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).
** Other contributions from population, participation and average hours growth.
Source: RBA.

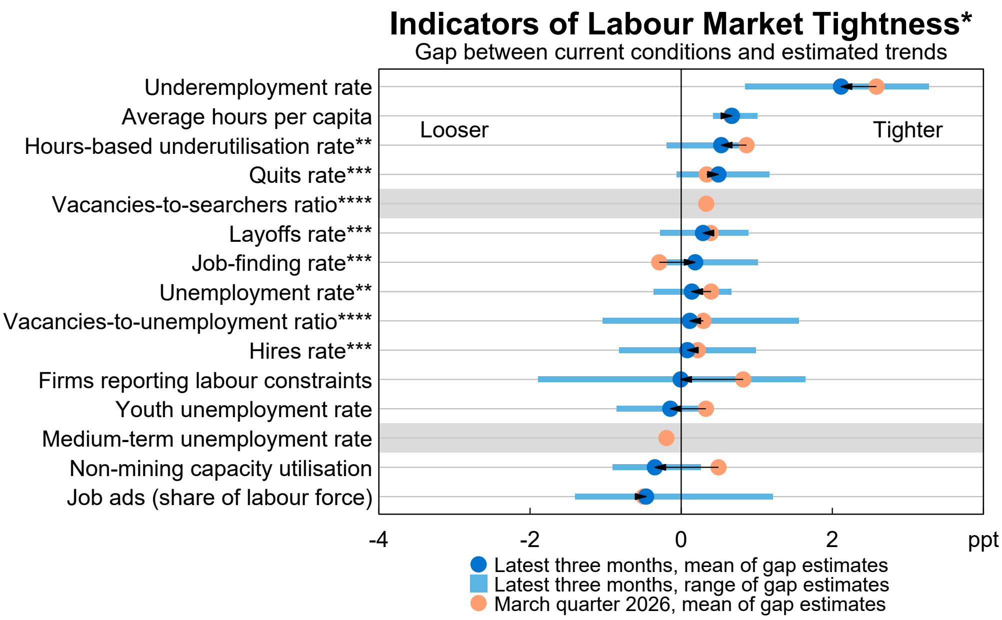
2.6 Assessment of spare capacity

The slowing in demand growth recently is helping to bring overall demand closer to potential supply, though we assess that some capacity pressures remain in the labour market and broader economy. Consistent with slightly weaker-than-expected labour market conditions, we assess the output gap to be a little smaller than anticipated in May.

Labour market conditions are judged to remain a little tight, despite easing a little over recent months; there is, as usual, considerable uncertainty around this judgement.

A majority of the labour market indicators we monitor are close to or tighter than their estimated trend levels (Graph 2.20).[4] The underemployment rate, average hours worked per capita and hours-based underutilisation rate in particular point to some tightness in the labour market. By contrast, job ads (as a share of the labour force) and non-mining capacity utilisation are below their estimated trends. A majority of indicators suggest some easing in conditions over recent months.

Graph 2.20

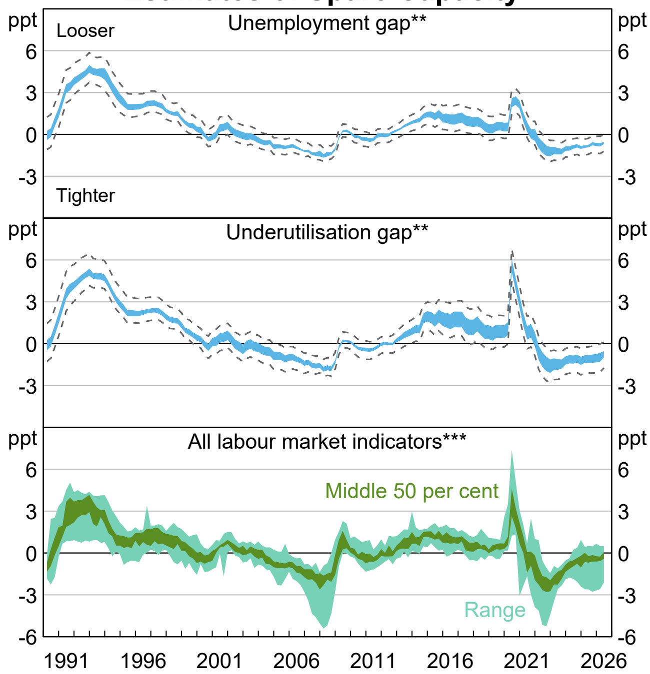


* Indicators scaled to the units of the unemployment rate; data for greyed-out indicators are only available to March 2026 due to changes to the Labour Force Survey (see May 2026 SMP, Box B).
** Range includes model-based estimates.
*** Estimates based on a smaller sample from April 2026 onwards due to changes to the Labour Force Survey.
**** Log-transformed.
Sources: ABS; ANZ–Indeed; NAB; RBA.

Model-based estimates of the non-accelerating inflation rate of unemployment (NAIRU) continue to point to a tighter labour market than suggested by our broader set of indicators. The unemployment and underutilisation gaps implied by the model-based estimates narrowed a little in the June quarter, although all models in the suite continue to suggest that labour market conditions are tighter than full employment (upper and middle panels in Graph 2.21). However, these estimates are uncertain, especially given the temporary cost shocks currently affecting inflation. The dark green range in the lower panel of Graph 2.21 summarises information from the broader suite of labour market indicators discussed above. These indicators also suggest that some capacity pressure remains in the labour market – though to a lesser extent than suggested by the model-based estimates.
The implications of uncertainty around our assessment of spare capacity are discussed further in Chapter 3: Outlook.

Graph 2.21

Estimates of Spare Capacity*



* June quarter 2026 values are partial estimates.
** Blue-shaded region shows illustrative range of central gap estimates from a selection of models; grey dashed lines are the maximum and minimum one-standard-error confidence intervals from the selection of models.
*** Range of the mean benchmark of each indicator.
Sources: ABS; ANZ–Indeed; NAB; RBA.

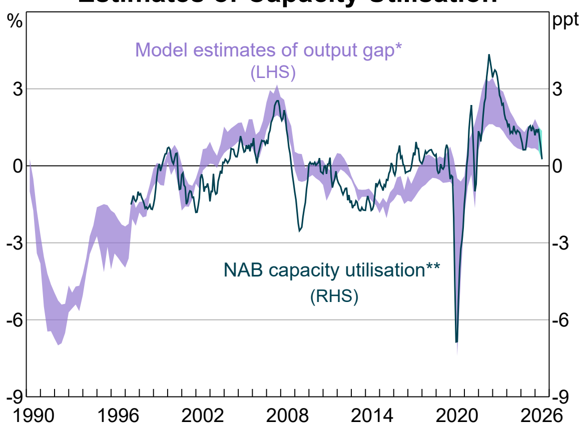
We continue to assess that there are some economy-wide capacity pressures, though the output gap is now estimated to be a little smaller than we thought in May.

Indicators of broader capacity utilisation suggest that capacity pressures have eased recently, although signals across sectors are mixed. The NAB measure of capacity utilisation has declined to around its long-run average (and below some estimates of its trend level). By contrast, residential vacancies data show that utilisation of the housing stock remains elevated, consistent with ongoing strength in advertised rents growth, despite some easing in recent quarters. Retail vacancy data suggest that utilisation of retail property has continued to increase. Information from liaison suggests conditions are also mixed across states – for example, in construction, contacts suggest capacity constraints are binding in Queensland and Western Australia more than in New South Wales and Victoria.

Taking survey evidence together with model-based estimates of the output gap, we assess that the output gap remained positive in the first half of the year, though the economy moved closer to balance over this period (Graph 2.22). Our current estimate of the output gap for the March and June quarters is slightly smaller than estimated in May, consistent with labour market conditions being a little weaker than expected. There is, however, significant uncertainty around estimates of the degree of capacity pressures (see Chapter 3: Outlook).

Graph 2.22

Estimates of Capacity Utilisation



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

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

Sources: ABS; NAB; RBA.

2.7 Inflation

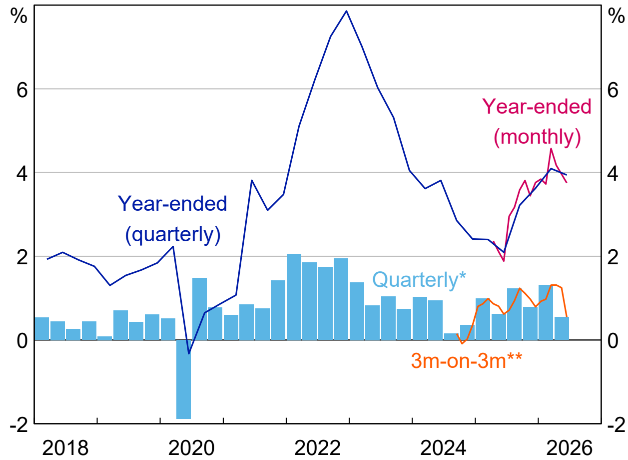
Headline inflation in the June quarter remained well above target, albeit materially lower than expected in the May *Statement* because of softer-than-expected fuel and travel price inflation. Underlying inflation also remained elevated, though slightly below our May forecast. The elevated rate of underlying inflation reflects capacity pressures in the economy and labour market, along with the effects of higher input costs due to the Middle East conflict. Consistent with our May forecast, inflation remained high in components closely linked to domestic capacity pressures, such as market services and new dwellings.

Headline inflation in the June quarter was materially weaker than expected in the May *Statement.*

Headline inflation was 3.9 per cent over the year to the June quarter, having eased slightly from the March quarter (Graph 2.23), and 3.8 per cent over the year to the month of June. The June quarter outcome was substantially lower than the 4.8 per cent expected in the May *Statement*. This primarily reflected weaker-than-expected outcomes for automotive fuel and travel prices. Over the June quarter, retail prices for automotive fuel declined much more quickly and to lower levels than expected at the time of the May *Statement*, reflecting both global developments and lower retail margins for petrol (see section 2.1: Commodity price developments related to the Middle East conflict); however, fuel prices picked up again over July. Inflation for domestic and overseas travel was also lower than expected in the June quarter, with the effect of higher jet fuel costs on travel prices being more muted than anticipated.

Graph 2.23

Headline Inflation

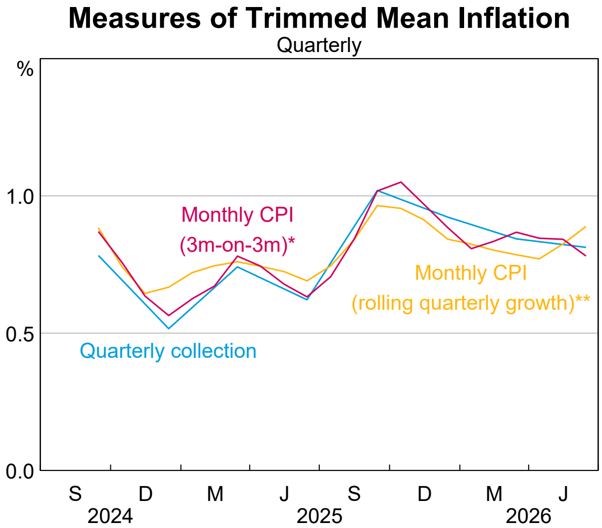


* Seasonally adjusted.
** Three-month-on-three-month percentage change; seasonally adjusted.
Sources: ABS; RBA.

Underlying inflation remained elevated in the June quarter, but was a little lower than expected in the May *Statement*.

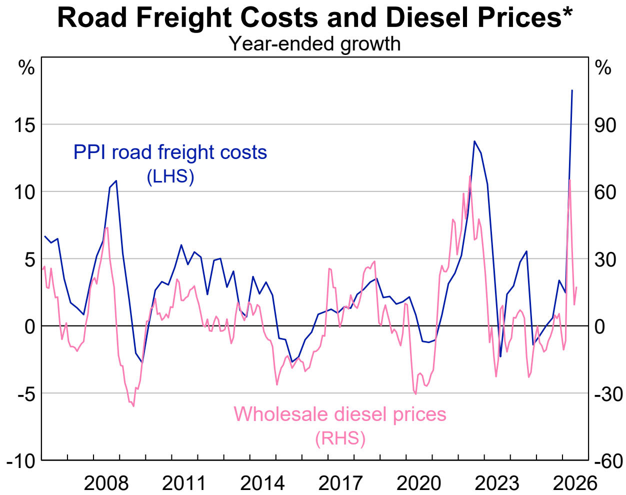
The quarterly rate of trimmed mean inflation was 0.8 per cent in the June quarter, the same as in the March quarter. In the June quarter, trimmed mean inflation increased to 3.6 per cent on a year-ended basis, up from 3.5 per cent in the March quarter but slightly below our May forecast. Various measures of underlying inflation from the monthly CPI show a similar pattern and have been broadly steady since earlier in the year (Graph 2.24). The softer-than-expected fuel and travel price outcomes in the June quarter contributed to trimmed mean inflation being a little lower than expected.[5]

Graph 2.24



* Calculated based on the distribution of three-month-on-three-month price changes.
** Calculated as the three-month-on-three-month growth in the monthly trimmed mean index.
Sources: ABS; RBA.

Graph 2.25



* For the PPI series, year-ended growth in the quarterly index; for the diesel prices series, year-ended growth in the monthly average of the terminal gate prices.
Sources: ABS; Australian Institute of Petroleum; RBA.

Elevated underlying inflation reflects a combination of capacity pressures in the domestic economy and, in some sectors, cost pressures related to the Middle East conflict. Based on the CPI data received to date, we judge that conflict-related cost effects (excluding the direct effect of retail fuel prices) contributed a bit more than 0.1 percentage points to trimmed mean inflation in the June quarter. This was a little less than we expected in May, although this estimate is uncertain. Pass-through of conflict-related costs was evident in new dwelling costs and, to a lesser extent, groceries prices (see below). Capacity pressures in the economy and labour market are also judged to have contributed to the high rate of underlying inflation in the quarter, as expected.

The Middle East conflict is raising firms' input costs, though pass-through to consumer prices has been limited so far.

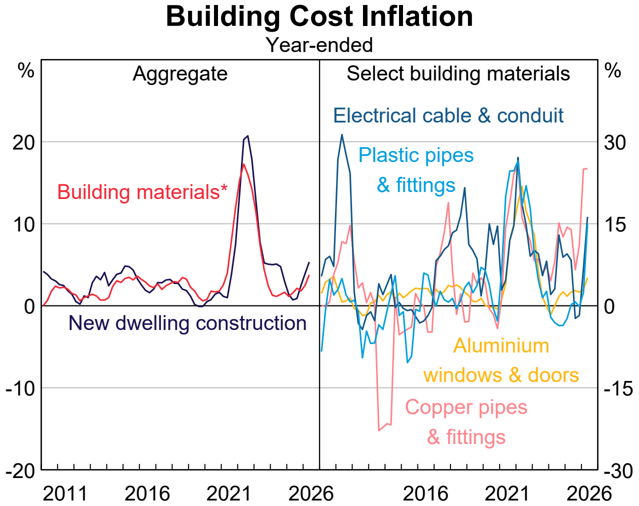
The conflict in the Middle East has contributed to upward pressure on non-labour costs for firms. The cost of several types of building materials increased sharply in the June quarter (see below) and import price data indicate sharp rises in the cost of some fertilisers, such as urea. Other cost increases have affected a broader range of firms. Most notably, the cost of transporting goods around the country by road increased by over 15 per cent in the June quarter (Graph 2.25).

These cost pressures are judged to have contributed to higher prices for some items in the June quarter, although these effects were a little smaller and less broad than expected in May. The increase in building materials costs is likely to have supported new dwellings inflation in the June quarter, and the increase in fertiliser costs is also judged to have contributed to price increases in some groceries (see below). Outside of these items, however, the effects on consumer prices across the CPI basket to date appear to have been limited, and a little smaller than we expected. For example, on average, consumer prices for items with a higher share of oil-derived input costs (e.g. fuel and fertiliser) did not tend to increase by more than would be expected given other determinants, such as the degree of tightness in the labour market and pre-conflict developments in import prices. Liaison information suggests that, while many homebuilders have passed on at least part of the construction materials cost increases, pass-through of above-average costs has been mixed in other sectors, with many consumer-facing firms closely monitoring demand conditions when making pricing decisions (see Box A: Insights from Liaison). Similarly, the ABS Business Conditions survey indicates that a large share of firms had absorbed fuel cost increases in May and June. We expect conflict-related costs to pass through supply chains to consumer prices until around early 2027 (see Chapter 3: Outlook).

Inflation remained elevated across most sectors, picking up for new dwellings and easing a little for rents.

New dwelling construction prices increased by 1.8 per cent in the June quarter and were 5.3 per cent higher in year-ended terms (Graph 2.26). This was stronger than expected in the May *Statement*, and we judge that this reflects larger conflict-related cost effects than we had anticipated. Liaison information suggests that homebuilders faced cost pressures for some construction materials, particularly oil-derived products. The data received to date suggest that part of these upstream cost pressures were passed on to consumer prices. Strong new dwelling price inflation came against the backdrop of an easing in price growth and activity in the established housing market over recent months (see section 2.3: Domestic economic activity). However, new dwelling costs tend to lag conditions in the established housing market, so it is likely too soon for the easing in housing market conditions that began late last year to have affected new dwellings inflation.

Graph 2.26

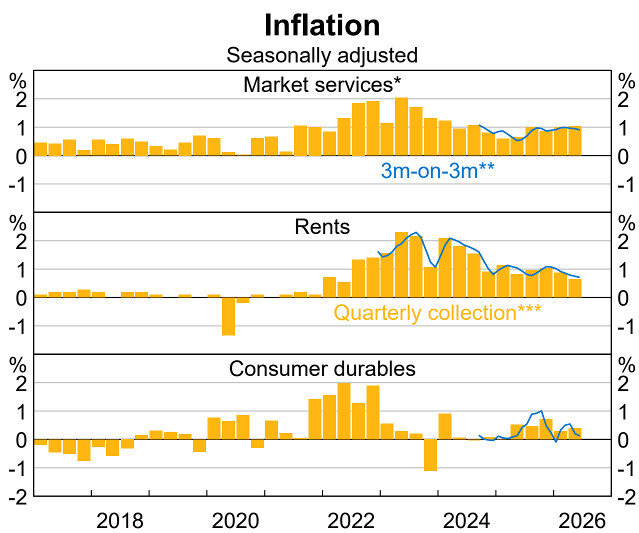


* Input prices for house construction from the PPI.
Sources: ABS; RBA.

CPI rent inflation eased slightly to 0.6 per cent in the June quarter and 3.6 per cent in year-ended terms, which was weaker than expected in May (Graph 2.27). Although strong advertised rental growth and low rental vacancy rates continue to point to tightness, we have seen limited upwards pressure on CPI rent inflation. It is possible that flow-through of rental market tightness to the stock of CPI rents may be more muted or occur more slowly than we had previously expected.

Market services inflation continued to be elevated in the June quarter at 1.0 per cent (Graph 2.27). Inflation in year-ended terms picked up to 3.9 per cent from 3.5 per cent. We assess that this largely reflects ongoing capacity pressures and, to a lesser extent, the cost effects from the conflict. The prices of these services are typically among the most sensitive to domestic conditions, and stronger inflation for market services since mid-2025 is consistent with capacity pressures in the economy and labour market. Liaison contacts in the hospitality sector reported an increase in costs in April, with many upstream firms raising or passing on fuel surcharges. CPI data received through June suggest that some firms may have passed on part of these costs to consumer prices.

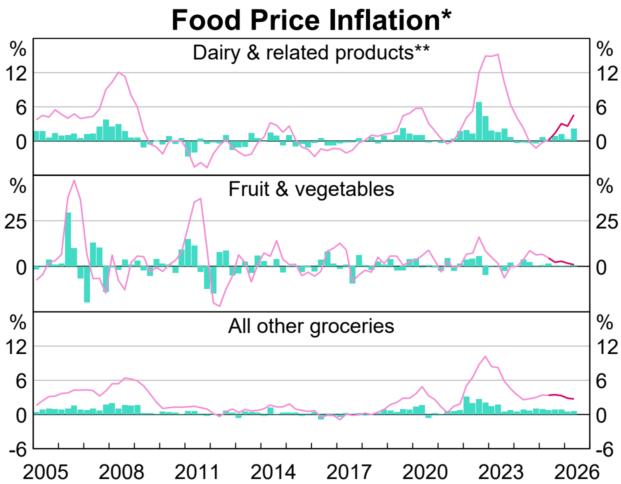
Graph 2.27



* Excludes domestic holiday travel & accommodation and telecommunications.
** Three-month-on-three-month percentage change.
*** Quarterly percentage change.
Sources: ABS; RBA.

Retail goods inflation was slightly weaker than expected in the June quarter. Prices for groceries (including fruit and vegetables) increased, but by less than we had anticipated. Prices for some dairy items, such as milk and cheese, increased sharply, at least partly reflecting increases in costs owing to the Middle East conflict (Graph 2.28). Consumer durables inflation was broadly as expected at 0.4 per cent in the June quarter and 1.9 per cent in year-ended terms.

Graph 2.28



* Lines show year-ended inflation. Dark pink line is monthly collection, light pink line is quarterly collection. Bars show quarterly inflation from quarterly collection. Adjusted for the tax changes of 1999–2000.
** Includes milk, cheese and other dairy products.
Sources: ABS; RBA.

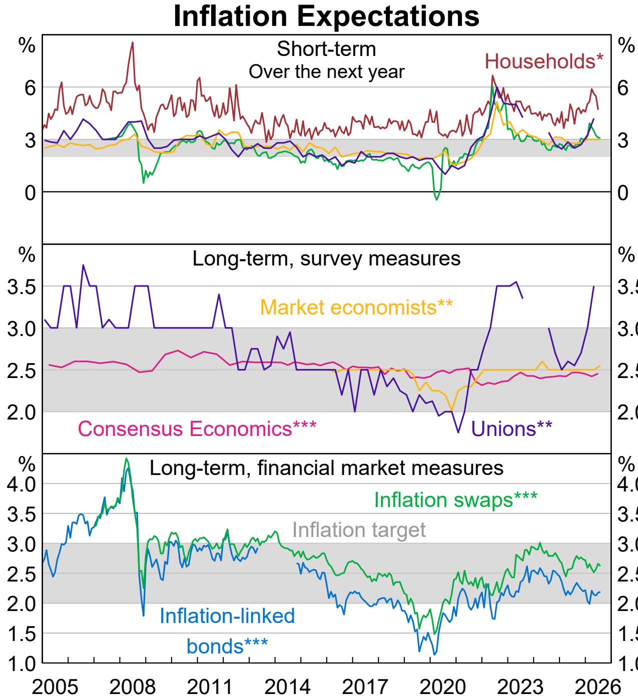
Inflation for goods and services with administered prices (excluding utilities) remained high in the June quarter, at 4.2 per cent in year-ended terms. Medical and hospital services inflation rose owing to the annual increase in health insurance premiums in April, which was the largest since 2017. Prices for public transport fell sharply as the Victorian and Tasmanian governments introduced free public transport in April; this more than offset increases in rideshare prices from higher fuel costs. Utilities prices inflation remained elevated at 15.2 per cent over the year to the June quarter, reflecting the expiry of energy bill rebates.

Short-term inflation expectations remain elevated, while most long-term measures remain consistent with achieving the inflation target.

Households' short-term inflation expectations remain above their long-run average but have eased to levels observed at the beginning of the year. The earlier run-up in short-term inflation expectations coincided with the start of the Middle East conflict and increase in fuel prices. The more recent easing in expectations coincided with the decline in fuel prices over May and June, although fuel prices have subsequently increased again. Similarly, financial market measures of near-term expectations remain elevated but have eased recently (see Chapter 1: Financial Conditions).

Elevated inflation expectations can contribute to higher realised inflation, as households and firms take expected inflation into account when making decisions about wages, prices and spending. While most measures of longer term expectations remain consistent with the inflation target, the pace at which short-term inflation expectations ease from their current elevated levels is a key risk to the outlook for wages growth and inflation (Graph 2.29) (see Chapter 3: Outlook).

Graph 2.29



* 30 per cent trimmed mean of responses to question on 'prices of things you buy'.

** Inflation expectations for unions are unavailable between November 2023 and May 2024. Long-term expectations are the average over the next 5–10 years.

*** Long-term expectations are the average over the five years starting from five years ahead.

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

Endnotes

1 Retail margins are the difference between retail and wholesale (or terminal gate) prices; wholesale margins are the difference between the wholesale price, excluding the fuel excise, and regional benchmark prices for refined fuel. Lower-than-expected wholesale margins for diesel may partly reflect a faster-than-expected normalisation in wholesalers' freight costs, which rose sharply following the onset of the conflict.

2 As a result of changes to the Labour Force Survey (see RBA (2026), 'Box B: Changes to the Labour Force Survey', *Statement on Monetary Policy*, May), estimates for hours-based underutilisation from April 2026 onwards have been constructed using preliminary ABS underemployment and underutilisation ('u-series') data.

3 See RBA (2025), 'Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth', *Statement on Monetary Policy*, August.

4 Some labour market indicators have been affected by changes to the Labour Force Survey from April 2026 onwards. See RBA (2026), 'Box B: Changes to the Labour Force Survey', *Statement on Monetary Policy*, May.

5 When inflation for a good or service is lower than expected and it is excluded from the items used to calculate the trimmed mean, it can nevertheless reduce trimmed mean inflation by bringing lower-inflation items than otherwise into the set of observations used to calculate the trimmed mean.

Box A: Insights From Liaison

This Box highlights key messages collected by the RBA's liaison teams in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 240 businesses, industry bodies, government agencies and community organisations from early-May to early-August 2026.

Liaison contacts report some moderation in business conditions since the start of the year, with demand growth easing across a range of sectors and regions. Firms continue to note ongoing cost pressures for both labour and non-labour inputs. While input cost and availability concerns stemming from the Middle East conflict are less acute than was the case a few months earlier, the effects on costs and prices are expected to persist for some time. Investment and employment intentions are currently around or a bit below their longer run averages.

Firms continue to report elevated cost inflation, but increasingly note that customer price sensitivity is constraining pass-through to selling prices.

As global and domestic fuel prices declined over late May and June, many of the fuel surcharges introduced at the height of the Middle East conflict began unwinding. This eased direct and indirect fuel cost pressures from their earlier peaks, but a range of contacts report that fuel and logistics costs remain above pre-conflict levels, particularly where suppliers have built higher fuel costs into base prices. Firms also note continued uncertainty around the outlook for these costs given the ongoing conflict.

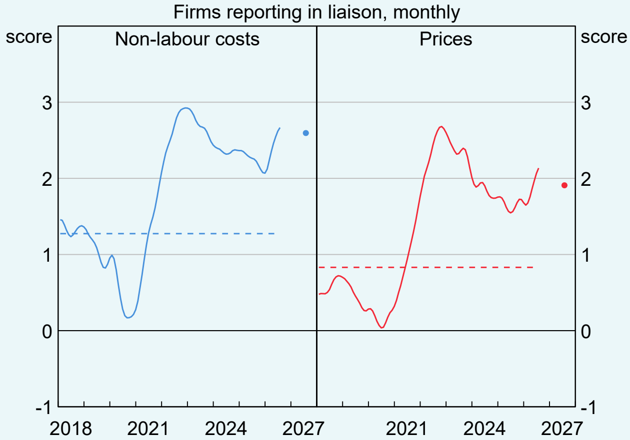
Availability of oil-derived inputs such as PVC pipes, plastics and fertiliser is not currently being flagged as an immediate challenge, though remains a watchpoint for some businesses. The cost of many of these products remains higher than pre-conflict levels. Firms in the construction sector report that this is adding to new build costs, which is being passed on through rise-and-fall provisions in commercial builds or in sales prices for home building (although less so in markets where demand has been softer). Trade labour costs have also risen, particularly where workers are attracted to stronger interstate markets or where there is competition for resources across infrastructure and non-residential construction.

More generally, firms across many industries report that growth in business costs has been above average and is expected to remain so in the near term (Graph A.1). This in part reflects some pass-through of recent fuel price costs into upstream supply chains and logistics costs, with some expectation that this will persist for a while longer. Firms also note ongoing inflation in other non-labour operating costs, such as IT (including recurrent software fees as well as other operating expenses) and other professional and support services.

Graph A.1

Non-labour Costs and Prices*

Firms reporting in liaison, monthly



* Solid lines are outcomes over the 12 months before each observation, with the series averages since 2001 shown as dashed lines; dots are expectations over the next 12 months from July 2026; smoothed with a 13-month Henderson trend; a score of 0 indicates a firm has reported no change.

Source: RBA.

Firms increasingly note that pass-through of these costs is being constrained by customer price sensitivity. While firms reported a pick-up in selling prices growth over recent months, some moderation is expected over the year ahead. Prices are expected to grow by less than costs, consistent with many firms reporting some modest margin compression.

Demand growth has moderated across a range of industries since the start of the year.

Firms are generally noting that demand conditions have eased since early 2026. Consumer-facing liaison contacts – particularly those in consumer durables retailing, accommodation and hospitality – report that demand growth has softened in recent months but remains positive, with households more cautious and price-sensitive than at the start of the year. Community service organisations continue to report elevated demand for their services, underscoring ongoing cost-of-living pressures.

While many housing builders continue to work through their existing pipelines, construction activity is expected to slow over the year ahead given lower sales volumes over recent months. Developers also note that sales momentum is softening, although demand for greenfield land continues to exceed supply in some regions. Contacts cite a range of drivers for this softer sales outlook, including higher interest rates and borrowing costs, elevated construction costs and the uncertain outlook for housing prices (in part due to tax and other policy changes). Demand conditions for construction and property development remain weaker in Victoria than other states.

Firms' investment intentions have eased in recent months but remain positive; fewer firms expect to be undertaking above-average capex over the year ahead. A number of contacts have indicated a cautious outlook, noting the potential for project delays and increases in input costs (including further fuel price increases) and that uncertainty about the economic outlook is still elevated. Some firms have already reported increased input costs and minor delays in project timelines, but are still going ahead with planned investments.

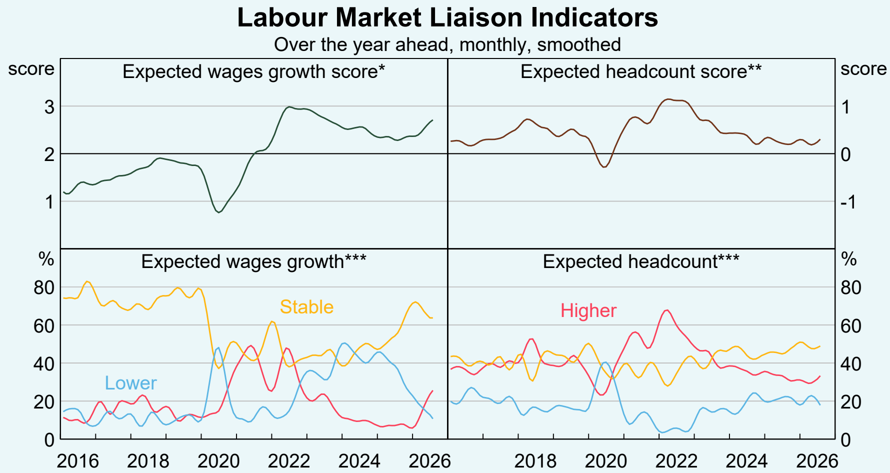
Data centre investment is strong at present, and developers and builders continue to see a strong near-term pipeline of this activity, although there is uncertainty about how long buoyant demand conditions will last. Domestic availability of materials and contractors is generally not a significant constraint; most activity in this sector is occurring in New South Wales and Victoria where capacity constraints are less binding than in other regions.

Contacts in Queensland continue to flag concerns around construction industry capacity in that state given the large pipeline of planned residential, non-residential and infrastructure projects.

Wages growth expectations have lifted, while firms' employment intentions have steadied over recent months.

Firms regularly note that wages remain a key source of upward cost pressure, with many firms reporting above-average wages growth expectations for the year ahead (Graph A.2). Firms note a factor in this is employee expectations, which remain elevated in light of persistent cost-of-living pressures. The Fair Work Commission's decision in June 2026 to increase award wages by 4.75 per cent was higher than most business contacts had expected. Consistent with this, there has been a marked lift in the share of firms expecting wages growth to pick up over the year ahead.

Graph A.2



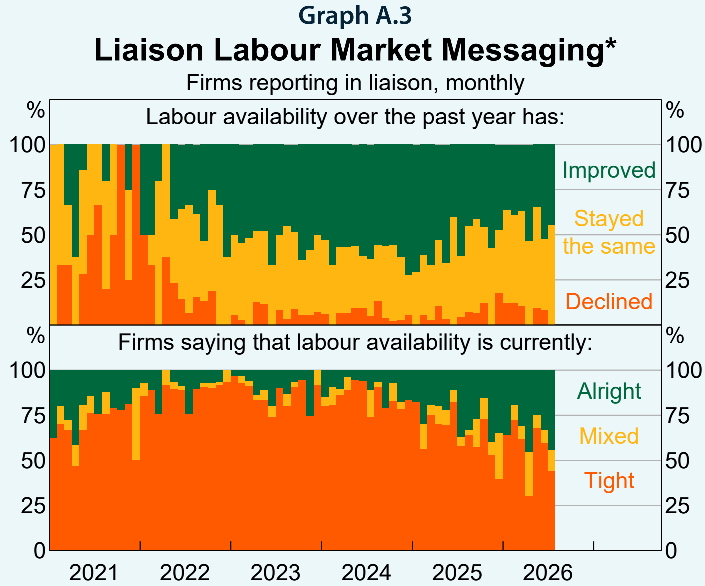
* A score of 2 indicates around-average expected growth in wages.
** A score of 0 indicates no expected change in headcount.
*** Share of contacts.
Source: RBA.

Employment intentions remain a bit below their longer run average. Partly to manage labour cost growth, close to half of firms in liaison are reporting they plan to hold headcount stable over the year ahead. The share of firms expecting to increase headcount remains below average though has ticked up a little recently; such firms typically cite expected good demand conditions as well as business expansions or project work as driving these planned headcount increases. As concerns around the effects of the Middle East conflict became less acute over recent months, the share of firms expecting to reduce headcount unwound a little.

Contacts generally report labour availability has stabilised or improved compared with a year earlier (Graph A.3). Even so, many contacts still note some labour market tightness and are actively competing for labour, and sourcing staff with appropriate skills and experience remains challenging in many industries.

Adoption of AI is not widely being reported as a factor behind headcount reductions – instead, most firms see AI as a tool for supporting revenue growth without a commensurate increase in their cost base. While the majority of firms in liaison report they are investigating AI usage in some form, most are in the early stages of adoption and AI has not yet materially changed how tasks are being performed. There are, though, a small minority of firms making substantially larger investments and related business changes.

Graph A.3



* Share of liaisons discussing each measure.
Source: RBA.

Chapter 3
Outlook

Summary

- **Consumer price inflation in Australia is elevated, and underlying inflation is expected to remain above the target band for some time.** Inflation is expected to ease over the next couple of years as somewhat restrictive financial conditions reduce capacity pressures in the domestic economy and the pass-through of higher costs related to the Middle East conflict are assumed to unwind. There are risks on both sides of this projection, but on balance we judge those risks are skewed to the upside. This includes the risk of greater pass-through of cost pressures related to the conflict to consumer prices, a more persistent conflict in the Middle East than assumed, or stronger spillovers to domestic capacity pressures from AI-related investment.
- **Our central projections are conditioned on the market curves for global oil prices and the cash rate, which imply that oil prices gradually recede from current levels and interest rates will be largely unchanged over the forecast period.** The oil price assumption is similar to that assumed in May. Based on financial market pricing, the forecasts assume less than one full cash rate increase by the end of 2026, before a small reduction in the cash rate further out; the cash rate path is around 25 basis points lower than the path underpinning the May forecasts.
- **The outlook for growth in Australia's major trading partners has been revised higher in the near term, as strength in AI-related activity continues to drive growth in high-income east Asian economies.** This follows a series of upside surprises to growth in recent quarters. Growth forecasts for economies outside east Asia are broadly unchanged from the May *Statement on Monetary Policy*, with the effects of the Middle East conflict on activity evolving largely as expected to date.
- **Against this backdrop, headline inflation in many economies is expected to remain above central bank targets into 2027.** We view the risks around this projection to be skewed to the upside. Fuel-related costs would increase if the Middle East conflict continued for longer than expected or global energy markets can no longer adjust to the disruption as they have in recent months. Furthermore, strong growth in technology-related activity may be sustained for longer than expected, flowing through to aggregate demand as well as higher consumer prices and business costs.
- **Australian GDP growth is expected to slow over 2026 before recovering gradually over the remainder of the forecast period.** GDP growth is expected to be subdued in 2026, as high inflation (which dampens household disposable income), the easing in established housing market conditions and the recent tightening in monetary policy combine to weigh on growth. Beyond 2026, growth is expected to pick up gradually as some of these headwinds ease but to remain below potential growth as financial conditions are assumed to remain somewhat restrictive.

- **Subdued GDP growth will weigh on labour demand, with the unemployment rate forecast to increase gradually to 4.8 per cent by end-2028.** This represents a modest upward revision since the May *Statement*, largely reflecting the higher starting point for the unemployment rate.
- **The slowing in demand growth is expected to return overall demand and potential supply to balance in 2027, after which some spare capacity emerges in both product and labour markets.** Our estimates of annual potential output growth have been revised slightly higher to average a bit over 2 per cent over the forecast period due to an upward revision to the population assumption. Productivity growth is projected to pick up over the forecast period to its assumed medium-run trend. We judge that the economy is likely to reach balance somewhat earlier than previously estimated and this will help reduce inflationary pressures in the economy.
- **The central projection for underlying (trimmed mean) inflation is very similar to that in May.** Both headline and underlying inflation are expected to remain elevated in the near term owing to existing capacity pressures in the economy and the pass-through of fuel and other conflict-related costs to consumer prices. Underlying inflation is expected to remain above 3 per cent until mid-2027 before declining to the midpoint of the 2–3 per cent target range in 2028 as capacity pressures and conflict-related cost pressures ease.

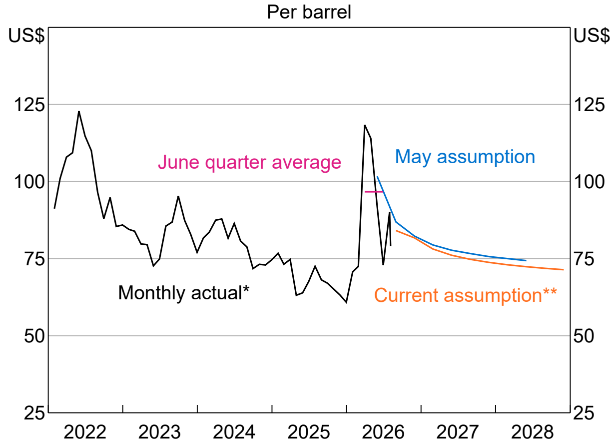
3.1 Key judgements in the forecast

The central forecast incorporates many judgements, such as the choice of models used and whether to deviate from the models given the signal from recent data or qualitative information from liaison. These judgements are extensively considered and debated during the construction of the forecast. The three most important judgements for our current assessment of the economic outlook are discussed below.

Key judgement #1 – There is progress towards resolution of the Middle East conflict over the second half of this year, but geopolitical tensions remain elevated.

Underpinning our central forecast is the assumption that the conflict in the Middle East gradually de-escalates and global trade flows continue to adjust to the evolving geopolitical environment, including a partial recovery in shipping volumes through the Strait of Hormuz. Oil prices are assumed to decline gradually over the forecast period but remain above pre-conflict levels, consistent with the latest Consensus forecasts (Graph 3.1). The spread between prices for refined fuel and Brent oil is assumed to return to historical average levels by early 2027.

Graph 3.1
Brent Oil Price
Per barrel



* Monthly actual for August 2026 is the price as at 5 August 2026.
** Based on Brent crude oil futures prices as at 5 August 2026.
Sources: Bloomberg; LSEG; RBA.

Our central forecasts for global and domestic growth implicitly assume that broader geopolitical uncertainty will remain elevated for some time. There is a possibility that renewed or broader hostilities in the Middle East region lead to an even more protracted disruption to global energy markets than in our central forecast, which was more fully explored in the adverse scenarios in the May *Statement*.

Key judgement #2 – Financial conditions remain restrictive enough to keep growth below potential and for the labour market to ease gradually.

We assess that some capacity pressures currently remain in the economy and labour market, contributing to inflation being above target (see Chapter 2: Economic Conditions). The forecasts are conditioned on a market path for the cash rate that increases by around 10 basis points over 2026 before declining to around 4.4 per cent towards the end of the forecast period. This is around 25 basis points lower than the path that underpinned the May forecasts. The assumed cash rate path remains a bit above the top of the range of estimates of the neutral cash rate, both from our models and market economists (see Chapter 1: Financial Conditions). Notwithstanding the significant uncertainty associated with these assessments, financial conditions are assumed to remain restrictive over the forecast period. This contributes to a period of below-trend growth that is sufficient to bring the economy back into balance in the first half of 2027, with spare capacity then emerging in the economy further out.

Consistent with below-trend economic growth, labour market conditions are expected to continue to ease over the forecast period. However, this easing is expected to be gradual. While labour market outcomes in the June quarter were weaker than expected, we judge that this primarily indicated a temporary easing in hiring in the early stages of the Middle East conflict rather than a materially weaker-than-expected outlook over the forecast period. This is consistent with the continued stability of leading indicators of labour demand, including job advertisements, and the recent rebound in employment intentions from the RBA's liaison program (which had eased after the onset of the conflict).

Key judgement #3 – Fuel and other conflict-related costs will add to inflation in the near term but contribute to the decline in inflation over the latter part of the forecast period as costs ease.

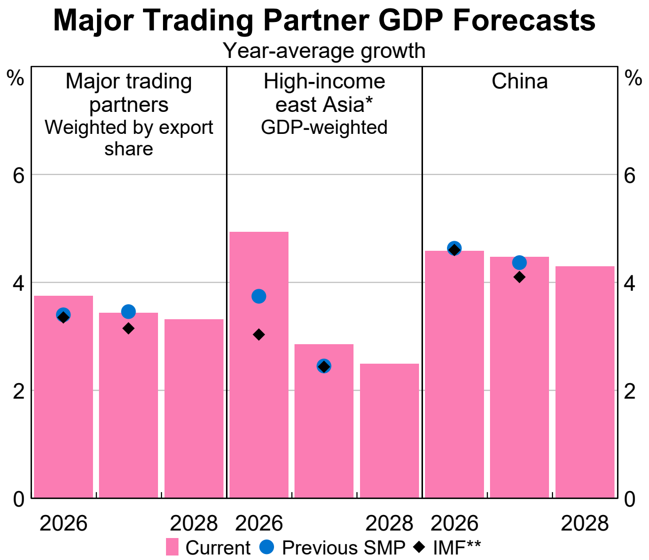
We assess that the pass-through of some of the higher costs of fuel and other inputs related to the Middle East conflict pushed up consumer price inflation in the June quarter and will continue to do so until around mid-2027. Empirical evidence from previous episodes suggests that a shock to oil prices tends to put upward pressure on prices for a range of goods and services, although the size and timing of this pass-through will depend on many factors. Similar to the forecast judgement in the May *Statement*, we continue to judge that the pass-through of these cost pressures to consumer prices will be relatively fast given existing capacity pressures in the economy. We also continue to expect that higher household inflation expectations will have some near-term impact on wage-setting processes. These upward effects on wages growth are assumed to be small, however, owing to the easing in the labour market at the same time. We assume conflict-related cost pressures will wane from mid-2027 onwards, contributing to a decline in wage and price inflation. These effects will be difficult to discern, though we will continue to assess this judgement over time, including by drawing on liaison information.

3.2 The global outlook

The outlook for major trading partner (MTP) growth has been revised higher in the near term; the boost to growth from AI-related activity, especially in east Asia, is expected to more than offset the adverse effects of the Middle East conflict.

Growth in Australia's MTPs, which has been stronger than expected over the past year in part due to the boom in AI-related investment, is now expected to be 3.8 per cent in 2026 (Graph 3.2). MTP growth is then expected to ease to 3.4 per cent in 2027 and 3.3 per cent in 2028, with the pace of growth in AI-enabling technology activity assumed to moderate and momentum in Chinese growth continuing to slow. The outlook for growth in Australia's MTPs is broadly in line with the International Monetary Fund's projections from the April 2026 *World Economic Outlook* and July 2026 *Update*, although there are some slight differences for individual countries and regions.

Graph 3.2



* High-income east Asia is a GDP-weighted average of South Korea, Taiwan, Hong Kong and Singapore.
** IMF forecasts from the July 2026 WEO Update for China and the April 2026 WEO for major trading partners and high-income east Asia.
Sources: ABS; CEIC Data; Consensus Economics; IMF; LSEG; RBA.

GDP growth across high-income east Asia has been revised higher since the May *Statement*, reflecting stronger-than-expected direct effects and spillovers from the global AI investment boom. Demand for semiconductors and other AI-enabling technologies has continued to support exports, industrial production and business investment in economies like South Korea and Taiwan that are deeply integrated into regional technology supply chains. The outlook for 2027 has not been materially revised and forecasters continue to expect growth in the region to slow considerably. However, there is a risk that growth proves stronger than currently expected if recent momentum reflects the early stages of a more sustained structural upswing in capital expenditures and production.

By contrast, the outlook for growth in other overseas economies is little changed from May, with growth prospects for each economy largely contingent on its reliance on energy imports. Middle-income east Asian economies (excluding China) are among the most exposed to the adverse effects of the Middle East conflict, reflecting their reliance on imported energy and the relatively high share of energy in some economies' consumption baskets. However, some of these economies, like Malaysia and Vietnam, are also benefiting from integration into AI-related value chains. Outside east Asia, Consensus forecasts for other advanced economies are also little changed from May. In the euro area and the United Kingdom, both net importers of energy, growth in 2026 and 2027 is expected to remain subdued. By contrast, the United States is expected to continue outperforming other major advanced economies, supported by ongoing strength in AI-related investment and lower reliance on energy imports.

The outlook for the Chinese economy is little changed from the May *Statement*, although our assessment is that the composition of growth is expected to shift. We continue to expect that any direct effects from the conflict-related disruptions on China will be relatively small and short-lived, given that the Chinese economy is less reliant on oil and gas for its domestic energy needs and has high levels of reserves of oil and refined products. We now expect authorities to rely more heavily on infrastructure investment to underpin economic activity through the second half of this year and into 2027. Recent policy announcements and the 15th Five-Year Plan suggest that China appears likely to remain committed to an investment-led growth model, rather than a more material rebalancing toward domestic consumption. Exports are expected to support growth in China over the year ahead, underpinned by the ongoing global AI investment cycle and the structural expansion of China's manufacturing capacity. Although growth in the June quarter was weaker-than-expected, year-average GDP growth is still forecast to be 4.6 per cent in 2026, while growth in 2027 has been revised slightly higher to 4.5 per cent, before easing to 4.3 per cent in 2028.

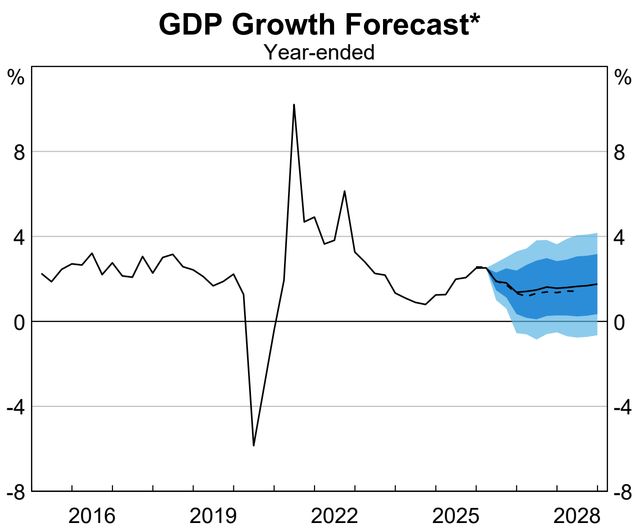
Headline inflation is expected to remain above target into 2027 across many economies due to elevated energy prices and, in some cases, the strength of AI-related demand. Pass-through to underlying measures of inflation from conflict-related cost increases is likely to be larger for economies where capacity pressures have been more pronounced. At the same time, we have revised our near-term outlook for globally traded goods inflation higher, reflecting the recent strength in AI-related goods prices. Export prices for semiconductors and technology-related machinery and equipment have risen rapidly across Asia, increasing by substantially more than expected at the time of the May *Statement*. However, there is a risk that price growth remains at current rates and/or capacity pressures spread to other segments of AI-related supply chains, generating stronger global inflationary pressures than currently assumed in our central forecasts (see Key risk #1).

3.3 The domestic outlook

Australian GDP growth is expected to slow over 2026 before recovering gradually over the remainder of the forecast period; GDP growth remains below our estimate of potential growth throughout the forecast period.

GDP growth is expected to be subdued over 2026 (Graph 3.3). Private demand grew strongly in 2025 and early 2026, contributing to capacity pressures in the economy. Growth in private demand is expected to moderate over the remainder of the year as several headwinds weigh on activity. These include the reduction in household disposable incomes from higher inflation related to the Middle East conflict, weaker conditions in the established housing market, and the tightening in monetary policy earlier in the year. Beyond 2026, growth is expected to pick up gradually as some of these headwinds ease but to remain below potential as financial conditions remain somewhat restrictive.

Graph 3.3



* 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.

Relative to the May forecast, a stronger population growth assumption has led to slightly higher GDP growth over most of the forecast period, all other things equal. Our population assumptions are based on estimates from the Australian Government, which were revised between the 2025 Mid-year Economic and Fiscal Outlook and the May 2026 budget. An increase in population adds to both supply and demand in the economy; as such, these changes are judged to have a broadly neutral effect on the balance of aggregate supply and demand.

However, the outlook for GDP per capita in 2026 has been revised down, driven by a more significant easing in the established housing market than was expected in May. Housing prices are assumed to continue to decline gradually for a period, reflecting the tightening in monetary policy earlier in the year, tax policy changes and the general economic environment. Lower housing prices weigh on household consumption by reducing household net wealth and spending related to housing turnover. Weaker housing prices also reduce the incentive to build new homes, although this channel is expected to be smaller than it has been historically given the large pipeline of work yet to be done. From 2027 onwards, growth in GDP per capita is expected to be a bit stronger than previously expected, reflecting a slightly lower market path for interest rates, the recent depreciation of the exchange rate, a gradual recovery in housing prices and the stronger outlook for data centre investment. The level of GDP per capita in mid-2028 is expected to be broadly unchanged from the May forecasts.

Business investment is expected to grow strongly over most of the forecast period, with the outlook for data centre-related investment revised upwards. Business investment in the March quarter was much stronger than expected, driven by data centre investment, and firms' surveyed expectations of future investment have been revised up over recent quarters. External projections of data centre spending through to 2030 have also been revised up of late and are consistent with a strong pipeline of data centre investment over coming years. That said, it is likely that this investment will be volatile from quarter-to-quarter because a significant share of expenditure is on imported IT equipment that is delivered in discrete batches. There is also considerable uncertainty around the extent of data centre investment that will occur over coming years, which will depend on a range of factors such as government policy, future demand for AI services and there being sufficient capacity to build and operate these facilities. We estimate that much of this additional investment will be imported and so the effects on GDP growth are judged to be relatively modest. We are continuing to assess potential spillovers from this spending on domestic capacity pressures; at this stage, most of this investment is occurring in New South Wales and Victoria where capacity constraints are less binding (see Box A: Insights from Liaison).

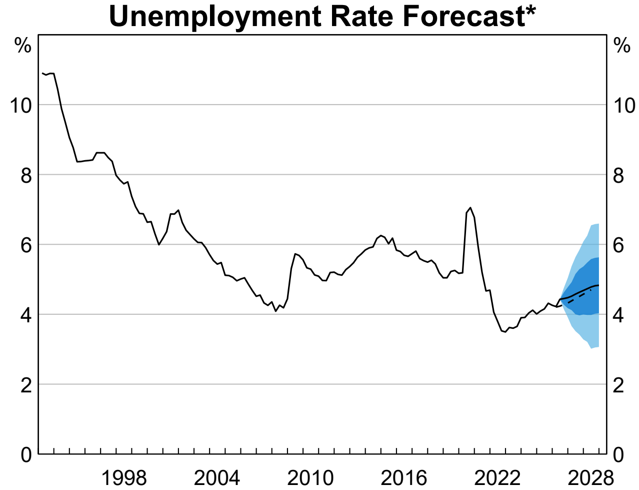
Public demand is expected to continue supporting growth over the forecast period. Recent budgets have not materially changed the outlook for public demand, with the small upward revisions to the forecast largely reflecting stronger population growth, broad-based increases across public consumption and some increases in state government investment plans.

The labour market is expected to ease gradually over the forecast period.

The unemployment rate is forecast to increase to 4.8 per cent by the end of 2028 (Graph 3.4). The gradual easing in labour market conditions is consistent with subdued GDP growth weighing on labour demand (see Key judgement #2). The modest upward revision to the unemployment rate since the May *Statement* is due to both the higher starting point for the unemployment rate and a slightly faster-than-expected easing of capacity pressures.

The employment-to-population ratio is expected to decline gradually through to late 2028. We expect employment growth to recover somewhat after some firms appeared to pause hiring in the early stages of the Middle East conflict; strong employment data in June and a recovery in employment intentions across the RBA's liaison program provide some support for this. Job advertisements have been broadly stable since the beginning of 2025 and are consistent with labour market conditions being stable in the near term or easing gradually. Over the longer term, employment growth is forecast to be a little higher than in the May *Statement* because of higher expected population growth, with the employment-to-population ratio revised a little lower owing to the weaker starting point and slightly faster-than-expected easing of capacity pressures.

Graph 3.4



* 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.

The participation rate, which has declined a little over the past year, is expected to be little changed for the rest of the forecast period. Job-finding rates, which have declined in recent years, are expected to remain low – reflecting subdued economic growth – reducing the incentive to seek work. This is expected to be largely offset by the long-run upward trend in female participation, as well as cost-of-living pressures that encourage people to enter or remain in the labour force.

Subdued growth in demand is expected to bring the economy into balance in 2027, with spare capacity then emerging in the economy later in the forecast period.

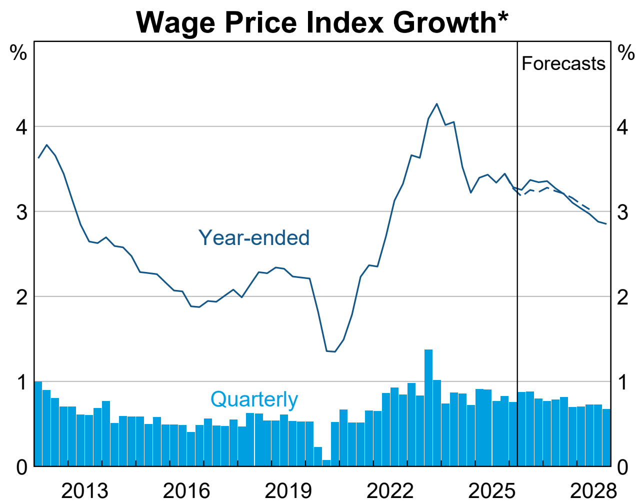
The staff's assumption for potential output growth is slightly higher than in the May *Statement*, reflecting an upward revision to the population growth assumption (as discussed above). Potential output growth is now expected to be a little bit above 2 per cent in 2027 and 2028. The assumption for trend labour productivity growth is broadly unchanged from May. Higher population growth is expected to add to both demand and supply in the economy, so the change in the assumption does not affect our assessment of capacity pressures over the forecast period.

Capacity pressures in the economy are expected to dissipate a bit earlier than previously estimated, although there is considerable uncertainty in this assessment in both directions. The activity forecasts imply that the labour market and the economy return to balance in 2027, with the economy operating with some spare capacity in the back half of the forecast period. However, the impact of conflict-related costs on inflation over the period ahead will make it difficult to assess the degree of underlying capacity pressures in the domestic economy.

Wages growth is expected to be slightly stronger in the near term than forecast in May, before easing alongside softening labour market conditions.

The forecast for year-ended wages growth has been revised higher until September quarter 2027. In the near term, nominal wages growth is expected to be supported by strong growth in public sector wages following some large increases across several enterprise agreements, the flow-through of the Annual Wage Review to award wage earners and other administered decisions. We also expect that elevated short-term inflation expectations will be a consideration in wage bargaining in the near term as workers seek to preserve real wages. Firms in the RBA's liaison program are expecting an increase in wages growth over the year ahead, with many citing inflation as a key driver. Wages growth is expected to moderate from mid-2027 in line with easing labour market conditions and inflation, falling to 2.9 per cent in year-ended terms at the end of the forecast period (Graph 3.5).

Graph 3.5

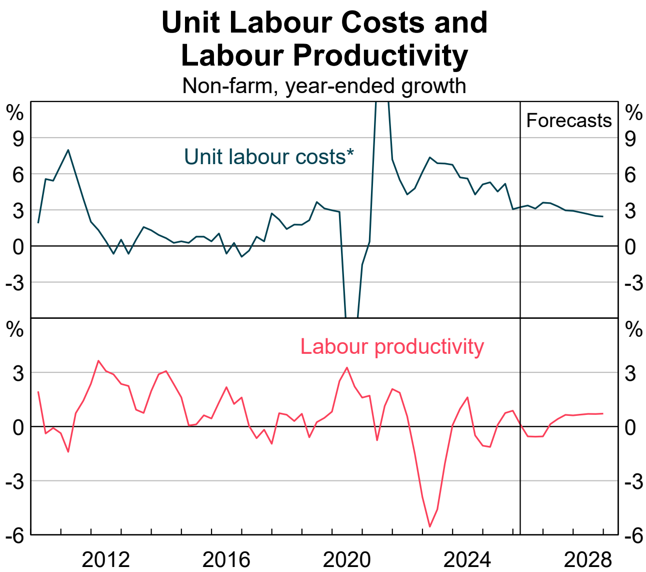


* Dashed line shows previous SMP forecast; seasonally adjusted.
Sources: ABS; RBA.

Unit labour costs are forecast to ease gradually from elevated levels.

Year-ended growth in unit labour costs (ULCs) is expected to be broadly stable in coming quarters before easing towards the end of the forecast period. Growth in nominal ULCs – the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes – is expected to remain somewhat elevated in the near term. Year-ended growth in ULCs is then expected to moderate from early 2027 onwards, alongside slowing nominal wages growth and a slight pick-up in productivity to its assumed medium-term trend growth rate of 0.7 per cent per year (Graph 3.6).

Graph 3.6

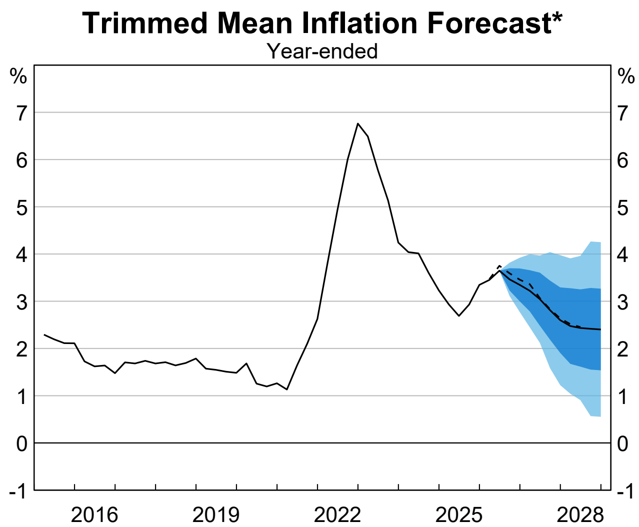


* Outliers during the COVID-19 pandemic have been truncated.
Sources: ABS; RBA.

Underlying inflation is forecast to remain elevated in the near term, before easing back towards the 2–3 per cent range as capacity pressures and conflict-related cost pressures fade.

Trimmed mean inflation is expected to remain above 3 per cent until mid-2027, before easing to 2.5 per cent by early-2028 (Graph 3.7). The quarterly rate of underlying inflation is expected to remain high throughout the remainder of 2026. This reflects our judgement that existing capacity pressures in the economy will persist for a time, with additional upward pressure from higher costs arising from the Middle East conflict. As capacity pressures ease alongside somewhat restrictive financial conditions and as the pass-through from conflict-related costs dissipates, underlying inflation is then expected to reach or be a bit below 2.5 per cent. The forecast for trimmed mean inflation is little changed relative to the May *Statement*, as a slightly faster easing in capacity pressures is offset by higher import prices and slightly more protracted pass-through of conflict-related cost increases.

Graph 3.7



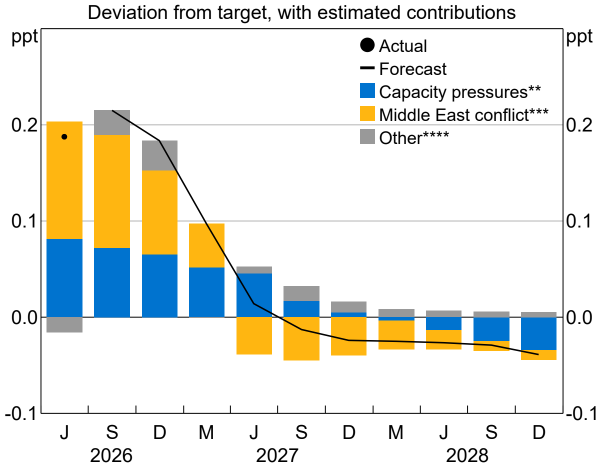
* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.
Sources: ABS; RBA.

Capacity pressures are expected to contribute to underlying inflation remaining above 2 ½ per cent until early 2028. We judge that capacity pressures in the economy and the labour market have placed upward pressure on inflation (see Chapter 2: Economic Conditions). While capacity pressures are forecast to continue to ease given subdued growth in domestic activity, we expect they will contribute to underlying inflation remaining above 2½ per cent until early 2028 (Graph 3.8). The emergence of spare capacity in the economy and the labour market, from next year, will contribute to gradual disinflation.

Graph 3.8

Quarterly Trimmed Mean Inflation Forecast*

Deviation from target, with estimated contributions



* Deviation from a quarterly rate of underlying inflation that is consistent with the midpoint of the target range.

** Includes contributions from the unemployment gap, output gap and nominal unit labour costs in a suite of trimmed mean inflation models.

*** Includes indirect cost effects from the conflict in the Middle East (excluding fuel) and short-term inflation expectations.

**** Includes contributions from some imported goods, automotive fuel and factors not otherwise specified.

Sources: ABS; RBA.

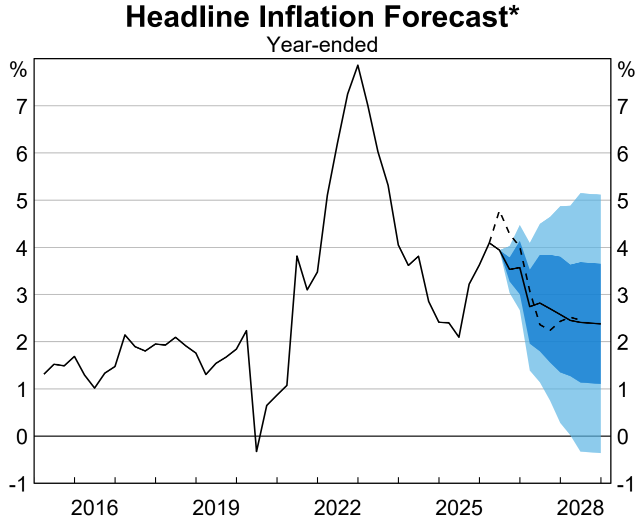
We assess that cost pressures related to the conflict will continue to put upward pressure on headline and underlying inflation in the near term. In the May *Statement*, we anticipated that the pass-through from these cost pressures would be relatively quick given existing capacity pressures. These cost effects are judged to have contributed to higher prices for new dwellings and some groceries in the June quarter, although there was little evidence of pass-through across a broader range of goods and services (see Chapter 2: Economic Conditions). We continue to expect that conflict-related cost pressures will put upward pressure on inflation over the coming months, with these effects easing through early next year (see Key judgement #3). Though highly uncertain, we judge that there will be further pass-through to new dwelling costs, groceries and some other goods, and some services. These cost effects then begin to unwind, contributing to disinflation from mid-2027. The appreciation of the exchange rate over the past year is expected to weigh on inflation in the near term, before the more recent depreciation of the exchange rate and strong growth in prices for globally traded goods contributes to higher inflation from mid-2027 onwards.

We continue to expect that elevated short-term inflation expectations will support the pass-through of conflict-related costs to consumer prices in the near term. Several measures of short-term inflation expectations rose around the beginning of the conflict, and these are judged to have effects on inflation and wages. Some measures of short-term inflation expectations have since eased in line with weaker outcomes for headline inflation and fuel prices, but remain elevated, and there is a risk that inflation expectations may rebound given the recent increase in fuel prices (see Chapter 2: Economic Conditions). We continue to assess that long-term inflation expectations will remain consistent with achieving the inflation target over the medium run, conditional on the assumed path for the cash rate.

Headline inflation is expected to remain high in the near term.

Headline inflation is now expected to have peaked in the June quarter 2026, and is forecast to return to the 2–3 per cent target range by early 2027 (Graph 3.9). The near-term year-ended forecast has been revised lower relative to the May *Statement*, reflecting weaker-than-expected fuel and travel inflation in the June quarter. From that point on, headline inflation is projected to ease along with underlying inflation, to be at or a little below the midpoint of the inflation target throughout 2028. The roll-off of the fuel excise reduction in July and August is expected to boost retail fuel prices and quarterly headline inflation in the September quarter.

Graph 3.9



* 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.

3.4 Key risks to the outlook

Key risk #1 – Global and domestic inflation could be more persistent and/or higher than expected.

Several factors point to the risks to the inflation outlook being skewed to the upside, and we assess there is a greater likelihood of inflation outcomes substantially above the forecast than substantially below it:

- **The conflict in the Middle East escalates and/or energy markets do not adjust as smoothly to the disruption as they have done in recent months, leading to higher cost pressures.** The adverse scenarios outlined in the May *Statement*, in which there is a longer closure of the Strait of Hormuz and greater damage to energy infrastructure, remain plausible tail risks that would lead to much higher inflation (which potentially could be mitigated by weaker demand). Even if there is no material escalation of the conflict, it is possible that global energy markets cannot continue to adjust to the same degree by trade re-routing and the use of inventories.
- **There is more pass-through into consumer prices of cost pressures related to the Middle East conflict than we expect.** Inflation may stay higher for longer if a broader set of inputs are affected, if firms do not fully unwind the assumed decline in costs through to final prices, or if shorter term inflation expectations play a larger role in price dynamics than expected. The elevated rate of inflation and households' inflation expectations may also place more upward pressure on wages growth than anticipated.
- **The global AI investment boom could generate greater inflationary pressures than assumed.** Strong demand for semiconductors and other AI-enabling technologies could prolong capacity constraints in parts of the technology sector or create additional bottlenecks in regional supply chains, leading to stronger goods price inflation. The ramp-up of investment in data centres may also contribute to pricing pressures domestically, particularly by drawing on resources in the construction industry. We may not have centralised enough of these effects on Australian inflation in the forecasts as there is limited evidence – including from the RBA's liaison program – of material spillovers to the broader Australian economy to date.

Key risk #2 – Economic activity could be weaker than expected.

- **The Middle East conflict could have a larger or more persistent negative impact on domestic economic activity than currently assumed.** This could work through a number of channels, including lower overseas demand, increased domestic costs and weaker domestic sentiment. The May forecasts incorporated small negative effects on activity, and the incoming data have largely remained consistent with this assumption. But consumer sentiment remains very low and this could weigh on household consumption at some point, and business confidence also remains somewhat below its long-run average.
- **Established housing prices could decline by more than anticipated in the central projection or the effect on economic activity and inflation could be different than in the past.** The modelling frameworks used in the central forecast capture the historical relationship between housing prices, economic activity and inflation. Much of this reflects both housing prices and activity responding to fundamental economic drivers, including changes in monetary policy. However, the size and scale of the overall impact would depend on the relative importance of housing-specific expectations and how they interact with other developments in the economy.

Key risk #3 – There remains considerable uncertainty around the outlook for productivity growth and the assessment of spare capacity.

- **There is little evidence of a sustained improvement in productivity growth to date.** If productivity growth were to remain subdued over the forecast period rather than pick up modestly as assumed, the economy's supply capacity would be lower than currently expected. Against this, it is possible that faster realisation of the benefits of AI adoption and other technological developments could result in higher productivity growth and productive capacity than assumed in the central forecast. The implications of these risks for inflation depend on how businesses and households would adjust their expectations and spending.
- **Some measures of labour market conditions continue to point to more tightness than currently assumed.** Model-based estimates continue to suggest that labour market conditions are tighter than assumed in the central forecast, which is also informed by a range of labour market indicators and measures of capacity utilisation that point to less excess demand. It is possible that we are understating the extent of labour market tightness.

3.5 Detailed forecast information

Table 3.1 provides additional detail on forecasts of key macroeconomic variables. 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 2026	Dec 2026	Jun 2027	Dec 2027	Jun 2028	Dec 2028
Activity						
Gross domestic product	1.9	1.4	1.5	1.6	1.6	1.8
Household consumption	1.8	1.6	1.6	1.8	1.9	1.9
Dwelling investment	3.6	2.1	0.9	–0.7	–0.8	0.0
Business investment	6.5	4.3	4.2	3.2	1.7	0.2
Public demand	3.6	3.2	3.1	2.8	2.6	2.2
Gross national expenditure	2.8	2.2	2.0	2.2	1.9	1.8
Major trading partner (export-weighted) GDP	3.8	3.4	3.5	3.5	3.3	3.3
Trade						
Imports	6.1	3.6	2.9	3.2	2.5	2.2
Exports	2.4	0.0	0.6	0.7	1.3	2.0
Terms of trade	–3.1	–2.8	0.7	0.5	0.5	1.1
Labour market						
Employment	1.1	1.4	1.2	1.1	1.1	1.2
Unemployment rate (quarterly, %)	4.4	4.5	4.6	4.7	4.8	4.8
Hours-based underutilisation rate (quarterly, %)[c]	5.6	5.8	5.9	6.0	6.1	6.2
Income						
Wage Price Index	3.3	3.3	3.3	3.1	3.0	2.9
Nominal average earnings per hour (non-farm)	2.7	3.0	3.7	3.6	3.4	3.2
Real household disposable income	2.1	1.3	2.0	1.7	1.7	1.7
Inflation						
Consumer Price Index	3.9	3.6	2.8	2.6	2.4	2.4
Trimmed mean inflation	3.6	3.3	3.0	2.6	2.4	2.4
Assumptions						
Cash rate (%)[d]	4.3	4.4	4.5	4.5	4.4	4.4
Trade-weighted index (index)[e]	66.1	65.3	65.3	65.3	65.3	65.3
Brent crude oil price (US$/bbl)[f]	94.9	81.2	75.9	73.6	72.3	71.3
Estimated resident population[g]	1.4	1.4	1.3	1.2	1.2	1.2
Memo items						
Labour productivity[h]	–0.5	–0.5	0.4	0.6	0.7	0.7
Household savings rate (%)[i]	6.1	6.4	6.4	6.2	6.3	6.1
Real Wage Price Index[j]	–0.7	–0.2	0.4	0.5	0.5	0.4
Real average earnings per hour (non-farm)[j]	–1.2	–0.5	0.8	0.9	0.9	0.8

(a) Forecasts finalised on 5 August.

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

(c) Data only available to March 2026 due to changes to the Labour Force Survey. For information about the changes, see RBA (2026), 'Box B: Changes to the Labour Force Survey', *Statement on Monetary Policy*, May.

(d) 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.

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

(f) For the current quarter, Brent crude oil prices are based on observed spot prices to date and market pricing for the remainder of the quarter. Thereafter, Brent crude oil prices are guided by market pricing.

(g) 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.

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

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

(j) 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.