

Statement on Monetary Policy

February 2026

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Overview

Australian economic growth and inflation have both been stronger than expected compared with six months ago. The recent pick-up in inflation has been broadly based and our assessment is that some of the increase in inflation has been driven by capacity constraints that are proving greater than previously anticipated.

Overall, the economy seems to be further from balance than had been assessed last year. Labour market conditions have been broadly steady in recent months and remain a little tight. The inflation outlook has been revised materially higher and inflation is expected to remain above target for some time. Given this, the Monetary Policy Board judged that it was appropriate to increase the cash rate target to 3.85 per cent.

Underlying inflation is higher than expected.

Underlying inflation rose to 3.4 per cent over the year to the December quarter, which was higher than expected three months ago and substantially higher than expected in the August Statement. The pick-up in inflation over the second half of 2025 was observed across a broad range of categories, including for services, retail goods and the cost of building new homes.

Headline inflation increased to 3.6 per cent over the year to the December quarter, which was also stronger than expected in the November Statement. In addition to the pick-up in underlying inflation, the outcome reflected higher inflation for some volatile items such as fuel and travel. The expiry of state electricity rebate schemes contributed around 0.5 percentage points to headline inflation over the past year.

GDP growth has continued to pick up, with private demand growth surprisingly strong.

GDP grew by 2.1 per cent over the year to the September quarter, which was around our estimate of the economy's potential growth rate. More recent data suggest that growth picked up further in the December quarter. In particular, growth in private demand looks to have been especially strong in the second half of 2025.

Household consumption grew solidly in the September quarter and timely indicators of household spending suggest that consumption growth continued to pick up during the December quarter and by much more than expected in the November *Statement*. Growth in dwelling investment has also been stronger than expected, consistent with the broader strength in housing market conditions and a recent increase in capacity pressures in the construction sector. However, some of the recent strength in business investment, which can be lumpy and have a high imported component, is expected to be temporary.

Labour market conditions have been stable.

The unemployment rate has been broadly stable at around 4¼ per cent in recent quarters, and the December quarter outcome was lower than anticipated in the November *Statement*. Other measures of labour underutilisation, such as the hours-based underutilisation rate, have been little changed.

Many of the indicators used to assess where the labour market stands relative to full employment suggest that labour market conditions remain a little tight.

The underemployment rate remains low and firms continue to report difficulty finding suitable workers. Growth in unit labour costs remains elevated.

Overall, capacity pressures in the Australian economy are judged to be greater than previously anticipated. This judgement reflects the strength and breadth of the recent increase in inflation, together with evidence from other indicators, including unit labour cost growth, survey measures of capacity utilisation and a range of other labour market indicators. Recent strength in consumption and investment growth has likely intensified capacity pressures and could continue to do so, to the extent it persists. Taken together, forward-looking indicators of the labour market, along with the recent strength in domestic economic activity, point to labour market conditions remaining a little tight in the near term.

Australian financial conditions eased over 2025, and in light of ongoing strength in activity and inflation, market participants expect the cash rate to increase this year.

Overall, financial conditions eased during 2025 alongside the reductions to the cash rate, with lending rates declining and credit growth picking up noticeably. There is uncertainty about whether financial conditions remain restrictive overall, with mixed signals across indicators. Market participants' expectations for the future cash rate have shifted up further since the November meeting, with expectations for at least two hikes over the forecast period. The Australian dollar has also appreciated against the US dollar and on a trade-weighted basis since the November *Statement*.

Global economic activity has proven resilient.

Global economic growth in the second half of 2025 was more resilient to developments in trade policy than anticipated. Economic growth in Australia's major trading partners has been stronger than expected. This has been supported by the rapid adjustment of international trade flows to higher US tariffs, as well as some product-specific exemptions that have reduced effective tariff rates. Strong US AI-related investment has also supported exports from east Asian economies. That said, trade policy uncertainty remains somewhat elevated, and risks to global growth are judged to remain tilted to the downside.

The recent escalation in geopolitical tensions has had a limited economic effect on Australia and its trading partners to date. However, these pose upside risks to the global inflation outlook, particularly in the near term, along with emerging capacity constraints in AI-related supply chains.

Risk premia in global financial markets continue to be very low despite the recent escalation in geopolitical tensions. Equity prices have risen in most advanced economies over the past three months and corporate bond spreads remain low. Nevertheless, the US dollar has depreciated, and gold and other precious metals prices have continued to increase. If key downside risks to economic activity were to materialise or be reassessed by financial markets, this could prompt a sharp tightening in global financial conditions with potential consequences for the global economy and, in the extreme, financial stability.

The near-term outlook for GDP growth has been revised higher and the outlook for inflation is materially higher.

Year-ended GDP growth is expected to pick up further in the near term as recent momentum persists. From late 2026, more restrictive monetary policy begins to weigh on economic activity, contributing to GDP growth moderating to be below its potential rate. Labour market conditions are expected to be broadly stable in the near term and then ease toward our assessment of full employment as GDP growth slows.

Overall, the level of demand in the economy is expected to come into balance with potential supply by the end of the forecast period, with inflation expected to remain above the target range for some time. Underlying inflation is projected to peak at 3.7 per cent in mid-2026 and remain above the 2–3 per cent range until early 2027; the outlook for headline inflation has also been revised up. As temporary factors that have been contributing to recent inflation outcomes unwind, and the assumed tightening in monetary policy eases capacity pressures, inflation is forecast to decline to be a little above the midpoint by mid-2028.

The Monetary Policy Board decided to raise the cash rate target.

A wide range of data over recent months have confirmed that inflationary pressures picked up materially in the second half of 2025. While part of the pick-up in inflation is assessed to reflect temporary factors, it is evident that private demand is growing more quickly than expected, capacity pressures are greater than previously assessed and labour market conditions are a little tight. The Board judged that inflation is likely to remain above target for some time and it was appropriate to increase the cash rate target. The Board will be attentive to the data and the evolving assessment of the outlook and risks to guide its decisions.

Table: Output Growth, Unemployment and Inflation Forecasts^(a)

Per cent

	Year-ended					
	Dec 2025	June 2026	Dec 2026	June 2027	Dec 2027	June 2028
GDP growth	2.3	2.1	1.8	1.6	1.6	1.6
(previous)	(2.0)	(1.9)	(1.9)	(2.0)	(2.0)	(n/a)
Unemployment rate ^(b)	4.2	4.3	4.3	4.4	4.5	4.6
(previous)	(4.4)	(4.4)	(4.4)	(4.4)	(4.4)	(n/a)
CPI inflation	3.6	4.2	3.6	2.9	2.7	2.6
(previous)	(3.3)	(3.7)	(3.2)	(2.7)	(2.6)	(n/a)
Trimmed mean inflation	3.4	3.7	3.2	2.8	2.7	2.6
(previous)	(3.2)	(3.2)	(2.7)	(2.6)	(2.6)	(n/a)

	Year-average					
	2025	2025/26	2026	2026/27	2027	2027/28
GDP growth	1.9	2.2	2.1	1.8	1.6	1.6
(previous)	(1.8)	(1.9)	(1.9)	(1.9)	(2.0)	(n/a)

	Assumptions ^(c)					
Cash rate (%)	3.6	3.9	4.2	4.2	4.3	4.2
Trade-weighted index (index)	61.3	64.3	64.3	64.3	64.3	64.3

(a) Forecasts finalised on 28 January. 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 28 January and the daily exchange rate (TWI) is assumed to be unchanged from its level at 28 January 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

- **Cash rate reductions in the past year led to an easing in financial conditions, reducing lending rates and encouraging a pick-up in credit growth. It is uncertain whether conditions overall remain restrictive.** The increase in credit growth has been bolstered by competition among lenders and strong household and business balance sheets, underpinned by a healthy labour market. Some indicators suggest that financial conditions may now be somewhat accommodative. For example, total credit growth has picked up sharply and is above its long-run average, the ratio of household credit to income appears to have ticked up after declining since 2022, the ratio of business debt to GDP has continued to increase and risk premia are low. Moreover, the cash rate is below the central estimates of several models of the neutral rate. At the same time, other indicators are consistent with financial conditions still being somewhat restrictive. In particular, the cash rate is above central estimates of some other models of the neutral rate, scheduled mortgage payments are above their historical average and measures of household saving remain above historical averages.
- **The market-implied future path for the cash rate has shifted up further since the November *Statement* and market pricing suggests around two rate rises this year.** This recent shift was in response to stronger-than-expected labour and inflation data and RBA communications. It followed an increase in expectations between August and November. Almost all market economists expect a cash rate rise at the February meeting and a little fewer than half expect a second rise by September this year.
- **The higher market-implied path for the cash rate has contributed to a tightening in some measures of financial conditions, including an appreciation in the Australian dollar and an increase in longer term interest rates.** The real trade-weighted exchange rate remains within the range of estimates of its long-run equilibrium value.
- **Policy rate expectations and bond yields have risen in many other advanced economies.** The increase in yields has been particularly large in Japan, as policy rate and inflation expectations have risen because of inflationary pressures arising from fiscal stimulus and a weaker currency. Market participants expect policy rates to rise or remain unchanged over 2026 in most other advanced economies, although the US policy rate is expected to decline. Short-term inflation expectations have risen in Australia since the November *Statement*, but longer term inflation expectations remain well anchored.
- **In China, the authorities have continued to describe their monetary policy stance as ‘moderately accommodative’ amid softness in parts of the economy and ongoing weakness in the property sector.** Household demand for credit remains weak.

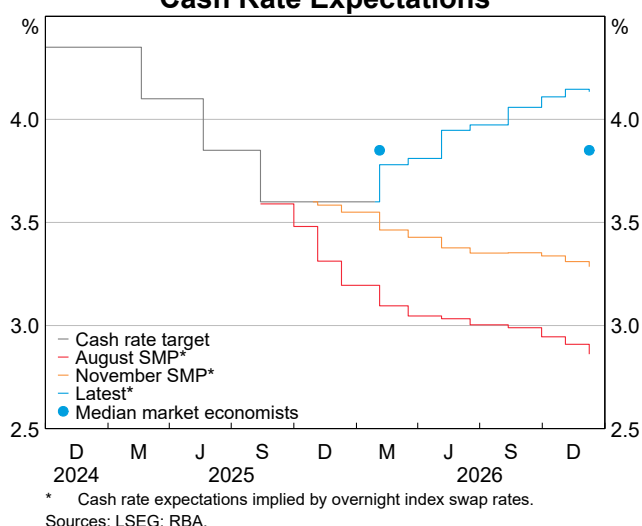
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- **The recent escalation in geopolitical events and threats to the independence of the Federal Reserve (Fed) have been reflected in financial market pricing, but most of the moves have been modest.** Nevertheless, the US dollar has depreciated, and gold and other precious metals prices have continued to increase. Further escalation could have adverse implications for financial markets and the global economy, though there are also upside risks from investment in AI.
 - **Equity prices have been little changed in Australia but have increased in most other advanced economies since the November *Statement*.** This divergence partly reflects the larger increase in policy rate expectations for Australia relative to other advanced economies. Corporate bond spreads are little changed at very low levels in Australia and other advanced economies. Equity and credit risk premia remain near historic lows in most markets including Australia.

1.1 Interest rate markets

Market pricing suggests participants expect around two cash rate rises in Australia during 2026, whereas at the time of the November *Statement* they had expected one cut over the same period.

The current market path implies that market participants expect one cash rate rise in the coming months and a second increase by the end of this year (Graph 1.1). Indeed, participants consider a rate hike in February is likely, with market pricing implying around a three in four chance. Almost all market economists tracked by the staff expect the cash rate to be raised at the February meeting and a little fewer than half expect a second cash rate rise by September this year. A small minority generally expect the cash rate to be unchanged for an extended period.

Graph 1.1
Cash Rate Expectations



Market participants' and market economists' expectations for the cash rate have risen in recent months in response to economic data and RBA communications. Market participants' expectations started to increase in September in response to stronger-than-expected economic data and RBA communications. Further increases followed in both November and January after labour market and inflation data that were stronger than participants had expected.

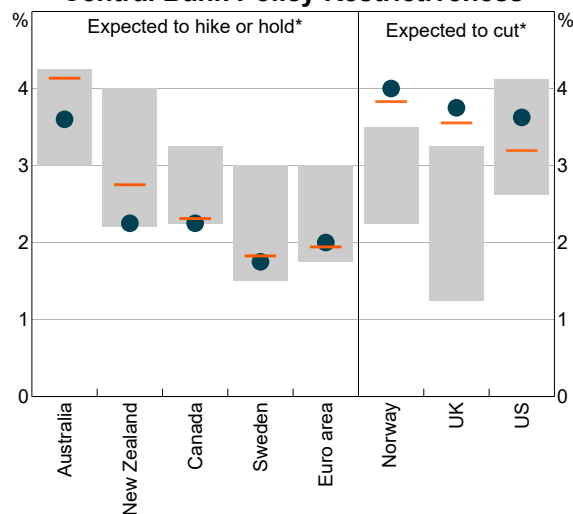
Participants and economists' expectations have also been influenced by public remarks by RBA officials since the November meeting; these were interpreted as suggesting a lower likelihood of policy easing this year and that policy may need to be tightened if inflationary pressures prove persistent. Since the November *Statement*, the cash rate path implied by market pricing has risen by the equivalent of a little more than three cash rate rises by end 2026 and a little more than that by end 2027.

Most central banks have signalled that they are likely to have finished easing policy and market participants expect some to raise policy rates over 2026, but the Fed is expected to continue easing policy gradually.

The Bank of Japan increased its policy rate by 25 basis points to 0.75 per cent in December, as expected. In its communications, it highlighted the steady momentum in wage and price growth and the decline in trade policy uncertainty. It also noted that its policy rate remains well below its estimate of the neutral rate. Meanwhile, policy rates have remained unchanged in recent months in the euro area, New Zealand, Canada and Sweden. Central banks in these economies have signalled that they are likely to have finished easing policy, in part based on their forecasts for inflation to remain at or near target and their policy rates being toward the lower end of neutral rate estimates (Graph 1.2). Market participants expect policy rates to remain on hold over 2026 in the euro area, Canada and Sweden, and to increase in Japan and New Zealand.

The Fed cut the target range for its policy rate by 25 basis points to 3.5–3.75 per cent in December and left it unchanged in January. Chair Powell noted that data since the US Federal Open Market Committee's (FOMC) December meeting indicated an improvement in the economic outlook, with upside risks to inflation while downside risks to employment had diminished.

Graph 1.2
Central Bank Policy Restrictiveness



● Current policy rate — Expected end-2026 policy rate
 ■ Range of central estimates of nominal neutral rates**

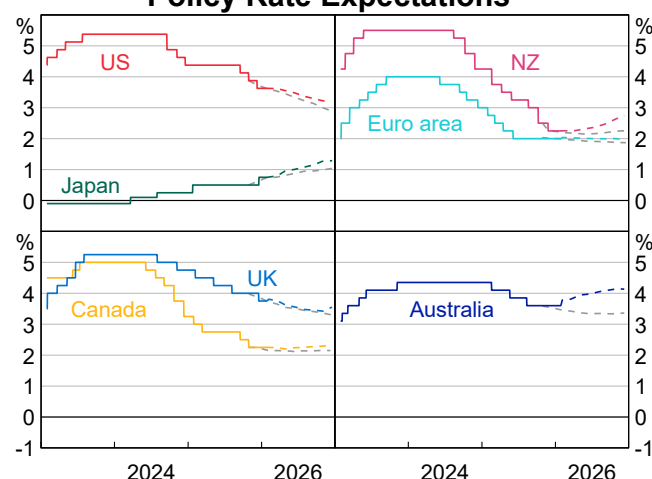
* Based on OIS pricing for respective policy rates at the end of 2026; at market close 28 January 2026.
 ** Range of estimates based on assessments by individual central banks.
 Sources: Bloomberg; central banks; RBA.

Threats to the Fed's independence increased in early 2026, but to date this has had no noticeable impact on financial market participants' policy rate expectations or inflation expectations. In January, the US Department of Justice served the Fed with grand jury subpoenas, threatening Chair Powell with criminal indictment. This escalation follows a series of actions over recent months, including the US administration discussing publicly the case to remove FOMC Chair Powell and seeking to remove Governor Cook 'for cause'. The negligible impact on US policy rate expectations and inflation expectations suggest that market participants continue to believe that the FOMC will ensure that the Fed stick to its current approach to inflation targeting even if some new members sympathetic to the US administration's desire for lower rates are appointed.

Market participants' policy rate expectations have increased by more in Australia than in most major advanced economies since the November

Statement. The increase in policy rate expectations has also been relatively strong in the United States, Japan, New Zealand and Canada, reflecting a combination of some economic data that were stronger than market participants had expected and central bank communications on the likely future path of policy rates (Graph 1.3). However, policy rates in these economies are lower than in Australia and, in the case of New Zealand and Canada, have declined substantially from their recent peaks.

Graph 1.3
Policy Rate Expectations*

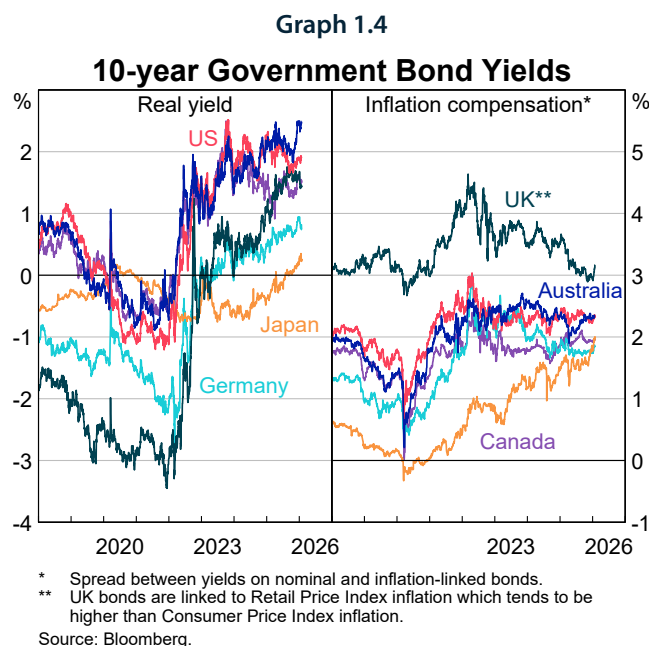


* Coloured dashed lines show expectations implied by current overnight index swap rates; grey dashed lines show the same expectations as of 29 October 2025.
 Sources: Bloomberg; RBA.

Short-term bond yields and short-term inflation expectations have risen in Australia and some other advanced economies since the November *Statement*, but longer term inflation expectations remain well anchored.

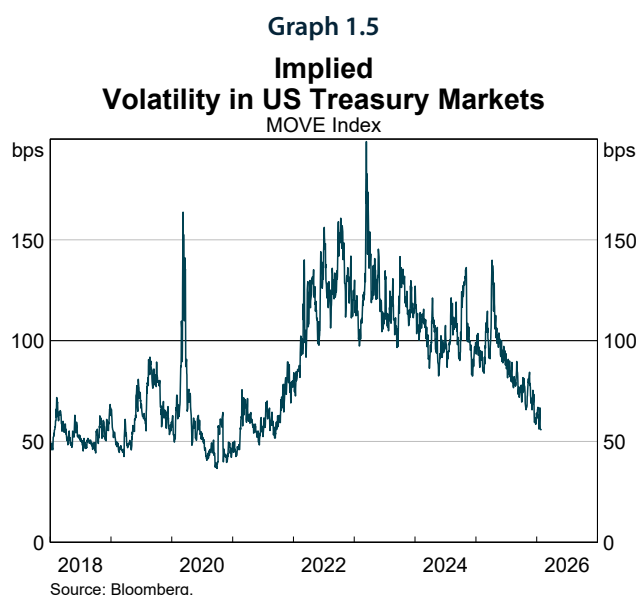
The rise in nominal yields partly reflects higher real rates, which have risen alongside policy rate expectations. The increase in yields in Australia and some other advanced economies follows stronger-than-expected economic data and central bank communications that were perceived as downplaying the likelihood of further policy rate cuts. Long-end yields have risen notably in Japan and have been volatile at times, driven by a rise in expectations for inflation and the policy rate, in turn reflecting the Bank of Japan's communications since its December meeting, a weaker currency and anticipation that a snap election (called on 20 January) could later lead to further fiscal stimulus. Yields on long-term government bonds remain above their decade average in most advanced economies. This in part reflects a rise in estimated term premia in recent years, owing to the effects of declining central bank bond holdings, fiscal sustainability concerns for some, and country-specific structural factors.

Market measures of shorter term inflation compensation have picked up noticeably in Australia. These measures lifted in recent months alongside higher realised inflation. Survey measures of households' short-term inflation expectations are also slightly above their long-run average (see Chapter 2: Economic Conditions). Market measures of long-term inflation expectations have increased noticeably in Germany and Japan, to a level closer to central bank targets, and in the United Kingdom. These measures have also increased a little in the United States and Canada but are little changed in Australia. Overall, inflation expectations appear well anchored and consistent with inflation targets (Graph 1.4).



Government bond markets have remained well functioning and measures of expected volatility have remained well below their post-pandemic average, despite the recent threats to Fed independence and other geopolitical events

(Graph 1.5). In Japan, anticipation of a snap election and associated fiscal stimulus (see above) caused some market volatility, though it was temporary and had only limited and temporary spillovers into other markets.



The gradual decline in the supply of central banks' reserves has been associated with increased money market pressures in a few advanced economies, but reserves remain more than ample in Australia.

Reserves have declined in many advanced economies in recent years as central banks' pandemic-related policy measures have gradually been unwound. Since November, some central banks have reacted to tighter money market conditions and an increase in demand for their lending facilities, which they judged to be signs of reserves approaching ample levels. If not managed, this could potentially have led to an unintended tightening in financial conditions. In the

United States, the Fed announced the end of its quantitative tightening program in November and started to purchase assets to support its management of reserves in December. In New Zealand, the Reserve Bank commenced weekly open market operations (OMOs) in December. Tightness in money markets declined following these actions.

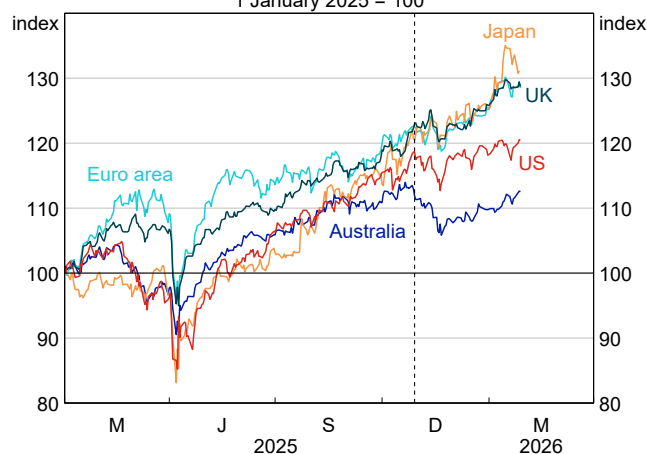
By contrast, in Australia indicators suggest that reserves continue to remain above ample, with no signs of pressure in money markets or increased demand at the RBA's weekly OMO facility. While the level of reserves is expected to continue to decline in response to the ongoing reduction in the RBA's bond holdings, demand at the RBA's OMO facility is expected to rise at some point in a way that will reduce the risk of pressures emerging in money markets.

1.2 Corporate funding markets

Risk premia in advanced economy corporate funding markets remain very low.

Equity prices have increased in several advanced economies since the November *Statement* but have been little changed in Australia (Graph 1.6). While much of the weaker performance of equities in Australia over the past year reflects the smaller increase in earnings expectations than in several other markets, the weaker performance over the most recent period has been driven by the larger increase in policy rate expectations in Australia. Australian equity prices declined in most sectors, though there was strong growth in the mining sector, which was supported by higher commodity prices. Though US equity prices have increased modestly since the November *Statement*, prices in the technology sector decreased. This was in part due to investor concerns around some AI-related companies' ability to achieve sufficient earnings growth to justify their current valuations and the borrowing required to fund their infrastructure investment. There were notable increases to equity prices in Europe and Japan over the same period, particularly in the banking sector where expectations for earnings and net interest margins were supported by steepening yield curves, expected fiscal stimulus and strong earnings results to date.

Graph 1.6
Equity Prices*
1 January 2025 = 100

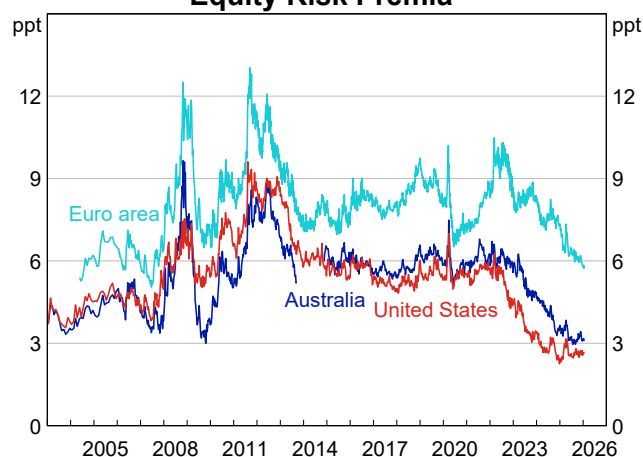


* Vertical dashed line indicates previous SMP paper on 29 October.
Sources: Bloomberg; LSEG; RBA.

Risk premia remain very low by historical standards in Australia and elsewhere, despite the recent renewed increase in geopolitical tensions.

The market reaction has been muted to events including the capture of the Venezuelan President and his wife by US forces, heightened tensions between the United States and Iran, concerted pressure by the United States to acquire Greenland, and the US Department of Justice criminal investigation into Fed Chair Powell. Measures of equity risk premia and expected future volatility are around long-term lows (Graph 1.7). Corporate bond spreads are little changed or have declined across advanced economies. However, prices of gold and other precious metals have continued to rise rapidly, which may be indicative of investor concerns about holding risk assets. The US dollar has also depreciated in recent weeks (see below). There remains a risk that international events could have larger and more lasting impacts on economic activity than expected and that a manifestation of downside risks could result in a significant tightening of financial conditions.

Graph 1.7
Equity Risk Premia*



* 12-month forward earnings yield less 10-year real government bonds. Euro area series is spliced with historical estimates of forward earnings yield, and real yields derived from breakeven inflation rates and nominal yields.

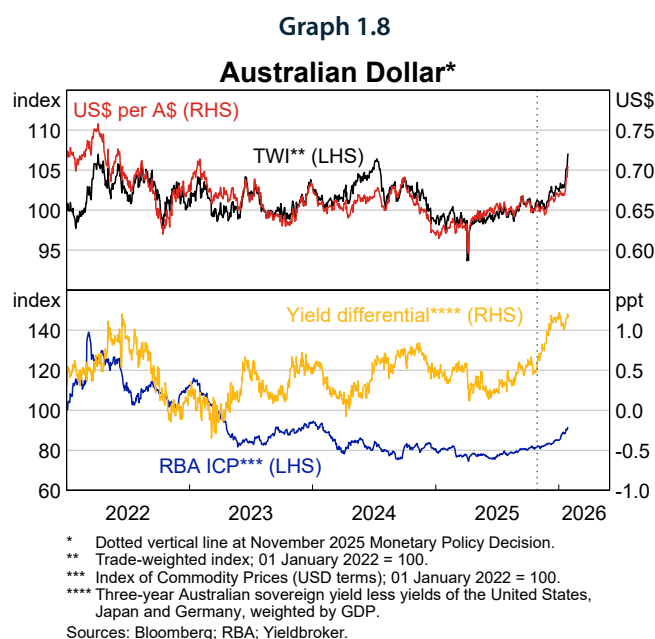
Sources: Bloomberg; LSEG; RBA.

1.3 Foreign exchange markets

Appreciation in the Australian dollar has added to the tightening in financial conditions since the November *Statement*.

The Australian dollar has appreciated around 5 per cent on a trade-weighted index (TWI) basis since the November *Statement* (Graph 1.8). This appreciation in part reflects the widening in short- and medium-term market-based policy expectations between Australia and other advanced economies (see above). Broad-based commodity prices growth has also supported an appreciation of the Australian dollar, along with the US dollar depreciation. The real TWI has also appreciated in recent months and remains broadly in line with the range of estimates of its long-run equilibrium value.

The US dollar has depreciated by about 2 per cent on a TWI basis since the November *Statement*, in part owing to recent US policy rate cuts and the expectation of further cuts in 2026. Recent escalating geopolitical tensions have likely weighed further on the US dollar in recent weeks.



1.4 Financial conditions in China

The People's Bank of China (PBC) has maintained what it describes as a 'moderately accommodative' monetary policy stance, as domestic demand has remained soft and household credit growth has moderated further.

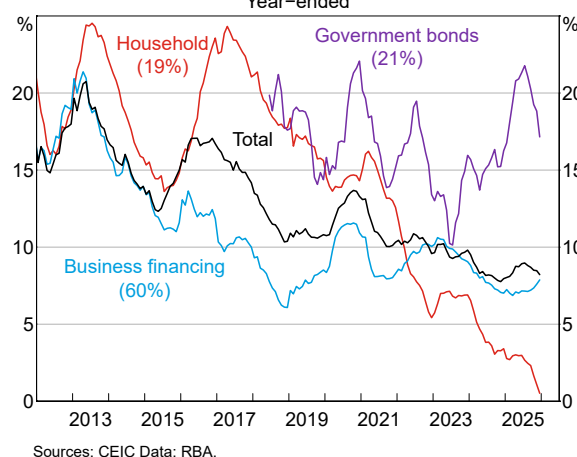
The PBC cut rates on its structural lending tools by 25 basis points in January, a continuation of its targeted approach to monetary policy stimulus.

These tools are used to support lending to certain sectors, such as agriculture and small enterprises.

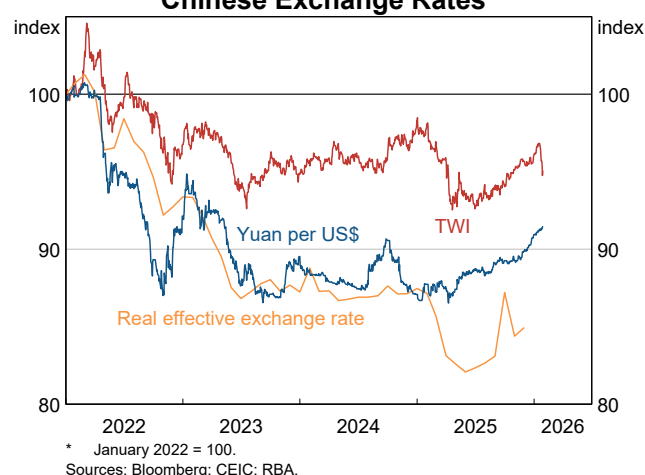
Household credit has continued to weigh on total social financing (TSF) growth, amid further weakness in the property sector. Short-term household credit has been particularly soft, declining in recent months, consistent with ongoing weakness in the property sector and soft consumer demand (Graph 1.9). Growth in medium-to-long term household credit – a proxy for mortgage demand – has also gradually declined as housing prices have continued to fall. However, TSF has continued to increase as a share of the economy due to strong government bond issuance and robust growth in business credit. Even so, the authorities have continued to de-emphasise TSF as a target for monetary policy.

The Chinese renminbi (RMB) has reached its highest level against the US dollar since mid-2023 but has depreciated recently against most other major currencies, including the Australian dollar. On a Chinese TWI basis, the RMB appreciated in late 2025 but subsequently returned to around its level at the time of the November *Statement*, still above the multi-year lows seen in 2025 (Graph 1.10). In real terms, the RMB has depreciated significantly in recent years given subdued inflation in China.

Graph 1.9
China – Growth in Total Social Financing
Year-ended



Graph 1.10
Chinese Exchange Rates*



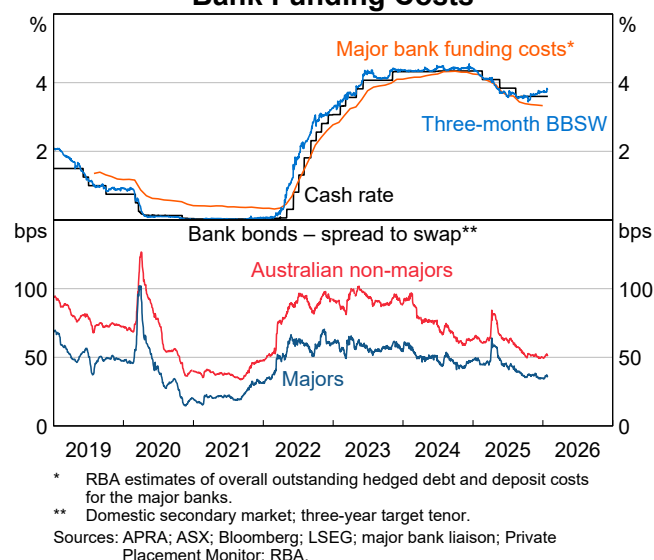
1.5 Australian banks and credit markets

Cash rate reductions in the past year have led to lower bank funding costs and lending rates.

Major banks' funding costs are estimated to have declined by a bit more than the cash rate over 2025 (Graph 1.11). This has supported full pass-through of cash rate reductions to bank lending rates. Recently, funding costs have been little changed, although the recent increase in cash rate expectations has led to higher term deposit rates and an increase in bank bill swap rates (BBSW) – to which much of banks' funding costs are linked, directly and via hedging. After declining for much of the past year, spreads between bank bond yields and swap rates have been little changed over recent months and remain near their narrowest level since early 2022. Lower spreads contribute to lower funding costs for banks.

Graph 1.11

Bank Funding Costs



Bank lending rates to households and businesses declined broadly in line with the cash rate and other benchmark rates over 2025. Average interest rates on variable-rate mortgages declined by 75–80 basis points over 2025. Rates on new fixed-rate mortgages also declined over 2025 but have increased slightly since the November *Statement*, owing to an increase in longer term reference rates alongside the rise in market participants' expectations for the cash rate. However, less

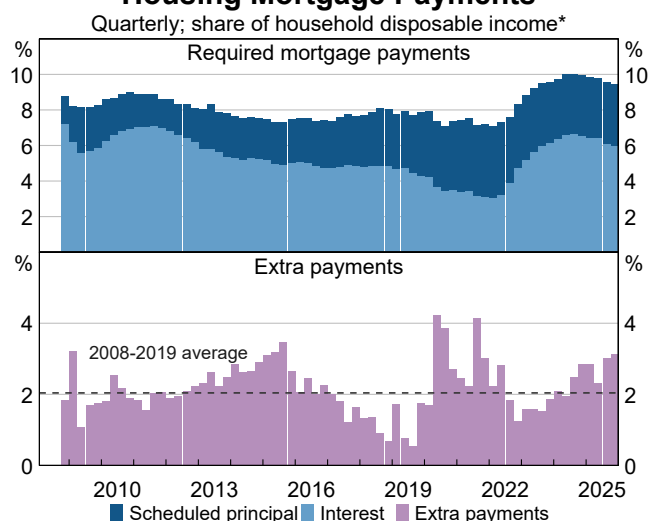
than 5 per cent of new and outstanding mortgages are on fixed-rate terms. Average rates on variable-rate business loans declined by around 85 basis points over 2025.

Scheduled mortgage payments have declined as a share of household disposable income since late 2024 but remain noticeably above their average of the past two decades.

Scheduled principal and interest payments on mortgages were unchanged at near 10 per cent of household disposable income in the December quarter (Graph 1.12). Scheduled mortgage payments declined over 2025, consistent with falls in variable mortgage rates, to a little below their historical peak in 2024. However, total scheduled household debt payments (including estimated repayments on consumer credit) have remained further below their historical peak as a share of household disposable income, owing to a notable decline in the use of consumer credit since the global financial crisis (GFC).

Graph 1.12

Housing Mortgage Payments



* December quarter 2025 data uses a forecast for household disposable income.
 Sources: ABS; APRA; RBA.

The flow of extra mortgage payments into offset and redraw accounts – a form of saving – has also remained above its average of the past two decades.

This is consistent with aggregate measures of household saving from the national accounts having remained a little above pre-pandemic averages (see Chapter 2: Economic Conditions). Above-average extra mortgage payments may partly reflect that interest rates have incentivised some borrowers to save, supporting the view that financial conditions have been restrictive. However, it may also reflect other factors. For example, some borrowers maintained their existing mortgage payments when interest rates fell in 2025, resulting in an accumulation of extra payments. Funds in offset and redraw accounts are easily accessible, so borrowers may choose to access these for consumption in the near future.

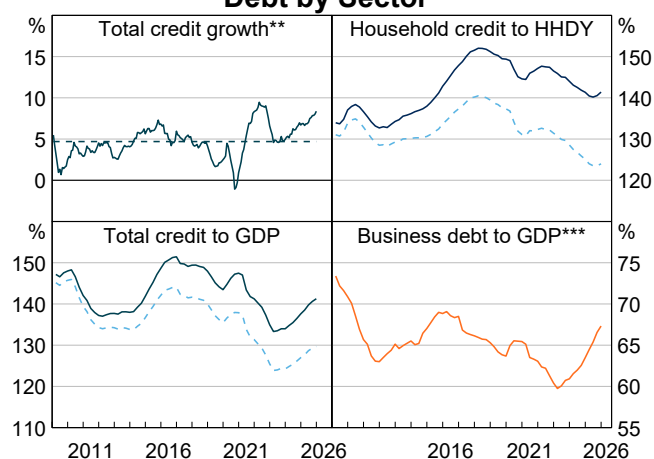
Total credit growth increased a little over the December quarter and is well above its post-GFC average.

Total credit continued to grow faster than nominal GDP over the December quarter (Graph 1.13), reflecting strong contributions from both housing and business credit. The ratio of business debt to GDP has risen strongly in recent years to be back around its pre-pandemic level. The ratio of household credit (net of offset balances) to household disposable incomes appears to have picked up after declining since mid-2022, primarily reflecting a pick-up in housing credit growth.

While the recent increase in the market-implied path of the cash rate could weigh on credit demand, it is too early to see evidence of this in loan commitments or credit data. This reflects both brief lags in data collection as well as behavioural lags in the responses of borrowers to changes in interest rate expectations.

A range of indicators suggest credit availability remains favourable, supporting economic activity. Lending spreads have been little changed over recent quarters but remain lower than before the pandemic, supported by favourable funding conditions and strong lender competition. Lending standards in the mortgage market have been largely stable over recent quarters but have eased slightly for commercial real estate lending across both bank and non-bank lenders. Over recent years, non-bank lending has also grown strongly, including in market segments that are less well serviced by banks, contributing to improved credit availability.

Graph 1.13
Debt by Sector*

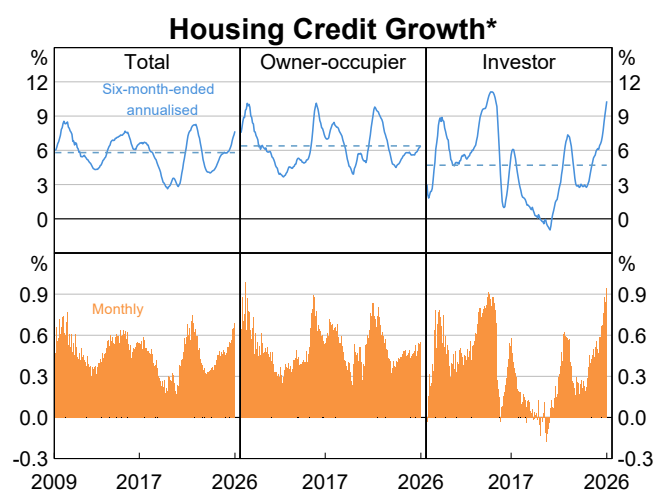


* Seasonally adjusted and break-adjusted; including securitisation. December quarter 2025 uses forecasts for household disposable income (HHDI) and GDP. Dashed lines in panels 2 and 3 are net of offsets.
 ** Six-month-ended annualised. Dashed line is the average from 2009 onwards.
 *** Includes business credit, corporate bonds and other lending.
 Sources: ABS; APRA; Bloomberg; LSEG; RBA.

Housing credit growth increased further in the December quarter.

The pick-up in housing credit growth over recent months has continued to largely reflect stronger investor credit growth. Investor credit growth is at its highest level since 2015 after increasing notably in 2025 alongside strong growth in housing prices (Graph 1.14). Owner-occupier credit growth (which comprises two-thirds of overall housing credit) has also increased, but by much less than investor credit growth. Housing loan commitments have also grown strongly over recent months, though declined slightly in December (Graph 1.15). Housing credit growth could stabilise given the recent stabilisation in housing price growth (see Chapter 2: Economic Conditions). Housing price data typically leads credit data owing to lags between the purchase and settlement of a property and lags in credit data collection that together can take up to three months.

Graph 1.14

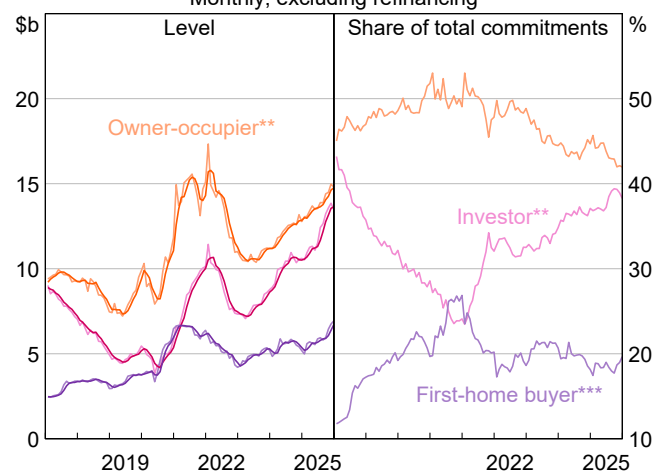


It is likely to take some months before the full effects of the Australian Government 5% Deposit Scheme on housing credit and the housing market become clear. Nonetheless, since the scheme came into effect in October, lenders have reported increased interest from first-home buyers and the share of new lending to first home buyers has increased slightly (Graph 1.15).

Graph 1.15

Housing Loan Commitments*

Monthly; excluding refinancing



* Seasonally adjusted and break-adjusted. Dark lines are the three-month moving average of monthly seasonally adjusted data. Shares may not add to 100 due to method of seasonal adjustment.

** Excluding first-home buyers.

*** Includes estimate of Investor FHB commitments prior to 2019. FHB commitments includes alterations and additions, and land.

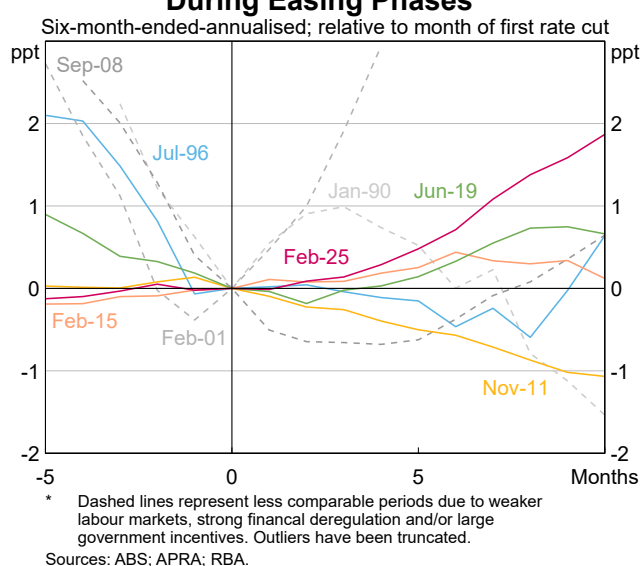
Sources: ABS; APRA; RBA.

The debt-to-income (DTI) lending limits on housing credit to be implemented by the Australian Prudential Regulation Authority (APRA) are unlikely to restrict credit supply in the near term. Announced in November and effective from February 2026, APRA intends for the DTI limits to prevent an unsustainable rise in household indebtedness during episodes of heightened risk, while not overly constraining credit supply at other times. The DTI limits allow up to 20 per cent of new mortgage lending to be at a DTI greater or equal to six, applying to lenders' owner-occupier and investor portfolios separately. The share of lending at a DTI greater or equal to six is currently well below these limits.

The increase in total housing credit growth since February 2025 has been strong relative to most recent easing phases (Graph 1.16). However, comparisons across easing phases must be interpreted carefully given differences in the extent of easing and level of the cash rate, fiscal and macroprudential policy settings, household leverage (which was much lower at the start of the 2000s), competition in the lending market and the prevailing economic environment. For example, looser mortgage lending standards were likely to have contributed to a stronger credit response in some pre-GFC easing phases, including the 2001 phase. More recently, the resilience of the labour market and growth in population and nominal household disposable incomes have contributed to growth in demand for housing credit over the tightening phase and into the easing phase. These factors have contributed to housing credit growth being on an upward trend before the start of easing, unlike in most previous easing phases.

Graph 1.16

Housing Credit Growth During Easing Phases*



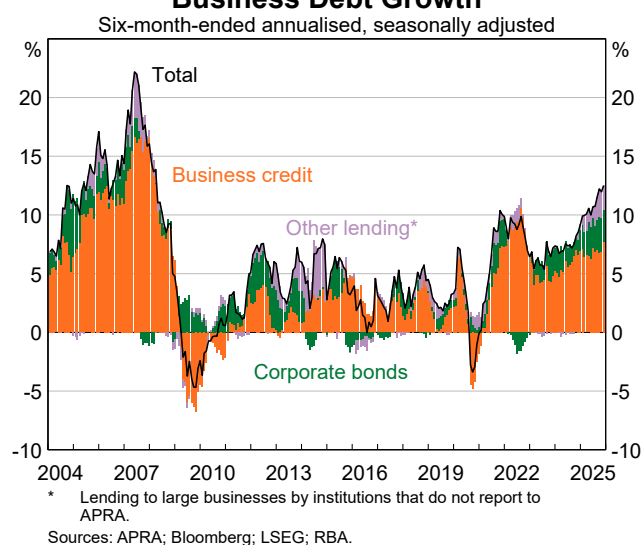
Growth in business debt remains strong.

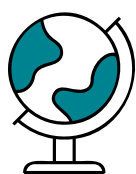
Business debt is growing at around its fastest pace since 2008 in nominal terms and has risen to around pre-pandemic levels as a share of GDP (Graph 1.17).

Over recent years, the growth in business debt has been strong compared with peer economies and has been broadly based across industries. The return of business debt to pre-pandemic levels (as a share of GDP) has been supported by favourable conditions in credit and wholesale funding markets, reflecting lenders' strong appetite to grow their business loan books and robust demand from investors for wholesale debt. Growth in business debt increased over 2025, reflecting a pick-up in syndicated lending growth, corporate bond issuance and business credit growth. Annual net bond issuance by non-financial corporations over 2025 was the strongest in the past decade as a share of GDP. The strength in business debt growth is consistent with improved business conditions, increased investment intentions in the capital expenditure survey and improvements in the supply of credit over the past few years. Even so, there is typically a weak relationship between aggregate business debt and investment since firms' investment spending is largely internally funded and their investment decisions are affected by a wide range of factors (such as business profitability and broader economic conditions).

Graph 1.17

Business Debt Growth





Chapter 2

Economic Conditions

Summary

Until mid-2025, underlying inflation in Australia had been easing gradually from its peak in late 2022, reaching 2.7 per cent in the June quarter 2025. This was consistent with an apparent easing in capacity pressures as the earlier period of restrictive monetary policy helped to bring aggregate demand and potential supply closer to balance. While GDP growth had been picking up (alongside a recovery in real household incomes), it was still below its estimated potential growth rate – so capacity pressures were projected to ease further. The central forecast in August was for the unemployment rate to pick up a little further and for underlying inflation to ease a little further in the second half of 2025, such that the economy would be close to balance and underlying inflation close to the midpoint of the 2–3 per cent range by the end of 2025. Since then, there have been a number of material developments:

- **Inflation in the December quarter 2025 came in above our November forecast and materially higher than anticipated in August.** Trimmed mean inflation increased to 3.4 per cent over the year to the December quarter and headline inflation rose to 3.6 per cent. The pick-up in the second half of 2025 was broadly based across services, goods and new dwelling inflation. Economy-wide capacity pressures – which look to have been greater last year than previously assessed and to have increased in the second half of the year – are judged to have contributed to some of the recent increase. The larger part of the increase is judged to reflect less-persistent factors, including price volatility in some categories and some sector-specific demand and price pressures – though the extent to which these latter factors will prove persistent is highly uncertain. It is possible that temporary factors were pushing down on inflation in late 2024 and early 2025, masking underlying inflationary pressures at that time and then accentuating the recent pick-up.
- **Private demand growth appears to have been much stronger than expected in the second half of 2025.** While GDP growth in the September quarter was around our estimate of potential growth and in line with our November forecast, partial data suggest it may have picked up further in the December quarter. If so, GDP growth will have been a little stronger than anticipated in November and considerably stronger than expected in August. Private demand growth looks to have been particularly strong in the second half of 2025. Amongst other things, that reflects a stronger-than-expected increase in housing prices and dwelling investment, higher-than-expected household income growth, an acceleration in investment related to data centres, and favourable financial conditions both domestically and internationally. While December quarter consumption was likely boosted by households bringing forward spending to benefit from sales and promotions, underlying consumption growth looks to have been strong.

- **Global economic activity last year was also stronger than expected. Trade flows adjusted rapidly to higher US tariffs, while the boom in US AI-related investment supported exports from east Asia.** Domestic demand was stronger than expected in both the United States and east Asia last year; in other advanced economies, GDP growth was subdued, broadly in line with expectations. Core measures of inflation remain elevated in many advanced economies due to persistent services inflation, while labour markets have continued to loosen gradually. GDP growth in China was in line with the authorities' growth target in 2025, supported by strong exports. Investment in China has been weak and there are limited signs that announced policy stimulus has begun to support an improvement in infrastructure investment; iron ore prices are nevertheless little changed.
- **The unanticipated strength of GDP growth in Australia in the second half of last year added to existing capacity pressures in the economy.** Looking through some monthly volatility, unemployment has remained broadly stable recently and, consistent with a range of other indicators, suggests that the labour market remains somewhat tight. Firms continued to report difficulties finding suitable labour and unit labour cost growth remained strong. Broader capacity pressures were evident outside the labour market – firms' reported capacity utilisation increased over the second half of 2025 and output price inflation measures remained elevated. The latest model estimates, while imprecise, suggest there was more excess demand in the economy through 2025 than expected. That is partly because estimates of the economy's supply capacity last year are a little lower than previously assessed. This possibility was identified as a risk in the August and November *Statements*; these models continue to point to further risks in that direction.
- **Much of the strengthening in private demand growth and inflation in the second half of 2025 is judged to reflect sector-specific factors that may not persist.** The strength in consumption over the latter part of the year coincided with stronger-than-expected durable goods price inflation. That may be because strong demand enabled retailers to increase their prices by more than otherwise, following reports in the first half of 2025 that weak demand growth had limited their ability to pass on cost pressures. With consumption growth expected to slow this year, the effect of this on inflation could prove temporary. Similarly, as housing demand recovered strongly, new dwelling inflation picked up sharply, in part because residential builders began removing discounts that were in place when the housing market was weaker. This too could prove temporary if housing demand growth slows. Alongside these sector-specific demand factors, some of the increase in CPI inflation likely reflects short-term price volatility in categories such as fuel and overseas travel. The extent to which demand and inflationary pressures will persist is a key uncertainty for the outlook (see Chapter 3: Outlook).

2.1 Global economic conditions

Economic activity in Australia's major trading partners was stronger than expected in 2025. International trade patterns appear to have adjusted quickly to higher US tariffs, and exports from east Asian economies have grown rapidly in response to strong AI- and broader technology-related US investment demand. Exports have also been stronger than expected in China, helping to ensure the Chinese authorities' growth target for 2025 was met, despite weakness in nominal investment persisting in the December quarter. Iron ore prices are little changed, supported by resilient demand from Chinese steel mills as increased steel exports offset weakening domestic demand (particularly for construction steel). Outside of China, domestic demand has been stronger than expected in the United States and in the rest of east Asia. By contrast, activity has been subdued in a range of other advanced economies, where labour market conditions continue to gradually loosen. Inflation has evolved broadly in line with expectations in most advanced economies, where core measures of inflation remain elevated.

Global economic growth was more resilient than expected in the second half of last year amid changing trade patterns and robust domestic demand in some economies.

Trade policy developments weighed less on global growth in the second half of 2025 than anticipated.

So far there is little evidence of a material reduction in global supply from higher US tariffs, with trade flows adjusting more rapidly than was initially expected, mitigating the negative impacts for global activity. Product-specific exemptions and potential enforcement issues continue to contribute to a significant gap between headline and effective tariff rates, which has further cushioned the impact of the tariffs on global trade and activity. The average effective US tariff rate declined somewhat following the November *Statement*, due to further reductions in headline tariffs for some trading partners and a temporary agreement between the United States and China that has lowered the effective US tariff rate on Chinese imports to around 40 per cent for one year. However, geopolitical tensions

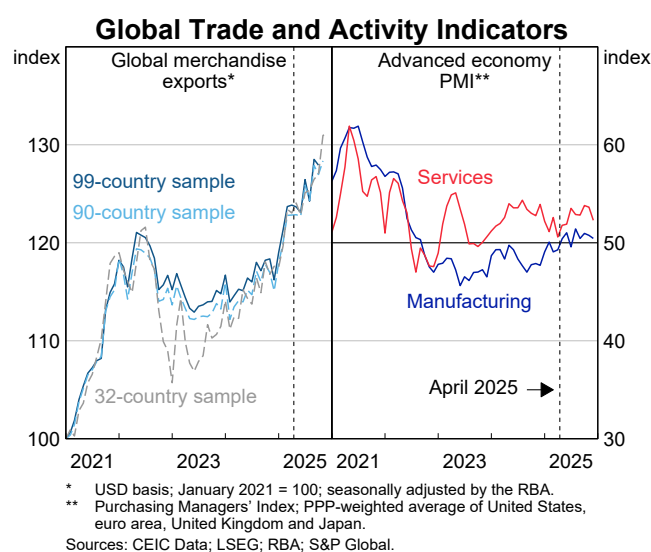
have risen and are increasingly spilling over into trade policy. Uncertainty about trade policy remains elevated more generally, due to ongoing trade investigations in several jurisdictions and pending a US Supreme Court decision on the legal basis for some US tariffs.

Stronger-than-expected growth in Australia's major trading partners has also been driven by a boom in US AI- and broader technology-related investment, which boosted east Asian manufactured goods exports in the second half of last year.

Timely east Asian trade data – including for South Korea, Singapore and Taiwan – suggest exports remained elevated in the December quarter (Graph 2.1). Domestic demand growth has also been stronger than expected in the United States and in several east Asian economies; partial data suggest the recent resilience will continue, supported by monetary and fiscal policy easing in some economies.

Outside of the United States, GDP growth in most other advanced economies remained relatively subdued in the September quarter, broadly in line with expectations. Measures of economic activity were particularly weak in the euro area, the United Kingdom and Japan. Sluggish industrial production and weak consumer confidence suggest that growth will continue to be subdued in the December quarter across many advanced economies.

Graph 2.1

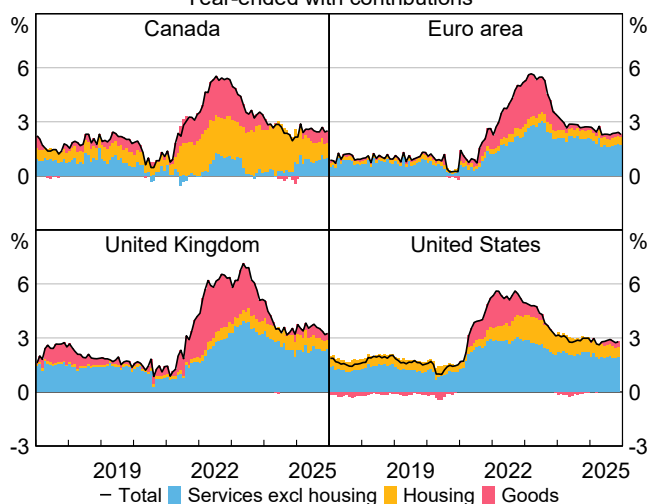


Although headline inflation in some advanced economies is near central banks' targets, core inflation remains above target-consistent rates in most advanced economies. Services inflation remains elevated due to a combination of rising labour and housing costs and some temporary factors (Graph 2.2). The elevated level of housing inflation partly reflects some persistence in rents. Core goods inflation has also risen in recent months in some economies, following a moderate recovery in demand and business conditions over the second half of last year. Central banks and Consensus forecasters widely expect these domestic price pressures in advanced economies to moderate, alongside a continued gradual easing in labour market conditions. To date, the easing in labour markets has been broadly based across a range of indicators, including unemployment and participation rates, employment and labour cost growth. However, the disinflationary pressures from loosening labour markets may be somewhat offset by the unexpected resilience in global demand recently. In line with expectations for inflation to remain stable at, or return to, their targets, several advanced economy central banks have signalled an end to further monetary policy easing as policy rates are toward the lower end of neutral rate estimates (see Chapter 1: Financial Conditions).

Graph 2.2

Core Inflation*

Year-ended with contributions



* PCE for United States, CPI for others.

Sources: BEA; Eurostat; LSEG; ONS; RBA; Statistics Canada.

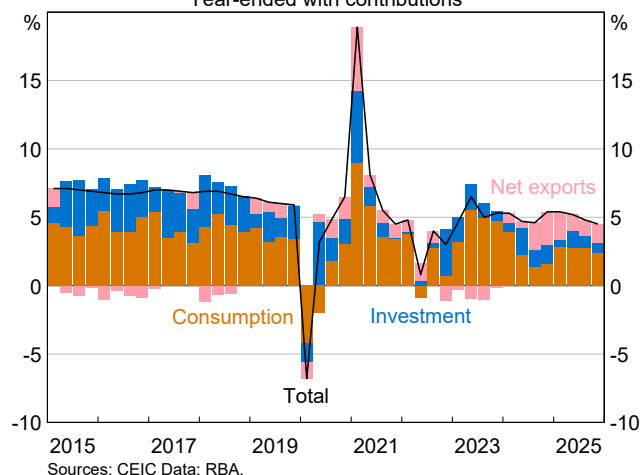
Chinese growth has remained resilient despite a softening in domestic demand.

China achieved its growth target of 'around 5 per cent' for 2025. A slowing in domestic demand growth in the second half of the year was partially offset by ongoing strength in net exports (Graph 2.3). Monthly fixed asset investment and retail sales data remained weak, although industrial production was resilient, in line with robust export levels.

Graph 2.3

China – Real GDP Growth

Year-ended with contributions



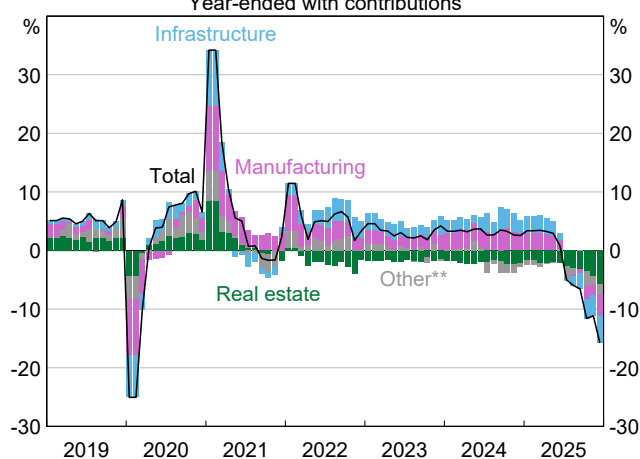
Sources: CEIC Data; RBA.

Nominal fixed asset investment (FAI) in China declined in the December quarter, and at a faster rate than in the September quarter.

However, the national accounts' measures of real investment have weakened only moderately, diverging from their historical relationship with FAI. The weakness in FAI has been broadly based across infrastructure, manufacturing and real estate (Graph 2.4). It could reflect a number of factors including a strengthening in authorities' resolve to curb excess capacity and address below-cost pricing in certain sectors, the impact of elevated tariff uncertainty and the direct effect of tariffs, and possible constraints on local government financing. At the Central Economic Work Conference in December – where Chinese leadership meet to set the economic policy agenda for the coming year – authorities acknowledged the recent weakness in investment and pledged to halt the decline. However, details of any further policy support, including via the infrastructure financing measures announced in late 2025, remain unclear. At the conference, authorities also identified the

disparity between strong domestic supply and weak demand as a concern, and emphasised the need to expand domestic demand and 'optimise' supply.

Graph 2.4
China – Fixed Asset Investment Growth*
Year-ended with contributions



* Seasonally adjusted by the RBA.

** Calculated as a residual; includes primary sector and services not elsewhere classified.

Sources: CEIC Data; RBA.

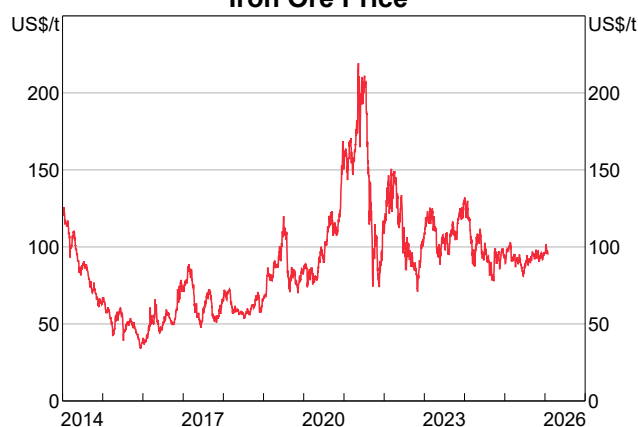
Chinese merchandise exports have increased strongly since the November Statement and remain higher than the levels recorded at the beginning of 2025. Alongside trade diversion to countries outside of the United States, which has cushioned the direct impact of US tariffs, continued strength in Chinese exports may reflect an ongoing structural rise in China's manufacturing capacity directed to export markets. The rise in exports of high-tech manufactured goods where China has invested significantly in recent years – for example, motor vehicles, ships and integrated circuits – has been particularly large. Chinese export prices have continued to decline, after temporarily stabilising in early 2025. This decline likely reflects in part the imbalance between strong supply and weak domestic demand identified by authorities. There are further downside risks to export prices if this imbalance persists.

Iron ore prices are little changed, despite weak investment in China, and oil prices are slightly higher alongside increased geopolitical tensions.

Iron ore prices are little changed since the November Statement (Graph 2.5). Over recent years, demand for iron ore from Chinese steel mills has remained robust despite declining domestic demand, particularly for construction steel. Steel production exceeding domestic demand has led to a rise in Chinese steel exports, as well as relatively weak domestic steel prices and steel mill profitability. There are downside risks to iron ore prices if Chinese authorities strengthen their resolve to consolidate capacity in the steel sector.

Oil prices are slightly higher since the November Statement. Oil prices have been supported by recent tensions in Iran, which pose an upside risk to prices given the importance of nearby waterways for the seaborne oil market. By contrast, recent US actions in Venezuela are unlikely to have a significant impact on oil prices in the short term because Venezuela only accounts for about 1 per cent of global crude oil supply. However, with the world's largest proven crude oil reserves, increased Venezuelan oil extraction could bear down on oil prices in the medium-to-longer term.

Graph 2.5
Iron Ore Price*



* 62% Fe fines index spot prices; free-on-board basis.

Sources: Bloomberg; RBA.

2.2 Domestic economic activity

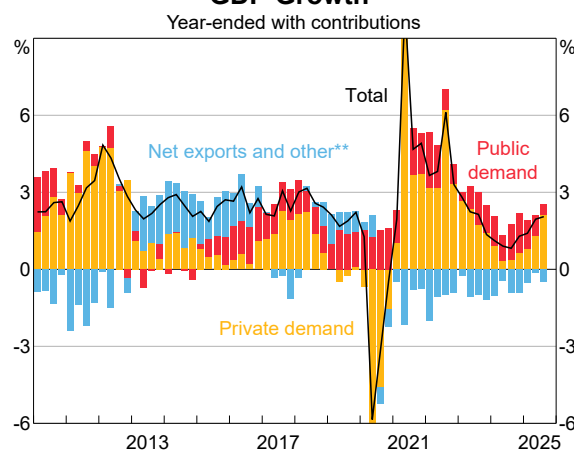
GDP growth in the September quarter was around our estimate of potential growth and in line with expectations. Partial data suggest growth may have picked up further in the December quarter and been a little stronger than expected in November – and considerably stronger than expected in August. In particular, private demand growth in the second half of 2025 looks to have been much stronger than anticipated. Some of this strength is likely to prove temporary – for example, private investment in the September quarter reflected some lumpy expenditures, consumption in the December quarter is likely to have been boosted by households bringing forward spending to benefit from sales and promotional periods, and the higher level of exports is not expected to be sustained into 2026. But underlying demand also looks to have been stronger than anticipated, reflecting a number of factors: a stronger-than-expected recovery in housing prices and dwelling investment over the past year; higher-than-expected growth in real household income; favourable financial conditions domestically and internationally, alongside the unexpected resilience of the global economy; and a stronger outlook for business investment related to data centres and the green energy transition (see Chapter 3: Outlook).

The contribution of public demand growth to GDP has decreased over the past year, although projections from government budgets suggest the underlying cash deficit will widen relative to GDP in 2025/26, as it did in 2024/25. The earlier monetary policy easing is expected to have most of its effect on GDP growth in 2026 rather than 2025, given typical lags in transmission, although there is inherent uncertainty around this assessment (particularly for dwelling investment).

Year-ended GDP growth picked up over the year to the September quarter to around estimates of potential growth and looks to have been a little stronger than expected in the December quarter.

GDP increased by 0.4 per cent in the September quarter to be 2.1 per cent higher over the year, broadly in line with expectations in the November Statement. Private demand was much stronger than expected and accounted for most of the increase in GDP (Graph 2.6). This unexpected strength was largely due to business investment, although some of this was concentrated in categories that can be lumpy and are mostly imported (so do not immediately add to GDP). Working in the other direction, inventories made a large and unexpected subtraction from GDP growth in the quarter. This mostly reflected a drawdown in trade-related mining inventories as previous supply disruptions were resolved and because of idiosyncratic factors in the gold market. The drawdown in mining inventories supported a pick-up in resource exports in the quarter, which drove a 1 per cent rise in export volumes overall.

Graph 2.6
GDP Growth*



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

** Includes change in inventories and the statistical discrepancy.

Sources: ABS; RBA.

The available indicators for the December quarter suggest that year-ended GDP growth will be a little stronger than expected in November, and considerably stronger than expected in August.

Household spending appears to have been stronger than expected, although some of that is likely to reflect spending brought forward from the March 2026 quarter (see below). Forward orders point to ongoing growth in domestic demand.

Data received since the November *Statement* suggest that household consumption growth increased by more than expected in the second half of the year.

Household consumption increased solidly over the year to the September quarter alongside strong growth in real incomes and wealth.

Household consumption grew by 0.5 per cent in the September quarter, broadly as expected. Spending growth on retail goods, which had been boosted by larger-than-usual end-of-financial-year sales in the June quarter, eased as anticipated. Growth in other discretionary components also slowed, but year-ended growth remained solid for most discretionary components. In per capita terms, consumption increased by 0.7 per cent over the year to the September quarter, up from 0.3 per cent over the year to the June quarter.

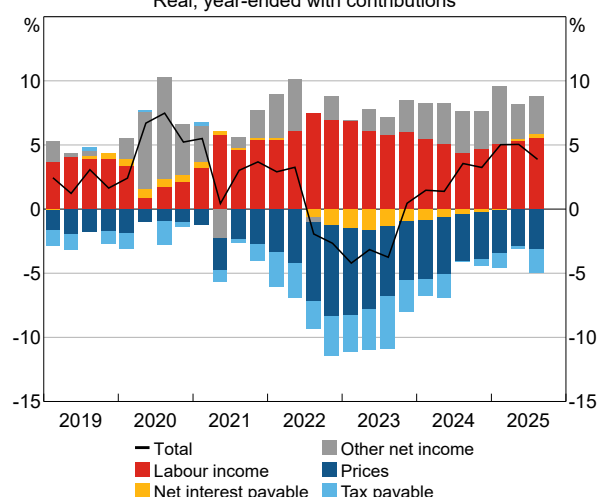
Timely indicators for the December quarter point to household consumption growth picking up much more than expected in November.

The ABS Household Spending Indicator points to strong spending growth in October and November. Much of this is likely to reflect stronger fundamentals, as growth was broadly based by spending category and growth in household income and wealth have been stronger than expected. However, some of the strength in household consumption is likely to be temporary, as retail spending was boosted by households bringing forward spending from the month of December and the March quarter to benefit from sales and promotional periods. Indeed, there were modest declines in retail categories in the month of December in bank transaction data, consistent with liaison contacts reporting that the Black Friday period pulled forward sales from early December. Consumer sentiment has also remained relatively flat over the past year at below-average levels.

Real disposable income growth picked up substantially in 2024 and 2025, reflecting amongst other things a boost from the easing in inflation and the Stage 3 tax cuts (Graph 2.7). The influence of those

factors is now fading – year-ended growth in real household disposable income slowed a little in the September quarter. However, the decline was less than expected, partly owing to stronger-than-expected labour income growth in the quarter. There was also a large upward revision to the level of household income over recent years, but this was primarily in components that are not easily accessible to spend for many households (including interest accrued on superannuation balances). Lower interest rates provided a small amount of direct support to aggregate household disposable income growth in the quarter as households' interest payments declined by more than their interest receipts.

Graph 2.7
Household Disposable Income Growth
Real, year-ended with contributions

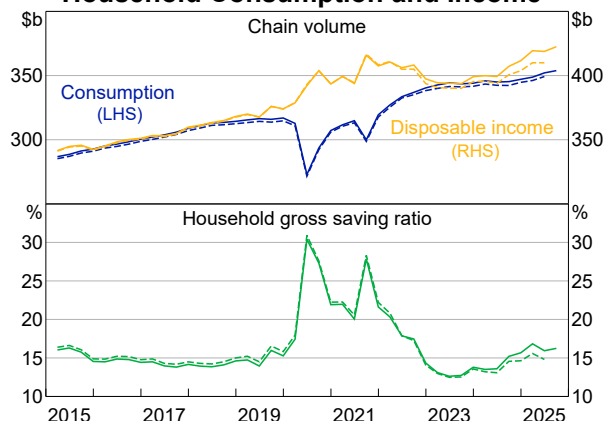


Sources: ABS; RBA.

The household saving ratio increased a little in the September quarter and is now notably higher than expected in the November *Statement*, owing to historical data revisions (Graph 2.8). The gross saving

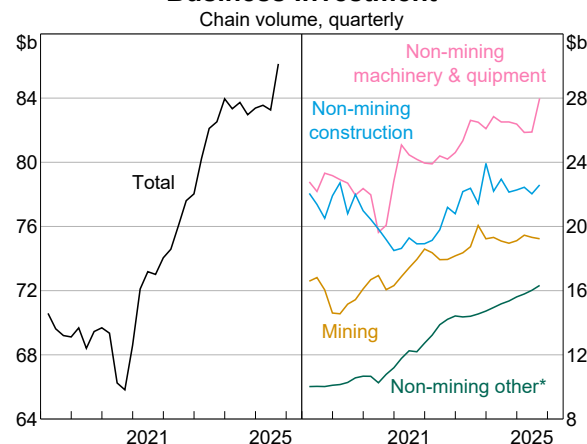
ratio was 1.7 percentage points higher than expected, largely because historical upward revisions to the level and growth of real household disposable income exceeded those for household consumption. Due to the composition of the income revisions, this does not materially change our assessment of households' willingness or ability to consume out of more accessible income (such as wages) over recent years.

Graph 2.8
Household Consumption and Income*



* Dashed lines show previous data vintage. Previous data vintage has been rebased to account for changes in the reference year.
Sources: ABS; RBA.

Graph 2.9
Business Investment



* Includes biological resources, artistic originals, non-mining software and non-mining research & development.
Sources: ABS; RBA.

Business investment increased sharply in the September quarter; while this was largely driven by categories where investment can be lumpy, firms are expecting to invest more in the coming quarters than previously indicated.

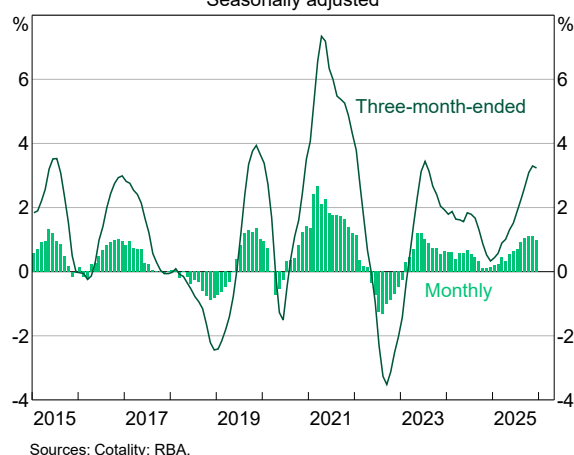
After little growth for almost two years, business investment increased by 3.4 per cent in the September quarter. This was much stronger than expected in the November *Statement*. Most categories of business investment outside mining rose in the quarter, including those that had been steady or declining for some time (Graph 2.9). The largest contribution to the quarterly surprise was from non-mining machinery and equipment investment, in large part relating to data centre fit outs and purchases of aircraft. These types of investment tend to be lumpy and have a large, imported component that limits the immediate boost to GDP.

There has also been a material uptick in businesses' near-term investment intentions. Firms' reported capital expenditure intentions point to an increase in non-mining investment in the current financial year as firms respond to the cyclical pick-up in private demand and as structural global trends like the renewable energy transition and strong data centre investment continue (see Box B: Insights from Liaison). The easing in monetary policy in 2025 may have also had some impact. Previous RBA research has shown that most of the transmission from monetary policy to business investment is through the effect of interest rates on private spending; that is, as businesses respond to a pick-up in private demand spurred by monetary easing, with the peak effect occurring after two to three years.

Housing market conditions picked up over 2025.

Housing prices have increased strongly over the past year, boosting household wealth, but monthly growth may have stabilised somewhat in recent months (Graph 2.10). Housing prices increased by 1 per cent in the month of December, to be 8.5 per cent higher over the year. The strength in housing prices over the past year is consistent with strong growth in housing credit; both have been stronger than in most previous monetary policy easing phases (see Chapter 1: Financial Conditions). However, this does not necessarily mean that monetary policy transmission is stronger than usual in the current episode. Recent housing price strength is also likely to reflect the stronger starting position of the labour market compared with past episodes of easing monetary policy. Recent housing market activity may also have been supported by the expansion of the Australian Government 5% Deposit Scheme, although the size of this effect is uncertain. The apparent stabilisation in monthly housing price growth in recent months is consistent with a drop in buyer sentiment in the Westpac-Melbourne consumer sentiment survey and the upward revision to the outlook for interest rates.

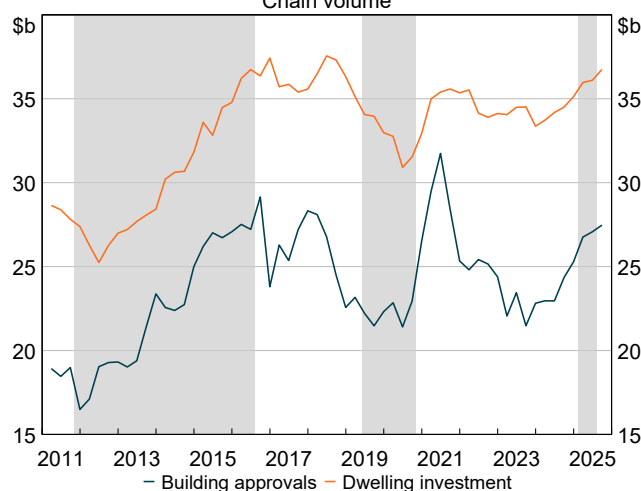
Graph 2.10
Housing Price Growth
Seasonally adjusted



Dwelling investment grew by 6.5 per cent over the year to the September quarter, stronger than expected in the November *Statement* (Graph 2.11).

Dwelling investment is relatively sensitive to changes in interest rates, both directly and via higher housing prices. However, forward-looking indicators of dwelling investment, such as building approvals, had started increasing prior to the first cash rate reduction. This is unlike in previous cycles and may have been related to expectations of monetary policy easing, as well as earlier strong population growth. An earlier easing in capacity constraints in the construction sector may also have played a role.

Graph 2.11
Dwelling Investment and Building Approvals*
Chain volume



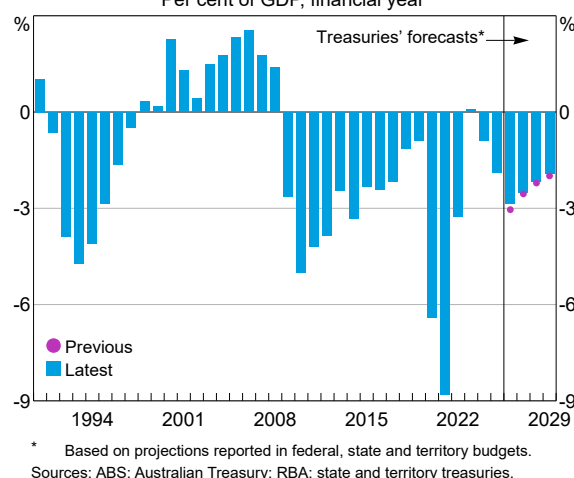
* Shaded area represents periods of a declining cash rate, beginning with the first rate cut and ending with the last cut. The end of the February 2025 phase is based on expectations derived from financial market pricing.
Sources: ABS; RBA.

While private demand growth was stronger than expected in the September quarter, the collective contribution of other components of GDP declined and was weaker than expected.

The contribution of public demand to year-ended GDP growth has continued to ease in recent quarters, as expected. Growth in public consumption in the September quarter was broadly in line with expectations, driven by continued growth in both real employee and other operating expenses. The level of spending on social benefits to households (which includes a range of payments to households, including relating to the NDIS, Medicare, the Pharmaceutical Benefits Scheme, aged care and childcare subsidies) has steadied in real terms in recent quarters after growing strongly in recent years. After three successive quarterly declines, public investment was expected to rebound in the September quarter, which it did, although the size of the increase was larger than anticipated.

Budget estimates of the fiscal balance provide a more comprehensive view of developments in fiscal policy than public demand alone. The consolidated underlying cash balance from federal, state and territory budgets incorporates a wider range of government spending, as well as taxes and transfers, which affect private activity. The mid-year budget updates suggest the consolidated government deficit will continue to widen in 2025/26, broadly in line with what was projected in the previous set of budgets from early-to-mid last year (Graph 2.12).

Graph 2.12
Consolidated Government
Underlying Cash Balance
Per cent of GDP, financial year



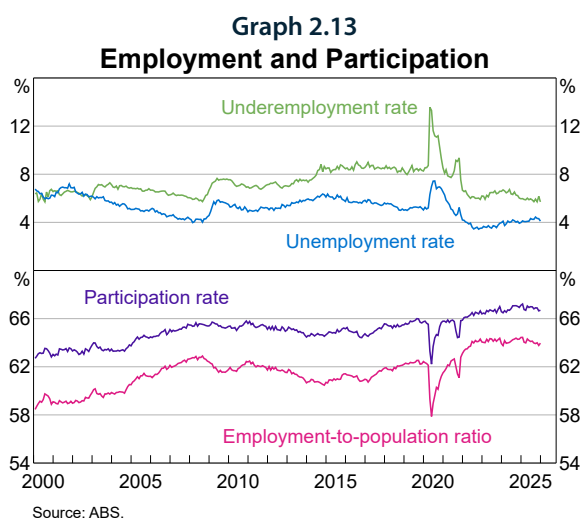
Net trade and inventories have together detracted modestly from GDP growth in recent quarters. Net trade subtracted 0.1 percentage points from GDP over the year to the September quarter as import volumes growth outpaced growth in export volumes. Partial data for the December quarter suggests solid growth in both imports (consistent with strength in domestic demand) and exports. Export volumes have increased over the past year as resilient global economic growth sustained demand for Australian commodities and services exports (such as tourism), and Australian iron ore production volumes increased.

2.3 Labour market and wages

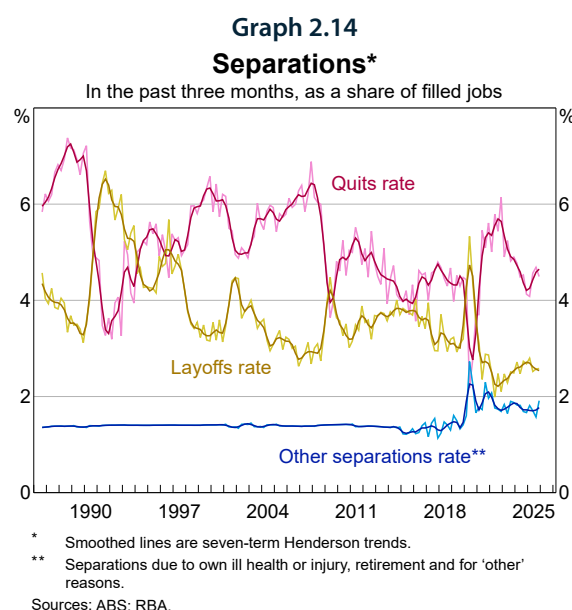
After a slight easing in the middle of 2025, labour market conditions appear to have stabilised in recent months, in line with stronger growth in economic activity. The unemployment rate was a little lower than expected in the December quarter, reflecting a sharp decline in the month of December that we assess in part to reflect monthly volatility. The employment-to-population ratio and participation rate eased a little in the December quarter. Timely indicators of labour demand such as job advertisements, vacancies and employment intentions point to a broadly stable near-term outlook for labour market conditions, consistent with the recovery in GDP growth through 2025. We continue to assess that there is some remaining tightness in the labour market (see section 2.4 Assessment of spare capacity). In line with this assessment, growth in unit labour costs remains elevated.

Overall, we assess that labour market conditions have been broadly stable in recent months.

The unemployment rate decreased to 4.1 per cent in the month of December (Graph 2.13). This decrease was unexpected, but monthly data can be volatile and we expect part of the decrease to be transitory. Nevertheless, for the December quarter as a whole, the unemployment rate averaged 4.2 per cent, below our November *Statement* forecast of 4.4 per cent. The underemployment rate was broadly stable at 5.9 per cent, remaining low by historical standards having trended down since early 2024. Recent analysis suggests that much of that decline in the underemployment rate – which measures the share of people in employment who are working fewer hours than they would like to – has been driven by some workers preferring fewer hours, rather than an increase in actual hours worked – suggesting a reduction in labour supply. The hours-based underutilisation rate – a broader measure of spare capacity – and the medium-term unemployment rate have largely tracked sideways since the start of 2025.



Some other indicators are also consistent with stable or even slightly tighter labour market conditions. The rate of layoffs, which began increasing in 2022, stabilised over the past year at a relatively low level by historical standards. The rate of voluntary job separations – the ‘quits rate’ – has picked up over the past year after having eased more rapidly than other labour market indicators since its 2022 peak (Graph 2.14). These developments could suggest that inter-firm competition to attract and retain staff has increased, indicating tighter labour market conditions.



Both the employment-to-population ratio and participation rate decreased a little in recent months.

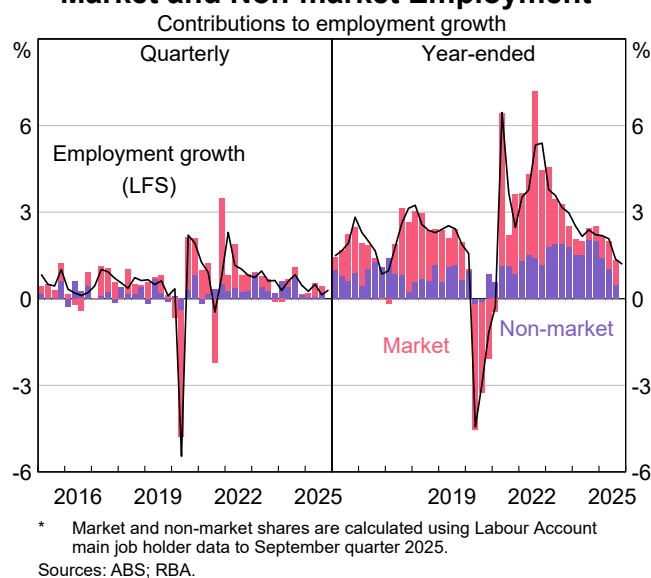
In the December quarter, the employment-to-population ratio was 63.9 per cent, slightly below our expectation at the time of the November *Statement*. The decline reflects the continued moderation of employment growth throughout 2025, which likely reflected some easing in labour demand growth as well as slower growth in labour supply. The participation rate ticked down in the December quarter to sit a little lower than expected. The fall in participation may reflect greater difficulty finding work over the past year due to a moderation in labour demand, as well as the earlier easing in cost-of-living pressures. Hires from outside the labour force have stabilised in the past six months, which is consistent with fewer workers being drawn in to a somewhat tight labour market. Notwithstanding participation outcomes being weaker than expected in the December quarter, we expect that participation will remain well above pre-pandemic levels, supported by long-run trends such as higher female participation.

In the year to September, the market sector became the main driver of employment growth as non-market sector employment growth declined.

Industry-level data (available to the September quarter) indicate that employment growth in the market sector continued to pick up in year-ended terms, consistent with the recovery in GDP growth and the shift in the composition of growth from the public to the private sector. The level of employment in the non-market sector picked up a little in the September quarter, after having been steady in the first half of the year (Graph 2.15).

Graph 2.15

Market and Non-market Employment*

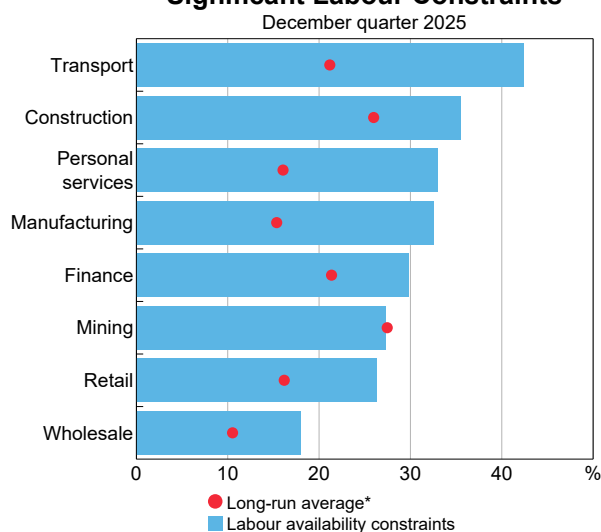


The availability of labour remains a constraint for many firms, consistent with some tightness remaining in the labour market.

Liaison suggests some firms are having less difficulty finding staff than a year ago, though many still struggle to find sufficiently skilled or high-quality candidates. Labour constraints have been broadly based across most industries (Graph 2.16; see also section 2.5 Inflation).

Graph 2.16

Share of Firms Reporting Significant Labour Constraints

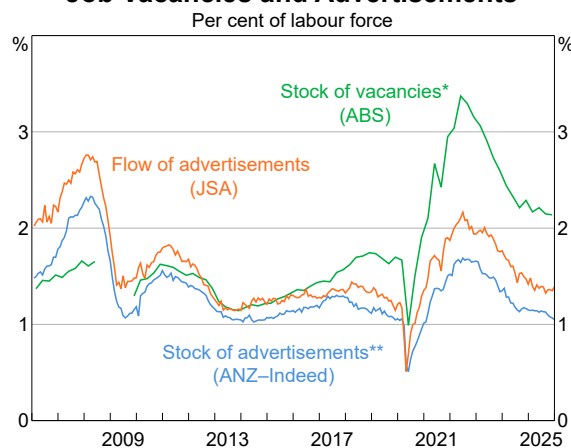


* Since 2000.
Sources: NAB; RBA.

Leading indicators point to a broadly stable outlook for labour market conditions in the near term.

Measures of labour demand such as job advertisements and vacancies have fallen a little in recent months and are slightly below levels of a year ago (Graph 2.17). Employment intentions from business surveys have been relatively stable, while employment intentions from the RBA's liaison program are broadly similar to a year ago and sit a little below their long-term average. Households' unemployment expectations ticked down in December, unwinding a large uptick in November. Taken together, these data suggest a stable near-term labour market outlook (see Chapter 3: Outlook).

Graph 2.17
Job Vacancies and Advertisements



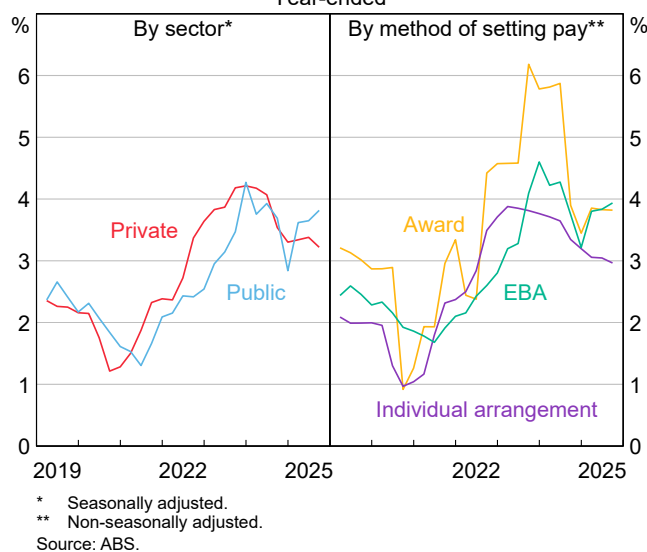
* This survey was suspended between May 2008 and November 2009.
 ** Volumes are backed out by splicing the current ANZ-Indeed job ads series with the historical ANZ Australian job ads series.
 Sources: ABS; ANZ-Indeed; JSA; RBA.

Wages growth was steady at 3.4 per cent in year-ended terms in the September quarter, as expected in the November *Statement*.

Private sector wage price index (WPI) growth eased to 3.2 per cent in year-ended terms, slightly below expectations. Quarterly private sector WPI growth – which had remained broadly steady over the first half of 2025 after accounting for one-off administered increases – declined to 0.7 per cent, its slowest rate since 2021. Both the share of private sector workers receiving a wage increase and the average size of hourly wage changes were slightly lower compared with a year ago but remained above pre-pandemic levels. Public sector WPI growth eased slightly to 0.9 per cent in the quarter but increased to 3.8 per cent in year-ended terms, in line with expectations.

Wages for workers (across both public and private sectors) paid under enterprise bargaining agreements (EBAs) and awards continued to grow more strongly over the year to September than those for workers paid under individual arrangements. Wages paid under individual arrangements – which tend to be the most responsive to current labour market conditions – increased by 3.0 per cent over the year (Graph 2.18).

Graph 2.18
Wages Growth
Year-ended

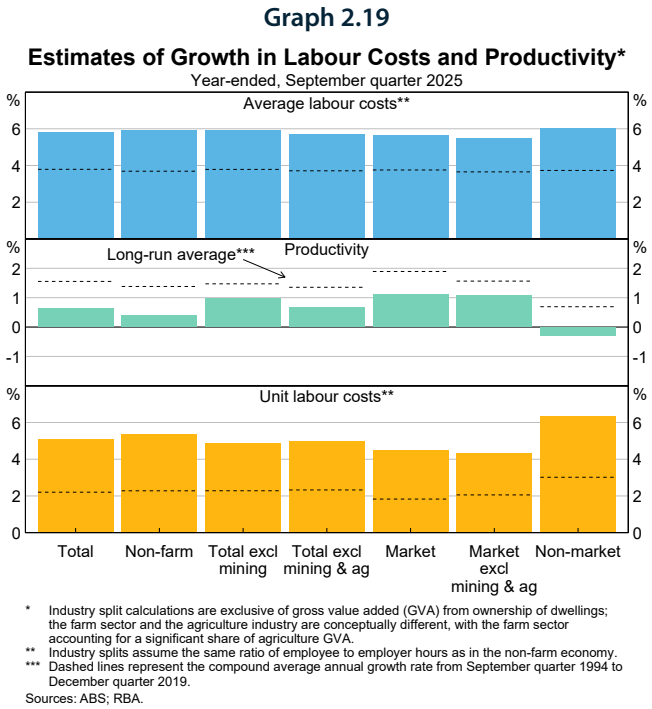


Growth in average earnings has continued to be higher than WPI growth, as is typically the case, and is above its long-run average growth rate.

Year-ended growth in the national accounts' measure of average earnings (AENA) per hour increased to 5.9 per cent in the September quarter, slightly stronger than expected in the November *Statement*. AENA is a broader measure of labour earnings than the WPI as it includes changes in bonuses, overtime and other payments, as well as the impact of workers transitioning to jobs with different levels of pay. Growth in AENA was bolstered in the September quarter by the scheduled increase in the Superannuation Guarantee from 11.5 per cent to 12.0 per cent from July 2025.

Weakness in productivity growth continued to contribute to elevated unit labour costs growth.

Labour productivity growth in the non-farm sector increased to 0.5 per cent over the year to the September quarter, which was a little weaker than expected. Productivity growth has been weak over recent years, but we expect some of the drivers of this weakness to wane. Growth in unit labour costs increased to 5.4 per cent over the year to the September quarter; elevated unit labour costs growth is consistent with more upwards pressure from labour market tightness flowing through to firms’ labour costs than is signalled by the WPI. Estimates of unit labour cost growth remain elevated even after excluding various industries (Graph 2.19).



2.4 Assessment of spare capacity

A range of information – including labour market and labour cost data, business surveys and model estimates – continues to suggest that labour market conditions are a little tight. Model-based estimates of the output gap and survey measures of firms' capacity utilisation indicate persistent capacity pressures in the economy more broadly. The extent of these capacity pressures now appears to have been somewhat greater through 2025 than previously assessed, and to have increased in the second half of the year. This partly reflects that demand growth picked up by more than expected over that period, and also that model estimates suggest potential supply over 2025 was lower than previously estimated – a possibility that was identified as a risk in the August and November *Statements*. Elevated capacity pressures are consistent with the recent pick-up in inflation, though less persistent sector-specific factors are assumed to explain most of the recent inflation surprise (see section 2.5 Inflation).

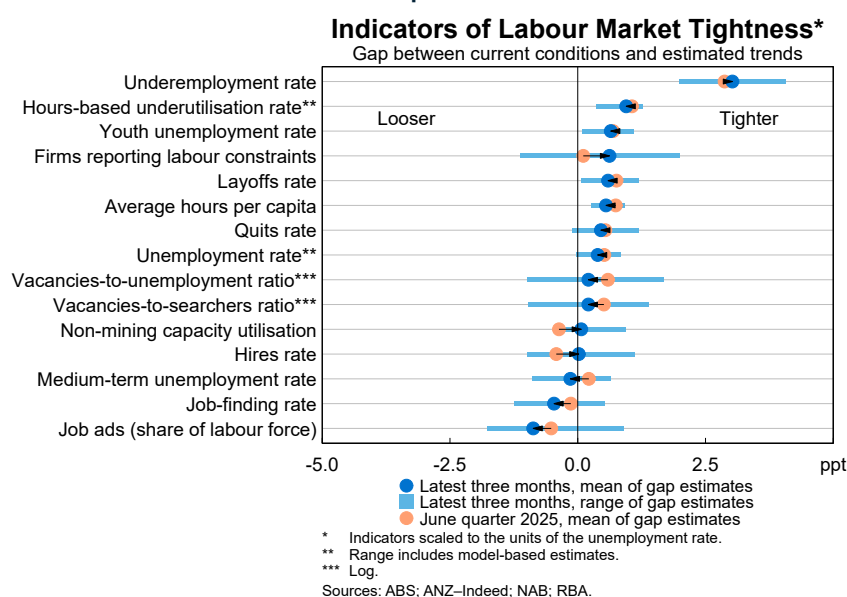
Our overall assessment is that the labour market is still a little tight.

A range of indicators continue to suggest some tightness in labour market conditions. We have recently revised our approach to assessing labour market conditions relative to full employment (see Box A: Update on the RBA's Approach to Assessing Full Employment). The revised approach continues to

support our assessment that the labour market is still a little tight. Most of the indicators we monitor remain tighter than their estimated trend level – as shown in Graph 2.20 by the blue dots and blue ranges sitting mostly to the right-hand side of the graph. Consistent with that assessment, in the December quarter, the unemployment rate was little changed from September and continues to point to a degree of tightness. The underemployment rate and hours-based underutilisation rate are both considerably tighter than estimates of their trend level.

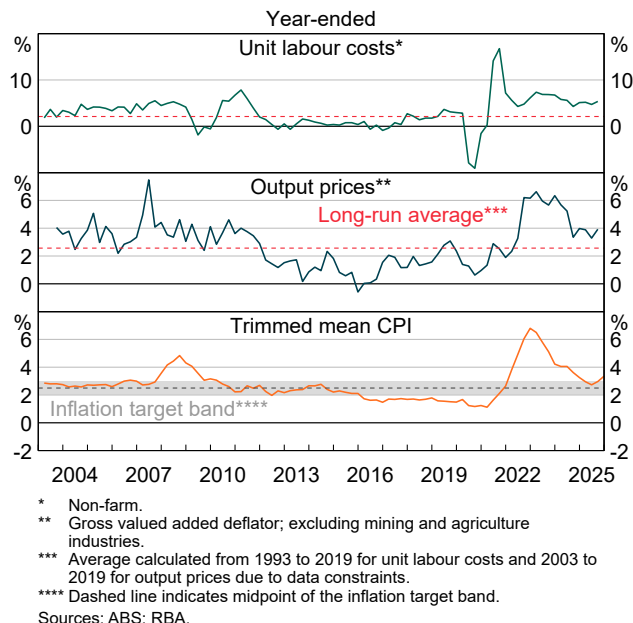
While the indicators overall suggest a degree of tightness, there is some dispersion in what they say about how spare capacity has evolved recently. Some indicators, including the ratio of vacancies to searchers and the youth unemployment rate, eased over the second half of last year (but still point to labour market tightness). By contrast, the quits rate, non-mining capacity utilisation rate and the share of firms reporting labour constraints have increased since mid-2025, suggesting some tightening in conditions. Only a few indicators are below their estimated trends. These include job ads (as a share of the labour force), and the job-finding rate of the unemployed, which has decreased over the past year as it has become more difficult to find work than when labour market conditions were very tight.

Graph 2.20



The degree of inflation in prices, wages and unit labour costs in the economy are important (though often lagging) indicators of the extent of capacity pressures in the labour market and broader economy, and we therefore monitor a range of measures.¹ A number of these measures, including consumer price inflation and unit labour cost growth, have been above their long-run averages (Graph 2.21). This is consistent with there being some ongoing capacity pressure in the labour market and economy.

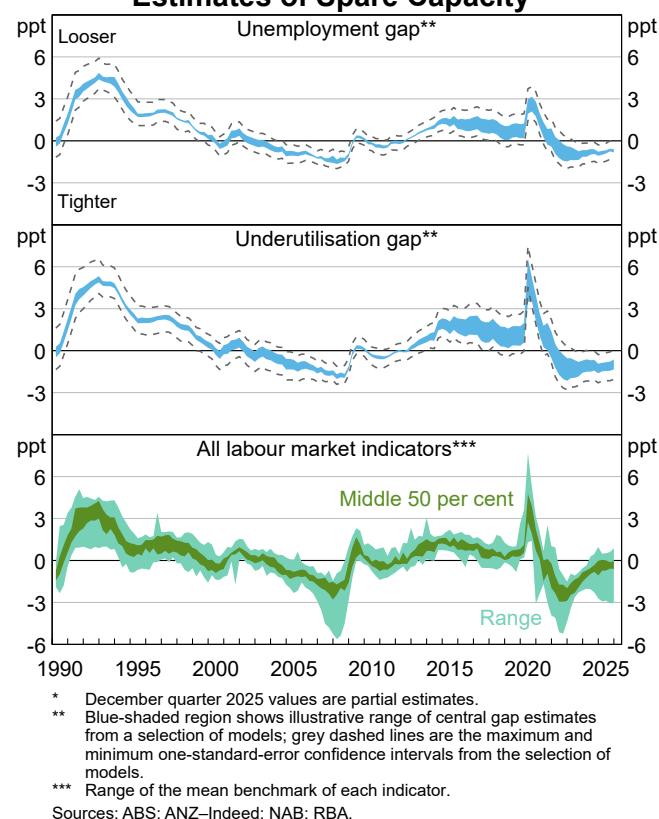
Graph 2.21
Price and Labour Cost Growth



Model-based estimates continue to indicate a tighter labour market than suggested by other indicators. Model-based estimates suggest that the labour market has seen only slow and modest easing in recent years and remains tight – as shown by the blue shaded areas in the upper and middle panels of Graph 2.22. The models interpret inflation and labour cost outcomes over 2025 as pointing to ongoing tightness in labour market conditions, with all models in the suite suggesting that conditions are tighter than full employment. Model estimates based on the latest data suggest the non-accelerating inflation rate of unemployment (NAIRU) could be a little higher than previously estimated. Model estimates of the NAIRU have tended to drift up in recent years, so that the increases seen in the unemployment and underutilisation rates have not flowed through one-for-one to declines in model-based estimates of labour market tightness. However, the model estimates

could also be affected by broader capacity pressures, or developments in particular sectors, rather than being a pure read on labour market conditions. By contrast, the central tendency of our broad suite of labour market indicators (the dark green range in the lower panel of Graph 2.22) suggests less tightness in the labour market – consistent with our overall assessment of labour market conditions as a little tight.²

Graph 2.22
Estimates of Spare Capacity*

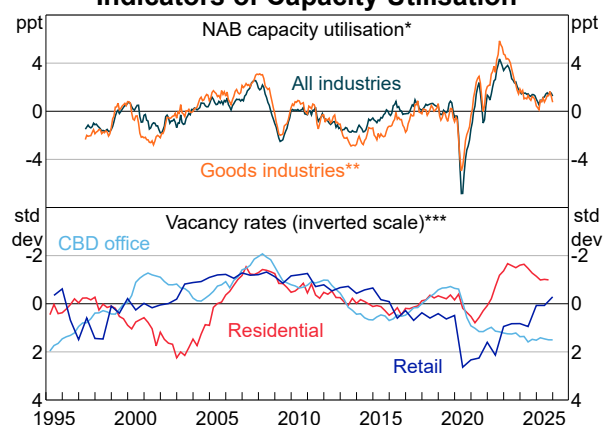


Recent data suggest somewhat greater capacity pressures in the economy than previously assessed.

Indicators of broader capacity utilisation suggest that some resources in the economy continue to be used intensively, and that capacity utilisation may have picked up since the first half of 2025. The NAB measure of capacity utilisation increased over the second half of 2025, alongside the pick-up in demand growth, and remains elevated (Graph 2.23). This suggests businesses are still using their labour and capital resources more intensively than usual to meet demand, although the increase over 2025 is most evident in the construction and wholesale sectors. Residential

vacancies remain low, consistent with ongoing inflationary pressure in the housing market. Retail vacancies data suggest occupation of retail property has consistently trended up in recent years, recovering from its sudden fall at the start of the pandemic, and is now above its historical average for the first time since December 2015. This may contribute to additional capacity pressure in the retail sector, particularly alongside the recent pick-up in household consumption growth.

Graph 2.23
Indicators of Capacity Utilisation



* 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.
 ** Goods industries include manufacturing, construction, wholesale and retail.
 *** Series are standardised to measure the number of standard deviations each series is from its mean value; retail refers to regional retail centres.
 Sources: ABS; JLL Research; NAB; RBA; REIA.

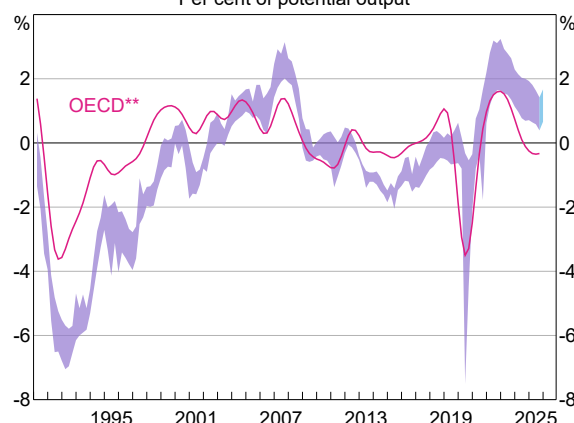
Taking survey evidence together with model-based estimates of the output gap, we assess that the output gap at the end of 2025 was positive, somewhat larger than expected in November and considerably larger than expected in August.

The level of GDP in the September quarter remained higher than most model estimates of the level of potential output, suggesting that aggregate demand continued to exceed the capacity of the economy to supply goods and services sustainably (Graph 2.24). Our estimates suggest that in the December quarter the

output gap may have widened a little. Over the past six months, the higher model estimates of the output gap and the increase in the NAB capacity utilisation measure, together with the pick-up in economic activity and inflation, indicate a marked tightening of capacity pressures relative to our assessment at the time of the *August Statement*.

Individual model estimates vary, reflecting differences in their design and how they interpret the data, and each is subject to estimation uncertainty. However, all the internal RBA models show a positive gap. Despite a recent upward revision, the OECD's estimate continues to be substantially lower, largely because it views recent weakness in labour productivity as mainly cyclical rather than structural, so that it does not have much effect on the estimated level of potential output. By contrast, weak productivity growth outcomes have continued to weigh on estimates of the current rate of potential output growth in other models.

Graph 2.24
Model Estimates of Output Gap*
Per cent of potential output



* Violet-shaded region shows illustrative range of central gap estimates from a selection of RBA's models encompassing different measures and definitions of the output gap; each estimate is subject to estimation uncertainty which is not shown in the graph, as well as revision due to data and model refinements. The blue-shaded region represents the partial estimates for the December quarter.
 ** Interpolated from annual estimates.

Sources: ABS; OECD; RBA.

2.5 Inflation

The monthly CPI is now Australia's primary measure of *headline* inflation. As outlined in the November *Statement*, however, the RBA will continue to focus on measures of underlying inflation from the quarterly CPI (based on the pre-October 2025 collection frequency) for a period.³ These quarterly data, which have well-understood properties and established seasonal patterns, provide an important source of continuity while the properties of the new monthly series become clear. In conjunction, the RBA will begin to analyse underlying inflation measures constructed using the monthly CPI.

The quarterly rate of underlying inflation eased only slightly in the December quarter and was higher than expected in the November *Statement*. Higher inflation in recent quarters has been broadly based across services, goods and new dwelling inflation. Economy-wide capacity pressures – which look to have been greater last year than previously assessed and to have increased in the second half of the year – are judged to have contributed to high underlying inflation but are unlikely to explain the majority of the recent increase. The larger remaining part is judged to reflect factors that may prove to be less persistent, including sector-specific demand pressures affecting new dwelling and durable goods prices, and price volatility in some categories such as fuel and overseas travel. Headline inflation was also stronger than expected in the November *Statement*, reflecting both firmer underlying inflation and stronger inflation in volatile items.

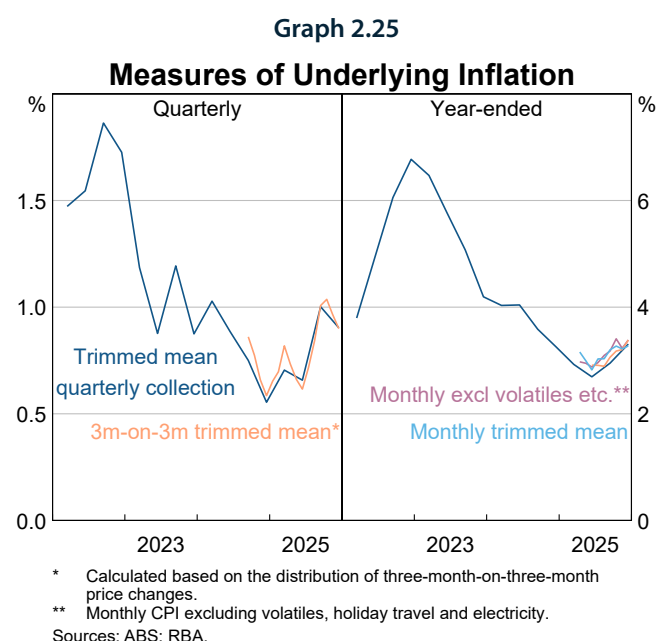
Inflation in the December quarter was stronger than expected in the November *Statement*. This followed stronger-than-expected inflation in the September quarter.

Headline inflation rose to 3.6 per cent over the year to the December quarter, from 3.2 per cent in the September quarter. This was stronger than the 3.3 per cent expected in the November *Statement*. Electricity inflation contributed around 0.6 percentage points to headline inflation over the year, with the expiration of rebates contributing around half a percentage point. Higher-than-expected inflation for

some volatile items such as fuel and travel also contributed to the increase in year-ended headline inflation and accounted for the surprise relative to the November forecast.

Trimmed mean inflation increased to 3.4 per cent over the year to the December quarter, from 3.0 per cent in the September quarter. The outcome was higher than expected in the November *Statement* and substantially higher than expected in the August forecast. Trimmed mean inflation eased slightly in quarterly terms, to 0.9 per cent, but by less than was expected in November.

Measures of underlying inflation from the monthly CPI also picked up in year-ended terms (Graph 2.25). There have been small differences between measures of underlying inflation from the monthly CPI and the quarterly trimmed mean since mid-2024 – the short period for which monthly data are available. Notwithstanding these small differences, all series trended up in the second half of 2025, consistent with the quarterly trimmed mean series.



Capacity pressures are judged to have contributed to high underlying inflation but are unlikely to explain the majority of the recent increase.

In quarterly terms, trimmed mean inflation was some way above a rate consistent with the middle of the target range in the December quarter. The elevated rate of trimmed mean inflation – taken together with continued strong growth in output prices and unit labour costs – is likely in part to reflect ongoing domestic capacity pressures. These economy-wide capacity pressures are now estimated to have been greater through last year than previously assessed, and to have increased in the second half of 2025 alongside strengthening GDP growth (see section 2.4 Assessment of spare capacity). Model estimates of the link between capacity pressures and inflation – while uncertain – suggest that economy-wide capacity pressures can only partly explain why inflation is elevated and are unlikely on their own to account for the strong pick-up in underlying inflation since mid-2025.

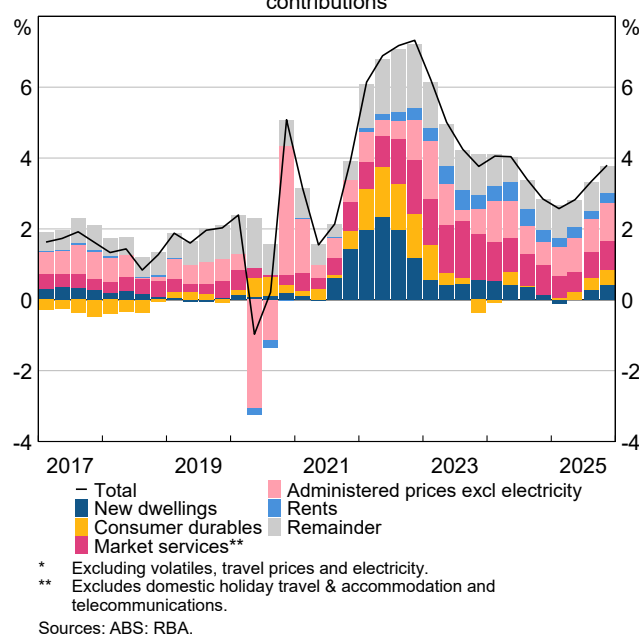
The larger part of the resurgence in inflation is judged to reflect some sector-specific demand and price pressures, which may not persist – though this judgement is very uncertain.

The resurgence in underlying inflation has coincided with stronger-than-expected private demand growth, particularly for housing and consumer durables (see section 2.2 Domestic economic activity). Correspondingly, increases in new dwelling and durable goods prices made a significant contribution to the increase in inflation since mid-2025 (Graph 2.26). It is possible that stronger demand growth in these sectors enabled larger price increases than otherwise, after a period in which there were reports that weak demand had prompted house builders to offer discounts, and limited retailers' ability to raise their prices. These price pressures could prove to be temporary if growth in housing demand and consumption slows as anticipated (see Chapter 3: Outlook), though this judgement is highly uncertain. Inflation in new dwelling and consumer durables prices was lower in late 2024 and early 2025, following a period of weaker demand conditions in those sectors that may have both masked the extent of capacity pressures in mid-2025 and accentuated the subsequent pick-up in inflation.

Graph 2.26

CPI Excluding Volatile Items*

Seasonally adjusted, two-quarter annualised growth with contributions



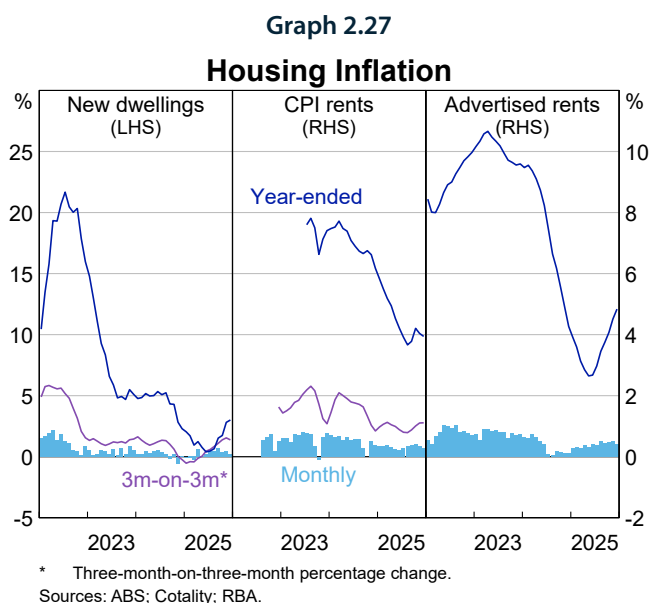
Housing inflation strengthened in the December quarter.

New dwelling construction prices increased by 1.3 per cent in the December quarter, which was stronger than in the November forecasts, as residential construction activity strengthened.

In year-ended terms, new dwelling inflation was 2.5 per cent in the December quarter, up from 0.9 per cent in the September quarter. Information from liaison indicates that demand for building new houses has picked up in recent months alongside improved buyer sentiment. The ABS has indicated that part of the price rises reflected that residential builders began removing discounts that were in place when the housing market was weaker. Cost growth for builders increased over the quarter, largely reflecting trade labour costs but also materials costs to a lesser extent.

CPI rent inflation picked up to 4.0 per cent over the year to the December quarter, slightly above expectations in the November Statement.

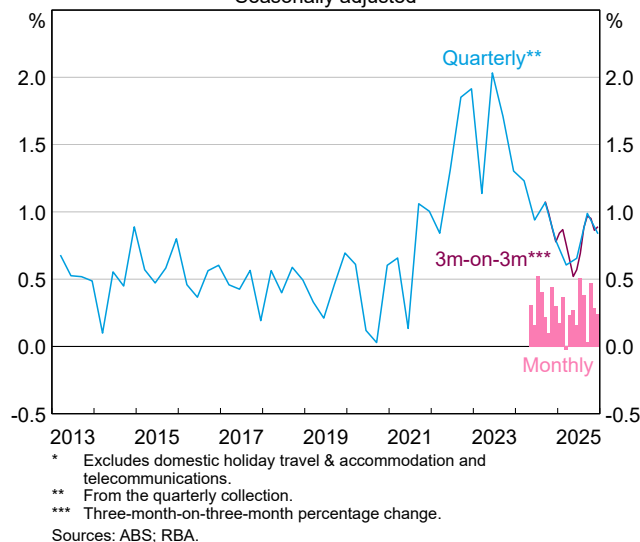
The quarterly rate of CPI rental inflation increased to 1.0 per cent from 0.9 per cent in the September quarter. This may reflect gradual pass-through from the pick-up in advertised rental growth, which has occurred alongside a tightening in rental market conditions (Graph 2.27).



Services inflation eased in quarterly terms in the December quarter.

In the December quarter, market services inflation (excluding telecommunications and domestic travel) eased to 0.8 per cent, but remained at 3.1 per cent in year-ended terms. The prices of these services are typically among the most sensitive to domestic labour costs, and stronger inflation for market services in the second half of 2025 is consistent with ongoing strength in broader measures of labour costs over the past year. In quarterly terms, inflation for meals out and takeaway eased in December 2025, but for most other market services categories inflation remained higher than in the first half of 2025 (Graph 2.28).

Graph 2.28
Market Services Inflation*
Seasonally adjusted



Inflation for goods and services with administered prices (excluding utilities) was broadly stable in the quarter but increased in year-ended terms.

Lower-than-expected inflation for medical and hospital services – owing to an expansion of bulk billing incentives introduced on 1 November 2025 – was offset by an increase in other motor vehicle costs due to the end of registration discounts in Queensland. Despite the increase in year-ended growth, administered price inflation has contributed little to the recent pick-up in inflation and remains around its historical average.

Utilities prices decreased 2.5 per cent in the December quarter, following an increase of 5.7 per cent in the September quarter. This reflected that households in some states received a double rebate for electricity prices following a delay in the timing of payments in the September quarter. Nonetheless, electricity prices increased by 26 per cent in year-ended terms, reflecting the expiration of some rebates. A large rise in water and sewerage prices in Sydney – due to a review of pricing that occurs approximately every five years – partially offset the quarterly decline in electricity prices. Although utilities inflation has boosted headline inflation over the past year, it has had a much smaller effect on measures of underlying inflation. The increase in electricity prices through the year primarily reflects a temporary impulse from the roll-off of rebates, which has largely been excluded from the quarterly trimmed mean over this period.

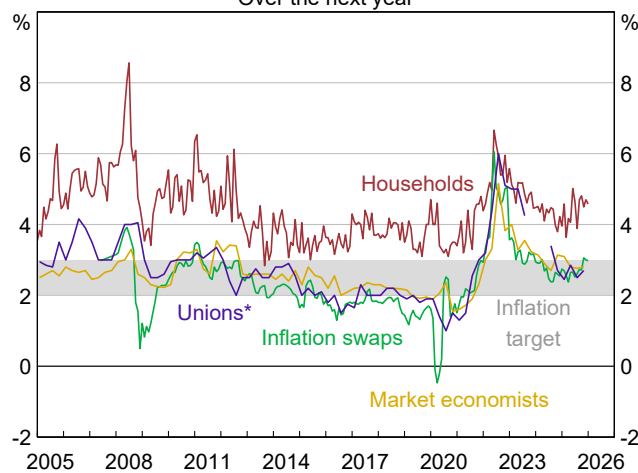
Goods inflation has picked up over the past half year.

Retail goods inflation was 2.1 per cent in year-ended terms in the December quarter, which was higher than the rate earlier in 2025. Consumer durables inflation increased by 0.6 per cent in the December quarter; however, it will take time to fully understand the seasonal patterns in the monthly data around sales events including Black Friday/Cyber Monday. The pick-up in consumer durables inflation was stronger than expected in the November *Statement* and coincided with stronger household spending growth (see section 2.2 Domestic economic activity). This may be because strong demand enabled retailers to increase prices by more than might be expected given changes in the prices of imported consumer goods; fewer retailers in the liaison program have reported margin compression as retail conditions have improved over the past six months. Groceries inflation, excluding fruit and vegetables, was unchanged in the December quarter. Information from liaison suggests that global trade tensions have not materially impacted most firms' pricing decisions.

While long-term inflation expectations remain consistent with achieving the inflation target, some short-term measures have increased since late 2024.

Survey measures of households' short-term inflation expectations have increased since late 2024 and are slightly above their long-run average. Financial market measures of short-term expectations derived from inflation swaps are also higher than in late 2024, having picked up in recent months alongside higher realised inflation (Graph 2.29) (see Chapter 1: Financial Conditions). However, survey and financial market measures of long-term inflation expectations remain broadly stable, supporting our assessment that long-term inflation expectations remain anchored at the target.

Graph 2.29
Short-term Inflation Expectations
Over the next year



* Data on union inflation expectations unavailable between November 2023 and May 2024.

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

Endnotes

- 1 See RBA (2026), 'Update on the RBA's Approach to Assessing Full Employment', Technical Note, February.
- 2 See RBA, n 1.
- 3 See RBA (2025), 'Box C: The Transition to a Complete Monthly CPI', *Statement on Monetary Policy*, November; RBA (2025), 'The Transition to a Complete Monthly CPI', Technical Note, November.

Box A: Update on the RBA's Approach to Assessing Full Employment

When assessing labour market conditions relative to full employment, the RBA considers wage and price indicators, model-based estimates and a range of labour market indicators. This Box summarises some recent updates to how we incorporate labour market indicators in our assessments.

Full employment is a longstanding objective of the RBA. The Monetary Policy Board aims to achieve 'sustained full employment', which is the maximum level of employment in the economy that is consistent with low and stable inflation.¹

Full employment cannot be observed directly or summarised by a single statistic, and it changes over time as the structure of the economy evolves. Accordingly, the RBA uses a broad set of information to assess how close the labour market is to full employment. This set includes wage and price indicators, model-based estimates and a range of labour market indicators.²

We recently reviewed how we incorporate information from our suite of labour market indicators, to make our approach to assessing labour market conditions more systematic, comprehensive and transparent. This review led to three key refinements:

- 1. Choice of labour market indicators.** We reviewed our labour market indicators to verify which indicators provide information about future inflation and wages growth. Indicators that meet this test can help guide an assessment as to whether labour market conditions are tight relative to full employment (i.e. likely to place upward pressure on inflation) or loose relative to full employment (i.e. likely to place downwards pressure on inflation). As a result of this review, we have added some new labour market indicators and removed one of the existing indicators. The new indicators are: the vacancies-to-searchers ratio; hours worked per capita; the job-finding rate of the unemployed; and non-mining capacity utilisation. The indicator we removed is firms' reported employment intentions, though we still watch this indicator closely in forecasting near-term employment growth.³
- 2. How we interpret each indicator.** We have implemented a more systematic approach to identifying what each indicator tells us about *how* tight or loose the labour market is relative to full employment. Our previous presentation of the suite of labour market indicators compared each indicator to its historical average. In practice this approach has the limitation that, when an indicator is trending – for example, due to structural change in the economy – a historical average will include observations from a time when the series was structurally much higher or lower than the present day and therefore may not be the best benchmark for current full employment. This limitation was noted when it was introduced, and our overall view of labour market conditions has taken account of trends where necessary. However, we have now adopted a consistent and systematic approach to removing trends from each indicator, so that it is clearer how the suite of indicators maps to our view of labour market conditions. Because identifying underlying trends can be difficult, for each indicator we use a range of different methods to calculate the trend and then calculate the average deviation from trend across the different trend measures to add further rigour to our assessment.

3. How we summarise the individual indicators. We have generated a new summary measure that helps us to assess what the suite of indicators is telling us about labour market conditions relative to full employment. For each labour market indicator, we first calculate the average deviation from the various measures of trend discussed above (see Graph 2.20 in Chapter 2: Economic Conditions). We then construct a new summary measure that presents the full range of average deviations across the various indicators, as well as the middle 50 per cent of these deviations (see Graph 2.22 in Chapter 2: Economic Conditions). This new labour market indicator summary measure tends to follow the model-based estimates of the unemployment gap quite closely much of the time. However, there are periods in which individual labour market indicators can diverge, highlighting that the labour market can sometimes adjust in ways that are not fully captured by the unemployment rate. The labour market indicator summary measure, along with wage and price indicators and model-based estimates, informs our judgement-based assessment of labour market conditions relative to full employment.

Overall, the revised approach provides additional support for our assessment that there remains some tightness in labour market conditions (see section 2.4 Assessment of spare capacity in Chapter 2: Economic Conditions).

For more detail, see RBA (2026), 'Update on the RBA's Approach to Assessing Full Employment', Technical Note, February.

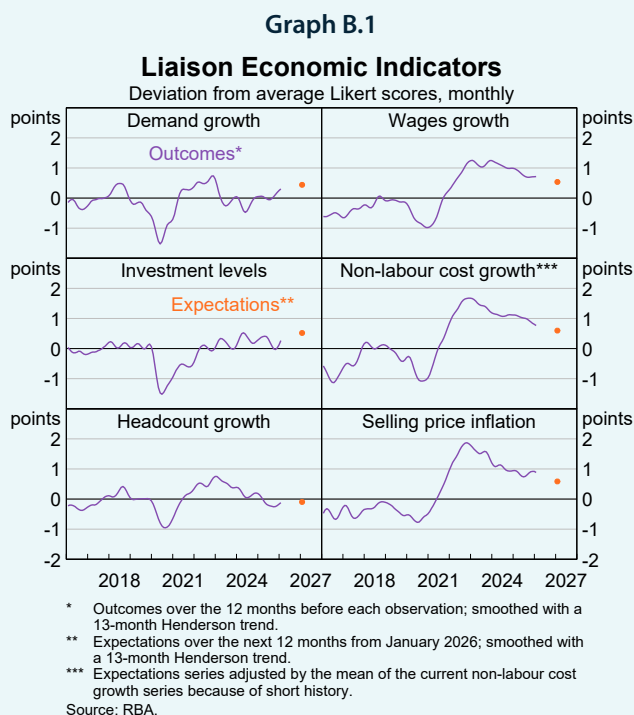
Endnotes

- 1 See Treasurer and Monetary Policy Board (2025), *Statement on the Conduct of Monetary Policy*, July.
- 2 The RBA's approach to assessing labour market conditions relative to full employment was set out in RBA (2024), 'Chapter 4: In Depth – Full Employment', *Statement on Monetary Policy*, February; Ballantyne A, A Sharma and T Taylor (2024), 'Assessing Full Employment in Australia', *RBA Bulletin*, April.
- 3 Employment growth is more closely related to the *change* in labour market conditions than the *level* of tightness of the labour market. For example, strong employment growth could be associated with a high and declining unemployment rate, or a low and declining unemployment rate.

Box B: 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 160 businesses, industry bodies, government agencies and community organisations from early-November 2025 to late-January 2026.

Liaison contacts report that demand has picked up over recent months, and it is expected to remain steady over the year ahead. Firms' investment intentions have also risen, reflecting planned projects across a broad range of industries. Despite the recent pick-up in demand growth, most firms are maintaining a focus on cost control, and say they plan to keep headcount stable, either by adopting a 'wait and see' approach or doing 'more with the same'. Recently, some contacts have noted tentative signs of a modest easing in cost pressures (including wages growth), although they remain above average. Selling price growth picked up slightly towards the end of last year, and while it is expected to ease over the year ahead, it is likely to remain above average (Graph B.1).



Retailers generally expect solid sales growth to continue.

Retailers reported that sales growth over the December quarter was solid, supported by strong demand throughout promotional periods, although outcomes were marginally below their expectations. Many retailers ran their Black Friday promotions for longer than in previous years and, in some cases, offered deeper discounts to attract deal-focused shoppers. Most retailers reported that the Black Friday period pulled forward sales from early December; however, demand has generally returned since the week before Christmas.

Retailers generally expect steady underlying growth in consumer demand over coming months. Most have noted an improvement in consumer sentiment relative to six months ago and generally expect current conditions to persist. Lower priced retailers continue to report better conditions than more discretionary firms. More generally, liaison contacts note that consumers remain value conscious and are increasingly 'mission shopping' (i.e. purchasing only specific planned items). This has contributed to somewhat inconsistent demand outside of promotional periods or new product launches. Some contacts have noted that, since late October, the change in the outlook for the cash rate has slightly tempered sales momentum.

Investment intentions have increased over the past few months.

Investment intentions for the year ahead have increased and are above their long-run average. Around one-third of firms spoken to in recent months (across a broad range of sectors) plan to increase investment, focusing on digital transformation projects (including automation and AI) and site expansions. Firms involved in data centre construction and fit-outs continue to see very strong demand with many projects in the pipeline.

Detached housing demand remains robust and high-density building conditions are improving, though capacity varies by state.

New home sales have picked up in New South Wales and Victoria, while demand in Western Australia, Queensland and South Australia remains robust. Contacts generally expect new detached home sales to continue rising over the year ahead, consistent with a sustained six-month increase in land sales. Builders in Western Australia are often operating at capacity, with 6–12 months of work in the pipeline, whereas those in New South Wales and Victoria have capacity to take on more projects. Trade labour availability tightened over the September quarter and contacts expect further tightening over the year ahead, alongside expected further increases in new home sales and detached construction activity.

Sentiment in high-density construction has improved gradually and contacts are more optimistic than a year ago. Recent increases in established apartment prices in New South Wales have supported modest improvements in project feasibility, leading to more non-premium projects commencing. Premium projects continue to progress, supported by relatively high selling prices. Contractor and labour capacity in high-density construction has improved in New South Wales and Victoria, primarily due to lower levels of public non-residential building activity. By contrast, capacity in high-density construction remains tight in some other states. Recent state government rezoning and planning reforms (especially in New South Wales) have been viewed favourably by industry contacts and are expected to materially support new medium- and high-density construction in coming years.

Firms expect growth in their headcounts to remain subdued.

Firms are trying to manage their headcount and labour costs more effectively, leading to subdued headcount growth over the past year, and project for this to continue in the year ahead. Most firms say they plan to keep headcount numbers stable (Graph B.2), either by taking a ‘wait and see’ approach or by continuing to reallocate existing headcount towards more productive or revenue-generating areas of the business. Some firms are doing this by replacing staff that joined soon after the COVID-19 pandemic with higher quality or skilled labour.

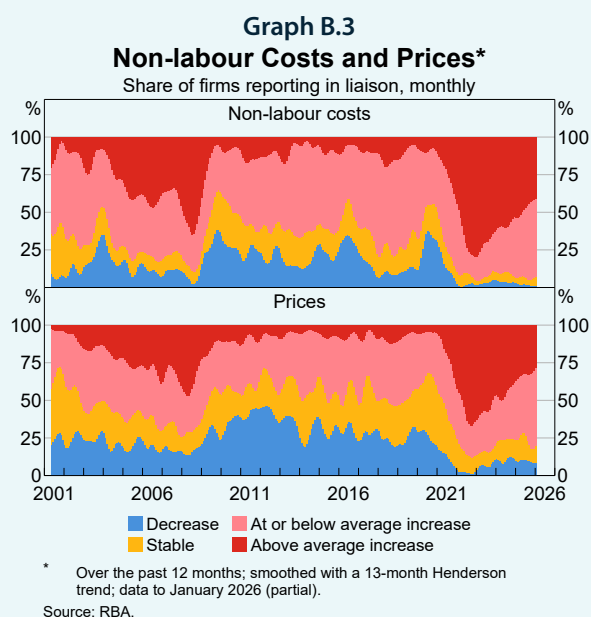


Hiring conditions are reported to be stable or improved, with job application numbers increasing; however, many contacts still struggle to find sufficiently skilled or high-quality candidates. Around half of firms still consider the labour market tight. Where shortages persist, firms are adapting by adjusting hiring practices, offering higher wages, or using non-wage incentives such as flexible hours, permanent roles, or housing.

Average wages growth has been little changed in recent months. Firms were surprised to the upside on their wages growth in early 2025, but the gap between expectations and outcomes has narrowed. Firms expect wages growth to ease marginally over the coming year.

Non-labour cost growth has eased gradually but remains elevated.

The share of firms reporting above-average non-labour cost increases continues to decline, although very few report stable or decreasing costs (Graph B.3). As a result, non-labour cost growth remains above its long-run average. Firms regularly highlight the elevated level of their overall cost base; most expect non-labour cost growth to either remain at its current rate or to ease slightly over the year ahead.



Selling price growth remains above its long-run average and is expected to ease over the year ahead.

Selling price growth for both goods and services has edged up in recent months, driven by fewer firms holding prices steady or decreasing prices (Graph B.3). A range of consumer-facing firms and builders have suggested that their margins were under less pressure in the second half of 2025 (compared with earlier in the year). In some cases, this is because they were able to pass through some cost increases to their prices. In other cases, firms found ways to reduce their cost base. Overall, contacts expect selling price growth to ease over the year ahead but to remain above average (Graph B.1).



Chapter 3 Outlook

Summary

- **Recent outcomes for economic activity, the labour market and inflation have been stronger than expected and market expectations for the cash rate – a key technical assumption to the forecasts – have shifted higher in response.** Based on financial market pricing, the forecasts assume the cash rate will increase by around 60 basis points by the end of the forecast period; by contrast, the November forecasts assumed the cash rate would decline by a further 30 basis points. The increase in market expectations for the cash rate has contributed to the 5 per cent appreciation of the exchange rate since the November *Statement* (see Chapter 1: Financial Conditions).
- **The economy is judged to be further from balance than we assessed last year, particularly in the near term.** The path for monetary policy assumed in the forecasts – with cash rate rises this year – is expected to restore balance between aggregate demand and potential supply. The assumed higher cash rate path contributes to a slowing in GDP growth to below its potential growth rate from late 2026 and a modest rise in the unemployment rate. Aggregate demand and potential supply are expected to have returned to balance by mid-2028, which is later than expected in the November *Statement*. Inflation is projected to be slightly above the midpoint of the target range by this time. However, this assessment is very uncertain and there is a risk that we have misjudged the extent of excess demand in the economy.
- **The near-term outlook for GDP growth has been revised higher, with growth now expected to be a little above its potential rate over most of 2026.** The near-term upward revision is driven by private demand, which looks to have been stronger than expected in the second half of 2025 due to both fundamental factors supporting growth as well as some temporary factors (see Chapter 2: Economic Conditions). We expect that some of this unanticipated strength in private demand will continue into 2026. From late 2026 onwards, GDP growth is expected to ease to below potential, reflecting the higher cash rate path and the waning boost from the factors that have supported growth recently.
- **The unemployment rate is expected to be broadly stable in the near term, before rising gradually to 4.6 per cent by mid-2028 because of a period of GDP growing below its potential rate.** Our assessment is that labour market conditions will be broadly stable in the near term; while some leading indicators of labour demand suggest that conditions could ease a little in coming quarters, this is balanced by the stronger near-term outlook for economic activity. From late 2026, the unemployment rate is forecast to edge higher as GDP growth slows. Wages growth is forecast to be a little higher than in the November *Statement*, but to ease slightly from late 2027 as the labour market moves closer to balance.

- **The outlook for inflation has been revised materially higher over the forecast period.** Inflation is now expected to peak in mid-2026 – with underlying inflation at 3.7 per cent and headline inflation at 4.2 per cent – before moderating to a little above the midpoint of the 2–3 per cent range by mid-2028. Strong inflation outturns in the second half of 2025 indicate that there is greater breadth and strength to current inflationary pressures than previously assessed. While much of this unexpected strength is judged to reflect sector-specific demand and price pressures that are expected to wane over the coming year, it also reflects greater capacity pressures in the economy than were assumed in the November *Statement*. The tightening in monetary policy assumed in the forecasts is expected to help ease these capacity pressures over the forecast period, with the economy returning to balance and inflation approaching the midpoint of the target range in mid-2028. We could have misjudged the role of temporary factors in driving recent inflation outcomes, and we will continue to monitor this risk closely.
- **Expectations for global growth have been revised upwards due to resilient trade flows and robust domestic demand in some key trading partners, but Consensus forecasts for global inflation remain broadly unchanged from the November *Statement*.** Risks to global activity remain to the downside over the medium term, but risks to the near-term global inflation outlook may have tilted somewhat to the upside due to bottlenecks in AI-related supply chains, recent developments in geopolitics and increased political pressure for more expansionary monetary policy in the United States. In China, uncertainty remains about the authorities' economic targets for 2026 and the composition and degree of support they are expected to provide this year in response to weakness in investment and the property market.

3.1 Key judgements

Key judgement #1 – There is more strength in private demand than previously assessed.

Growth in private demand in the second half of 2025 looks to have picked up by more than previously expected. Partial data for the December quarter suggest that growth in household consumption will be significantly stronger than expected in the November *Statement*. Part of this is judged to have been a ‘bring forward’ of expenditure in response to sales and promotional activity in late 2025. Household spending in categories where promotional activity is prevalent grew very strongly in the December quarter, and we expect some of this to unwind in the March quarter. But the broad-based nature of the pick-up suggests that part of it will be more persistent, and the forecasts therefore assume somewhat greater near-term strength in household spending. Similarly, while some of the unexpectedly strong increase in business investment in the September quarter is judged to reflect temporary or one-off factors, the upward revision to firms’ investment intentions for the year ahead suggests a somewhat stronger expenditure path. Consistent with these points, the outlook for private demand has been revised up over 2026.

However, there is considerable uncertainty around the extent to which the recent strength in private spending reflects stronger underlying momentum, or a bring forward of demand that may not persist. The implications of this are explored in Key risk #2.

Key judgement #2 – The unexpected strength in inflation in the second half of 2025 largely reflects sector-specific demand and price pressures that are assumed to abate over 2026, but is also indicative of more persistent economy-wide capacity pressures than previously assessed.

We judge that sector-specific factors account for much of the recent unexpected strength in inflation.

The unexpectedly strong pick-up in private demand in the second half of 2025, particularly for consumption goods and housing, is judged to have allowed firms to pass input cost increases through to prices to a greater extent than in late 2024 and the first half of 2025; during this earlier period, firms in some sectors indicated that subdued demand constrained their ability to pass on cost increases. We assume that the recent contribution to the unexpected strength in inflation from these dynamics’ wanes over 2026, in part because some of the unexpected increase in demand is assumed to represent a bring forward of expenditure. Further, a portion of the pick-up in inflation is judged to have reflected one-off price level increases, for example for fuel, with no persistent implications for inflation.

However, some of the unexpected strength in inflation is judged to be indicative of greater capacity pressures in the economy than previously expected. The lift in price pressures in the second half of 2025 has been seen in a broad range of categories, resulting in both headline and underlying inflation increasing. Consistent with this, there has been ongoing strength in other measures of inflationary pressures in the economy, such as unit labour costs and output prices, while survey measures of capacity utilisation have tightened. Together, these observations indicate that the economy remains capacity constrained, resulting in a persistent increase in inflationary pressures, particularly for components such as services inflation.

Key judgement #3 – Financial conditions are expected to become modestly restrictive under the assumed market path for interest rates.

The easing in monetary policy over the past year has coincided with a broader easing in wider financial conditions; taken together, it is uncertain whether conditions remain restrictive (see Chapter 1: Financial Conditions).

Notwithstanding this uncertainty, the higher market path for the cash rate (relative to the November forecasts) is assumed to lead to financial conditions becoming modestly restrictive in the forecast period. Conditional on this policy path, a period of below-potential growth in activity brings the economy back into balance by mid-2028. In turn, this is judged to return underlying inflation close to the midpoint of the target band by the end of the forecast period.

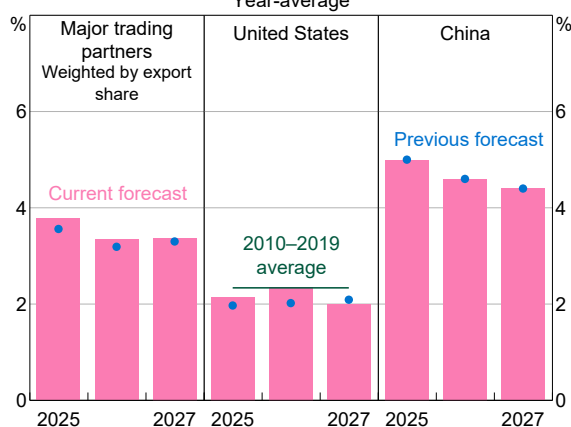
3.2 The global outlook

The outlook for major trading partner (MTP) growth has been revised up in 2026, amid continued resilience to trade policy developments and stronger growth in AI-related spending, while the assumed outlook for global inflation is little changed.

Growth in Australia's MTPs has been stronger than expected, supported by resilient trade flows and robust domestic demand in some economies.

Year-average MTP GDP growth is expected to have been 3.8 per cent last year (Graph 3.1). This is higher than was expected at the time of the November 2025 *Statement*, reflecting higher growth in the United States and for several east Asian economies in particular. Global growth is no longer expected to decelerate as sharply in 2026, as the rapid reconfiguration of trade flows and supply chains last year is judged to have helped mitigate the negative impacts of higher US tariffs, together with the range of product-specific exemptions that have also lowered the effective US tariff rate (see Chapter 2: Economic Conditions).

Graph 3.1
Major Trading Partner GDP Growth
Year-average



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

The boom in global AI- and broader technology-related spending is expected to drive continued strength in exports from east Asia, particularly for Taiwan, South Korea and Singapore.

Consensus forecasters expect the level of GDP in these countries to be higher over the next two years than was expected at the time of the November *Statement*, although growth is still expected to moderate from the rapid rates observed in 2025. More expansionary fiscal policy in Japan has also driven a modest upward revision to the outlook for activity in 2026.

Consensus forecasts for US growth have been revised upwards given the strong momentum in US private fixed capital investment and consumption.

AI-related investment is expected to remain particularly strong, although its contribution to GDP growth will continue to be partially offset by imports of intermediate inputs from east Asia. Easing monetary policy and expansionary fiscal measures are also expected to support US growth over the next two years. By contrast, Consensus forecasts for US inflation have been revised down in the near term following lower-than-expected CPI inflation in the December quarter. Part of this near-term revision reflects ongoing measurement issues related to the US federal government shutdown last year; however, lower-than-expected core goods inflation may also suggest that firms' pass-through of higher tariff costs to consumer prices may be smaller, or happening at a slower pace, than was previously anticipated.

Consensus forecasts for other advanced economies are broadly unchanged, with growth expected to be modest and inflation stable or declining. The effects of earlier monetary policy easing continue to support demand in most advanced economies. In Europe, higher fiscal spending in Germany is also expected to spill over to nearby countries and support growth in the region. Headline CPI inflation has returned to central bank targets in some economies and is expected to remain there (e.g. in the euro area and Sweden). For other advanced economies (e.g. the United States and the United Kingdom), inflation remains elevated but is expected to decline over 2026, in line with gradually easing labour market conditions. We also expect price

growth for MTP goods exports to remain subdued, consistent with weaker-than-expected growth in Chinese export prices in the second half of 2025.

Growth in China is expected to moderate a little in 2026 and 2027. Year-average GDP growth is forecast to be 4.6 per cent in 2026, and 4.4 per cent in 2027. These growth forecasts are unchanged compared with the November *Statement*, but our judgement around the composition of growth over the forecast horizon has changed in light of continued soft domestic demand outcomes and strong exports growth. The outlook for investment has been revised down further, reflecting weaker-than-expected nominal investment growth in the December quarter and a continued deterioration in

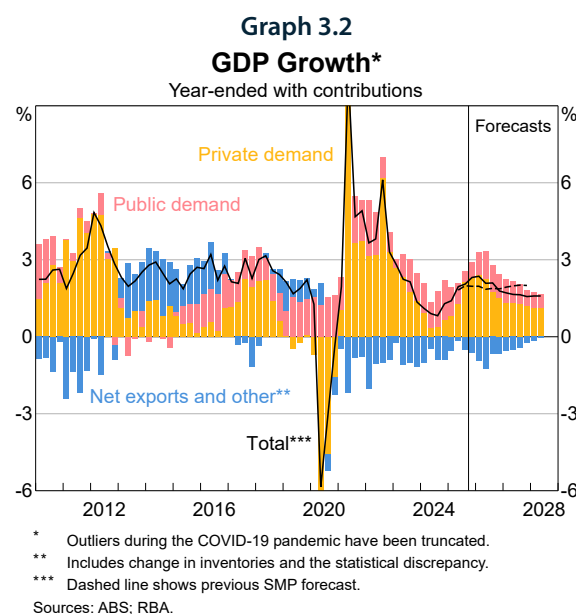
real estate market conditions. However, we continue to anticipate that announced policy stimulus will limit any further weakness in infrastructure investment. We expect net exports to contribute a little more to growth than previously assessed. We judge continued strong growth in export volumes to reflect in part an ongoing structural rise in China's manufacturing capacity, with growth particularly driven by exports of higher value-added products like vehicles, ships and semiconductors. The Chinese authorities' 2026 growth target, which will be published in March, may pose an upside risk to the degree of policy support currently embodied in our forecasts and therefore our MTP growth forecast if it is set in line with the 2025 target of 'around 5 per cent' (see Key risk #3).

3.3 The domestic outlook

On the assumption that the cash rate follows the market path, Australian GDP growth is projected to pick up further in the near term, before declining to below estimates of potential growth.

Year-ended GDP growth over most of 2026 is expected to be above our estimate of potential growth and our previous forecast (Graph 3.2). Private demand growth has been stronger than expected recently, reflecting the impact of several underlying (as well as some more transitory) forces in the domestic and global economies (see Chapter 2: Economic Conditions). Some of these have been at play for some time, like the cyclical recovery in the domestic economy as household incomes have risen. More recently, the early effects of monetary policy easing, more accommodative broader financial conditions domestically and internationally, stronger-than-expected global growth and an acceleration of business spending on new technologies have all contributed to an additional pick-up in spending growth. While none of these developments individually represents a significant surprise, at least directionally, our assessment is that collectively they have driven materially stronger-than-expected spending as they coalesced in the second half of last year. The upgrade to the near-term outlook for GDP growth recognises this stronger momentum and the judgement that many of these forces are likely to continue into 2026.

From late 2026 onwards, GDP growth is expected to be lower than in the November *Statement* and below our estimate of potential growth, with the higher assumed cash rate path beginning to weigh on private demand and GDP. The forecasts are conditioned on the market path for interest rates, with market participants expecting the cash rate to increase by around 60 basis points; by contrast, the November forecasts assumed the cash rate would decline by a further 30 basis points. The outlook for dwelling investment growth has been revised lower in response, due to both the direct effects of higher interest rates and because of slower housing price growth over the forecast period. The outlook for household consumption



growth and non-mining business investment in 2027 have also been revised down. The appreciation of the exchange rate is also expected to weigh on GDP growth, by supporting growth in imports and weighing on growth in some categories of exports (see Chapter 1: Financial Conditions). Exports growth is also expected to slow over the forecast period as the level of resources exports comes back into line with productive capacity, having been boosted recently by a drawdown in inventories.

The labour market is expected to remain a little tight in the near term.

The unemployment rate is forecast to be little changed in the near term, before gradually increasing to reach 4.6 per cent by mid-2028

(Graph 3.3). Leading indicators such as job ads, vacancies and employment intentions suggest labour market conditions could ease a little in the near term, although this is balanced by the stronger near-term outlook for activity. Taking these points together, we expect labour market conditions to remain stable over the next few quarters. From late 2026, the unemployment rate is forecast to rise gradually, reflecting the slowing in GDP growth over 2026. The underemployment rate is also expected to edge a little higher.

Graph 3.3
Unemployment Rate Forecast*



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

Sources: ABS; RBA.

The outlook for the employment-to-population ratio and participation rate have been revised down a little since the November Statement, taking signal from recent data. Population growth is assumed to

continue to ease from the very strong growth rates over recent years (Table 3.1). The employment-to-population ratio is expected to decline gradually as activity slows. Growth in non-market sector employment is expected to be below the very strong rates of the past few years.

The participation rate is forecast to be broadly stable. We expect that the participation rate will continue to be supported by long-run trends – such as increasing female participation – but will decrease a little in the near term, as we expect there to be less incentive to enter or remain in the labour force than in previous

years. This reduced incentive reflects a possible lessening in cost-of-living pressures, as evidenced by the decrease in the multiple jobholding rate over 2025. The decline in job-finding rates observed in recent years for both the unemployed and new labour force entrants is also expected to reduce the incentive to seek work.

In the central projection, aggregate demand remains above potential supply for most of the forecast period, with the economy only returning to balance in mid-2028; however, there is considerable uncertainty around this assessment, in both directions.

We assess that there will be a little more excess demand in parts of the economy and the labour market than previously expected (see Chapter 2: Economic Conditions). The staff's assumption for potential output growth is broadly unchanged from the November *Statement*, with potential output expected to grow at an annual rate of around 2 per cent over most of the forecast period. However, the small downward revision to the assessment of current supply capacity flows through the entire forecast period. Under the GDP growth forecasts, which assume the cash rate follows the market path, capacity pressures in parts of the economy – particularly the housing sector – are expected to increase in the near term before starting to ease from late 2026. The labour market is expected to remain a little tight in the near term and will ease only a little over the forecast period. Both the labour market and the broader economy are forecast to return to balance by the end of the forecast period.

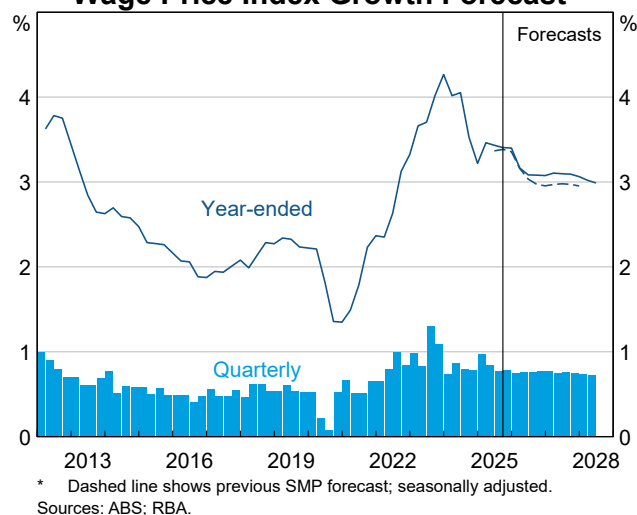
This assessment remains highly uncertain. We have sought to account for some of the risk identified in the August and November *Statements* that there is a little more excess demand for output and labour, especially in the near term. However, there is considerable uncertainty in assessing potential output, full employment and the outlook for capacity pressures. The possibility that we are misjudging the degree of spare capacity is covered in Key risk #2.

We expect slightly less moderation in wages growth than in November; this is consistent with our assessment that capacity pressures in the labour market will be a little more pronounced within the forecast period.

The forecast for year-ended nominal wages growth has been revised slightly higher from mid-2026 onwards (Graph 3.4). In the near term, underlying momentum in quarterly wages growth is expected to remain broadly stable, although changes in the timing of pay increases for some significant agreements and announced administered decisions may contribute to volatility in quarterly outcomes, particularly for the public sector. Beyond the near term, the higher outlook for wages growth relative to November reflects our assessment that there is slightly more capacity pressure in the economy than previously thought (see Chapter 2: Economic Conditions). Quarterly wages growth is expected to moderate gradually from late 2027 onwards as the labour market moves closer to balance.

Graph 3.4

Wage Price Index Growth Forecast*

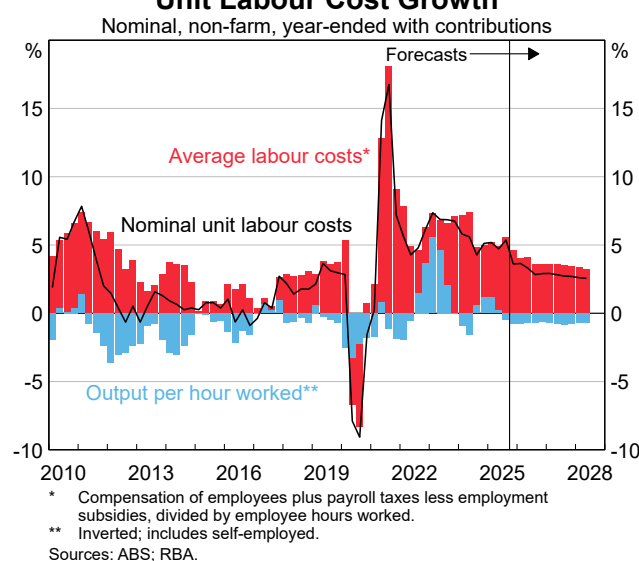


Growth in unit labour costs (ULCs) is expected to ease over the forecast period, on the assumption that the cash rate follows the market path. Growth in nominal ULCs – the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes – has been elevated in recent years, due to

both weak productivity growth and strong average labour cost growth. Growth in ULCs has also been stronger than forecast in recent quarters, largely due to stronger-than-expected growth in average labour costs. Year-ended growth in ULCs is expected to moderate over the forecast period, in line with easing growth in nominal wages and a projected pick-up in productivity growth (Graph 3.5).

Graph 3.5

Unit Labour Cost Growth



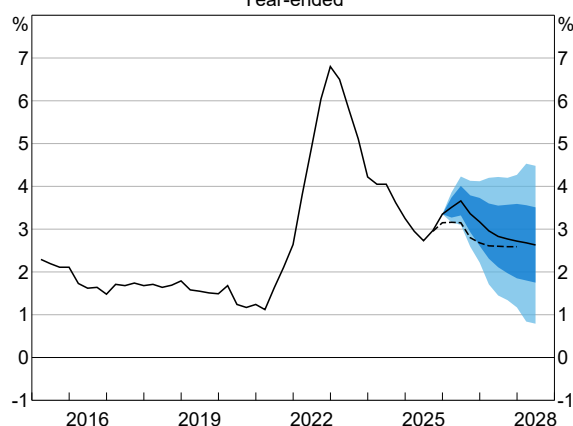
The forecast for underlying inflation has been revised higher relative to the November *Statement*.

On the assumption that the cash rate follows the market path, the central projection is for year-ended trimmed mean inflation to peak in mid-2026 before easing gradually, remaining above 3 per cent until early 2027 and approaching the midpoint of the target range by mid-2028.¹

The central projection assumes the quarterly rate of underlying inflation in the first quarter of 2026 is roughly unchanged. This reflects the upward revision to our assessment of capacity pressures, and that the December quarter outcome for CPI indicated greater strength across a broader range of goods and services than we had expected in November.

Inflation is expected to moderate over the forecast period to reach 2.6 per cent by mid-2028 (Graph 3.6). In quarterly terms, underlying inflation is forecast to start slowing from the June quarter of 2026, including because consumption growth and housing demand slows and places less upward pressure on new dwelling and consumer durables inflation. An easing in economy-wide capacity pressures over 2027, driven by slower growth in economic activity and a gradual easing in the labour market, is also expected to support disinflation. The anticipated moderation in ULC growth is expected to ease some pressures on firms' costs. The outlook for inflation is subject to considerable uncertainty in both directions: on the upside, capacity pressures may prove stronger than assumed in the central case; on the downside, the recent strength in CPI may prove to be more transitory. Inflation expectations are assumed to remain consistent with achieving the inflation target over the long term.

Graph 3.6
Trimmed Mean Inflation Forecast*
Year-ended



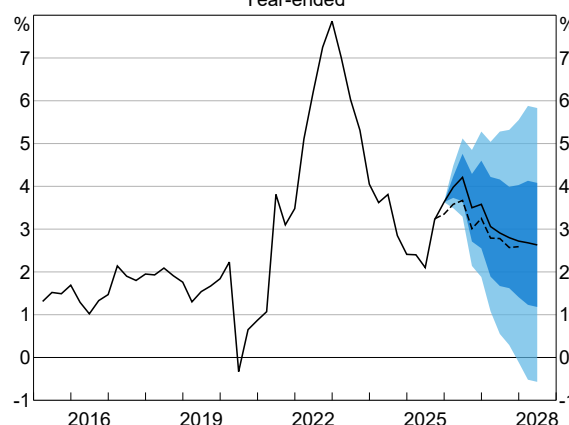
* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

The forecast for headline inflation has also been revised higher relative to the November Statement, primarily reflecting the stronger outlook for underlying inflation. Headline inflation is forecast to reach 4.2 per cent by mid-2026, then ease to around 2.6 per cent by the end of the forecast period (Graph 3.7). The roll-off of government electricity price rebates contributes to higher inflation in the near term and adds some volatility to the forecasts. Because headline inflation can be affected by large swings in the

prices of individual items, we will continue to pay close attention to underlying measures as an indicator of momentum in consumer price inflation.²

Graph 3.7
Headline Inflation Forecast*
Year-ended



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

Sources: ABS; RBA.

Housing inflation – measured in the CPI as the cost of constructing a new dwelling and rents currently being paid by households – is expected be higher in the near term relative to the November Statement.

The outlook for new dwellings inflation has been revised higher in the near term, which reflects the stronger-than-expected momentum in recent data. New dwellings inflation is expected to remain elevated in coming quarters, before easing in line with a weaker outlook for housing market activity. CPI rents are also expected to be a little higher over the forecast period. Near-term indicators of advertised rents suggest more strength in the rental market than assumed in November, which gradually passes through to the stock of rents as measured in the CPI.

Market services inflation is forecast to remain higher in the near term than in the November Statement.

A stronger profile for market services inflation reflects our assessment that there will be more capacity pressure in the economy than previously thought. Market services inflation is expected to increase in the first half of the year, before slowing only gradually as capacity and labour cost pressures ease.

3.4 Key risks to the outlook

Key risk #1 – The central projection may place too much weight on the role of temporary factors in driving recent inflation outcomes.

A key judgement in the central projection is that much of the unexpected strength in inflation in the second half of 2025 reflects some temporary and sector-specific factors that should abate over coming quarters (see Key judgement #2). This assumption accounts for most of the disinflation expected to occur over 2026.

The central projection may have ascribed too much weight to these temporary factors and therefore underestimated the degree of signal that recent inflation outcomes are providing about capacity pressures in the economy. Model-based estimates of spare capacity continue to point to a tighter labour market and economy than suggested by some other indicators. The breadth of the pick-up in inflation across components suggests there is a risk that inflation may remain higher for longer, particularly if it is being driven by broader strength in demand or capacity constraints affecting multiple sectors. At the same time, it is possible that some of the sectoral drivers may be less temporary than assumed – for example, if strength in demand for consumer goods is longer lasting. If we have overestimated the importance of these temporary factors, then the pace of disinflation over coming years is likely to be slower than expected.

Key risk #2 – The balance of demand and supply in the economy and the labour market may evolve in a way that differs from that assumed in the central projection.

There are a range of risks to the demand outlook, the assessment of supply capacity, and the outlook for labour market conditions that could all materialise and have implications for the outlook for inflation.

Demand growth could be stronger or weaker than forecast. This could occur because factors supporting the recent strength in private demand are more, or less,

persistent than assumed. For example, if household consumption indicators in October and November have been boosted by promotional periods by more (less) than assumed, it would suggest there would be less (more) underlying momentum to support household consumption in early 2026. The contribution of monetary policy to recent economic outcomes is also a source of uncertainty. The earlier monetary policy easing may have had a larger or earlier effect on private demand than implied by historical relationships because of the easing in broader financial conditions. If that is the case, then the withdrawal of that policy support may also have larger-than-anticipated effects.

The labour market may also adjust to future activity in a way that is different to that assumed in the central projection. The near-term strength in economic activity is not expected to translate into significantly stronger employment growth, consistent with leading indicators of labour demand having been stable or eased slightly in recent months, and feedback from liaison. However, the strength in private demand could translate into a stronger-than-expected increase in market sector employment growth and place downward pressure on the unemployment rate, particularly over the next year. Further out, there is a risk that employment growth is stronger or weaker than forecast, given uncertainty about how the labour market will adjust to the ongoing shift from public to private demand.

A particular source of uncertainty is the judgement about the economy's supply capacity over the forecast period. The central projection is based on an assumption that the starting point for supply capacity in the economy is a little less than in the November *Statement*, which flows through the entire forecast period, but that the outlook for *growth* in supply capacity is broadly unchanged. It is possible that we should be taking more signal from the recent strength in inflation and ongoing weakness in productivity growth to inform our outlook for supply capacity. The labour supply response to the gradual easing in conditions could result in individuals exiting the labour force due to increased difficulty finding work, with this decline in participation putting downward pressure on unemployment.

Key risk #3 – Risks to global activity remain tilted to the downside over the medium term, but the risks to the global inflation outlook may be shifting to the upside, particularly in the near term, because of increased geopolitical tensions and emerging bottlenecks in some supply chains.

Trade policy risks continue to evolve and remain to the downside, with uncertainty still somewhat elevated. While most bilateral US tariff rates have remained broadly stable since the November *Statement*, the recent increase in geopolitical tensions has seen some jurisdictions contemplate further increases to trade barriers as a retaliatory response to events. Ongoing and expected legal reviews, investigations and negotiations in several countries could raise or lower global trade barriers, and are also contributing to near-term policy uncertainty. There remains a risk that tariffs have a larger but more gradual impact on global supply capacity, taking years rather than months to fully materialise.

Global risks related to geopolitics and political interference in economic institutions have increased, but the impacts for Australia and most of its trading partners have so far been limited.

Geopolitical tensions have increased in several regions but have not yet led to significant disruptions to global trade flows or financial markets. However, an escalation in tensions in the Middle East could raise oil prices, which would increase inflation and weigh on activity

globally. Sustained political pressure for more expansionary monetary policy in the United States could also lead to higher inflation expectations, but financial market measures remain broadly stable. If these geopolitical and institutional pressures continue to build, downside risks to global growth could materialise, with a wide range of possible outcomes for global prices.

The surge in AI-related investment poses asymmetric risks to the outlook for global activity and prices.

In the near term, emerging supply chain bottlenecks may limit the strong growth of global AI-related investment and manufacturing, and raise input costs for other industries. Elevated asset price valuations tied to AI are also supporting household wealth in the United States and in parts of east Asia. A sudden decline in these valuations could weigh on both investment and consumption and create negative spillovers to global activity and inflation.

In China, risks to the growth outlook are balanced.

Weakness in investment, persisting for longer than expected due to structural factors, remains a key downside risk. On the other hand, Chinese authorities could provide more policy support than expected, including if they choose to support a growth target in line with 2025 of ‘around 5 per cent’. There are also uncertainties about the composition of growth. If policies to achieve the Chinese authorities’ stated goal of significantly increasing the consumption share of GDP materialise, the composition of Chinese growth could become less resource intensive. By contrast, policy support in recent years has tended to tilt towards infrastructure and manufacturing investment, contributing to demand for Australian resources.

3.5 Detailed forecast information

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

Table 3.1: Detailed Forecast Table^(a)

Percentage change through the four quarters to quarter shown, unless otherwise specified^(b)

	Dec 2025	Jun 2026	Dec 2026	Jun 2027	Dec 2027	Jun 2028
Activity						
Gross domestic product	2.3	2.1	1.8	1.6	1.6	1.6
Household consumption	3.1	2.8	2.1	1.9	1.7	1.7
Dwelling investment	5.5	3.7	1.8	1.1	0.3	–0.4
Business investment	2.5	3.7	2.4	2.4	2.2	2.0
Public demand	2.2	3.8	3.2	2.9	2.2	1.9
Gross national expenditure	2.9	3.1	2.6	2.2	1.8	1.6
Major trading partner (export-weighted) GDP	3.5	3.3	3.4	3.4	3.2	3.2
Trade						
Imports	6.3	4.6	3.0	3.7	2.6	2.2
Exports	3.9	0.7	–0.4	1.5	1.5	2.0
Terms of trade	4.7	6.8	–0.4	–0.9	0.1	0.4
Labour market						
Employment	1.2	1.1	1.3	1.2	1.2	1.2
Unemployment rate (quarterly, %)	4.2	4.3	4.3	4.4	4.5	4.6
Hours-based underutilisation rate (quarterly, %)	5.4	5.3	5.4	5.5	5.6	5.7
Income						
Wage Price Index	3.4	3.1	3.1	3.1	3.1	3.0
Nominal average earnings per hour (non-farm)	4.4	3.9	3.6	3.6	3.5	3.3
Real household disposable income	3.3	2.5	1.8	1.5	1.4	1.3
Inflation						
Consumer Price Index	3.6	4.2	3.6	2.9	2.7	2.6
Trimmed mean inflation	3.4	3.7	3.2	2.8	2.7	2.6
Assumptions						
Cash rate (%) ^(c)	3.6	3.9	4.2	4.2	4.3	4.2
Trade-weighted index (index) ^(d)	61.3	64.3	64.3	64.3	64.3	64.3
Brent crude oil price (US\$/bbl) ^(e)	63.1	63.8	63.8	63.8	63.8	63.8
Estimated resident population ^(f)	1.5	1.3	1.2	1.2	1.2	1.2
Memo items						
Labour productivity ^(g)	0.7	0.6	0.6	0.6	0.7	0.7
Household savings rate (%) ^(h)	6.0	5.9	5.5	5.4	5.2	5.1
Real Wage Price Index ⁽ⁱ⁾	–0.3	–0.9	–0.4	0.3	0.5	0.3
Real average earnings per hour (non-farm) ⁽ⁱ⁾	0.7	0.0	0.1	0.8	0.8	0.6

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- (a) Forecasts finalised on 28 January.
 - (b) Forecasts are rounded to the first decimal point. Shading indicates historical data.
 - (c) The cash rate is assumed to move in line with expectations derived from financial market pricing. For the February 2026 *Statement*, the RBA has made some technical changes to the methodology used to derive market expectations, including to better align with market conventions. The revised methodology has almost no effect on the cash rate path out to one year, and results in a modest upward shift in the cash rate path beyond that. The revised market path has no material effect on the forecasts or our current assessment of financial conditions. For more information, see *A Change to the Cash Rate Assumption Method for the Forecasts*.
 - (d) The daily exchange rate (TWI) is assumed to be unchanged at its current level going forward.
 - (e) Oil prices are assumed to remain constant at the current price over the current quarter. For the rest of the forecast period oil prices are expected to remain around the price implied by the six-month-forward rate.
 - (f) The population assumption draws on a range of sources, including partial indicators from the Australian Bureau of Statistics, migration policies, and estimates made by the Australian Government.
 - (g) GDP per hour worked (non-farm).
 - (h) Household savings ratio refers to the ratio of household saving (disposable income minus consumption) to household disposable income, net of depreciation.
 - (i) Real Wage Price Index and non-farm average earnings per hour worked are both deflated by Consumer Price Index.

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

Endnotes

- 1 The Australian Bureau of Statistics started publishing a complete monthly CPI in November 2025; it will continue to publish some data from the seasonally adjusted quarterly CPI series (based on the pre-October 2025 collection frequency), including quarterly trimmed mean, for at least 18 months. As noted in the November 2025 *Statement*, for headline CPI inflation, we will forecast year-ended headline inflation based on the quarter-average of the monthly CPI. This is consistent with the approach taken by many other central banks that have access to monthly inflation data. For underlying inflation, initially we will continue to forecast quarterly trimmed mean inflation from the quarterly CPI, although our forecast will be informed by the monthly CPI data. See RBA (2025), 'Box C: Transition to a Complete Monthly CPI', *Statement on Monetary Policy*, November; RBA (2025), 'Transition to a Complete Monthly CPI', Technical Note, November.
- 2 See RBA (2024), 'Box C: Headline and Underlying Inflation', *Statement on Monetary Policy*, August.