RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

November 2026

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Overview

Inflation in Australia remains well above target and a number of upside risks have crystallised since the August *Statement*. In particular, materially higher global energy prices as a result of the Middle East conflict have added to inflationary pressures. Government bond yields in advanced economies have risen to their highest levels in many years, reflecting a combination of higher term premia, higher neutral rates and expectations of higher policy rates for a time in response to global inflationary pressures. Domestically, housing market conditions have eased and the unemployment rate has risen further than anticipated. However, a range of data, including persistently strong inflation and growth in a broad range of costs, suggest that domestic capacity pressures have been a little greater than previously assessed.

The outlook for inflation has been revised materially higher and reflects a higher assumed path for energy prices amid the ongoing Middle East conflict and greater domestic capacity pressures. Headline and underlying inflation are expected to remain above 3 per cent until end-2027, some time later than forecast in August, and reach the midpoint of the 2–3 per cent range in mid-2028. The risks to the inflation outlook are judged to remain skewed to the upside reflecting risks posed by the Middle East conflict. Tighter monetary policy alongside a weaker outlook for the housing market is expected to keep GDP growth below trend. The unemployment rate is projected to reach a bit over 5 per cent at the end of 2028.

The Monetary Policy Board decided it was appropriate to increase the cash rate target by 25 basis points to 4.85 per cent. Inflation remains elevated and recent data indicate that it is broadly based. The Board noted the increasing risk that higher inflation expectations will become embedded and judged that a further tightening in financial conditions is warranted to support the return of inflation to target.

Globally, higher energy prices and resilient demand growth have added to inflationary pressures, and most advanced-economy central banks have either raised policy rates or are expected to.

The ongoing Middle East conflict has pushed up energy prices. As a result, headline inflation has increased across most economies. Prices for a range of base metals and agricultural commodities have also risen sharply in recent months, driven by the conflicts in the Middle East and Ukraine and adverse weather.

Global economic demand has also been more resilient than expected, supported by the AI boom overseas. GDP growth in Australia's major trading partners has trended higher over recent years. Recently, the boost to trading partner growth from AI-related demand and supportive fiscal measures in many economies has offset the adverse effects of the Middle East conflict. Market pricing implies that most advanced economy central banks are expected to increase policy rates at least twice by the end of 2027, in line with higher near-term inflationary pressures.

This in part explains why government bond yields have risen to multi-year highs.

Against the backdrop of stronger global inflationary pressures, government bond yields have risen since the August *Statement*, to their highest level in many years, including in Australia. This reflects a range of factors including expectations of tighter monetary policy in the near term given global capacity and inflationary pressures, as well as some combination of higher neutral interest rates and higher term premia. Long-term inflation expectations in financial markets remain consistent with central bank targets.

Growth in Australia's major trading partners is still expected to moderate over the next couple of years as the boost from AI-related activity slows and growth in China eases. Headline inflation is expected to remain above central bank targets into 2027 in many advanced economies, reflecting higher energy and other commodity prices, resilient demand and rapid growth in AI-related prices. Risks to global inflation are judged to remain skewed to the upside.

Domestically, growth in activity has slowed, housing market conditions have eased further, and the unemployment rate has risen by more than expected.

In Australia, GDP growth has slowed to a little below its estimated potential growth rate, largely reflecting softer growth in household consumption – consistent with the earlier easing in growth in household income and wealth – exports and public demand. Notwithstanding this slowing in growth, recent data suggest that activity growth this year has been a little stronger than anticipated in the August *Statement*, supported by rapid growth in data centre investment.

By contrast, conditions in the housing market have eased further. Housing prices in September were almost 5 per cent below their March peak, reflecting higher interest rates and tax changes announced in the federal budget. The unemployment rate rose by more than expected to average 4.6 per cent in the September quarter. That appears to largely reflect a stronger-than-expected pick-up in labour force participation amid cost-of-living pressures, while employment growth has held up.

But inflation has been higher than expected, cost pressures remain elevated, and capacity constraints are now assessed to have been a little tighter than previously thought.

Headline inflation was 3.9 per cent over the year to the September quarter and trimmed mean inflation was 3.7 per cent. While the price of fuel has increased significantly, inflation has been broad-based, with sizeable price increases for a range of market services. Liaison contacts across most industries continue to report sustained cost pressures.

The persistence of high inflation and cost pressures, despite the easing in GDP growth and the rise in unemployment, suggests that domestic capacity constraints have been tighter than previously assessed. Reflecting this, the staff's assessment of the unemployment rate consistent with low and stable inflation has increased a little, though this assessment remains highly uncertain.

Financial conditions appear to be restrictive, which is expected to weigh on domestic capacity pressures.

Financial conditions are judged to be restrictive. There is, however, significant uncertainty around the extent of this restrictiveness given conflicting evidence. Supporting this assessment, the current level of the cash rate is slightly above the top of the range of central estimates of the neutral rate, and the expected cash rate path is higher still. Housing prices have declined and new housing lending has fallen sharply. However, business credit growth remains strong and corporate risk premia remain low.

The Australian dollar has appreciated since the start of the year and is judged to be around estimates of its long-run equilibrium.

Ahead of the November meeting, market pricing was implying expectations of around one and a half further cash rate increases by mid-next year.

Inflation is expected to remain above 3 per cent until late 2027, reflecting recent increases in fuel and other conflict-related costs and greater domestic capacity pressures.

The outlook for inflation has been revised materially higher relative to the August *Statement*, particularly through to late 2027. Fuel and other conflict-related costs have increased by more than expected since August, owing to the ongoing conflict in the Middle East. Some of these additional costs are expected to be passed on to consumer prices, while elevated prices of petrol and diesel will also contribute directly to higher headline inflation in the near term. The stronger outlook for underlying inflation also reflects the staff's judgement that capacity pressures have been a little greater this year than thought in August. Headline and trimmed mean inflation are now expected to remain above 3 per cent until end-2027, some time later than forecast in August, and to return to 2.5 per cent in mid-2028.

The risks to the inflation outlook remain skewed to the upside.

Some of the upside risks identified in August have materialised and are now incorporated in the central forecast, including greater domestic capacity pressures and higher oil prices. But upside risks to inflation from the Middle East conflict and AI-related investment are judged to remain. Energy prices could stay at current elevated levels or rise further, rather than decline as assumed, if disruptions to shipping and refining persist. Combined with ongoing capacity pressures in the domestic economy and elevated inflation expectations, this would increase the risk of stronger pass-through to consumer prices. Strong AI-related investment activity could also push up input costs by more than expected, both directly and by adding to capacity pressures.

However, inflation could fall faster than forecast. For example, capacity pressures could ease sooner if higher interest rates, conflict-related cost pressures and uncertainty, and falling housing prices combine to weigh more heavily than expected on spending and investment.

In Australia, tighter monetary policy is expected to keep GDP growth below potential, with spare capacity emerging in the labour market in 2027.

Higher-than-expected global energy prices, a softer housing market and a higher assumed path for the cash rate than in the August forecasts are expected to constrain domestic GDP growth. The very strong expansion in data centre investment is expected to only partly offset these headwinds to growth.

Labour market conditions are expected to ease. The unemployment rate is forecast to rise to a bit over 5 per cent by end-2028. That is consistent with below-potential GDP growth but is around ¼ percentage point higher than previously expected, largely reflecting the judgement that more people than previously forecast will remain in or join the labour force. The economy is currently operating with excess demand and is judged to reach balance next year, slightly later than previously thought, with spare capacity emerging in 2027.

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

Inflation remains elevated and data since the previous meeting have confirmed that underlying inflation remains broadly based. Capacity pressures appear a little tighter than previously estimated and there are indications that higher fuel prices are being passed through to prices of other goods and services. Inflation is now expected to remain above 3 per cent for the coming year and there is an increasing risk that higher inflation expectations will become embedded. Given the revised inflation outlook and the continuing upside risks, the Board judged that a further tightening in financial conditions is warranted to support the return of inflation to target. The Board stated that it will continue to do what it considers necessary to bring inflation sustainably back to target.

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

Per cent

	Year-ended					
	June 2026	Dec 2026	June 2027	Dec 2027	June 2028	Dec 2028
GDP growth	2.1	1.6	1.6	1.3	1.3	1.5
(previous)	(1.9)	(1.4)	(1.5)	(1.6)	(1.6)	(1.8)
Unemployment rate[b]	4.4	4.7	4.8	4.9	5.0	5.1
(previous)	(4.4)	(4.5)	(4.6)	(4.7)	(4.8)	(4.8)
CPI inflation	3.9	4.5	3.7	2.7	2.5	2.4
(previous)	(3.9)	(3.6)	(2.8)	(2.6)	(2.4)	(2.4)
Trimmed mean inflation	3.6	3.6	3.5	2.9	2.5	2.4
(previous)	(3.6)	(3.3)	(3.0)	(2.6)	(2.4)	(2.4)

	Year-average					
	2025/26	2026	2026/27	2027	2027/28	2028
GDP growth	2.3	2.1	1.8	1.5	1.3	1.4
(previous)	(2.2)	(1.9)	(1.5)	(1.5)	(1.6)	(1.7)

	Assumptions[c]					
Cash rate (%)	4.3	4.7	4.9	4.8	4.8	4.8
Trade-weighted index (index)	66.1	65.2	65.3	65.3	65.3	65.3

(a) Forecasts finalised on 28 October. Shading indicates historical data.

(b) Average rate in the quarter.

(c) The forecasts incorporate several technical assumptions. The cash rate is assumed to move in line with expectations derived from financial market pricing as per 28 October and the daily exchange rate (TWI) is assumed to be unchanged from its level at 28 October 2026 going forward. See notes to Table 3.1: Detailed Forecast Table in Chapter 3: Outlook for other forecast assumptions.

Sources: ABS; LSEG; RBA.



Chapter 1
Financial Conditions

Summary

- **Financial conditions are judged to be restrictive, but with various cross-currents making it difficult to determine the extent of this.** Over the course of this year, the rise in the cash rate target and the expected path of rates, along with higher term premia, have contributed to tighter financial conditions. And while some estimates of the neutral rate have also risen, the cash rate and market-implied path are still a little above the top of the range of central estimates of neutral. Also, housing prices have declined by more than expected and new housing lending has declined sharply in response to tighter monetary policy and recent tax changes. Meanwhile, the nominal exchange rate has appreciated since the start of the year but remains broadly in line with estimates of its long-run equilibrium relationship. By contrast, business credit growth remains very strong and corporate risk premia are very low. Moreover, funding remains readily available for banks and most household and business borrowers.
- **Overnight indexed swap (OIS) pricing implies market participants assign an 85 per cent probability to a cash rate increase in November, with around one and a half cash rate increases priced in by mid-2027.** Expectations for the cash rate have increased since the August *Statement*. This reflects stronger-than-expected domestic inflation data, higher oil prices, the September cash rate increase, and RBA communications that on balance were interpreted as hawkish. Almost all market economists tracked by the staff expect a cash rate increase in November.
- **Most advanced economy central banks are expected to raise policy rates further over the next year.** Since the August *Statement*, the US Federal Reserve (Fed), European Central Bank (ECB), Bank of Japan (BoJ), Bank of Canada (BoC), Reserve Bank of New Zealand (RBNZ), Norges Bank and Bank of Korea (BoK) increased their policy rates, while the Bank of England (BoE) left its policy rate unchanged but retained a tightening bias. These actions, and the increase in market-implied future policy paths since August, reflect the re-escalation of the Middle East conflict and, in some economies, persistent inflationary pressures stemming from capacity constraints. Market pricing implies that most advanced economy central banks are expected to increase policy rates at least twice by the end of 2027.

- **Government bond yields have increased notably across advanced economies in recent months, in many cases reaching their highest levels in many years, including in Australia.** Higher yields reflect expectations of tighter monetary policy in the near term, higher neutral interest rates and higher term premia. The increase in longer-term yields has occurred at a time of strong public and private sector debt issuance, and models suggest that roughly half of the rise in yields is due to term premia and half to perceptions of neutral (although there is considerable uncertainty around these estimates). Long-term inflation expectations remain consistent with central bank targets even though shorter-term expectations are elevated. While sovereign debt markets have continued to function well across major advanced economies, bond market volatility has increased in recent weeks and the rise in bond yields in some European countries has been large (particularly France, amid fiscal concerns).
- **In corporate funding markets, equity and credit risk premia remain low for higher-quality firms but have risen for lower-rated and more interest-rate-sensitive firms.** Spreads on investment-grade corporate bonds, including in Australia, remain around historical lows despite strong issuance, while sub-investment grade spreads have widened but remain very low in historical terms. In major equity markets, strong gains in energy stocks and some IT stocks since the August *Statement* have offset declines in most other sectors, though investors are differentiating more between AI-related firms. Australian equity prices have declined in response to the rise in interest rates and as the downturn in the housing market has lowered earnings expectations in some key sectors.

1.1 Assessment of financial conditions

Financial conditions in Australia are assessed to be restrictive, but with various cross-currents making it difficult to determine the extent of this.

The cash rate is slightly above the range of model-based and market economist estimates of neutral, and the expected cash rate path based on market pricing is higher still, suggesting that policy is restrictive. Other indicators paint a mixed picture. For example, housing market conditions have weakened by more than the tightening in monetary policy would suggest and funding conditions for property developers have tightened, suggesting that financial conditions are clearly restrictive. At the same time, however, funding conditions for most other businesses remain favourable and do not suggest that conditions are particularly restrictive. Table 1.1 summarises evidence contributing to this assessment.

Table 1.1: Various Measures of Financial Conditions[(a)]

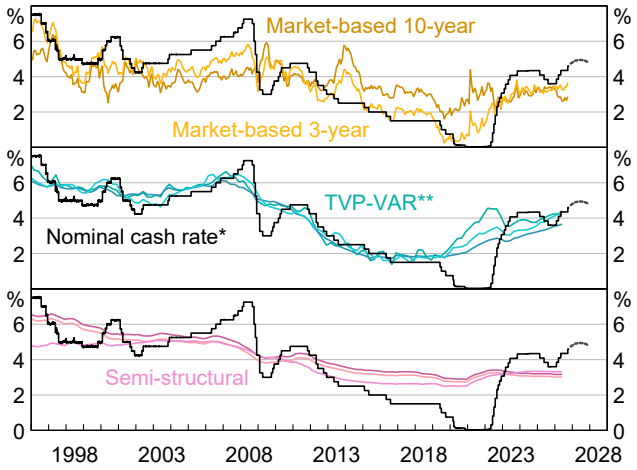
Measure	Implications for financial conditions	Notes supporting assessment
Cash rate path (as per market)	Restrictive (●)	Cash rate is slightly above the top of the range of model and market economists' estimates of neutral; the market path rises above that
Housing market indicators and household credit	Weakening, implies financial conditions are restrictive (●)	Tax changes amplifying the effects of monetary policy; prices and lending falling faster than expected (albeit after very strong growth)
Long-term Australian Government Securities (AGS) yields	May be adding to restrictiveness at the margin (○)	At least some of the recent increase is judged to be driven by term premia, raising longer-term borrowing costs and weighing on asset valuations; however, effects of longer-term yields are less than shorter-term yields in Australia
AUD trade-weighted index (TWI)	TWI judged to be in line with fundamentals, although there is uncertainty around this assessment	Broadly consistent with moves in interest rates
Bank lending rates	In line with the rise in the cash rate	Broadly consistent with moves in the cash rate
Business credit	Implies financial conditions are less restrictive (♦)	Growth remains strong and credit remains readily available for most borrowers
Corporate risk premia	Implies financial conditions are less restrictive (♦)	Credit and equity risk premia are low despite subdued Australian earnings expectations

(a) Red shading (● and ○) is used for measures that imply more restrictive financial conditions, while green shading (♦) is used for measures that imply less restrictive conditions.

Source: RBA.

There are some tentative signs that neutral rates may be rising, globally and in Australia. Since the pandemic, estimates of neutral rates in advanced economies have increased by 1–3 percentage points, and the recent sharp increase in long-term global bond yields is consistent with market participants revising their estimates of the global neutral rate higher still (see Box A: How Does an Increase in Longer-term Real Yields Affect Financial Conditions?). As a small open economy, Australia's neutral rate is likely to be significantly influenced by neutral rates globally (see Box B: Developments in the Neutral Rate of Interest). Consistent with that, some of our estimates of neutral and those of market economists have increased since the August *Statement*, though the average of all measures is not much changed (Graph 1.1).

Graph 1.1
Nominal Neutral Rate
Suite of models



* Dashed line shows cash rate expectations implied by overnight index swap rates.
** Time-varying parameter vector autoregression models (TVP-VAR).
Source: RBA.

By itself, a rising neutral rate would imply that any given path for policy rates is somewhat less restrictive than previously assessed. However, the cash rate and market path have also increased since the August *Statement*, and term premia estimates are higher. Long-term inflation expectations are little changed and consistent with the inflation target, suggesting that market participants expect policy will be set at a level that is sufficiently restrictive to contain inflationary pressures.

Other indicators of financial conditions provide a mixed picture. Bank lending rates and short-term bond yields have evolved broadly in line with increases in the cash rate and its expected path. Housing prices and new lending have declined by more than expected, indicating tight financial conditions for the housing sector in response to monetary policy tightening and tax changes. By contrast, strong business credit growth and generally very low corporate borrowing spreads and equity risk premia suggest that financial conditions are not overly restraining aggregate business funding (though conditions have tightened considerably in some sectors, most notably housing construction).

This assessment of financial conditions is subject to uncertainty. Elevated global borrowing by the public and private sector, including to fund AI investments – and the possibility of stronger AI-led productivity growth in future – could materially raise global and domestic neutral rates over time. Conversely, the strong response of the Australian housing market could indicate that the tax changes are amplifying the effects of tighter monetary policy by more than expected, while weaker-than-expected labour market outcomes suggest that policy is working to restrain economic activity. Term premia also appear to have risen, which would tighten financial conditions at the margin. However, there is considerable uncertainty around estimates of term premia, neutral rates and the lags with which changes in the cash rate affect financial conditions.

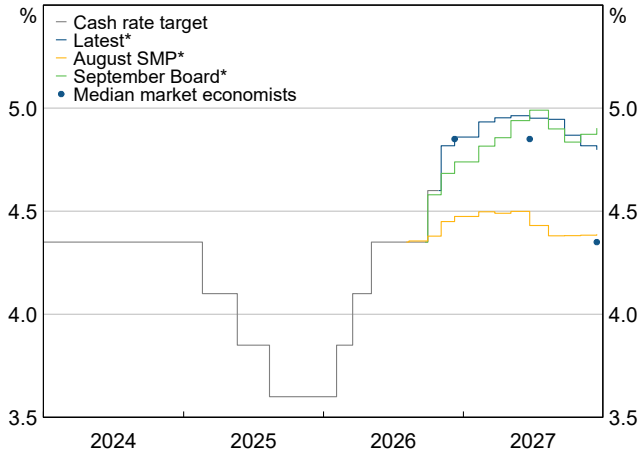
1.2 Interest rate markets

Expectations for the cash rate implied by market pricing have risen since the August *Statement*.

OIS pricing implies market participants assign an 85 per cent probability to a cash rate increase in November, and around one and a half cash rate increases are priced by mid-2027 (Graph 1.2). The rise in expectations reflects stronger-than-expected domestic inflation data, higher oil prices, the September cash rate increase, and RBA communications that on balance were interpreted as hawkish. Almost all market economists tracked by the staff expect a cash rate increase in November.

Graph 1.2

Cash Rate Expectations



* Cash rate expectations implied by overnight index swap rates, latest is at close 28 October.

Sources: LSEG; RBA.

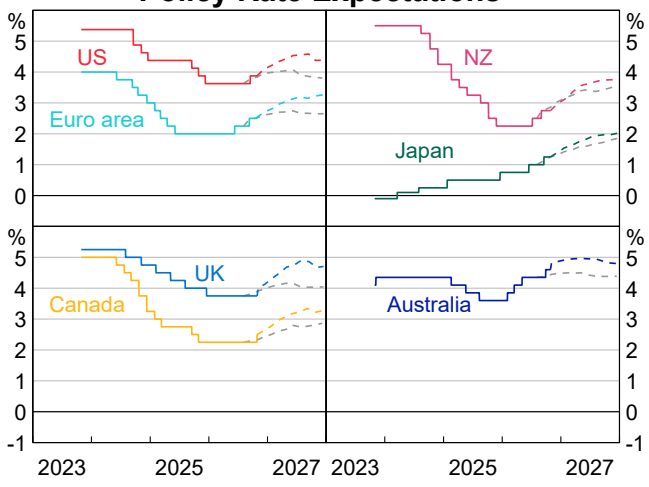
Most advanced economy central banks are expected to tighten policy further, reflecting inflationary pressures, including from the effects of the Middle East conflict.

Since the August *Statement*, the Fed, ECB, BoJ, BoC, RBNZ, Norges Bank and BoK all increased their policy rates. Many of these central banks highlighted the strength or resilience of economic growth and inflationary pressures from the re-escalation in the Middle East conflict, with inflation already persistently above target in some economies. By contrast, the BoE left its policy rates unchanged, citing a balance between downside risks to activity and upside risks to inflation. The BoE indicated that it would tighten policy further if upside inflation risks were to materialise.

Market-implied policy paths have shifted up in advanced economies since the August *Statement* (Graph 1.3). Market pricing implies policy rates are expected to increase by around 75 basis points and be at or above the range of estimates of neutral in many advanced economies by the end of next year (although central banks have expressed uncertainty about the level of neutral) (Graph 1.4). For most economies, much of the increase in policy rate paths occurred following the re-escalation in the Middle East conflict. Stronger-than-expected economic activity and central bank communication emphasising upside risks to inflation also contributed to the upward shift in some economies.

Graph 1.3

Policy Rate Expectations*

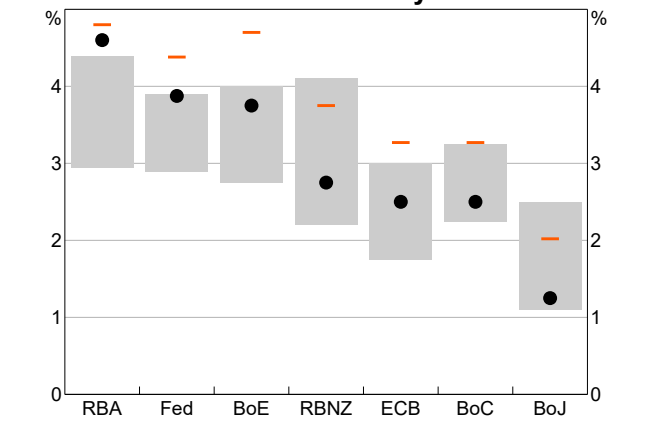


* Coloured dashed lines show expectations implied by current overnight index swap rates; grey dashed lines show the same expectations as of 5 August 2026.

Sources: Bloomberg; RBA.

Graph 1.4

Estimates of Central Bank Policy Restrictiveness*



* Range of estimates of nominal neutral rate are based on assessments by individual central banks and are not directly comparable across countries.

** Based on OIS pricing for policy rates at the end of 2027.

*** Ranges for the RBA, RBNZ, BoC, BoE, ECB and BoJ are based on the range of central estimates from a range of models; and for the Fed are the range of FOMC participants' longer-run Fed Funds rate projections.

Sources: Bloomberg; central banks; RBA.

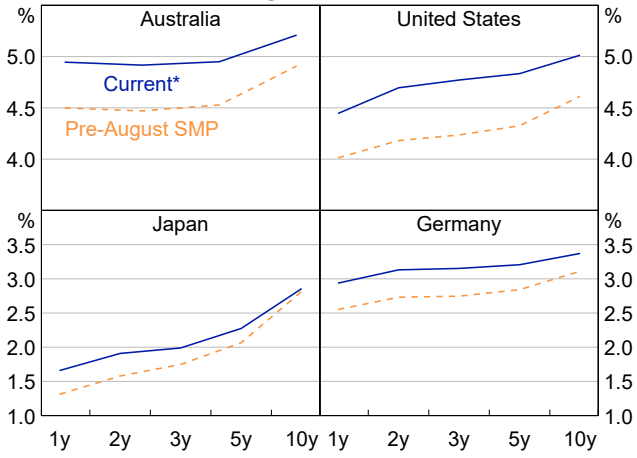
The People's Bank of China (PBC) has retained a slight easing bias amid low inflation, and incrementally eased policy in late September through structural policy tools. The tools direct lending to priority sectors, including infrastructure and manufacturing, and accompanied increased bond issuance quotas for local governments (see Chapter 2: Economic Conditions). Authorities have said that they are concerned that broader monetary easing through a lower policy rate would pressure bank profitability.

Advanced economy government bond yields have risen further to be around their highest level in many years.

Government bond yields have increased materially across advanced economies since the August *Statement*, notwithstanding some retracement over recent weeks alongside declines in equity prices. Shorter-term yields are around 40 basis points higher, reflecting expectations of monetary policy tightening in response to near-term inflationary pressure (Graph 1.5). Longer-term yields have increased by around 30 basis points for many economies, driven by an increase in real yields. Most recently, growing concerns about the sustainability and profitability of capital expenditure plans at some AI-related firms (see below) has seen yields decline somewhat as investors have switched into safer government bonds. Model-based decompositions attribute roughly half of the increase in the US 10-year nominal Treasury yield since the August *Statement* to higher expected future real policy rates, and the rest to higher term premia, but there is considerable uncertainty around these estimates. Box A: How Does an Increase in Longer-term Real Yields Affect Financial Conditions? discusses the recent increase in yields globally and the implications for financial conditions in Australia, while Box B: Developments in the Neutral Rate of Interest discusses the neutral rate and its longer-term drivers.

Graph 1.5

Sovereign Yield Curves

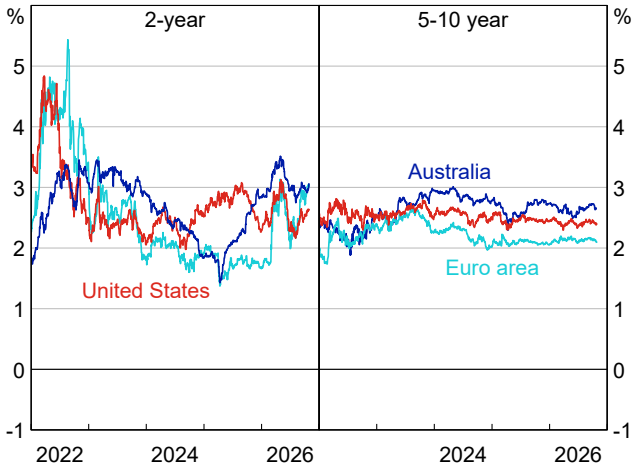


* At market close 28 October 2026.

Source: Bloomberg.

Longer-term inflation compensation is little changed and remains consistent with central bank targets, implying that market participants expect central banks to set policy rates to ensure that inflation is returned to target in a timely way (Graph 1.6).

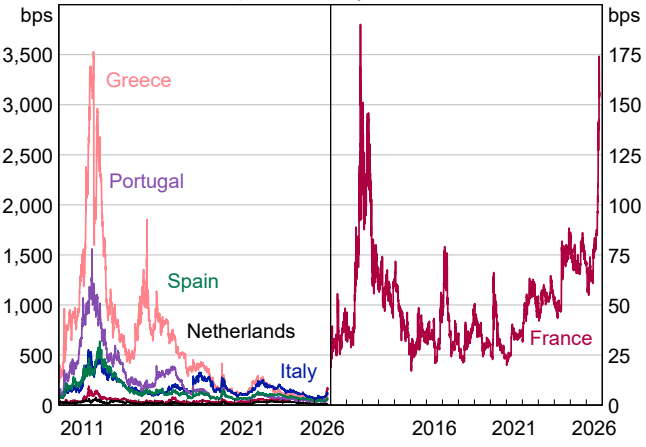
Graph 1.6
Measures of Inflation Compensation
Implied by market pricing*



* Inflation swap-implied rates, except for the Australian 2-year rate, which is the breakeven inflation rate implied by inflation-linked bonds.
Sources: Bloomberg; RBA.

Volatility has increased in many sovereign bond markets. Concerns about fiscal sustainability in France saw the spread between 10-year French and German government bonds rise to around the highest level since the eurozone crisis (Graph 1.7). However, outside Europe, market pricing provides little evidence of material concerns about sovereign credit risk: government bond auctions have generally remained well supported, long-term inflation compensation remains anchored and sovereign credit default swap premia remain low.

Graph 1.7
10-year Government Bond Yields
Euro area spreads to 10-year German Bund

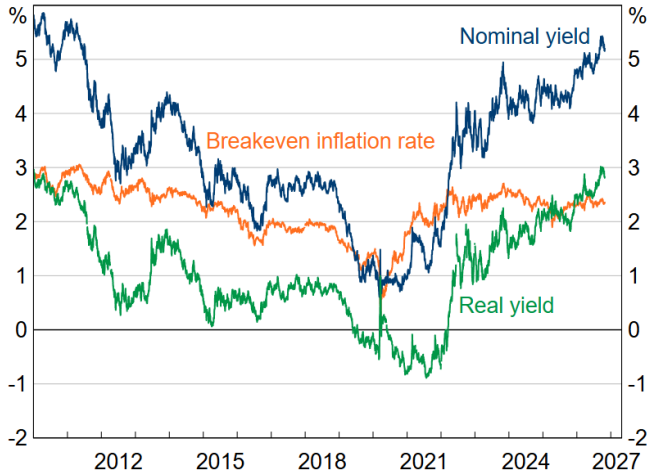


Source: Bloomberg.

In emerging markets, local-currency sovereign bond yields have risen since the August *Statement*, though in many cases by a little less than in advanced markets. Chinese bond yields remain little changed, underpinned by low inflation and low policy rates, and with capital controls reducing the sensitivity of Chinese yields to movements in global rates. In the rest of emerging Asia, lower debt-to-GDP ratios in many countries, compared with advanced economies, may be contributing to generally more modest yield increases.

Australian government bond yields have also increased since the August *Statement* to be around their highest levels in many years (Graph 1.8). As in other advanced economies, much of the increase in longer-term yields has been driven by a rise in real yields, while measures of longer-term inflation compensation have been little changed. Market contacts have attributed the rise in longer-term real yields to a combination of higher expected policy rates (including because of a potential rise in the neutral rate) and higher term premia, although views differ on the relative importance (the RBA's model estimates suggest a roughly even split between the two). In recent weeks, yields have declined a little alongside similar moves offshore. The increase in volatility in AGS has been smaller than in peer economies, and AGS market functioning remains good.

Graph 1.8
Components of the 10-year AGS Yield



Sources: Bloomberg; RBA.

1.3 Corporate funding markets

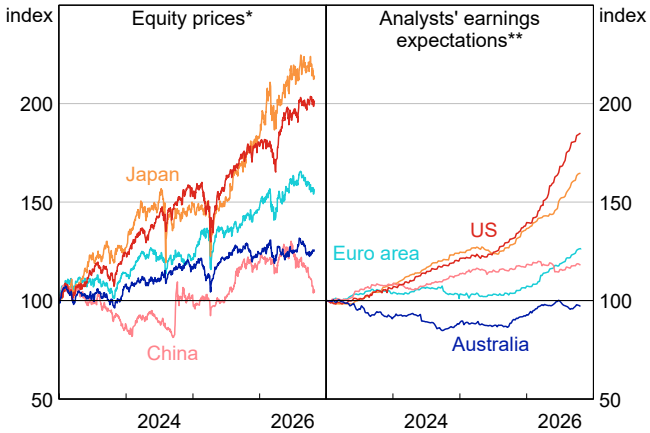
Risk premia for equities and investment-grade corporate bonds remain very low but have increased for lower-rated bonds.

Equity prices in advanced overseas economies have been overall little changed since the August *Statement*, masking significant divergences across sectors and economies (Graph 1.9). Higher interest rates and ongoing tensions in the Middle East have weighed on some sectors, with consumer discretionary and industrial stocks – which are more sensitive to higher yields and energy prices – declining the most (Graph 1.10). By contrast, energy stocks and some IT stocks have continued to rise, although investors are differentiating between technology firms more (see below). In China, equity prices have declined sharply, particularly for AI stocks affected by declining data centre investment sentiment. Meanwhile, earnings growth in the United States has remained broadly based, reflecting continued resilience in economic activity, with growth strongest in AI-related firms. Measures of equity risk premia remain around long-term lows.

Graph 1.9

Equity Prices and Analysts' Earnings Expectations

1 Jan 2023 = 100



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

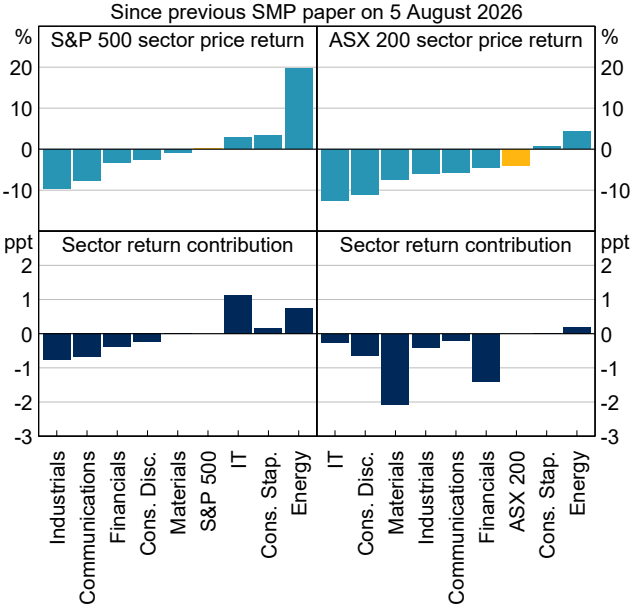
** 12-month forward earnings per share.

Sources: Bloomberg; LSEG; RBA.

Graph 1.10

Equity Sector Price Returns

Since previous SMP paper on 5 August 2026



Sources: Bloomberg; LSEG; RBA.

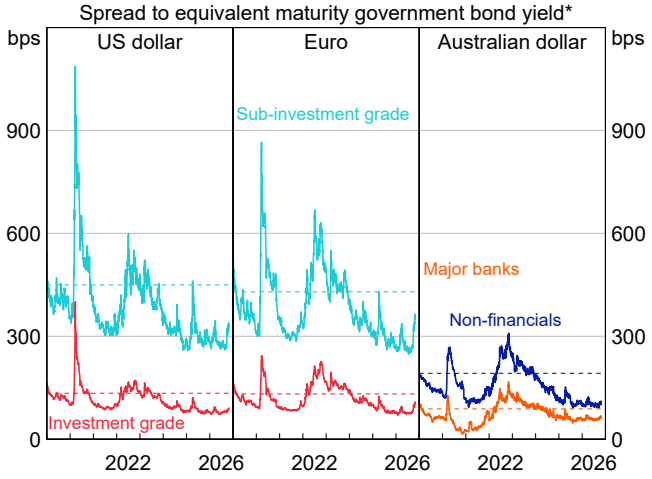
Australian equity prices have declined since the August *Statement*, owing to the effect of higher interest rates and weakness in sectors exposed to the downturn in the domestic housing market. Share prices for banks, consumer discretionary and real estate firms have declined alongside weaker earnings expectations and a higher expected path for the cash rate, and suggest that investors expect consumer spending to remain subdued. Consumer-facing firms continue to report that households remain value conscious and are trading down to lower-cost alternatives, weighing on profitability in discretionary sectors. Profits at consumer staples firms have been more resilient, while equity prices for Australian-listed energy companies have increased alongside higher oil prices. Overall, analysts' earnings expectations for Australian firms have declined recently, having trailed other advanced economies for some years including due to lower prices for key commodities and subdued economic growth.

Investment grade corporate bond spreads have increased slightly in advanced economies but remain around historically low levels (Graph 1.11). The rise in spreads for sub-investment grade firms has been more noticeable, in part because their creditworthiness is more sensitive to higher interest rates, although spreads remain low. The slight increase in Australian bond spreads has tightened funding conditions in Australia at the margin, though funding is readily available to investment grade firms. Borrowers reliant on private credit have seen a more significant tightening of funding conditions, discussed below.

Graph 1.11

Corporate Bond Spreads

Spread to equivalent maturity government bond yield*



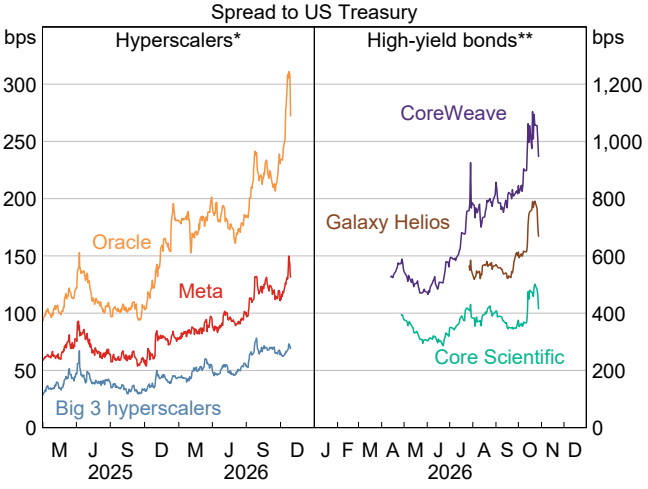
* Dashed lines show long-run averages since 2010.
Sources: Bloomberg; ICE Data used with permission; RBA.

Investors are differentiating between technology firms more. Large 'AI hyperscalers' reported very strong revenue growth in the latest quarter, but their share prices and bond spreads have become more sensitive to substantial upward revisions to planned capital expenditure and to concerns about whether this investment will earn adequate returns (Graph 1.12). Capital expenditure by these firms is now expected to be around US$800 billion this year and to approach US$1.4 trillion by the end of 2027 – around 5 per cent of US GDP and around twice what was expected in late 2025 – with a growing share financed through bond issuance. Korean equity prices have declined, driven by falls in the share prices of memory chip producers amid concerns about the scale and sustainability of the AI data centre build-out; these concerns have also affected Chinese AI stocks (Graph 1.13). By contrast, Taiwanese equities have outperformed those elsewhere in Asia, partly reflecting stronger earnings expectations for chip manufacturer TSMC.

Graph 1.12

Data Centre Corporate Bond Spreads

Spread to US Treasury

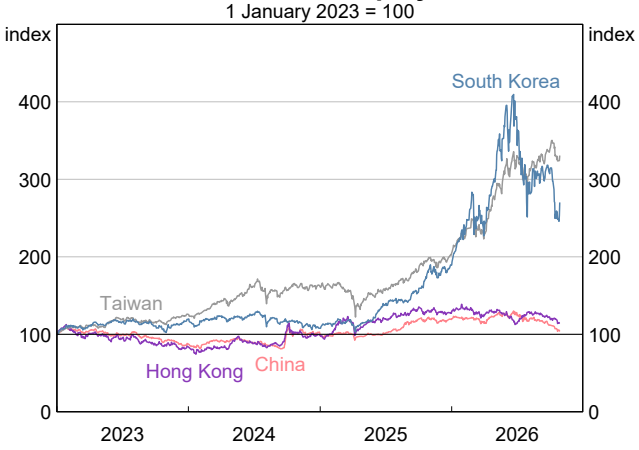


* The Big 3 hyperscalers are Amazon, Google and Microsoft, shown as a simple average. Hyperscaler spreads are interpolated 10-year spreads from LSEG.
** The high-yield data centre bonds are individual bonds that mature in 2031.
Sources: LSEG; RBA.

Graph 1.13

North-East Asian Equity Prices

1 January 2023 = 100



Sources: Bloomberg; LSEG; RBA.

Similarly, some Australian data centre firms have faced increased investor scrutiny. Most notably, AI data centre developer Firmus withdrew its planned initial public offering (IPO) in October following weak investor demand at the proposed valuation, and some other data centre operators have experienced equity price falls and a widening in credit spreads; commentators suggest that the IPO withdrawal may have been one factor contributing to weaker global sentiment towards AI-related firms. By contrast, a range of other Australian data centre operators have seen little change in their cost of capital.

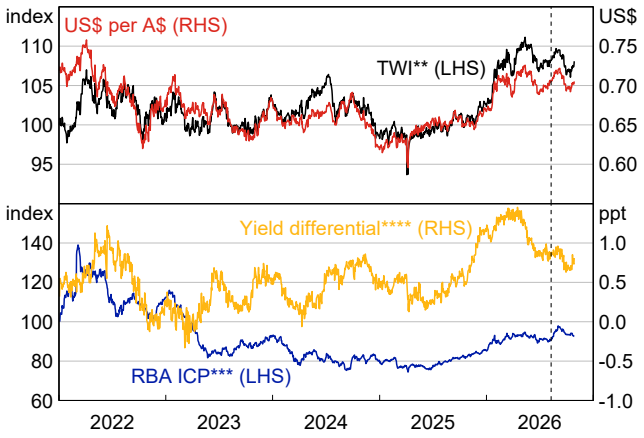
Low corporate credit and equity risk premia suggest that investors continue to expect the economic impact of the Middle East conflict to be limited and AI investment to ultimately be profitable, among other things. However, a material reassessment of the economic viability of AI-related investment, the effects of the Middle East conflict, US policy uncertainty following the midterm elections or concerns about fiscal sustainability globally could lead to a broader weakening in risk sentiment. This could spill over to Australian markets via higher risk premia and reduced access to funding.[1]

1.4 Foreign exchange markets

The Australian dollar is little changed since the August *Statement* and remains around 5 per cent higher than the start of the year.

The Australian dollar TWI is little changed since the August *Statement* (Graph 1.14). Australian government bond yields have risen since August, but major trading partner yields have risen by a similar, and in some cases greater, degree. This modest narrowing in yield differentials has been offset by support from the weaker euro following concerns regarding fiscal sustainability in France. Since the start of the year, the Australian dollar has appreciated by around 5 per cent in TWI terms and remains broadly consistent with estimates of its long-run equilibrium level, although there is a degree of uncertainty around this assessment.

Graph 1.14
Australian Dollar*



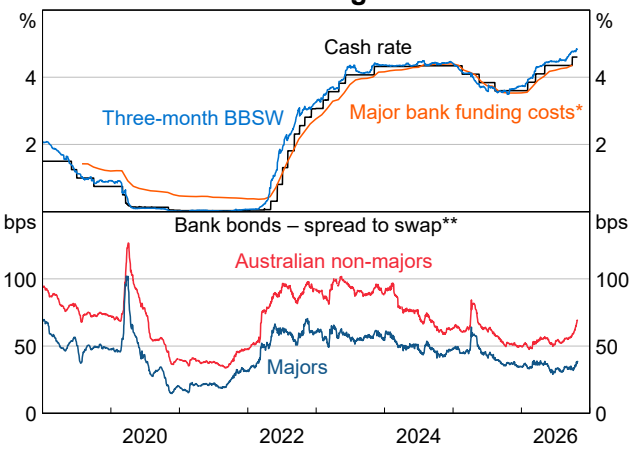
* Dotted vertical line indicates latest SMP publication.
** Trade-weighted index; 01 January 2022 = 100.
*** Index of Commodity Prices (USD terms); 01 January 2022 = 100.
**** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.
Sources: Bloomberg;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

1.5 Australian banks and credit markets

Banks' funding costs and lending rates have increased in line with the cash rate since the beginning of the year.

Banks' funding costs rose by around 80 basis points between January and September, and will rise further as September's increase in the cash rate continues to be passed through (Graph 1.15). Banks have increased average deposit rates broadly in line with increases in the cash rate this year. This contrasts with previous easing and tightening phases, when average deposit rates have tended to change by less than the cash rate because some deposits, such as transaction accounts, do not reprice fully when the cash rate changes. The stronger-than-usual pass-through this year is consistent with some banks highlighting strong competition for deposits over recent quarters. Wholesale funding conditions remain favourable, with spreads between bank bond yields and swap rates remaining low. Bank bond issuance has been a little above average in 2026.

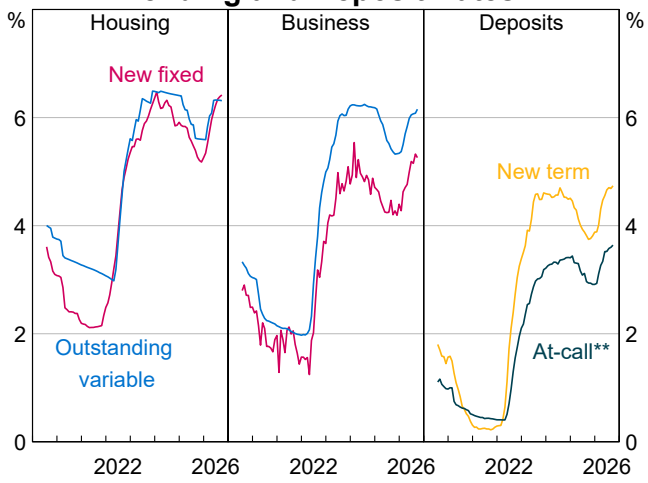
Graph 1.15
Bank Funding Costs



* 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; RBA.

Lending rates have increased broadly in line with the cash rate and other reference rates over 2026 (Graph 1.16). Variable mortgage rates rose by almost 75 basis points between January and September, and most banks have since increased their standard variable mortgage rates in line with the September cash rate increase. Prior to September, some lenders had reduced advertised mortgage rates slightly amid strong competition for mortgage customers, though this has had a negligible effect on average new and outstanding mortgage rates. Variable business rates have increased broadly in line with increases in bank bill rates (BBSW) and the cash rate this year.

Graph 1.16
Lending and Deposit Rates*

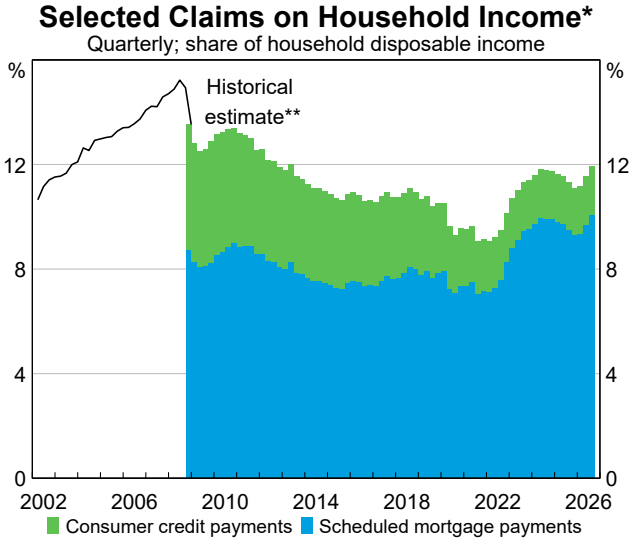


* Latest observation is September 2026.
** Includes deposits in housing loan offset accounts.
Sources: APRA; RBA.

Cash rate increases over 2026 have flowed through to higher scheduled mortgage payments.

Scheduled principal and interest mortgage payments increased to just over 10 per cent of household disposable income in the September quarter, around their 2024 peak (Graph 1.17). Scheduled mortgage payments will rise a little further as September's increase in the cash rate is passed through to mortgage payments (which can take up to three months). Nonetheless, total scheduled household debt payments (including estimated repayments on consumer credit) remain well below the 2008 peak, reflecting a long-run decline in consumer credit relative to household disposable income.[2]

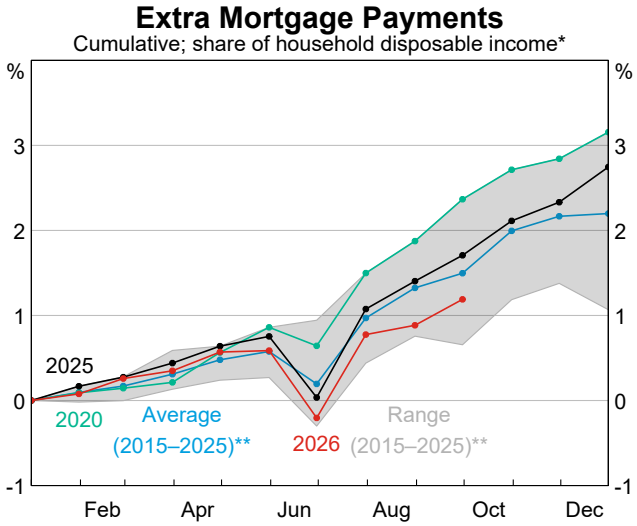
Graph 1.17



* Seasonally adjusted and break-adjusted. Latest observation is September 2026. September quarter 2026 data are based on forecasts for household disposable income.
** Estimated using credit foncier model.
Sources: ABS; APRA; RBA.

Extra mortgage payments have been a bit lower in 2026 compared with 2025 (Graph 1.18). By contrast, the overall household saving ratio has remained relatively stable (see Chapter 2: Economic Conditions). While higher interest rates provide an incentive to save, they also reduce borrowers' cash flows, which can lead to a reduction in extra mortgage payments. Nonetheless, extra payments are still positive and so adding to the significant mortgage buffers that most borrowers have. Indeed, the median borrower in the lowest income quartile has enough savings in offset and redraw accounts to cover around a year's worth of scheduled mortgage payments.[3]

Graph 1.18

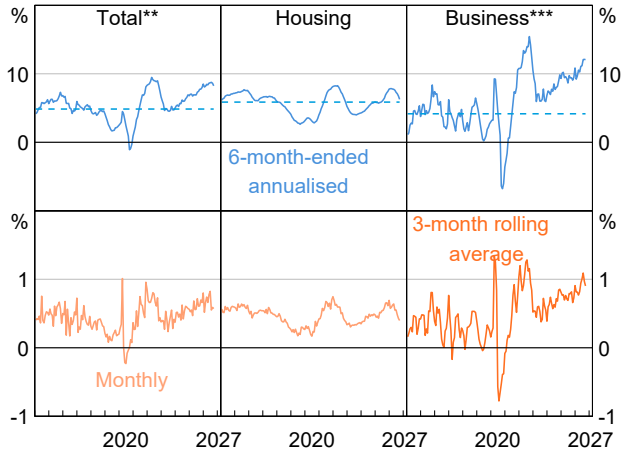


* Data are not seasonally adjusted. Series are calculated as the cumulative sum of extra payments divided by the total for household disposable income over that year. September quarter 2026 data are based on forecasts for household disposable income.
** Available data prior to 2020 are quarterly.
Sources: ABS; APRA; RBA.

Total credit growth has remained well above its post-global financial crisis (GFC) average over recent months.

Total credit growth has declined slightly since the August *Statement*, but remains strong at 8.2 per cent in six-month-ended annualised terms (Graph 1.19). A decline in housing credit growth, to around its post-GFC average, has been largely offset by an increase in business credit growth. These contrasting trends are discussed in more detail below.

Graph 1.19
Credit Growth by Sector*

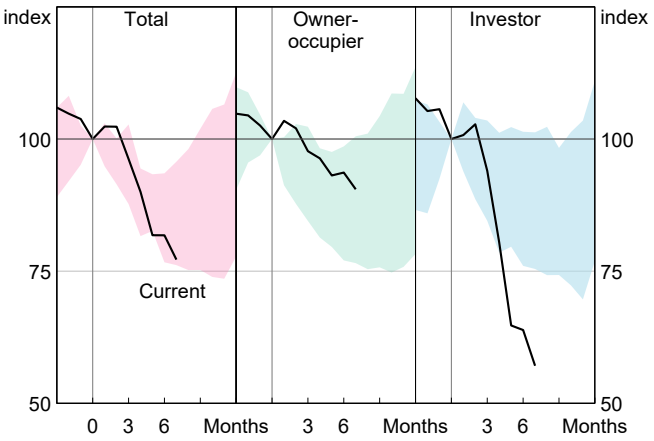


* Seasonally adjusted and break-adjusted. Dashed lines represent average growth rate.
** Includes housing, personal and business credit.
*** Excludes financial businesses.
Sources: APRA; RBA.

New housing loan commitments have declined sharply, particularly for investors, and housing credit growth has eased.

New housing loan commitments have declined further since the August *Statement* and are now 27 per cent below their peak in November 2025. The decline in overall housing loan commitments to date is larger than most tightening phases since 1990, though not as large as at the same point in the 2022 tightening phase (Graph 1.20).[4] While the increase in interest rates over 2026 has weighed on demand from all categories of borrowers, the decline in new lending has been most pronounced for investors and has been concentrated in loans to purchase established dwellings. This is consistent with the recent changes to negative gearing and capital gains tax decreasing the after-tax returns on investments in established housing.

Graph 1.20
New Housing Commitments over Tightening Phases*
Indexed to month of first rate increase

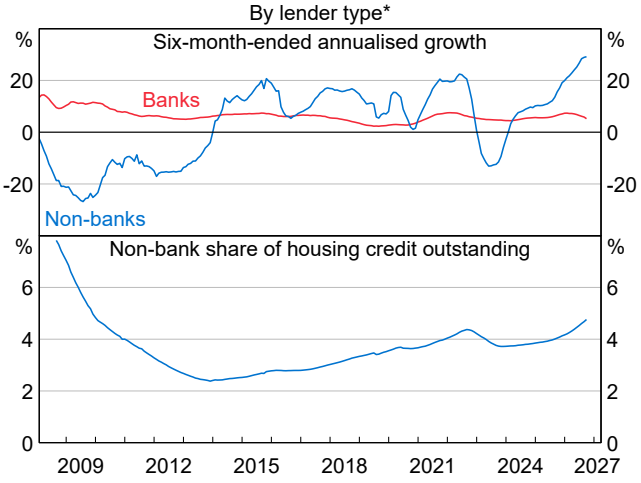


* Monthly data, excluding refinancing, seasonally adjusted and break-adjusted. Shaded areas represent historical range of cumulative changes in commitments during previous tightening phases since 1990.
Sources: ABS; APRA; RBA.

Housing credit growth is now 6.3 per cent in six-month-ended annualised terms, lower than at the time of the August *Statement* but still around its post-GFC average. The recent decline has reflected a fall in investor credit growth; owner-occupier credit growth has remained little changed in six-month-ended terms and has softened only slightly in monthly terms, in line with the more modest decline in owner-occupier commitments. Housing loan commitments and credit growth tend to lag housing price growth by up to three months, largely reflecting lags between the purchase and settlement of property. As a result, housing credit growth is expected to decline further over coming months as recent declines in housing prices and turnover continue to flow through to credit (see Chapter 2: Economic Conditions).

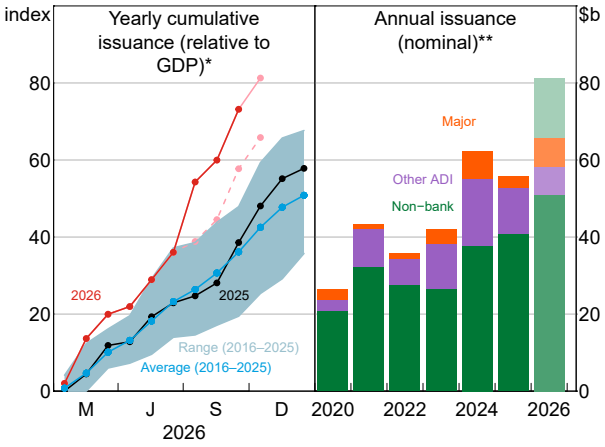
Non-bank housing credit is a small share of total housing credit but has been growing quickly (Graph 1.21). Growth in non-bank housing credit has accelerated considerably over the past 18 months, mainly reflecting new lending rather than refinancing of bank loans. In part, this growth is likely to reflect less stringent debt servicing tests at some non-banks compared with banks (which are required to assess serviceability at an interest rate that is three percentage points above the prevailing mortgage rate, reflecting the Australian Prudential Regulation Authority's (APRA) serviceability buffer). Non-bank credit growth has also been supported by generally favourable conditions in securitisation markets – a key funding source for these lenders – allowing non-banks to compete more readily with banks for customers. Issuance of residential mortgage-backed securities has been very strong, with cumulative issuance in the year-to-date (relative to GDP) exceeding the range seen in recent years (Graph 1.22). While spreads on residential mortgage-backed securities have increased recently they remained very narrow in historical terms.

Graph 1.21
Housing Credit
By lender type*



* Seasonally adjusted and break-adjusted.
Sources: APRA; RBA.

Graph 1.22
RMBS Issuance



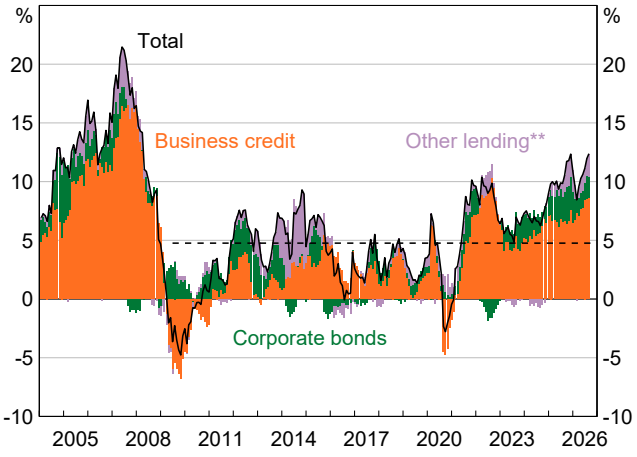
* For years before 2026, cumulative issuance is scaled by that year's nominal GDP relative to 2026. Dotted line shows issuance excluding non-bank Pepper Cashmere deal ($15b portfolio transfer RMBS) as the deal did not constitute new credit. Latest observation is 28 October 2026.

** Lighter green in 2026 partial data denotes Pepper Cashmere deal.
Sources: ABS; KangaNews; RBA.

Growth in business debt remains strong and has increased recently.

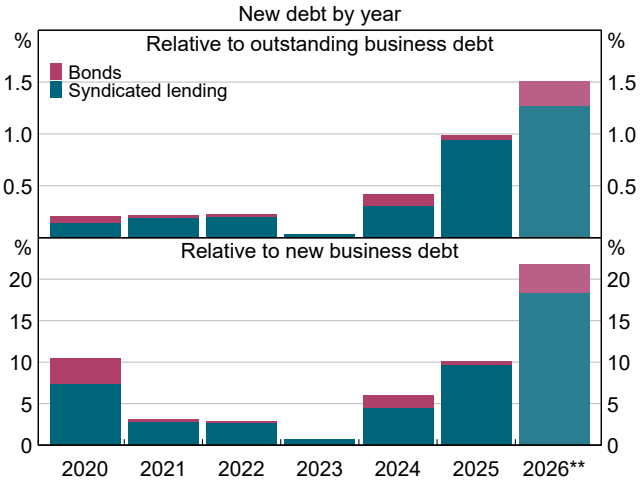
Business debt growth is well above its post-GFC average (Graph 1.23). Business credit growth has accelerated in recent months, supporting the strong growth in overall business debt. By contrast, corporate bond issuance has slowed, largely because high earnings have allowed some resource companies (which typically play a material role in debt issuance) to rely more heavily on internal funding. The largest contributors to business debt growth have been industrial businesses – including borrowing to fund data centre investment, discussed below – as well as consumer-facing industries and real estate businesses.

Graph 1.23
Business Debt Growth*



* Six-month-ended annualised, seasonally adjusted. Dashed line is average since 2009.
** Lending to large businesses by institutions that do not report to APRA.
Sources: APRA; Bloomberg; LSEG; RBA.

Graph 1.24
Australian Data Centre Debt Funding*



* Selected debt funding sources only, comprising syndicated loans and bond issuance; excludes other bank loans. Sample comprises NextDC, Infratil (CDC), Macquarie Technology, Goodman, AirTrunk, Firmus and local funding vehicles of Stack and Equinix.
** Data updated to 28 October 2026.
Sources: Bloomberg; LSEG; RBA.

As in some overseas jurisdictions, debt financing for Australian data centre operators has been an important contributor to strong business debt growth. In 2026 to date, operators have raised at least $30 billion in the bond and syndicated loans markets (domestically and offshore), including syndicates involving Australian banks. This is equivalent to around one-fifth of the increase in the stock of business debt so far this year (Graph 1.24). However, operators may also use other sources of debt funding such as bilateral bank loans and private credit. This suggests that the total volume of borrowing by operators is likely to be higher than the $30 billion quoted above (though it is unclear how much higher). So far, the decline in global and domestic investor sentiment towards some riskier AI-related firms (discussed above) is having only a limited effect on broader cost and availability of funding for most Australian data centre operators. Even so, this remains a risk if sentiment were to deteriorate further.

Funding conditions for private credit lenders have tightened recently, which could reduce the availability of credit for new residential construction. Media reports and liaison information have noted an increase in investors' redemption requests at some funds. At the same time, lenders have noted a less profitable outlook for new residential property developments due to higher construction costs and weaker housing market conditions, which is expected to weigh on both developers' demand for finance and lenders' appetite to supply finance. Available information suggests non-bank lenders (including private credit funds) comprise at least 40–50 per cent of lending for residential property construction.[5]

Endnotes

1 For further discussion, see RBA (2026), *Financial Stability Review*, October.

2 See Appendix A of Jennison S and M Miller (2025), 'An Update on the Household Cash-flow Channel of Monetary Policy', RBA *Bulletin*, January.

3 See Graph 2.4 in RBA (2026), 'Chapter 2: Resilience of Australian Households and Businesses', *Financial Stability Review*, October.

4 At the same point in the 2022 tightening phase the cash rate target was at 3.10 per cent, following 300 basis points of cash rate increases (with around 75 basis points of additional increases expected over the coming year).

5 For example, see Graph 12 in Jennison S, J Spiller and P Wallis (2026), 'Recent Changes in Credit Markets and Their Implications for Monetary Policy', RBA *Bulletin*, February.

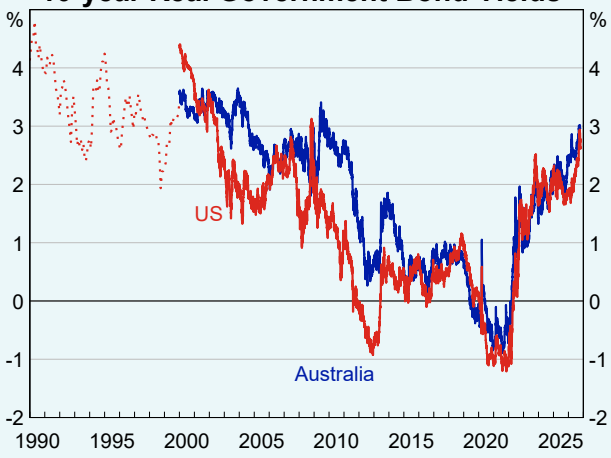
Box A: How Does an Increase in Longer-term Real Yields Affect Financial Conditions?

Longer-term real government yields have risen sharply across advanced economies in recent months. Whether this tightens financial conditions depends on why yields have risen. If yields have risen because markets expect stronger growth, the prospect of higher earnings and returns on investment can more than offset higher discount rates, thereby supporting asset prices and investment. If they have risen because markets expect more restrictive monetary policy or require a higher term premium, there is no such support and financial conditions are likely to have tightened. The recent rise in yields appears to reflect a mix of factors. In Australia, long-term yields have less direct influence on borrowing costs than in the United States because most borrowing here is at variable rates. However, this does not necessarily mean weak transmission overall: increases in foreign yields can still affect domestic financial conditions through asset prices and the exchange rate. This Box examines the drivers of longer-term real yields, places the recent increase in historical context, and considers how higher yields affect financial conditions in Australia.

Longer-term real government yields have risen by as much as 85 basis points over 2026, reaching their highest levels since the early 2000s (Graph A.1). Most of this increase reflects higher real yields rather than changes in longer-term inflation expectations, which have remained broadly stable. The current increase is part of a broader and more sustained rise in longer-term yields since 2021 (see Box B: Developments in the Neutral Rate of Interest). Higher real yields do not necessarily imply tighter financial conditions. Their effect on financial conditions depends on what is driving the increase and how changes in long-term rates are transmitted through the economy.

Graph A.1

10-year Real Government Bond Yields*



* US data before January 2000 (dotted red line) are the Federal Reserve Bank of Cleveland's model-based monthly 10-year real interest rate.

Sources: Bloomberg; Federal Reserve Bank of Cleveland; RBA.

What drives longer-term real yields?

Longer-term real yields reflect the expected path of future short-term real rates and a so-called 'term premium'. Increases in real yields can be grouped into three broad drivers, with the first two working through expected policy rates:

1. **stronger expected growth:** markets may expect stronger economic growth, which can raise expected real policy rates because the neutral rate is thought to have risen (e.g. because of higher productivity growth)
2. **other policy repricing:** markets could expect policy rates to stay higher for longer for reasons other than stronger growth, such as when inflationary pressures lead markets to expect policy to remain restrictive (i.e. above the neutral rate) for a time, such as during persistent adverse supply shocks
3. **higher term premium:** investors may demand greater compensation to hold longer-term bonds, above what they would demand to hold a series of equivalent shorter-term instruments, while expectations for growth and policy rates are little changed.

These drivers can have different implications for financial conditions. When higher yields reflect stronger expected growth, higher expected earnings and returns on investment can more than offset higher discount rates, thereby supporting asset prices. By contrast, when yields rise because of expectations of more restrictive monetary policy or a higher term premium, there is no comparable offset and financial conditions are more likely to tighten. In practice, yield movements can reflect a combination of these drivers.

Putting the recent increase in historical context.

The increase in real yields this year is notable, but not unprecedented. It is comparable in size with several previous episodes, including the dot-com boom, the pre-global financial crisis (GFC) expansion and the 2023 term premium sell-off (Graph A.2). The drivers of these episodes differed, however. Table A.1 classifies past episodes by our assessment of their predominant driver, based on contemporaneous market developments and revisions to consensus forecasts of activity, inflation and policy rates. Several episodes reflected more than one driver.

Table A.1: Historical Episodes of Increases in Real Rates
Grouped by predominant driver

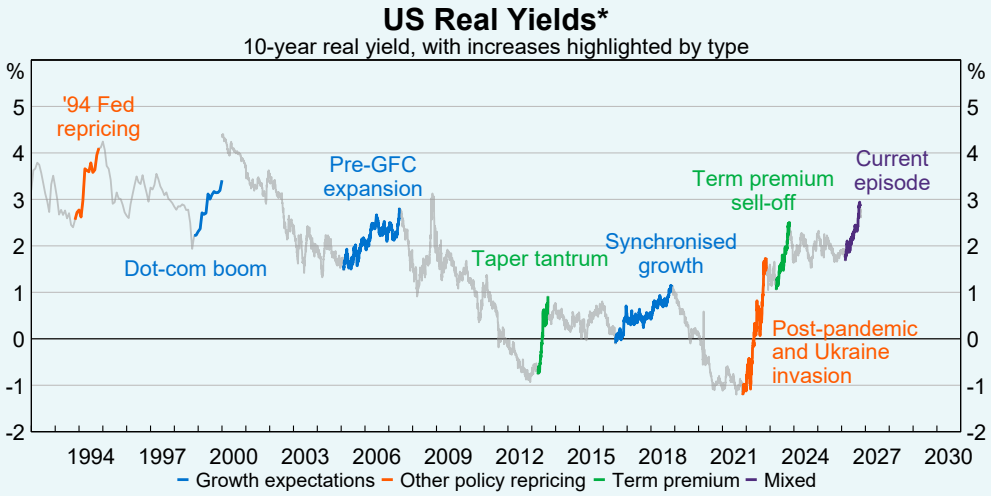
Episode	Period	Description
Growth expectations		
Dot-com boom	Oct 1998–Jan 2000	Optimism about technology and productivity supported a sharp rise in equity prices. Long-term growth forecasts rose substantially, while long-term inflation forecasts were broadly stable.
Pre-GFC expansion	Feb 2005–Jun 2007	Solid global growth, rising equity and housing prices and rapid credit growth pointed to optimism about future activity and returns.
Synchronised growth	Jul 2016–Nov 2018	A broad-based global upswing in economic activity, along with higher equity prices and compressed risk spreads.
Other policy repricing		
'94 Fed repricing	Oct 1993–Nov 1994	Stronger activity and concerns about prospective inflation, together with limited advance communication, left markets unprepared for the pace of monetary tightening, producing a sharp bond-market adjustment.
Post-pandemic reopening and Russian invasion of Ukraine	Nov 2021–Nov 2022	Reopening of economies, supply disruptions and the energy shock led markets to expect rapid monetary tightening; bond yields increased, equity prices declined, and growth forecasts were revised lower.
Term premium		
Taper tantrum	Apr–Sep 2013	The prospect of reduced asset purchases by the US Federal Reserve triggered a sharp bond sell-off and retrenchment from emerging-market assets.

Episode	Period	Description
Term premium sell-off	Apr–Oct 2023	Increased government bond supply raised term premia and risky asset prices weakened as yields rose.
Mixed		
Current episode	Feb 2026–	Stronger US earnings expectations, AI-related equity gains and modestly higher long-term growth forecasts point to a growth component. Increased bond issuance and quantitative tightening point to higher term premia, while expected policy rates have also risen.

Source: RBA.

The dot-com boom provides the clearest example of higher yields accompanying stronger expected longer-term growth. The pre-GFC and 2016–2018 synchronised growth periods were also associated with strong asset prices and economic activity, but forecasts at the time suggest that stronger growth was expected to be cyclical rather than structural. By contrast, the taper tantrum and 2023 term premium sell-off were associated with weaker asset prices and little change in long-term growth expectations, consistent with a larger role for term premia.

Graph A.2



* Grey line: US TIPS yield from January 2000; prior observations are Federal Reserve Bank of Cleveland model estimates (monthly). The series are not spliced due to differences in measurement and levels.

Sources: Bloomberg; Federal Reserve Bank of Cleveland.

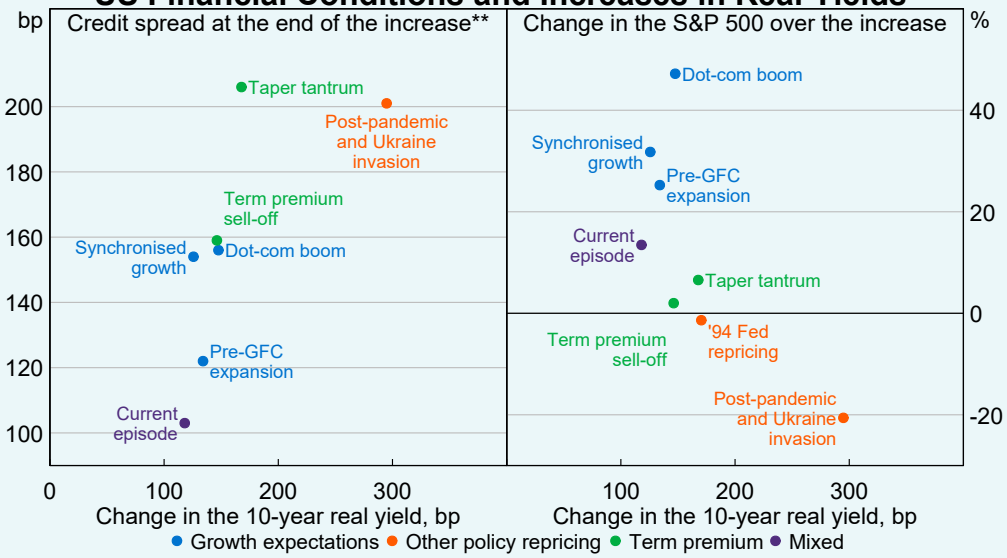
Historical experience also provides a useful reminder that the expectations underpinning market pricing are not always realised. In some cases, periods of strong optimism about future growth have given way to sharp falls in risk asset prices, notably following the dot-com boom and the expansion preceding the GFC. In others, interest rate markets may be slow to recognise lasting improvement in growth prospects.

The current episode appears to reflect a combination of these drivers. In the United States, higher growth expectations appear to have contributed: rising yields have coincided with stronger earnings expectations and higher equity prices, particularly in AI-sensitive sectors, while credit spreads have remained near historical lows (Graph A.3). Expectations of a higher path for policy rates have also contributed. Increased debt issuance and ongoing quantitative tightening, alongside an investor base that is becoming more sensitive to expected returns, also appear to be placing upward pressure on term premia.

In Australia, however, the rise in yields has not been accompanied by a comparable improvement in growth expectations priced into financial assets. That is consistent with the much smaller AI-related sector here, and the less pronounced reassessment of the broader domestic economic outlook. Instead, the rise in Australian yields appears to reflect expectations of a higher path for the cash rate and spillovers from global yields (see Chapter 1: Financial Conditions and Box B: Developments in the Neutral Rate of Interest). As a small open economy, Australia is affected by global movements in longer-term yields, including in neutral rates and term premia, even when domestic fundamentals have changed little.

Graph A.3

US Financial Conditions and Increases in Real Yields*



* Each dot is an episode of a material increase in US 10-year real yields (US TIPS yield; Cleveland Fed estimate for 1994 and 1998–2000).
** US BBB option-adjusted spread; '94 Fed repricing omitted (no spread data).
Sources: Bloomberg; Federal Reserve Bank of Cleveland; ICE Data.

How do longer-term real yields affect financial conditions in Australia?

An increase in longer-term real yields can be transmitted into broader financial conditions through borrowing costs, asset prices, investment and the exchange rate. The overall effect on financial conditions depends on why yields have risen, with the three drivers discussed above having different implications for Australia.

When higher global yields reflect stronger expected growth, the implications for Australian financial conditions are ambiguous. If stronger growth is also expected for Australia, higher expected earnings and returns on investment may offset the effects of higher discount rates. But if the improvement in growth expectations is concentrated abroad, such as from AI-related investments, Australia may import some of the rise in long-term yields without receiving the same benefit of higher expected growth. In that case, the increase in global yields could tighten Australian financial conditions. A persistent productivity or growth differential (in favour of the United States for example) would also be expected to put downward pressure on the real exchange rate, which would provide some offset to the tightening in domestic financial conditions. Similarly, stronger overseas activity could provide some offset by lifting domestic incomes (through trade and commodity-price channels).

When higher yields reflect expectations of more restrictive monetary policy, financial conditions are more likely to tighten. Expected borrowing costs rise, while higher discount rates weigh on asset prices and investment. If Australian policy rates are expected to rise relative to those abroad, a higher exchange rate could tighten domestic conditions further.

When higher yields reflect a higher term premium, the direct effect on broader financial conditions depends partly on the economy's exposure to longer-term rates. Differences in financing structures can therefore mean that the same rise in longer-term yields is transmitted differently across economies.

Australian household borrowing is concentrated in variable-rate mortgages, making borrowing costs less directly sensitive to term premia than in the United States (Table A.2). Thirty-year fixed-rate mortgages are common in the United States, which makes new borrowing rates sensitive to term premia but also means that changes in term premia can take a long time to affect average outstanding rates on mortgages. The differences are less clear-cut for business financing. Higher discount rates may have a larger direct effect on aggregate US equity indices because they are more heavily weighted towards technology companies, whose valuations depend heavily on earnings many years ahead.

Table A.2: Selected Financing Features in Australia and Other Advanced Economies

	Australia	United States	United Kingdom
Household borrowing			
Effective period before mortgage rates reprice[(a)]	<1 month	8.5 years (mostly 30-year fixed term)	3 years (mostly fixed terms of 2–5 years)
Business borrowing[(b)]			
Bank loan structure	89 per cent variable-rate	Mostly variable-rate for larger businesses; mostly fixed-rate for small businesses	Mostly variable-rate
Bond tenor[(c)]	6.0 years	8.4 years	8.3 years[(d)]
Bond/loan share	19 per cent bonds	39 per cent bonds	24 per cent bonds
Government borrowing			
Funding tenor[(e)]	6.5 years	5.9 years	13.4 years

(a) Effective period for which rates on outstanding mortgages are fixed. For Australia and the United Kingdom, this is calculated as a weighted (by amount outstanding) average of the fixed-rate period, with variable-rate mortgages treated as able to reprice immediately; the Australian figure uses the residual term of the fixed-rate period, while the UK figure uses original maturity due to data limitations. The US estimate uses average duration of agency mortgage-backed securities.

(b) Non-financial incorporated and unincorporated businesses.

(c) Residual tenor. Australian and US figures are for bonds only, while the UK figure includes bills but excludes commercial paper. Includes offshore issuance, where available.

(d) Average residual maturity of UK non-financial corporate fixed-rate, non-convertible bonds from 1997Q4 to 2024Q2, excluding those maturing in less than a year.

(e) Residual tenor on all debt including bills.

Sources: AOFM; APRA; Bank of England; Bloomberg; Federal Reserve; LSEG; Office for National Statistics; RBA; UK Debt Management Office; US Congress Joint Economic Committee.

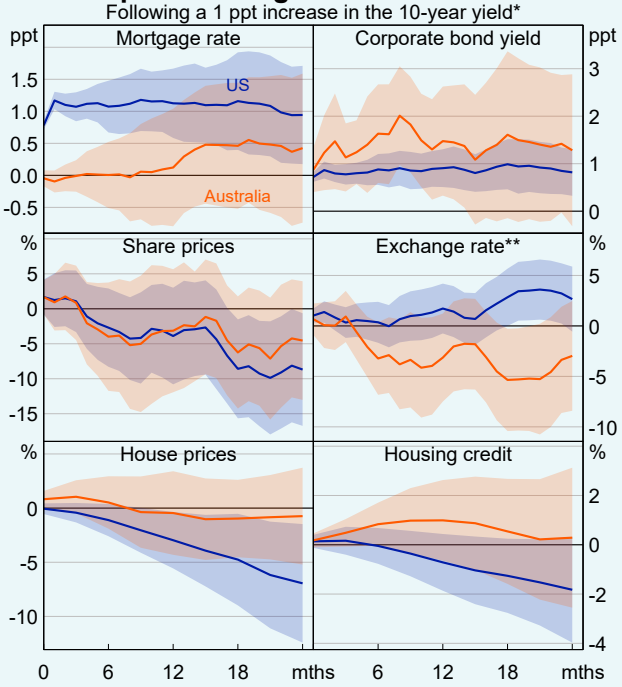
While differences in financial structures affect the direct transmission of higher yields to the economy, the overall effect on financial conditions also depends on broader responses in asset prices and other financial variables. Model-based estimates, using data from 1995 onwards, suggest that US term-premia-driven increases in longer-term yields have, on average, been associated with higher borrowing costs and lower equity and housing prices in both Australia and the United States (Graph A.4).[1]

As expected, these estimates show a larger impact on mortgage rates and housing prices in the United States than in Australia. By contrast, equity prices fall by at least as much in Australia as in the United States, illustrating that weaker direct pass-through to borrowing rates does not necessarily imply weaker transmission overall. Even so, the associated wealth effects from equity market holdings may be weaker in Australia than in the United States because a substantial share of Australian households' equity wealth is held indirectly through superannuation, which is less readily accessible for consumption.[2] The Australian dollar also tends to depreciate in such situations, partly offsetting the tightening in domestic financial conditions; this is consistent with a US term-premium shock raising US yields more than Australian yields.

Graph A.4

Response to Higher US Term Premia

Following a 1 ppt increase in the 10-year yield*



* Increase in each country's own 10-year yield, instrumented with the change in the US 10-year term premium (Kim-Wright); local projections, 1995-2026. Controls: lags of the outcome, the yield and the policy rate. Shaded areas are 95 per cent confidence intervals.

** Each country's trade-weighted exchange rate: the BIS broad nominal index of the US dollar for the US, the Australian dollar TWI for Australia.

Sources: BIS; Bloomberg; Federal Reserve; FRED; Kim and Wright (2005); RBA.

Endnotes

1 The responses in Graph A.4 are estimated using local projections (Jordà O (2005), 'Estimation and Inference of Impulse Responses by Local Projections', *American Economic Review*, 95(1), pp 161–182), with the change in the US 10-year term premium (Kim D and J Wright (2005), 'An Arbitrage-Free Three-Factor Term Structure Model and the Recent Behavior of Long-Term Yields and Distant-Horizon Forward Rates', FEDS No 2005-33) used as an instrument for each market's 10-year government bond yield. Because US term premium movements can reflect a range of underlying shocks, the estimates capture average historical associations rather than the effects of a specific structural shock. In addition, the term premium estimates we use are model-based decompositions that cannot always distinguish perfectly between increases in yields stemming from the term premium and those from other drivers such as growth expectations. For a small open economy like Australia, the instrumental variable approach nonetheless helps to separate movements in yields from developments affecting both yields and financial conditions (this interpretation is less straightforward for the United States). This means that some of the results in Graph A.4 – for instance, the slight increase in mortgage rates and housing credit – may reflect in part higher expected global growth instead of a 'pure' increase in the US term premium. The confidence intervals around these estimates are wide, particularly for Australia.

2 Equity ownership is more concentrated among wealthy households in the United States, which may reduce the aggregate consumption response because those households tend to have lower marginal propensities to consume out of stock market wealth. However, their large quantity of equity holdings means that they can still account for a substantial share of the aggregate consumption response to equity price movements (Mitra I and D Rapach (2026), 'Downside Risk to the Stock Market and Consumption', Federal Reserve Bank of Atlanta Policy Hub Series No 6-2026).

Box B: Developments in the Neutral Rate of Interest

Long-term bond yields in advanced economies have increased substantially recently, continuing their upward trend in the post-pandemic period (see Chapter 1: Financial Conditions). Part of this increase is likely to reflect a rise in the neutral rate of interest – the level of the short-term real interest rate that balances saving and investment and neither stimulates nor dampens demand once temporary influences on the economy have faded. The neutral rate can help inform assessments of the stance of monetary policy. All else equal, a higher neutral rate implies that a given level of the cash rate is less restrictive than otherwise. However, the neutral rate is not directly observed and estimates are subject to considerable uncertainty both about its level and underlying drivers. There is also uncertainty about estimates of other influences on long-term interest rates, notably term premia, which have also contributed to the increase in longer-term sovereign bond yields. This Box discusses the concept of the neutral rate, its possible drivers and the associated uncertainties.

What is the neutral interest rate?

The neutral rate of interest can refer to short-run or long-run concepts, each of which has different connections to forecasts and policy. The long-run neutral rate is the level of the cash rate that neither stimulates nor dampens demand once temporary shocks and structural forces have played out. At that point, demand and potential supply will be in balance, with full employment and inflation at target. It is also consistent with global saving and investment being in balance. Some of the RBA's Australian neutral rate models lend themselves more to this long-run concept of neutral.[1]

However, the long-run neutral rate may not correspond to the appropriate setting for the cash rate in the short term because monetary policy may need to respond to temporary influences on activity and inflation. The short-run neutral rate is a related concept that aims to capture these forces. This is the cash rate that neither stimulates nor dampens demand over the next few years, taking account of ongoing shocks and structural changes.[2] The short-run neutral rate is less commonly estimated in the literature, although some models in the RBA's suite provide signals about shorter-run developments, particularly those based on forward-looking financial market pricing. In practice, it is often unclear in real time whether developments are temporary or persistent, meaning that short-run and long-run concepts of neutral can overlap. Consequently, even models that are intended to represent a long-run forecast of the policy rate may partly capture shorter-run trends.

The RBA's forecasts set out our assessment of how shorter-run developments in financial and economic conditions are likely to affect inflation and unemployment, which helps inform the Monetary Policy Board's assessment of the appropriate stance of monetary policy. The forecasts also attempt to capture the direct impact on the economic outlook of structural change, for example by factoring in estimates of the non-accelerating inflation rate of unemployment and potential output. Estimates of neutral rates provide a useful cross-check of the forecasts. These estimates are shaped by many of the same developments but infer their effects from economic data and market prices using different techniques. This provides an additional perspective on developments in the economy but can also make it difficult to tell whether developments driving the neutral rate estimates are reflected in the forecasts. The value of the cross-check comes from understanding what the estimates imply about the stance of monetary policy and what is likely to be driving these estimates.

When examining the neutral rate and its drivers, it is important to consider both domestic and global factors. Australia is a small open economy, which means that we are price takers in global financial (and other) markets given the sizeable influence of capital flows on domestic financial conditions. Hence, shifts in the

global balance of saving and investment will have a large influence on the neutral rate in Australia, though they are not the only influence (see below). Global forces relevant to the neutral rate include productivity growth, demographic trends and government debt levels.

Estimates of neutral rates have increased in the post-pandemic period and there are a range of possible explanations.

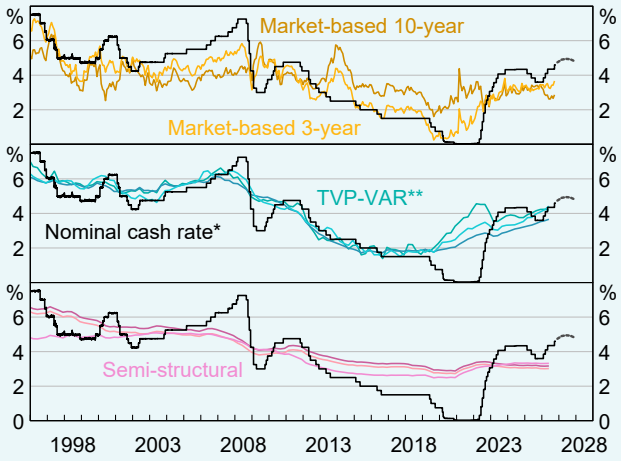
Estimates of the neutral rate in Australia have increased over recent years to be above their pre-pandemic levels, partly reversing a long-run decline (Graph B.1). A similar trend is evident in many advanced economies, including the United States.[3] Although the increase over recent years is relevant to the assessment of the current stance of monetary policy, understanding it requires considering why neutral rate estimates declined over the decades leading up to the pandemic. The research literature has put forward two competing explanations. First, the decline could reflect slow-moving structural factors, such as demographics, weak productivity growth and inequality, that caused 'secular stagnation'. Second, the particularly sharp decline in neutral rate estimates in the 2010s could be picking up more temporary factors, such as the need to repair balance sheets in the aftermath of the global financial crisis (GFC).[4]

The first explanation, secular stagnation, argues that households and businesses increasingly wished to save more, relative to firms' desired investment, placing downward pressure on interest rates.[5] Three possible causes identified in the literature are demographic change, weak productivity growth and rising inequality globally. Population ageing and rising inequality can increase desired saving, while weaker productivity growth can reduce desired investment. Together, these factors will put downward pressure on interest rates. At the same time, a number of governments globally ran substantial fiscal deficits, including because of increased social security expenditure to support ageing populations. The literature argues that the decline in neutral rates would probably have been even larger without these fiscal deficits.

Graph B.1

Nominal Neutral Rate

Suite of models



* Dashed line shows cash rate expectations implied by overnight index swap rates.
** Time-varying parameter vector autoregression models (TVP-VAR).
Source: RBA.

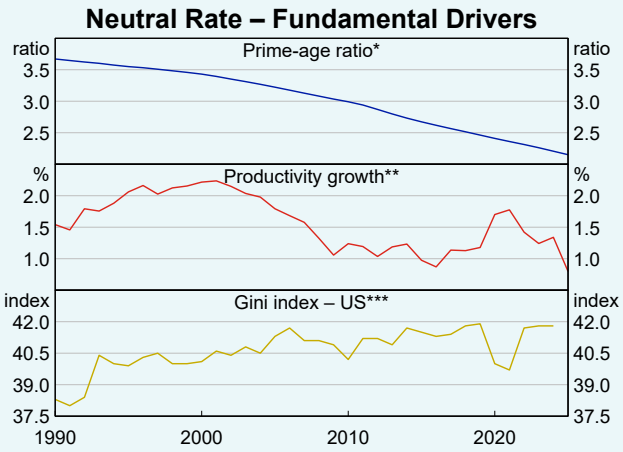
A second explanation is that the unsustainable credit boom in the 2000s and the balance sheet damage caused by the resulting GFC placed persistent, but ultimately temporary, downward pressure on interest rates.[6] This literature argues that many of the slow-moving structural factors associated with secular stagnation do not align with either the steep decline in estimated neutral rates during the 2010s or their subsequent increase. For example, the working-age population has declined relative to the old-age population in the OECD in a relatively steady way that does not match the sharper decline and then rebound in neutral rate estimates. Instead, this literature argues that high levels of household and business debt and large falls in asset prices led households, businesses and financial intermediaries to spend a prolonged period repairing their balance sheets. This desire to increase private saving and reduce private investment worked to lower neutral rates. As the effects of the GFC faded and balance sheets were repaired, this downward influence on neutral should have dissipated.

While the estimates presented above suggest that neutral interest rates have increased materially since the pandemic, the drivers of that increase remain uncertain. The increase over recent years is broadly consistent with explanations that emphasise the fading effects of the GFC, but it could also reflect

changes in longer-running structural factors (Graph B.2; Table B.1). For example, the post-pandemic rise in neutral rate estimates has coincided with a rapid expansion in AI-related investment and stronger US productivity growth than in the 2010s. Higher expected productivity can raise the expected return on investment and encourage businesses to invest more, placing upward pressure on neutral rates. Large and persistent fiscal deficits in advanced overseas economies could also be putting upward pressure on neutral rate estimates by reducing public saving. As a share of GDP, post-pandemic deficits in the United States and elsewhere have been larger than in the late 2010s or before the GFC.

The magnitude of these effects remains highly uncertain.[7] Structural changes, such as in expected future productivity, are hard to measure and do not necessarily occur gradually nor independently of other forces. Newer and ongoing structural changes are likely to be evolving in their effect on neutral rates. The effects of climate change, for example, are ambiguous: additional investment in renewables, including to meet the energy requirements of AI, could put upward pressure on neutral rates, whereas the higher returns required by investors to compensate for physical climate risks could work in the opposite direction.[8] Globally, government deficits have also continued to increase, and political and geopolitical factors could sustain this trend. At the same time, ageing populations and rising inequality continue to weigh on neutral rates.

Graph B.2



* Population aged 25-55 divided by population over 65 for available OECD countries.
** Rolling 5-year average growth in real GDP per hour worked for available OECD countries, weighted by GDP-PPP.
*** Gini index represents the distribution of income among households relative to a perfectly equal distribution. A higher Gini index represents greater income inequality.
Sources: OECD; RBA; World Bank.

Table B.1: Neutral Rate – Selected Potential Drivers(a)

Economic/financial development	Channel	Implication for r*	Persistence
Population ageing	Increases desired household saving	Lower	Structural
Rising inequality	Shifts income towards households with higher saving propensities	Lower	Structural
Stronger/weaker productivity growth	Increases/reduces expected returns to capital and desired investment	Higher/Lower	Structural
Post-GFC balance sheet repair	Raises private saving and reduces investment while households and firms deleverage	Lower	Persistent but temporary
Larger government deficits	Reduce public saving	Higher	Depends on fiscal persistence
Climate change and adaptation	Raises investment in energy transition, while greater physical climate risk can weigh on investment, among others	Ambiguous	Potentially structural

(a) Summary of potential macroeconomic drivers of the neutral rate discussed above and in International Monetary Fund (2023), 'The Natural Rate of Interest: Drivers and Implications for Policy', *World Economic Outlook*, April, Chapter 2. Other potential economic/financial drivers of neutral rates from IMF (2023) include scarcity of safe assets, risk aversion and financial stress.

Sources: IMF (2023); RBA.

The global neutral rate is not the only driver of the neutral rate in Australia.

As mentioned above, global forces have a strong influence on the Australian neutral rate because of Australia's role as a small open economy. However, they do not determine it completely. One study suggests that changes in US neutral rates explain around half of the variation in Australian neutral rate estimates.[9] In theory, once the economy is in balance, shocks have dissipated and monetary policy is therefore no longer responding to domestic or international shocks, the neutral rate in a small open economy should equal the global neutral rate plus a risk premium. This risk premium could reflect impediments to the free flow of capital or differences in the compensation that domestic and international investors require for risk.

There remain considerable uncertainties about both the level and drivers of the neutral rate, which are consequential for policy.

Although neutral interest rates are an important conceptual framework for considering the stance of policy, they cannot be observed directly and are difficult to measure. Different approaches to measuring neutral rates offer different perspectives. Some approaches infer neutral from financial market prices and some are estimated by examining the evolution of macroeconomic variables. The RBA accounts for this uncertainty by examining a range of models. Another source of uncertainty arises from how these statistical models are estimated, meaning that even a single model can produce a wide range of plausible estimates of the neutral rate.[10] And, as noted above, it is difficult to tell in real time how much each model reflects long-run trends rather than shorter-term developments.

Reflecting this uncertainty, policymakers are cautious when interpreting (small) short-term moves. Most models suggest that neutral rates have increased over recent years. However, the rise in long-term bond yields over the year to date could reflect a number of factors other than changes in neutral rates, such as expectations about future inflation and the additional compensation that investors require to hold longer-term bonds (see Box A: How Does an Increase in Longer-term Real Yields Affect Financial Conditions). An increase in long-term yields therefore does not, by itself, mean that the neutral rate has risen.

Even if neutral rates have increased, it is difficult to determine what has driven the increase. The relevance of the long-run neutral rate estimates to current policy is mainly the information they contain about underlying developments in the economy, and whether those are adequately reflected in the RBA's forecasts. The persistence and effects of these developments matter for the appropriate setting of policy over the next few years, as captured by the short-run concept of neutral.

As an example, suppose the emergence of AI technologies leads to a modest increase in global productivity in the long term. This could place some upward pressure on long-run neutral rate estimates without necessarily significantly affecting near-term inflation or the appropriate cash rate today. However, if AI also increased near-term aggregate demand by increasing investment in data centres and related infrastructure, then the appropriate policy response could be to increase the cash rate by more than the change in the long-run neutral rate. Given the uncertainty around both the extent of any increase in neutral rates and the forces driving it, the possibility of a higher neutral rate is partially embedded in the current forecasts and is otherwise being monitored as a source of uncertainty for the outlook (see Chapter 3: Outlook).

The RBA will continue to develop our understanding of the structural drivers of neutral rates and the degree to which they are likely to have implications over different horizons for the appropriate setting of monetary policy. Key areas for research include connecting movements in the neutral rate suite to fundamental economic drivers, including better understanding the 'wedge' between domestic and global neutral rates.

Endnotes

1 See, for example, Kent C (2026), 'Reassessing Australian Financial Conditions', Speech at the KangaNews Debt Capital Market Summit, Sydney, 26 March. Also see Smith P (2025), 'How Developments in International Financial Markets Shape Financial Conditions in Australia', Speech at Australian Securitisation Conference, Sydney, 26 November, on the role of global neutral.

2 See Kent, n 1. Also see Obstfeld M (2023), 'Natural and Neutral Real Interest Rates: Past and Future', NBER Working Paper No 31949.

3 See Federal Reserve Bank of New York (2026), 'Measuring the Natural Rate of Interest', available at <https://www.newyorkfed.org/research/policy/rstar/>.

4 This is not an exhaustive survey of possible drivers of the neutral interest rate; other explanations include changes in the demand for safe and liquid assets and associated convenience yields. See International Monetary Fund (2023), 'The Natural Rate of Interest: Drivers and Implications for Policy', *World Economic Outlook*, April, Chapter 2.

5 See Rachel L and L Summers (2019), 'On Secular Stagnation in the Industrialized World', Brooking Papers on Economic Activity No 26198.

6 Eggerston G and P Krugman (2012), 'Debt, Deleveraging, and the Liquidity Trap: A Fisher-Minsky-Koo Approach', *The Quarterly Journal of Economics*, 127(3), pp 1469–1513; and Rogoff K (2025), 'Debt Supercycle Versus Secular Stagnation', *Journal of Policy Modelling*, 47(4), pp 723–737.

7 See Korinek A *et al* (2026), 'Economic Scenarios for Transformative AI', Centre for Economic Policy Research Paper No 21939.

8 See Angeli M *et al* (2022), 'Climate Change: Possible Macroeconomic Implications', Bank of England *Quarterly Bulletin*, October.

9 Morley J and B Wong (2026), 'How Important is Global R-star for Open Economies?', *European Economic Review*, 188(August), No 105391.

10 For example, in one of the RBA's semi-structural models, the 90 per cent probability interval for the current neutral rate spans around 7 percentage points, indicating that the true neutral rate could be far from the central estimate.

Chapter 2
Economic Conditions

Summary

Global cost pressures from the Middle East conflict and AI boom have increased since August.

- **The re-escalation of the Middle East conflict has pushed up energy prices**, as global energy supply continues to be constrained by disruptions to shipping and damage to refineries. Crude oil and refined product prices have risen by 20–25 per cent and are materially higher than was assumed in the August forecasts. Prices of a range of base metals and agricultural commodities have also increased this year, including because of the conflicts in the Middle East and Ukraine and adverse weather.
- **Global economic activity has been more resilient than expected, underpinned by the AI boom and supportive fiscal measures.** GDP growth in Australia's major trading partners has trended higher over the past few years. Recently, the strength in global AI-related demand and fiscal measures in some major economies have more than offset the negative impacts of the Middle East conflict. The underlying strength in the global economy has added to global cost and price pressures, with the surge in data centre activity creating capacity constraints in related supply chains.
- **The extent to which global cost pressures will pass through to consumer prices is uncertain.** Headline inflation has increased in most economies following increases in energy prices, while core inflation is already above central bank targets in many advanced economies. Policy rate expectations implied by market pricing have increased in many advanced economies, in line with higher near-term inflationary pressures (see Chapter 1: Financial Conditions).

In Australia, GDP growth has slowed this year to a little below its potential growth rate.

- **This largely reflects softer growth in household consumption, consistent with the earlier easing in household income growth, as well as in exports and public demand.** The Middle East conflict is assessed to have had only modest effects on overall domestic activity so far. Notwithstanding the slowing in growth, recent data suggest that activity growth this year has been a bit stronger than anticipated in the August forecasts, supported by very strong investment in data centres.
- **Conditions in the housing market have eased and the unemployment rate has increased, both by more than expected in August.** Housing prices have declined further from their peak in March, primarily reflecting the effects of monetary policy and tax changes announced in the federal budget. The unemployment rate increased to 4.6 per cent in the September quarter. That appears largely to reflect stronger-than-expected labour supply; employment growth held up in the September quarter as expected and liaison and leading indicators suggest a stable near-term outlook for labour demand.

Domestic inflation is elevated and has been stronger than expected recently. We now assess that capacity constraints in the first half of the year were a little tighter than previously judged.

- **Headline inflation was 3.9 per cent over the year to the September quarter and trimmed mean inflation ticked up to 3.7 per cent.** The upside surprise in trimmed mean inflation – relative to the August forecasts – is judged to reflect that domestic capacity pressures this year have been stronger than previously assessed, with the indirect effects of cost pressures related to the Middle East conflict passing through to inflation broadly as anticipated. While the price of fuel has increased strongly, inflation has been broad-based, including significant price increases for a range of market services. This is consistent with elevated growth in unit labour costs. Liaison contacts across most industries continue to report sustained cost pressures.
- **Despite the easing in GDP growth and increase in the unemployment rate we continue to assess that there are some capacity pressures in the economy.** While below-trend GDP growth and rising unemployment by themselves imply that aggregate demand and potential supply are moving closer to balance, a range of data – including persistently high inflation and elevated growth in labour and non-labour input costs – suggest that domestic capacity constraints are greater than previously assessed and so capacity pressures remain. Accordingly, we have raised our estimate of the unemployment rate consistent with low and stable inflation a little, though this estimate remains very uncertain.
- **Some measures of short-term and longer-term inflation expectations have increased since August.** Elevated inflation expectations, including shorter-term expectations, may contribute to higher realised inflation if they influence wage- and price-setting decisions today.

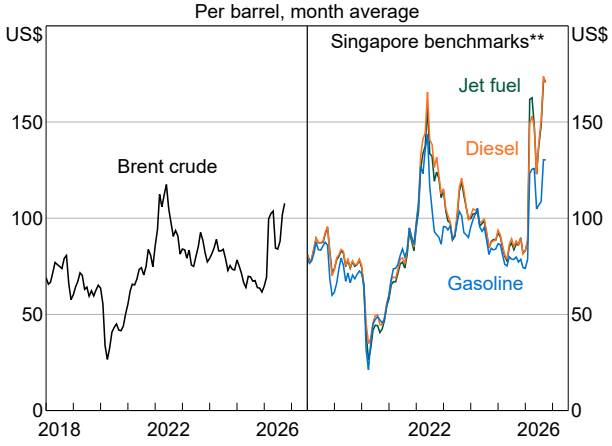
2.1 Commodity price developments

Some of the upside risks to global cost pressures identified in the August *Statement* have materialised. Global oil and refined product prices have increased sharply due to ongoing disruptions related to the Middle East conflict, and these prices are now expected to remain elevated for longer. More broadly, a range of supply disruptions caused by conflicts and adverse weather events, alongside strong AI-related demand, are boosting prices of a range of commodities and inflation in many economies.

Energy prices have increased since the August *Statement*.

Front-month Brent crude oil futures prices have increased by around 25 per cent since the August *Statement* and are currently around US$115 per barrel (Graph 2.1). A renewal of hostilities in the Middle East led to a sharp increase in global crude oil prices in September and October, to around their peak level from earlier this year. That is despite a recovery in crude oil exports from the Middle East owing to the rerouting of oil flows and use of ship-to-ship transfers to enable crude oil flows through the Strait of Hormuz. Elevated prices likely also reflect an increased geopolitical risk premium associated with the risk of further disruption to crude oil flows due to the conflict.

Graph 2.1
Oil and Refined Product Prices*
Per barrel, month average

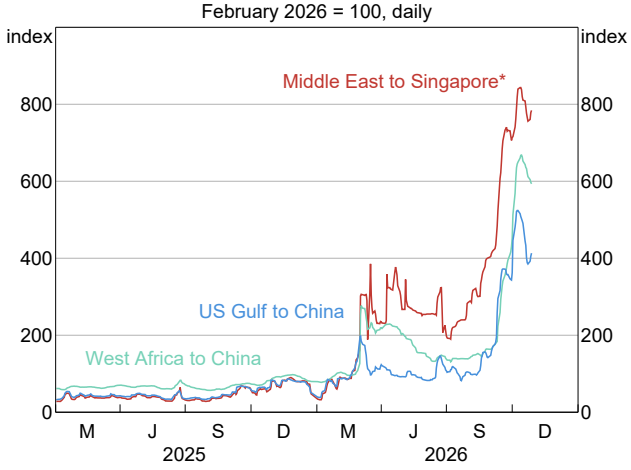


* The October 2026 observation for all series is an average to 28 October.
** Front-month forward prices.
Sources: Bloomberg; RBA.

There continues to be little sign of progress toward a resolution of the conflict and commodity analysts have revised their outlook for oil prices higher in 2026 and 2027. The downward slope of the futures curve has also steepened since the August *Statement*, reflecting tight physical oil supply and falling inventories as conflicts escalated over September and October (see Graph 3.1 in Chapter 3: Outlook).

Prices of refined oil products have increased substantially since the August *Statement*. The spreads between the prices of refined products and crude oil ('crack spreads') have been elevated for some time, reflecting supply constraints. Refined product exports from the Middle East have recovered by less than crude oil exports in recent months. In addition, global refining capacity remains constrained due to outages in Russia and the Middle East, further limiting supplies, particularly of diesel. Since August, gasoline, diesel and jet fuel prices have increased by around 20–25 per cent. That largely reflects increases in the cost of buying and shipping oil, as the rerouting of crude oil and the use of ship-to-ship transfers have caused congestion and raised shipping costs for refiners (Graph 2.2). Market reporting indicates that higher shipping costs have not been fully passed through to refined product prices, as profit margins for some Asian refiners have been squeezed. Compressed margins may discourage refiner production in the near term, helping maintain elevated refined product prices and crack spreads.

Graph 2.2
Crude Oil Shipping Cost Indexes
February 2026 = 100, daily



* Route begins in the Strait of Hormuz. Price formation for this index is likely disrupted.
Sources: LSEG; RBA.

Low inventory levels and a recovery in Chinese oil imports leave energy markets vulnerable to further supply disruptions and upward pressure on prices. A drawdown in global inventories and a reduction in Chinese demand for oil imports helped energy markets absorb the initial impact of the Middle East conflict. While increases in crude oil supply over August and early September allowed for a modest restocking of global crude oil inventories, market analysts estimate that inventories remain around historically low levels. Refined product inventories have continued to decline and are approaching historical minimum levels. Chinese oil imports have increased recently and a sustained recovery – for example, to support inventory restocking – presents an upside risk to global crude oil prices.

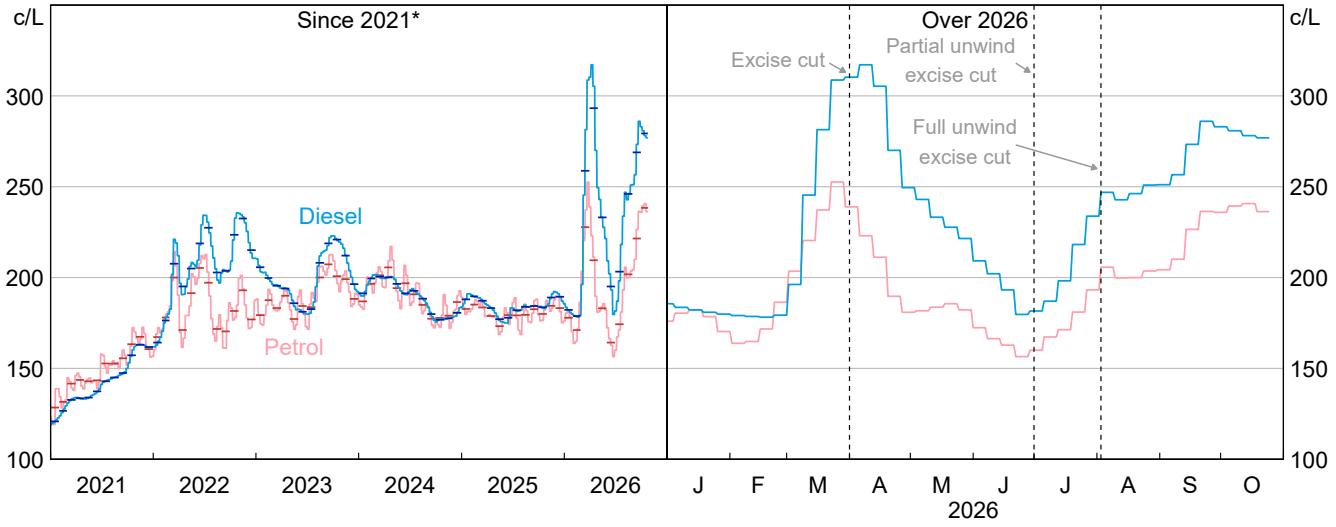
Retail petrol and diesel prices in Australia have increased substantially and are well above the August forecast assumption and their pre-conflict levels (Graph 2.3). The increase reflects both the rise in regional benchmark prices for refined fuel and the ending of the temporary fuel excise reduction in July and August. Nonetheless, refined fuel prices, especially for diesel, remain below the peaks observed earlier this year, which reflected severe dislocations in Asian refined product markets following the announcement of export bans in several exporting countries in the region.

Prices of natural gas have increased in line with other energy commodities. Asian liquefied natural gas (LNG) and European natural gas prices have increased by more than 50 per cent to be around the high levels observed during the early stages of the Middle East conflict, driven by restocking demand in Europe ahead of winter and concerns over future supply from the Middle East.

Graph 2.3

Fuel Prices by Type

Cents per litre, weekly



* Darker horizontal lines are monthly averages.

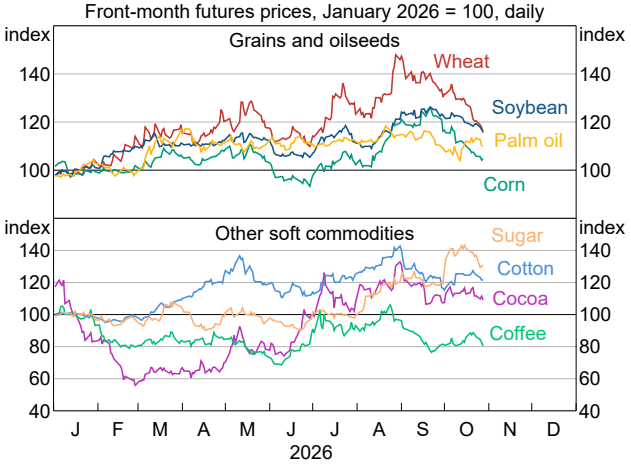
Sources: Australian Institute of Petroleum; RBA.

Supply disruptions continue to affect a range of other commodity prices.

Prices of some base metals have risen since August, while agricultural commodity prices remain elevated. Copper, zinc and aluminium prices remain elevated following mining and shipping disruptions, including due to the Middle East conflict, alongside continued demand pressure from the energy transition and AI-related investment. Prices for agricultural commodities, including wheat, have risen through 2026, following supply chain disruptions in the Middle East and Ukraine (Graph 2.4). The increase in fertiliser prices in March and April as a result of the Middle East conflict may now also be contributing to elevated agricultural commodity prices. Adverse weather conditions, including drought in parts of the United States and repeated heatwaves in Europe, have also affected harvests, pushing up grain prices earlier this year.

The internationally declared El Niño event is yet to materially affect commodity prices but poses risks to agricultural yields and prices over the year ahead. The estimated effects on agricultural output and prices in previous El Niño episodes have varied and tend to differ across both regions and commodities. El Niño can increase the likelihood of extreme weather events, which may exacerbate supply disruptions and contribute to periods of elevated commodity price volatility.

Graph 2.4
Agricultural Commodity Prices
Front-month futures prices, January 2026 = 100, daily



Sources: Bloomberg; RBA.

In terms of key Australian commodity exports, the price of iron ore has fallen slightly, while the price of coking coal has increased by 6 per cent since the August *Statement*. Iron ore price pressures remain subdued as supply remains abundant, while coking coal prices have been boosted by supply disruptions in China and Indonesia.

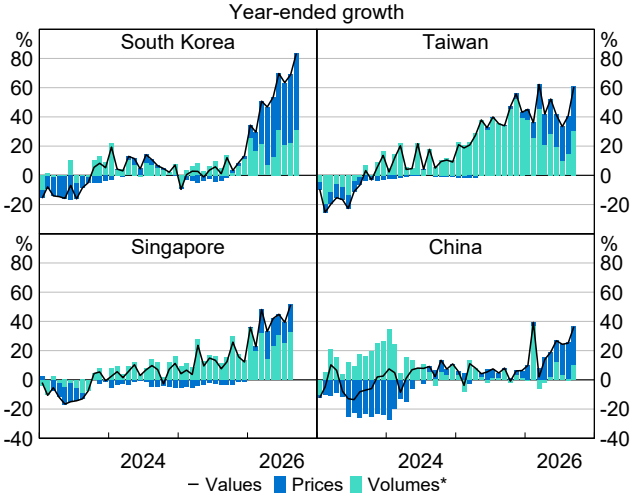
2.2 Global economic conditions

Economic growth in Australia's major trading partners (MTPs) has trended higher and been consistently stronger than expected over the past year or so. MTP growth has been resilient and slightly higher than some estimates of trend growth recently. Growth has been supported by the global surge in AI-related investment, fiscal policy measures targeted at households and business in many economies, and higher defence spending in some economies. Against a backdrop of higher public and private investment, government bond yields have increased across advanced economies; this reflects expectations that policy rates will remain higher for longer, as well as increases in term premia (see Chapter 1: Financial Conditions). Upstream cost pressures are intensifying as capacity in AI-related supply chains struggles to keep pace with soaring demand – particularly in high-income east Asia – and global energy prices have been persistently elevated. These pressures are passing through to some consumer goods prices. The rise in goods prices has occurred alongside a stalling in disinflation in services prices, leaving core measures of inflation elevated relative to central banks' targets. Central bank policy responses are discussed in Chapter 1: Financial Conditions.

MTP growth has been stronger than expected in the August *Statement*, supported by the boom in AI-related investment that has more than offset headwinds from the Middle East conflict.

Growth in Australia's trading partners remained resilient in the June and likely also the September quarters, partly reflecting the global investment boom, particularly for AI-enabling products. GDP growth was stronger than expected in economies with significant exposure to AI-related supply chains, such as South Korea and Singapore, reflecting robust net exports and an increase in construction activity. Timely trade data across several east Asian economies indicate that export prices continued to rise sharply in the September quarter – by around 40 per cent in year-ended terms in South Korea – consistent with manufacturing capacity being fully utilised, compounding cost pressures from higher energy prices (Graph 2.5). These upstream cost pressures have flowed through east Asian supply chains and into some consumer goods prices.

Graph 2.5
East Asia Goods Exports
Year-ended growth



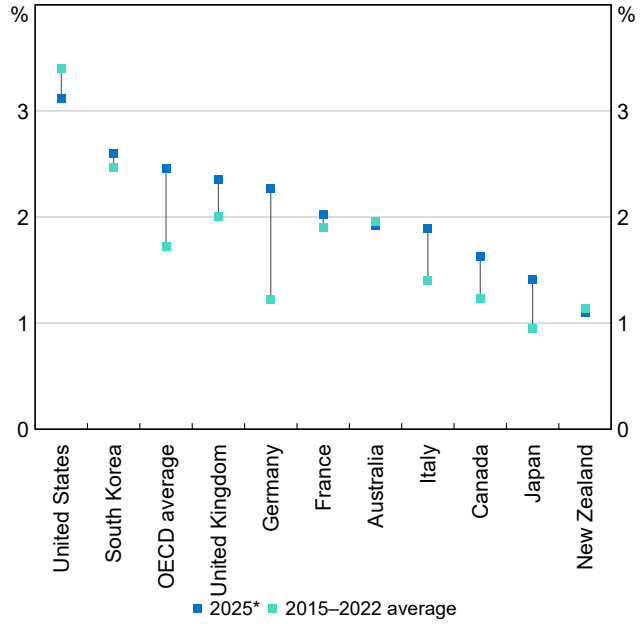
* Volumes are implied from US dollar export values and export price indices.
Sources: CEIC Data; LSEG; RBA.

Outside of east Asia, growth in advanced economies appears to have remained steady in the September quarter following stronger-than-expected growth in the June quarter. Timely indicators point to continued strength in manufacturing activity and investment in the September quarter, reflecting AI- and defence-related demand. Business surveys also suggest that services activity growth may have strengthened in the September quarter. In the United States, household consumption and private sector labour demand remain resilient despite higher energy prices; retail sales growth over August and September was strong, while employment growth has remained broadly in line with estimates of labour supply growth, leaving the unemployment rate little changed.

Growth in many trading partners has also been supported by fiscal policies shielding households and businesses from higher energy costs, as well as rising defence spending in some economies. In the first half of the year, many governments implemented tax cuts, subsidies and fiscal transfers to support households and businesses through the Middle East energy shock. While there had been a gradual shift away from subsidies and price caps for retail fuel, allowing

upstream cost increases to pass through to producer and consumer prices, some trading partners have extended or re-introduced these policies following more recent increases in refined product prices globally. Defence spending has also supported growth in some trading partners, particularly in the euro area where its share in GDP has increased since Russia's invasion of Ukraine in 2022 (Graph 2.6). The impact of higher government spending (and other factors) on government bond yields globally is discussed further in Box B: Developments in the Neutral Rate of Interest.

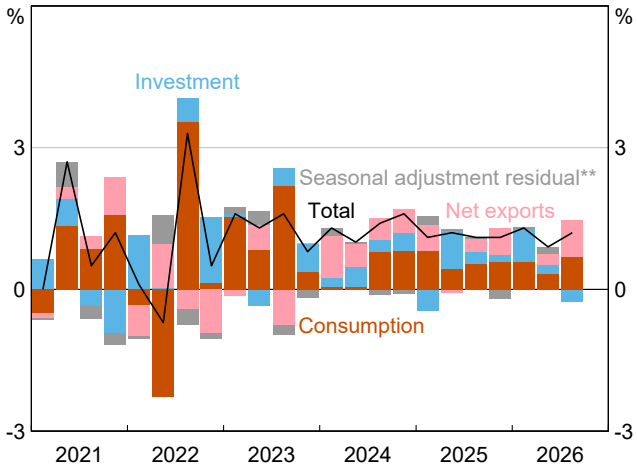
Graph 2.6
Defence Spending in Selected Major Trading Partners
Share of GDP



* Data are OECD estimates.
Sources: OECD; RBA.

consumption, lifting the savings ratio amid ongoing weakness in household sentiment and spending. Monthly indicators suggest that there was some improvement in momentum towards the end of the quarter, led by fixed asset investment and industrial production as authorities continue to prioritise development of advanced manufacturing and 'Six Networks' infrastructure projects.[1] Local government special bond issuance increased in August and September, which should support infrastructure investment further over the coming months. Property sector activity continued to decline. Developments in the Middle East conflict and the AI-investment boom have affected Chinese trade flows and contributed to large increases in Chinese export prices.

Graph 2.7
China – GDP Growth*
Quarterly with estimated contributions



* Components seasonally adjusted by the RBA and their contributions calculated by the RBA.
** Reflects the difference between RBA and NBS seasonal adjustment.
Sources: CEIC Data; RBA.

GDP growth in China rebounded in the September quarter which, alongside the announcement of additional policy support, means that growth is on track to achieve the annual GDP growth target.

Chinese economic activity strengthened over the September quarter, following a period of subdued activity. Growth was supported by a moderate increase in consumption and a large positive contribution from net exports, while investment declined (Graph 2.7). Household income growth continued to outpace

In response to subdued growth in the middle of the year, authorities shifted to a more supportive policy stance and reaffirmed their commitment to achieve the 2026 annual growth target. The new policy measures include expanding policy bank lending to cover infrastructure projects that are part of the 'Six Networks' construction initiative and allowing local governments to draw on unused special bond quotas from previous years. Alongside other adjustments to monetary policy settings and mortgage policies, the new measures signal that lifting economic growth to achieve the annual target has become more of a policy priority, which should support a strong increase in infrastructure investment over the remainder of 2026 and early 2027.

Core inflation remains elevated in many economies and energy and upstream AI cost pressures have intensified.

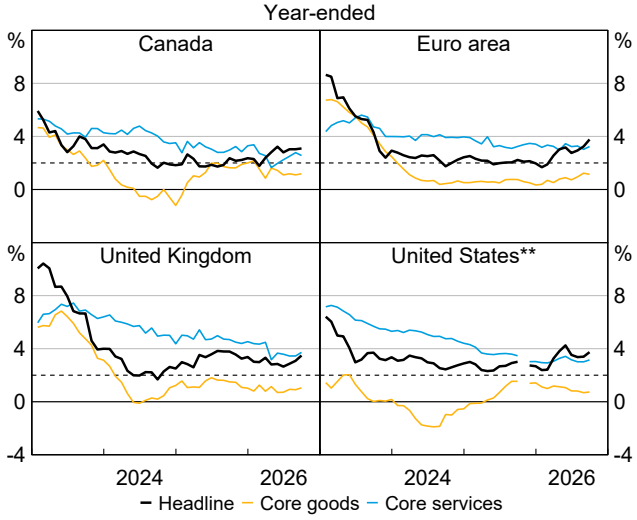
Headline inflation has risen across most economies, driven by higher energy prices following the re-escalation of hostilities in the Middle East (Graph 2.8). Most advanced economy central banks have revised their near-term headline inflation forecasts higher to reflect elevated energy prices, though most still expect inflation to return to target by 2028. Available measures of households' longer-term inflation expectations have risen in some advanced economies, in line with higher energy price inflation. Producer prices and a range of indicators from timely business surveys suggest that cost pressures for firms in all advanced economies remain elevated due to higher energy, materials and transport prices related to suply disruptions caused by the Middle East conflict. Some firms also report limited ability to pass cost increases on to price-sensitive consumers.

Upstream costs in AI-related supply chains are passing through to some core consumer goods prices, while disinflation in services prices has stalled, leaving core inflation elevated. Core goods inflation has picked up in many advanced economies this year and remains above its pre-pandemic averages in most economies. Prices of some consumer electronics have risen sharply as upstream costs in AI-related supply chains have been passed through to related consumer goods like personal computers. Impacts on aggregate headline and core measures of inflation have so far been limited because the affected goods tend to have small weights in consumer price baskets. Core services inflation remains above rates consistent with central bank targets and progress on disinflation in a number of advanced economies has stalled alongside upward pressure on transportation costs and signs of strengthening activity in their services sectors.

Graph 2.8

Goods and Services Consumer Price Inflation*

Year-ended

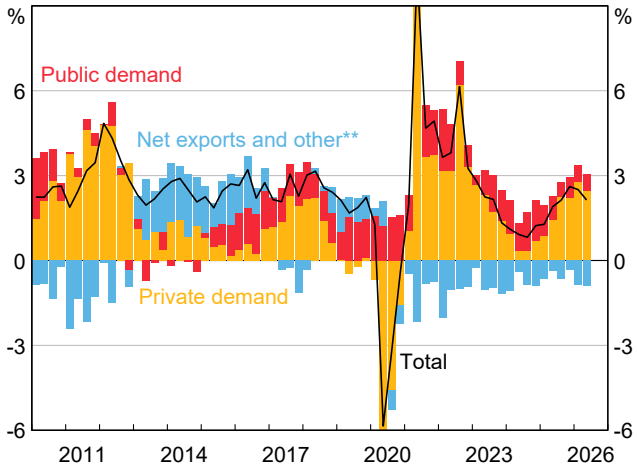


* Dashed line is the central bank headline inflation target or midpoint of central bank target range; PCE inflation target for the United States.
** CPI data not available for October 2025.
Sources: BLS; Eurostat; LSEG; RBA.

2.3 Domestic economic activity

GDP growth has slowed to below its potential growth rate in 2026, as some of the factors that supported above-trend growth in late 2025 (including strong growth in income) have waned. The initial phase of the Middle East conflict looks to have weighed only modestly on activity growth, as expected. However, the slowing has been a little more gradual than was expected in August, largely reflecting stronger-than-expected business investment related to data centres and the renewable energy transition. Household consumption growth has moderated broadly as expected, despite consumer sentiment being very low, supported by resilient household balance sheets and modest real income growth. By contrast, housing market conditions have eased by more than expected over recent months.

Graph 2.9
GDP Growth*
Year-ended with contributions



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

Growth in domestic activity has slowed in 2026 following strong growth over the second half of 2025.

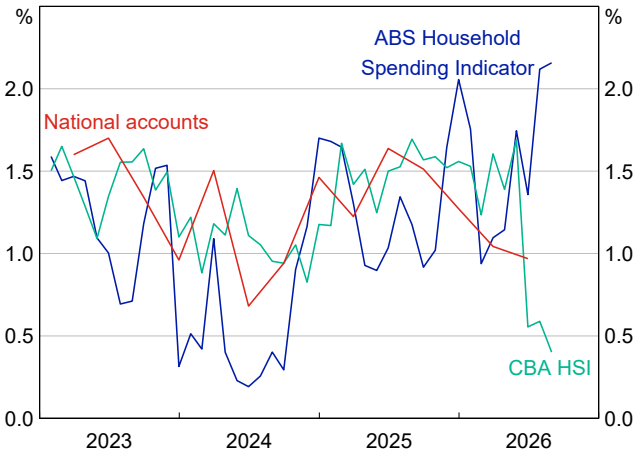
GDP grew by 0.4 per cent in the June quarter, below its potential growth rate but a little stronger than expected in the August forecasts (Graph 2.9). Growth eased in the first half of 2026. That reflected softer growth in household consumption, exports and public demand, which outweighed strong growth in dwelling investment and business investment. The strength in business investment was relatively broad-based, though spending related to data centres and renewable energy projects was particularly strong. Investment in data centres has mostly been met by stronger imports, which has limited the impact on overall GDP. Given the usual lags, the recent tightening in monetary policy and easing in conditions in the established housing market are assessed to have had only modest effects on GDP growth in the first half of the year.

Household consumption growth has slowed this year to be a little below trend, consistent with the earlier slowing in the growth of household income.

Consumption growth in the June quarter was as expected, with the net effects from the Middle East conflict appearing to be modest. Household consumption grew by 0.4 per cent in the quarter and year-ended growth slowed to 1.8 per cent alongside slowing growth in income. Australians' spending on overseas travel fell sharply in the quarter, and consumption of fuel and transport services declined. However, this was largely offset by stronger electric vehicle purchases and discretionary spending domestically.

We assess that consumption growth in the September quarter was little changed from the June quarter's below-trend rate, though given the mixed signals from the available timely indicators, this assessment is quite uncertain (Graph 2.10). The ABS Household Spending Indicator, which captures spending within Australia, was unchanged in August but points to strong quarterly growth in nominal spending. However, other indicators, including liaison and transaction data from some banks, suggest more modest growth. Vehicle purchases remained at very high levels in July and August but are not expected to contribute much to growth in the quarter. There appears to have been only a modest recovery in overseas travel so far, based on spending and departures data.

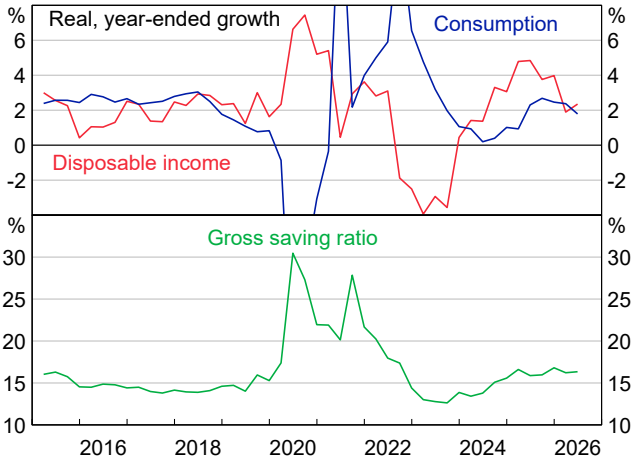
Graph 2.10
Household Consumption Indicators*
Nominal, quarterly growth



* CBA HSI and the ABS Household Spending Indicator are three-month-on-three-month growth rates as these series are monthly.
Sources: ABS; CBA; RBA.

The moderation in consumption growth this year, compared with the second half of last year, is consistent with the earlier slowing in growth in household income. Year-ended growth in real household disposable income has slowed materially as the earlier boost from the Stage 3 tax cuts has waned, alongside slower growth in labour and rental income and higher inflation (Graph 2.11). Despite consumer sentiment remaining near all-time lows (across all income levels and for both renters and homeowners, regardless of whether they have a mortgage), the household saving ratio has been relatively stable since the start of the year, suggesting little change in aggregate consumption or saving behaviour so far. This is consistent with the fact that household balance sheets remain quite resilient on average – real household net wealth remains around 37 per cent higher than its pre-pandemic level – and with the results of previous analysis that sentiment is typically not an independent driver of consumption over and above fundamentals such as income and wealth. However, there is a risk that the multiple headwinds affecting households and historically low sentiment have a greater bearing on household spending decisions than would normally be expected (see Chapter 3: Outlook).

Graph 2.11
Household Consumption and Income*

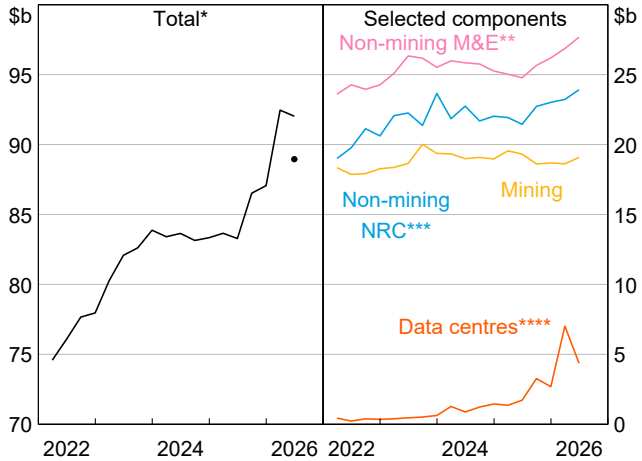


* Outliers during the COVID-19 pandemic have been truncated.
Sources: ABS; RBA.

Business investment grew strongly over the past year; while increased investment in data centres and renewable energy projects were key drivers, investment picked up across other industries too.

Business investment in the June quarter was significantly stronger than expected, increasing by 10.5 per cent over the year (Graph 2.12). While investment declined a little in the quarter, we had expected a larger decline following very strong growth in the March quarter related to data centres. Non-residential construction, particularly of lumpy renewable energy projects (unrelated to data centres), made the largest contribution to the upside surprise on investment. Data centre investment grew strongly over the past year but was volatile. Much of this spending was on imported equipment, which limited the boost to GDP. Strength in investment was also evident across a broad range of industries, consistent with the earlier easing in financial conditions and the upswing in domestic activity through 2025.

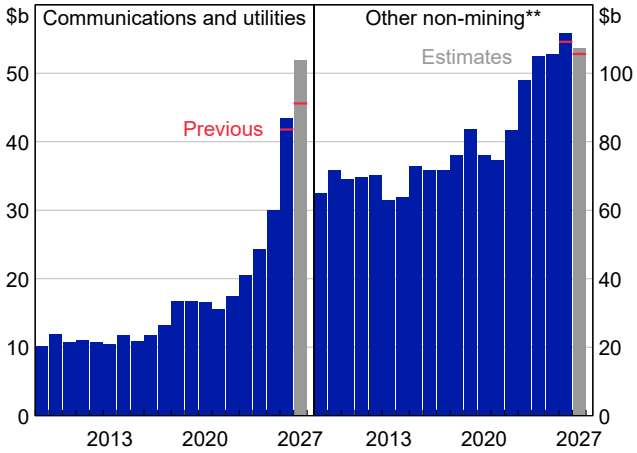
Graph 2.12
Business Investment
Chain volume, quarterly



* Dot represents nowcast at August 2026 SMP for comparison.
** Non-mining machinery & equipment; excluding investment in data centres.
*** Non-mining non-residential construction; excluding investment in data centres.
**** Estimate of data centre spending derived from information media & telecommunications capital expenditure and subject to assumptions.
Sources: ABS; RBA.

Firms' surveyed capital expenditure intentions for the year ahead have been revised higher, underpinned by strong growth in expected investment in data centres and renewables (Graph 2.13). Building approvals for these industries have risen persistently and firms in the liaison program note that buoyant conditions for data centre development could support renewable energy investment in the medium term. Timely trade data point to strong data centre investment in the September quarter; imports of equipment related to data centre fit outs increased sharply in July and August, while prices are also expected to have risen alongside surging global demand for AI-enabling products.

Graph 2.13
Non-mining Capital Expenditure*
Nominal, financial year



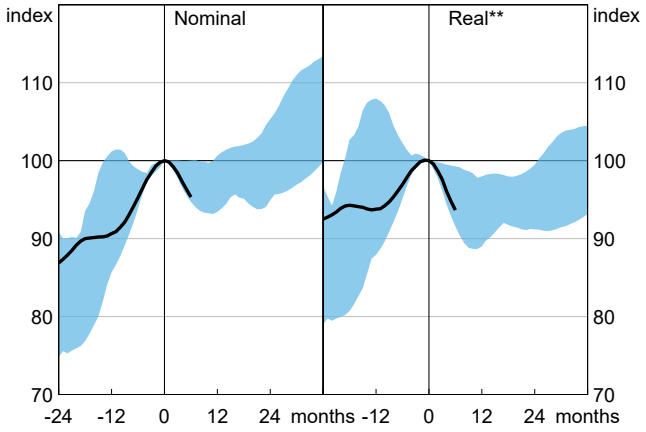
* Data from Capex survey. Estimates are firms' expected capital expenditure adjusted for the historical average difference between expected and realised spending. Survey estimates are typically below the level of business investment recorded in the National Accounts due to differences in coverage, definitions and sources.
** Excluding communications and utilities.
Sources: ABS; RBA.

Outside of data centres and renewables, capital expenditure intentions suggest investment will decline a little but remain around the average level of recent years. The effects of tighter monetary policy and cost pressures related to the Middle East conflict appear to be dampening capital expenditure intentions a little. Surveyed business conditions in the September quarter declined to their lowest level since 2020, consistent with continued input cost growth in recent months weighing on profitability, while business confidence also remains very low. However, there is only a moderate correlation between business conditions, business confidence and investment activity. Notwithstanding the modest decline expected over the year ahead, firms in the liaison program expect investment to remain a little above the long-term average.

Established housing market conditions have continued to weaken by more than expected, driven by a range of factors, including higher interest rates and tax changes for investors.

In September, national housing prices were 4.7 per cent below their recent peak (Graph 2.14). The current downturn is one of the steepest over the past 50 years, and price declines have broadened to most capital cities. Housing market activity has also continued to soften, with auction clearance rates remaining very low, time on market rising sharply to above long-run average levels and housing market turnover declining to low levels.

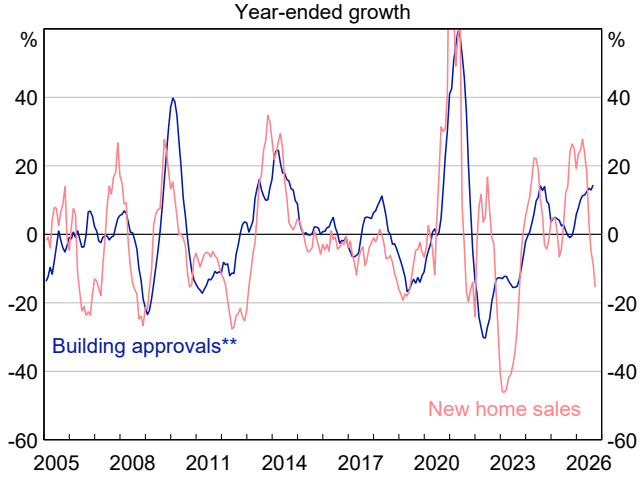
Graph 2.14
Housing Price Downturns*
Indexed to nominal pre-downturn peak



* Shaded area shows the range across previous downturns; the line is the current cycle.
** Deflated by quarterly trimmed mean CPI, interpolated to months.
Sources: ABS; Cotality; RBA.

Dwelling investment was much stronger than expected over the first half of 2026, although leading indicators of activity have started to soften, consistent with the ongoing housing market downturn (Graph 2.15). Activity was stronger than expected in the June quarter and there were also upward revisions to earlier periods, suggesting there is more capacity in the sector than previously assessed. Growth in higher density construction and renovation activity were particularly strong, but construction of detached housing also increased over the year. Elevated cost growth and trade availability measures remain consistent with ongoing capacity pressures. Consistent with the usual lags, early indications of a softening in residential construction activity have become visible in recent months following the declines in established housing prices. HIA new home sales, a leading indicator of dwelling demand, have declined materially, and many builders in the liaison program have reported a decline in enquiries, buyer conversion rates and sales.

Graph 2.15
Dwelling Investment Indicators*
Year-ended growth



* Three-month moving average of year-ended growth rates. Outliers during the COVID-19 pandemic have been truncated.
** Detached building approvals.
Sources: ABS; HIA; RBA.

Public demand growth has moderated over the past year.

Public demand was weaker than expected over the first half of the year, with growth moderating from elevated rates observed over recent years. An easing in public consumption growth reflected the ending of some temporary cost-of-living measures, alongside moderation in some categories of government spending such as defence and disability and aged care services. Public investment has moved around a broadly stable level since late 2024, and budget projections continue to suggest that there is a substantial pipeline of public infrastructure projects.

Exports supported GDP growth in the June quarter, though the strength largely reflected temporary supply factors and growth has slowed since late 2025.

Exports increased by 0.8 per cent in the quarter, in line with expectations and driven by resource and manufactured exports, though year-ended growth slowed further. A rebound in resource exports largely reflected a recovery from weather-related disruptions in the previous quarter, met by strong mining inventory drawdowns. As expected, the effect of the Middle East conflict on resource exports has largely operated through higher commodity prices and export earnings; production and export volumes are unlikely to respond materially to price movements unless higher prices are expected to persist, given the long lead times for new investments. Services exports have declined this year, reflecting declines in both education and tourism exports, with support from stronger global growth offset by changes to student visa settings, some disruption to international travel from the Middle East conflict, and the appreciation of the Australian dollar since late last year. The boom in AI-related activity globally does not appear to have had a material influence on Australia's exports, as production of critical minerals remains small and the expansion in data centre capacity has been to service domestic demand for computing capacity.

2.4 Labour market and wages

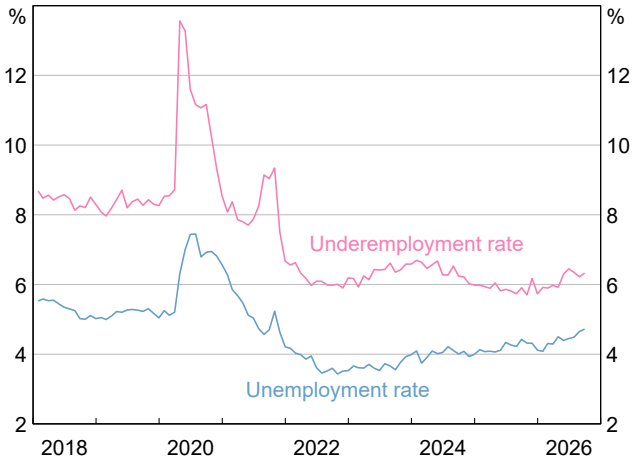
Labour market conditions have eased by more than expected recently. This easing is judged largely to reflect stronger-than-expected labour supply, rather than an unexpected weakening in labour demand. Elevated cost-of-living pressures may be leading some people to seek additional hours or enter the labour force, which may be contributing to the increase in labour supply. Timely indicators of labour demand, such as job advertisements, are generally consistent with stable growth in labour demand in the near term, though signals differ across the measures. Despite the recent easing in conditions, we continue to assess that the labour market remains a little tight (see section 2.5 Assessment of spare capacity). Wages growth was stable over the first half of 2026 and in line with expectations, though growth in unit labour costs picked up in the first half of the year to be further above average, and a little stronger than anticipated. Liaison contacts' expectations for wages growth over the year ahead remain elevated, driven by an expected continuation of cost-of-living pressures.

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

The unemployment rate was 4.7 per cent in the month of September, and averaged 4.6 per cent in the September quarter (Graph 2.16).[2] This was higher than our August *Statement* forecast of 4.4 per cent for the quarter and was accounted for by stronger-than-expected labour force participation rather than weaker-than-expected employment. The underemployment rate increased to 6.3 per cent in September, though remained low by historical standards.

Over the year to the June quarter, employment growth was increasingly driven by the market sector, with construction making the largest contribution to growth. In the September quarter, the employment-to-population ratio was 63.8 per cent, in line with expectations in August (Graph 2.17). After declining for a few months, average hours per worker have partially recovered recently, to be near their levels at the beginning of the year (Graph 2.17).

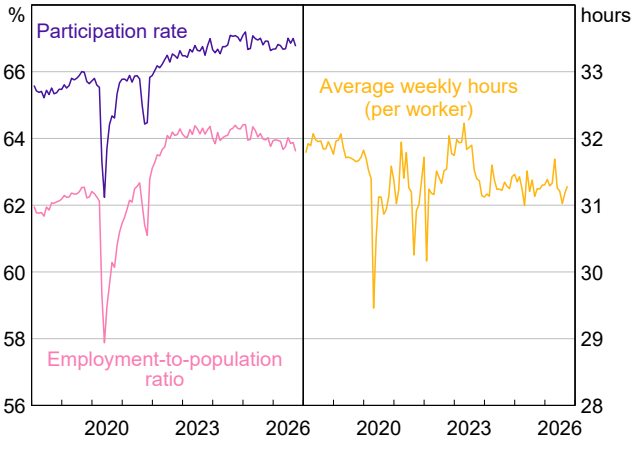
Graph 2.16
Labour Underutilisation



Source: ABS.

The participation rate increased to 66.9 per cent in the September quarter, above our expectations, reflecting ongoing resilience in labour supply (Graph 2.17). The participation rate remained around historically high levels, supported by long-run trends such as higher female participation, as well as cyclical pressures – such as elevated cost-of-living pressures – which may be encouraging people to enter or remain in the labour force. The share of employed persons holding multiple jobs also increased sharply from 6.5 per cent to 6.9 per cent in the June quarter.

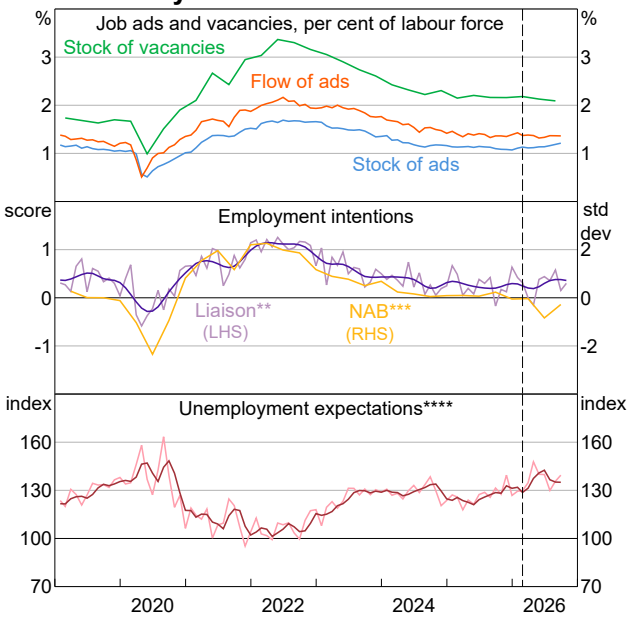
Graph 2.17
Labour Market Indicators



Sources: ABS; RBA.

Leading indicators generally point to stable growth in labour demand in the near term, although the signal differs somewhat across measures. Job advertisements have increased slightly or remained broadly stable over recent months, while vacancies (as a share of the labour force) declined in the past quarter (Graph 2.18). Employment intentions from business surveys partially rebounded in the quarter and the measure from the RBA's liaison program has also strengthened a little since earlier in the year. Households' unemployment expectations have ticked back up in August and September to be a little above their long-run average.

Graph 2.18
Timely Labour Market Indicators*

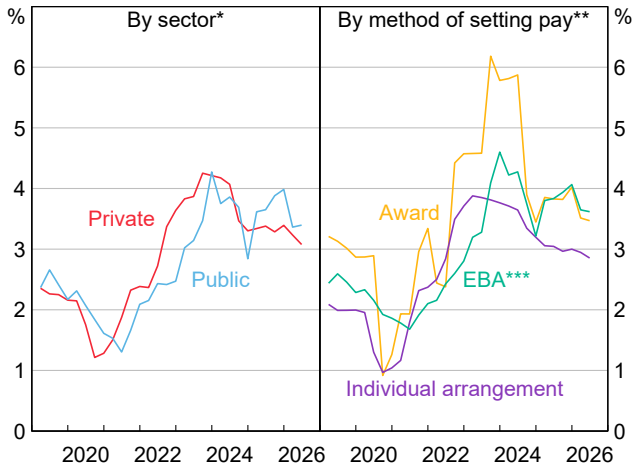


* Dashed line shows the start of the Middle East conflict.
** Score of 0 indicates a firm has reported no change; dark line shows Henderson trend.
*** 12 months ahead; standard deviations from mean.
**** Dark line shows three-month moving average.
Sources: ABS; ANZ–Indeed; JSA; NAB; RBA; Westpac–Melbourne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

Aggregate wages growth remained stable (at a relatively elevated rate) in the June quarter, as expected, but liaison contacts report a noticeable increase in wages growth since July.

The June quarter Wage Price Index (WPI) affirmed our assessment in the August *Statement* that growth in base wages had remained broadly stable. The WPI increased by 3.2 per cent over the year; private sector WPI growth remained broadly stable at 0.7 per cent in the quarter and eased to 3.1 per cent over the year, as expected (Graph 2.19). Wages growth for workers on individual arrangements – which tends to be most responsive to current labour market conditions – remained at 2.9 per cent over the year but eased a little relative to its pace in 2025, consistent with an easing in labour market conditions since then. Public sector WPI growth remained stronger than private sector WPI growth. Overall, the June quarter data are consistent with our assessment that labour market conditions remain a little tight.

Graph 2.19
Wages Growth
Year-ended



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

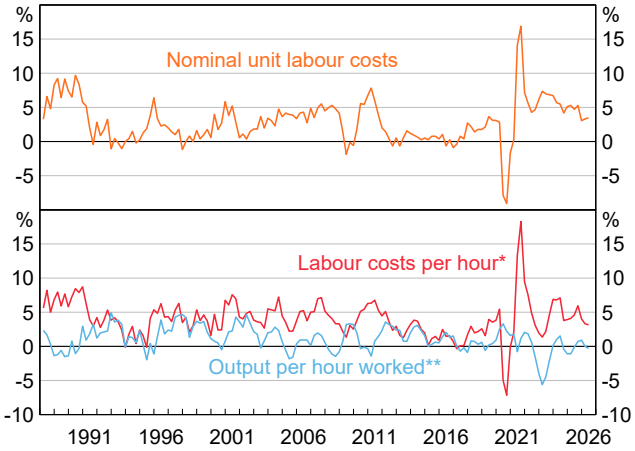
Wages growth is expected to have picked up in the September quarter, in part reflecting the recent Fair Work Commission (FWC) decision to increase all modern award wages by 4.75 per cent. Meanwhile, some pass-through from higher inflation to private enterprise bargaining agreements and individual arrangements is expected to have supported wages growth, as workers seek to preserve recent real wage gains. Consistent with this, liaison contacts have reported that wages growth has increased noticeably since July, including for firms that are not reliant on awards for setting wages. Liaison contacts' expectations for wages growth over the year ahead remain elevated, driven by an expected continuation of cost-of-living pressures.

Growth in the national accounts' measure of average earnings per hour (AENA) eased to 3.2 per cent over the year to the June quarter. AENA growth was stronger than forecast in the August *Statement*, suggesting there was a little more momentum in labour costs than previously expected. AENA is a broader measure of labour costs than the WPI but tends to be more volatile, and so provides a noisier read on wage pressures arising from conditions in the labour market. In real terms, AENA has grown by more than real WPI in recent years and is above its pre-pandemic level. Despite the easing in average earnings growth, it remained elevated relative to the current pace of productivity growth, and weaker productivity growth contributed to an increase in growth in unit labour costs (ULCs) in the first half of this year (Graph 2.20). At 3.5 per cent in year-ended terms, ULCs growth remained significantly above the rate that is consistent with inflation being at target, contributing to ongoing domestic cost pressures and pointing to some tightness in labour market conditions.

Graph 2.20

Nominal Unit Labour Cost Growth

Non-farm, year-ended



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

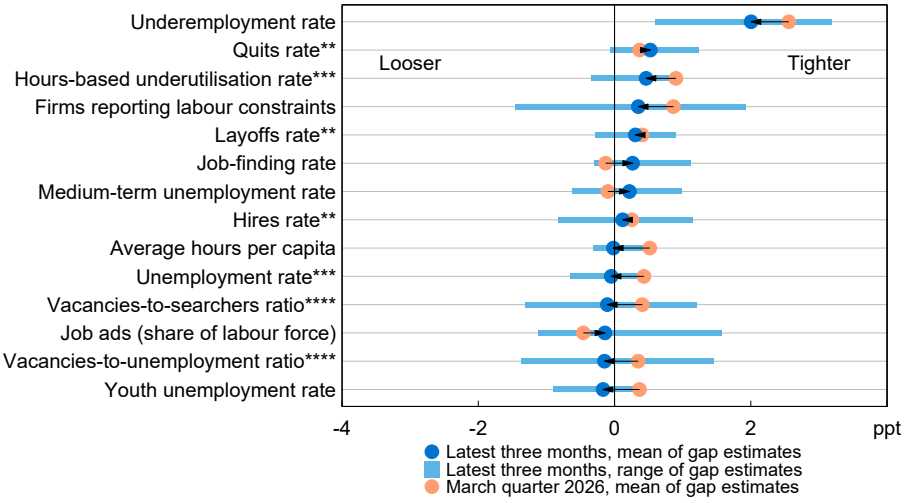
2.5 Assessment of spare capacity

Despite the recent slowing in demand growth and easing in labour market conditions, we continue to assess that there are some capacity pressures in the Australian economy. Further, those capacity pressures are now assessed to have been a little greater over the first half of the year than we thought at the time of the August *Statement*. A number of factors support this judgement, including: strong ongoing domestically generated cost and price pressures, particularly in components most sensitive to domestic capacity pressures; continued weak productivity outcomes; and survey evidence pointing to elevated capacity pressures. Consistent with that, we have raised our assessment of the non-accelerating inflation rate of unemployment (NAIRU) a little. A higher NAIRU implies tighter labour market conditions for a given unemployment rate. As a result, despite actual unemployment having increased recently, we assess that the labour market remains a little tight, broadly as anticipated in August.

Labour market conditions have eased over recent months, but are judged to remain a little tight.

Most of the labour market indicators we monitor suggest some easing in conditions over recent months. But a majority are close to or slightly tighter than their estimated trend levels (Graph 2.21).[3] The underemployment rate, hours-based underutilisation rate and quits rate in particular point to some tightness in the labour market.

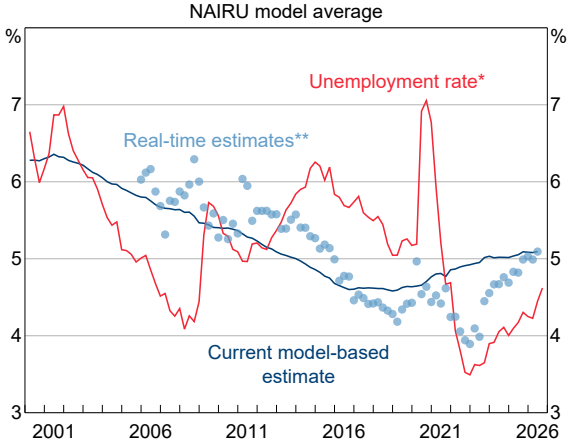
Graph 2.21
Indicators of Labour Market Tightness*
Gap between current conditions and estimated trends



* Indicators scaled to the units of the unemployment rate.
** Latest observations are for June quarter 2026.
*** Range includes model-based estimates.
**** Log-transformed.
Sources: ABS; ANZ–Indeed; NAB; RBA.

Model-based estimates of the NAIRU have gradually moved higher over recent years. The model average is now around 5 per cent (Graph 2.22), although these estimates are just one input to our overall assessment of the NAIRU (see below), alongside evidence from the broader suite of indicators and judgement. Model-based estimates have moved higher in response to persistently elevated unit labour cost growth and inflation over recent years.

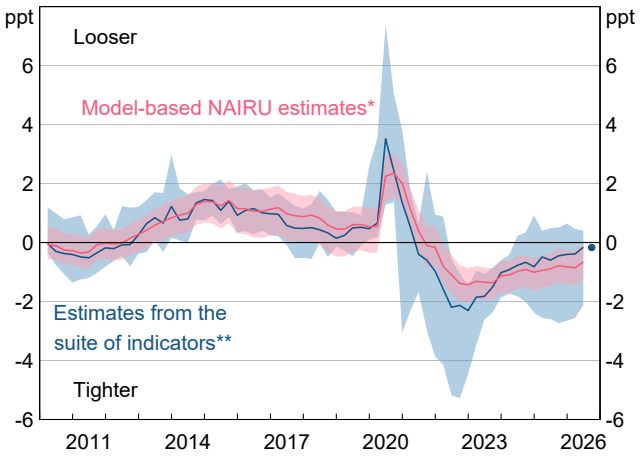
Graph 2.22
Model-based NAIRU Estimates
NAIRU model average



* Quarterly average of monthly data.
** Up to March quarter 2024, dots are model-based NAIRU endpoint reconstructions applying a consistent model framework to the data available at each point in time. See Sullivan and West (forthcoming). From June quarter 2024, dots are model-based NAIRU endpoint estimates as produced at the time, including any model framework changes. These do not reflect the RBA's overall assessment of the NAIRU at the time.
Sources: ABS; RBA.

We now assess the NAIRU to be slightly higher than was factored into the August forecasts. For some time we have noted that our model-based estimates have been pointing to a higher NAIRU – and therefore more capacity pressures – than the broader suite of labour market indicators (Graph 2.23). Our overall assessment has generally taken more signal from the broader set of indicators. However, underlying inflation and labour cost growth have been persistently elevated, and stronger than expected recently (see section 2.6 Inflation). These outcomes suggest putting a little more weight on the model-based estimates than we had been doing. Accordingly, we are increasing our assessment of the NAIRU to around 4¾ per cent. This is a modest adjustment when compared with the range of uncertainty around estimates from either the models or broader set of indicators.

Graph 2.23
Labour Market Spare Capacity



* Red line shows the model average and swathe shows the highest and lowest bounds of the one-standard-error confidence intervals across the selection of models.
** Blue line shows median indicator, swathe shows range of indicators and dot indicates partial estimate of median indicator for September quarter 2026.
Source: RBA.

Given this judgement, we continue to assess that the labour market is a little tight, despite the recent easing in a number of indicators. The revision to our NAIRU estimate implies that the labour market was a little tighter through the first half of this year than previously assessed. It also implies that there was a small amount of tightness remaining in the September quarter, despite the unemployment rate having increased by more than expected in recent months (because the unemployment rate remained a little below our upwardly revised assessment of the NAIRU). That is consistent with the signal from the broader suite of labour market indicators for the September quarter, which continue to suggest a little tightness in labour market conditions.

Economy-wide indicators continue to suggest that some capacity pressures remain in the broader economy, consistent with the signal from the labour market. The June quarter output gap is now estimated to have been a little larger than assessed in August.

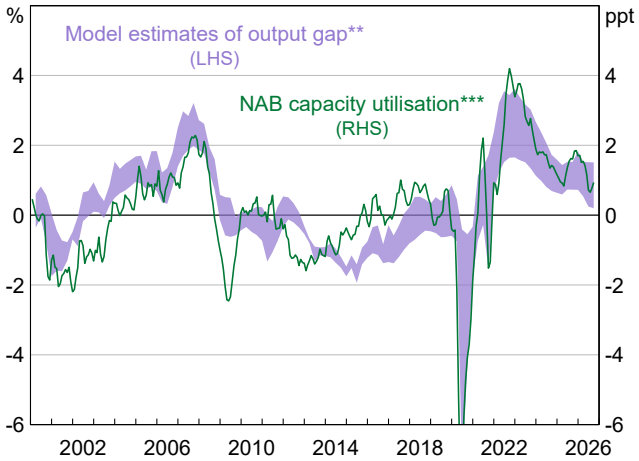
Slower productivity growth has lowered the economy's potential growth rate compared with previous decades. The level of productivity is broadly unchanged since the end of 2019. This has contributed to capacity pressures persisting despite relatively modest GDP growth in recent years. Combined with resilient wages growth and elevated growth in non-labour input costs, the lack of productivity improvement is likely to have limited firms' ability to absorb higher costs without raising output prices and to have contributed to inflation being above the target range.

Indicators of capacity utilisation continue to point to there being some capacity pressures in the economy. Signals across sectors are mixed, but the NAB measure of capacity utilisation remains above its historical average. There is also marked variation across states, with business liaison suggesting that parts of Queensland in particular continue to face capacity constraints, whereas conditions are less tight in Victoria.

Taking survey evidence together with model-based estimates of the output gap, we assess that the output gap was positive in the June and September quarters (Graph 2.24) and slightly larger than assessed in August. That reflects both stronger-than-expected real activity data and a small downward judgement applied to the level of potential output. This is consistent with our judgement on the NAIRU; other things equal, a higher NAIRU implies lower potential supply capacity. Our judgement on potential output and the output gap is relatively modest compared with the uncertainty around estimates of capacity pressures; the range of model estimates and responses to the RBA survey of market economists in August suggests the output gap could be between zero and 1½ per cent. An alternative rationale for downwardly adjusting the level of potential output would be to take greater signal from the weakness in actual productivity outcomes for the trend level of productivity. We have not changed our expectation of potential output growth and productivity growth in the medium term.

Graph 2.24

Estimates of Capacity Utilisation*



* Outliers during the COVID-19 pandemic have been truncated.
** Per cent of potential output; the shaded region shows an illustrative range of central gap estimates from a selection of RBA internal models with different measures and definitions of the output gap. The latest observation is an expectation for the September quarter.
*** Three-month moving average deviation from the long-run average capacity utilisation rate; the long-run average is calculated from March 1997 onwards; excludes mining; weighted by industry using share of gross value added.

Sources: ABS; NAB; RBA.

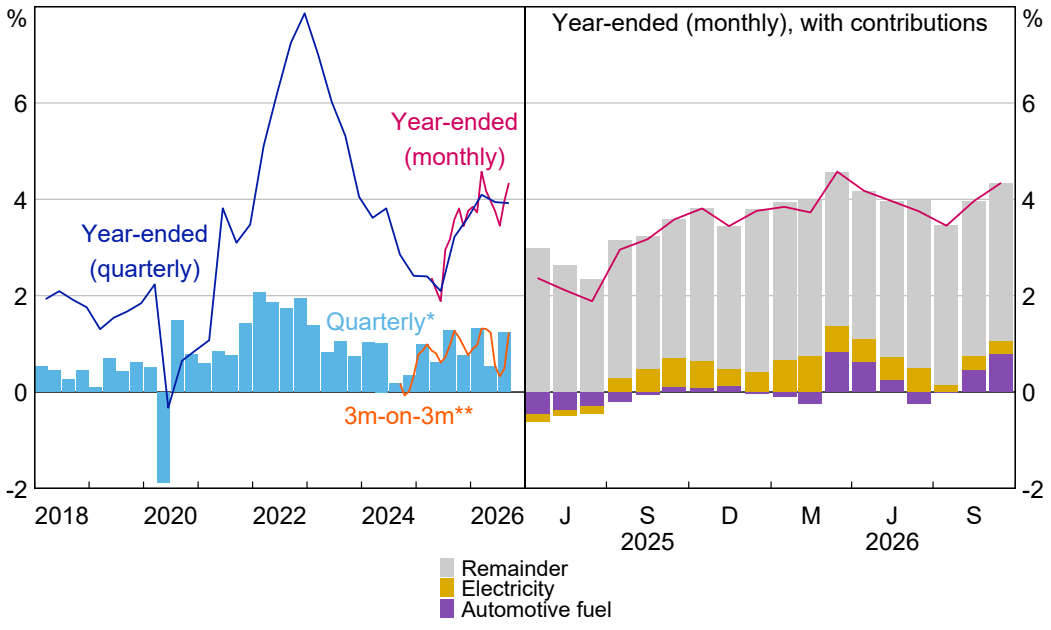
2.6 Inflation

Inflation in the September quarter was stronger than anticipated in the August forecasts and remained well above target, as some of the upside risks identified in August materialised. Retail fuel prices made the largest contribution to the upside surprise in headline inflation. We judge that domestic capacity pressures also made a stronger-than-expected contribution to both underlying and headline inflation in the quarter. Wider cost pressures related to the Middle East conflict have contributed to inflation, with the size of these effects having been broadly as anticipated so far (excluding the direct effect of retail fuel prices). Measures of cost growth remain elevated, with renewed pressure on fuel costs following the re-escalation of the conflict and ongoing cost pressures from wages, technology and services. Some measures of inflation expectations – including longer-term measures – have increased, and this may be contributing to inflation if it is influencing households' and firms' expectations for wages and cost growth. Households and firms have increasingly been paying greater attention to inflation, which may make their inflation expectations more sensitive to future shocks.

Headline inflation in the September quarter was stronger than anticipated in the August *Statement*.

In year-ended terms, headline inflation was unchanged at 3.9 per cent in the September quarter. This outcome reflected stronger-than-expected underlying inflation, as well as stronger-than-expected growth in automotive fuel prices because of a material increase in regional benchmark prices for refined fuel (see section 2.1 Commodity price developments) (Graph 2.3). Fuel contributed around 0.4 percentage points to year-ended headline inflation in the quarter, which was higher than expected at the time of the August *Statement*. Headline inflation in the month of September increased to 4.3 per cent, consistent with ongoing upward pressure from fuel prices (Graph 2.25).

Graph 2.25
Headline Inflation

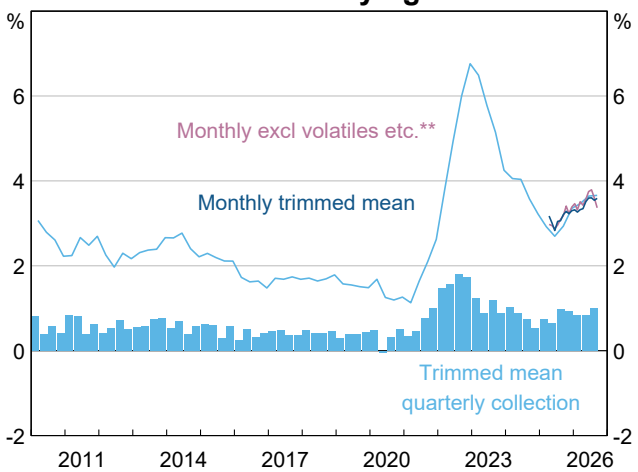


* Seasonally adjusted.
** Three-month-on-three-month percentage change; seasonally adjusted.
Sources: ABS; RBA.

Underlying inflation picked up in the September quarter by more than expected; we attribute this to stronger-than-expected domestic capacity pressures.

Trimmed mean inflation increased to 1.0 per cent in the September quarter, from 0.8 per cent in the June quarter, and picked up to 3.7 per cent in year-ended terms. Various measures of underlying inflation from the monthly CPI also picked up in the September quarter and remained elevated in year-ended terms (Graph 2.26). A majority of items in the CPI (by count and weight) recorded inflation above rates consistent with the inflation target, and this share has increased since the beginning of the year. We assess that the upward surprise in underlying inflation reflects stronger-than-expected domestic capacity pressures this year. Inflation for market services (excluding telecommunication and domestic travel), which is typically among the most sensitive to domestic conditions, increased and was materially stronger than expected in the August forecasts; some of this strength reflects the award wage increase.

Graph 2.26
Measures of Underlying Inflation*



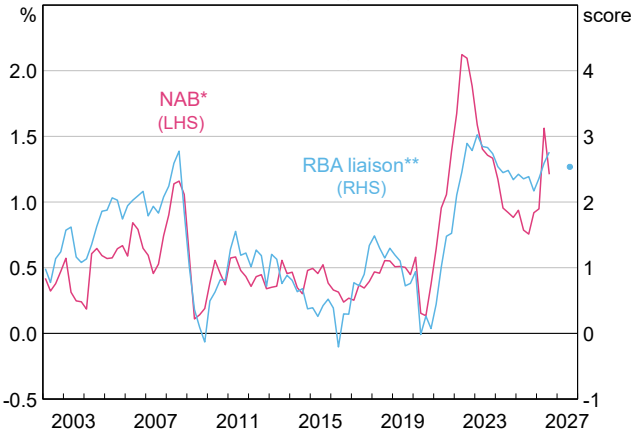
* Lines represent year-ended inflation and bars represent quarterly inflation.
** Monthly CPI excluding volatiles, holiday travel and electricity.
Sources: ABS; RBA.

Cost pressures related to the Middle East conflict are judged to have contributed to higher prices in the September quarter.

Conflict-related cost pressures are estimated to have contributed around 0.1 percentage points to quarterly trimmed mean inflation (excluding the direct effect of higher retail fuel prices), broadly as expected in the August *Statement*. However, these cost pressures appear to have affected a broader range of prices in the quarter than previously anticipated. Increases in building materials costs are judged to have had less effect on new dwellings inflation than expected. However, information from RBA liaison suggests conflict-related cost pressures contributed to price increases for other items, including some market services and durable goods. Many liaison contacts have continued to report higher fuel costs, while some have also continued to note ongoing concerns about higher costs for oil-derived products such as plastics following the re-escalation of tensions in the Middle East (see Box C: Insights from Liaison).

Broader measures of cost growth from business surveys and RBA liaison remain elevated (Graph 2.27). Liaison contacts report that a broad range of cost pressures – including for wages, technology and services – are contributing to expectations of continued elevated cost growth over the year ahead. AI-related cost pressures have had only a modest impact on consumer prices to date, but strong price growth for technology-related goods and services such as computers and software is contributing to firms' cost pressures. Firms are also noting potential future risks to food supply chains arising from El Niño and avian influenza, which could put further upward pressure on costs. Firms' expectations for aggregate inflation are also elevated, which may be reinforcing expectations of strong growth in their own costs.

Graph 2.27
Non-labour Costs
Current and expected



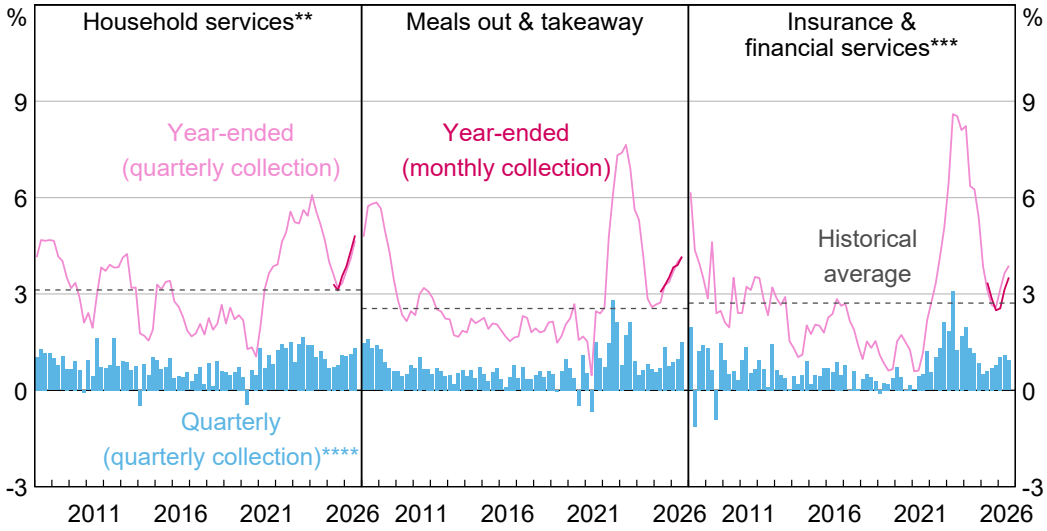
* Average of respondents' quarterly per cent changes.
** Quarterly average. Dot shows expectation for 12 months ahead.
Sources: NAB; RBA.

Survey and liaison data suggest that many firms have not yet been able to fully pass through increases in labour and non-labour costs to consumer prices, resulting in downward pressure on margins over the past few months. However, in the Business Outlook Scenario Survey (BOSS) in September, firms reported that they plan to continue to increase prices in response to past cost increases arising from the Middle East conflict, and that they plan to pass through a greater share of these future cost increases to prices than they had planned in April.[4] Moreover, firms that experienced larger changes in costs in response to the conflict have increased the frequency with which they adjust prices. Consistent with this, liaison contacts are not expecting growth in costs, wages and selling prices to ease much over the year ahead.

Inflation was elevated across most sectors in the September quarter and picked up for market services, rents and consumer durables.

Market services inflation (excluding telecommunications and domestic travel) increased to 1.3 per cent in the September quarter, from 1.1 per cent in the June quarter. In year-ended terms, it increased to 4.2 per cent (Graph 2.28). We assess that this strength primarily reflected domestic capacity pressures and, to a lesser extent, pass-through of conflict-related cost pressures (such as from food and fuel inputs). Some of the recent increase in inflation, for example in the prices of restaurant meals, likely reflected the impact of the FWC award wage decision (which came into effect on 1 July). While the effect of the award wage increase on inflation may be short-lived, firms' apparent ability to pass through this cost increase to prices is consistent with there being some remaining capacity pressures.

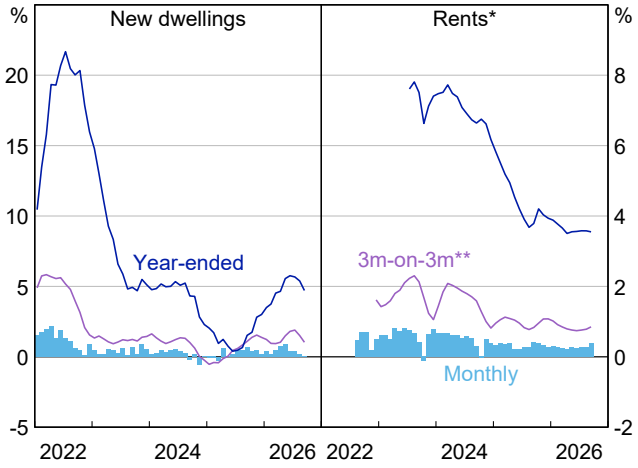
Graph 2.28
Market Services Inflation*



* Historical averages are for year-ended (quarterly collection) inflation. The average is calculated from 1993–2019 for household services as well as meals out & takeaway. The average is calculated from 2001–2019 for insurance & financial services.
** Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services.
*** Excludes deposit & loans to June quarter of 2011.
**** Seasonally adjusted.
Sources: ABS; RBA.

New dwelling construction prices increased by 1.0 per cent in the September quarter to be 5.2 per cent higher over the year (Graph 2.29). This was weaker than expected in the August *Statement*, which we judge reflected smaller conflict-related cost effects than anticipated. Liaison information suggests that while homebuilders continue to experience elevated labour and materials costs, they have been less able to pass these costs through to prices recently in states where housing demand has weakened. New dwelling inflation tends to lag conditions in the established housing market, so this may be early evidence that the easing in housing market conditions that began late last year is beginning to weigh on new dwelling construction prices (see section 2.3 Domestic economic activity).

Graph 2.29
Housing Inflation

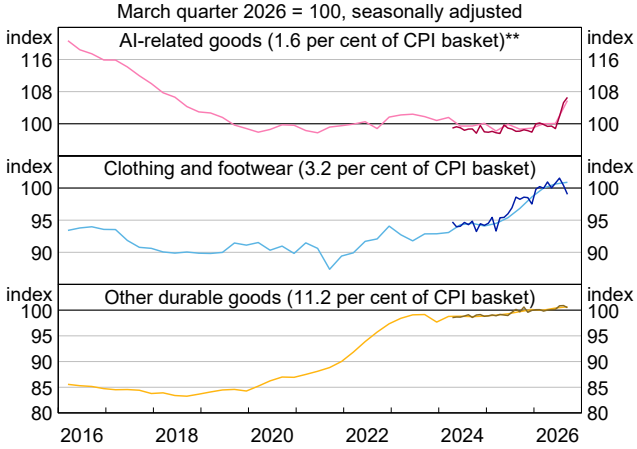


* Monthly and 3m-on-3m inflation rates are calculated using seasonally adjusted data.
** Three-month-on-three-month percentage change.
Sources: ABS; RBA.

CPI rent inflation increased to 0.9 per cent in the September quarter, from 0.6 per cent in the June quarter, and was 3.6 per cent in year-ended terms. The pick-up in the quarter was stronger than expected in the August *Statement*. This may be early evidence that the earlier strong growth in advertised rents – arising from an imbalance between housing supply and demand, as reflected in low vacancy rates – is beginning to pass through to CPI rents, following limited pass-through over the year to the June quarter. More recently, vacancy rates have increased modestly and growth in advertised rents has slowed.

Retail goods inflation was stronger than expected in the September quarter, largely driven by a pick-up in consumer durables inflation. This outcome reflected higher prices for some consumer electronics (such as computers, televisions and gaming consoles) driven by strong memory chip cost growth associated with demand for AI-enabling inputs (Graph 2.30). Although it is too early to judge the persistence of these price rises, similar price increases from AI-related cost pressures have been observed in other advanced economies (see section 2.2 Global economic conditions).

Graph 2.30
Components of Durables Prices*
March quarter 2026 = 100, seasonally adjusted

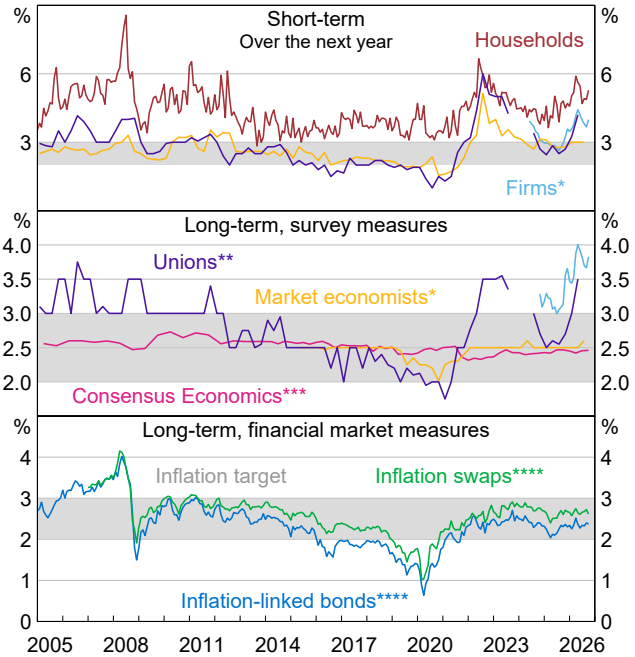


* Light coloured line is quarterly collection, dark coloured line is monthly collection.
** Includes audio, visual & computing equipment as well as games, toys & hobbies.
Sources: ABS; RBA.

Some measures of short-term inflation expectations have increased from already elevated levels. While most measures of longer-term inflation expectations remain consistent with achieving the inflation target, some have also increased.

Households' short-term inflation expectations have increased in recent months, and are above levels observed prior to the Middle East conflict (Graph 2.31). Expectations rose sharply following the onset of the conflict and associated increase in fuel prices, before easing as fuel prices declined from May. More recently, they have increased again alongside stronger fuel price inflation and the re-escalation of the conflict. Firms' short- and medium-term inflation expectations have also increased in recent months.

Graph 2.31
Inflation Expectations

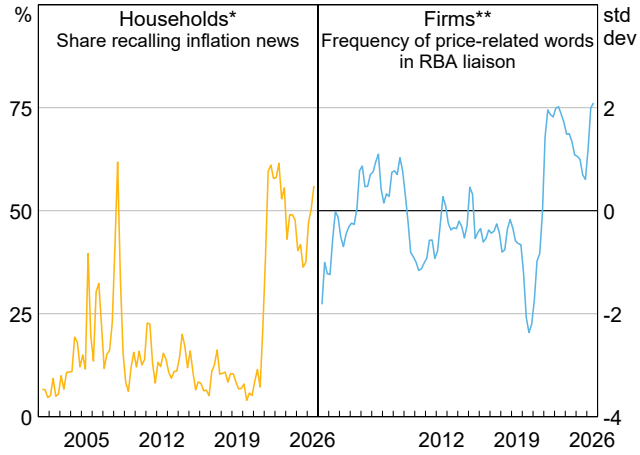


* Long-term expectations are the average expected annual rate of inflation over the next 5–10 years.
** Inflation expectations are unavailable between November 2023 and May 2024, and after May 2026. Long-term expectations are the average expected annual rate of inflation over the next 5–10 years.
*** Long-term expectations are the average expected annual rate of inflation over the 5 years starting from 5 years ahead.
**** Long-term expectations are the average expected annual rate of inflation over the next 10 years.
Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; Employment Research Australia; Macquarie University; Melbourne Institute; RBA; Workplace Research Centre.

Longer-term inflation expectations are mostly consistent with the inflation target, although some measures have increased. Financial market measures of inflation expectations remain consistent with inflation at target over the longer term. However, other longer-term inflation expectations have increased. The median market economist now expects inflation to average 2.6 per cent over the next 5–10 years. Firms' longer-term inflation expectations have also increased since mid-2025, and the BOSS survey suggests firms have become less confident that inflation will return to target, a sentiment also shared by some contacts in the liaison program.

Elevated inflation expectations may be contributing to higher realised inflation if they are influencing households' and firms' expectations for wages and cost growth. Households and firms are increasingly paying more attention to inflation, which may make their inflation expectations more backward-looking and more sensitive to future shocks (Graph 2.32). The heightened attentiveness of households and firms to inflation – together with the re-escalation of the conflict – raises the likelihood that elevated inflation expectations feed into price- and wage-setting decisions, thereby posing a key upside risk to the outlook for wages growth and inflation (see Chapter 3: Outlook).

Graph 2.32
Inflation Awareness



* Share of respondents to quarterly Westpac–Melbourne Institute survey recalling inflation news.
** Frequency of price-related words in RBA liaison, based on an expert-selected dictionary; higher values indicate greater prominence. Standardised over full history; two-quarter rolling average.
Sources: RBA; Westpac–Melbourne Institute.

Endnotes

1 Authorities announced plans to invest around RMB7 trillion in the 'Six Networks' initiatives in 2026, as part of the 15th Five-Year Plan, with projects spanning water, energy, computing, communications, logistics and urban pipeline infrastructure.

2 Changes to the ABS Labour Force Survey in August may have introduced some additional volatility in seasonally adjusted employment and unemployment, although the ABS has said it expects these effects to be small relative to the normal month-to-month variation. For more information, see ABS (2026), 'Supplementary Survey Methodology Changes in the Labour Force Survey', September.

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

4 This is consistent with the pass-through of costs to prices and the role of expectations described in Georgiakakis F, J Hambur and C Ryan (2026), 'Digest: The Literature on Non-linear Phillips Curves', Insight 2026-01.

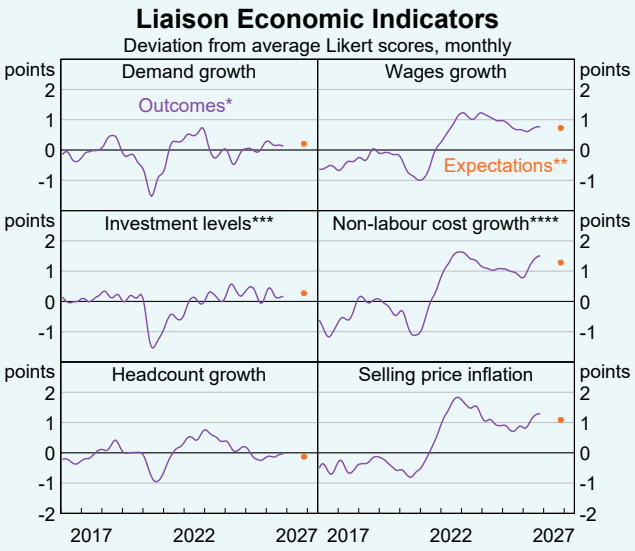
Box C: Insights From Liaison

This Box highlights key messages collected by the RBA's liaison teams based in New South Wales, Queensland, South Australia, Victoria and Western Australia during discussions with around 240 businesses, industry bodies, government agencies and community organisations from early-August to end-October 2026.

Liaison contacts report that cost and price pressures remain elevated and are expected to ease only moderately over the year ahead (Graph C.1). Wages growth outcomes and expectations have picked up since the middle of the year. Demand conditions generally remain around longer-run averages, with softening conditions in retail and dwelling investment being broadly offset by relatively stronger conditions in other areas of business activity. Expectations for growth in demand, investment and employment are also close to their longer-run averages, although with some variation across regions.

Businesses across most industries continue to report sustained labour and non-labour cost pressures, which are flowing through to prices. Most firms continue to expect above-average increases in their selling prices over the year ahead. Retail conditions are increasingly mixed; food retailers, for example, report fairly solid underlying growth, while more discretionary spending is softer than earlier in the year. Housing construction activity is currently being supported by existing pipelines of work in many regions, but a marked slowdown in forward sales suggests a weaker outlook. Nationally, non-residential construction and other business investment spending has been solid, and investment intentions are a bit above average at present. Employment intentions are close to average, having stabilised since earlier in the year.

Graph C.1



* Outcomes over the 12 months before each observation; smoothed with a 13-month Henderson trend.
** Expectations over the next 12 months from October 2026; smoothed with a 13-month Henderson trend.
*** Non-mining firms.
**** Expectations series adjusted by the mean of the current non-labour cost growth series because of short history.
Source: RBA.

Cost and price pressures remain broadly based and elevated and are expected to ease only a little over the year ahead.

Businesses continue to report widespread increases in operating costs. Higher fuel costs are flowing through in the form of surcharges and general transport-related expenses. While some firms are singling this out as a specific cost driver, others report that fuel-related costs are increasingly mingled into the broader elevated operating cost environment they are facing. Higher global costs for other oil-derived products are also flowing through to offshore and domestic supply chains and to consumer prices, though some contacts note that the appreciation of the Australian dollar is helping to moderate some of this impact.

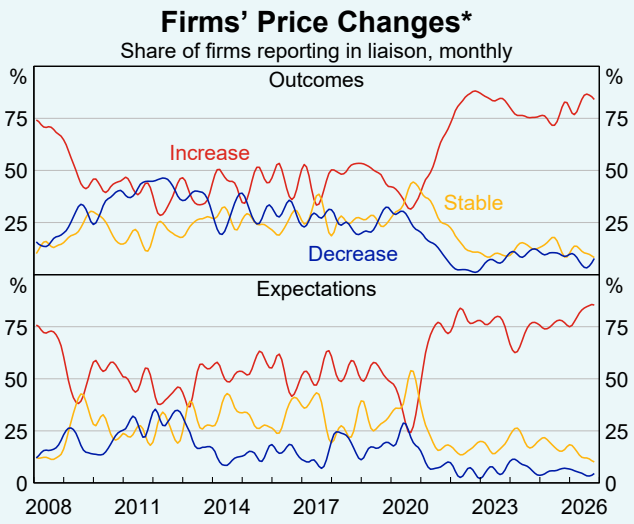
There is also ongoing upward pressure on other cost base components. Faster growth in IT costs, in part driven by global competition for memory chips, has been highlighted by many firms. Where firms are purchasing services from global and domestic IT vendors, these firms are passing through their own upstream costs into service and subscription prices. Other frequently cited components of operating cost increases include occupancy expenses, professional services, other labour-intensive third-party services, government

charges and regulatory compliance costs. Many contacts observe that these categories have experienced repeated increases over recent years. Firms are generally expecting cost growth to remain above longer-run averages over the year ahead.

Reflecting this cost environment, price increases – both business-to-business and consumer-facing – remain broadly based across firms in the liaison program (Graph C.2). Over three-quarters of firms reported increasing prices over the past year; this share had drifted a little lower through to 2025 but picked up again over the past year. In contrast to the experience pre-pandemic, very few firms reported that prices had been reduced or held steady over the past year.

Within this, the size of increases in consumer-facing prices has been mixed, in part reflecting different demand conditions. Price increases for household goods have been relatively modest in general, although an exception has been consumer electronics given global IT hardware cost developments. New detached dwelling price growth is increasingly uneven across states. Builders have generally been able to pass cost increases through to prices in markets where demand conditions are stronger and land supply relatively tight, whereas pass-through has been more limited in Victoria and New South Wales, with some contacts in those states reporting some discounting to support sales.

Graph C.2



* Over the past 12 months for outcomes and over the next 12 months for expectations; smoothed with a 13-month Henderson trend; data to October 2026 (partial).

Source: RBA.

Looking ahead, the share of firms expecting to increase prices is elevated and has increased further over recent months. Firms generally expect above-average increases in selling prices in the year ahead. Given firms generally see little prospect of moderating upstream cost pressures, in many cases contacts note that margins are under pressure and therefore they continue to look for ways to adjust their cost structures to manage this.

Household spending growth has been fairly steady overall, although discretionary spending is softer than earlier in the year.

Food retailers continue to report solid growth in consumption spending, broadly tracking trends in population and household income growth. In contrast, household goods retailers report that conditions are more challenging now than they were six months or so ago. Contacts attribute this to persistent household budget pressures, including from higher interest rates and the effects of the Middle East conflict on fuel prices. Consistent with this, some contacts have flagged an increase in consumers trading down and a greater focus on bargain hunting than was seen earlier in the year. Businesses in the tourism sector similarly report softer conditions than earlier in the year, although major sporting and cultural events continue to generate strong demand. Contacts generally expect that current softer conditions for consumer discretionary spending will continue into 2027.

Retailers with exposure to multiple states report better conditions in Queensland and Western Australia and relatively weaker conditions in Victoria. Higher fuel prices and general cost-of-living pressures are reported to be having a greater effect in remote areas and for lower-income households than in major urban centres and higher-income groups.

As has been the case for some time, community services organisations report elevated demand for their services, with a growing trend of more acute and complex needs. Over recent years there has been a larger cohort of people looking for support from these organisations to address housing stress and budget pressures, including dual-income households.

Housing construction activity is currently solid, but declining forward sales point to a weaker outlook …

Residential builders in most markets report solid activity levels at present, with earlier strength in sales supporting current work pipelines. This is expected to maintain momentum in construction activity into early 2027; contacts in Sydney and Melbourne report around six months of work compared with longer pipelines for those operating elsewhere. Softer activity is expected over the year ahead, given the decline in sales since earlier in 2026. Builders and developers variously attribute this to higher interest rates, tax reforms, and broader economic uncertainty. Several contacts have reported more buyers are adopting a 'wait-and-see' approach, reflected in longer decision-making timeframes and weaker sales, as well as some increase in contract cancellation rates over recent months.

Apartment builders continue to report affordability constraints and poor project feasibility as key factors weighing on development activity, with viable projects mainly concentrated in more premium segments of the market. Contacts note that demand fundamentals – strong population growth, low unemployment and ongoing housing shortages in many markets – are supportive, but there remains a significant gap between current market pricing and the price at which most apartments can be profitably built.

… while conditions for non-residential construction and other business investment are more resilient.

Firms' investment intentions have been resilient over recent months and remain a little above longer-run averages. Within this, a number of businesses have noted upward revisions to capex costs over recent months, in part due to increases in construction and technology costs, but this has not materially changed plans. Firms with above-average investment intentions are primarily spending on projects to expand their businesses and to slow growth in operating costs. Commonly cited project types include construction to expand sites and capacity, new machinery and equipment (including automation), and technology programs.

Consistent with this, firms in the non-residential construction sector report solid demand conditions; public and private sector spending is fairly strong at present, and contacts are anticipating a good pipeline of activity over the next year or so across many regions. Firms associated with data centre developments continue to report particularly buoyant conditions, although contacts have flagged some uncertainty from approval processes and constraints on construction resource availability, as well as fluidity in underlying client demand. Developers of renewable energy generation assets generally see the data centre pipeline as a positive for their sector, but note that these renewables projects are more difficult to progress than was the case a few years ago and also typically involve longer timelines than data centres. Challenges cited include approval delays, longer investment decision-making timetables and interdependencies with grid expansions. Revenue projections for some proposals could also be at risk if the relatively low and stable wholesale electricity prices seen over the past year were sustained.

Some contacts in the higher education sector note discretionary capex is being deferred or scaled back given reduced fee revenue from weaker international student enrolments; instead, capex is being increasingly concentrated in committed projects and essential maintenance. Current and expected spending across other categories of public investment remain solid, including in defence, transport infrastructure, water utilities and healthcare projects in many regions.

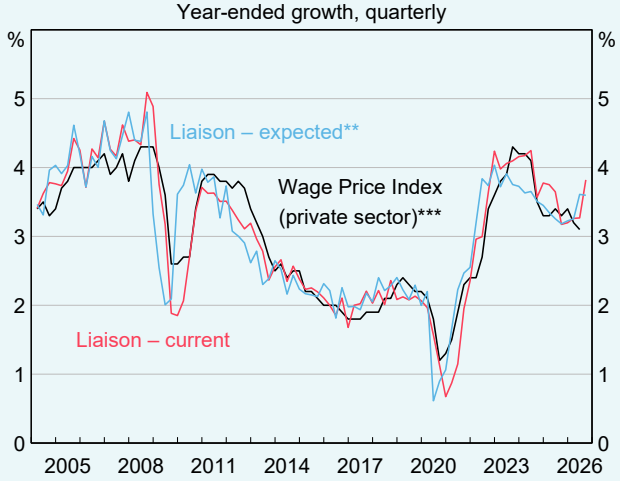
Firms report hiring intentions are around their long-run average and wages growth has strengthened.

Consistent with broadly steady demand conditions, firms' employment intentions are currently sitting close to their long-run average, having strengthened a little since earlier in the year (when some contacts noted uncertainty in hiring plans during the acute period of the Middle East conflict and oil price increases). Contacts expecting headcount growth report this as being supported by project work, expansion activity, ongoing growth in regulatory and compliance obligations, as well as underlying demand conditions. Firms' characterisations of labour market conditions have not changed materially over recent months. While recruiting and retaining staff is generally reported to be easier than a couple of years ago, some firms note competition for labour remains strong, particularly in sectors such as health care, mining, transport and construction trades, though with some variation across regions.

Labour costs remain a focus for firms, amid a recent pick-up in wages growth. Reported wages growth has lifted to be around 3¾ per cent over the September quarter, a marked move upwards from earlier in the year (Graph C.3). This is consistent with the flow-through since July of the Fair Work Commission's 4.75 per cent award wage increase decision. Firms also note general cost-of-living pressures and labour market tightness in some areas as factors influencing wage outcomes over recent months. Contacts expect these factors to also bear on outcomes over the year ahead and are generally not expecting wages growth to slow materially from the current pace.

Given this, many contacts have noted they are looking to drive efficiency gains from improved rostering, staff reallocations and technological improvements. For most firms, AI has not affected headcount and is not expected to do so over the next year. Many firms are hopeful that AI-driven productivity gains will support more efficient use of existing staff resources and may influence future hiring decisions. To date, though, firms have reported mixed productivity experiences; while some more routine tasks are being successfully automated, some contacts have noted the increased overhead associated with exploring and implementing AI as well as responding to AI-generated material from customers and other third parties.

Graph C.3
Private Sector Wages*
Year-ended growth, quarterly



* Liaison series are trimmed and rescaled by the mean of Wage Price Index (private sector).
** Data prior to 2019:Q3 is derived from Likert scores of firms' wage expectations.
*** Total hourly rates excluding bonuses.
Sources: ABS; RBA.



Chapter 3
Outlook

Summary

- **The outlook for inflation has been revised materially higher, especially in the earlier part of the forecast period; the forecasts assume that the cash rate follows the market path.** A number of upside risks flagged in the August *Statement* have since been incorporated into the central inflation forecast. Fuel and other commodity prices affected by the ongoing Middle East conflict are expected to contribute more to underlying and headline inflation than previously expected. Capacity constraints are also judged to have been somewhat greater throughout this year than we thought in August and inflation expectations have increased, adding to inflationary pressures. Underlying inflation is now expected to remain above 3 per cent until late 2027 and to reach 2½ per cent around mid-2028.
- **Headline inflation is expected to remain above 3 per cent until late 2027, around three quarters longer than in the August forecast.** Headline inflation is expected to peak at 4.5 per cent in the December 2026 quarter and reach the midpoint of the 2–3 per cent inflation target a bit later than was expected in August. The decline in inflation is expected to reflect conflict-related cost pressures easing and spare capacity emerging in the labour market and economy more broadly. Risks to the domestic inflation outlook are more balanced than they were in the August *Statement*, but still skewed to the upside. This reflects the incorporation in the central inflation forecast of some of the risks identified in August. However, inflation could be higher if global and domestic cost pressures are more persistent than assumed, or if inflation expectations rise further or exert greater influence on wage- and price-setting.
- **The outlook for growth in Australia's major trading partners has been revised higher, owing to a stronger outlook for AI-related activity and, more broadly, resilient demand.** Growth is still expected to moderate from its current strong pace over the next couple of years, as the boost from AI-related activity slows and growth in China continues to ease. The risks to the outlook are relatively balanced. AI-related activity could continue to be stronger than expected, while ongoing higher energy prices could weigh on growth by more than anticipated. The rise in global interest rates presents risks on both sides of the outlook: it may signal stronger demand and investment than currently expected, but may also result in tighter financial conditions than assumed.
- **The global inflation outlook has also been revised higher, reflecting renewed pressure from energy and other commodity prices, resilient demand and rapid growth in AI-related prices.** The oil price assumption underpinning the forecasts is much higher than in August, reflecting the re-escalation of tensions in the Middle East in recent months. Consensus forecasters expect headline inflation to remain above central bank targets into 2027 in many advanced economies as a result of higher energy costs. More broadly, increases in a range of commodity prices and strong AI-related demand are driving up input costs, which are expected to be passed through to inflation to some degree. The risks to global inflation are judged to remain skewed to the upside.

- **Australian GDP growth is expected to remain below estimates of potential growth over coming years.** Based on financial market pricing, the forecasts assume the cash rate will increase by around 35 basis points by mid-2027; this cash rate path is up to 50 basis points higher than was assumed in the August forecasts. Compared with August, the outlook for GDP growth over the year ahead has been revised higher, driven by a stronger outlook for data centre investment. From mid-2027, however, forecast growth has been revised lower because of the higher assumed cash rate path and a weaker outlook for the housing market. Higher-than-expected global energy prices is also expected to weigh a little on activity. Overall, the forecast level of GDP at end-2028 is broadly unchanged from the August forecasts. The risks to domestic growth appear to be broadly balanced. There are upside risks to global and domestic economic activity from AI-related demand, but economic activity could be weaker if the Middle East conflict and the decline in housing prices affect the economy by more than assumed in the central forecast.
- **Labour market conditions are expected to ease further, consistent with below-potential GDP growth.** The unemployment rate is forecast to increase to 5.1 per cent by end-2028. This is around ¼ percentage points higher than previously expected, largely reflecting the higher starting point for the unemployment rate and an expectation that more people will remain in or join the labour force.
- **Despite this, we assess that capacity constraints in the economy and labour market have been a little tighter than previously judged, contributing more to wage and inflationary pressures** (see Chapter 2: Economic Conditions). From this starting point, we judge that aggregate demand and potential supply in the economy are likely to reach balance next year (slightly later than previously thought), before spare capacity emerges. It is possible we have misjudged the supply capacity of the economy and labour market.

3.1 Key judgements in the forecast

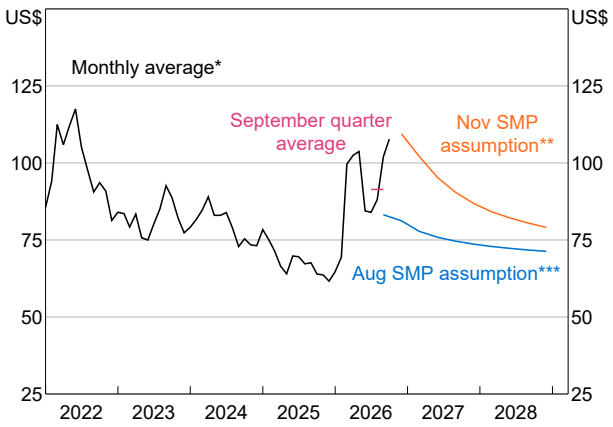
The central forecast incorporates many judgements, such as the choice of models used and whether to deviate from the models given the signal from recent data or information from liaison. These judgements are extensively considered and debated during the construction of the forecast. The three most important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

The annual review of the staff's economic forecasts will be discussed at the December Board meeting (and the results will be published following the meeting). The review will assess what we have learned about the economy, how the judgements that underpin the forecasts have fared and how the risks around the outlook have evolved.

Key judgement #1 – Global oil and refined product prices decline gradually but remain above pre-conflict levels.

The assumption that global oil and related prices decline gradually but remain above levels prior to the Middle East conflict underpins the central forecasts (Graph 3.1). The assumed oil price in the December quarter is 35 per cent higher than assumed in August, following a re-escalation of the conflict in recent months. From this higher starting point, oil prices are assumed to be 11 per cent higher by end-2028 than assumed in August. This assumed decline is consistent with energy markets continuing to adjust to the conflict and/or progress towards resolution of the conflict, and is within the range of the latest Consensus forecasts. The spreads between prices for refined fuels and Brent crude oil, which have widened since the start of the conflict, are assumed to return to their historical averages by mid-2027 – around two quarters later than assumed in the August *Statement*. Oil and refined product prices could rise further or remain elevated for longer than assumed, which would drive up global and domestic inflation and could also weigh on activity (see Key risk #1 and Key risk #3).

Graph 3.1
Brent Oil Price
Per barrel



* Monthly average for October 2026 is average of daily prices to 28 October 2026.
** Based on Brent crude oil futures prices as at 28 October.
*** Based on Brent crude oil futures prices as at 5 August.
Sources: Bloomberg; LSEG; RBA.

Key judgement #2 – Restrictive financial conditions will contribute to the emergence of some spare capacity in the economy and the labour market, helping reduce inflationary pressures.

The forecasts are conditioned on a market path for the cash rate that increases by 35 basis points by mid-2027, before declining a little to stabilise at 4.8 per cent in 2028. This is up to 50 basis points higher than the path that underpinned the August forecasts. Conditioned on that path, the forecast is for a period of below-potential growth that is sufficient to generate some spare capacity in the economy and help return inflation to target. In other words, the assumed path for policy is judged to be restrictive.

One way to cross-check the plausibility of this judgement is to compare the market path with current estimates of the neutral cash rate derived from models and market economists. The assumed cash rate path lies above the top of the range of these estimates (see Chapter 1: Financial Conditions). These estimates are subject to considerable uncertainty, however, and it is common for them to be revised as more information becomes available. A key question is how to interpret

the recent material increase in longer-term real yields (see Box A: How Does an Increase in Longer-term Real Yields Affect Financial Conditions? and Box B: Developments in the Neutral Rate of Interest). To the extent that this reflects higher neutral policy rates globally (and for Australia), the assumed cash rate path would, by itself, be less restrictive and could weigh less on activity than projected. On the other hand, if the recent rise in global yields primarily reflects higher term premia, that would imply tighter financial conditions than assumed in the forecast, although this is less likely to materially change our assessment of restrictiveness, given the relatively short duration of household and business liabilities in Australia.

Key judgement #3 – Some of the current drivers of inflation are expected to persist and will take time to moderate.

Some of the upside risks to the inflation outlook identified in the August *Statement* have since materialised and are now incorporated in the central forecast for inflation. These factors have led to an upward revision to the inflation outlook over the next year or so and a delay in the expected timeframe for inflation to return to the target range. Higher fuel and other commodity prices from the Middle East conflict are expected to put sustained upward pressure on inflation over the coming year as these higher input costs are passed on to consumer prices to some degree over time. These cost pressures are expected to ease over the latter part of the forecast period, contributing to the decline in inflation. The change to the judgement around the degree of domestic capacity constraints implies more persistent inflationary pressures than in the August forecasts, all else equal (see Chapter 2: Economic Conditions). That is, we now assess that domestic capacity pressures have been contributing more to recent elevated inflation outcomes than we had previously judged, and from this higher starting point will contribute a bit more to inflation in the next year. The elevated level of inflation expectations is also projected to influence price- and wage-setting behaviour and boost inflation and wages growth a little more than previously expected.

We view the risks to the inflation outlook as still skewed to the upside. Alongside the potential for global cost pressures to be higher than assumed, it is also possible we have misjudged the extent of capacity pressures in the economy and the labour market, and the impact of the recent increase in inflation expectations in price- and wage-setting behaviour (see section 3.4 Key risks to the outlook).

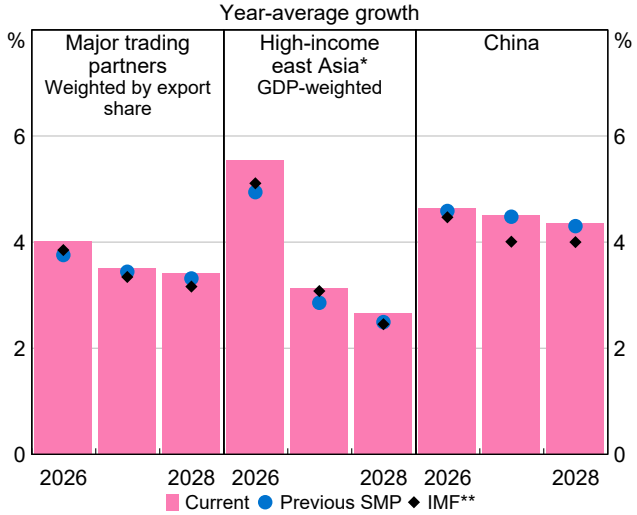
3.2 The global outlook

The outlook for growth in Australia's major trading partners (MTPs) has been revised higher over the next couple of years, but growth is expected to moderate from its current strong pace.

The MTP GDP growth forecast has been revised upwards to 4.0 per cent in 2026, before slowing to 3.5 per cent in 2027 and 3.4 per cent in 2028 as growth in global AI-related activity and China is expected to moderate (Graph 3.2). Growth has been above some estimates of potential and stronger than expected over the past year, reflecting strong AI-related activity and, in some economies, continued fiscal support. These have more than offset the headwinds from the Middle East conflict. MTP growth is expected to moderate to around potential over 2027 and 2028. Overall, we judge that the risks around this outlook for MTP growth are broadly balanced. The expansion in global AI-related investment and production may be more persistent than Consensus forecasters have factored in, but higher energy prices could also weigh on activity by more than currently assumed. The outlook for MTP growth as a whole is broadly in line with the International Monetary Fund's projections in the October 2026 *World Economic Outlook*.

The upward revision to MTP growth is concentrated in high-income east Asian economies, which are key exporters of AI-related goods. Strong demand for semiconductors and other AI-enabling technologies has supported activity in economies that are deeply integrated into regional technology supply chains, such as South Korea and Taiwan. While the outlook for growth in 2027 has been revised a little higher by external forecasters, it is still expected to moderate from the strong pace over the past year towards estimates of potential growth.

Graph 3.2
Major Trading Partner GDP Forecasts
Year-average growth



* High-income east Asia is a GDP-weighted average of South Korea, Taiwan, Hong Kong and Singapore.
** IMF forecasts from the October 2026 World Economic Outlook.
Sources: ABS; CEIC Data; Consensus Economics; IMF; LSEG; Oxford Economics Limited; RBA.

Growth in other advanced economies has also been more resilient than expected, prompting upward revisions to near-term forecasts. AI-related investment and stronger underlying momentum have supported activity in the United States, while defence spending and broader resilience across services and investment have contributed to growth in the euro area. Activity in the United Kingdom has also held up better than expected, supported by business investment. These tailwinds across advanced economies have so far offset some of the drag to activity from higher energy costs. However, external forecasters and central banks expect persistently elevated energy costs to reduce household purchasing power, raise firms' costs and increasingly weigh on consumption and investment. In some advanced economies, tighter financial conditions will also weigh on growth.

The outlook for GDP growth in China is broadly unchanged from the August *Statement*, though there have been some changes to the expected timing and composition of growth. GDP growth is forecast to be 4.6 per cent in 2026, before easing slightly to 4.5 per cent in 2027 and 4.4 per cent in 2028. The pick-up in growth in the September quarter is expected to continue in the near term, given the announcement of new policy support for infrastructure investment and signals from authorities that supporting economic activity will be elevated as a near-term policy priority. Infrastructure investment is now expected to recover from late 2026 as this support takes effect, while structural headwinds are expected to continue weighing on domestic demand more broadly. The timing and effectiveness of the policy support remain uncertain, particularly given high local government debt and a range of barriers to some local governments commencing infrastructure projects.

Longer-term government bond yields have risen across advanced economies, alongside resilient activity and persistent inflation. The increase appears to reflect a combination of higher expected near-term policy rates and higher longer-term real rates, reflecting a mix of higher term premia and potentially higher neutral rates. Market-based measures of long-term inflation expectations remain consistent with central bank targets. Strong investment and public demand may be placing upward pressure on real rates, and expectations of stronger future productivity growth – including from the adoption of AI – may also be contributing. Higher public and private debt issuance and uncertainty about inflation and fiscal trajectories may also be adding to the compensation investors require to hold longer-duration bonds (see Box A: How Does an Increase in Longer-term Real Yields Affect Financial Conditions? and Box B: Developments in the Neutral Rate of Interest).

The global inflation outlook has been revised higher, reflecting an increase in energy prices and continued resilience in global demand. Consensus forecasters expect headline inflation to remain above central bank targets into 2027 in many advanced economies. Services disinflation has stalled, while core goods inflation has picked up. The outlook for globally traded goods inflation has been revised higher, reflecting higher commodity prices and further strong increases in export prices for semiconductors and other AI-related goods across parts of Asia. AI-related price pressures have not broadened materially beyond electronics but could become more persistent or spread to other parts of global supply chains if strong demand continues to run ahead of the expansion in productive capacity (see Key risk #2). The further increase in energy prices since August could add to these upstream cost pressures, although the extent and timing of pass-through to consumer prices remains uncertain. Overall, we continue to judge that the risks to global inflation remain skewed to the upside.

3.3 Domestic outlook

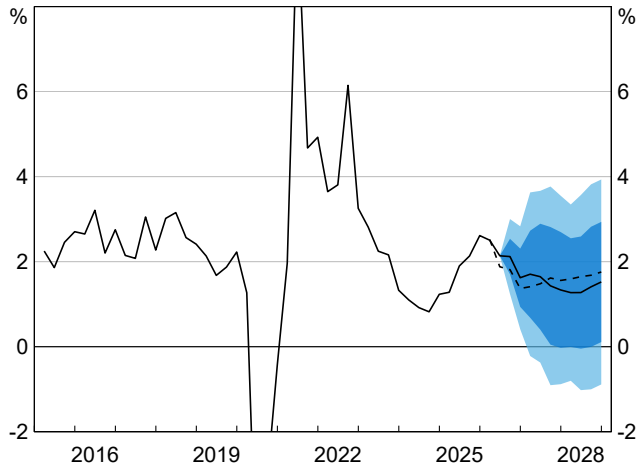
Australian GDP growth is expected to remain below our estimate of potential growth throughout the forecast period.

GDP growth has slowed since the end of 2025 and is expected to remain subdued over the next couple of years (Graph 3.3). The expected slowing in growth over 2026 reflects the effects of several headwinds weighing on private activity, including the reduction in household disposable incomes from higher inflation, weaker conditions in the established housing market, and the tightening in monetary policy, which more than offset very strong data centre-related investment. Growth is expected to remain below potential over the forecast period, reflecting an assumption that financial conditions remain restrictive (see Key judgement #2). Consistent with the latest state and federal budgets, public demand is expected to continue supporting growth over the forecast period.

The risks to activity appear to be broadly balanced. Stronger-than-expected global growth and further strength in AI and data centre-related activity pose upside risks to domestic growth (see Key risk #2). However, historically low consumer and business sentiment could be pointing to the risk that the combined effect on domestic activity of the Middle East conflict, the decline in housing prices and the tightening in monetary policy could be more than assumed (see Key risk #3).

The level of GDP at end-2028 is expected to be broadly unchanged from the August forecasts. Growth is projected to be slightly stronger than expected in the near term, reflecting a much stronger outlook for data centre-related investment compared with the August *Statement*. Weighing against that is the higher assumed market path for the cash rate, a weaker outlook for the housing market and higher oil prices. These pull growth in the latter part of the forecast period a little below that expected in the August *Statement*.

Graph 3.3
GDP Growth Forecast*
Year-ended



* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue. Outliers during the COVID-19 pandemic have been truncated.

Sources: ABS; RBA.

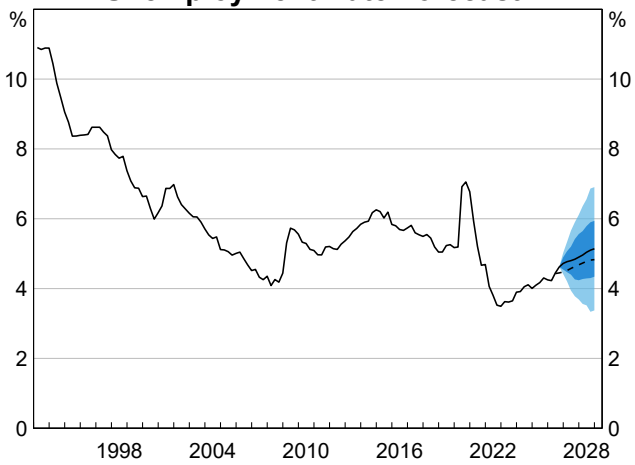
Business investment is expected to increase strongly and the outlook has been revised up significantly, largely driven by data centre-related investment. Business investment was stronger than expected in the June quarter and firms' surveyed expectations of future investment were again revised higher. External projections for the expected increase in Australia's data centre capacity through to 2030 have also continued to be revised up as the size of the development pipeline has increased. Our forecast for data centre investment is in line with recent baseline external projections, but below projections that assume Australia becomes a significant regional hub for data centres. There is considerable uncertainty around the extent of data centre investment over coming years. This will depend on a range of factors such as government policy, community expectations, future demand for AI services and grid capacity. We continue to expect that much of this additional investment will be imported (around 70 per cent), limiting the boost to GDP growth. However, data centre construction, as well as any potential spillovers to higher investment in energy and utilities infrastructure, will require domestically sourced labour and materials. At this stage, most of this investment pipeline is in New South Wales and Victoria where liaison information suggests capacity constraints in the construction sector are somewhat less binding.

At the same time, a higher assumed cash rate path, a more significant easing in the established housing market and higher global oil prices are expected to weigh more on activity than in the August forecasts. The forecasts are conditioned on a higher market path for interest rates relative to August. In addition, established housing prices have continued to fall more quickly than expected, with external forecasters now expecting a deeper downturn than assumed a few months ago. The outlook for oil prices is also much higher than assumed in August, which will weigh on real household incomes. Reflecting these factors, the outlook for household consumption and dwelling investment has been revised lower, as has the outlook for business investment unrelated to data centres.

The labour market is expected to continue easing over the forecast period, consistent with below-potential GDP growth.

The unemployment rate is forecast to increase to 5.1 per cent by the end of 2028, which is around ¼ percentage point higher than previously expected (Graph 3.4). The unemployment rate has risen by more than expected over recent months, and the upward revision to forecast relative to the August *Statement* largely reflects this higher starting point. Elevated cost-of-living pressures appear to have encouraged workers to enter or remain in the labour force to a greater extent in recent months than was expected at the time of the August *Statement*. These pressures are expected to continue to support participation for some time. The participation rate is expected to decline very modestly by the end of 2028 as easing cyclical pressures are expected to more than offset the longer-run upward trend in female participation. A slightly weaker outlook for demand later in the forecast period is also contributing a little to the upward revision to the unemployment rate profile by late 2028.

Graph 3.4
Unemployment Rate Forecast*



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

As in previous forecasts, the employment-to-population ratio is expected to decline through to late 2028. Employment growth is expected to remain broadly stable over the next year, in line with the leading indicators of labour demand. From mid-2027, employment growth is expected to be a little weaker than in the August *Statement*, reflecting the weaker outlook for GDP growth later in the forecast period. The forecast employment-to-population ratio is similar to the August *Statement* in the near term, before declining more quickly to reach a lower level by the end of the forecast period.

The economy is expected to move into balance in 2027, with spare capacity then emerging in the economy over the rest of the forecast period.

Below-potential output growth and an easing in labour market conditions are expected to see the economy move from a position of excess demand to around balance in 2027, before some spare capacity emerges. The timing of the return to balance is slightly later than in the August *Statement*, as a result of the upgrade to near-term GDP growth.

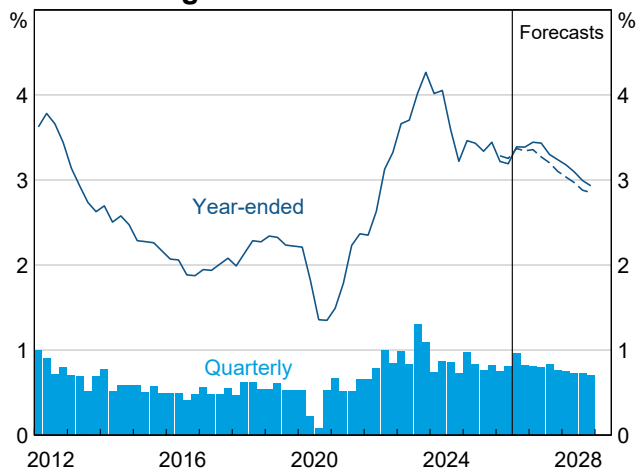
However, there is considerable uncertainty around the assessment of when the economy will return to balance and the extent of spare capacity that emerges. The impact of conflict-related costs on inflation over the period ahead will also make it more difficult to assess the degree of underlying capacity pressures in the domestic economy. Our assumption for potential output growth over the next couple of years assumes productivity growth will pick up gradually (see Key risk #4). However, with the level of labour productivity remaining around the same rate as prior to the pandemic – implying near-zero productivity growth on average over that period – continued weak productivity outcomes may be constraining the ability of firms to grow their supply capacity without generating inflationary pressure.

Wages growth is expected to pick up a little in the near term, then moderate gradually from 2027 as labour market conditions ease.

The forecast for year-ended wages growth has been revised a little higher across the forecast period. In the near term, nominal wages growth is expected to be supported by the effect of higher-than-expected capacity pressures in the first half of the year as well as the Fair Work Commission's award wage decision (which had already been incorporated in the August forecasts). The influence of both higher-than-expected inflation outcomes and inflation expectations on wage negotiations is expected to add further upward pressure on wages growth relative to the August forecast. Some large wage increases in enterprise bargaining agreements are expected to support wages growth in the near term, although the timing of pay increases for these agreements may contribute to volatility in quarterly outcomes, particularly for the public sector.

Wages growth expectations from firms in the RBA's liaison program are elevated and suggest little easing over the year ahead (see Box C: Insights from Liaison). This is consistent with the central forecast for wages growth. Growth is expected to moderate from mid-2027 onwards, reflecting easing labour market conditions and lower inflation outcomes. Wages growth is expected to have eased to 2.9 per cent in year-ended terms by end-2028 (Graph 3.5).

Graph 3.5
Wage Price Index Growth*



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

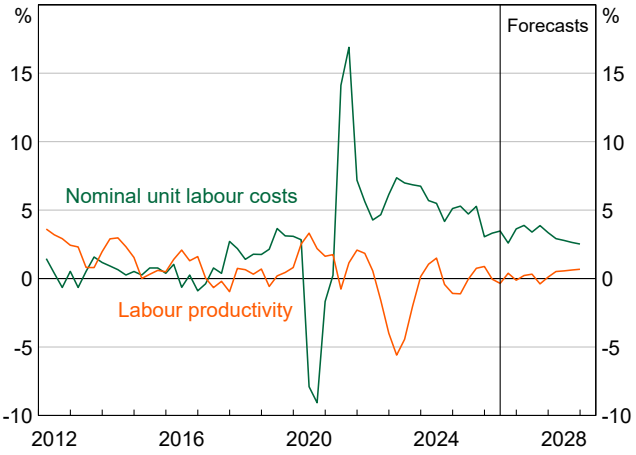
Unit labour cost growth is forecast to be elevated in the near term, before easing over the second half of the forecast period.

Year-ended growth in unit labour costs (ULCs) is expected to increase in coming quarters, reflecting weak productivity growth and higher wages growth. Year-ended growth in ULCs is then expected to moderate from late 2027 onwards, alongside slowing nominal wages growth and the pick-up in productivity growth to its assumed medium-term trend growth rate of 0.7 per cent per year (Graph 3.6). Nominal ULCs are the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes. Year-ended ULCs growth is expected to remain above 2.5 per cent – the rate that is consistent with inflation being sustainably at target – until late in the forecast period.

Graph 3.6

Labour Cost and Productivity Growth

Non-farm, seasonally adjusted, year-ended



Sources: ABS; RBA.

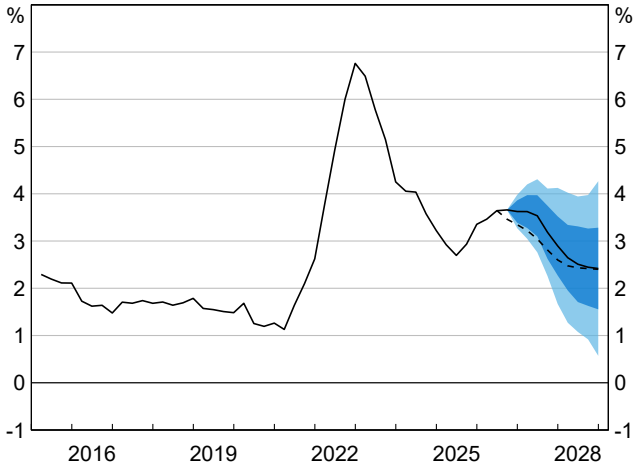
The forecast for underlying inflation has been revised higher over the next year, mainly owing to higher conflict-related cost pressures and higher-than-expected domestic capacity pressures.

Trimmed mean inflation is expected to remain above 3 per cent until the end of 2027, easing gradually to reach 2½ per cent around mid-2028 (Graph 3.7). Year-ended underlying inflation is expected to remain elevated at a little above 3½ per cent until mid-2027, reflecting existing capacity pressures in the economy and the pass-through of higher conflict-related costs to consumer prices. Elevated inflation expectations are also contributing to underlying inflation over the coming year or so. From mid-2027 onwards, inflation is expected to ease due to the emergence of spare capacity in the economy and labour market and as conflict-related cost effects begin to unwind.

Graph 3.7

Trimmed Mean Inflation Forecast*

Year-ended



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

Sources: ABS; RBA.

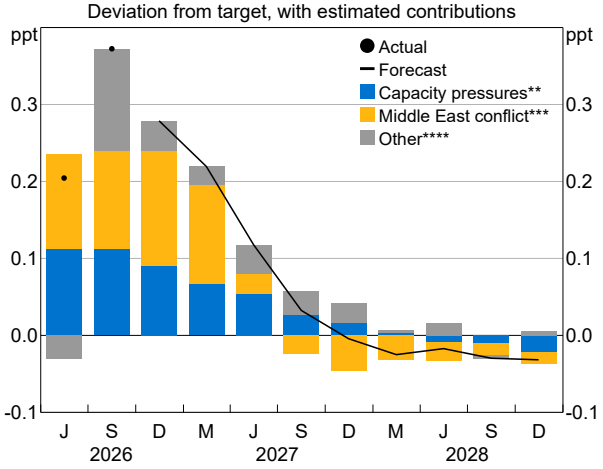
Cost pressures related to the Middle East conflict are expected to place more upward pressure on underlying inflation over the year ahead than previously assumed. A possible re-escalation in the conflict had been flagged as an upside risk to inflation in the August *Statement*. Since then, oil and fuel prices have increased by much more than had been assumed and are now assumed to remain at a higher level over the forecast period. We expect higher global energy prices will contribute to higher domestic inflationary pressures in late 2026 and early 2027, even as domestic activity slows and the labour market eases (Graph 3.8). The judgement around the degree of pass-through from global energy prices to domestic prices is broadly similar to what had been assumed in August. It is consistent with information from liaison and the Business Outlook Scenario Survey (BOSS) in September, where firms reported plans to continue raising prices in response to past cost increases arising partially from the conflict. From mid-2027 onwards, we expect cost effects to unwind in net terms, albeit to a lesser extent than assumed in the August *Statement* as oil prices are now assumed to remain at a higher level than previously expected and refined margins are assumed to remain elevated for longer (see Key judgement #1). The balance of risks to conflict-related inflationary pressures remains skewed to the upside, particularly as crude oil and refined fuel prices could remain elevated or rise further (see Key risk #1).

Relative to the August forecasts, domestic capacity pressures are also expected to exert a bit more upward pressure on inflation over the year ahead. We now judge that stronger-than-expected domestic capacity pressures explain more of the recent unexpected strength in underlying inflation (see Chapter 2: Economic Conditions). Those higher capacity pressures are also expected to contribute a little more to inflation over the year ahead. This upward pressure is expected to ease gradually over the forecast period, as spare capacity emerges in the economy and the labour market.

Graph 3.8

Quarterly Trimmed Mean Inflation Forecast*

Deviation from target, with estimated contributions



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

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

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

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

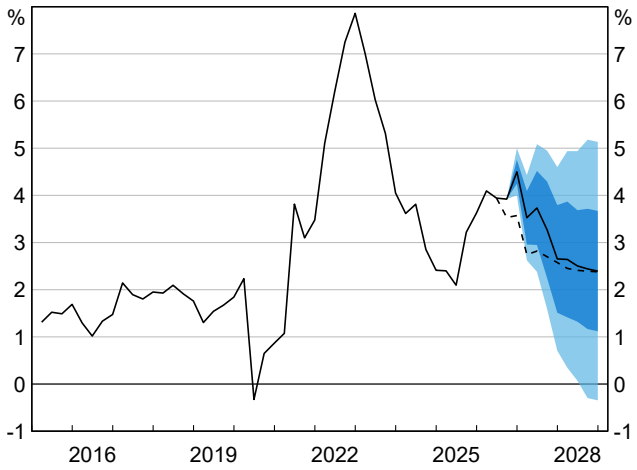
Sources: ABS; RBA.

Elevated inflation expectations are expected to contribute to inflationary pressure over the forecast period, supporting the pass-through of firms' costs to consumer prices. Several measures of short- and medium-term inflation expectations have increased alongside the recent increases in fuel prices, and some measures of longer-term expectations have also drifted higher (see Chapter 2: Economic Conditions). We judge that elevated expectations will contribute to higher realised inflation by supporting expected cost growth, making firms more willing to pass these higher costs through to prices, and placing upward pressure on wages growth. If the conflict in the Middle East is more protracted than assumed in our baseline forecasts, there is a risk that inflation expectations may increase further (see Key risk #1).

Headline inflation has been revised higher in the near term due to stronger growth in fuel prices and higher underlying inflation.

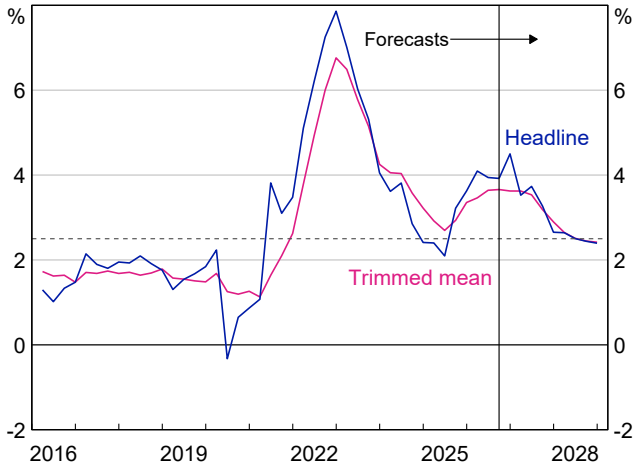
Headline inflation is expected to remain above 3 per cent until late 2027, which is around three quarters longer than in the August forecast, and reach the midpoint of the 2–3 per cent inflation target range a bit later than expected in August (Graph 3.9). Headline inflation is expected to peak at 4.5 per cent in the December quarter this year due to higher-than-expected fuel prices. The assumed decline in global oil prices is expected to put downward pressure on headline inflation from early 2027. Over the remainder of the forecast period, headline inflation has been revised higher relative to our August forecasts, reflecting higher underlying inflation (Graph 3.10). Headline inflation is expected to reach the midpoint of the target in mid-2028 as capacity pressures and conflict-related costs ease.

Graph 3.9
Headline Inflation Forecast*
Year-ended



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

Graph 3.10
Inflation*
Year-ended



* Dashed line is midpoint of 2–3 per cent target range.
Sources: ABS; RBA.

3.4 Key risks to the outlook

The staff assess that the risks to the domestic inflation outlook are skewed to the upside, despite becoming more balanced since the August *Statement* as some of the risks identified then have been incorporated into the central forecast. In August, we identified three main sources of upside risk to the global and domestic inflation outlook: a re-escalation of the Middle East conflict; domestic capacity pressures being greater than assumed; and the global AI boom generating more of an inflationary impetus than assumed. Since then, the risk of a re-escalation of the Middle East conflict has crystallised and staff have re-evaluated the extent of domestic capacity constraints; both of which have led to upward revisions to the central inflation forecast over the next year. However, there is still uncertainty around the outlook for global energy prices, the role of inflation expectations in price and wage dynamics as well as the impact on inflation from AI activity.

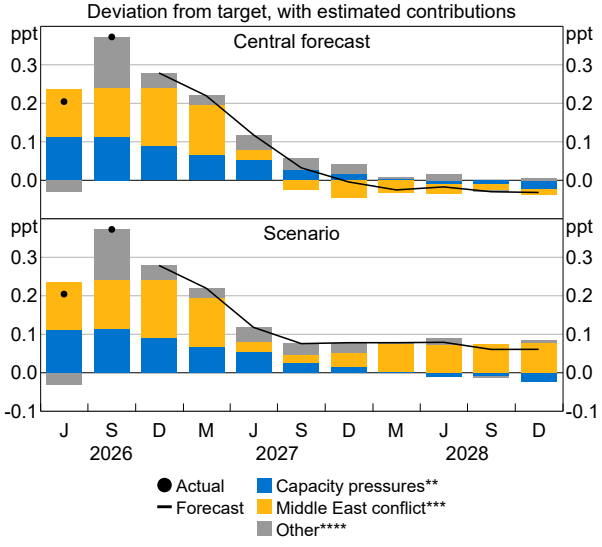
The staff also identified in August that there were upside risks to global and domestic economic activity from AI-related demand, but that domestic economic activity could be weaker if the Middle East conflict and the decline in housing prices affected the economy by more than assumed in the central forecast. These remain key risks to the outlook.

Key risk #1 – High inflation could be more persistent if energy prices remain elevated, or if inflation expectations increase or start to have a greater bearing on wage- and price-setting.

We have modelled a scenario where crude oil remains around US$100 per barrel and refined product prices remain at elevated levels over the forecast period. Many external forecasters are revising higher their outlook for crude oil and refined product prices, on concerns that some of the key margins of adjustment in global energy markets that have helped to cushion the impact of the disruption to oil supply and global activity are reaching their limits (see Chapter 2: Economic Conditions and Key judgement #1).

Persistently higher global oil prices would leave domestic inflation higher for a longer period than in the central forecast. Higher oil prices would directly increase fuel prices and firms' input costs, with the latter gradually passed through to consumer prices as firms adjust to persistently higher costs. By contrast, the central forecast assumes a decline in oil prices, which starts to ease cost pressures related to the Middle East conflict from mid-2027, contributing to lower inflation over time (Graph 3.11). Higher inflation also raises inflation expectations in the scenario, reinforcing inflationary pressures over the forecast period. Assuming that the cash rate and exchange rate follow the same path that underpins the central forecasts, underlying inflation would be around 2¾ per cent by end-2028 rather than being around the 2½ per cent.

Graph 3.11
Quarterly Trimmed Mean Inflation Forecast*
Deviation from target, with estimated contributions



* Deviation from a quarterly rate of underlying inflation that is consistent with the midpoint of the target range.
** Includes contributions from the unemployment gap, output gap and nominal unit labour costs in a suite of trimmed mean inflation models.
*** Includes indirect cost effects from the conflict in the Middle East (excluding fuel) and short-term inflation expectations.
**** Includes contributions from some imported goods, automotive fuel and factors not otherwise specified.
Sources: ABS; RBA.

It is possible that inflation expectations could rise even further or that inflation expectations provide greater impetus to wages growth and inflation through second-round effects. The central forecasts and scenario assume that the increase in households' and firms' inflation expectations do exert some upward pressure on inflation and wages growth. However, given households and firms are paying particularly close attention to inflation, it is possible that inflation expectations will influence price- and wage-setting decisions by more than assumed. This heightened attentiveness to inflation could also make expectations more persistent and more responsive to realised inflation. With headline inflation forecast to rise further in the near term, this increases the risk that inflation expectations remain higher for longer than assumed in our central forecast.

Key risk #2 – The global AI demand boom may continue to drive up global growth and inflation.

MTP growth may not moderate as expected over the next few years if AI-demand growth continues at the same pace. It is possible that growth forecasts could continue to be upwardly revised by Consensus forecasters if the current upswing in AI-related investment (and spillovers associated with the boom) is more persistent than currently assumed. The rise in interest rates across the yield curve in many advanced economies may reflect higher neutral rates – that is, expectations that demand will prove more resilient and inflation more persistent than currently assumed. Higher longer-term real rates may partly reflect expectations of stronger future productivity growth, including from the adoption of AI. Further investment in anticipation of higher productivity could also support demand and add to capacity pressures over the next few years, while most of the productivity gains are likely to manifest beyond the next two years (at least in Australia).

The ramp-up of investment in data centres may also contribute to capacity and pricing pressures domestically, particularly by drawing on resources in the construction industry. These price pressures could be stronger than currently expected as the forecast pipeline of investment is worked through, or if investment proves stronger than expected.

Key risk #3 – Domestic economic activity could be weaker than expected.

It is possible that the headwinds affecting households and businesses over the next year could have a larger adverse effect than assumed. The central forecasts assume that higher oil prices, higher interest rates and lower housing prices all weigh on domestic economic activity broadly in line with average historical relationships. Timely indicators of spending remain consistent with this assumption, with no evidence of a material slowing in consumption growth in recent months. However, the very weak levels of consumer and business sentiment could be pointing to a more pronounced slowing in household and business spending growth than assumed.

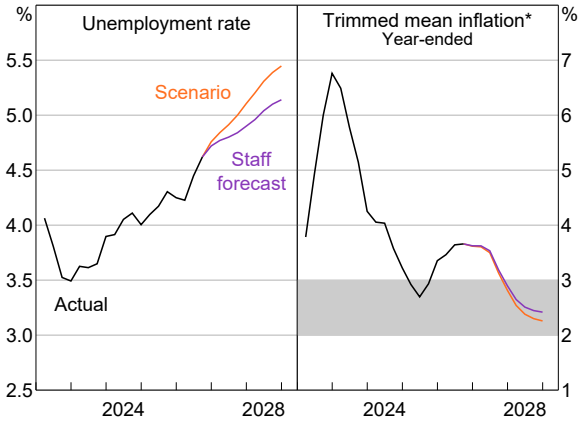
We have calibrated a downside domestic activity scenario where there is a larger response in household and business spending to these headwinds. There is a range of estimates for the effects of these headwinds in the literature, highlighting the uncertainty around their impact on economic activity. Drawing on this evidence, the scenario uses larger responses than assumed in the central forecast, thereby identifying a plausible downside outlook for domestic activity. In the scenario, firms feel forced to pass on the conflict-related costs to prices as in the central forecast; but households respond more cautiously to the resultant pressures on real income and wealth, reducing discretionary consumption by more than assumed in the central forecast. Such an effect on spending might be compounded by a tightening in borrowing constraints and incentives for housing investors. The scenario assumes firms respond to weaker demand and margin pressure with a sharper pullback on (non-data centre) investment and hiring. Overall, the level of GDP is around 1.0 per cent lower than the central forecasts by end-2028.

The larger pullback in household and business spending results in weaker activity and employment growth, but only modestly lower inflation than in the central forecast, assuming interest rates and the exchange rate follow the same path as the central forecast. The greater caution exhibited by households pushes the gross household saving ratio up gradually to a peak of around 17 per cent, where it remains over the remainder of the forecast period. The greater reduction

in hiring pushes the unemployment rate 0.3 percentage points higher by end-2028, creating more spare capacity in the domestic economy than in the central forecast (Graph 3.12). The additional spare capacity in the economy and the labour market reduces inflationary pressures somewhat, but the assumption of cost pass-through by firms limits this effect. Overall, trimmed mean inflation reaches 2½ per cent only one quarter earlier than in the central forecast.

Graph 3.12

Weaker Domestic Economic Activity – Labour Market and Inflation Outcomes



* Shaded area shows 2–3 per cent inflation target range.

Sources: ABS; RBA.

Key risk #4 – There remains considerable uncertainty about the degree of capacity pressures in the domestic economy and labour market.

Despite the recent reassessment, it is possible that we are still understating the extent of capacity pressures. While we assess that capacity constraints in the economy and labour market have been tighter than previously judged, model-based estimates of the unemployment rate that is consistent with low and stable inflation continue to point to greater tightness in labour market conditions than our central assessment. In addition, if productivity growth were to remain subdued over the forecast period, rather than pick up modestly as assumed, it may suggest that the economy's supply capacity would be lower than currently expected. The implications for inflation would depend on how households and businesses adjust their spending and expectations.

Conversely, capacity pressures may be weaker than expected. The broader suite of full employment indicators points to somewhat less labour market tightness than our central assessment. It is also possible that more of the recent strength in wages growth and inflation reflects factors other than excess demand, such as conflict-related cost effects or higher inflation expectations. In these cases, wages growth and inflation may moderate more quickly than in the central forecast. Productivity growth could also recover more quickly than assumed, including if the anticipated benefits of AI adoption and other technological developments are realised sooner.

There is also a risk that the unemployment rate increases by more than expected if labour supply remains stronger than assumed. There is a risk that elevated cost-of-living pressures could support labour force participation for longer, or to a greater extent, than assumed. If so, stronger labour supply could result in a higher unemployment rate than forecast, even if labour demand evolves broadly as expected.

3.5 Detailed forecast information

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

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

	Jun 2026	Dec 2026	Jun 2027	Dec 2027	Jun 2028	Dec 2028
Activity						
Gross domestic product	2.1	1.6	1.6	1.3	1.3	1.5
Household consumption	1.8	1.4	1.4	1.8	1.7	1.6
Dwelling investment	5.8	5.1	1.3	−2.8	−3.5	−1.8
Business investment	10.5	12.0	7.8	2.2	0.2	−0.3
Public demand	2.1	2.1	3.8	3.0	2.7	2.3
Gross national expenditure	2.9	2.6	2.7	2.0	1.6	1.6
Major trading partner (export-weighted) GDP	4.1	3.8	3.5	3.6	3.4	3.3
Trade						
Imports	6.7	4.6	4.0	3.7	2.7	2.0
Exports	2.9	−0.3	0.3	0.9	1.3	1.8
Terms of trade	−0.5	−2.4	−4.9	−2.4	0.9	0.9
Labour market						
Employment	1.1	1.4	1.2	1.1	1.0	1.1
Unemployment rate (quarterly, %)	4.4	4.7	4.8	4.9	5.0	5.1
Hours-based underutilisation rate (quarterly, %)	5.5	5.8	5.9	6.0	6.2	6.4
Income						
Wage Price Index	3.2	3.4	3.4	3.2	3.1	2.9
Nominal average earnings per hour (non-farm)	3.2	3.5	3.7	3.5	3.4	3.2
Real household disposable income	2.3	1.0	1.6	1.5	1.3	1.3
Inflation						
Consumer Price Index	3.9	4.5	3.7	2.7	2.5	2.4
Trimmed mean inflation	3.6	3.6	3.5	2.9	2.5	2.4
Assumptions						
Cash rate (%)[(c)]	4.3	4.7	4.9	4.8	4.8	4.8
Trade-weighted index (index)[(d)]	66.1	65.2	65.3	65.3	65.3	65.3
Brent crude oil price (US$/bbl)[(e)]	94.9	109.5	95.3	86.9	82.1	79.1
Estimated resident population[(f)]	1.5	1.5	1.3	1.2	1.2	1.2
Memo items						
Labour productivity[(g)]	−0.4	−0.1	0.3	0.1	0.6	0.7
Household savings rate (%)[(h)]	6.5	6.6	6.7	6.3	6.3	6.0
Real Wage Price Index[(i)]	−0.8	−1.0	−0.3	0.6	0.6	0.5
Real average earnings per hour (non-farm)[(i)]	−0.8	−0.9	0.0	0.8	0.8	0.8

(a) Forecasts finalised on 28 October.

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

(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; Oxford Economics Limited; RBA.