RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

May 2026

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Contents

Overview

Prior to the conflict in the Middle East, inflation in Australia was materially above target, and the economy and labour market were operating with ongoing capacity pressures. GDP growth picked up strongly in the December quarter 2025, as expected, to be above estimates of the potential rate of growth. Labour market outcomes have been broadly as expected recently and conditions remain somewhat tight.

The conflict has led to sharp increases in commodity prices, particularly energy, which has pushed inflation higher. This has contributed to market expectations for the cash rate shifting higher. Large increases in fuel prices drove a significant increase in headline inflation in March. Trimmed mean inflation also remained elevated at 3.5 per cent over the year to the March quarter, although it only captured one month of the conflict. There are indications that higher fuel prices are likely to have second-round effects on prices for goods and services more broadly.

The near-term outlook for inflation has been revised higher. In time, the labour market and capacity pressures are expected to ease by a little more than expected in the February *Statement*, reflecting that the cash rate is assumed to increase to 4.7 per cent by the end of 2026, compared with 4.2 per cent in February. In the baseline forecast, inflation is expected to ease towards the midpoint of the target range by mid-2028. Given uncertainty around the duration and severity of the conflict, the outlook for inflation and economic conditions is more uncertain than usual, and this *Statement* presents two alternative scenarios to illustrate aspects of this uncertainty.

The Monetary Policy Board decided it was appropriate to increase the cash rate target by 25 basis points to 4.35 per cent. The Board assessed that inflation is likely to remain above target for some time and that the risks remain tilted to the upside, including to inflation expectations.

Capacity pressures in the Australian economy remain elevated and inflation was above target before the onset of the conflict.

GDP growth picked up strongly in the December quarter, as expected, to be above our estimates of its potential growth rate. Survey measures of capacity utilisation remained above average in February and March, suggesting that capacity pressures persisted into early 2026.

Private investment was stronger than anticipated in the December quarter while household consumption growth was weaker than expected. Recent spending data suggest that there was a little less underlying momentum in household consumption prior to the conflict than had been anticipated.

The labour market has evolved broadly as expected and conditions remain somewhat tight relative to full employment. The unemployment rate was unchanged at 4.3 per cent in March. A range of other indicators, including the underemployment rate and underutilisation rate, also suggest that labour market conditions remain somewhat tight.

Underlying inflation picked up to 3.5 per cent over the year to the March quarter, though the quarterly outcome was a little lower than expected in the February *Statement*. The elevated rate of underlying inflation in the March quarter reflected ongoing strength across a broad range of components, including market services.

The conflict has driven global oil prices sharply higher.

The conflict in the Middle East has severely disrupted energy production and shipping in the region, driving sharp increases in the global prices of oil and liquefied natural gas. The conflict has also had a significant impact on the production and trade of other commodities that are key inputs into industries such as agriculture and manufacturing. These disruptions will persist for some time even after the conflict ends. Measures of global economic uncertainty have increased.

The conflict has contributed to a modest tightening in global financial conditions. Market expectations of central bank policy rates have increased in advanced economies, including in Australia, consistent with an expectation that central banks will tighten policy to meet their inflation targets. Uncertainty surrounding the conflict has made global financial markets more volatile, though they have remained functional and risk premia have returned to low levels in recent weeks.

In line with these developments, Australian financial conditions have tightened, in part reflecting the impact of the conflict on cash rate expectations, and recent cash rate increases, which have been passed on to lending and deposit rates. The Australian dollar has appreciated on a trade-weighted basis since the February *Statement* and remains consistent with its fundamental determinants, including the rise in government bond yields in Australia relative to those in major advanced economies. Even so, the extent to which Australian financial conditions are restrictive overall remains uncertain, with credit growth well above its long-run average and funding remaining readily available for banks, households and businesses. Market participants expect the cash rate to increase by 60 basis points to 4.7 per cent by the end of 2026.

Higher oil prices have already pushed inflation higher and sentiment lower.

The effects of the conflict on global and domestic inflation are already evident, with data for March showing a sharp increase in headline inflation in most economies, including Australia.

In Australia, headline inflation increased to 4.6 per cent in March, with the higher fuel prices contributing 0.8 percentage points. The outcome also reflected the expiry of electricity rebates and strength in underlying inflation. The full effects of higher fuel costs on underlying inflation will take time to materialise as they typically pass through to other goods and services prices gradually.

Financial market measures of long-term inflation expectations remain anchored around the midpoint of the inflation target, while short-term inflation expectations have risen. Short-term inflation expectations have risen this year, particularly since the conflict in the Middle East. If the increase in inflation expectations persists, this could feed into actual price- and wage-setting behaviour and pose the risk of inflation being above target for even longer.

The conflict has also led to a sharp drop in consumer sentiment and business confidence, though timely consumer spending data do not suggest a material slowing in household consumption over the same period.

Inflation is expected to ease towards 2½ per cent by mid-2028, and growth is forecast to be lower than previously expected.

The inflation outlook for Australia's major trading partners has been revised higher, while revisions to GDP growth in each region vary. Overall, the disruptions to global energy supply from the conflict are expected to weigh on global economic activity in the year ahead and largely offset the boost from AI-related investment.

In the baseline forecasts, which assume oil prices recede somewhat gradually over coming quarters, the near-term outlook for inflation in Australia is materially higher than expected in the February *Statement*. Higher fuel and raw material costs are expected to boost inflation over the next few quarters. Headline inflation is expected to peak at 4.8 per cent in mid-2026, and underlying inflation is expected to remain above 3 per cent until mid-2027.

Australian GDP growth is forecast to be a little lower than previously expected due to higher fuel prices and the assumed higher path for interest rates. In the near term, higher fuel prices will erode real household disposable incomes, which is expected to slow household consumption growth. As this temporary effect wanes, the assumed higher path for interest rates (reflected in market pricing) is expected to weigh on activity and the labour market. Labour market conditions are expected to ease by a little more than expected in the February *Statement*, which would leave it operating with a little spare capacity by mid-2028. As capacity pressures ease and fuel-related costs decline, underlying inflation is projected to ease towards 2½ per cent by mid-2028.

Uncertainty about the duration and severity of the conflict and its effects on the Australian economy mean the outlook is more uncertain than usual.

A plausible risk is that the conflict is more prolonged and results in more significant and longer-lasting damage to energy production. If energy prices remain high over the forecast period because of a longer or more severe conflict, inflation can be expected to be higher, which will reduce growth in household disposable incomes and household consumption, and businesses potentially reducing investment spending. If uncertainty becomes particularly high, households and businesses could cut their spending by much more, which would mitigate some of the increase in inflation but lead to a higher unemployment rate.

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

The Board assessed that inflation is likely to remain above target for some time and that the risks remain tilted to the upside, including to inflation expectations. Higher fuel prices are adding to inflation and there are indications that this is likely to have second-round effects on prices for goods and services more broadly. This is in addition to the high inflation around the start of 2026, reflecting capacity pressures in the economy. The Board will be attentive to the data and the evolving assessment of the outlook and risks to guide its decisions. Having raised the cash rate three times, monetary policy is well placed to respond to developments and the Board is focused on its mandate to deliver price stability and full employment.

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	2.6	1.9	1.3	1.3	1.4	1.4
(previous)	(2.3)	(2.1)	(1.8)	(1.6)	(1.6)	(1.6)
Unemployment rate[(b)]	4.3	4.2	4.3	4.4	4.6	4.7
(previous)	(4.2)	(4.3)	(4.3)	(4.4)	(4.5)	(4.6)
CPI inflation	3.6	4.8	4.0	2.4	2.4	2.5
(previous)	(3.6)	(4.2)	(3.6)	(2.9)	(2.7)	(2.6)
Trimmed mean inflation	3.4	3.8	3.5	3.1	2.6	2.5
(previous)	(3.4)	(3.7)	(3.2)	(2.8)	(2.7)	(2.6)

	Year-average					
	2025	2025/26	2026	2026/27	2027	2027/28
GDP growth	2.0	2.3	1.9	1.4	1.3	1.4
(previous)	(1.9)	(2.2)	(2.1)	(1.8)	(1.6)	(1.6)

	Assumptions[(c)]					
Cash rate (%)	3.6	4.2	4.7	4.6	4.7	4.7
Trade-weighted index (index)	61.3	66.4	66.6	66.6	66.6	66.6

(a) Forecasts finalised on 29 April. 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 29 April and the daily exchange rate (TWI) is assumed to be unchanged from its level at 29 April 2026 going forward. See notes to Table 3.2: Detailed Baseline Forecast Table in Chapter 3: Outlook for other forecast assumptions.

Sources: ABS; LSEG; RBA.

Chapter 1
Financial Conditions

Summary

- **Financial conditions in Australia have tightened following the cash rate increases in February and March and the start of the Middle East conflict.** Banks have largely passed on the cash rate increases to lending and deposit rates. Also, the expected market path for the cash rate has shifted up in response to the cash rate increases, RBA communications and the conflict. Meanwhile, long-term nominal and real government bond yields have increased to around their highest levels since 2011. The Australian dollar has appreciated on a trade-weighted basis but remains broadly consistent with estimates of its long-run equilibrium level. This has been supported by further widening in yield differentials between Australia and its major trading partners.
- **Disruptions to global supplies of oil and other commodities have caused a modest tightening in global financial conditions, largely through a rise in expectations for policy rate paths.** In most advanced economies, financial market measures of short-term inflation expectations have increased but longer term inflation expectations are little changed. This is consistent with an expectation that most central banks will tighten policy over time to meet their inflation targets and with oil futures markets, which suggest that the recent significant increase in oil prices will be transitory.
- **Prices of risky assets are consistent with the conflict having a limited effect on global economic activity.** Global equity prices fell after the conflict began, owing to higher policy rate paths and concerns about weaker economic activity, but have since largely retraced. This rebound was supported by a material upward revision in earnings forecasts for a few sectors, most notably for semiconductor producers in the United States. Corporate bond spreads have risen but remain low compared with historical averages. Uncertainty about the conflict and the outlook for energy prices have made financial markets more volatile, though they have remained functional throughout. Global financial conditions could tighten sharply if the conflict were to escalate or markets lost confidence in it being resolved in a timely manner.
- **Market participants expect the cash rate to increase by around 60 basis points by the end of 2026.** They are fully pricing in a 25 basis point cash rate increase by the June meeting and see around a 70 per cent chance that the increase will occur in May.
- **The extent to which financial conditions in Australia are restrictive remains uncertain.** Some indicators suggest that conditions may be neutral or slightly restrictive. The cash rate currently sits within (but near the top of) our range of central estimates of neutral rates and markets expect it to be slightly above that range by the end of this year. These estimates of neutral are underpinned by measures of longer term inflation expectations, which have remained stable and near the inflation target. However, short-term inflation expectations have risen this year, particularly since the conflict began. Funding remains readily available for banks, households and businesses. Total and housing credit growth remain well above their long-run averages.

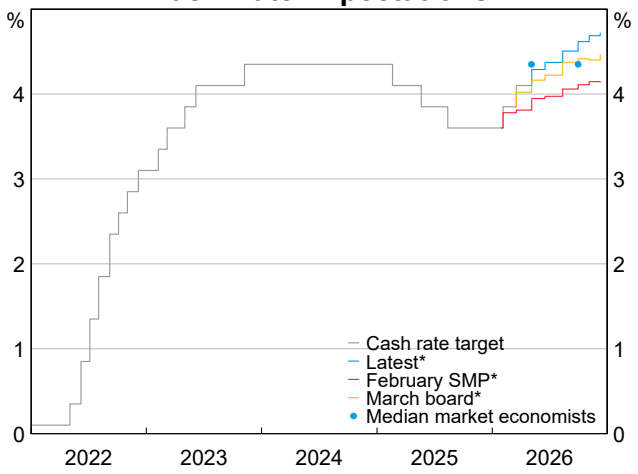
1.1 Interest rate markets

The market path of the cash rate has increased since the February *Statement*, with most of the increase occurring after the Middle East conflict began.

Market participants are fully pricing in a 25 basis point cash rate increase by the June meeting and see around a 70 per cent chance that the increase will occur in May (Graph 1.1). Almost all market economists tracked by staff expect the cash rate to be increased at the May meeting. Nearly one-third expect a further increase later this year.

Graph 1.1

Cash Rate Expectations



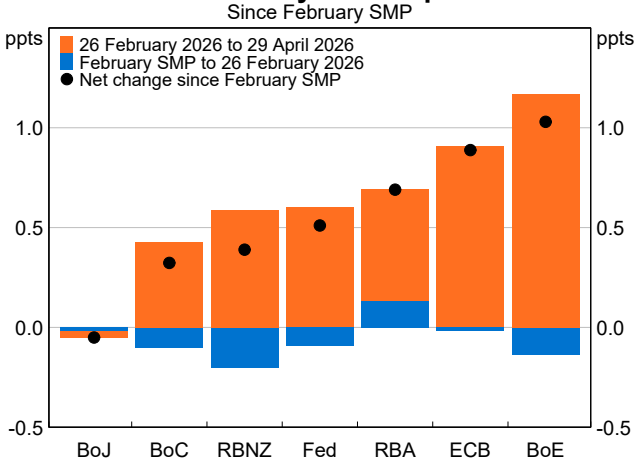
* Cash rate expectations implied by overnight index swap rates.
Sources: LSEG; RBA.

Since the February *Statement*, the shift up in market policy rate expectations for Australia has been within the range of increases seen in other advanced economies (Graph 1.2). Market pricing is for the cash rate to increase 60 basis points to 4.70 per cent by the end of 2026, which is 50 basis points more than was expected in early February. Unlike in other advanced economies, cash rate expectations in Australia had been rising before the conflict, indeed since the latter part of last year. This reflected the view that policy would tighten in response to a pick-up in capacity and inflationary pressures. But since the conflict, policy rate expectations have risen in Australia by a similar amount to several other advanced economies, though there has been variation depending on each economy's existing capacity pressures and the extent to which higher energy prices are likely to affect inflation. The cash rate path in Australia has been little changed in response to domestic economic data since the conflict, with major data releases broadly in line with market expectations. However, cash rate expectations for the end of this year and beyond have been volatile as markets have reassessed the inflationary effect of the conflict.

Graph 1.2

Change in End-2026 Policy Rate Expectations*

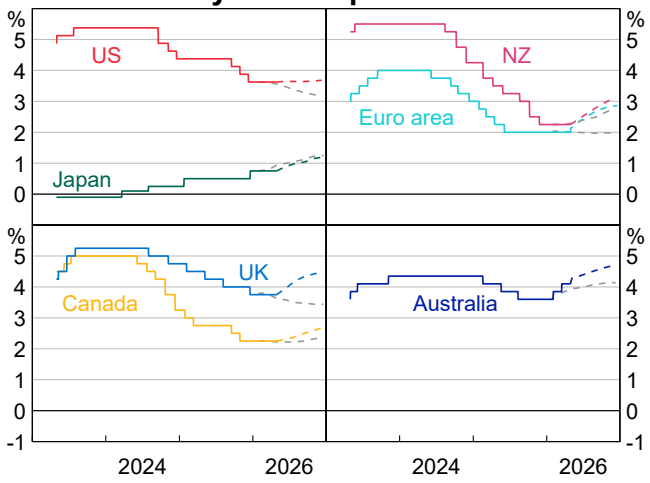
Since February SMP



* Expected end-2026 policy rate derived from overnight index swap rates.
Sources: Bloomberg; RBA.

Policy rate expectations in some advanced economies, including Australia, have eased a bit in recent weeks and with the ceasefire in the Middle East. This easing may reflect markets reassessing the longer term inflationary effect of the conflict, the risks to economic activity from continued disruption to global energy supplies, and some investors closing pre-conflict trades that had anticipated near-term policy rate cuts in some economies. However, market participants currently expect most central banks to raise policy rates over 2026 or, in the case of the US Federal Reserve (Fed), leave the policy rate unchanged (Graph 1.3).

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 28 January 2026.

Sources: Bloomberg; RBA.

Advanced economy central banks have said that they will look though the direct impact of the conflict on inflation but may respond to indirect effects.

Advanced economy central banks, including the Fed, have left policy rates unchanged since the February *Statement*. In their communications, central banks have cautioned that it is too early to determine the medium-to-long term economic impacts of the conflict and the appropriate monetary policy response, noting that the inflationary impact will depend on the persistence and severity of the conflict. Policymakers have noted that monetary policy will not respond to the direct impact of higher energy prices on inflation in the near term and, while policy rates may need to respond to the indirect effects on inflation and economic activity in the medium term, they need more evidence to understand the scale of those effects.

Following the Fed's decision to leave policy rates unchanged in April, Chair Powell noted that higher energy prices will push up inflation and there are risks of this spilling over to broader price pressures. He noted that the Fed will continue to monitor risks to both the inflation and employment sides of its mandate, although the labour market is not thought to be a source of inflation pressures despite some recent signs of strength. The Fed retained an easing bias in its post-meeting statement, although three Federal Open Market Committee members dissented against retaining this bias. Chair Powell noted that none of these dissenters believed the policy rate should be raised immediately; conversely, another member voted to lower the policy rate.

Policy rates currently lie within the range of model-based central estimates of the neutral rate in many advanced economies, including Australia.

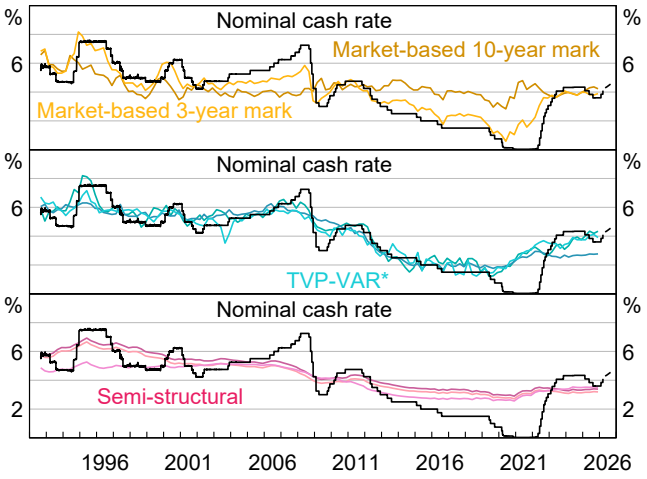
In Australia, the cash rate currently sits within (but near the top of) the range of model-based central estimates of the nominal neutral rate and the market path implies that it is expected to be slightly above that range by the end of 2026 (Graph 1.4). However, the range of central estimates is wide, and each central estimate is imprecise. Adding to this uncertainty is the choice of inflation expectations used to estimate the *nominal* neutral rates. These estimates are made by adding a measure of inflation expectations to each estimate of the *real* neutral rate generated by the models. This makes it easy to compare to the level of the nominal cash rate. In doing so, we use a measure of long-term inflation expectations that corresponds to the long-term horizon of many saving and investment decisions made by households and businesses. This measure has been relatively stable and near the inflation target for some time. By contrast, short-term inflation expectation measures are higher and have risen this year (Graph 1.5). The estimated nominal neutral rates we show in Graph 1.4 would be higher if long-term inflation expectations increased or if we placed more weight on short-term inflation expectations in the estimates of the nominal neutral rates. All else equal, this would imply that the cash rate path is less restrictive.

Even when based on the relatively stable long-run trend measure of inflation expectations, some estimates of the nominal neutral rate have picked up in recent years and have continued to increase this year. These include the central estimates from the market-based model, which uses data that react relatively quickly to changes in the neutral rate, and from an empirical model, which may capture factors relevant to a short-run neutral rate concept. Plausible explanations for the rise in neutral rates in recent years include larger global government deficits absorbing savings, investments arising from AI and the green transition, and strong investor risk appetites.

Graph 1.4

Nominal Neutral Rate

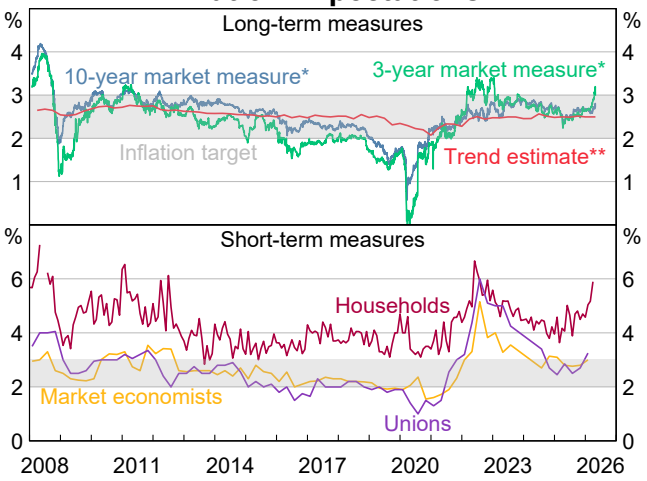
Suite of models



* Time-varying parameter vector autoregression models (TVP-VAR).
Sources: LSEG; RBA.

Graph 1.5

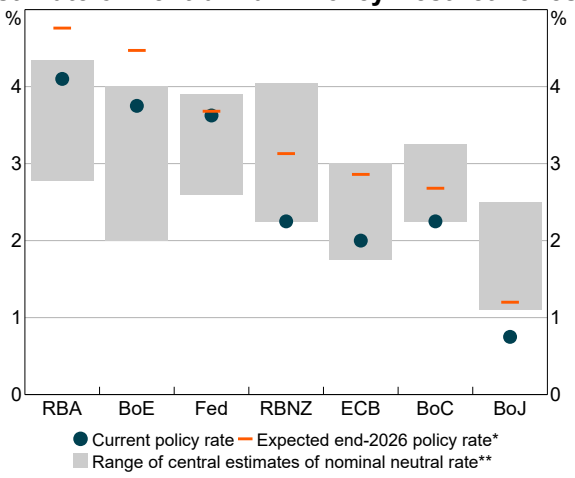
Inflation Expectations



* Inflation expectations implied by swaps pricing.
** The long-term trend estimate is used to inflate real neutral rate estimates to nominal neutral rate estimates.
Sources: Australian Council of Trade Unions; Bloomberg; RBA.

In many other advanced economies, both current policy rates and those expected by market participants for the end of 2026 lie within the range of central estimates of the nominal neutral rate (Graph 1.6). The variation across economies can be explained by the prevailing domestic economic conditions and the expected economic impact of the conflict on each economy.

Graph 1.6
Estimate of Central Bank Policy Restrictiveness



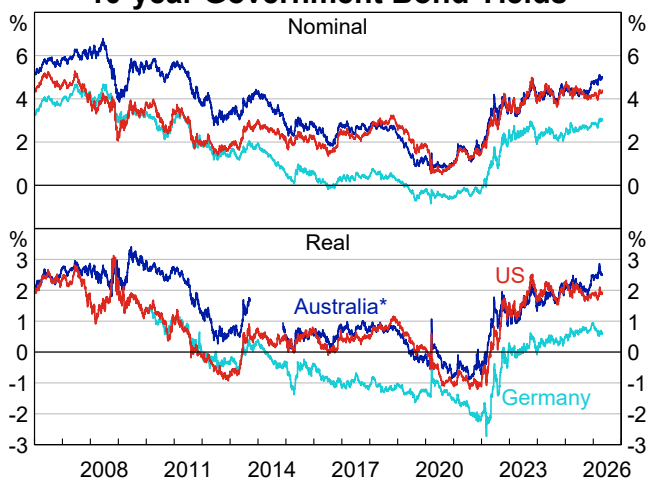
* Based on OIS pricing for policy rates at the end of 2026.
** Range of estimates of nominal neutral rate based on assessments by individual central banks.
Sources: Bloomberg; central banks; RBA.

Government bond yields in advanced economies have increased since the February *Statement* and have been volatile since the conflict began. In Australia, long-term nominal yields have increased to around their highest level since 2011, driven by a rise in long-term real yields, with long-term inflation expectations little changed.

Short-term bond yields have risen alongside policy rate expectations in most advanced economies. Medium and long-term bond yields have also increased, but by less, and term premia estimates are little changed (Graph 1.7). Measures of short-term inflation expectations increased sharply after the start of the conflict but the increase in measures of long-term inflation expectations has been muted to date (Graph 1.8). This is consistent with markets expecting the inflationary effects of the conflict to be relatively short-lived (and shorter lived than their traditional relationship with oil prices would imply) and for central banks to meet their inflation targets over time.

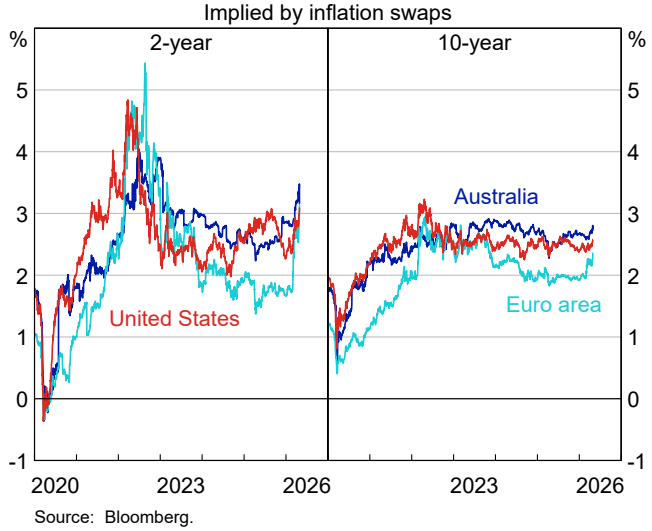
Longer term real rates have increased in advanced economies, including Australia, since the conflict began. This is consistent with markets expecting central banks to tighten policy to meet their inflation targets.

Graph 1.7
10-year Government Bond Yields



* Series break in Australian real yields due to data availability.
Source: Bloomberg.

Graph 1.8
Measures of Inflation Compensation
Implied by inflation swaps



Source: Bloomberg.

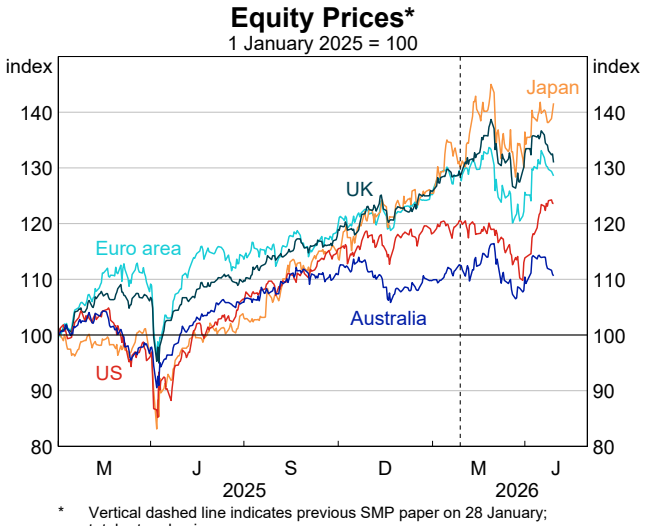
1.2 Corporate funding markets

Risk premia in advanced economies remain low despite the conflict, partly reflecting higher earnings forecasts and investor expectations that the economic impact of the conflict is likely to be limited.

Equity prices have increased in many economies since the February *Statement* but in Australia are 5 per cent below their early March record high. Equity prices declined after the conflict began, with declines largest in some large energy-importing economies, including the euro area, the United Kingdom and several of Australia's major trading partners in Asia (Graph 1.9). These declines were largely unwound in many economies after the ceasefire and in response to material upward revisions to 12-month forward earnings expectations in a few sectors (Graph 1.10).

The upward revisions to earnings forecasts since the conflict have been driven by a small number of sectors. The increase in US earnings forecasts was largely driven by the information technology sector, principally in the semiconductor subsector. This was in part in response to stronger-than-expected earnings and forward guidance from several firms that prompted investors to revise higher their expectations for AI-related demand. Earnings forecasts for US energy companies have also been revised up noticeably. In Europe, higher earnings forecasts have been driven by the energy and financial sectors. Expected earnings for listed Australian firms have also increased, principally for firms in the energy sector, though by less than for US firms. Earnings expectations in Australia's non-energy sectors have been little changed to date, though they could be reassessed in time as the impact of the conflict becomes clearer.

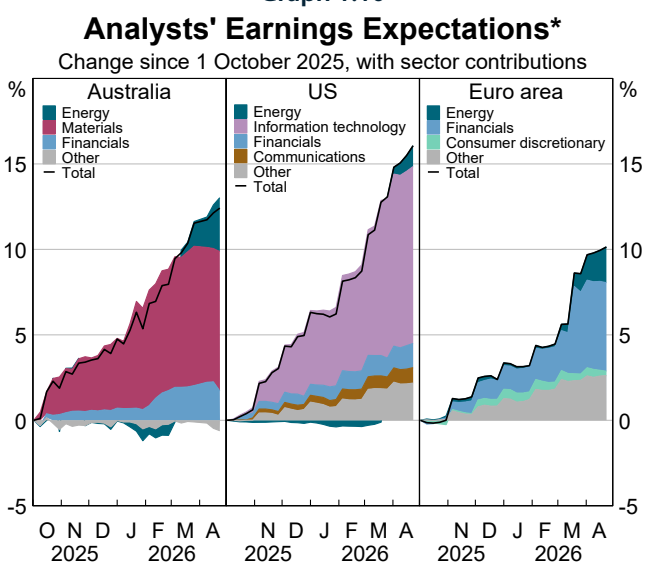
Graph 1.9



* Vertical dashed line indicates previous SMP paper on 28 January; total return basis.

Sources: Bloomberg; LSEG; RBA.

Graph 1.10



* 12-month forward earnings per share for the S&P/ASX 200, S&P 500, and EURO STOXX.

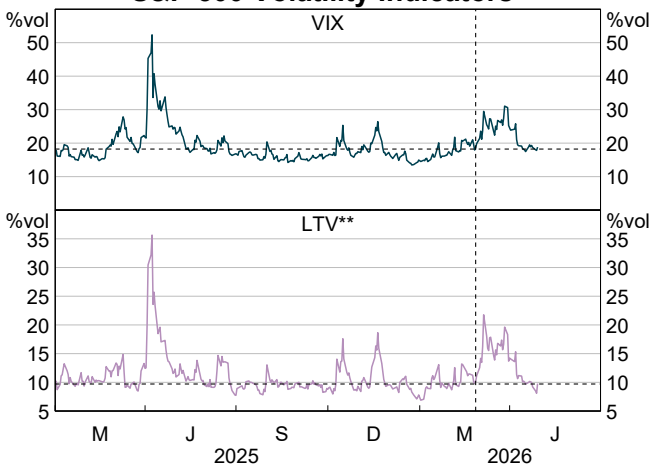
Sources: Bloomberg; LSEG; RBA.

Risk premia in equity markets are low and the expected volatility of equity markets are near long-term averages in several advanced economies. Equity risk premia rose slightly in the initial days of the conflict but later eased back towards historically low levels. Meanwhile, corporate bond spreads have widened slightly but remain narrow compared with their average since the global financial crisis (GFC), including for Australian bank and non-financial corporate bonds. In the US equity market, measures of expected volatility and investor pricing for tail risk increased sharply after the conflict began but later unwound amid optimism that the conflict would have a limited effect on corporate earnings (Graph 1.11).

The low level of risk premia suggests that market participants think the conflict is unlikely to materially reduce economic activity in advanced economies, despite ongoing disruptions to global energy supply. This view is consistent with the resilience to date of earnings forecasts, consumer spending and some timely indicators of economic activity. It may also reflect an expectation by investors that the United States will withdraw from the conflict before it materially weakens global economic activity. However, it may be too early to determine the full impact of the conflict from current indicators (including what signal to take from weak consumer confidence) and the conflict could pan out differently than investors expect. History shows that earnings forecasts and risk premia can be slow to react to new information before eventually moving sharply. A sharp re-pricing in risk assets would, by itself, tighten global financial conditions.

Graph 1.11

S&P 500 Volatility Indicators*



* Dashed vertical line indicates the start of the conflict in the Middle East; dashed horizontal lines show median since 2019.
** The Cboe LTV (Left Tail Volatility) Index is a measure of short-term tail risk derived from S&P 500 put options.

Sources: Bloomberg; RBA.

1.3 Foreign exchange markets

The Australian dollar has appreciated since the February *Statement*, broadly in line with a further widening in interest rate differentials between Australia and other advanced economies.

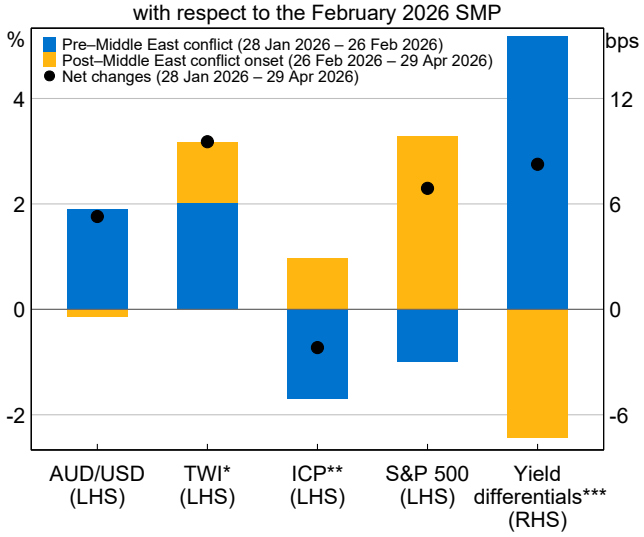
The Australian dollar has appreciated on both a trade-weighted basis and against the US dollar. Most of the appreciation on a trade-weighted basis occurred before the conflict and largely reflects a further widening in interest rate differentials between Australia and other advanced economies (Graph 1.12). While this appreciation has contributed to tighter financial conditions arising from changes in market policy rate paths, it has been consistent with the standard transmission of monetary policy expectations. As such, the Australian dollar remains broadly consistent with model estimates of its long-run equilibrium on a trade-weighted basis.

The Australian dollar has at times been volatile, moving in line with developments in the conflict and associated changes in policy rate paths and risk sentiment. However, foreign exchange markets have remained functional throughout.

Graph 1.12

Changes in Australian Dollar and Its Determinants

with respect to the February 2026 SMP



* Trade-weighted index.
** Index of Commodity Prices (USD terms).
*** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.

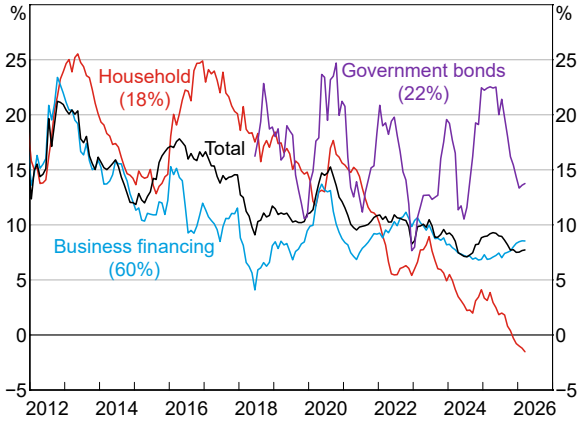
Sources: Bloomberg; RBA; Yieldbroker.

1.4 Financial conditions in China

The property downturn in China has continued to weigh on household credit demand, but total social financing growth has been supported by government bond issuance.

Household credit growth has been very weak, with the level of household credit having declined over the past six months – the first decline on record (Graph 1.13). This is consistent with weak property market conditions, which persist amid overcapacity and a declining population. However, government bond issuance is expected to remain elevated, with planned bond issuance for 2026 broadly unchanged from high issuance last year. Business financing growth has also remained robust amid an accommodative interest rate environment and a rebound in investment in the March quarter.

Graph 1.13
China – Growth in Total Social Financing
6–month annualised

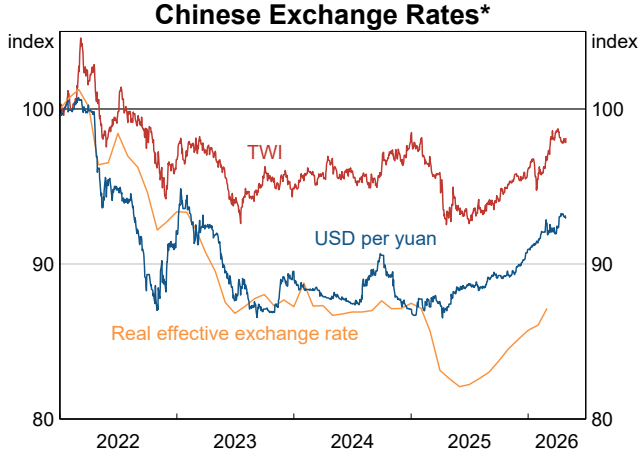


Sources: CEIC Data; RBA.

The People's Bank of China (PBC) has stated that its monetary policy stance remains 'moderately accommodative' and is unchanged, despite weakness in domestic demand. Recent communications have noted the use of structural policy measures to boost domestic demand, including a proposal to reduce non-interest costs charged by banks (such as service and channel fees). At the same time, inflationary pressure from higher oil prices has pushed back market expectations for an interest rate cut, though financial conditions more broadly are little changed since the start of the conflict.

The Chinese renminbi (RMB) has appreciated against the US dollar since the previous *Statement*, though it has been volatile over the period, largely driven by shifts in the US dollar in response to developments in the conflict (Graph 1.14). The RMB appreciation against the US dollar stalled following the start of the conflict but resumed after the ceasefire announcement. On a trade-weighted basis, the RMB has appreciated at a more gradual pace.

Graph 1.14
Chinese Exchange Rates*



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

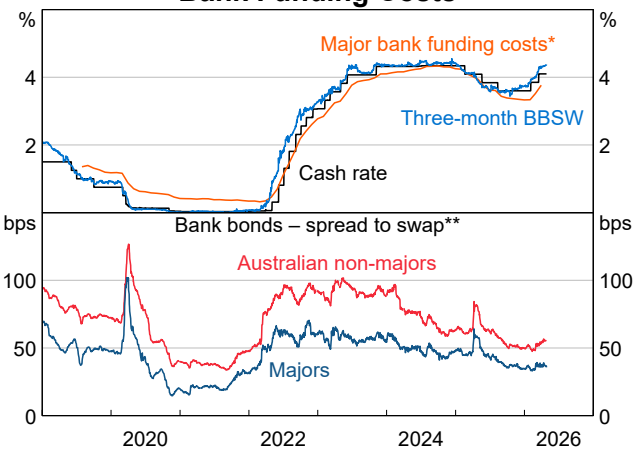
1.5 Australian banks and credit markets

Banks' funding costs increased in the March quarter, but banks are readily able to obtain funding in wholesale markets at relatively low spreads.

Advertised at-call deposit rates have increased by around 35 basis points since the February *Statement* as banks passed on the February and March cash rate increases. Less-than-full pass-through is consistent with some at-call deposit rates not being tied to the cash rate. Bank bill swap reference rates (BBSW) – a key benchmark rate to which banks' funding costs are closely linked – have also risen as the market path for the cash rate shifted up, contributing to higher bank funding costs (Graph 1.15). Advertised rates on new term deposits have increased by around 40 basis points since late 2025, alongside increases in BBSW. BBSW rose ahead of the increases in the cash rate as it tends to move in line with cash rate expectations.

Funding is readily available to banks in wholesale markets and at low spreads to swap rates, despite a brief pause in bond issuance in the first half of March amid heightened volatility in bond markets. Banks resumed issuing bonds from mid-March, initially issuing at shorter tenors, on a secured basis and mostly offshore. Pricing was at slightly higher spreads to swap rates than before the conflict. Since then, banks' domestic and offshore issuance has largely normalised; cumulative bank bond issuance since the start of 2026 is around its decade average, relative to GDP. Spreads between bank bond yields and swap rates have narrowed to near their pre-pandemic lows. In addition, securitisation issuance – a source of funding for banks and a key source for non-bank lenders – in the year to date is at a post-GFC high (relative to GDP).

Graph 1.15
Bank Funding Costs

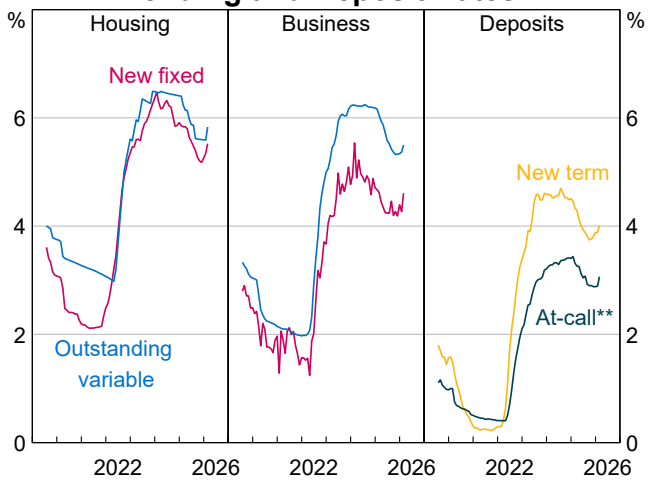


* RBA estimates of overall outstanding hedged debt and deposit costs for the major banks.
** Domestic secondary market; three-year target tenor.
Sources: APRA; ASX; Bloomberg; LSEG; major bank liaison; Private Placement Monitor; RBA.

Lenders have largely passed on the February and March cash rate increases to mortgage and business lending rates, in line with the standard transmission of monetary policy.

New and outstanding variable mortgage rates have increased broadly in line with the cash rate, alongside continued strong competition between lenders. New and outstanding variable mortgage rates increased by almost 25 basis points following the February cash rate increase (Graph 1.16), and recent changes in advertised rates are consistent with full pass-through of the March increase. Spreads between mortgage rates and the cash rate have narrowed notably in recent years amid strong competition between lenders.[1]

Graph 1.16
Lending and Deposit Rates*



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

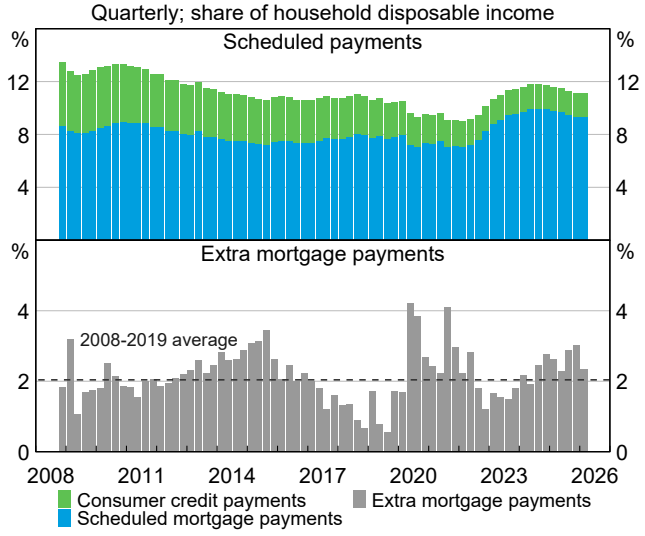
Advertised variable business rates have increased in line with the cash rate since the February *Statement*. Consistent with the normal transmission of monetary policy, it may take longer for the cash rate increases to flow through to outstanding business rates than to mortgage rates, as some business loans reprice (off BBSW) at set intervals.

Scheduled mortgage payments have increased, though the full effects of the recent cash rate increases will not be evident until June.

Scheduled mortgage and consumer credit payments remained at 11 per cent of household disposable income in the March quarter (Graph 1.17). Cash rate increases can take up to three months to flow through to minimum required variable-rate mortgage payments. Reflecting this lag, by June, scheduled mortgage payments as a share of household disposable income are expected to increase to a little below their level in early 2025, prior to the cash rate cuts that year.

Flows into mortgage offset and redraw accounts over recent months have remained above their pre-pandemic average. Many borrowers have sizeable buffers in these accounts that they could use to meet higher repayments or to support consumption.[2] There is evidence from 2022 to 2023 that households facing higher mortgage payments drew down on savings buffers to smooth consumption when interest rates were rising. For example, the spending of households with variable-rate mortgages remained similar to households with fixed-rate mortgages for at least two years after interest rates started to increase.[3]

Graph 1.17
Selected Claims on Household Income*
Quarterly; share of household disposable income



* Seasonally adjusted and break-adjusted. Latest observation is March 2026.
Sources: ABS; APRA; RBA.

Credit growth remained well above its post-GFC average in March and there is little evidence to date that volatility in financial markets has affected credit supply from banks.

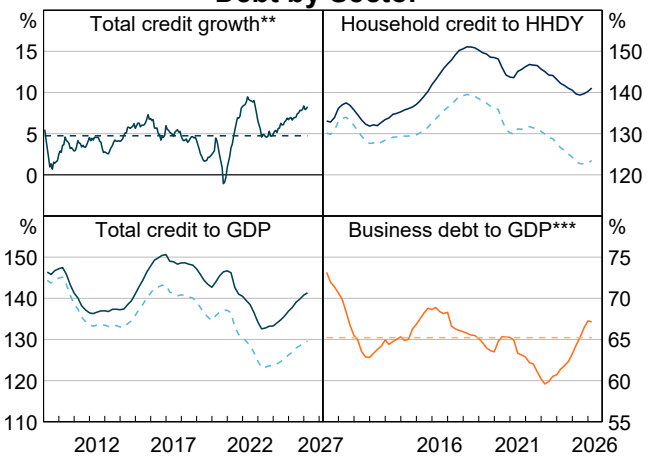
Credit grew at 8.3 per cent in six-month annualised terms in March and has continued to outpace nominal GDP growth, reflecting ongoing strength in the housing and business sectors (Graph 1.18). Broad money growth – which can provide an early but imprecise signal of trends in aggregate spending and inflation – grew around 1 percentage point faster than its post-GFC average in March in six-month-ended annualised terms.

The ratio of business debt to GDP has risen strongly in recent years to be above its long-run average, despite an easing in business debt growth since December (discussed below). The ratio of household credit (net of offset balances) to household disposable income has increased a little recently, following several years of declines. The effects of economic uncertainty and the higher expected path of lending rates may weigh on future credit demand for a time.

Recent bank commentary has provided little evidence of banks tightening credit supply conditions of late. Credit supply conditions at banks have been favourable in recent years, supporting easier financial conditions. This reflects signs of elevated housing and business lending competition, lending spreads that are narrower than before the pandemic, and the easing of some business and commercial real estate lending standards.[4] Since the conflict, some banks have said that they are monitoring and engaging with industries that are more heavily affected by supply disruptions, such as agriculture and transport. In mid-April, some banks – including all four majors – announced that they will offer zero-interest loans to eligible business customers after the Australian Government-funded National Reconstruction Fund Corporation announced a $1 billion Economic Resilience Program to help businesses manage rising fuel and input costs. The high quantity and quality of capital held by banks means that they can continue to lend even if there is an economic downturn.[5]

Graph 1.18

Debt by Sector*



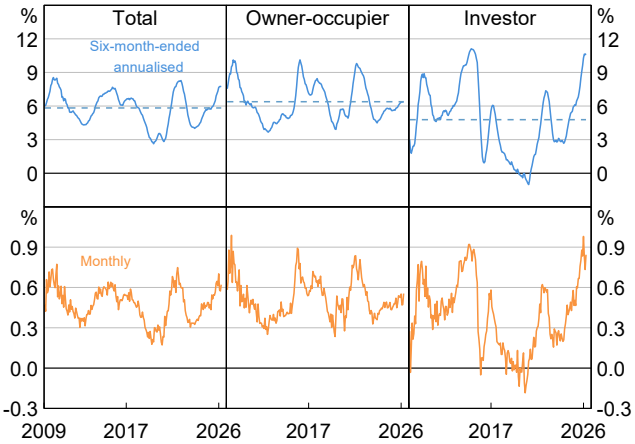
* Seasonally adjusted and break-adjusted; including securitisation. March quarter 2026 figures based on forecast for household disposable income (HHDY) and gross domestic product (GDP). Dashed lines in panels 2 and 3 are net of offsets.
** Six-month-ended annualised. Dashed line is the average from 2009 onwards.
*** Includes business credit, corporate bonds and other lending. Dashed line is the average from 2009 onwards.
Sources: ABS; APRA; Bloomberg; LSEG; RBA.

Housing credit growth has remained strong, though it is likely too early to see the full effect of the recent tightening in monetary policy and the associated easing in housing price growth.

Housing credit growth remained well above its post-GFC average in March at 7.7 per cent in six-month-ended annualised terms. This is despite a recent moderation in new housing lending, an easing in housing price growth, and higher expected interest rates (see Chapter 2: Economic Conditions). Trends in housing credit growth tend to lag housing price growth by up to three months, so the full effect of the easing in housing price growth is likely to flow through to credit data in the coming months. Investor credit growth has increased further over recent months to slightly below its 2015 peak, while owner-occupier credit growth has remained around its longer term average (Graph 1.19).

Graph 1.19

Housing Credit Growth*



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

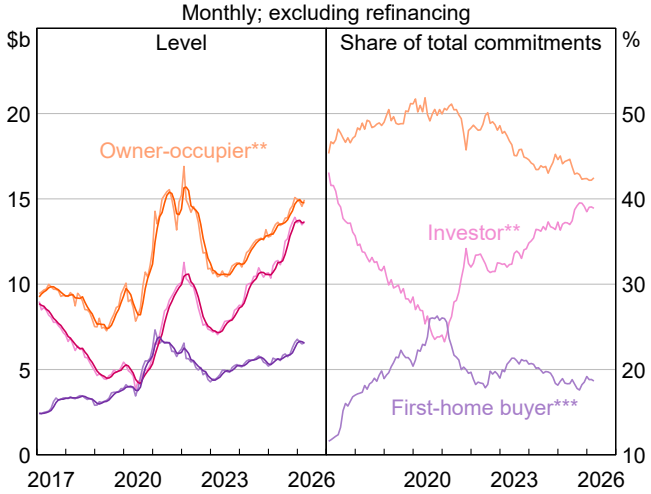
Sources: ABS; APRA; RBA.

New lending to first-home buyers has decreased over recent months, following a notable increase after the introduction of the Australian Government 5% Deposit Scheme in October 2025 (Graph 1.20). First-home buyer loan commitments in March were around 11 per cent higher than in September 2025, largely reflecting an increase in the average loan size (rather than the number of new loans).

Graph 1.20

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 first-home buyer commitments prior to 2019. First-home buyer commitments includes alterations and additions, and land.

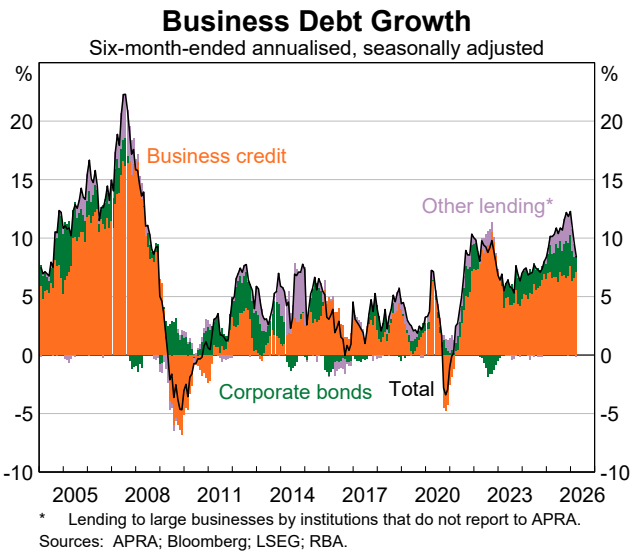
Sources: ABS; APRA; RBA.

Growth of business debt has eased in recent months but remains strong relative to its post-GFC average, with bond issuance picking up strongly after a brief pause at the start of the conflict.

Debt growth has eased since December but remains high relative to its post-GFC average (Graph 1.21). Part of the recent slowing may reflect businesses adjusting their borrowing plans in response to higher expected interest rates and the evolving macroeconomic and geopolitical outlook. But a large part can be attributed to an easing in growth following the completion of several large syndicated financing deals for data centres over 2025.

After a significant lull in corporate bond issuance for a few weeks after the start of the conflict, issuance resumed strongly in April across a wide range of issuers. Liaison contacts suggest that even during the lull, wholesale funding markets remained functional and open to issuance, but businesses were well funded and did not need to issue bonds amid rate volatility and at the slightly higher spreads at the time. Issuance restarted as spreads narrowed to be near pre-conflict levels. Cumulative issuance from non-financial corporations this year is now above its decade average.

Graph 1.21



Endnotes

1 See Jennison S, J Spiller and P Wallis (2026), 'Recent Changes in Credit Markets and Their Implications for Monetary Policy', RBA *Bulletin*, February.

2 See RBA (2026), *Financial Stability Review*, March.

3 See Elias M, C Gillitzer, G Kaplan, G La Cava and NV Prasad (2025), 'The Mortgage Debt Channel of Monetary Policy when Mortgages are Liquid', NBER Working Paper No 34461.

4 See RBA, n 2.

5 See RBA, n 2.

Chapter 2
Economic Conditions

Summary

- **Prior to the conflict in the Middle East, growth in Australia's major trading partners had been stronger than expected, as a surge in AI-related investment boosted US domestic demand and east Asian exports.** Trade policy developments had also weighed on growth by less than anticipated in 2025 and financial conditions had been favourable. Growth in advanced economies other than the United States was generally subdued in late 2025, broadly as expected in February. GDP growth in China in the March quarter 2026 was slightly stronger than expected, at 1.3 per cent.
- **In Australia, GDP growth had picked up strongly in the December quarter 2025, as expected, supported by some of the same factors as global growth. Prior to the Middle East conflict, domestic capacity and inflation pressures remained elevated and had been evolving broadly as anticipated.** Private investment was stronger than anticipated in the December quarter while household consumption growth was well below the (very strong) expected outcome. Timely data suggest that consumption growth momentum at the start of this year may have been a little weaker than anticipated. Labour market outcomes have been broadly in line with expectations recently, and conditions remain somewhat tight relative to full employment. Underlying inflation remained elevated in the March quarter, though was slightly lower than forecast in February. Overall, recent data have not materially changed our view of domestic inflationary pressures prior to the start of the Middle East conflict.
- **The Middle East conflict has severely disrupted energy production and shipping in the region, driving sharp increases in the global prices of oil (66 per cent), liquefied natural gas (44 per cent) and other key commodities.** The closure of the Strait of Hormuz has resulted in a reduction in the global supply of liquefied natural gas by around 20 per cent. After allowing for the fact that some oil has been redirected, the global supply of oil has fallen by around 10 per cent. The conflict has also significantly increased prices of related commodities, such as thermal coal and some fertilisers. Measures of global economic uncertainty have increased.
- **Headline inflation in Australia and many other economies increased in March as the direct effects of higher fuel costs flowed through to consumer prices.** In Australia, CPI inflation increased to 4.6 per cent in the month of March, with fuel prices contributing 0.8 percentage points. The reduction in fuel excise duty from 1 April is expected to have reduced year-ended headline inflation in April by around 0.5 percentage points. Fuel cost increases typically pass through to other goods and services prices over time. Many consumer-facing firms in the RBA's liaison program report that they have not yet passed through higher costs to their prices, although an increasing share now expect above-average price increases over the coming year.

- **While higher inflation is weighing on real incomes in many economies, the overall impact of the conflict on economic activity will vary by country.** In the event of a prolonged conflict, many of Australia's east Asian trading partners may be at risk of a relatively larger impact on growth because they are net energy importers with a relatively high share of energy-intensive manufacturing in total output. China's economy is likely to be relatively insulated in the near term, owing to its diversified energy mix, large strategic reserves of oil and petroleum products, and its use of regulatory instruments to limit retail fuel price increases.
- **There is little evidence so far that overall economic activity in Australia has been significantly affected by the conflict. The fuel price increases seen to date imply a limited impact on households' real income.** While consumer and business sentiment indicators have fallen sharply in Australia since the start of the conflict, these series are typically only weakly correlated with actual spending. By contrast to the sentiment data, recent survey and liaison evidence do not suggest a material decline in business conditions, and early consumer spending data – while volatile – do not suggest a material slowing in real household consumption. Nominal spending at petrol stations has increased sharply, but there does not yet appear to be an offsetting decline in other types of spending. The additional spending on fuel since the start of the conflict amounts to less than 1 per cent of total household income over that period, though for some households it will be a higher share.

2.1 Global economic conditions

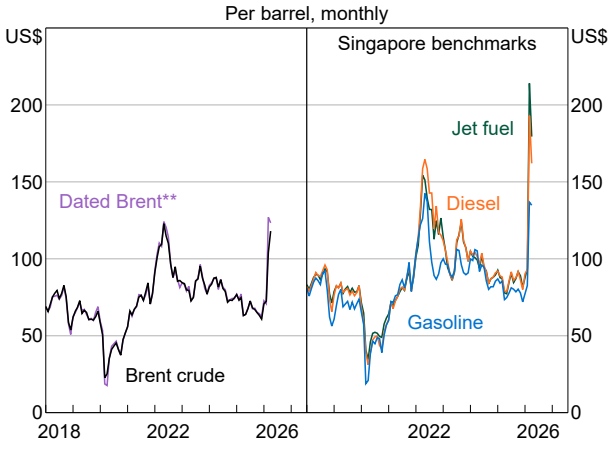
The conflict in the Middle East and de-facto closure of the Strait of Hormuz – through which around 20 per cent of global crude oil and liquefied natural gas (LNG) supplies usually transit – has driven energy prices sharply higher. Higher energy prices are pushing consumer price inflation higher in most economies and are expected to weigh on global economic activity. However, the impact on each economy is likely to depend on factors such as the extent of capacity pressures at the start of the conflict and whether they are net exporters or importers of energy commodities.

Prior to the conflict, growth in many advanced economies had been subdued, broadly as expected, while growth in Australia's Asian trading partners had been stronger than expected, supported by the global surge in AI-related investment. However, some countries in the Asian region (outside of China and high-income east Asian economies, which have substantial reserves and higher purchasing power) are likely to be among the more vulnerable to the effects of the conflict. Given the outsized share of energy-intensive manufacturing in economic activity across Asia, and that the region is a net energy importer, a more prolonged closure of the Strait of Hormuz would likely pose a material downside risk to major trading partner (MTP) growth.

Energy prices have increased sharply since the onset of the Middle East conflict and the closure of the Strait of Hormuz in late February.

The headline Brent crude oil (futures) price has risen by 66 per cent since the February *Statement on Monetary Policy*, in response to an estimated decline in global oil production of 13 million barrels per day – or around 10 per cent of daily global supply (Graph 2.1). The price of dated Brent crude – which represents the cost of near-immediate physical delivery in northern Europe – has increased by more than headline futures prices, rising by 70 per cent since the February *Statement*. The gap between these prices has been volatile in recent weeks, but has widened since the start of the conflict, reflecting both acute near-term physical supply shortages (with refiners willing to pay a premium for immediate delivery) and expectations that these shortages should abate in the coming weeks if the Strait is reopened.

Graph 2.1
Oil and Refined Product Prices*

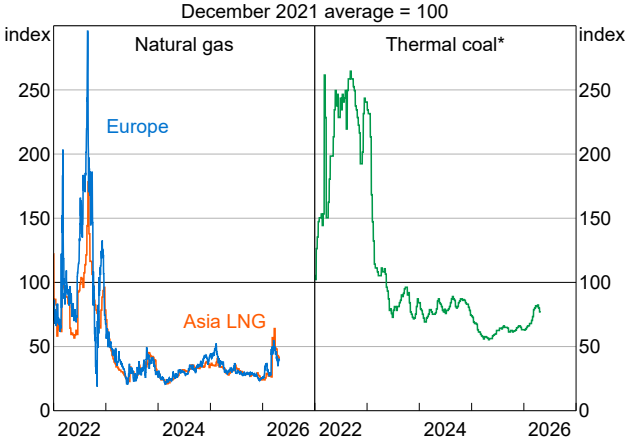


* The April 2026 observation for all series is as at 30 April.
** Dated Brent is the physical spot price for Brent crude.
Sources: Bloomberg; RBA.

The prices of refined oil products have increased by significantly more than crude oil prices, with their spreads to Brent crude oil at historically high levels. Asian refiners' gasoline, diesel and jet fuel prices have increased by 72 per cent, 78 per cent, and 99 per cent respectively since the previous *Statement*. Many refiners across Asia have chosen to slow production rates to carefully manage existing inventories, as completely shutting down and restarting production is costly. Involuntary cuts to output in the Middle East and Russia, where refineries have been damaged by the conflict, as well as limited global stockpiles of refined products, have also added to price pressures.

Disruptions to natural gas supply and demand for substitute energy commodities, such as thermal coal, have driven prices of those commodities higher. The spot price of LNG – an important Australian export – has increased by 44 per cent in Asian markets since the February *Statement* (Graph 2.2). Qatari authorities expect damage to the Ras Laffan oil and gas complex to have long-lasting effects on LNG production. While most exports are expected to resume with a reopening of the Strait, a full restoration of LNG export capacity may take several years. Disruptions to oil and LNG supply have spilled over into higher demand for other energy commodities, especially thermal coal – another important Australian export. The Newcastle thermal coal spot price has increased by 16 per cent since the February Statement, as demand has increased from buyers in Europe and Asia looking to secure alternative energy sources. However, price increases for thermal coal and natural gas remain well below what was observed following Russia's invasion of Ukraine in 2022.

Graph 2.2
Other Energy Commodities
December 2021 average = 100

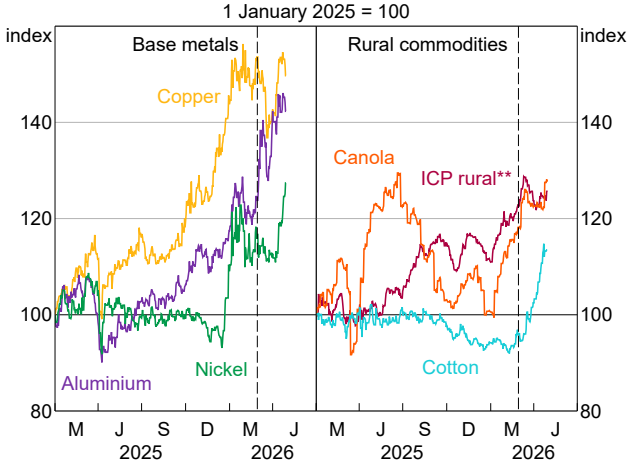


* Newcastle spot price.
Sources: CRU; LSEG; RBA.

Non-energy commodity markets for which Gulf states are major producers and exporters have also been affected by the closure of the Strait of Hormuz.

Disruption to fertiliser supply chains may put upward pressure on food prices. Around one-third of global nitrogenous fertiliser and nearly half of global seaborne sulphur trade (used in phosphate fertilisers) typically transits the Strait of Hormuz. The closure of the Strait has led to a surge in the price of fertiliser products like urea and ammonia, which is increasing the input costs for agricultural products. Given the lags in planting and harvesting cycles, this is raising concerns about future agricultural crop production and yields and is placing potential upwards pressure on consumer food prices. Some rural commodity prices where fertilisers are key inputs have risen since the February *Statement*. For example, prices of canola and cotton, which are produced and exported by Australia, have increased notably (Graph 2.3).

Graph 2.3
Commodity Prices*
1 January 2025 = 100

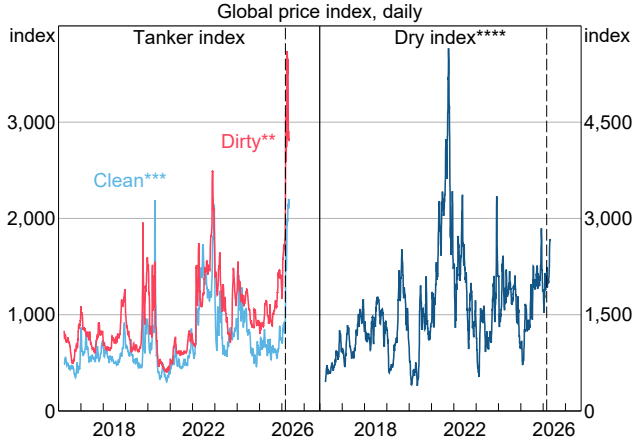


* Dashed line shows the start of the Middle East conflict.
** RBA's rural sub-index of the Index of Commodity Prices.
Sources: Bloomberg; RBA.

Supplies of some other commodities, including helium and aluminium, have also been disrupted. Qatar usually accounts for around one-third of global helium production. Helium plays an important role in semiconductor manufacturing (among other uses), though key producers reportedly have significant inventories so this has not materially affected output so far. Separately, aluminium prices have increased by 20 per cent since February, owing to supply disruptions in the Middle East – which accounts for around 7 per cent of global production. This may result in some positive spillovers for Australia given our prominent role in the global aluminium value chain.

Shipping costs have risen, further increasing import costs, particularly for oil and refined products. Global price indices for transporting crude oil and refined products have surged by 64 per cent and 135 per cent respectively since the February *Statement* (Graph 2.4). This increase is due to sharply higher demand for timely deliveries along specific shipping routes, to replace cargoes affected by the Middle East conflict, as well as increased war-risk insurance costs and fuel surcharges. The index for shipping raw materials has also increased, though by less (and by much less than it did during the pandemic).

Graph 2.4
Baltic Exchange Shipping Costs*
Global price index, daily



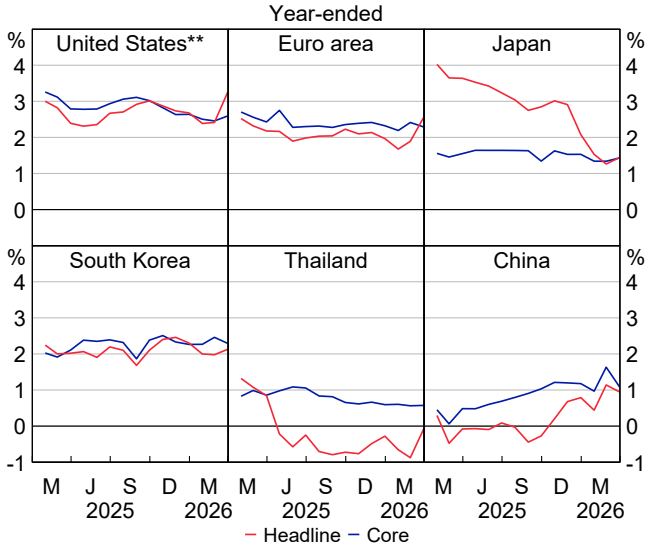
* Dashed line shows the start of the Middle East conflict.
** Unrefined crude oil or heavy fuel oil.
*** Refined products like gasoline, diesel, and jet fuel.
**** Raw materials like iron ore and coal.
Sources: CEIC Data; RBA.

Headline inflation has started to rise in many economies, reflecting sharp increases in fuel prices. Economies with greater capacity pressures could experience larger or more persistent indirect effects on core measures of inflation.

Increases in fuel prices pushed up consumer price inflation in many economies in March (Graph 2.5). Headline inflation is expected to rise further in subsequent months as higher energy prices are passed through to electricity and transportation costs for both households and businesses. A range of survey indicators suggest that firms' input costs increased sharply in March across advanced economies and Australia's MTPs, which may lead to price increases for other goods and services. In response, some governments have introduced price controls, subsidies or tax cuts to cushion the impacts of higher fuel prices on households and businesses, which has limited pass-through to consumer prices in some countries.

Graph 2.5

Headline and Core Inflation*



* Core inflation defined as excluding food and energy.
** Data not available for October 2025.
Sources: CEIC Data; LSEG; RBA.

Deflationary pressures in China have eased somewhat, largely because of higher commodity prices and temporary factors. Both consumer and producer price inflation in China have increased since the February *Statement*. This has been largely driven by external factors and issues with seasonality around the timing of the Lunar New Year; excess supply in the domestic economy has persisted. Higher energy prices led to a notable increase in producer price inflation in March, despite prices for some industrial inputs like copper declining. CPI inflation remains elevated relative to recent history, but the effects of higher fuel prices have been relatively contained so far as authorities have directly cushioned price increases, including by adjusting retail petrol prices.

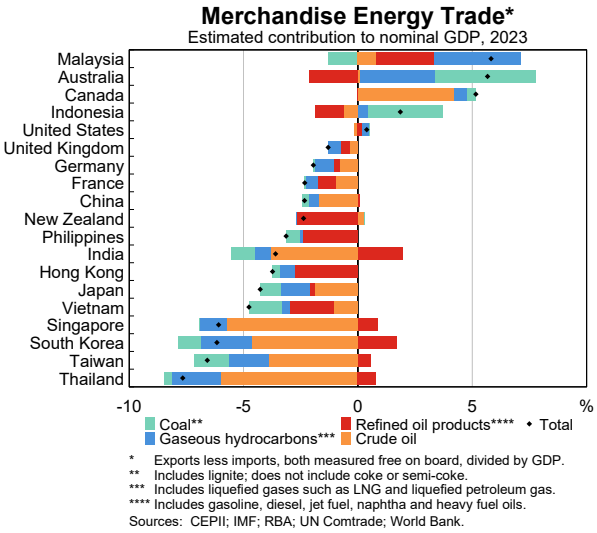
Differences in the extent of capacity pressures across countries may affect how inflation responds to higher energy prices. In some advanced economies, like New Zealand and the United Kingdom, unemployment rates are somewhat elevated following a period of subdued GDP and employment growth last year. In other economies, such as Japan and Norway, labour markets appear to be relatively tight, consistent with high rates of wages growth. For economies with tighter labour markets, persistently higher energy prices could have larger and more persistent indirect effects on inflation (see Chapter 4: In Depth – The Impact of Higher Global Energy Prices on the Australian Economy).

Timely indicators suggest that higher energy prices may be weighing on sentiment and real incomes in some advanced economies, but energy exporters are expected to benefit in the near term.

GDP growth in advanced economies in the December quarter was broadly in line with expectations at the time of the February *Statement*. US GDP growth slowed due to the US federal government shutdown, but underlying growth was stronger than had been expected, supported by robust growth in AI-related investment. More recently, survey measures of consumer and business sentiment have declined across advanced economies since the Middle East conflict began, with higher energy prices expected to weigh on real incomes. However, net energy

exporters, including the United States and Canada (Graph 2.6), are benefiting from higher prices that will improve their terms of trade and increase their national income, all else equal. By contrast, most other advanced economies, like the euro area and the United Kingdom, are net energy importers, so higher energy prices will worsen their terms of trade and reduce national incomes. This has been reflected in larger downgrades to the growth outlook for these economies (see Chapter 3: Outlook).

Graph 2.6



Trade policy uncertainty remains somewhat elevated as the US administration works to introduce new tariffs, after the US Supreme Court ruled in mid-February that many existing US tariffs were unlawful. As an interim measure, the administration has introduced a global tariff of 10 per cent, making use of alternative legislation, which applies for a maximum of 150 days. This lowers the average tariff rate for exports from China to the United States. These tariff developments are unlikely to have a material impact on the Australian economy.

Growth in east Asia in late 2025 was stronger than expected at the time of the February *Statement*, but a prolonged disruption to global energy supplies poses a material downside risk to the region.

Net exports contributed significantly to stronger-than-expected east Asian GDP growth in the December quarter, driven by robust growth in global demand for AI-enabling products such as semiconductors. Timely trade and industrial production data suggest that the momentum in exports and manufacturing continued into the March quarter, and Consensus forecasters expect strong growth in high income east Asian economies such as Taiwan and South Korea to continue over 2026 (see Chapter 3: Outlook). However, higher energy costs pose a larger downside risk to activity in energy-intensive manufacturing industries, which make up a larger share of GDP in east Asian MTPs than in other economies (Graph 2.7). And like many advanced economies, many Asian MTPs are net importers of energy commodities and other raw materials, so higher energy prices will reduce real national incomes.

Graph 2.7

Sources: CEIC Data; FRED; Government of Japan; RBA; Stats NZ.

Some Asian MTPs will be able to mitigate near-term impacts of the conflict by drawing on strategic reserves, but a prolonged closure of the Strait of Hormuz is a material downside risk for the region. Several high income east Asian countries have substantial strategic reserves of oil and other commodities affected by the Middle East conflict, such as helium. Economies with sufficient refining capacity, such as South Korea and China, have also introduced export restrictions to prioritise domestic fuel supplies. These countries have greater capacity to smooth their fuel consumption and production activities in response to a temporary disruption to global energy production. However, if inventories are exhausted, countries will have to pay considerably higher prices for energy imports or reduce their consumption of those commodities. This is already occurring in some parts of middle-income east Asia. In these economies, purchasing power is lower and the share of energy in household consumption larger, implying larger negative impacts on households' real incomes. To conserve limited energy supplies, some governments in the region – including in Indonesia, Malaysia and the Philippines – have introduced some activity restrictions and strongly encouraged reducing non-essential energy usage.

The Chinese economy may be less vulnerable to the Middle East conflict than some other MTPs. Investment in China rebounded in the March quarter.

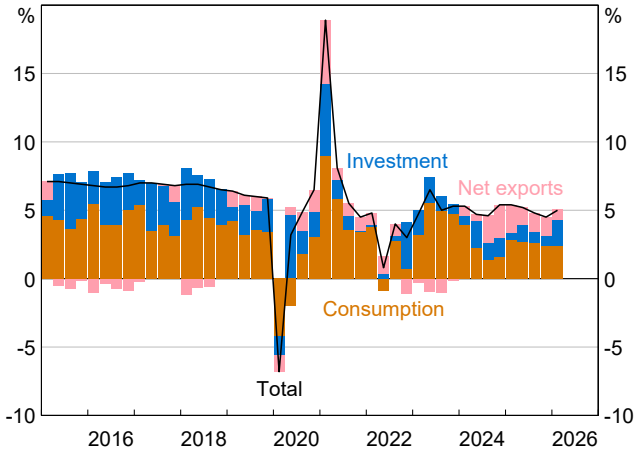
A combination of factors means that China has been relatively insulated from the Middle East conflict so far. China's energy mix has a low dependence on oil and LNG, it has large strategic reserves of oil and petroleum products, and authorities have used regulatory instruments to limit retail fuel price increases.

The Chinese economy grew by 1.3 per cent in the March quarter, driven by stronger-than-expected growth in investment (Graph 2.8). The national accounts measure of investment rebounded, with monthly indicators suggesting this was broadly based across sectors. Notwithstanding a sharp increase in real estate investment in the quarter, growth in housing sales and prices have remained weak. The structural imbalance between strong domestic supply and soft domestic demand has persisted, underpinned by continued weakness in household consumption growth in the March quarter. Policy priorities for 2026 announced by authorities in the early March annual Government Work Report are broadly supportive of investment, while policy measures in the report to support household consumption appear to be modest.

Graph 2.8

China – Real GDP Growth

Year-ended with contributions



Sources: CEIC Data; RBA.

Exports continued to rise strongly in China while imports grew even faster. The recent strength in exports likely reflects the substantial reduction in average US tariff rates in February and continued demand for technology-related exports fuelled by the global AI boom, which has also supported Chinese imports. These factors have aided the resilience of Chinese exports to negative impacts of the Middle East conflict. However, external demand – particularly from east Asia – could weaken if the conflict persists.

Iron ore prices have risen by 3 per cent since the February *Statement*. Prices have been supported by demand from China, weather-related supply disruptions in Australia, and concerns that diesel shortages stemming from the Middle East conflict could limit supply from smaller Australian producers. Nevertheless, iron ore spot prices continue to trade in their narrow range of the past two years.

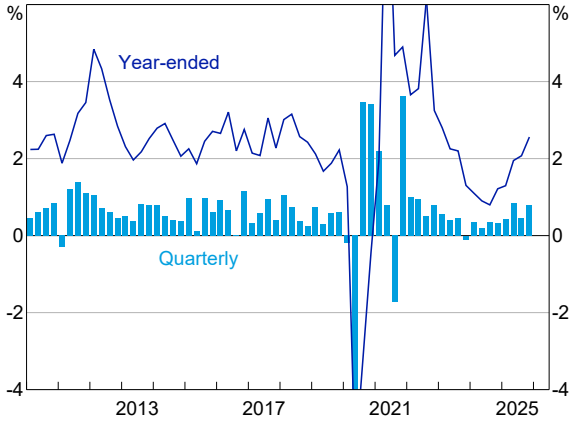
2.2 Australian economic conditions prior to the Middle East conflict

Prior to the conflict, domestic capacity pressures appeared to have been evolving broadly as anticipated in the February *Statement*. GDP growth in the December quarter picked up strongly, as expected, to be above our estimates of its potential growth rate. Business investment was stronger than anticipated, in part reflecting spending on data centres. But household consumption growth was weaker than expected, and more timely data suggest there was a little less underlying momentum in consumer spending at the start of this year than previously assessed. Recent labour market outcomes have been broadly in line with the February forecasts. Conditions are judged to remain tighter than full employment. Underlying inflation remains elevated, reflecting ongoing strength across several components. While trimmed mean inflation in the March quarter was slightly lower than expected, recent data have not materially altered our view of underlying domestic inflationary pressures prevailing prior to the conflict.

Year-ended GDP growth picked up in the December quarter to be above our estimates of potential growth.

GDP increased by 0.8 per cent in the December quarter to be 2.6 per cent higher over the year (Graph 2.9). This was broadly in line with our expectations and above our estimates of potential growth, adding to existing capacity pressures. A number of factors supported growth over 2025, including strong growth in household income and wealth, easing financial conditions domestically and internationally, resilient global growth and strong business investment related to data centres and the green energy transition. The monetary policy easing during the earlier part of 2025 is expected to have had only a modest effect on GDP growth in 2025, given typical lags in transmission, although there is inherent uncertainty around this assessment.

Graph 2.9
GDP Growth*

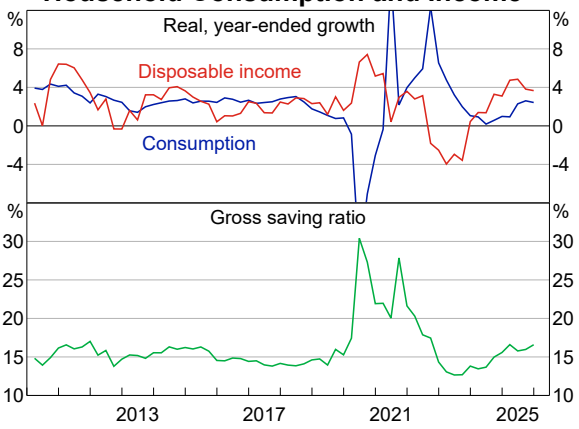


* Outliers during the COVID-19 pandemic have been truncated.
Source: ABS.

Public demand growth was strong in the December quarter, increasing by 0.9 per cent (broadly in line with expectations). Public consumption and investment grew by 0.9 per cent and 1.0 per cent respectively in the quarter. Over the year to the December quarter, public demand grew by 2.4 per cent, with growth having eased compared with the more rapid rates seen in 2023 and 2024. Growth in public consumption over recent years has been driven by increased government operating expenses and spending on social benefits provided in-kind to households (including under the NDIS and Medicare), while public investment has grown alongside public infrastructure spending at the state level.
The consolidated underlying cash balance from federal, state and territory budgets provides a more comprehensive indication than public demand of how developments in fiscal policy may be affecting aggregate demand. The mid-year updates from government budgets released late last year suggested the consolidated government deficit would widen further in financial year 2025/26.

Year-ended household consumption growth picked up over 2025, but by much less than expected in the February *Statement*. The pick-up in year-ended consumption growth over 2025, to 2.4 per cent, was supported by strong growth in real household disposable income and wealth (Graph 2.10). But household consumption growth was only 0.3 per cent in the December quarter and was weaker than expected across most spending categories. That suggests there was less underlying momentum at the end of last year than previously anticipated. We also judge that there was less promotion-induced bring-forward of spending in the December quarter than previously expected. Some idiosyncratic factors also weighed on consumption growth (e.g. relating to cigarette, tobacco and electricity consumption).

Graph 2.10
Household Consumption and Income*



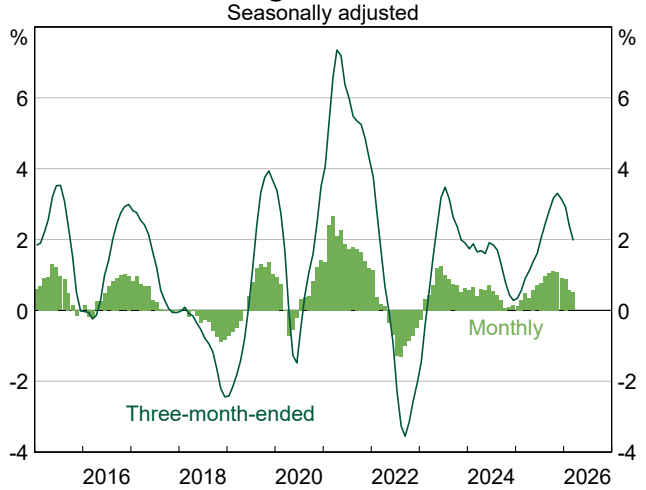
* Outliers during the COVID-19 pandemic have been truncated.
Sources: ABS; RBA.

Household consumption is expected to have grown solidly in the March quarter, although this partly reflects a boost from the unwinding of electricity subsidies. The level of consumption is forecast to be lower than expected in the February *Statement*, given the weaker-than-expected December quarter outcome. The nominal ABS household spending indicator (ABS HSI) grew only modestly in January and February and year-ended growth declined a little. That could indicate relatively soft consumption growth in the March quarter. However, the mapping from the ABS HSI to the national accounts measure of consumption is imprecise, and the HSI was stronger than the equivalent components in the national accounts measure in the December quarter. Spending data from commercial banks are consistent with a fairly wide range of possible outcomes for March quarter consumption. Retail liaison contacts generally reported solid trading conditions in the first two months of this year (though within this there has been some unevenness across sales periods, geography and product categories). Taking these indicators together, we expect modest growth in underlying consumption in the March quarter. The unwinding of the electricity subsidies is expected to boost measured household consumption noticeably, contributing around 0.3 percentage points to quarterly growth.

Private investment increased strongly over 2025, and by more than expected in the February *Statement*. Dwelling investment growth was strong over the year, which likely reflects a range of factors including the lagged effects of earlier strong population growth and monetary policy easing, and an easing in construction sector capacity constraints at the start of 2025. This strong growth contributed to the return of capacity pressures in the construction sector and higher new dwellings inflation in the second half of last year. Business investment also picked up further in the December quarter. While this was driven most prominently by continued data centre building activity and energy projects, investment was stronger than expected across almost all categories.

Housing price growth has eased in recent months, and by a little more than expected, after growing strongly over 2025 (Graph 2.11). Auction clearance rates have also fallen since the start of the year in Sydney and Melbourne to be below their long-run averages. The easing in conditions likely reflects softer demand due to the recent cash rate increases, expectations for a higher future path for interest rates and moderating market sentiment. The change in sentiment could also be related to the conflict in the Middle East. Dwelling prices in the more expensive segments of the market (which tend to be more interest rate sensitive) have declined in recent months, concentrated in Sydney and Melbourne. Prices in the lower and middle tiers of the market have been relatively more resilient, noting that demand may have been supported by the Australian Government 5% Deposit Scheme.

Graph 2.11
Housing Price Growth
Seasonally adjusted

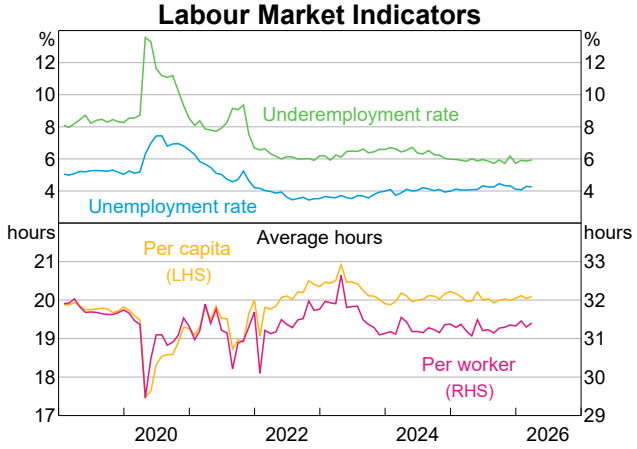


Sources: Cotality; RBA.

Labour market conditions have evolved broadly as expected in the February forecasts.

The unemployment rate was unchanged at 4.3 per cent in the month of March and in quarterly terms was 4.2 per cent, only marginally below our February forecast (Graph 2.12). The underemployment rate remained unchanged at 5.9 per cent in the March quarter. In trend terms, it has been broadly stable over the past year and remains low by historical standards. The hours-based underutilisation rate – a broader measure of spare capacity – and the medium-term unemployment rate have also largely been unchanged since the start of 2025.

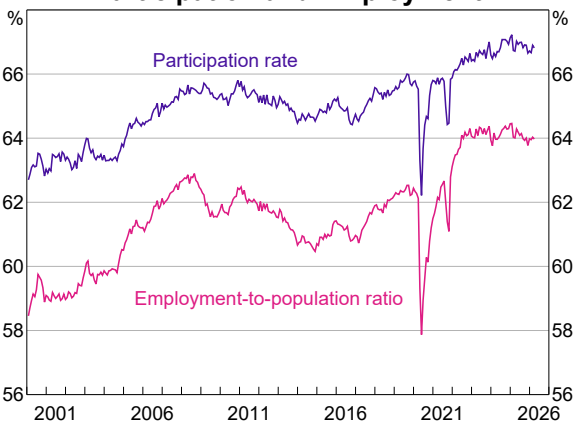
Graph 2.12
Labour Market Indicators



Sources: ABS; RBA.

The employment-to-population ratio increased to 64.0 per cent in the March quarter, supported by strong employment growth (Graph 2.13). The strength in employment growth occurred alongside modest increases in average hours worked per employed person and hours worked per capita. Industry-level data indicate that the market sector was the main driver of employment growth in late 2025. Likewise, the increase in vacancies in the three months to February was mostly driven by the market sector. The participation rate was unchanged at 66.8 per cent in the March quarter.

Graph 2.13
Participation and Employment

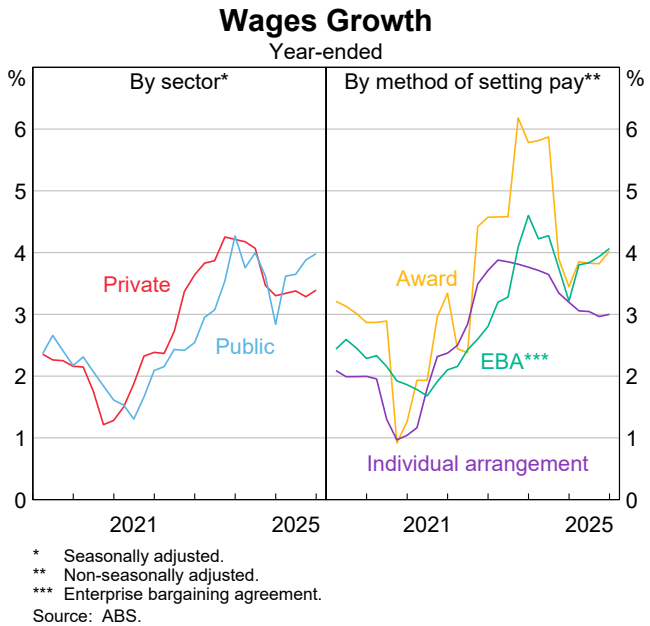


Source: ABS.

Aggregate wages increased by 3.4 per cent over 2025, as expected in the February *Statement*. Private sector wages growth was a little stronger than expected.

Private sector wage price index (WPI) growth remained steady at 0.8 per cent in the December quarter and was 3.4 per cent in year-ended terms, which was above expectations (Graph 2.14). Recent data, including historical revisions, now suggest that the underlying rate of quarterly private sector wages growth – that is, after accounting for one-off administered increases – remained broadly steady over 2025, rather than easing a little as looked to be the case in February. Wages growth for workers on individual agreements – which tend to be the most responsive to current labour market conditions – remained steady at 3.0 per cent over the year, slightly higher than anticipated. Public sector WPI growth declined to 0.8 per cent in the December quarter but increased to 4.0 per cent in year-ended terms.

Graph 2.14



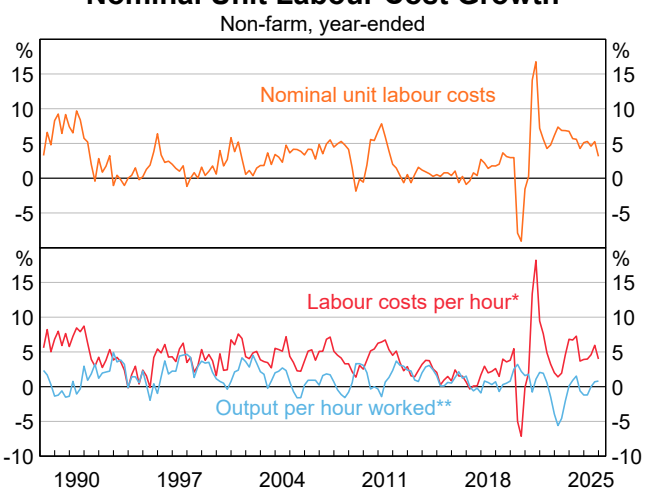
* Seasonally adjusted.
** Non-seasonally adjusted.
*** Enterprise bargaining agreement.
Source: ABS.

Growth in the national accounts' measure of average earnings (AENA) eased to 4.1 per cent in the December quarter, below expectations in the February *Statement*. As such, WPI and national accounts data since the February Statement have provided mixed signals for growth in labour costs. Nonetheless, AENA growth remained above its long-run average in year-ended terms and exceeded WPI growth by an amount that is greater than its pre-pandemic average.

Unit labour costs growth moderated over the year to the December quarter 2025, driven by the easing in AENA growth.

Unit labour costs growth declined from 5.3 per cent to 3.1 per cent in year-ended terms in the December quarter, a larger decline than expected (Graph 2.15). The greater-than-expected easing was primarily due to slower AENA growth than forecast. The elevated rate of growth in unit labour costs over much of 2025 reflected both weakness in productivity and cyclically high growth in AENA. Labour productivity increased by 0.2 per cent in the December quarter and 0.8 per cent in year-ended terms, broadly as expected in the February *Statement*.

Graph 2.15



* Compensation of employees plus payroll taxes less employment subsidies, divided by employee hours worked.
** Includes self-employed.
Sources: ABS; RBA.

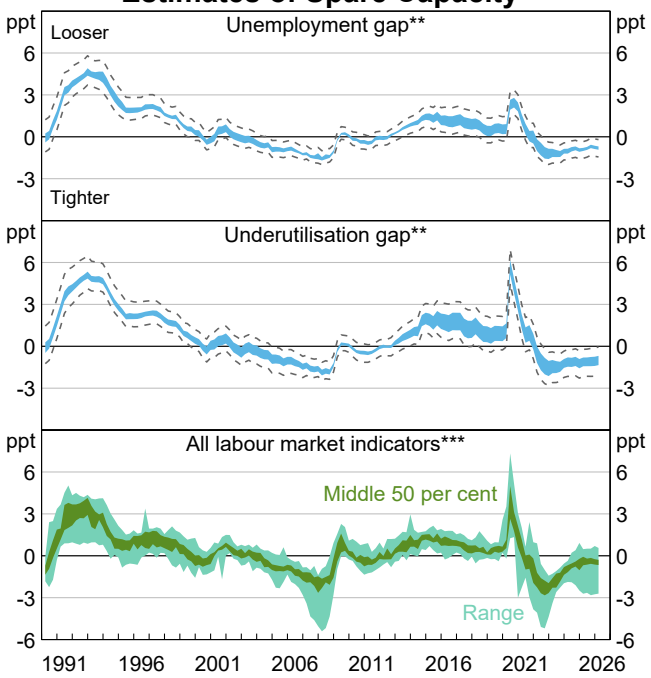
Labour market conditions are still judged to be somewhat tight, similar to our assessment in February.

Most of the labour market indicators we monitor remain tighter than their estimated trend levels (Graph 2.16).[1] The underemployment rate and hours-based underutilisation rate both point to tightness in the labour market. Average hours per capita, the share of firms reporting labour constraints and non-mining capacity utilisation suggest some tightening in conditions over the past six months, while most other indicators have remained little changed. Only a couple of indicators are below their estimated trends, namely job ads (as a share of the labour force) and the job-finding rate of the unemployed.

Model-based estimates of the non-accelerating inflation rate of unemployment (NAIRU) continue to indicate a tighter labour market than suggested by most other indicators. 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. These estimates suggest that the labour market has seen only limited easing in recent years (upper and middle panels in Graph 2.17). The central tendency of our broad suite of labour market indicators (the dark green range in the lower panel below), which has guided our overall assessment of labour market conditions, suggests somewhat less tightness than model estimates.

Graph 2.17

Estimates of Spare Capacity*

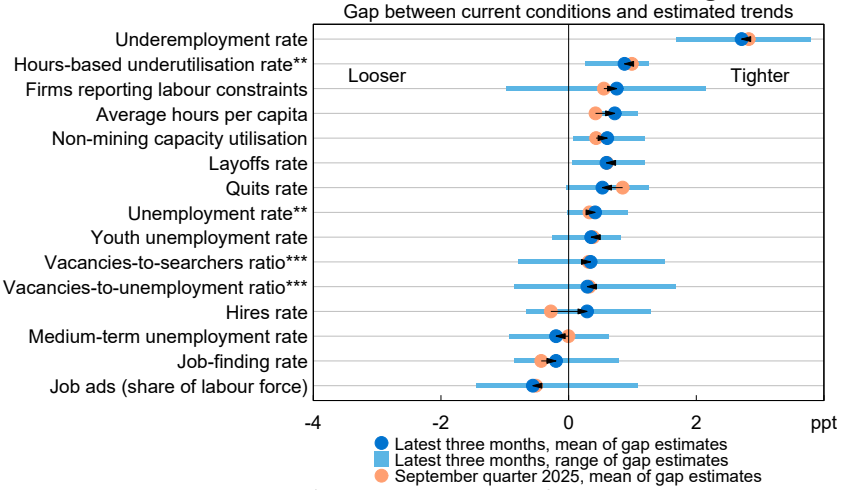


* March quarter 2026 gap estimates use updated labour market outcomes applied to December quarter 2025 NAIRU and labour market trend estimates.
** Blue-shaded region shows illustrative range of central gap estimates from a selection of models; grey dashed lines are the maximum and minimum one-standard-error confidence intervals from the selection of models.
*** Range of the mean benchmark of each indicator.
Sources: ABS; ANZ–Indeed; NAB; RBA.

Graph 2.16

Indicators of Labour Market Tightness*

Gap between current conditions and estimated trends

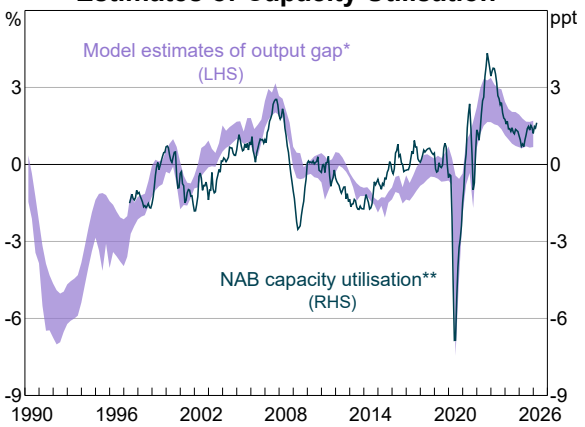


* Indicators scaled to the units of the unemployment rate.
** Range includes model-based estimates.
*** Log.
Sources: ABS; ANZ–Indeed; NAB; RBA.

Economy-wide capacity pressures remain elevated and look to have increased over the second half of 2025, broadly as expected in the February *Statement*.

Model-based estimates indicate that the output gap remained positive in the December quarter of 2025, before the increases in the cash rate target. The level of GDP in the December quarter remained above model estimates of the level of potential output, suggesting that aggregate demand continued to exceed the economy's sustainable supply capacity (Graph 2.18). While individual model estimates vary and are subject to uncertainty, all internal RBA models point to a positive output gap. This partly reflects recent inflation and unemployment outcomes, which suggest ongoing tightness in the labour market and broader capacity pressures.

Graph 2.18
Estimates of Capacity Utilisation



* Per cent of potential output; violet-shaded region shows an illustrative range of central gap estimates from a selection of RBA internal models, encompassing different measures and definitions of the output gap; OECD output gap estimates, which were included previously, are excluded from the current model suite to ensure consistency with internal methodologies and assumptions.

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

Sources: ABS; NAB; RBA.

More timely survey-based indicators of broader capacity utilisation, which partly post-date the monetary tightening, remain consistent with this assessment. The NAB measure of capacity utilisation increased in the second half of 2025 and remained elevated in the March quarter 2026.

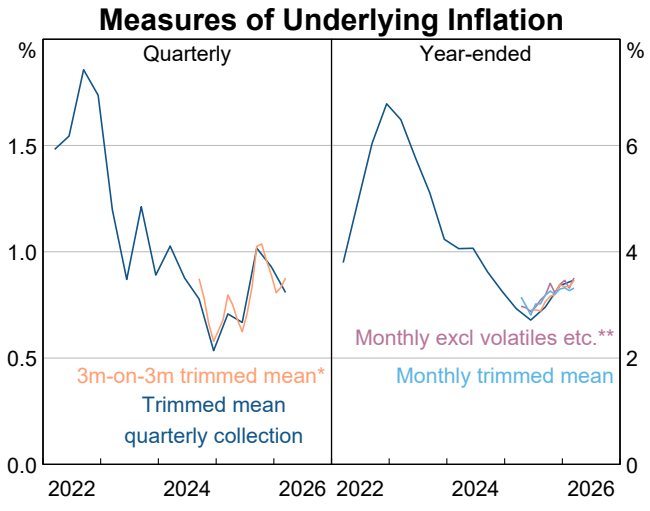
Underlying inflation remained elevated in the March quarter, though was slightly lower than expected in the February *Statement*.

The prices of most consumer goods and services in the March quarter had not yet been materially affected by the onset of the Middle East conflict, with the exception of fuel prices. Broader pass-through of fuel costs is expected from the June quarter onwards (see section 2.3 below and Chapter 3: Outlook). Headline inflation increased to 4.1 per cent over the year to the March quarter, from 3.6 per cent in the December quarter. The elevated rate of headline inflation reflected the increase in fuel prices – which contributed 0.2 percentage points to year-ended inflation in the quarter – and the roll-off of electricity rebates, as well as ongoing strength in underlying inflation. Headline inflation rose to 4.6 per cent in the month of March in year-ended terms, with a 0.8 percentage point contribution from fuel prices.

Trimmed mean inflation remained elevated at 0.8 per cent in the March quarter and increased to 3.5 per cent in year-ended terms.[2] Measures of underlying inflation from the monthly CPI show a similar pattern (Graph 2.19). The elevated rate of underlying inflation reflected ongoing strength across a broad range of components. Setting aside the direct effects of the increase in fuel prices faced by households – which caused quarterly trimmed mean inflation to be around 0.1 percentage points higher than otherwise, as fuel's position within the quarterly distribution of price changes shifted relative to expectations in the February *Statement* – underlying inflation was slightly lower than expected in the February *Statement*.[3]

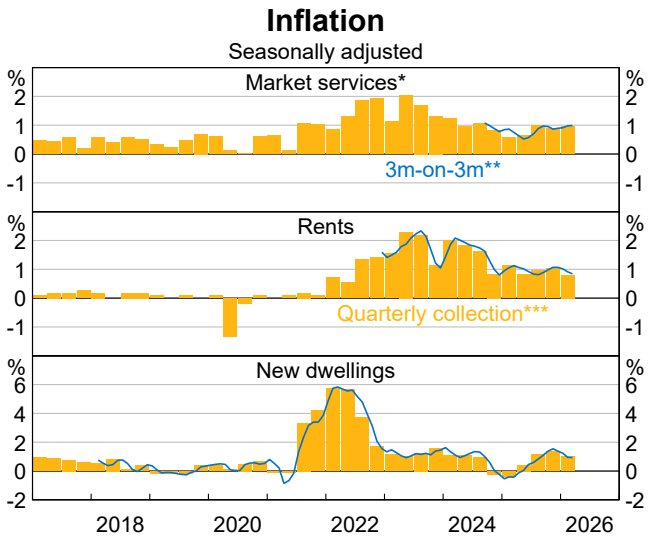
Some of the softness in trimmed mean inflation, relative to the February forecast, was driven by an unexpected decline in domestic travel prices, which are volatile. Prices growth for new dwelling construction eased by more than expected in the March quarter, as did groceries inflation (excluding fruit and vegetables), which eased to its lowest rate (in year-ended terms) since late 2024. Consumer durables inflation, which was surprisingly strong in late 2025, eased in the March quarter, broadly in line with expectations. However, growth in market services prices was stronger than expected in the February *Statement*.

Graph 2.19



* Calculated based on the distribution of three-month-on-three-month price changes.
** Monthly CPI excluding volatiles, holiday travel and electricity.
Sources: ABS; RBA.

Graph 2.20



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

Taken together with elevated growth in output prices, the high outcome for underlying inflation in the March quarter is consistent with there being ongoing domestic capacity pressures. Overall, recent data do not materially alter our assessment of underlying inflationary pressures prior to the onset of the conflict, as set out in the February *Statement*.

New dwelling construction prices increased by 1.0 per cent in the March quarter and were 3.9 per cent higher in year-ended terms (Graph 2.20). New dwelling inflation was weaker than expected in the February forecasts, coinciding with the slowing in established housing price growth and in housing market activity. Information from liaison indicates that demand for building new houses may have stabilised somewhat in recent months following the recent cash rate increases.

CPI rent inflation eased to 0.8 per cent in the March quarter, below expectations in the February *Statement*, and was 3.7 per cent in year-ended terms. Advertised rental growth and rental vacancy rates continue to point to tightness, which may gradually flow through to the stock of CPI rents as leases are updated.

Market services inflation (excluding telecommunications and domestic travel) increased to 1.0 per cent in the March quarter, above expectations in the February *Statement*. In year-ended terms, inflation increased to 3.5 per cent. The prices of these services are typically among the most sensitive to domestic labour costs, and stronger inflation for market services since mid-2025 is consistent with strength in broader measures of labour costs over the past year.

Inflation for goods and services with administered prices (excluding utilities) eased to 4.3 per cent in year-ended terms. Utilities prices inflation increased to 19.9 per cent in year-ended terms, reflecting a sharp increase in electricity prices as rebates expired. The expiration of rebates will continue to affect year-ended headline inflation until the March quarter 2027.

Consumer durables inflation eased to 0.3 per cent in the March quarter, broadly in line with expectations in the February *Statement*. Groceries inflation, excluding fruit and vegetables, also slowed in the March quarter.

Prior to the onset of the Middle East conflict, survey measures of households' short-term inflation expectations had continued to increase in line with recent stronger inflation outcomes. Financial market measures of short-term expectations derived from inflation swaps had also increased further. Measures of long-term inflation expectations remained broadly stable.

2.3 Early indicators of the effect of the Middle East conflict on the Australian economy

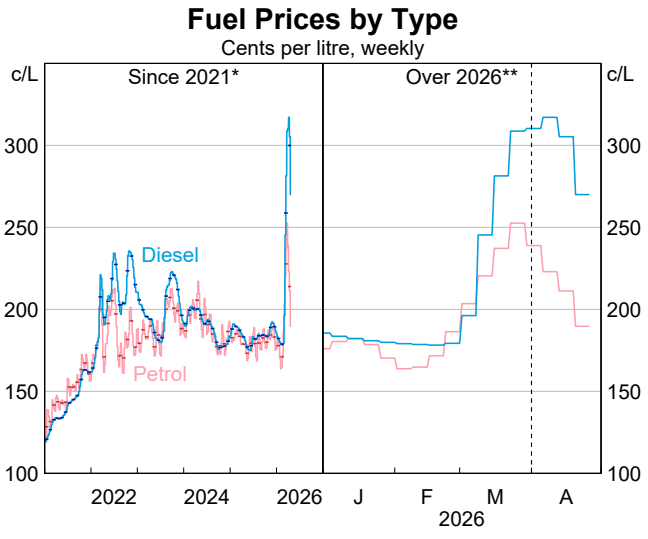
The conflict has caused the global price of oil and some oil-related products to rise sharply. These price rises have begun to flow through directly to inflation via increases in fuel prices, lifting the year-ended rate of headline inflation by 0.8 percentage points in the month of March. Since then, policy changes such as the temporary halving of the fuel excise have partially mitigated the increase in fuel costs faced by households and by some businesses. The pass-through by firms of fuel cost increases to other consumer goods and services is expected to take place from the June quarter onwards.

The increase in fuel prices has contributed to a large deterioration in consumer and business sentiment. Household spending at petrol stations has increased sharply in the past two months (although has now declined from its peak in the earlier weeks of the conflict); compared with many goods, demand for petrol tends to be relatively insensitive to prices. However, there is little evidence of a material pullback in other types of spending so far, with the usual noise in weekly card spending data and other timely indicators meaning it is difficult to identify more modest shifts in spending patterns. Timely indicators also suggest that the conflict has had little effect on labour demand so far, though some recent reports from liaison suggest a weakening in hiring intentions.

Domestic prices for fuel have risen substantially in response to higher international oil and refined fuel prices, while policy changes have provided a partial offset.

Rising international prices for crude oil and refined fuels have led to substantial rises in domestic fuel prices since the start of the conflict. Wholesale prices for petrol and diesel are up around 19 per cent and 48 per cent respectively since the end of February. Retail prices for petrol and diesel have declined from their peak in late March; retail petrol prices are now 2 per cent above their pre-conflict levels, while diesel prices are 51 per cent higher (Graph 2.21). Policy changes have contributed to the decline in retail prices since March, partially mitigating the increase in fuel costs faced by households and by some businesses. The changes include a temporary halving of the fuel excise, a reduction in the heavy vehicle road user charge to zero, and the forgoing of higher GST revenue (via a further reduction in fuel excise).

Graph 2.21



* Darker horizontal lines are monthly averages.
** Vertical dashed line reflects when the cut to the fuel excise took effect.
Sources: Australian Institute of Petroleum; RBA.

The Middle East conflict has already contributed to higher inflation directly through fuel costs and indirectly through prices in travel and transport-related sectors.

Higher fuel costs contributed directly to inflation in the March quarter. CPI fuel prices increased by around 32 per cent in March, contributing materially to headline inflation, lifting the year-ended headline inflation rate by around 0.8 percentage points in the month of March and 0.2 percentage points in the March quarter. Higher fuel prices had a smaller effect on underlying inflation (see section 2.2 above).

Higher fuel prices will also contribute indirectly to inflationary pressures as firms pass on some of their higher costs to final prices, but this will generally take place from the June quarter onwards. For example, increased prices for domestic and international flights owing to the substantial increase in the price of jet fuel – which is around 92 per cent higher since the start of the conflict – are expected to flow through into the CPI data from the June quarter.

Liaison contacts have expressed concern regarding increases in input costs and potential availability issues for critical inputs such as diesel and oil-derived products. The most immediate and widespread impact reported by firms is higher fuel surcharges imposed by upstream firms (e.g. in the transportation sector), which have been incurred by firms across a broad set of industries including agriculture, construction, retail and hospitality (see Box A: Insights from Liaison). The cost of oil-derived products (e.g. fertiliser, plastics and other petrochemicals) has also escalated over recent weeks. Some fuel stockouts occurred in the first few weeks of the conflict – particularly in regional areas – driven by a sharp and largely temporary increase in demand. More recently, availability concerns have eased as fuel demand has stabilised.

Many consumer-facing firms in our liaison program have not yet passed through the higher costs to their base prices. However, an increasing share of firms in our liaison program now expect above-average increases in prices for the year ahead. Some firms have expressed uncertainty regarding the timing and extent of pass-through to consumer prices as they are yet to observe the full impact of higher input costs, which in part depends on the duration of the conflict. Some firms are still negotiating their contracts with suppliers, and others expect costs to be passed through over the course of the year, depending on how long the conflict persists. Nevertheless, firms' pass-through would depend on factors such as the share of fuel and oil-related products in their total cost base, hedging practices and existing margin buffers. Many firms in liaison have also noted that they are anticipating the possibility that rising headline inflation may lead to increased wage demands from workers (see further discussion of how inflation may feed into wages growth in Chapter 3: Outlook).

In recent months, and particularly since the onset of the Middle East conflict, survey measures of households' short-term inflation expectations and financial market measures of short-term inflation expectations have increased sharply (see Chapter 1: Financial Conditions). These increases in inflation expectations are broadly consistent with the changing outlook for inflation described in our forecasts (see Chapter 3: Outlook). Meanwhile, financial market measures of long-term expectations have been more stable, consistent with our assessment that they remain anchored at the target, given market expectations for the future path of interest rates (see Chapter 1: Financial Conditions).

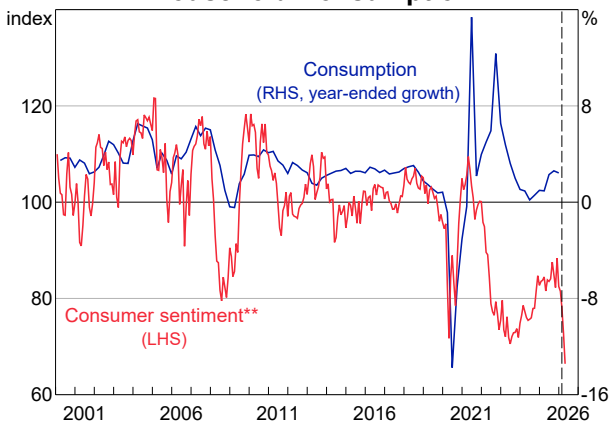
Consumer and business sentiment declined notably in March and April, but timely indicators do not suggest a sharp slowing in real household consumption.

The Middle East conflict has prompted a sharp decline in consumer sentiment, which had also fallen somewhat in the lead up to and following the Monetary Policy Board's decision to raise interest rates in February. The weekly measure has recovered in the past four weeks but remains notably lower than prior to the conflict. The overall decline to date has been relatively broad-based with the largest falls relating to near-term economic conditions, evaluations of personal finances, and buying conditions for major household items. Higher inflation is likely to be weighing on consumer sentiment, although the recent fall in sentiment has been larger than can be explained by economic 'fundamentals' like inflation, inflation expectations, the cash rate or unemployment (based on the past relationship between these fundamentals and sentiment).

Past RBA work has found limited evidence that consumer sentiment is an independent driver of household consumption. While consumer sentiment and consumption have generally shared similar broad trends over time, that reflects their common drivers and there can be significant short-run divergences. That said, given the scale of the observed decline and because sentiment is very low by historic standards, the deterioration in sentiment could have a greater bearing on household spending decisions than would normally be expected (Graph 2.22).

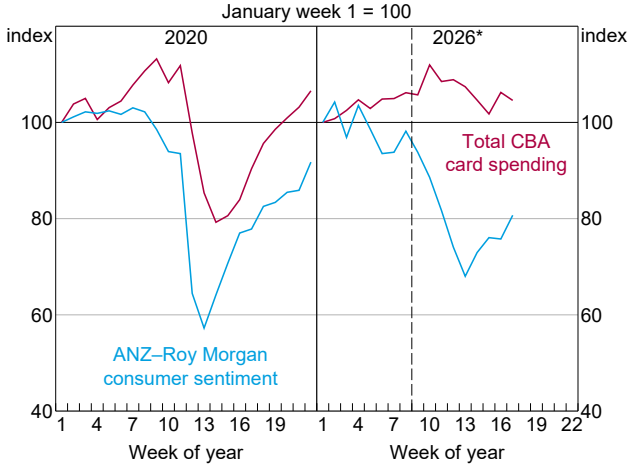
There is little evidence that consumers have noticeably reduced non-petrol spending to date (Graph 2.23). Timely card spending data released by major banks shows that nominal spending (excluding petrol stations) has not materially declined – noting that these weekly data are inherently volatile. However, modest changes in growth are difficult to detect and the movements in non-petrol spending since the start of the conflict vary by data source.

Graph 2.22
Consumer Sentiment and Household Consumption*



* Dashed line shows the start of the Middle East conflict.
** Average since 1996 = 100; mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys.
Sources: ABS; ANZ–Roy Morgan; RBA; Westpac–Melbourne Institute.

Graph 2.23
Consumption and Consumer Sentiment
January week 1 = 100



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

Household spending on petrol has risen sharply in the past two months, largely due to higher prices. Card spending data show that nominal spending at petrol stations increased sharply in the past two months (although it has declined from its peak earlier in the conflict), broadly in line with movements in fuel prices. This is consistent with the volume of petrol purchases being less sensitive to prices than many other goods, at least in the short run, because for many people alternative options may be limited. The *number* of transactions at petrol station transactions also increased, likely reflecting a combination of precautionary purchases and smaller purchase size, though has similarly declined over recent weeks suggesting an unwind in this behaviour.

Households were, in aggregate, in a strong financial position at the start of the conflict following the recovery in real incomes and strong growth in wealth in recent years. The household saving ratio has risen above pre-pandemic averages recently and many borrowers have sizeable buffers in mortgage offset and redraw accounts (see Chapter 1: Financial Conditions). This strong financial position means that households are, in aggregate, well placed to smooth their consumption when faced with a reduction in their real incomes, if they view much of the recent increases in fuel prices as temporary. Given increases in fuel prices since the start of the conflict, additional fuel costs are estimated to have been less than 1 per cent of total household income over that period, although it will have been more than that for some households.

While there has not been a noticeable change in aggregate spending patterns, there do appear to have been shifts in the composition of spending. There has been reduced spending in more discretionary areas – with card spending lower in categories such as travel. However, this has been offset by strength in other areas. For example, electric vehicle purchases have been elevated in recent months, according to information from the Electric Vehicle Council. There is also some evidence of increased usage of public transport, possibly reflecting some substitution away from driving as it has become more expensive and the introduction of free public transport in some states.

Business confidence also fell sharply in March, reflecting elevated uncertainty about the demand outlook and rising input costs associated with the Middle East conflict (Graph 2.24). The decline in confidence was broadly based across industries and was largest in transport and utilities, and retail. The sharp decline in confidence suggests a deterioration in more forward-looking business sentiment, even as business conditions (which reflect current activity) have remained relatively stable and forward orders have remained around their long-run average. Lower business confidence is typically only weakly correlated with business investment and is unlikely to affect business investment in the short term, with many firms in the RBA's liaison program noting they are going ahead with current investment plans. However, if uncertainty and weak business sentiment were to persist for some time, it is more likely that investment plans would be affected.

Graph 2.24

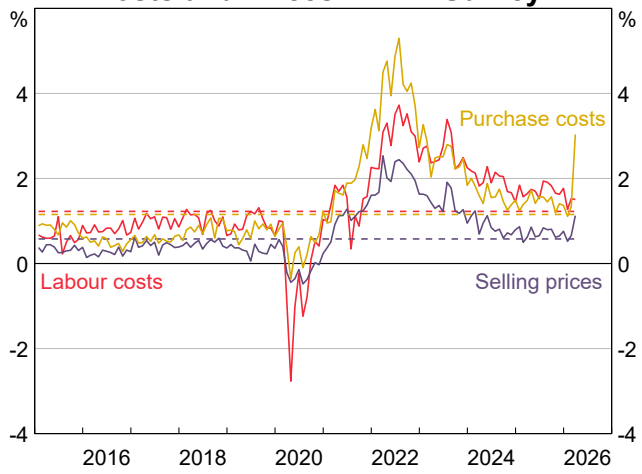
Business Sentiment and Forward Orders*

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

Sources: NAB; RBA.

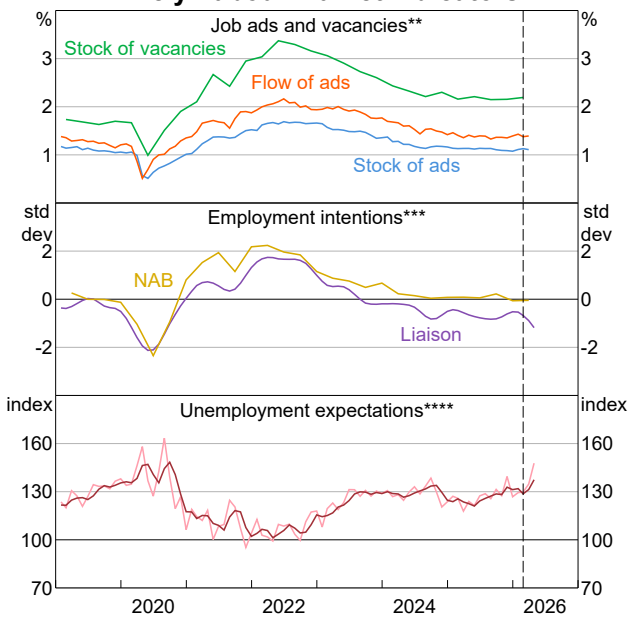
Surveyed firms reported a sharp increase in input costs in March, amid much higher raw material and fuel costs. This has occurred alongside an increase in selling prices (albeit by less, suggesting firms are not yet fully passing on higher costs to customers; Graph 2.25). Similar themes have also been reflected in discussions with businesses through the RBA's liaison program (see Box A: Insights from Liaison). Survey measures of capacity utilisation have edged up slightly since the onset of the conflict, suggesting that firms have not scaled back utilisation in response to higher costs.

Graph 2.25
Costs and Prices – NAB Survey*



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

Graph 2.26
Timely Labour Market Indicators*



* Dashed line shows the start of the Middle East conflict.
** Per cent of labour force.
*** 12 months ahead; standard deviations from mean.
**** Dark line shows three-month moving average.
Sources: ABS; ANZ–Indeed; JSA; NAB; RBA; Westpac–Melbourne Institute.

Timely indicators suggest that the conflict has had little effect on labour demand so far. Leading indicators were broadly unchanged over March relative to their pre-conflict levels (Graph 2.26).
Job advertisements for occupations that may be more exposed to fuel, such as logistics and transport, were also little changed in March. Some indicators, however, may point towards a possible weakening of labour demand. Unemployment expectations spiked in April and employment intentions from the RBA's liaison program have also decreased, particularly in recent weeks, with a smaller share of firms expecting to increase their workforce over the year ahead. In liaison, some firms have indicated they are considering how their hiring plans could change if the effects of the conflict are prolonged.

Endnotes

1 The ABS is implementing some changes to the Labour Force Survey, to be phased in from the April 2026 reference month (see Box B: Changes to the Labour Force Survey).

2 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. 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.

3 In the February *Statement*, which was prior to the onset of the Middle East conflict, fuel was expected to be in the 'lower tail' of the distribution of price changes (i.e. the bottom 15 per cent of the distribution) in the March quarter. Owing to the conflict, fuel was in the 'upper tail' of the distribution of price changes (i.e. the top 15 per cent of the distribution) in the March quarter. When an item's inflation rate moves from the lower tail to the upper tail, it causes higher item-level inflation rates to be included in the trimmed distribution over which the mean is calculated, such that trimmed mean inflation will be higher than otherwise. See RBA (2025), 'Explainer: Inflation and its Measurement' for more information about the trimmed mean as a measure of underlying inflation.

Box A: Insights From Liaison

This Box highlights key messages collected by the RBA's liaison teams in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 270 businesses, industry bodies, government agencies and community organisations from early-February to late-April 2026.

Prior to the start of the Middle East conflict, the themes and sentiment raised in liaison discussions had been little changed over preceding months. Demand conditions remained positive, albeit a little more moderate than last year, and investment intentions were quite strong. Firms were generally not expecting large changes in their headcount or in the pace of prices and wages growth over the year ahead.

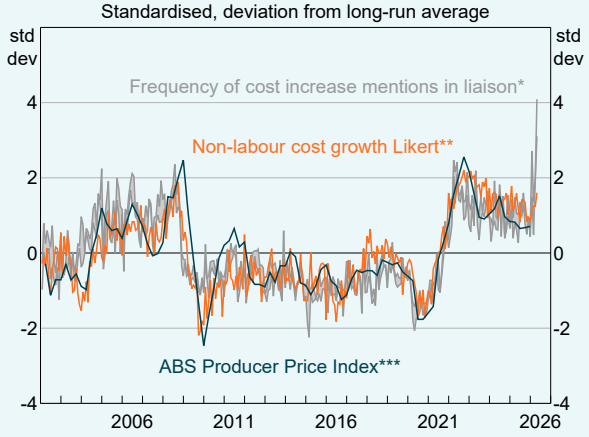
However, a dominant issue since mid-March has been the effects of the Middle East conflict and disruptions to oil markets. Immediate impacts reported by firms have related mostly to non-labour input costs, as prices have risen for fuel and oil-derived inputs. Cost increases have been reported as transmitting quickly through many supply chains, and some of this is beginning to flow through to selling prices, although firms note there is considerable uncertainty regarding their pricing decisions. Expectations for forward demand have slowed further, as have employment expectations. That said, the impact of current events on firms varies widely, and a range of businesses continue to report positive demand conditions and above-average investment plans to support longer run growth and to manage business costs.

Global oil market disruptions have quickly affected input costs for many businesses.

Firms are widely reporting marked increases in input costs over March and April.
The frequency with which cost increases are being mentioned in liaison discussions is higher than at any time in recent decades (Graph A.1). The primary driver of these reports has been higher prices for fuel and transport services, which have rapidly passed through supply chains. As these prices spiked higher, firms with existing contractual fuel surcharge rights quickly adjusted customer pricing, and surcharge arrangements were also quickly adopted more broadly by suppliers and contractors. Fuel costs are also being cited by many suppliers as the basis for general increases in their own prices.

In addition to fuel, contacts across the manufacturing, construction and primary production industries have reported large cost increases for various petrochemical-derivative products such as fertiliser, bitumen, resins, PVC and other plastics.

Graph A.1
Non-labour Cost Indicators
Standardised, deviation from long-run average



* Range of two text-based measures (i) net balance of 'increasing' / 'decreasing' word count, and (ii) intensity of infrequent word usage; monthly; unsmoothed.
** Non-labour cost growth outcomes over the 12 months before each observation; monthly; unsmoothed.
*** Quarterly; year-ended percentage change; latest data point at time of finalisation was December quarter 2025.
Sources: ABS; RBA.

While there had been some fuel shortages in the first few weeks of the conflict – particularly in regional areas – these were mainly driven by a sharp and largely temporary increase in demand, and availability concerns have eased as demand has stabilised. Some agricultural producers have reported actual or contemplated delays, reductions or switches in crop plantings in response to higher costs and uncertain availability for farm inputs such as fuel, fertiliser and packaging. Some manufacturers reliant on petrochemical-derivative inputs have also expressed concerns around availability over the period ahead. Builders are generally not reporting issues around availability of materials, though some have noted concerns around potential disruptions should shortages eventuate. Wholesalers and retailers are not otherwise reporting issues around availability and distribution of imports or domestically produced goods.

Downstream price pressures have been building across supply chains.

Firms have reported that higher costs for fuel and some other inputs started being passed through supply chains as soon as global markets were affected in March. While liaison contacts generally expect indexed fuel surcharges and materials costs to move in line with raw materials prices over time, some contacts expect some other supplier prices might remain higher even if global disruptions are resolved soon. To date many contacts have not increased consumer-facing prices, although firms widely report that they are actively considering what price changes they might make if input cost increases persist or broaden.

Liaison discussions indicate downstream cost impacts have been particularly evident in the construction and property development industries, given transport and oil-derived raw materials are a relatively large share of input costs. Many construction firms therefore are implementing and/or actively considering increases to prices. In existing civil and commercial projects this is typically via fuel surcharging or 'rise-and-fall' contract provisions. Firms also note that new projects are being costed on the basis of higher prices. Residential builders which have sold fixed price contracts are pushing back on supplier cost increases where they can. Pricing for new contracts is being reviewed, although reported actual increases have been fairly modest to date. In regions where demand conditions have been solid for a sustained period of time – such as South East Queensland, South Australia and Western Australia – firms are noting that higher prices are being implemented fairly quickly. Where conditions have been more subdued, firms have reported being somewhat wary about the potential effect of higher prices on demand, but some upward movement is still likely.

Energy market contacts do not expect higher international energy prices to have material effects on domestic electricity and gas prices. A risk to this outlook would be if the conflict were to be prolonged and result in domestic shortages of fuel necessary for generator operations. In the retail electricity market, draft price determinations suggest retail prices will generally be lower for the year ahead. In the east coast gas market, contacts report the market is currently well supplied, against a backdrop of gradually softening demand.

For other businesses, the outlook for selling prices is more mixed. Prior to the conflict, liaison contacts had generally expected selling price inflation to ease a little over the year ahead, but that is now less clear.

Macquarie University's March 2026 Business Outlook Scenarios Survey (BOSS) included a special module, designed in collaboration with the RBA, to explore the effects of current events (most respondents are small- and medium-sized businesses).[1] Survey respondents reported that average input cost increases of around 10–15 per cent are expected over the coming 12 months, of which a large share had already occurred. Respondents also reported that they expected only partial (around 30 per cent) pass-through of higher costs to selling prices. Many firms noted competitive pressure as a key constraint to fully passing on upstream cost increases, but this would be less so if price increases became more generalised across other firms and industries.

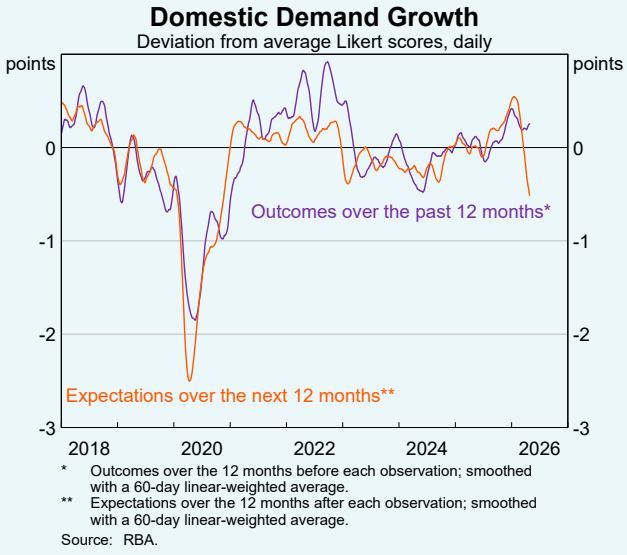
Discussions with liaison contacts over recent weeks have been consistent with these survey results. Where costs have increased markedly (such as fuel), these have been passed through quickly to commercial customers. But while the magnitude of some individual input cost increases is large, in many (though not all) cases these are a relatively small share of firms' total cost base. To date, only a few firms have reported actual increases in their consumer prices, although many contacts note that increases are under active consideration.

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

Contacts in general had been reporting that positive demand conditions had been sustained into the first few months of the year (Graph A.2). However, even prior to the Middle East conflict, firms had been downgrading their outlook for demand given signs of moderating consumer spending and an increase in interest rate expectations. Expectations for forward demand have since slowed further.

Over the first few months of 2026, retailers were generally reporting solid sales, although possibly a bit softer than seen over the peak promotional periods in late 2025. One factor cited as maybe weighing on spending has been households responding to higher expected interest rates since the start of the year. A consistent theme across retailers for the past year has been that generating sales growth requires more effort than a few years ago, but demand is generally evident when consumers perceive value. In response, some retailers have been adjusting their product mix to attract more value-conscious shoppers.

Graph A.2



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

As recent events unfolded, some food retailing businesses reported seeing some limited precautionary purchasing by consumers, but this has since stabilised. Retailers otherwise are not reporting significant shifts in sales volumes, although some are observing a switch to lower priced goods as households look to manage budget pressures from higher transport costs. Some businesses that are more exposed to discretionary spending – such as in hospitality and tourism – have seen evidence of a pullback in spending over recent weeks. Airlines are also reducing some capacity in light of higher fuel costs. Consistent with the impact of higher transport costs, community services organisations are reporting some pick-up in enquiries and demand from more vulnerable households.

Prior to the conflict, builders and developers were seeing solid home building demand over early 2026, although the pace appears to have moderated compared with 2025, which some contacts attributed to higher interest rates. Some residential industry contacts are reporting further slowing in sales enquiries and deposits in some markets in recent weeks, which they attribute to economic uncertainty and the effect of higher fuel prices on household budgets. Selling conditions have been more resilient in more supply-constrained markets. Given earlier strength in sales, the volume of work under construction remains elevated for many homebuilders. Cancellation rates remain low; however, if they were to increase sharply over the next few months, the pipeline of work could fall significantly from current levels.

Investment spending and intentions had remained solid through the first few months of the year. Prior to recent events, businesses in aggregate had expected investment spending to ease from its recent strength as some larger projects near completion, but still remain above average. More recently, the outlook for higher construction costs has been noted by some contacts as likely to see some private and public sector clients review forward spending plans. Some mining industry contacts have noted deferred investment expenditure due to global economic uncertainty. In other cases, though, contacts are planning for above-average spending to support business growth. Construction and fit-out of data centres has remained strong, and businesses more generally continue to explore ways to reduce operating costs through investment in enterprise systems and other IT programs.

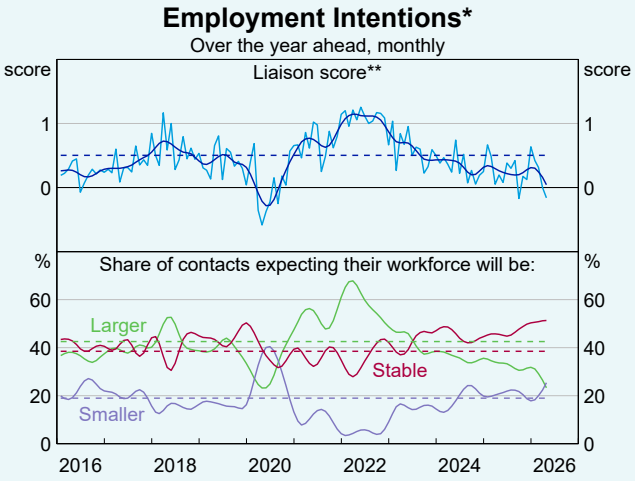
Lifting productivity continues to be a key motivation for firms exploring artificial intelligence (AI) tools, although adoption varies widely and many are still in early stages of experimentation.[2] A growing number of firms report plans to leverage AI to use staff resources more effectively, noting that the likelihood and timing of any future employment changes remain uncertain. Few firms have reported making actual adjustments to their headcount to date.

Firms have been reporting that the labour market remains a bit tight but hiring intentions have recently moved lower.

Headcount growth picked up a little at the beginning of 2026, with hiring underpinned by investment and project work as well as continued growth in sales and demand. Liaison measures of hiring intentions for the year ahead have moved lower since the start of the year. The share of firms now reporting plans to keep headcount stable in the year ahead is well above its long-run average, and the share of firms expecting lower headcount has lifted (Graph A.3). Labour availability is still reported as being a bit tight overall, though with some variation across regions.

Consistent with a fairly tight labour market, a number of universities have flagged an ongoing shift in domestic student enrolments towards part-time study as students engage in more paid employment. International student enrolments remain generally positive but are expected to soften in the year ahead. Factors cited for this softening include increased competition from other countries, high fees and charges, and tighter student visa policy settings. A range of contacts in industries such as retail and hospitality have noted that restrictions on international students have affected labour availability.

Graph A.3



* Dark blue solid line in the top panel and all solid lines in the bottom panel are 13-month Henderson trends, with the long-run series averages since 2003 shown as dashed lines.
** A score of 0 indicates no change.
Source: RBA.

Firms' messages on current labour costs have been little changed recently, and wages growth had been gradually moderating over the past year. However, a growing share of firms are expecting wages growth to pick up over the year ahead. Reasons cited for this include the pick-up in headline inflation over recent quarters flowing through to wage demands, as well as recently elevated fuel prices and the risk of a further increase in inflation.

Endnotes

1 For more information, see Macquarie University (2026), 'Business Outlook Scenarios Survey (BOSS)'.

2 For a recent discussion of Australian firms' current and planned adoption of AI, see Fernando J, K McLoughlin and R Ratnayake (2025), 'Technology Investment and AI: What Are Firms Telling Us?', RBA *Bulletin*, November.

Box B: Changes to the Labour Force Survey

The Labour Force Survey (LFS) is the official source of labour market statistics in Australia. Between April and August 2026, the Australian Bureau of Statistics (ABS) is implementing some changes to the LFS. This Box outlines the key changes, the data series that will be affected during the transition to the new collection methods and how the RBA will interpret labour market data during the transition period. Following the transition period, all of the data series that the RBA monitors regularly are planned to resume.

What the upcoming changes to the LFS involve.

Data from the LFS are a key input into the RBA's assessment of labour market conditions and the economic outlook. For example, our assessment of conditions relative to full employment is based on a suite of labour market indicators, many of which are derived from the LFS (including the unemployment rate).[1]

The ABS is implementing some changes to how the LFS data are collected.[2] The changes are designed to support survey response rates – which remain high by international standards – so that the survey will continue to provide reliable and timely information.[3]

Currently, a surveyed household remains in the LFS for eight months, with core questions asked each month and additional content collected either quarterly or through annual supplementary surveys. Following the changes, core questions will continue to be asked each month, including some content previously asked quarterly, but supplementary questions will be asked only in the final month of a household's participation. In addition, the survey will be made easier to complete on a smartphone and the structure of the survey will be simplified. These changes are intended to support survey response rates by reducing the burden on respondents.

The concepts, definitions and methods used to produce headline labour market indicators – such as unemployment, employment and participation – will be unaffected by the survey changes.

What the impact on LFS data will be during the transition.

The changes to the LFS survey will be phased in progressively from the April 2026 reference month (published in May), with all sampled households transitioning to the new model by the August 2026 reference month (published in September). During this transition:

- **publication of monthly LFS data will be delayed by one week**, as the ABS will be conducting additional analysis of the data to identify any unintended statistical effects.[4] This will not affect the availability of LFS data ahead of the Monetary Policy Board meetings.
- **headline data series such as unemployment, employment and participation will continue to be published** with no change in data quality.
- **some data series will be paused during the transition period.** These include layoffs, quits, hires, and the vacancies-to-searchers ratio, which are some of the variables used to inform the RBA's assessment of labour market tightness (see Chapter 2: Economic Conditions). The ABS is reviewing which of these series it will be able to publish during the transition period, subject to an assessment of data quality once the data are collected. Where the quality of the data is assessed to be fit for purpose, the ABS intends to publish these series, using a subset of the full sample.
- **a small number of disaggregated data series will be discontinued permanently.**[5] This will not affect the RBA's capacity to assess labour market conditions.

During the transition, the RBA will continue to publish charts showing our suite of indicators of labour market tightness.[6] We will indicate clearly which series are based on a subset of the full sample and which series are not updated due to the LFS transition.

What LFS data will resume after the transition.

Following the transition period, publication of all of the labour market series that the RBA monitors regularly is planned to resume. Most series will continue without material breaks, including unemployment, underemployment, employment and participation.

Endnotes

1 For more information on the RBA's approach to assessing full employment, and the suite of labour market indicators, see RBA (2026), 'Box A: Update on the RBA's Approach to Assessing Full Employment', *Statement on Monetary Policy*, February.

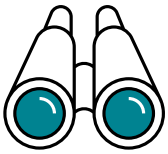
2 For a statement from the ABS about the upcoming changes, see ABS (2026), 'Modernising the Labour Force Survey From April 2026', Media Statement, 19 March.

3 This program of work is part of the ABS' Data Acquisition Modernisation Program. For details about the program, see ABS (n.d.), 'About the Data Acquisition Modernisation Program', ABS Website.

4 For information on how the ABS will approach quality assurance during this time, see ABS (2026), 'How the ABS Quality Assures Labour Force Data During Times of Change', ABS Article, 16 April.

5 See ABS (2026), 'Upcoming Changes to Labour Force Survey Outputs', Information Paper, 19 March 2026.

6 See RBA, n 1.



Chapter 3
Outlook

Summary

- **Prior to the onset of the Middle East conflict, domestic capacity and inflationary pressures were elevated. The conflict has caused significant disruption to global trade and production for energy commodities and some other inputs into global supply chains.** Elevated prices for these commodities are expected to drive inflation in Australia even higher over the year ahead. The conflict is expected to weigh on growth in economic activity in Australia. Given the current uncertainty around the likely size of the shock, we present both the baseline forecast and a more adverse outcome in which the conflict and related damage to energy production is longer lasting.
- **Our baseline forecasts are conditioned on (a) an assumption that a resolution of the conflict allows oil prices to recede somewhat gradually over coming quarters and (b) an increase in interest rates of 60 basis points.** We use market pricing to construct the technical assumption for oil prices in the forecasts; current pricing indicates that most market participants anticipate the supply disruptions related to the conflict will be largely resolved before the end of 2026, although oil prices are assumed to remain well above pre-conflict levels at the end of the forecast period. The cash rate assumed in the forecasts – also based on market pricing – increases to 4.70 per cent by the end of 2026.
- **In the baseline forecast for Australia's major trading partners, inflation has been revised higher while the direction and extent of revisions to GDP growth in each region varies.** Overall, the disruptions to global energy supply from the conflict are expected to weigh on global activity in the year ahead and largely offset the boost from AI-related investment.
- **The baseline forecast is for Australian GDP growth to be a little lower than previously expected.** GDP growth is expected to remain below estimates of potential growth over the forecast period. The main effect on GDP growth from the conflict and higher energy prices is expected to be a slowing in household consumption growth in the near term, offset to some extent by lower imports growth. As the effect on activity from higher energy prices wanes, the assumed higher interest rates over the forecast period are expected to weigh on interest-sensitive components of private demand such as consumption and housing activity.
- **Labour market conditions are expected to ease by a little more than expected in the February *Statement on Monetary Policy*.** The anticipated weaker growth in economic activity weighs on labour demand, and the unemployment rate is forecast to increase to 4.7 per cent by mid-2028. This is expected to leave the labour market operating with a little spare capacity towards the end of the forecast period.

- **Domestic inflation was already elevated prior to the conflict. The recent increases in fuel and raw material costs are expected to push inflation higher over the next year or so.** In the baseline forecast, headline inflation is expected to peak at 4.8 per cent in the June quarter 2026. Underlying (trimmed mean) inflation is expected to remain above 3 per cent until mid-2027, as fuel-related cost increases are passed through to consumer prices; we judge that this pass-through occurs a little faster than usual given existing capacity pressures in the economy. Underlying inflation is then expected to ease towards the middle of the 2–3 per cent range as capacity pressures ease from the tighter monetary policy, and as fuel-related cost pressures abate.
- **We also present two adverse scenarios in which a longer lasting conflict in the Middle East results in a more significant disruption to global energy supply.** In these scenarios, the increase in energy prices is considerably higher and longer lasting than in the baseline forecast. To aid comparison, the scenarios assume the same path for the cash rate as in the baseline forecast. In both scenarios, inflation would be much higher over the year ahead, with the extent of the increase depending on the speed of pass-through from higher fuel and related costs into consumer prices, the degree to which higher shorter-run inflation expectations feed into wage- and price-setting outcomes, and the impact of heightened uncertainty on asset prices and spending decisions in the economy. However, the two scenarios differ by the extent to which demand is affected by the conflict; a much larger pullback in spending by households and businesses in response to heightened uncertainty (alongside the assumed cash rate increases) would be expected to create more spare capacity in the economy and result in inflation returning to target sooner than otherwise.

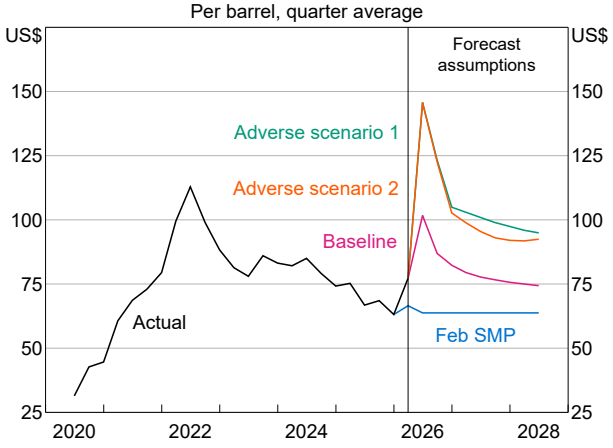
3.1 Key conditioning assumptions across the baseline forecast and adverse scenarios

The RBA, like many other central banks, typically presents its economic outlook in the form of a central or baseline forecast. Given the heightened uncertainty around the international environment, this *Statement* also considers the possible implications of a more protracted disruption to global energy supply.

All the forecasts and scenarios presented in this chapter are based on current market pricing for the cash rate, which is for the cash rate to be 60 basis points higher by the end of the year. Most of the recent rise in the market-implied cash rate path occurred after the start of the Middle East conflict (see Chapter 1: Financial Conditions). Global policy rate expectations have also increased across advanced economies, alongside the higher outlook for inflation stemming from the conflict.

The baseline forecast assumes that the worst of the disruptions to global energy supply are resolved in the coming quarters, consistent with market pricing. The baseline forecast is conditioned on a technical assumption that the global prices of oil and other energy commodities evolve broadly in line with current market expectations (based on market pricing for Brent crude oil). Consistent with the current ceasefire and steps to establish negotiations, market pricing currently suggests that oil prices will soon start to decline from elevated levels, though they remain well above pre-conflict levels through 2026 and beyond (Graph 3.1). Liquefied natural gas (LNG) spot prices, which have risen sharply because of the disruption to supply from the closure of the Strait of Hormuz as well as damage to LNG production in Qatar, are also assumed to decline gradually over the forecast period. The expected path for energy prices is consistent with a relatively prompt resolution to the conflict and limited additional damage to oil and LNG infrastructure over and above that already incurred (see Table 3.1 for detailed assumptions and Key judgement #1).

Graph 3.1
Brent Oil Price
Per barrel, quarter average



Sources: Bloomberg; RBA.

It is possible there is a much more protracted disruption to global energy supply than we have assumed in the baseline forecast. To consider how such a shock could propagate through the economy, in section 3.5 we model two adverse scenarios that both incorporate a longer closure of the Strait of Hormuz, a halt to energy production in the Middle East, and significantly more damage to energy infrastructure. This would cause oil and LNG prices to rise very sharply in the near term and unwind gradually, but remain well above energy prices in the baseline forecast. Current market pricing suggests our assumptions for energy prices in these adverse scenarios would be consistent with a range of plausible tail risk events, so it is useful to consider the extent to which this larger shock could affect growth and inflation (relative to the baseline forecast). The two adverse scenarios we consider are differentiated by the degree to which demand is affected by the energy shock.

Table 3.1: Baseline Forecast and Alternative Scenarios Assumptions

	Baseline	Adverse Scenario 1	Adverse Scenario 2
Disruption to energy supply	There is some resolution to the Middle East conflict shortly, with no further damage to energy infrastructure. The Strait of Hormuz is reopened soon and shipping flows return to pre-conflict levels in Q4 2026.	The Middle East conflict is protracted, with further damage to energy infrastructure. The Strait of Hormuz remains closed in the near term. Shipping flows resume from Q1 2027, but normalisation takes much longer than baseline. Shipping flows do not return to pre-conflict levels by end of forecast period.	Same as Adverse Scenario 1.
Commodity prices[(a)]	Brent oil price peaks at around US$100/bbl in Q2 2026 and gradually declines to around US$75/bbl by the end of the forecast period. LNG price is assumed to be US$12.1 MMBtu in Q3 2026 before declining to US$10.7 MMBtu at the end of the forecast period.	Brent oil price peaks at around US$145/bbl in Q2 2026 and gradually declines to around US$95/bbl by the end of the forecast period. LNG price is assumed to reach US$30 MMBtu in Q3 2026 before declining to US$17 MMBtu at the end of the forecast period.	Brent oil price peaks at around US$145/bbl in Q2 2026 and gradually declines to around US$90/bbl by the end of the forecast period. This is lower than in Adverse Scenario 1 due to weaker global demand. LNG price is assumed to reach US$30 MMBtu in Q3 2026 before declining to US$16 MMBtu at the end of the forecast period.
Domestic financial conditions	Cash rate follows current market path.[(b)] The trade-weighted index of the Australian dollar (TWI) remains unchanged at 66.6	Cash rate follows current market path.[(b)] The TWI appreciates relative to baseline, due to higher terms of trade.	Cash rate follows current market path.[(b)] The TWI appreciates relative to baseline, but less than in Adverse Scenario 1 due to safe haven flows. Large fall in global and domestic equity prices.

	Baseline	Adverse Scenario 1	Adverse Scenario 2
Additional domestic assumptions	The spread between refined fuel prices and Brent oil is assumed to return to historical average levels by Q1 2027. Margins on domestic fuel prices are assumed to gradually return to historical average levels by late 2026.	The spread between refined fuel prices and Brent oil is assumed to return to historical average levels by Q3 2027. Margins on domestic fuel prices are assumed to gradually return to historical average levels by late 2026.	Same as Adverse Scenario 1.

(a) The international standard unit of measurement for crude oil is barrels (bbl). The unit of measurement for natural gas is millions of British thermal units (MMBtu). The LNG price refers to the spot price of LNG in Asian markets.

(b) The cash rate is assumed to move in line with expectations derived from financial market pricing, which is for the cash rate to be 60 basis points higher by the end of 2026.

Source: RBA.

3.2 Key judgements in the baseline forecast

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

Key judgement #1 – There is a near term de-escalation in the Middle East conflict, consistent with market pricing for Brent crude oil.

Underpinning our baseline forecast is the assumption that, given the current ceasefire and steps to establish negotiations, the conflict de-escalates and trade activity through the Strait of Hormuz normalises over the coming quarters. This is consistent with current market pricing for Brent crude oil and the latest Consensus forecasts. The cost of insurance against further large increases in oil prices, as measured by options-implied volatilities, has declined considerably since the onset of the conflict, suggesting that market participants increasingly view some form of resolution in the near term as the most likely path forward. However, the situation continues to be characterised by a high degree of uncertainty and we explore the implications of a more protracted conflict in section 3.5.

Key judgement #2 – The spike in fuel prices has relatively contained and short-lived effects on overall economic growth and on the labour market.

In the baseline forecast, the Middle East conflict and the large increase in energy prices is judged to have a modest negative effect on GDP growth and labour market conditions. There are a number of reasons why we judge that the effects are not more negative. First, the baseline assumes that most of the increase in fuel prices is relatively short-lived, such that households and businesses do not respond to higher fuel prices and heightened international uncertainty by materially reducing consumption or increasing layoffs, instead using other margins of adjustment (such as drawing on savings) to smooth through the temporary shock. Second, while fuel and oil remain key inputs to domestic production, GDP is now less oil-intensive than it was during previous global energy price shocks (see Chapter 4: In Depth – The Impact of Higher Global Energy Prices on the Australian Economy). Third, higher export revenue from LNG will also boost national income. And fourth, higher oil prices could raise the relative cost of imports – given that Australia's imports are more oil intensive than domestic production – and encourage some substitution towards domestically produced goods. That said, it is possible that GDP growth could be weaker than we have judged. While the timely data on spending do not yet show a sharp slowdown, households and businesses could pull back on non-fuel spending more sharply than expected.

It is also possible that the effects on GDP from the energy shock are neutral or even positive for GDP growth. For example, if the exchange rate depreciates and there is more substitution from imports to domestically produced goods and services than expected, or if the positive impact on the economy from higher LNG export revenue is higher than we have estimated. The empirical literature on the effect of oil price shocks on economic output for net energy exporters like Australia is mixed and sensitive to the nature of the shock, with some papers finding positive effects and others negative effects (although smaller negative effects than for net energy importers). We will continue to monitor timely indicators of spending and information from liaison around this judgement.

Key judgement #3 – The rise in fuel prices flows through to underlying inflation relatively quickly given existing capacity pressures.

The temporary increase in oil and fuel prices boosts underlying inflation over the next year as these additional costs are passed through the supply chain to consumer prices. Empirical modelling suggests that the effect of a supply-driven increase in fuel prices has historically flowed through to higher underlying inflation over one to two years. In the current episode, we judge that the pass-through of cost increases occurs relatively quickly – at the faster end of these empirical estimates – given that inflation and shorter term inflation expectations are already high and that the labour market is a little tight. The recent post-pandemic experience, in which costs rose sharply, may also prompt firms to raise prices more quickly than otherwise. The baseline wages forecast also incorporates a small additional effect from higher shorter term inflation expectations, reflecting an assumption that the starting point of some tightness in the labour market allows some workers to push for higher wages growth than expected prior to the conflict.

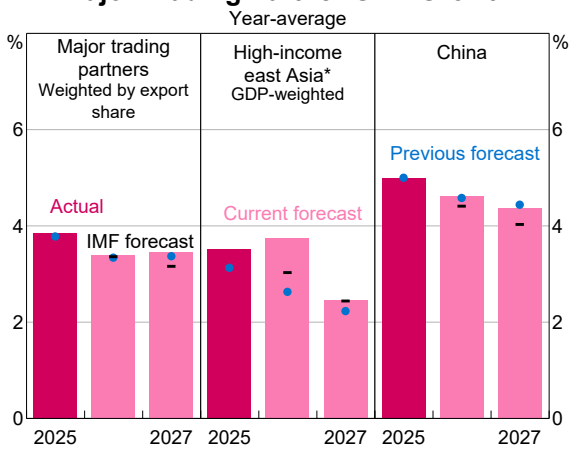
3.3 Baseline global outlook

Consensus forecasters have started to revise GDP growth downwards across Australia's major trading partners (MTP); however, the extent of revision varies by region and the impact on MTP growth has been limited to date.

The disruptions to global energy supply from the conflict are expected to weigh on global activity in the year ahead and largely offset the boost from AI-related investment. In terms of Australia's trading partners, the negative effects from the conflict are expected to be most acute for middle-income Asian economies (excluding China); this reflects the region's reliance on Middle Eastern commodities for production and the high share of energy and food in some economies' consumption baskets. By contrast, the outlook for high-income east Asia has been upgraded, reflecting expectations for continued growth in global demand for AI-enabling products (Graph 3.2; see Chapter 2: Economic Conditions). If the conflict is not resolved shortly, Consensus forecasters are likely to make further downward revisions to their outlook for GDP growth across Asia.

Outside of Asia, the direction and extent of the revisions to Consensus forecasters for advanced economies has largely reflected each economy's degree of exposure to affected commodities in the Middle East and whether it is a net energy importer or exporter. For example, the GDP outlook has been revised lower in the euro area and the United Kingdom but is largely unchanged in net energy exporters such as Canada and the United States. The outlook for growth in Australia's MTPs is broadly in line with the International Monetary Fund's projections from the April 2026 *World Economic Outlook*, although there are some slight differences for individual countries and regions.

Graph 3.2
Major Trading Partner GDP Growth
Year-average



* High-income east Asia is a GDP-weighted average of South Korea, Taiwan, Hong Kong and Singapore.
Sources: ABS; CEIC Data; Consensus Economics; IMF; LSEG; RBA.

Year-average MTP GDP growth in 2027 is expected to be broadly unchanged from the February *Statement*. Growth across east Asia is expected to recover quite quickly once the supply of commodities from the Middle East resumes. Similarly, for most advanced economies, Consensus forecasters have not materially changed their assessment of growth in 2027, with the exception of the euro area and the United Kingdom, where the negative effects of higher energy prices are expected to linger.

In China, our forecast for GDP growth is broadly unchanged from the February *Statement* as we judge China will be relatively resilient to the global energy disruption. Growth in 2026 is expected to be 4.6 per cent, which is at the lower end of the 4.5–5.0 per cent growth target announced by authorities in March but in the middle of the range of external estimates. Under the baseline assumptions, we judge that any direct effects from the conflict-related disruptions on China will be relatively small and short-lived, given that the Chinese economy is less reliant on oil and gas for its domestic energy needs and has high levels of reserves of oil and refined products. While Chinese domestic demand showed some tentative signs of improvement in the March quarter, under the baseline forecast assumptions we do not expect a more material rebalancing toward domestic activity in the near term.

Exports are expected to be a key source of growth in China over the year ahead. The ongoing AI investment boom, the structural rise in China's manufacturing capacity (particularly in higher value-added products like vehicles, ships and semiconductors), and the recent substantive decline in the US tariff rate are all expected to support continued strength in exports. These factors are judged to more than offset the modestly weaker outlook for global demand factored in under the baseline assumptions. However, a deterioriation in external demand, which may arise if the conflict and global supply disruptions persist for longer than expected, is the key risk for the outlook for China.

Consensus forecasts for headline inflation globally have been revised notably higher. Beyond the direct effects on consumer fuel prices, higher energy and transportation costs are also expected to have downstream effects on global supply chains, particularly in east Asian manufacturing industries that rely on energy imports from the Middle East. This would raise inflation for globally traded goods and as such we forecast world export prices to be higher throughout the forecast period relative to the February *Statement*. Given the slow pace of services disinflation in many advanced economies to date and, in select cases, relatively tight labour markets, indirect effects on core measures of inflation from the increase in energy prices are likely to be larger for economies where services inflation has been stickier or labour markets have been relatively tighter.

3.4 Baseline domestic outlook

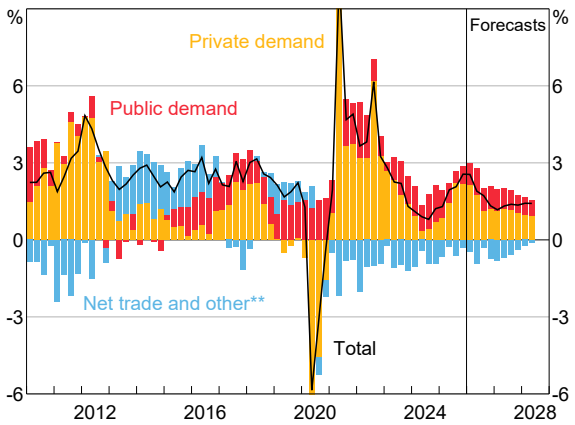
Australian GDP growth is expected to be below potential growth over the forecast period.

GDP growth is expected to slow over 2026 in the baseline forecast (Graph 3.3). Private demand grew strongly in 2025 but the pace is expected to ease over the year ahead as the earlier support provided by several domestic and global factors begins to wane and because of the direct effects of the Middle East conflict (see below and Chapter 4: In Depth – The Impact of Higher Global Energy Prices on the Australian Economy). In addition, growth in exports is forecast to slow over 2026, as the level of iron ore exports comes back into line with typical productive capacity after being temporarily boosted by inventory rebuilding in China. The tightening in monetary policy assumed under the market path also weighs on the growth of interest-sensitive components of private demand, such as dwelling investment, household consumption, and non-mining business investment. Investment growth is expected to continue in sectors of the economy with strong structural tailwinds, such as software, data centres and renewable energy.

Public demand is expected to continue supporting growth over the forecast period. This forecast is broadly unchanged from the February *Statement* and based on spending projections in mid-year budget updates released in late 2025, adjusted for the long-run average difference between budget projections and actual outcomes. This is consistent with our usual approach to forecasting public demand based on information in the latest available federal and state budgets, in addition to new policies legislated in between these updates.

The level of GDP at the end of the forecast period is expected to be lower than in the February *Statement*, largely reflecting a reassessment of momentum prior to the conflict and the higher assumed path for the cash rate (reflecting market pricing). The much weaker-than-expected growth in household consumption in the December quarter National Accounts, combined with soft growth in timely household spending data in January and February,

Graph 3.3
GDP Growth*
Year-ended with contributions



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

suggest there was less underlying momentum in household consumption prior to the conflict than previously assessed; some of this is expected to persist over the forecast period (see Chapter 2: Economic Conditions). In addition, there is around 50 basis points of additional tightening in monetary policy embodied in the market path than in February, reflecting market participants' perceptions of the stance of policy required to bring inflation back to target. This is expected to weigh on growth in household consumption, dwelling investment and non-mining business investment.

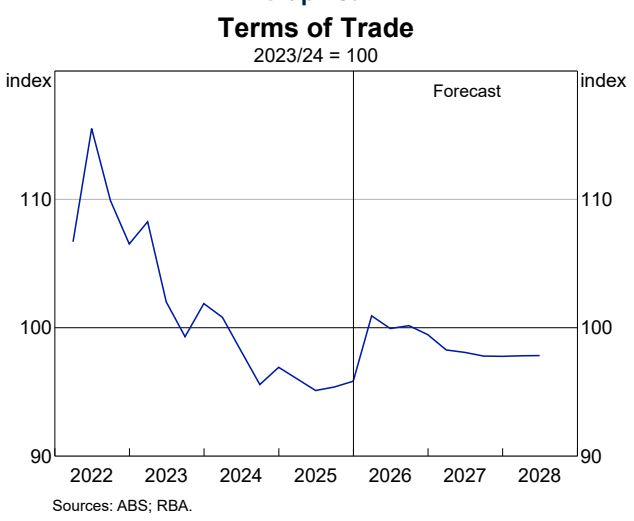
The Middle East conflict is also expected to weigh directly on domestic activity, although the effects are expected to be relatively small in the baseline forecasts. The large increase in fuel prices since February is expected to lower real household incomes and consumption. However, these effects are relatively small; for example, because the shock is assumed to be short-lived and fuel accounts for only a small share of household spending (see Key judgement #2). Early indicators of consumer spending also do not necessarily suggest a sharp slowing in non-fuel spending at this stage.

That said, the response of consumption to lower real household incomes is assumed to be faster than the typical historical experience, given the sharp declines we have seen in consumer sentiment. There are no additional effects in the baseline forecast (above and beyond the negative impact of higher energy prices on real incomes) to incorporate weaker sentiment, though additional sentiment effects on spending are incorporated in the adverse scenarios where the conflict is assumed to last longer.

Some of the downgrade in consumption is expected to materialise as weaker imports, which provides some offset to the impact on GDP growth. There is also expected to be some substitution away from imported goods and services to domestic products given movements in relative prices in response to the shock, which will also provide a small boost to GDP growth (see Chapter 4: In Depth – The Impact of Higher Global Energy Prices on the Australian Economy).

The outlook for Australia's terms of trade has been revised a little higher in response to the Middle East conflict (Graph 3.4). The outlook for export prices has been upgraded, reflecting a stronger outlook for energy commodity prices, including LNG and thermal coal. This is partially offset by a higher forecast for import prices, largely driven by the increase in fuel prices and related higher world export prices. The boost to national income from the higher terms of trade is judged to have only a modest impact on real activity. This is because the positive shock to commodity prices from the conflict is assumed to be short-lived, with few lasting implications for mining investment and output in Australia.

Graph 3.4

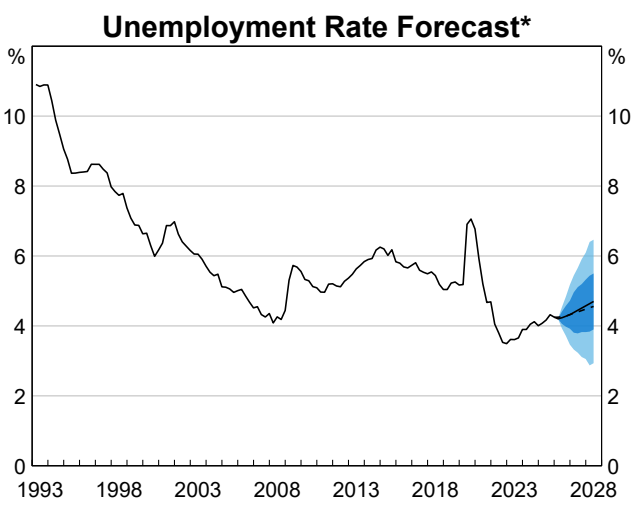


Sources: ABS; RBA.

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

The unemployment rate increases to 4.7 per cent by mid-2028 in the baseline forecast (Graph 3.5). Labour market conditions had largely stabilised prior to the Middle East conflict, and were broadly in line with expectations in the February *Statement*. Some easing in labour market conditions is expected over 2026 as the conflict and earlier tightening in the cash rate reduce labour demand somewhat. From 2027 onwards, the unemployment rate is expected to increase a little more quickly than expected in the February *Statement*, given the weaker outlook for domestic activity. Given the expected rise in the unemployment rate, the baseline forecast is for the labour market to be operating with a little spare capacity towards the end of the forecast period, although this judgement is highly uncertain.

Graph 3.5



* 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 employment-to-population ratio is expected to be higher throughout 2026 compared with the February forecasts (largely reflecting strong recent outcomes) but decreases gradually over the forecast period. Timely indicators of labour demand are mixed. Job ads and surveyed employment intentions from business surveys do not suggest a marked deterioration in labour demand in response to the conflict, though employment intentions from the RBA's liaison program have decreased in recent weeks. We expect labour demand growth to soften a little as firms adopt a 'wait

and see' approach to hiring decisions amid heighted uncertainty. Further out in the forecast period, employment growth is expected to remain subdued due to the weaker outlook for domestic activity.

The participation rate is forecast to be little changed over 2026. Cost-of-living pressures continue to persist in the near term, encouraging people to enter or remain in the labour force. From 2027 onwards, the participation rate is projected to ease steadily, as the weaker outlook for domestic activity makes it harder for those without a job to find employment, reducing the incentive to join or remain in the labour force.

Given the expected slowdown in GDP growth in the baseline forecast, aggregate demand is projected to fall below potential supply during the forecast period.

The GDP growth forecasts (which assume the cash rate follows the market path) suggest that capacity pressures in the economy will ease over the next couple of years and there will be some spare capacity in the economy by the end of the forecast period. The labour market is expected to remain a little tight in the near term, with capacity pressures lagging those in the broader economy, consistent with past relationships – but the labour market is projected to be operating with a little spare capacity by mid-2028.

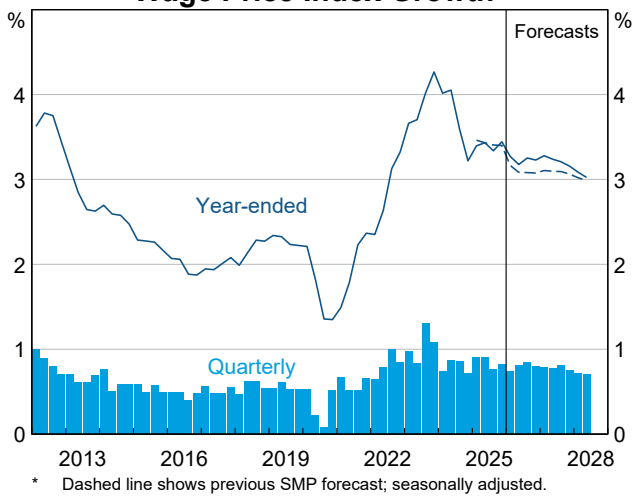
This assessment remains highly uncertain and is conditional on assumptions. The assessment of the economy's potential output is more uncertain than usual given the disruptions to oil supply. The assessment in the baseline forecast is that disruptions to global oil markets have little effect on potential output because the shock is temporary, and the level of capital and labour available to produce output is unaffected (see Chapter 4: In Depth – The Impact of Higher Global Energy Prices on the Australian Economy).

Wages growth in the baseline forecast is stronger in the near term, reflecting the higher outlook for inflation.

The forecast for year-ended wages growth has been revised higher. In the near term, nominal wages growth is expected to be supported by the higher inflation stemming from energy prices, as well as continued tightness in the labour market. We expect that higher short-term inflation expectations will be a consideration in wage bargaining in the near term as workers seek to preserve real wages. Consistent with this, some firms in the RBA's liaison program have upgraded their expectations for wages growth over the year ahead. Wages growth is expected to moderate from late 2027 as labour market conditions ease. Wages growth will continue to be supported by announced administered decisions for several large awards (Graph 3.6).

Graph 3.6

Wage Price Index Growth*

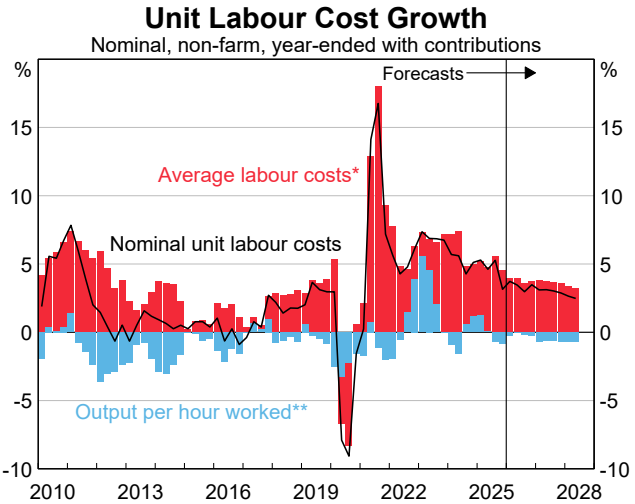


* Dashed line shows previous SMP forecast; seasonally adjusted.
Sources: ABS; RBA.

Real average earnings per hour is forecast to temporarily decline in the near term, given the projected increase in inflation. Average earnings, which is a broader measure of labour earnings, are forecast to be at a lower level in real terms at the end of the forecast period relative to February, but higher than their current level.

Growth in year-ended unit labour costs (ULCs) is expected to be broadly stable in coming quarters before easing towards the end of the forecast period. Growth in nominal ULCs – the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes – is likely to remain somewhat elevated in the near term. Year-ended growth in ULCs is then expected to moderate from early 2027 onwards, alongside an easing in labour market conditions and slowing nominal wages growth. Productivity growth is likely to be weak in the near term as firms adjust to slowing demand and higher fuel-related costs, before picking up in 2027 and contributing to the easing in ULCs growth (Graph 3.7).

Graph 3.7

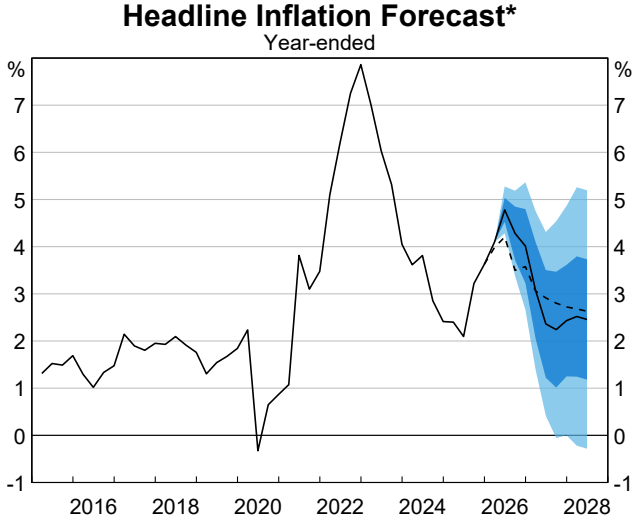


* Compensation of employees plus payroll taxes less employment subsidies, divided by employee hours worked.
** Inverted; includes self-employed.
Sources: ABS; RBA.

The outlook for headline inflation in the baseline forecast has been revised materially higher in the near term due to higher fuel prices.

Headline inflation is expected to peak at 4.8 per cent in the June quarter. The higher prices for crude oil and refined fuels will lead to significant price increases for motor vehicle fuel and domestic and international travel. We expect this will contribute around 0.5 percentage points to headline inflation in the June quarter 2026. The increase in fuel prices in the June quarter is projected to be reduced by the temporary reduction in fuel excise, which is scheduled to reverse on 1 July. The assumed roll-off of government electricity price rebates also contributes to higher headline inflation in the near term, although this had been factored into our forecasts for some time. The decline in fuel prices over the second half of 2026 – as assumed in the baseline forecasts – leads to downward pressure on headline inflation, particularly as the prices of motor vehicle fuel and travel decline. This downward pressure contributes to headline inflation easing to a low of 2¼ per cent in mid-late 2027. Subsequently, as these prices stabilise, the drag on headline inflation abates, causing it to pick up to 2½ per cent by mid-2028 (Graph 3.8).

Graph 3.8



* 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.

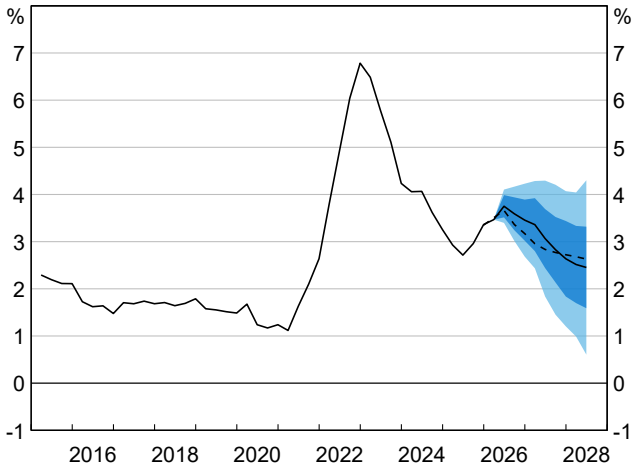
The forecast for underlying inflation has been revised higher in the near term, with the spike in fuel prices putting upward pressure on consumer prices, which then eases as fuel-related costs decline and the labour market eases.

Trimmed mean inflation is now expected to remain above 3 per cent until mid-2027, before easing to 2.5 per cent by early 2028, assuming the cash rate follows the market path (Graph 3.9). The quarterly rate of underlying inflation is expected to remain high throughout the remainder of 2026. This reflects our judgement that existing capacity pressures in the labour market and parts of the economy will persist for a time, with additional upward pressure from higher fuel and fuel-related costs arising from the Middle East conflict. Relative to the February *Statement*, the assumed higher path for the cash rate contributes to a greater easing in capacity pressures over 2027, which is expected to support disinflation. As aggregate demand is expected to fall below potential supply by the end of the forecast period, inflation eases to the midpoint of the target range.

Graph 3.9

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.

We expect that the pass-through from fuel-related cost pressures to consumer prices will be relatively fast. This reflects the fact that the shock is large (though assumed temporary in the baseline forecast) and affecting many firms, and that inflation and short-term inflation expectations are already elevated given the starting point of the economy prior to the conflict (see Chapter 2: Economic Conditions). Moreover, short-term inflation expectations have increased further since the conflict began, likely owing to the sharp increase in fuel prices. Although short-term inflation expectations are likely to stay elevated for a time or rise further, long-term inflation expectations are assumed to remain consistent with achieving the inflation target over the medium run, conditional on the market path. The effects of higher fuel-related costs on consumer prices are expected to be strongest around the middle of 2026 and contribute around 0.4 percentage points to underlying inflation in the year to the March quarter 2027. From mid-2027 onwards, the expected decline in fuel-related costs puts downward pressure on the quarterly rate of inflation. However, there is a high degree of uncertainty around the intensity and breadth of cost pressures resulting from the conflict and the degree of pass-through to final consumer prices (see Key judgement #3).

New dwelling inflation remains high, and significant price increases for fuel and construction materials are expected to place some upward pressure on inflation in the near term. Businesses in the RBA's liaison program report significant cost increases for construction materials, particularly oil-based products like polyvinyl chloride (PVC) and high-density polyethylene (HDPE) pipes, as well as concrete, steel and bricks due to higher fuel costs. There are concerns that shortages of key inputs could disrupt project schedules and increase the risk of delays. Later in the forecast period, cost increases stemming from the conflict are expected to unwind, placing some downward pressure on new dwelling inflation.

Significant price increases for fuel and fertilisers, including urea, are also expected to place some upward pressure on groceries inflation in the near term. Agricultural contacts in the RBA's liaison program have reported that 'emergency surcharges' – introduced by some transport providers to manage escalating fuel prices – are increasing fuel costs by as much as 40 per cent. Pass-through to grocery prices is expected to occur more quickly for fast-moving goods (such as fresh produce) than for slower moving items.

3.5 Adverse scenarios

We consider two adverse scenarios, with each assuming that the Middle East conflict is longer lasting, including an extended closure of the Strait of Hormuz, significant damage to infrastructure and disruption to energy production. Energy prices in both scenarios are assumed to rise very sharply in the near term and remain elevated over the forecast period (see Graph 3.1) and the assumptions outlined in section 3.1 and Table 3.1). At this stage, such an outcome for energy prices is considered somewhat of a tail risk but the situation continues to evolve.

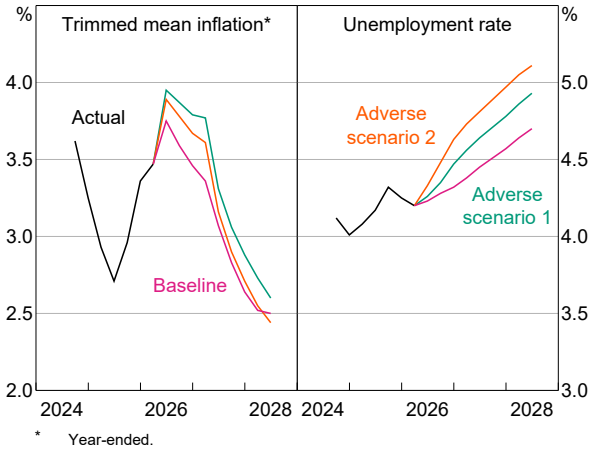
The two adverse scenarios are differentiated by the degree to which aggregate demand is affected by a more protracted conflict. The first scenario considers the effects on the economy and inflation from the larger global energy supply shock. The second scenario considers what could also occur if there was a much larger reduction in spending by households and businesses; for example, if the heightened geopolitical uncertainty led to risk averse behaviour. We construct the scenarios using the Global Economic Model from Oxford Economics and MARTIN (the RBA's macroeconometric model).

Adverse Scenario 1: Significantly higher energy prices drive higher and more persistent inflationary pressures and weaker economic activity.

- In this scenario, global energy prices rise even more sharply (relative to the baseline forecast), as do the prices of other commodities that are key inputs into global supply chains. This increases global inflation directly via higher prices for fuel exports and indirectly through higher production input costs. The shock adds around 3.7 percentage points to MTP-weighted year-ended headline inflation in the June quarter 2026 relative to the baseline.
- To aid comparison with the baseline forecasts, the assumed cash rate for Australia in the scenario is the same as the baseline assumption and implies a cumulative tightening of 60 basis points by mid-2028. The Australian TWI is assumed to appreciate a little relative to the baseline forecast, given that in this scenario the large assumed increase in LNG prices results in a higher terms of trade for Australia.
- The level of domestic GDP is around 0.5 per cent lower by mid-2028 than in the baseline forecast. Household consumption growth slows by more than in the baseline forecast reflecting a sharper decline in real income (as a result of the higher energy prices), while we also assume that persistently weaker consumer confidence reduces spending. Lower global demand reduces Australian export volumes.
  We assume that there is some offset to GDP growth as the large shift in the relative cost of imports in this scenario encourages some substitution towards domestically produced goods and services.
  The higher export revenue from higher LNG prices provides an increase in national income, though we assume that the resulting increase in mining investment is not material (in comparison to previous terms of trade booms). We also do not make any assumptions about any changes in fiscal policy in this scenario; any additional public demand could provide a further offset to the fall in GDP.

- The lower level of GDP means that the unemployment rate increases by more than in the baseline, leading to some additional spare capacity in the labour market. It is possible that more of the adjustment could come through a greater fall in hours worked or participation (rather than via the unemployment rate) than we have judged.
- The very large increase in energy prices adds directly to headline inflation through higher prices for retail fuel. In this scenario, headline inflation peaks at 5.2 per cent in June 2026. Trimmed mean inflation remains elevated compared with the baseline – around 0.4 percentage points higher by early 2027 – as the larger and more persistent energy price shock passes through to consumer prices (Graph 3.10). As in the baseline forecast, the effects on underlying inflation depend on the degree of any second-round effects of the shock on foreign and domestic activity, as well as any increase in inflation expectations. We assume that, given the large and longer lasting increase in fuel prices, shorter term inflation expectations move higher. This has the effect of pushing inflation higher than otherwise. As cost and capacity pressures wane because of both the supply disruptions eventually easing and tighter monetary policy, inflation in this scenario is expected to slow but remain above the midpoint of the target range by mid-2028.
- Even with higher fuel prices for longer in this scenario, past experience suggests that oil use will not change much over the forecast period, and so the economy's productive capacity is judged to be only marginally affected. Given the fall in GDP, the net effect of this scenario is judged to make the output gap more negative by the end of the forecast period.

Graph 3.10
Adverse Scenario Forecasts



* Year-ended.
Sources: ABS; RBA.

Adverse Scenario 2: Significantly higher energy prices are associated with a more material decline in aggregate demand.

- In the second adverse scenario, we explore the possibility that elevated uncertainty around the conflict and the associated energy supply disruptions lead to an even sharper decline in global and domestic demand than in the first adverse scenario. We begin by adopting all the assumptions of the first scenario although the oil price gradually responds to the weaker global demand and declines by a little more than in the first scenario. We incorporate a large increase in global risk premia (triggered by the more protracted conflict) which, all else equal, dampens both global and domestic demand. We also assume that the decline in consumer and business confidence is even more pronounced and protracted than in the first scenario, which leads to additional precautionary savings behaviour and a larger delay or cancellation of investment.
- To aid comparisons, the assumed cash rate path in this scenario is the same as in the baseline forecast and the first adverse scenario, implying cumulative tightening of 60 basis points by mid-2028. The decline in global risk appetite weighs on demand for the Australian dollar; as such, the Australian dollar TWI appreciates by less than in the first scenario.
- The level of domestic GDP is more than 0.8 per cent below the baseline forecast and 0.2 per cent below the first adverse scenario. This is driven primarily by weaker consumption and business investment growth following the confidence shock; weaker equity prices also flow through to lower spending via wealth channels.
- Lower economic activity reduces labour demand, and the unemployment rate rises to 5.1 per cent; the labour market moves from being tight at the start of the forecast period to having spare capacity by the end. The increase in the unemployment rate would be less pronounced if we assumed more of a decline in labour force participation given the weaker labour market conditions.
- Trimmed mean inflation peaks at 3.9 per cent in June quarter of 2026. Importantly, the disinflation from the peak is faster in this second scenario (relative to both the baseline and the first scenario) as the additional

demand shock leads to weaker GDP growth, a higher unemployment rate and more spare capacity in the economy. Under the current market pricing for the cash rate, inflation is would be below the midpoint of the target range by mid-2028.

The adverse scenarios and baseline forecasts assume that Australia continues to receive enough imported fuel products to meet domestic demand

Australia could face physical supply shortages of oil products. Standard economic frameworks suggest that if shortages affect businesses, they are likely to result in lower output and labour demand, as well as higher prices. If firms cannot get oil products (or other related inputs), there may be a hard cap on their production and so their output will have to decline. Demand will outstrip the new lower productive capacity of the economy, and so prices will rise. Even if firms can replace oil products with other inputs, like labour, doing so is likely to be expensive and inefficient, and so costs and prices are likely to rise and output is likely to fall. Labour demand is likely to fall as activity declines, though this may be offset somewhat if firms do try to substitute towards labour (e.g. using people to replace some machines).

The size of the effects of any fuel shortages on the economy are uncertain and depend on a range of factors. The size, duration and nature of any shortages will matter for the effect on domestic economic conditions, as will the ability of firms to substitute between oil and other inputs in their production processes. The policy response will play an important role too. In addition to directly addressing fuel supply and allocations, governments may consider policies to support households and businesses.

3.6 Detailed baseline forecast information

Table 3.2 provides additional detail on baseline 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 3.2: Detailed Baseline 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	2.6	1.9	1.3	1.3	1.4	1.4
Household consumption	2.4	1.9	1.9	1.7	1.7	1.6
Dwelling investment	5.5	3.8	2.0	1.0	–0.3	–1.1
Business investment	4.4	3.9	0.8	2.2	1.8	1.3
Public demand	2.4	3.7	3.1	2.8	2.3	2.1
Gross national expenditure	3.0	2.7	2.0	2.0	1.7	1.5
Major trading partner (export-weighted) GDP	3.9	3.4	3.3	3.6	3.3	3.2
Trade						
Imports	6.7	3.8	1.9	3.8	2.9	2.3
Exports	5.2	1.3	–0.9	1.0	1.3	1.8
Terms of trade	–1.1	5.1	3.8	–1.9	–1.7	–0.3
Labour market						
Employment	1.1	1.3	1.4	1.0	1.0	0.9
Unemployment rate (quarterly, %)	4.3	4.2	4.3	4.4	4.6	4.7
Hours-based underutilisation rate (quarterly, %)	5.4	5.4	5.5	5.7	5.8	6.0
Income						
Wage Price Index	3.4	3.2	3.2	3.2	3.2	3.0
Nominal average earnings per hour (non-farm)	4.1	3.4	3.7	3.8	3.6	3.2
Real household disposable income	3.7	1.8	1.1	1.8	1.4	1.2
Inflation						
Consumer Price Index	3.6	4.8	4.0	2.4	2.4	2.5
Trimmed mean inflation	3.4	3.8	3.5	3.1	2.6	2.5
Assumptions						
Cash rate (%)[(c)]	3.6	4.2	4.7	4.6	4.7	4.7
Trade-weighted index (index)[(d)]	61.3	66.4	66.6	66.6	66.6	66.6
Brent crude oil price (US$/bbl)[(e)]	63.1	101.7	82.3	77.7	75.7	74.4
Estimated resident population[(f)]	1.5	1.3	1.2	1.2	1.2	1.2
Memo items						
Labour productivity[(g)]	0.8	0.0	0.2	0.6	0.7	0.7
Household savings rate (%)[(h)]	6.9	5.8	5.8	5.7	5.5	5.4
Real Wage Price Index[(i)]	–0.2	–1.5	–0.6	0.9	0.7	0.6
Real average earnings per hour (non-farm)[(i)]	0.4	–1.2	–0.1	1.4	1.1	0.7

(a) Forecasts finalised on 29 April.

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

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

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

(e) Brent crude oil prices are assumed to remain around the current price over the current quarter. For the rest of the forecast period, brent crude oil prices are guided by market pricing.

(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.

Chapter 4

In Depth – The Impact of Higher Global Energy Prices on the Australian Economy

Summary

- **The Middle East conflict has driven large increases in global energy prices.** This chapter sets out the channels through which increases in energy prices can affect output and inflation, and provides some estimates of the size of these effects for Australia. The chapter focuses on higher energy prices as this is likely to be the main channel by which the conflict will affect the Australian economy. But there are also likely to be important spillovers via the prices of other commodities, including fertiliser, rural commodities and aluminium, as well as an increase in global uncertainty.
- **In general, energy price increases add to inflation for a period, but their effect on output in Australia is less certain.** Higher energy prices can reduce demand through some channels and boost demand through others. For example, energy price increases reduce aggregate household real incomes, weighing on spending (though the strong financial position of Australian households in aggregate could act as a buffer). On the other hand, Australia is a net energy exporter, so higher energy prices may raise national income; and energy price increases tend to raise the price of imports relative to domestic production, which could weigh on imports and support GDP growth.
- **In practice, the extent to which the conflict affects the Australian economy will depend on its duration and intensity, its effect on global energy supply, relative price movements of the energy commodities Australia exports and imports, and domestic supply and demand conditions.** The pass-through of higher energy prices to inflation may be larger and occur more quickly when inflation and short-term inflation expectations are elevated and the economy is operating with capacity pressures, as is currently the case. Chapter 3: Outlook presents scenarios that illustrate how the economy might evolve under some specific alternative assumptions about energy and commodity prices; in the baseline forecast energy price increases are expected to boost inflation in the near term but have only a modest negative effect on GDP growth.

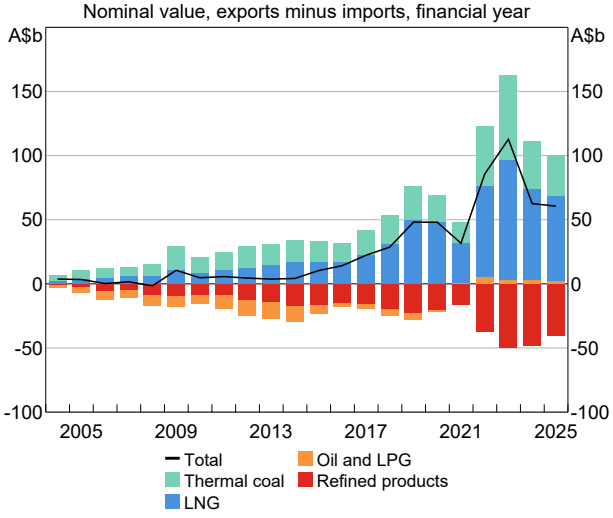
4.1 Energy commodities play an important role in the Australian economy

Australia imports oil and refined products but is a net exporter of energy overall.

Australia is a substantial net exporter of energy, in particular of thermal coal and liquefied natural gas (LNG), but a net importer of oil, especially refined products like diesel, petrol and jet fuel (Graph 4.1). Almost 80 per cent of Australia's total demand for these refined products (on an energy-equivalent basis) is met via imports, with the bulk of these imports coming from Asian countries such as Singapore, South Korea and Malaysia. Most Asian refiners, in turn, typically source crude oil from the Middle East, and face technical constraints to using alternative sources in the short run as their refineries are optimised for specific types of crude oil. This has led to lower fuel production across Asia recently – as refiners adjust to these constraints and conserve limited crude oil inventories – and higher fuel prices (see Chapter 2: Economic Conditions). Australian importers have been able to source refined products from alternative sources on global markets when necessary, though these have come at substantially higher cost.

Australia has stocks of around 30 days of diesel and jet fuel, and around 45 days of petrol. While these stock levels are lower than some other countries, the risk of shortages affecting Australia (and other higher income economies) may be mitigated if they are willing to pay higher prices than lower income countries to secure supplies in global markets.

Graph 4.1
Australia's Net Energy Trade
Nominal value, exports minus imports, financial year



Sources: ABS; DFAT; RBA.

Oil products are important inputs to production, but GDP is less oil-intensive than in the past.

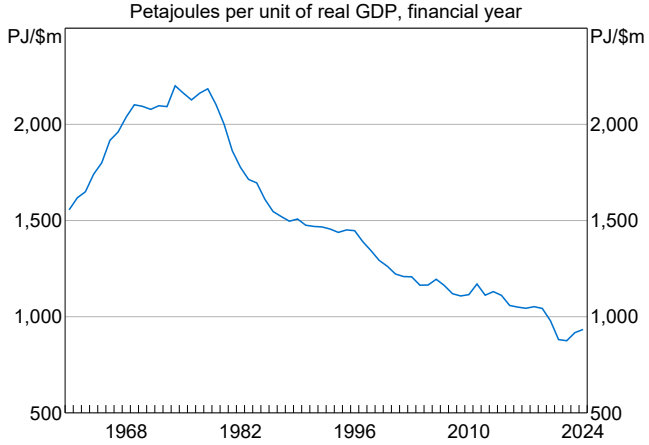
Almost all industries use fuel, notably diesel, as an input to production, with the transport, mining and agriculture sectors in particular accounting for a large share of fuel use by Australian businesses. Around 90 per cent of Australia's diesel consumption is by businesses. By contrast, most petrol consumption in Australia is directly by households.

That said, as in other advanced economies, the amount of oil needed to produce a unit of output (the 'oil intensity' of GDP) in Australia has declined over time, alongside declining energy intensity of the economy more broadly (Graph 4.2). The declining oil intensity of GDP has reflected a structural shift in the composition of domestic output away from oil-intensive sectors towards services industries, improved energy and fuel efficiency, and a decline in the use of oil for electricity generation. An important exception to this trend has been diesel. Australia's use of diesel per unit of GDP has increased since the 2000s (though not by so much as to offset the decline in the use of crude oil and other refined fuels). This has reflected strong demand from diesel-intensive sectors such as mining and agriculture, greater reliance on diesel-powered road freight – where substitution options are limited in the short run – and the increased popularity of diesel passenger vehicles. Consistent with this, Australia's per capita diesel consumption is among the highest globally.

Graph 4.2

Oil Intensity of GDP – Australia

Petajoules per unit of real GDP, financial year



Sources: ABS; DCCEEW; RBA.

In addition to oil products, gas is an important energy source for the Australian economy.

Gas is used both directly by households and businesses, and as an input to electricity production. Gas accounted for 5 per cent of electricity generation over the past year. While gas-fired generators are not the dominant source of electricity in Australia, they are sometimes used as a source of 'marginal supply' and, under marginal cost pricing, gas-fired generators sometimes set wholesale prices. However, domestic wholesale and retail gas prices have recently tended to be quite insulated from the global gas market, partly due to regulation. They have not responded to recent international gas price increases so far, and energy market contacts do not currently expect them to, absent an increase in domestic demand for gas (for example, in response to disruptions in the availability of other energy sources).

4.2 Higher energy prices will have direct and indirect effects on inflation

Higher fuel prices will push up consumer price inflation through several channels. The higher cost of retail fuel in the CPI will have a direct effect on consumer prices. Over time, higher fuel prices will tend to cause other consumer prices to rise as higher input costs are passed through. An increase in general price inflation could also potentially increase inflation expectations, which could further flow back into price and wage setting behaviour.

The speed with which the indirect effects of higher fuel prices flow through to consumer prices is uncertain. Empirical exercises suggest that full pass-through typically takes around one to two years, though the speed and extent of pass-through are likely to depend on the economic backdrop.[1] In circumstances – such as currently – in which the increase is large, inflation and short-run inflation expectations are high, and the economy is operating with capacity pressures, firms may respond more quickly than otherwise, and second-round effects via inflation expectations may be larger (see Chapter 3: Outlook). For example, firms are likely to be reviewing and changing prices more frequently when inflation is high, and consumers may be less sensitive to price changes when economic conditions are strong.

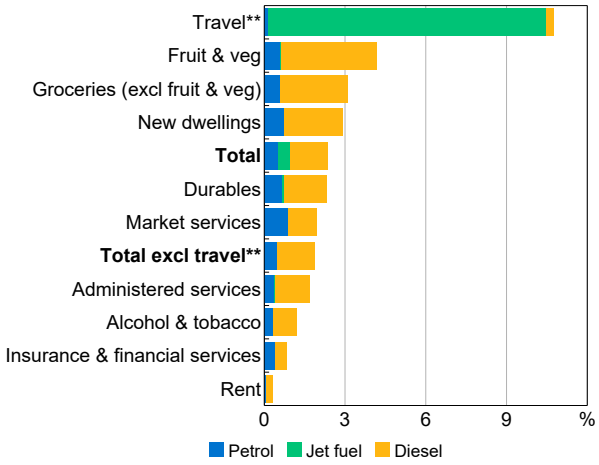
The price of fuel used by households directly affects CPI inflation.

The large recent increase in energy prices is already adding directly to headline inflation through higher prices for retail fuel (see Chapter 2: Economic Conditions). A rule of thumb is that the *direct* effect of a 10 per cent increase in domestic fuel prices will lead to an increase in headline inflation (via higher retail fuel prices) of a bit over 0.3 percentage points over one to two quarters. This reflects the fact that fuel directly makes up 3.3 per cent of the CPI basket. For households, petrol makes up around 90 per cent of fuel consumption, while diesel is much less important. In Australia, global crude oil prices account for around 40 per cent of the final price of retail fuel, and oil price changes tend to flow through quickly to fuel with a lag of up to one to two weeks. However, the change in the local price of retail fuel is not always consistent with the change in crude oil prices (adjusted for the 40 per cent share of oil in fuel), particularly during periods of disruption to refining or shipping capacity. As such, the effect of changes in global oil prices on Australian inflation can differ over time.

Fuel price increases also affect inflation indirectly over time via higher input costs.

Higher fuel and other oil-sensitive prices also influence inflation indirectly and over a longer period through higher input costs, which in turn may be passed on to consumers. These costs can be related to the cost of imports (including oil-derived products such as fertiliser and plastics), domestic production costs and transportation costs. For domestic production and transport, diesel is the most important type of fuel, accounting for three-quarters of usage in production (excluding the travel industry, which uses jet fuel). Indirectly, fuel accounts for around 2 to 2½ per cent of the domestic costs of producing and distributing other goods and services in the CPI (Graph 4.3).
The contribution of oil within global supply chains to import prices is more difficult to quantify.

Graph 4.3
Indirect Domestic Fuel Intensity of CPI*
Fuel share of final prices, 2023/24



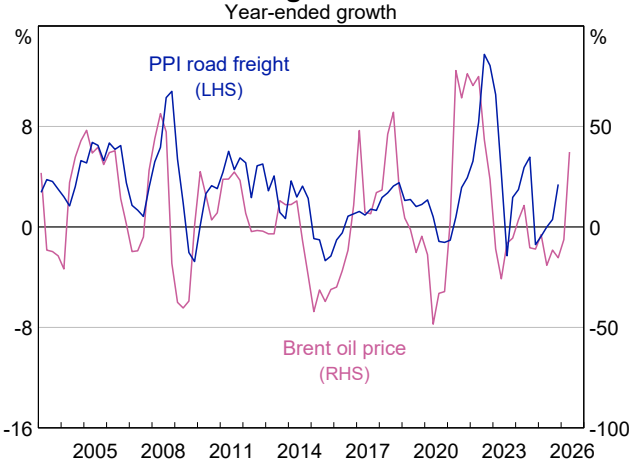
* Share of fuel in domestic production and distribution, calculated from input-output tables; totals exclude fuel used directly by consumers via the automotive fuel expenditure class.
** Travel represents the domestic and international holiday travel and accommodation expenditure classes, which includes fuel usage by airlines but not usage of fuel by consumers for passenger vehicles.
Sources: ABS; RBA.

Overall, we estimate that the *indirect* domestic *cost* effects of a 10 per cent domestic fuel price increase, via higher input costs, would cause the price level to be around 0.2–0.25 per cent higher over one to two years, other things equal. This assumes the increase in domestic fuel prices is expected to persist long enough that all costs are eventually fully passed through to prices, and excludes the effect of any changes in non-fuel import costs. This indirect cost channel would generally be expected to have equal-sized effects on headline and underlying inflation. The speed of pass-through to prices would vary across different products, depending on where costs are incurred in the supply chain. An empirical exercise suggests the pass-through to prices is faster for goods than it is for market services, for example.

If fuel price increases were only temporary, or expected to be temporary, the *indirect cost* effects on consumer prices are less clear. On the one hand, some firms – for example, in sectors where consumer demand is more sensitive to price changes – may look through an increase in fuel prices that is widely expected to be temporary, absorbing the higher costs in their margins for a time. On the other hand, in the event of a large but temporary shock, firms may raise prices initially and then reduce them. This may be more likely to occur when the economy is operating with limited spare capacity.

An increase in fuel costs will affect specific consumer prices differently, reflecting – among other factors – the share of fuel-related costs in total costs of production and distribution. Higher fuel costs will tend to push up the cost of most goods via higher transportation costs, such as road freight costs (Graph 4.4). Food and dwelling construction are more reliant than most items on fuel and fuel-related costs (for example, domestically produced materials) (Graph 4.3). Unsurprisingly, holiday travel is heavily reliant on jet fuel, and so travel prices may be most sensitive to higher fuel costs.

Graph 4.4
PPI Road Freight and Oil Price*
Year-ended growth



* For the Producer Price Index (PPI) series, year-ended growth in the quarterly index; for the oil price series, year-ended growth in the quarterly price average (measured in AUD per barrel).
Sources: ABS; Bloomberg; LSEG; RBA.

Fuel price increases may also have 'second round' effects via higher inflation expectations and wages growth, particularly when the increase in fuel prices is large and/or sustained.

Higher fuel prices, along with the resulting increase in inflation, can influence short-term inflation expectations. Research in Australia and elsewhere finds that changes in fuel prices can affect households' inflation expectations by more than might be expected given its share in overall consumption.[2] This is likely to be because fuel is frequently purchased, and its price is highly visible and widely covered in the press.

An increase in inflation expectations can flow through to higher inflation now and in the future. If firms expect costs and their competitors' prices to increase, they could be more likely to increase their own prices by more than otherwise.

An increase in inflation, and inflation expectations, may also be expected to contribute to higher wages growth. Workers who expect higher inflation may build this into their bargaining for wages, and an unexpected pick-up in inflation could influence subsequent negotiations as workers seek to catch up with the higher level of prices. Since enterprise bargaining agreements are re-set every three years, on average, some of the effect of higher inflation would flow through to wages growth with a lag.

While wages growth may pick up in response to higher inflation, we would generally still expect real wages to decline. Indeed, empirical evidence suggests oil supply shocks have tended to push up nominal wages growth in Australia, but by less than the increase in inflation. Nonetheless, the extent of this decline in real wages would be likely to depend on the extent of tightness or otherwise in the labour market at the time.

4.3 Recent energy price increases are likely to weigh on output growth

Increases in energy prices can affect economic activity through several channels, some of which tend to boost aggregate demand and some of which tend to reduce aggregate demand. Overall, the net effect of higher energy prices on Australian GDP is uncertain but, if a range of energy commodity prices increase at the same time, is likely to be only modestly adverse (though the scale of the effect on economic activity will depend on the size and duration of the price increases, and how the relative prices of key energy commodities change). That reflects the buffers available to many households to smooth their consumption, Australia's position as a net energy exporter, and the potential for substitution towards domestically produced goods and services.

While higher energy prices are likely to weigh on households' and firms' spending, the adverse effect on output may be mitigated by the relatively strong financial position of the Australian household sector and other channels that could provide an offsetting boost to growth.

Energy price increases can affect economic activity – and hence aggregate labour demand and employment – through a number of channels:

- **Higher energy prices will (all else equal) tend to reduce total real household income.** That will tend to reduce aggregate household spending in real terms, as demand for energy products is relatively insensitive to price changes in the short run and many households will need to allocate a larger share of their budgets to energy. The size of the spending impact will depend in part on the degree to which households are willing and able to reduce saving to maintain their consumption of non-fuel goods and services and housing investment; the strong financial position of most Australian households[3] should enable them to smooth their spending if desired. Households with minimal savings buffers and those who need to spend a relatively high share of their income on fuel will, however, be more likely to need to reduce their consumption of other goods and services.
- **A deterioration in sentiment or heightened uncertainty about future economic prospects could reduce asset prices, household spending and business investment.** Alongside the effect of higher energy prices on real incomes, the impact on household spending will depend on factors such as: whether fuel prices are expected to stay high; the extent of households' uncertainty about their future economic position; and the effect of changes in sentiment on equity and housing prices, which affect household wealth. Business investment could also be lower, for example if higher energy input costs compress firms' expected margins, or lead to heightened uncertainty around future demand or input availability. Lower overall household and business spending in the economy would also be expected to weigh on investment.
- **Higher prices for oil- and fuel-intensive imports could encourage households and firms to substitute towards different goods and services that are produced domestically.** Australia's domestic production is generally less oil-intensive than our imports, so higher oil prices may raise the cost of imports relative to goods and services produced in Australia (depending on the exchange rate). To the extent households and businesses substitute towards domestically produced items, that would boost GDP growth in Australia (all else equal) by reducing imports. For example, consumers could substitute some of their spending away from imports such as international travel. On the other hand, demand for Australia's non-energy exports may be somewhat lower if energy price increases reduce economic growth in our trading partners.
- **Energy price increases boost earnings from Australian energy exports such as LNG and thermal coal** (which is a partial substitute for oil and gas). While Australian production and export volumes are unlikely to respond materially to these price movements in the near term, this will nevertheless raise Australian exporters' revenues (provided movements in the Australian dollar exchange rate do

not fully offset this). If prices were persistently high, exporting firms, for example in the LNG sector, would have a greater incentive to invest to increase production (though this is unlikely to happen in the near term, given the very long lead times for such investment).

- **Higher export prices and profits in energy-producing sectors raise government tax revenues and household incomes.** Higher dividends would boost households' non-labour income (though a large share of dividends accrues to foreign investors), and wages in energy-producing sectors could increase. If export prices were to rise by more than import prices – which is a favourable shift in the terms of trade – that would increase national income and purchasing power overall, though the size and persistence of the effect would depend on relative commodity price movements as well as the exchange rate. Following the Russian invasion of Ukraine in 2022, Australia's terms of trade increased sharply, as the effects on thermal coal and LNG export prices outweighed higher crude oil and imported fuel prices.

The extent to which changes in energy prices affect output growth overall will depend on the relative strength of these different channels. Estimates of the impact of energy price changes on GDP tend in practice to be relatively small. For example, a modelling exercise suggests that a 10 per cent increase in oil and LNG prices, even if it persisted for two years, would reduce the level of Australian GDP by less than 0.1 percentage point. However, such estimates are uncertain and the impact of higher energy prices in any given episode will depend on the specific nature of the shock and prevailing economic conditions; in the current episode, we expect higher energy prices to weigh modestly on GDP growth (see Chapter 3: Outlook), though uncertainty and confidence effects could increase the size of the adverse impact on GDP.

Increases in energy price are likely to affect households unevenly. For example, cost pressures from higher fuel prices would likely fall disproportionately on lower income households, which tend to spend a larger share of their income on petrol, and on those based in rural or regional areas needing to drive longer distances and with limited public transport options, while the benefits of higher export incomes accrue elsewhere. That said, Australia's domestic gas production helps to reduce the extent to which global energy price increases would otherwise impact real household incomes.

A prolonged increase in energy prices may reduce the economy's medium-term potential supply capacity, though this effect is likely to be small.

Temporary increases in energy input costs, of the kind assumed in the baseline forecast set out in Chapter 3: Outlook, are unlikely to affect the economy's medium-term potential supply capacity because the capital and labour available to produce output will not change.

If higher energy prices were sustained for an extended period, some firms may reassess their production methods, write off equipment, postpone maintenance or delay investment plans, which could affect capital accumulation and reduce potential output over time. On the other hand, there may be some countervailing effects if other firms and sectors, for example natural gas, expand over the medium term.

Higher energy prices may also encourage measures that strengthen resilience to future energy price increases but weigh on productivity, such as investment in storage capacity that is infrequently used or investment in relatively high cost domestic refining capacity. Changes in production methods or a reallocation of activity across firms and sectors may also reduce productivity, and could lead to some mismatch in skills between workers and available jobs, further reducing potential output at least for a time.

Higher energy prices could also affect labour supply directly, though the overall effect is uncertain. In the short run, higher living costs may encourage some workers to enter or remain in the labour force, in an attempt to offset any fall in their real incomes.[4] Over time, however, weaker domestic activity associated with higher energy costs and softer demand could make it harder for job seekers to find employment, discouraging people from joining or remaining in the labour force.

Overall, the reduction in potential output following energy price increases is typically estimated to be small even if higher prices are sustained for several years.[5]

Endnotes

1 There are several reasons why the actual response may differ from these estimates. First, the estimates assume an oil price increase that persists for around two quarters. If oil prices were to stay high for longer, the effects on inflation and activity would be larger and longer lived. Second, our analysis is based on movements in Brent crude oil prices, whereas households and firms are more directly exposed to prices for refined petroleum products, such as petrol and diesel, which can respond differently in different episodes.

2 See, for example, Brassil A, Y Haidari, J Hambur, G Nolan and C Ryan (2024), 'How Do Households Form Inflation and Wage Expectations?', RBA Research Discussion Paper No 2024-07.

3 See RBA (2026), *Financial Stability Review*, March.

4 See, for example, Das M, J Hambur, KP Hellwig and JA Spray (2026), 'Labor Supply Effects of Monetary Policy: Evidence from Australian Mortgage Holders', IMF *Working Papers*, Issue 71.

5 See, for example, Le Roux J, B Szörfi and M Weißler (2022), 'How Higher Oil Prices Could Affect Euro Area Potential Output', ECB *Economic Bulletin*, Issue 5; Baumeister C, G Peersman and I Van Robays (2009), 'The Economic Consequences of Oil Shocks: Differences across Countries and Time', RBA Annual Conference.