RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

May 2025

The cut-off for data used to prepare the forecasts for the *Statement on Monetary Policy* was 14 May 2025. The data cut-off for Chapter 3: Australian Economic Conditions was 15 May 2025.

Some graphs in this publication were generated using Mathematica.

ISSN 1448–5141

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Contents

Overview

In Australia, inflationary pressures have continued to ease, and both headline and underlying inflation are within the 2–3 per cent range. The unemployment rate has remained steady and employment growth has remained firm, but the pick-up in household consumption seems to be a bit softer than previously expected. The global economic outlook has worsened following the introduction of higher tariffs by the United States and a significant increase in uncertainty related to trade policies. This is expected to weigh on Australia's domestic activity and inflation in the forecast period, slowing the pick-up in GDP growth a little while inflation returns sustainably to around the midpoint of the target.

The Monetary Policy Board judged that the risks to inflation had become more balanced but that the outlook is uncertain and depends heavily on unpredictable developments in global trade policy. Against this backdrop, the Board decided to lower the cash rate target by 25 basis points to 3.85 per cent.

Underlying inflation has returned to the 2–3 per cent range.

Underlying inflation has continued to decrease as expected. Trimmed mean inflation was 2.9 per cent over the year to the March quarter. The slowdown in underlying inflation has been broadly based.

Headline inflation was 2.4 per cent over the year to the March quarter. Temporary government subsidies to households continued to weigh on the year-ended rate. Quarterly inflation picked up in March, however, as some of these subsidies were unwound.

Labour market conditions have been steady, as expected.

The unemployment rate has remained around its current level of 4.1 per cent. The labour market is still judged to be tight, although the assessment of full employment is uncertain. Year-ended wages growth increased slightly in the March quarter but is lower than a year ago as momentum in private sector wages has declined over the past year. However, growth in broader measures of labour costs – including unit labour costs – remains elevated, partly due to subdued productivity growth. The share of firms reporting that labour availability is constraining output remains higher than usual.

Growth in household consumption in early 2025 appears a little weaker than expected. GDP growth over the December and March quarters is likely to have been broadly as expected in February. That said, partial data for early 2025 suggest a softer pick-up in household consumption growth in the near term than previously forecast.

Globally, uncertainty has increased.

Global trade policy uncertainty has risen substantially following the announcement of significant increases in tariffs by the United States in early April. Many of these tariffs were subsequently reduced as the United States announced pauses to allow trade negotiations to take place. The Chinese authorities also lowered the tariffs they had

announced on US imports in response and signalled a more expansionary policy stance to support domestic economic growth. Financial market liquidity was strained in early April and pricing was volatile, but markets did not experience the persistent disruptions seen in some past episodes of stress. Market participants have lowered their expectations for the paths of central bank policy rates in most advanced economies, consistent with expectations of weaker economic outcomes. However, market pricing suggests that participants see the risk of a severe downturn as low, posing downside risks if the trade conflict re-escalates.

The outlook for the economy is a little weaker amid heightened uncertainty.

Given the range of potential outcomes for trade policy and the global economy, the outlook for the domestic economy is more uncertain than usual. To assess a plausible range of outcomes for Australia's economy, we have complemented our baseline forecast with scenarios.

The outlook for the global economy has deteriorated. Trade policy developments and associated uncertainty are likely to weigh on global economic activity, but the expected effect on inflation rates in overseas markets is less clear. For countries that have not imposed higher tariffs, weaker global demand should put downward pressure on inflation, though any disruption to global manufacturing supply chains could lead to higher prices for some goods.

In response, financial market participants have revised down their expectations for the path of the cash rate a little. This has flowed through to lower interest rates on private sector debt in Australia, with the decline in risk-free rates more than offsetting a slight rise in risk premiums. The Australian dollar is little changed on a trade-weighted basis, despite considerable volatility in recent weeks. Appreciation against the US dollar has been offset by depreciation against the currencies of other major trading partners.

Domestic GDP growth is still expected to pick up, but at a somewhat more gradual pace. Although there have not been signs of a material deterioration in leading indicators, the pick-up in GDP growth is expected to occur more gradually than previously forecast due to softer global demand and weaker consumption momentum. The effects of weaker demand are somewhat offset by the lower market path for the cash rate, on which the forecasts are conditioned.

Labour market conditions are expected to ease slightly. Consistent with the softer outlook for domestic growth, the unemployment rate is expected to increase a little over 2025 before stabilising in early 2026. Employment growth is forecast to ease by slightly more than expected in the February *Statement* but remain positive, and wages growth is forecast to stabilise at a slightly lower rate.

In the baseline forecast, underlying inflation is projected to return to and remain sustainably around the midpoint of the 2–3 per cent range. Conditioned on the market path for policy, the outlook for domestic inflation has been revised a little lower since the February *Statement*. This reflects judgements that the trade conflict will be disinflationary for Australia and that the softer outlook for domestic growth will return the economy and labour market closer to balance. Headline inflation is expected to increase over the second half of 2025 as temporary government subsidies to households are unwound, before returning to around the midpoint of the target range later in the forecast period.

With heightened global uncertainty, and the current unpredictability of trade policy, there are many plausible paths for how the economy might evolve. In this *Statement* we illustrate some of these paths with scenarios. The baseline forecast assumes that tariff rates remain around their current levels and the impact of trade policy uncertainty gradually declines over the year ahead but remains elevated relative to history. A re-escalation of the trade conflict that primarily weakens demand could lead to a slowing in domestic activity, a sharp rise in the unemployment rate and a decrease in inflation. If the trade conflict causes material supply-side disruptions, inflation could move in the other direction. By contrast, a swift resolution to the trade conflict and reduced uncertainty could see upside economic risks to the baseline forecast.

The Monetary Policy Board decided to lower the cash rate target by 25 basis points to 3.85 per cent.

The Board judged that the risks to inflation had become more balanced but was mindful of the considerable uncertainty about the outlook. International developments are expected to weigh on the economy and, with inflation expected to remain around target, the Board judged that it was appropriate to ease monetary policy at this meeting. The Board nevertheless remains cautious about the outlook. The Board considered the severe downside scenario presented in this *Statement* and noted that monetary policy is well placed to respond decisively to international developments if they were to have material implications for activity and inflation in Australia. The Board will be attentive to the data and the evolving assessment of risks and is focused on its mandate to deliver price stability and full employment.

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

Per cent

	Year-ended					
	Dec 2024	June 2025	Dec 2025	June 2026	Dec 2026	June 2027
GDP growth	1.3	1.8	2.1	2.2	2.2	2.2
(previous)	(1.1)	(2.0)	(2.4)	(2.3)	(2.3)	(2.2)
Unemployment rate[b]	4.0	4.2	4.3	4.3	4.3	4.3
(previous)	(4.0)	(4.2)	(4.2)	(4.2)	(4.2)	(4.2)
CPI inflation	2.4	2.1	3.0	3.1	2.9	2.6
(previous)	(2.4)	(2.4)	(3.7)	(3.2)	(2.8)	(2.7)
Trimmed mean inflation	3.3	2.6	2.6	2.6	2.6	2.6
(previous)	(3.2)	(2.7)	(2.7)	(2.7)	(2.7)	(2.7)

	Year-average					
	2024	2024/25	2025	2025/26	2026	2026/27
GDP growth	1.0	1.4	1.9	2.1	2.2	2.2
(previous)	(1.0)	(1.4)	(2.1)	(2.4)	(2.3)	(2.3)

	Assumptions[c]					
Cash rate (%)	4.3	4.0	3.4	3.2	3.2	3.2
Trade-weighted index (index)	61.5	60.0	60.6	60.6	60.6	60.6

(a) Forecasts finalised on 14 May. 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 14 May and the daily exchange rate (TWI) is assumed to be unchanged from its level at 14 May 2025 going forward. See notes to Table 4.2: Detailed Forecast Table in Chapter 4: Outlook for other forecast assumptions.

Sources: ABS; LSEG; RBA.

Chapter 1

In Depth – Global Economy and Financial Markets

Summary

- **Since the February *Statement*, there has been a significant increase in global trade barriers and related policy uncertainty, led by the United States, with potentially far-reaching economic implications.** This chapter draws together the key changes and how they could affect the global economy, as well as the financial market and policy responses to date. The implications for the Australian economy and financial conditions are set out in the rest of this *Statement*.
- **The extent to which higher tariffs and elevated uncertainty weigh on global growth and affect inflation will depend on a range of factors.** These include: the outcome of ongoing trade negotiations between the United States and its major trading partners; the impact of related policy uncertainty on the willingness of businesses and households to invest and spend; the nature of how trading patterns adjust; and the extent of disruptions to global supply chains from higher barriers to trade. The impact on global growth and inflation will also depend on the extent to which policymakers are willing and able to ease fiscal and monetary policy. Judgements on the implications for the Australian economy are set out in Chapter 4: Outlook.
- **Although the trade and related uncertainty shocks are likely to weigh on global economic activity, the effects on inflation are ambiguous and likely to vary across countries.** Inflation in the United States is expected to increase in the near term as higher tariffs will be passed through to consumer prices to some extent. In countries not levying new tariffs, weaker global demand should put downward pressure on inflation, though any disruptions to global manufacturing supply chains could lead to higher prices in some goods categories.
- **The Chinese authorities are aiming to use fiscal and monetary policy to support economic growth in the face of higher US tariffs.** Some other economies, particularly in Europe, have also signalled that fiscal settings will be loosened. Meanwhile, some advanced economy central banks have cut rates further in recent months while emphasising the increased uncertainty affecting the outlook for monetary policy. Most have also emphasised that monetary policy cannot simultaneously offset weaker demand and address higher inflation, if this were to result from the supply-side effects of tariffs dominating uncertainty and other effects on demand.

- **Pricing in financial markets has been fluid over recent months as market participants have responded to a rapidly changing trade policy environment.** Riskier asset prices declined sharply on initial tariff announcements but have since recovered, following the US administration's decision to pause or reduce many tariffs while negotiations take place. Short-term government bond yields have generally declined, in line with market expectations that the path for central bank policy rates will be lower to support global demand. Financial conditions could tighten sharply again if expectations for significantly lower tariffs than originally announced following negotiations do not materialise, and the outlook for trade policies remains very uncertain.
- **As risk aversion rose sharply in early April, the US dollar depreciated alongside declines in the prices of long-term US government bonds and some riskier assets relative to those in other economies.** This was in contrast with many previous 'risk-off' episodes. Although the US dollar remains below its February level on a trade-weighted basis, and market participants are also demanding more compensation for holding long-term US interest rate risk, it is too early to tell whether this episode reflects a lasting view that the relative safety of US assets has diminished. The episode could also be explained by more conventional factors like the unwinding of stretched positioning and the rebalancing of investor portfolios. While financial market liquidity was strained in early April, markets did not experience the dislocations seen in past episodes of stress.

1.1 How has global trade policy changed since the February *Statement*?

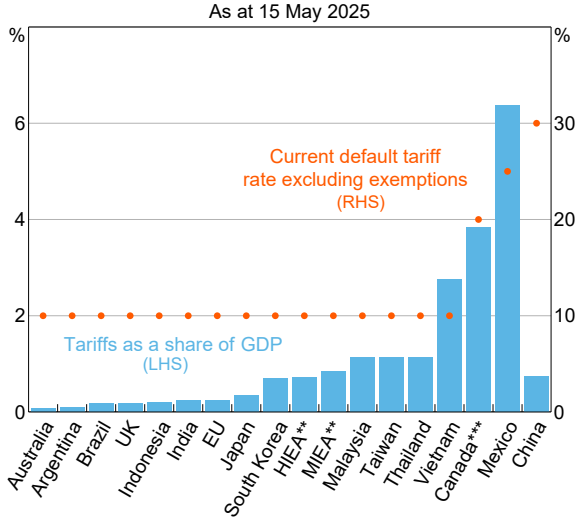
Global economic uncertainty has increased substantially, amid significant increases in tariffs.

Since the previous *Statement*, the United States has implemented higher tariffs on almost all of its trading partners and some economies have introduced retaliatory tariffs. Currently, the higher US tariffs include country-level tariffs starting at 10 per cent, as well as tariffs imposed on specific sectors. The largest increase in US tariffs has been on imports from China – Australia's largest trading partner – with a current default tariff rate of 30 per cent (Graph 1.1). Exemptions have been put in place for a range of imported goods, including around 15 per cent of Chinese exports to the United States.

Current tariff rates are a long way below the levels initially implemented in early April as higher tariffs have been paused to allow for trade negotiations to take place. The most notable de-escalation has been between the United States and China. The United States initially increased its default tariff rate on Chinese imports to 145 per cent and China had retaliated with a 125 per cent tariff on imports from the United States. These remained in place for some of April and May but were put on pause for 90 days from 14 May. Even after accounting for current exemptions and pauses, tariffs imposed since January 2025 have raised the average effective tariff rate on US imports from around 2 per cent to around 15 per cent. This is the highest level since the 1930s and a much larger increase than the 1.5 percentage point tariff increase in 2018. The US administration has also signalled its intention to impose additional sector-specific tariffs, including on pharmaceutical and semi-conductor imports.

There is significant uncertainty as to how US trade policy will evolve and how its trading partners will respond (Graph 1.2). In some cases, bilateral tariff rates may fall further as negotiations proceed; in others they may rise. The pause on very high US–China bilateral tariffs has driven a small decrease in US trade policy uncertainty, but against the backdrop of temporary pauses and continued negotiations, uncertainty is likely to remain elevated for some time.

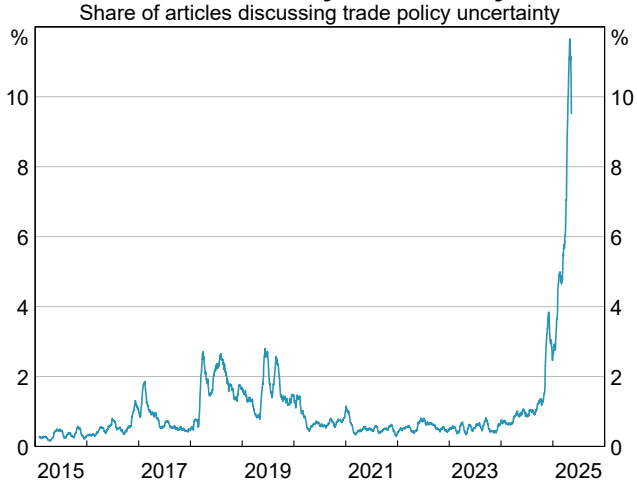
Graph 1.1
Direct Exposure to US Tariffs*
As at 15 May 2025



* Calculated as tariff rate multiplied by value of 2023 exports to the US divided by GDP in current US$; accounts for tariff pauses but not for exemptions, trade redirection, tax incidence, or price changes.
** Middle-income east Asia comprises Vietnam, Thailand, Malaysia, the Philippines and Indonesia; high-income east Asia comprises Hong Kong, Taiwan, Singapore and South Korea.
*** Reflects 10 per cent tariff on energy exports and 25 per cent tariff on all other exports.

Sources: OEC; RBA; UN Comtrade; World Bank.

Graph 1.2
US Trade Policy Uncertainty*
Share of articles discussing trade policy uncertainty



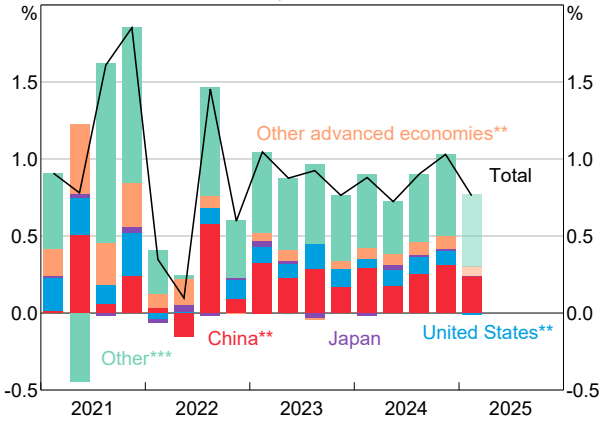
* Daily 30-day moving average of the share of articles mentioning trade policy uncertainty in automated text searches of mostly US newspapers: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post.

Sources: Caldara et al (2019); RBA.

The global economy was growing at a moderate rate in early 2025 ahead of the increases in US tariffs and policy uncertainty.

Global economic growth outside of North America was solid in the March quarter, following a period of stable growth in 2024 (Graph 1.3). In China, stronger-than-expected quarterly growth was driven by a pick-up in household consumption amid an increase in fiscal support. In the United States, GDP declined in the March quarter, mostly reflecting a large swing in net exports due to frontloading ahead of tariffs, though measures of private domestic demand remained solid.

Graph 1.3
Global Growth*
Real, quarterly with contributions



* PPP-weighted estimate from countries that together comprise 72 per cent of global GDP, scaled up.
** For March quarter 2025, actual for United States, euro area and China, forecasts elsewhere.
*** Residual that assumes countries not covered by data grow by the same weighted average as the rest of the world.
Sources: ABS; CEIC Data; Consensus Economics; LSEG; RBA.

Disinflation in advanced economies has generally continued in recent months, notwithstanding some volatility. In the United States, services disinflation has driven recent declines. Labour market conditions were relatively stable in the March quarter and appear close to balance in most peer economies.

1.2 How do higher tariffs affect the global economy?

Persistently higher tariffs would weigh on global growth, though the implications for inflation are likely to vary across countries.

Higher tariffs affect the global economy through a range of channels. In countries imposing tariffs, the cost of imported inputs to production and imported consumption goods will increase. This provides an incentive for demand to shift towards domestically produced goods and away from imports. However, domestic production may be less efficient, as supply chains and the economy's production structure adjust, resulting in higher intermediate and final prices for a wide range of goods. By disrupting supply chains, reducing productivity and raising costs, tariffs reduce the supply capacity of the economy. At the same time, consumers' and business' real purchasing power and spending will decline. While government revenues and profits for some domestic firms may increase, the overall effect is likely to be a reduction in aggregate demand and activity.

In addition to the direct effect of tariffs, trade tensions between large economies can result in significant increases in uncertainty in affected economies and more widely, as is currently the case. That can have a large effect on demand as households increase precautionary saving and businesses delay investment; if higher tariffs are sustained, innovations and technological progress may also slow.

Falls in asset prices, resulting from increased uncertainty and a sharp repricing of risk premia, can further reduce household spending and increase businesses' cost of funding, lowering growth prospects further. This could be exacerbated if market functioning was impaired.

Due to differences between US tariff rates on China and its other trading partners, global trade flows may adjust to some extent, reducing the impact of the supply and demand shocks. For example, Chinese exports may find new markets, while lower tariffed countries may export more to the United States in place of China. To an extent, these changing trading patterns helped to offset the impact of higher US tariffs in 2018 and 2019, though effective tariff rates and policy uncertainty increased by much less in that episode. The degree to, and speed with, which global trade flows reorient are uncertain and depend on future US trade policy.

The impact on inflation will depend on the timing and severity of the supply- and demand-side effects in each economy, and on movements in exchange rates. The timing of and extent to which businesses pass through the cost of tariffs can also affect how tariffs add to inflationary pressures. In the short run, US tariffs are likely to lead to higher inflation in the United States as the price level adjusts higher. In line with higher market-implied measures of inflation compensation, market economists' outlook for US inflation in the short term has increased substantially and so have households' short-term inflation expectations, though most measures of medium-term inflation expectations remain close to the Federal Reserve's inflation target. The effect on inflation outside the United States is less certain. Weaker global demand will put downward pressure on inflation, while disruptions to global manufacturing supply chains could pose upside risks. The nature of countries' fiscal and monetary policy responses will also affect the outcome.

A range of indicators will signal how the trade shocks are affecting global trade and economic activity over coming months.

The early effects of the tariff and uncertainty shock are already evident in some timely indicators. Consumer sentiment has declined sharply in the United States and most other advanced economies, although it remains resilient in Australia (Graph 1.4). Business investment intentions have declined in North America but have not shifted much in other advanced economies so far, including in Australia (see Box C: Insights from Liaison). Consumer price inflation in the United States eased in April, with tariff impacts yet to materialise.

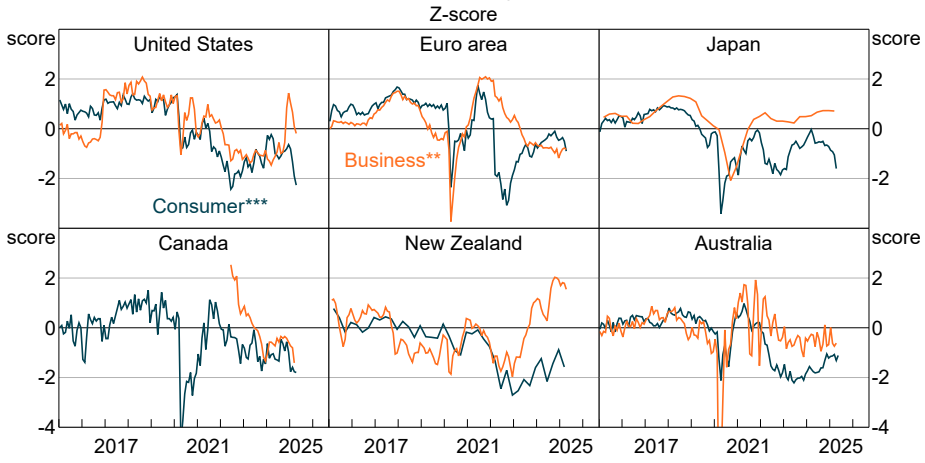
A range of data shows that international trade has been resilient thus far, with the exception of trade between China and the United States. Trade data from China showed exports to the United States fell by 20 per cent in April, but this was partly offset by an increase in exports to other countries (Graph 1.5). Official trade data for the United States for April is not yet available, but container traffic data indicated goods imports to the United States remained solid at around their 2024 levels. However, it may take time for trade data to fully reflect current tariff rates as there may be lags between the response of importers to changes in tariff rates and trade flows. In addition, businesses brought forward the import of some goods to mitigate the risk that tariff rates increase after temporary exemptions expire.

Graph 1.5
China – Merchandise Trade
Seasonally adjusted, monthly

Sources: CEIC Data; RBA.

As we gauge the likely economic impact of higher tariffs and policy uncertainty in the months ahead, we will continue to closely monitor news on tariff policies and associated policy uncertainty indicators, prices of financial assets and commodities, consumer and business sentiment indicators, and data on supply chains, shipping and trade flows. These indicators will be particularly important as it is likely to take some time for official economic data to show the impact of tariffs due to the usual lags in the publication of data, the potential for some demand to be brought forward and lags between when investment decisions are made and when the investment happens.

Graph 1.4
Advanced Economy Sentiment*
Z-score



* Outliers during the COVID-19 pandemic have been truncated.
** US data are NFIB Small Business Optimism; euro area and Japan data are manufacturing sector firms only.
*** US data are University of Michigan; Australia data are the mean of Westpac–Melbourne Institute and ANZ–Roy Morgan surveys' deviations from average.

Sources: ANZ–Roy Morgan; Bank of Canada; CEIC Data; LSEG; RBA; Westpac–Melbourne Institute.

1.3 How has fiscal and monetary policy responded so far?

In response to tariffs and trade policy uncertainty, some policymakers, including in China, have adopted a more expansionary policy stance.

Chinese authorities announced a GDP growth target of around 5 per cent for 2025 (unchanged from 2024) at the National People's Congress in March and have indicated that they are willing to ease fiscal policy further to mitigate the effects on domestic growth of higher tariffs and weaker global demand. The People's Bank of China (PBC) also eased monetary policy modestly in May by lowering its key policy rate by 10 basis points and reducing the reserve requirement ratio by 50 basis points. Additional funding has also been made available to priority sectors via banks through the medium-term lending facility and structural lending facilities.

Commensurate with this, Chinese Government bond yields have continued to decline since the start of April. Some broader measures of financial conditions have tightened modestly amid heightened trade uncertainty and a softer outlook for growth. Authorities have responded by intervening in the onshore equity market through the purchase of securities by state-backed investment funds to support prices. The PBC has also continued to emphasise currency stability, which limits the exchange rate's ability to offset the macroeconomic impact of the tariffs.

There has been a material easing in the fiscal stance outside of China. In Europe, leaders have announced their intention to significantly increase defence and infrastructure spending. This includes a major fiscal expansion in Germany, where the parliament has approved a 500 billion infrastructure fund and relaxed the fiscal rules applicable to defence spending. Japan and Korea have also announced fiscal packages to reduce the adverse economic impacts of higher US tariffs.

A few advanced economy central banks have cut rates further while emphasising increased uncertainty affecting the outlook for policy.

The European Central Bank, Bank of England and Reserve Bank of New Zealand have further reduced policy rates in their first meetings following the tariff announcements on 2 April. These central banks highlighted progress on disinflation, while observing that the growth outlook had deteriorated due to trade tensions and emphasising the high degree of uncertainty about the outlook. They communicated further rate cuts would depend on future developments in trade policy and the evolving evidence of the effects on economic activity and inflation. These meetings (and those discussed below) took place before the recent announcement of a temporary reduction in tariffs between the United States and China.

Other central banks left policy rates unchanged. These central banks acknowledged the weaker outlook for growth against a backdrop of prior rate cuts, but some, including the US Federal Reserve (Fed), noted the potential for tariffs to raise inflation in the near term. The Fed communicated there were risks to both sides of its dual mandate and stated that it would wait for further data before considering any adjustments to its policy stance, but could act quickly if needed. The Bank of Canada similarly pointed to high uncertainty, indicating a data-dependent strategy that places less weight on highly uncertain forecasts. Meanwhile, the Bank of Japan kept its policy rate on hold given the high level of uncertainty and noting downside risks to activity and prices, but said it expects to resume rate increases if inflationary pressures do not subside.

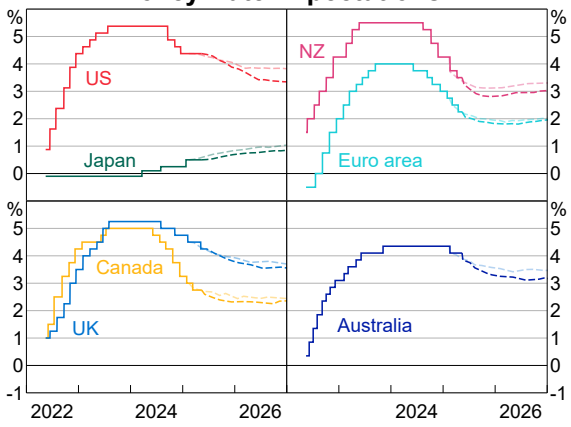
Most central banks have emphasised that while monetary policy can offset weaker demand resulting from higher tariffs, it is not an effective tool for addressing any supply-side effects. Some central bank officials have flagged the likelihood that weaker demand will push down both growth and inflation, particularly in economies less directly exposed to US trade and less likely to impose retaliatory tariffs of their own. However, others have highlighted the risk that

higher near-term inflation from supply-side disruptions could have a persistent effect if they raise inflation expectations, limiting the ability of monetary policy to offset weaker growth. Market participants appear less concerned by the latter possibility, given the decline in both longer term inflation compensation measures and policy rate expectations.

Market participants expect a modestly lower path for policy rates in response to a weaker growth outlook.

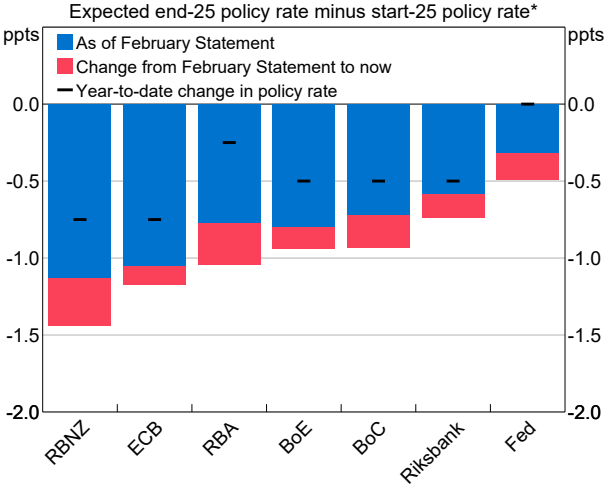
Policy rate expectations declined earlier in the United States than in most other advanced economies, but have recovered some of these declines in recent weeks (Graph 1.6; Graph 1.7). Previously announced tariffs raised expectations that demand would weaken but also result in higher near-term inflation, limiting the scope for market participants to price in further US rate cuts as tariff announcements escalated. Subsequent progress in tariff negotiations has strengthened confidence that tariffs will settle at substantially lower levels than initially announced, while cautious central bank messaging had also reduced expectations of a rapid easing of policy rates. In most other advanced economies, most of the overall decline in policy rate expectations took place following the April announcement. Expectations are now only modestly lower than in February as market participants anticipate that a less adverse outlook for global trade barriers and growth will require less offsetting policy easing.

Graph 1.6
Policy Rate Expectations*



* Darker dashed lines show expectations implied by current overnight index swap rates; lighter dashed lines show the same expectations as of 13 February 2025.
Sources: Bloomberg; RBA.

Graph 1.7
Expected Change in Policy Rate over 2025
Expected end-25 policy rate minus start-25 policy rate*



* Expected end-25 policy rate derived from overnight index swap rates.
Sources: Bloomberg; RBA.

1.4 How have financial markets reacted to developments?

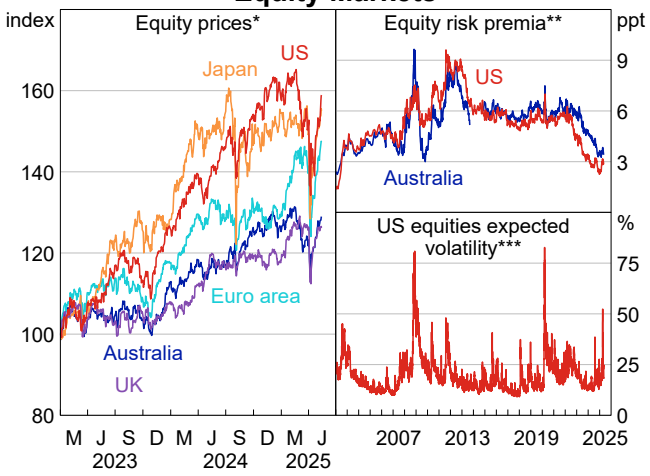
Pricing in financial markets has been fluid over recent months as market participants have responded to rapidly changing news about trade policy.

Equity prices across advanced economies fell sharply and spreads on corporate bonds widened as risk sentiment deteriorated immediately following the US tariff announcements on 2 April and subsequent retaliation by China. They have, however, recovered following the pause in implementation of some tariffs, supported also by expectations of lower policy rates (Graph 1.8; Graph 1.9). While equity risk premiums and corporate bond spreads have increased slightly from the historically low levels reached earlier in the year, they remain well below long-run average levels across most markets, while expected volatility has subsided from sharply higher levels reached in early April. Overall, financial market participants currently appear to be pricing in some modest downside risks to global growth, but not a significant downturn. This is consistent with expectations that tariffs will settle at a less disruptive level, with trade policy uncertainty also declining, and their negative effects on growth somewhat offset by easier monetary and fiscal policy. However, if outcomes for trade policy or economic developments are worse than currently expected, riskier asset prices could fall sharply, contributing to a tightening in financial conditions.

US equity and sub-investment grade corporate bond prices have declined by more than in other advanced economies in an environment of heightened policy uncertainty and already stretched valuations. Riskier asset prices in Europe appear to have held up better, in part because European growth is expected to be supported by increased fiscal spending. Globally, stocks in sectors that are more exposed to trade and the economic cycle have been among those with the weakest relative performance across most markets in recent months.

Graph 1.8

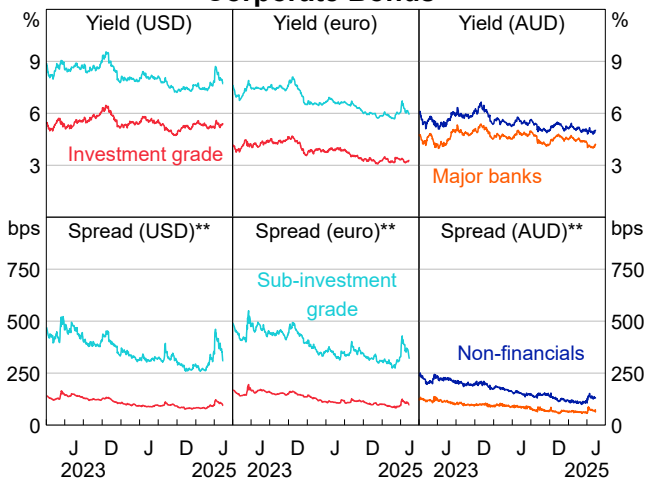
Equity Markets



* Total return basis, where 1 January 2023 = 100.
** 12-month forward earnings yield less 10-year inflation-linked government bond yield. Break in series due to data limitations.
*** Implied from 30-day S&P 500 options prices, annualised.
Sources: Bloomberg; LSEG; RBA.

Graph 1.9

Corporate Bonds*

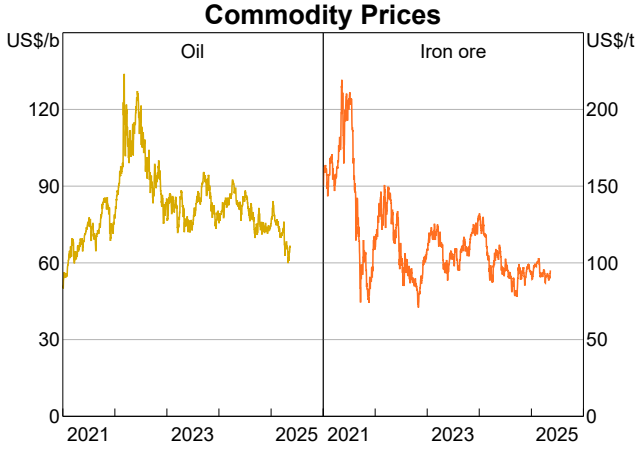


* The USD and euro series are the ICE BofA high yield and investment grade indices. The AUD series are three-year bonds for the major banks, and five-year BBB-rated bonds for non-financials.
** Spread to equivalent maturity government bond yield.
Sources: Bloomberg; ICE Data used with permission; RBA.

Oil prices have declined around 13 per cent since early April, but prices in most other key industrial commodity markets are now little changed.

Global growth concerns weighed on oil and base metal prices following the initial announcement of US tariffs in early April (Graph 1.10). Base metals prices recovered significantly following tariff pauses and expectations of trade deals, but OPEC+ supply increases kept oil prices low. Iron ore prices have remained resilient against the backdrop of the Chinese authorities' stated commitment to support activity in China; stimulus in China is expected to have a strong investment component.

Graph 1.10
Commodity Prices



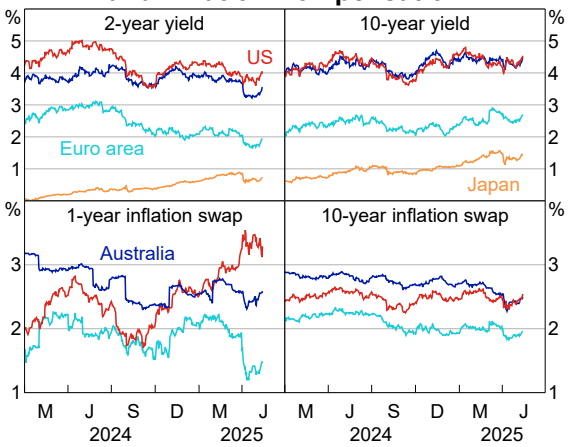
Sources: Bloomberg; RBA.

Short-term government bond yields in advanced economies have declined since the February *Statement*, though risk premiums on longer term US Treasuries have increased.

The decline in yields on short-term government bonds is consistent with modestly lower expectations for the near-term path of policy rates, while longer term yields have generally increased outside the United States (Graph 1.11). In most economies, measures of inflation compensation have declined, particularly at the short end, as market participants assess that the adverse demand implications of tariff developments will outweigh adverse supply-side effects, and in line with declining oil prices. By contrast, inflation compensation measures in the United States have increased over short horizons (of less than around two years) but declined further out. This suggests that market participants expect tariffs to have a material but short-lived effect on inflation, including perhaps because of an expectation that current tariff policy settings will be reversed.

The term premium on US Treasuries – which measures the compensation investors demand for bearing interest rate and other risk on longer term sovereign exposures – has risen in recent months. This contributed to the sharp increases in yields on long-term US Treasuries during the recent bout of volatility (discussed below), although the modest decline in policy rate expectations means that long-term US Treasury yields are slightly lower than in February. An increase in the term premium is consistent with the rise in economic uncertainty, while some market participants have suggested that concerns from foreign investors about the potential for more persistent uncertainty over US policy settings may also have reduced the foreign demand for US Treasuries.

Graph 1.11
Government Bond Yields and Inflation Compensation



Source: Bloomberg.

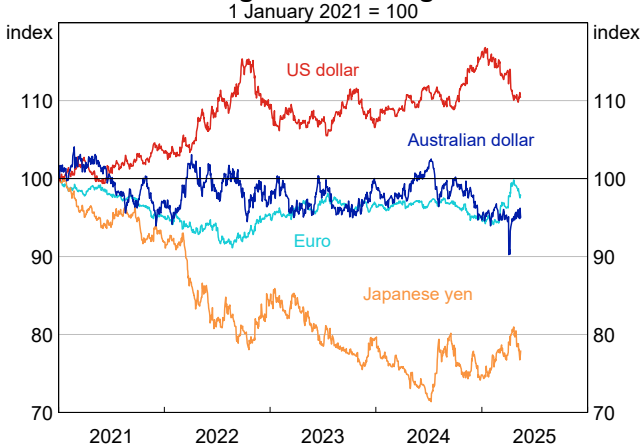
The US dollar depreciated against most advanced economy currencies, while the euro has appreciated.

After reaching multi-decade highs at the beginning of the year, the US dollar depreciated notably on a trade-weighted basis following the US tariff announcements in early April (Graph 1.12). This contrasted with many previous episodes of heightened uncertainty and risk aversion in financial markets, where the US dollar had tended to appreciate (discussed below). These developments also went against some market participants' expectations that tariffs would support the US dollar through reducing demand for imports into the United States, which would, in turn, lower demand for other currencies. Some weakening in forward-looking indicators of US activity – which led to downward revisions to US policy rate expectations – have also weighed on the dollar. The euro appreciated over this period, with relative expectations for euro area economic activity supported by expectations of increased fiscal spending. Movements in the Australian dollar are discussed in Chapter 2: Australian Financial Conditions.

Graph 1.12

Nominal Trade-weighted Exchange Rates

1 January 2021 = 100



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

In early April, moves in US asset prices and the US dollar departed from the more typical 'risk-off' pattern of recent decades, as some investors have sought to reduce US exposures.

Yields on long-term US Treasuries rose sharply alongside the broad-based depreciation of the US dollar on several days around the peak of heightened risk aversion at the start of April. This contrasted with the more common pattern of 'risk-off' market moves, where investors sell riskier assets such as equities and buy assets perceived to be safer such as longer dated US Treasuries, driving down the yield. While a depreciation in the US dollar during a 'risk-off' event is not unprecedented (e.g. a similar unwinding occurred following the collapse of the US 'dot-com bubble' in the early 2000s), the combination of this with large increases in long-term US Treasury yields was unusual by historical standards. Other benchmark government bonds (e.g. in Germany and Japan) experienced much smaller moves in yields than US Treasuries, while gold (another traditional 'safe haven' asset) increased in price. Pressure on US asset prices (but not the US dollar) diminished as market stress subsided in the days following the US administration's decisions to pause some tariffs and enter negotiations with its trading partners.

It is too early to tell whether this episode reflects a lasting view among investors that the degree of safety from US assets may have diminished, as some commentators have suggested. The episode was short-lived and could be explained by more conventional factors such as the unwinding of stretched positioning and the rebalancing of investor portfolios (rather than one motivated primarily by US safety concerns), since many investors were overweight US assets prior to the shock. Information from market liaison suggests that an unwinding of leveraged positions may also have contributed to the rise in long-term US Treasury yields. However, given the key role that US dollar assets, and particularly US Treasuries, play in global funding markets and the management of market participants' credit and liquidity risks, any lasting shift in investor behaviour towards US assets could increase the risks to market functioning or financial stability in the event of another similar negative shock. A view that the

US dollar is more likely to depreciate during these types of 'risk-off' episodes could also result in some international investors, who historically relied on an appreciating US dollar to be a 'natural hedge' in such episodes, choosing to increase currency hedges on their US dollar exposures; an increase in hedging of this nature reportedly contributed to a sharp appreciation of the New Taiwan dollar against the US dollar in early May.

Liquidity was strained at times, but markets did not experience the dislocations seen in past episodes of significant stress.

Measures of market functioning deteriorated in the days following the US tariff announcements on 2 April, most notably in the United States. Bid-ask spreads widened for both government and private sector securities, and while trading volumes increased, indicators of market depth (which represent the availability of willing buyers and sellers at close to market prices) deteriorated. Strained market liquidity and the elevated level of economic uncertainty contributed to an increase in realised and expected volatility in asset prices. In US equity markets, expected volatility rose to levels only exceeded during the global financial crisis and early days of the COVID-19 pandemic. Concerns about US Treasury market functioning following sharp increases in long-term yields were cited as one factor contributing to the US decision to pause some tariffs. However, markets did not experience the extreme dislocations seen in these previous crises. Since the US pause of some tariffs, liquidity has improved and volatility has subsided. Issuance of corporate bonds has also recovered somewhat from very low levels in early April.

Chapter 2
Australian Financial Conditions

Summary

- **Measures of Australian financial conditions have been mixed since the February *Statement* as markets have responded to changing trade policies and associated uncertainty for the economic outlook.** Risk sentiment deteriorated and market volatility increased following the US trade policy announcements in early April, but conditions have since improved as trade tensions have de-escalated. Nevertheless, yields on shorter term Australian Government bonds have declined, consistent with a softening in market participants' expectations for global growth and domestic growth and inflation. This has flowed through to lower yields on private sector debt in Australia, with the decline in risk-free rates more than offsetting the slight rise in risk premiums. Corporations have resumed bond issuance, after pausing their issuance for a couple of weeks in April. Meanwhile, the February cash rate reduction has flowed through the Australian financial system.
- **Domestic markets continued to function through the recent bout of volatility, but liquidity has been low at times and markets remain sensitive to international policy developments.** The trade policy news in April led to large price changes, which involved some rapid deleveraging of positions. Even so, market functioning did not deteriorate to the extent seen during the pandemic and has improved more recently. Financial conditions could tighten sharply if market participants' expectations for economic growth deteriorate further.
- **Market participants' expectations for the path of the cash rate have been revised lower, given the softer outlook for growth and inflation.** Market pricing implies that 80 basis points of cuts are expected in 2025, which is 30 basis points more than at the February *Statement*. This path would see the cash rate reach 3.30 per cent later in the year. Similarly, market economists, expect about 75 basis points of cuts by the end of the year.
- **There has been considerable volatility in the Australian dollar, though it is little changed on a trade-weighted basis since February.** The Australian dollar depreciated sharply alongside the deterioration in risk sentiment in early April. That depreciation has since unwound, driven by an improvement in sentiment and broad-based US dollar weakness alongside what appears to have been international portfolio adjustment away from US dollar assets. While the Australian dollar has appreciated relative to the US dollar, it remains lower against several other advanced economy currencies, reflecting Australian yields having declined by more than in those economies and concerns about the global growth outlook.
- **The spread that Australian banks and corporations pay over risk-free rates for market funding has increased slightly.** The widening in bond spreads relative to risk-free rates and the decline in Australian equity prices since the February *Statement* in part reflect investors' demand for more compensation to hold riskier assets. However, risk premiums remain low by historical standards, which suggests only a modest revision in market participants' outlook for the Australian economy, in part supported by an expected monetary policy response.

- **Bank funding costs have declined and credit growth has remained strong.** The February reduction in the cash rate flowed through to deposit and lending rates. Measures of bank funding costs have since declined further alongside decreases in risk-free rates, despite some volatility in short-term funding markets and a pause in sizeable bank bond issuances. Banks remain well funded following strong issuance last year. Household credit growth was little changed over the March quarter, while business credit growth remained strong.

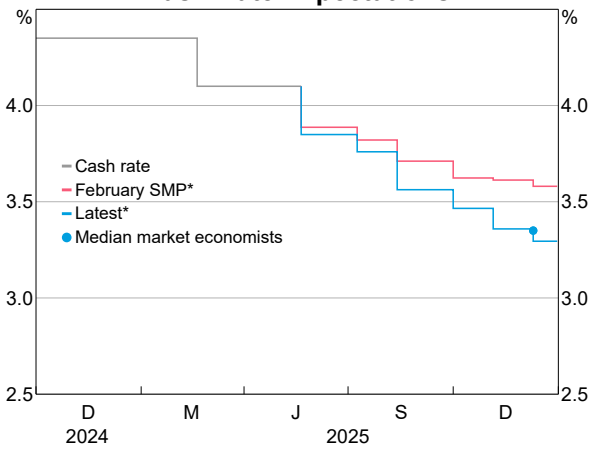
2.1 Interest rate markets

Market participants' expectations for the path of the cash rate have been revised lower.

Market-based expectations for the cash rate have declined since the US trade policy announcement in early April (see Chapter 1: In Depth – Global Economy and Financial Markets). The Monetary Policy Board's decision to keep the cash rate unchanged in April, which was shortly before the US trade policy announcement, had little impact on market-implied policy rate expectations. A 25-basis point reduction in the cash rate is now fully priced in for the May meeting and additional cuts of 55 basis points are expected by the end of 2025, which is 30 basis points more than in February (Graph 2.1).

Most market economists also expect a 25-basis point cut in May and a similar number of cuts as implied by market pricing thereafter. Several economists have added one additional 25 basis point cut to their end-2025 cash rate expectations and have brought forward the timing of expected easing, noting progress on disinflation and downside risks to global growth.

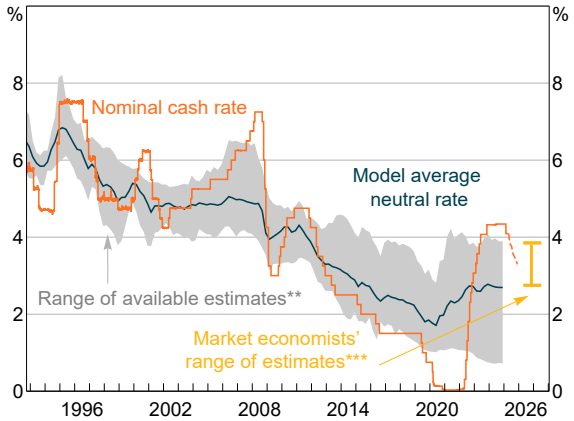
Graph 2.1
Cash Rate Expectations



* Cash rate expectations implied by OIS.
Sources: LSEG; RBA.

The market curve lies within the range of model-based estimates of the neutral interest rate (Graph 2.2). In other words, there are estimates of the nominal neutral rate that are above the market curve and estimates that are below. There is a large degree of uncertainty about these estimates, where each individual model estimate is also subject to its own uncertainty.

Graph 2.2
Nominal Neutral Rate*

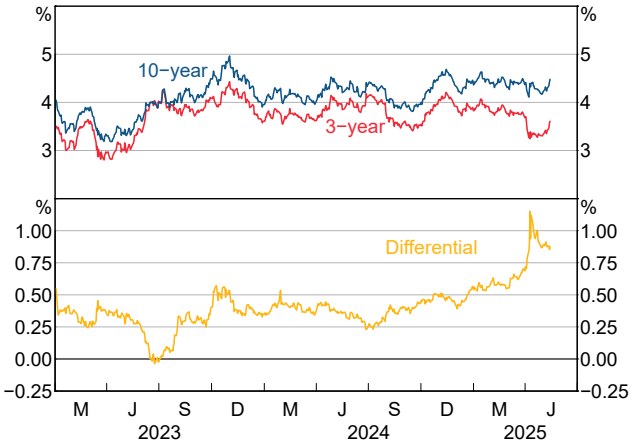


* Nominal neutral rates are defined using trend inflation expectations. Dashed lines show cash rate expectations implied by OIS as at 14 May 2025.
** Range of central estimates corresponding to available models; this range does not reflect considerable uncertainty around the central estimates.
*** The range of market economists' estimates has been adjusted by excluding the two highest and lowest observations.
Sources: Bloomberg; LSEG; RBA.

Short-term Australian Government bond yields have declined.

Yields on short-term Australian Government Securities (AGS) have declined (Graph 2.3). Longer term yields are little changed, as uncertainty around the US administration's policies have kept term premiums elevated. Expectations of easing monetary policy, particularly in the near term, and greater compensation for risk have both contributed to the AGS yield curve reaching its steepest level since 2021.

Graph 2.3
Australian Government Bond Yields



Sources: Bloomberg; RBA.

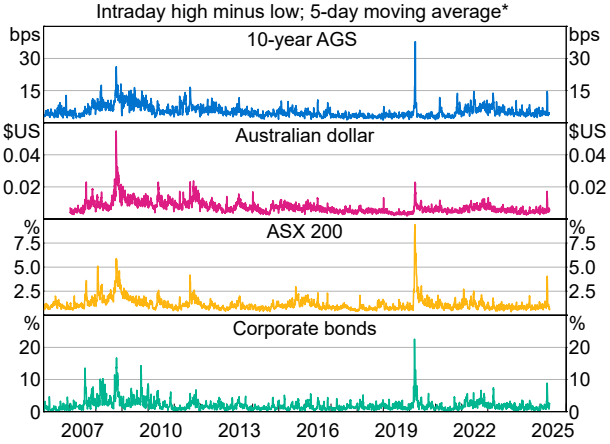
Market-based measures of inflation expectations are a little lower but remain anchored within the RBA's target range. Both break-even rates and inflation expectations implied by swap markets have declined since the February *Statement*. However, much of the decline was driven by a deterioration in liquidity in these markets and market participants reducing their trading positions following the US trade policy announcements in early April.

Domestic markets continued to function through the recent bout of volatility, but liquidity has been low at times and markets remain sensitive to international policy developments.

In April, conditions in Australian Government bond markets were volatile and liquidity deteriorated (Graph 2.4). Market participants reduced trading positions and leverage, and market makers increased the compensation they required from market participants to facilitate transactions. Although the moves were sizable, the extent of the reduction in trading positions and deterioration in market functioning was considerably smaller than during the pandemic. Primary issuance by the Australian Office of Financial Management and state and territory issuing authorities continued, albeit at a slower pace for some. Issuers entered this period ahead of their planned funding tasks. Liquidity deteriorated in short-term interest rate derivatives markets, which contributed to sharp declines in market-implied cash rate expectations during the month.

Similarly, volatility in the markets for the Australian dollar, Australian equities and corporate bonds increased noticeably in April, but by markedly less than during the pandemic. Indicators of liquidity in these markets, including bid-ask spreads, also widened sharply in currency and corporate bond markets in early April before improving gradually.

Graph 2.4
Volatility in Selected Markets
Intraday high minus low; 5-day moving average*



* The ASX 200 panel shows the intraday range as a percentage of the intraday low for the ASX 200 index; the corporate bonds panel shows the daily absolute percent change on the Markit iTraxx Australia CDS index, which comprises both financial and non–financial corporate credit default swaps.

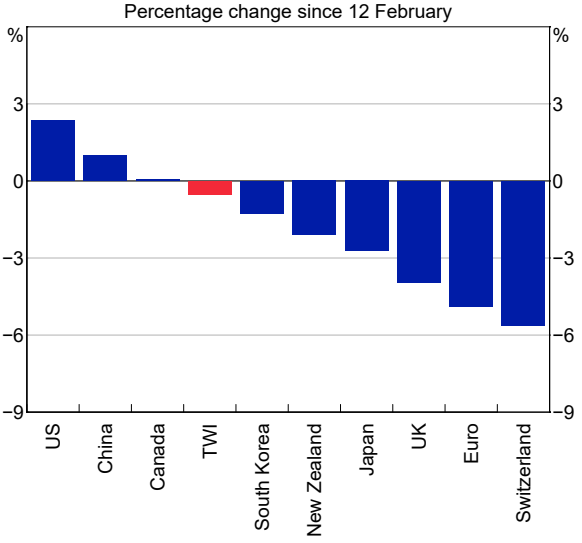
Sources: Bloomberg; RBA.

2.2 Australian dollar

There has been considerable volatility in the Australian dollar, but on a trade-weighted basis it remains little changed since the February *Statement*.

The Australian dollar depreciated sharply on a trade-weighted basis following the US trade policy announcement in early April but has since recovered alongside risk assets prices to be around its February level (Graph 2.5). The Australian dollar has appreciated against the US dollar amid broad-based US dollar weakness but has depreciated against most other advanced economy currencies. This is consistent with both Australian yields having declined by more than in many of these economies and the increased uncertainty around the outlook for the Chinese economy. The Australian dollar TWI remains around the bottom of the range observed since 2022, and in real terms is slightly below the level implied by the long-run historical relationship with the forecast terms of trade and real yield differentials.

Graph 2.5
Australian Dollar
Percentage change since 12 February



Source: Bloomberg; RBA.

The Australian dollar has historically been an important buffer for the Australian economy, depreciating in response to a downgrade in global growth or increased global risk aversion. In this way it supports demand in Australia by making local producers more competitive. Over recent months, the Australian dollar has remained sensitive to news about the global outlook, and much of its recent resilience is consistent with financial markets that appear to be pricing in only modest downward revision to global growth. However, if the US dollar continues to depreciate during periods of heightened risk aversion, then this could, at the margin, dampen this dimension of the shock-absorbing role of the Australian dollar. The recent US dollar depreciation is discussed in more detail in Chapter 1: In Depth – Global Economy and Financial Markets.

2.3 Australian equity, credit and banking markets

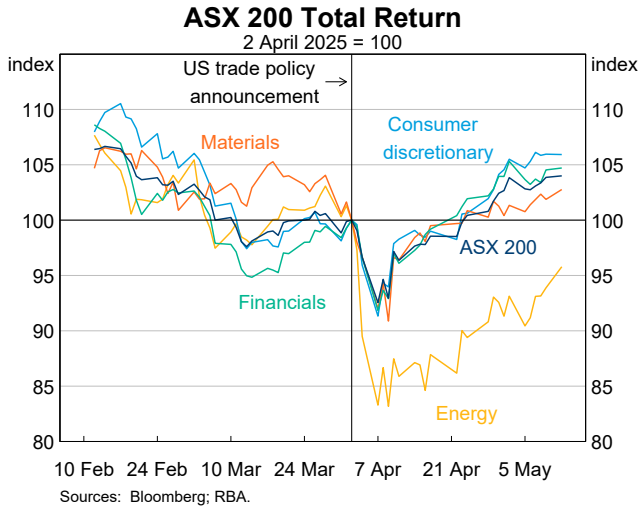
The spread that Australian banks and corporations pay over risk-free rates for market funding has increased slightly.

Investors have demanded more compensation to hold riskier assets since the February *Statement*. The repricing was particularly sharp after the US tariff announcements on 2 April, with a more muted reaction in Australia than in the United States (see Chapter 1: In Depth – Global Economy and Financial Markets). This has largely unwound since, in line with international developments. Overall, the rise in risk premiums in Australia is consistent with a somewhat softer domestic economic outlook and lower path for the cash rate providing some support to the Australian economy if global growth slows. Even so, the still relatively low level of risk premiums leave asset prices susceptible to a sharp repricing in the event of adverse news, which could abruptly increase borrowing costs for businesses, including banks.[1]

Australian equity prices declined sharply in early April but have since recovered. The decline was particularly prominent in the energy sector, in line with a sharp fall in oil prices and OPEC+'s plans to increase production (Graph 2.6). The ASX 200 has rebounded on news of smaller and delayed implementation of tariffs; however, it is still 1.6 per cent lower since the February *Statement*. Equity prices in sectors that are particularly sensitive to changes in the economic outlook, such as the consumer discretionary sector, have largely tracked the main index.

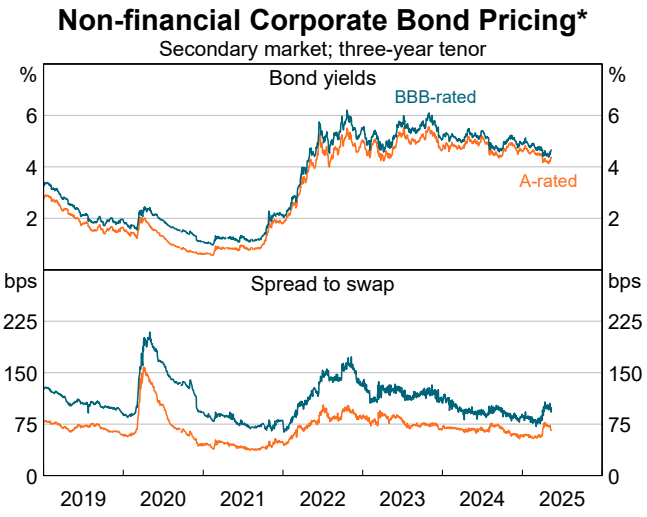
Spreads in the secondary market on bonds issued by banks and non-financial corporations have widened slightly. Despite this, yields on bank and non-financial corporate bonds have declined at shorter tenors as the decline in risk-free rates more than offset wider spreads (Graph 2.7). The similar widening in spreads across higher and lower rated corporate bonds is consistent with only a modest revision in market participants' outlook for the Australian economy.

Graph 2.6



Sources: Bloomberg; RBA.

Graph 2.7



* A-rated and BBB-rated include both bonds issued domestically, and bonds issued offshore swapped back into AUD.

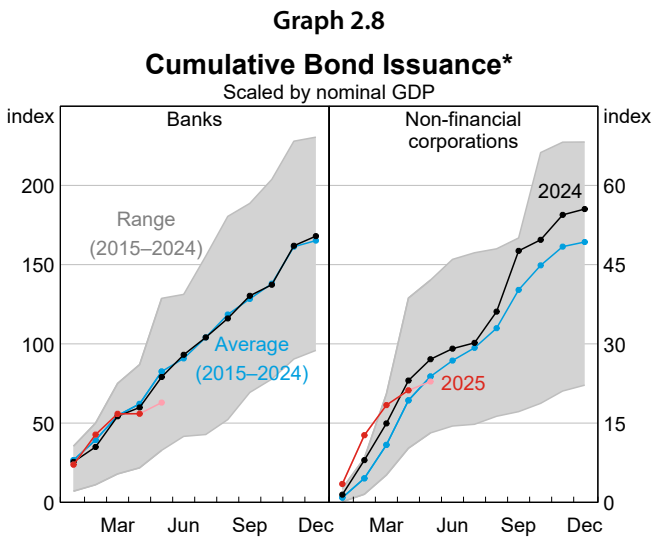
Sources: Bloomberg; RBA.

Corporate bond issuance has resumed after a brief hiatus.

International developments and heightened volatility led to a brief pause in non-financial corporate bond issuance and a longer pause in sizeable bond issuance from Australian banks (Graph 2.8). Such pauses are rare outside of year-end holiday periods. However, this followed strong non-financial corporate issuance earlier in the year. Issuance resumed in late April for non-financial corporations, which have issued mostly offshore in euros. Similarly, there was a lengthy pause in bond issuance from Australian banks starting around mid-March, which was longer than typically seen ahead of banks' reporting of half-yearly results. Liaison with market participants suggests that the domestic market remains open to bank and non-financial corporate issuers, albeit with more challenging deal execution due to continued uncertainty. Many issuers are well funded for the months ahead and are waiting for spreads to narrow further before resuming issuance; some are also turning to bank credit, which liaison suggests is currently a more attractive source of funding for large corporations as spreads in wholesale markets have widened.

Securitisation issuance – a key source of funding for non-bank lenders – has also slowed significantly since April, following strong volumes in the March quarter. Some issuers paused their in-progress deals because of market conditions. Issuance resumed in May, at wider spreads in line with trends observed in other wholesale funding markets.

Graph 2.8



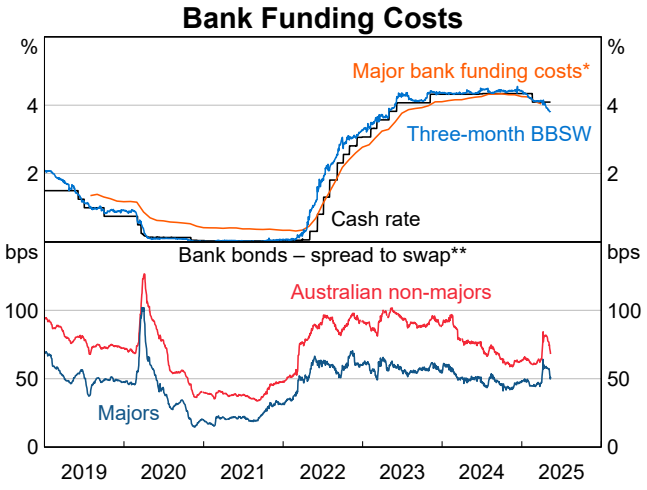
* Cumulative gross issuance from the start of each calendar year; includes hybrids. For years before 2025, issuance is scaled by that year's nominal GDP relative to 2025: $100bn of issuance in 2025 is indexed to 100. Current year nominal GDP is the average of all available quarters in the current year. The May 2025 observation is to 14 May.

Sources: Bloomberg; Private Placement Monitor; RBA.

Bank funding costs have declined since the cash rate was reduced in February and as expectations for the path of the cash rate have decreased further.

Bank funding costs have declined since February (Graph 2.9). In part, this reflects banks having passed the February reduction in the cash rate through to rates paid on deposits. It also reflects a decline in bank bill swap rates (BBSW) – to which much of banks' funding costs are ultimately linked – driven by a decline in market participants' expectations for the path of the cash rate. Spreads between bank bond yields and the swap rate widened following the US trade policy announcements but have since narrowed in line with international developments; even at their widest, they remained well below levels reached during the pandemic. Interest rates on overnight repo – which banks use in managing their liquidity – increased a little in April following the announcements and as the RBA increased its open market operation (OMO) pricing (relative to the cash rate target).

Graph 2.9



* RBA estimates of overall outstanding hedged debt and deposit costs for the major banks.

** Domestic secondary market; three-year target tenor.

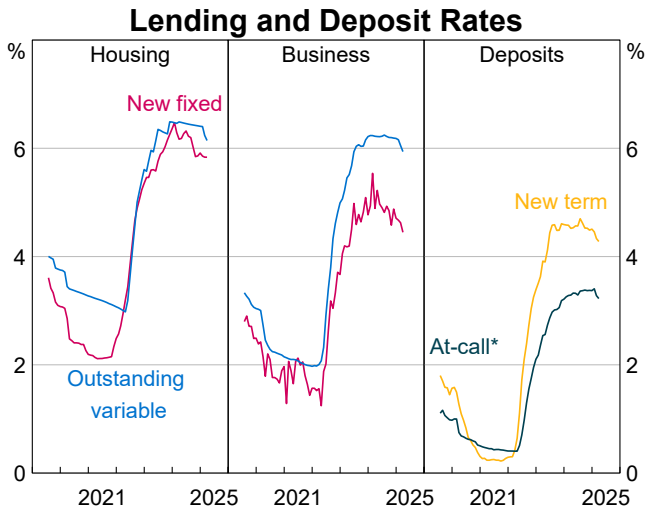
Sources: APRA; ASX; Bloomberg; LSEG; major bank liaison; Private Placement Monitor; RBA.

Even if there were a significant economic downturn, the banking sector is well placed to absorb large losses and continue lending to households and businesses.[2] Banks remain well funded following strong issuance last year, despite the pause in bond issuance discussed above, and continue to maintain capital and liquidity buffers well above regulatory requirements.

Lenders passed through the February cash rate reduction to lending and deposit rates.

Average new and outstanding variable mortgage rates declined by around 25 basis points over February and March, reflecting the pass-through of the February cash rate reduction (Graph 2.10). The average interest rate on new fixed-rate mortgage lending was little changed over the March quarter but is 65 basis points below its early 2024 peak. Business lending rates have also declined alongside declines in BBSW rates. Banks have also lowered at-call and term deposit rates, reflecting the cash rate reduction and declines in short-term market rates.

Graph 2.10



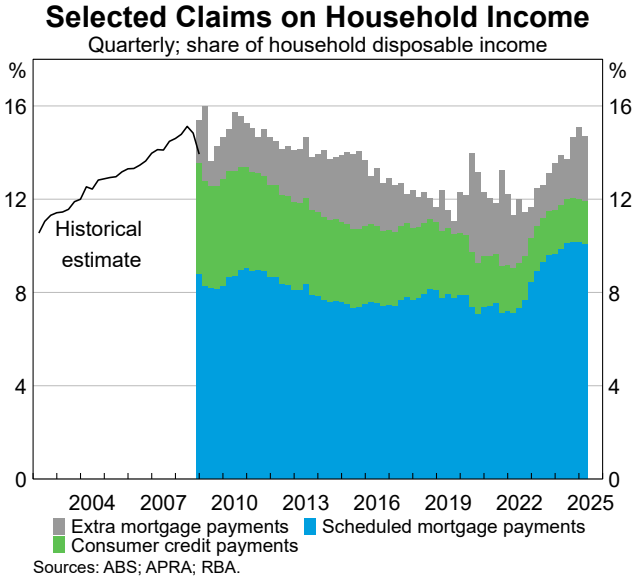
* Includes deposits in housing loan offset accounts.
Sources: APRA; RBA.

Since April, there have been further reductions in advertised interest rates on fixed-rate mortgages alongside declines in swap rates. Some lenders have reduced advertised interest rates on some fixed-rate mortgage products by more than 50 basis points over 2025 to date. However, these reductions have had little effect on overall household financial conditions because most mortgage lending has been variable rate; in March, less than 3 per cent of new mortgage lending was fixed-rate. Banks also reduced advertised interest rates on term deposits in April alongside declines in BBSW, though these reductions were generally smaller and less widespread than those on fixed-rate mortgages.

Scheduled mortgage payments decreased following the February cash rate reduction but remain high.

Scheduled principal and interest mortgage payments decreased in the March quarter to 10.1 per cent of household disposable income. However, the value of scheduled mortgage and consumer credit payments as a share of household disposable income remains around its highest level since 2012 (Graph 2.11, blue and green bars) – and payments into mortgage offset and redraw accounts (Graph 2.11, grey bars) remain above their pre-pandemic average. The share of borrowers that are behind on their loan repayments remains low.[3]

Graph 2.11

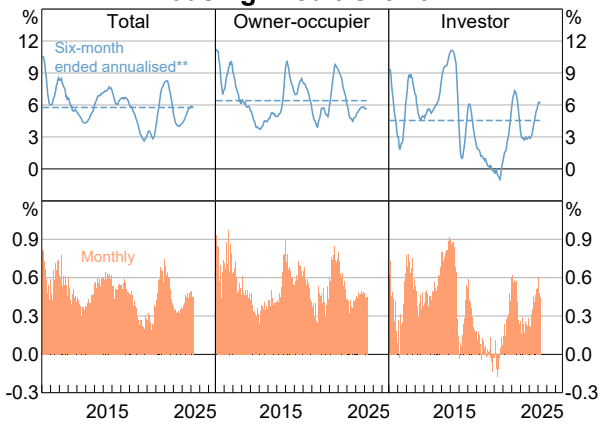


Sources: ABS; APRA; RBA.

Household credit growth remained steady over the March quarter, while the household credit to income ratio declined further.

Housing credit growth was little changed over the March quarter alongside soft housing price growth. Owner-occupier credit growth declined slightly over this period, offsetting increased growth in investor credit (Graph 2.12). Overall housing credit growth remains around its post-2008 average. Despite continued growth in housing credit, overall household credit (including personal credit) declined further as a share of household disposable income over the quarter to December 2024.

Graph 2.12
Housing Credit Growth*

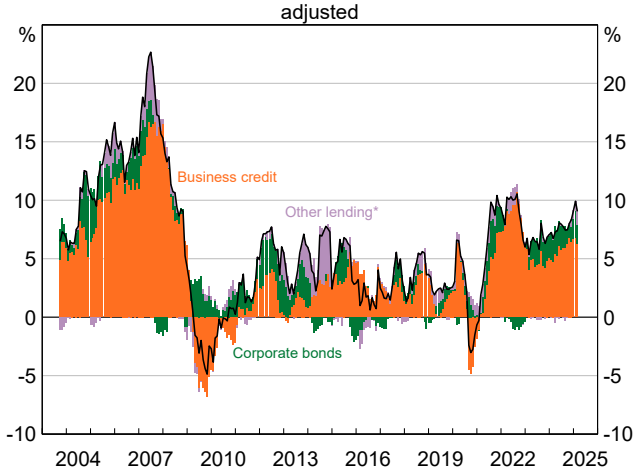


* Seasonally adjusted and break-adjusted.
** Dashed lines are the post-2008 averages for each series.
Sources: ABS; APRA; RBA.

Growth in business debt remained strong in the March quarter.

Business debt growth remained strong in the March quarter in six-month-ended terms (Graph 2.13). Business credit growth has been broadly based across industries, supported by strong competition among lenders for business customers. Business debt has increased slightly as a share of nominal GDP since mid-2023. Profit margins for most businesses remain around pre-pandemic levels, which has supported businesses' borrowing and debt-servicing capacity.

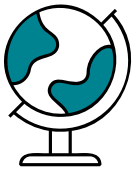
Graph 2.13
Business Debt
Six-month-ended annualised growth, seasonally adjusted



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

Endnotes

1 See RBA (2025), 'Chapter 1: The Global Macro-Financial Environment', *Financial Stability Review*, April.
2 See RBA (2025), 'Chapter 3: Resilience of the Australian Financial System', *Financial Stability Review*, April.
3 See RBA (2025), 'Chapter 2: Resilience of Australian Households and Businesses', *Financial Stability Review*, April.

Chapter 3

Australian Economic Conditions

Summary

- **Economic activity in Australia has evolved broadly as expected in the February *Statement*, though the data mostly pre-date the escalation in international trade tensions.** GDP growth increased in the December quarter, and in year-ended terms looks to have picked up a little further in March. There appears to have been slightly less growth in household spending in the March quarter than had been expected in February, partly reflecting the impact of flooding in Queensland and New South Wales.
- **Underlying inflation has continued to ease in year-ended terms, as expected.** Trimmed mean inflation was 0.7 per cent in the March quarter and 2.9 per cent in year-ended terms, returning to the 2–3 per cent range for the first time since late 2021. There has been a broad-based easing in underlying inflation over the past year. Services inflation eased to around its historical average in early 2025, while new dwelling costs continued to decline.
- **Headline inflation was unchanged at 2.4 per cent in year-ended terms in the March quarter.** The quarterly rate picked up strongly to 0.9 per cent, reflecting the unwinding of some government subsidies to households.
- **While there are limited data available for the June quarter, recent international developments have had only a modest impact on timely indicators of domestic activity.** Surveys and liaison suggest that business and consumer sentiment has been little changed. While liaison contacts have noted concerns about the outlook, they have reported that domestic conditions generally remain favourable and that global developments have had limited direct effect on their investment or employment decisions.
- **Housing market conditions eased over most of 2024 but had stabilised before the reduction in the cash rate in February.** Since then, seasonally adjusted monthly housing price growth has remained relatively stable, suggesting that it is yet to respond materially to easier borrowing conditions.
- **Labour market conditions are still assessed to be tight and have not eased materially since mid-2024. Broader capacity pressures have likely eased.** Overall, there remains considerable uncertainty around estimates of spare capacity. Recent unemployment outcomes have been in line with the February forecasts.
  The unemployment rate has been steady at around its current level of 4.1 per cent since the middle of last year while the underemployment rate has declined a little over that period. The share of firms reporting that labour availability is constraining output remains elevated. The participation rate and employment-to-population ratio are around their

levels in late 2024. Timely indicators of labour demand, such as job advertisements, have been little changed in recent months. This suggests recent international developments have not yet had a material impact on the Australian labour market.

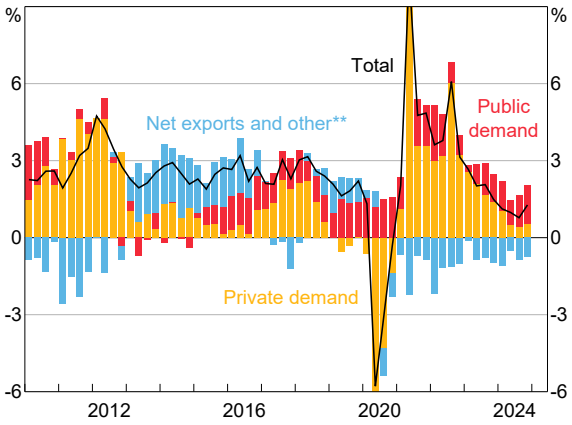
- **Year-ended wages growth increased slightly to 3.4 per cent in the March quarter, as expected in the February *Statement*, but remains lower than a year earlier.** Looking through the effects of administered wage decisions, growth in private sector nominal wages has declined over the past year. Public sector wages growth continues to be volatile and recent strength has been driven by several large enterprise agreements. Unit labour cost growth – a comprehensive, though more volatile, measure of labour cost pressures – remains elevated, reflecting persistently weak productivity growth.

3.1 Domestic economic activity

Australian GDP growth over the December and March quarters together looks to have been broadly as expected, though recent data suggest there was slightly less growth in household spending in the March quarter than anticipated in the February *Statement*.

GDP grew by 0.6 per cent in the December quarter, a touch above our expectation of 0.5 per cent in the February *Statement*, supporting our view that a modest recovery in domestic demand was underway. Public demand accounted for around half of GDP growth in the quarter (Graph 3.1). Recent growth in public consumption has been driven by spending on social benefit programs like the National Disability Insurance Scheme (NDIS) and aged care as well as electricity subsidies to households. Continued strength in public investment has reflected spending on defence and public infrastructure projects.

Graph 3.1
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.

Timely data suggest that GDP growth in the March quarter is likely to have been a little weaker than forecast in the February *Statement*. Part of this reflects temporary effects from flooding in New South Wales and Queensland (see Box B: The Impact of the Recent Floods on the Australian Economy). Abstracting from the effect of the floods, household spending growth looks to have been slightly weaker than expected (see below for more details). Partial data suggest net trade will detract from GDP growth in the quarter, driven by solid growth in imports and a decline in services exports.

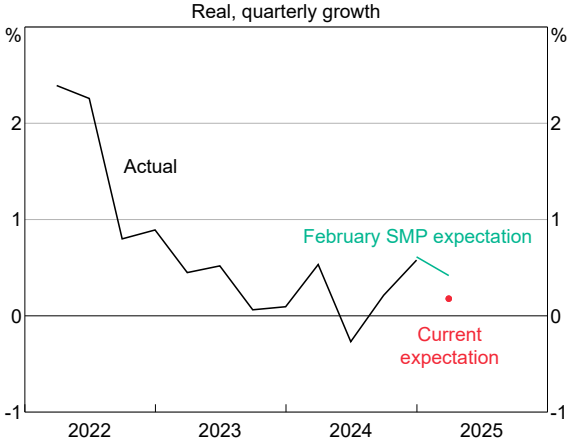
Household spending continued to grow in early 2025, though by a little less than expected in the February *Statement*.

Household consumption grew by 0.4 per cent in the December quarter of 2024, broadly in line with our February forecast. In underlying terms (abstracting from electricity subsidies), household consumption growth was slightly stronger at around 0.5 per cent. Growth was broadly based, with increases recorded across discretionary and essential spending categories. Some of the strength in consumption in the December quarter likely reflected price-sensitive consumers concentrating their spending in promotional periods. The further increase in real incomes in the quarter, driven by labour income, also supported spending growth.

While growth in underlying household consumption had been expected to moderate in the March quarter as promotional periods ended, timely indicators suggest it may have eased by a little more than anticipated in the February *Statement*. The nominal ABS household spending indicator pointed to a decrease in spending on promotion-affected categories in the March quarter, as expected. However, growth in other discretionary household consumption categories (such as eating out) also looks to have eased, which could suggest that momentum in household consumption growth is a little weaker than previously judged. Part of the easing in aggregate growth also reflects the effects of recent flooding, which is expected to have been temporary. Overall, underlying household

consumption growth is now expected to have eased to 0.2 per cent in the March quarter, a little slower than the 0.4 per cent expected in the February *Statement* (Graph 3.2). This is broadly consistent with liaison reports that retail conditions have not picked up much since late 2024. Contacts continue to indicate that consumers remain price sensitive, with this behaviour expected to persist for some time.

Graph 3.2
Underlying Household Consumption*
Real, quarterly growth



* Excludes the estimated effect of household energy subsidies from ABS published consumption growth.

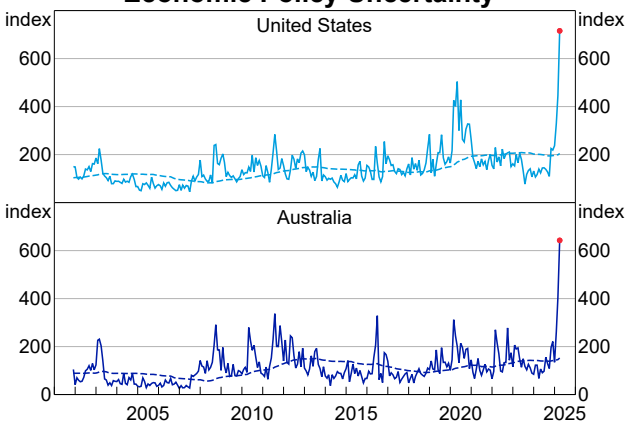
Sources: ABS; RBA.

While there are few data available for the June quarter, recent international developments have had only a modest impact on timely indicators of domestic activity.

There is limited economic activity data available for the June quarter to date and liaison contacts generally report that it is still too early to assess the likely implications for their business from recent international developments (see Box C: Insights from Liaison). The direct effects of announced US tariffs on Australian exports are expected to be small, though there are a range of indirect effects that could affect Australia's trade (see Box A: How Might Tariffs Affect Australian Trade?).

Australian economic activity could also be affected by increasing uncertainty. The escalation of trade tensions has increased policy uncertainty in Australia in the June quarter (Graph 3.3). High levels of uncertainty can lead firms to delay investment decisions that would be costly to reverse, because it increases the value of waiting for additional information. Similarly, some households may delay large purchases and increase precautionary savings. There is some empirical evidence, including for Australia, that high uncertainty leads to a decline in business investment, with negative but smaller effects on employment, household consumption and inflation.[1]

Graph 3.3
Economic Policy Uncertainty*

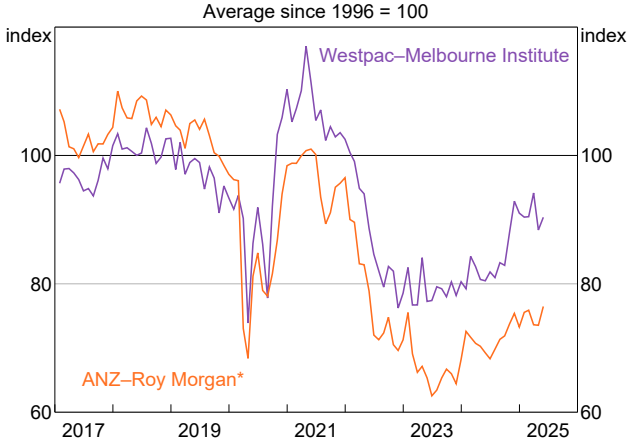


* Dashed line shows five-year moving average; dot represents latest data as at April 2025.

Sources: Baker, Bloom and Davis (2016); RBA.

The recent escalation in trade tensions so far appears to have had a limited impact on consumer sentiment in Australia, which remains above its post-pandemic lows. Consumer sentiment indicators had risen solidly over the second half of 2024, supported by the pick-up in real household incomes, but have remained relatively stable since the start of the year (Graph 3.4). Since the start of April, when global trade tensions escalated sharply, consumer sentiment has been more resilient in Australia than in a number of other advanced economies (see Chapter 1: In Depth – Global Economy and Financial Markets).

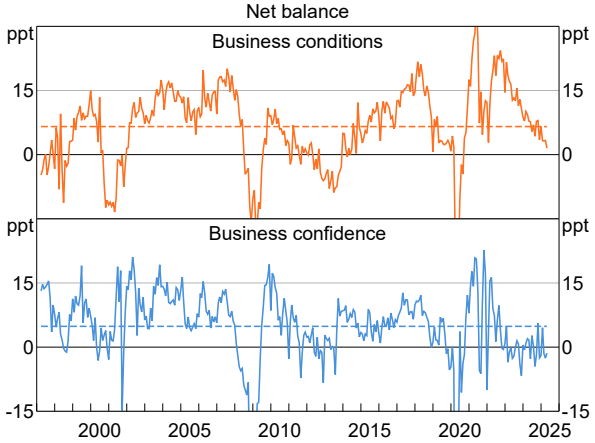
Graph 3.4
Headline Consumer Sentiment
Average since 1996 = 100



* Rescaled to have the same average as the Westpac–Melbourne Institute index since 1996.
Sources: ANZ–Roy Morgan; RBA; Westpac–Melbourne Institute.

Business sentiment also shows little sign of having been affected by global developments, though it remains below long-term averages and uncertainty about the outlook has increased. Surveyed business conditions, which have trended downwards since mid-2022, declined slightly in April (Graph 3.5). Business confidence (a forward-looking indicator) edged up slightly in April despite global developments, though it remained negative. Prior to April, firms in surveys cited wage costs, consumer demand and margin pressure as key factors contributing to weaker business conditions and confidence.

Graph 3.5
Business Sentiment*
Net balance



* Dashed lines represent the long-term average of each series from 1997; outliers have been truncated.
Sources: NAB; RBA.

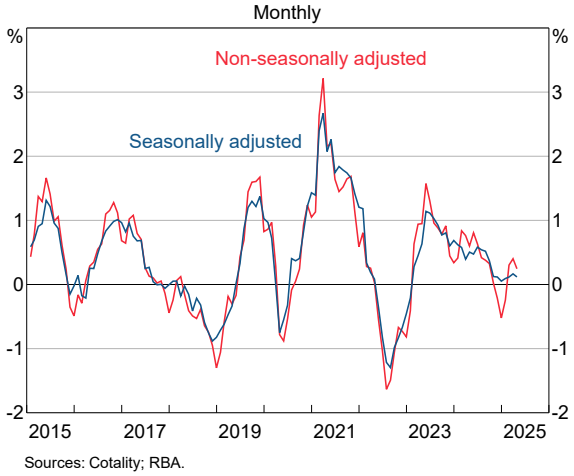
Conditions reported by firms in the liaison program have been relatively steady over recent months. Few firms in the RBA's liaison program have reported any changes to their investment plans in response to recent international developments. Some liaison contacts have continued to cite elevated input costs (particularly in the construction sector) as a key factor weighing on investment intentions. Firms also report that investment in large renewable energy projects continues to be pushed back. Nevertheless, investment related to the energy transition, together with investment in computer software and data centres, was an important driver of overall business investment over the past year. This was offset by weakness in machinery and equipment and buildings investment to leave business investment broadly flat over 2024.

Housing market conditions have been stable in recent months after easing over most of 2024.

New dwelling investment was steady in the December quarter and was broadly in line with its average level over the past few years. Weak commencements and capacity constraints in the finishing stages of the construction process held back activity, but this weakness was broadly offset by projects in the pipeline moving closer to completion. Building approvals for higher density construction have picked up since the start of 2024, although the level of approvals and commencements remains low on a per capita basis; liaison contacts have noted that high costs challenge the feasibility of some higher density construction. Detached commencements decreased in the December quarter after increasing earlier in the year, reflecting subdued demand for new home sales.

Housing price growth has been steady at a relatively low rate. The reduction in the cash rate in February is yet to have a noticeable impact on aggregate housing market indicators. After seasonal adjustment, housing prices increased at an annualised rate of around 1 per cent in April, similar to growth rates observed since October and in line with expectations in the February *Statement* (Graph 3.6). While housing prices typically respond relatively quickly to interest rate changes, the speed and size of the response depends on the expected path of future interest rates and other macroeconomic variables.[2]

Graph 3.6
Housing Price Growth



Sources: Cotality; RBA.

3.2 Labour market and wages

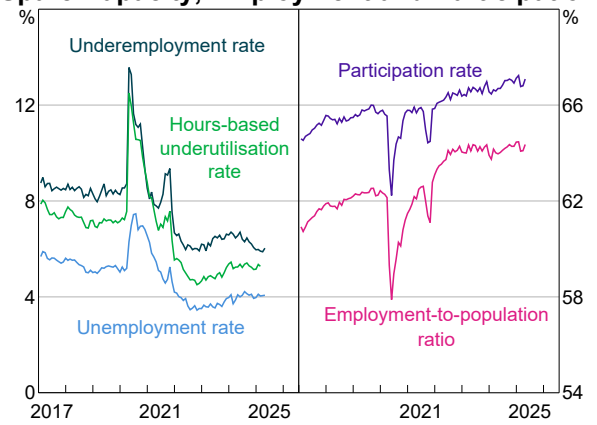
Overall labour market conditions and wages growth have been broadly as expected in the February *Statement*.

Conditions in the labour market have been steady in recent months. The unemployment rate has been little changed so far this year, as anticipated in the February *Statement*. Some labour market indicators that appeared to be tightening in late 2024 have since stabilised. Measures of job ads – which tend to lead changes in the unemployment rate – had been steady or eased only slightly leading up to the escalation of trade tensions in early April and have remained broadly stable since. With labour market conditions steady recently, we continue to assess that the labour market is tight, although there is considerable uncertainty around estimates of full employment (see section 3.3 Assessment of Spare Capacity). The rate at which workers move between jobs has continued to trend downwards over recent quarters, which might indicate less upwards pressure on wages growth and inflation than implied by the unemployment rate. Nevertheless, recent wages growth outcomes have been in line with expectations in the February *Statement*, though growth in unit labour costs remains high and has been stronger than expected.

Many labour market indicators have stabilised recently.

The unemployment rate was 4.1 per cent in April, as expected in the February *Statement*, and is little changed since mid-2024 (Graph 3.7). The underemployment rate had been declining over the second half of 2024 but has stabilised since the start of the year at 6.0 per cent, close to its level in late 2022. Other measures of labour underutilisation, including the hours-based underutilisation rate – a broader measure of spare capacity – and the medium-term unemployment rate have largely tracked sideways since the start of the year.

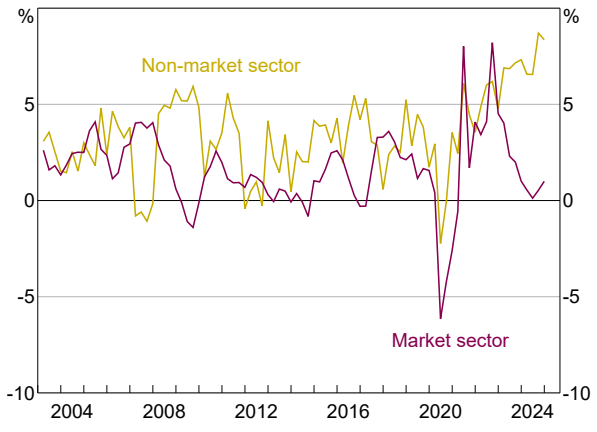
Graph 3.7
Spare Capacity, Employment and Participation



Sources: ABS; RBA.

Employment growth has been solid since the start of the year, notwithstanding monthly volatility. The employment-to-population ratio rose to 64.3 per cent in April to be around its level in late 2024. Industry-level data (available up to December 2024) suggest that the non-market sector, which includes the health care and education industries, continued to support aggregate year-ended employment growth through to late 2024 (Graph 3.8). Year-ended employment growth in the market sector has recovered slightly from subdued levels, consistent with the gradual pick-up in GDP growth. The participation rate – the share of the working age population either employed or searching for a job – increased to 67.1 per cent in April to be around historical highs. The longer run trend of higher female participation continues to support recent participation rate outcomes.

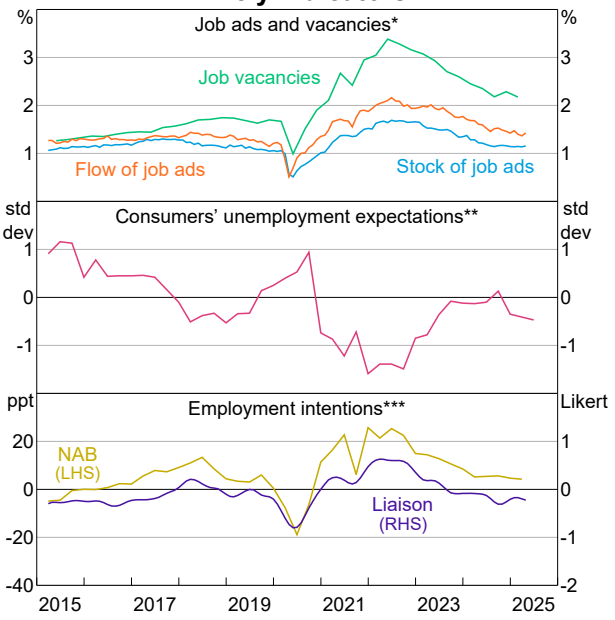
Graph 3.8
Employment Growth
Year-ended



Sources: ABS; RBA.

Timely indicators of labour demand suggest that the recent escalation in global trade tensions has not yet had a material impact on the Australian labour market (Graph 3.9). Following the escalation in trade tensions in April, measures of job advertisements and households' unemployment expectations have been broadly stable. Contacts in the RBA's liaison program have not generally changed their hiring intentions in response to these global developments. We will continue to monitor these indicators closely in the period ahead, as the impact of heightened global policy uncertainty on the Australian labour market becomes clearer.

Graph 3.9
Timely Indicators

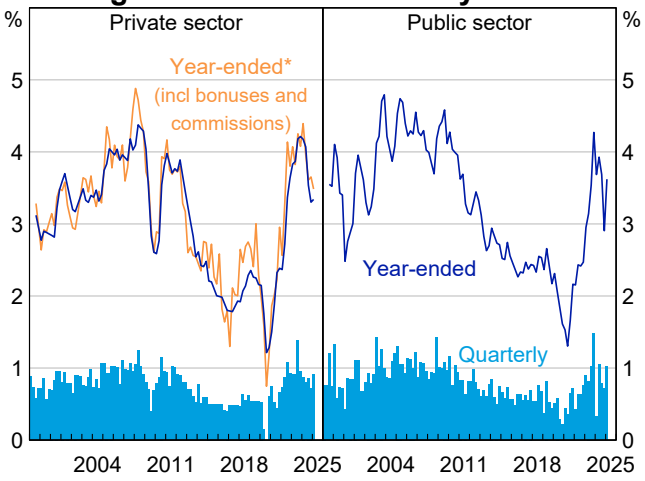


* As a share of the labour force.
** Standard deviations from 1980–2025 average; an increase indicates more consumers expect unemployment to rise over the year ahead; quarter average; survey by Westpac–Melbourne Institute; seasonally adjusted by the RBA; June quarter 2025 outcome is the average of the April and May 2025 outcomes.
*** Deviation from long-run average.
Sources: ABS; ANZ–Indeed; JSA; NAB; RBA; Westpac–Melbourne Institute.

Wages growth, on a year-ended basis, has moderated over the past year.

Wages growth ticked up slightly to 3.4 per cent in the March quarter, as expected in February. Quarterly growth in private sector wages picked up to 0.9 per cent in March, largely reflecting increases to the award wages of childcare and aged care workers (Graph 3.10). Public sector wages growth increased, owing primarily to several large agreements. The finalisation of some agreements had been delayed in previous quarters and has contributed to volatility in recent Wage Price Index (WPI) outcomes.

Graph 3.10
Wage Price Index Growth by Sector



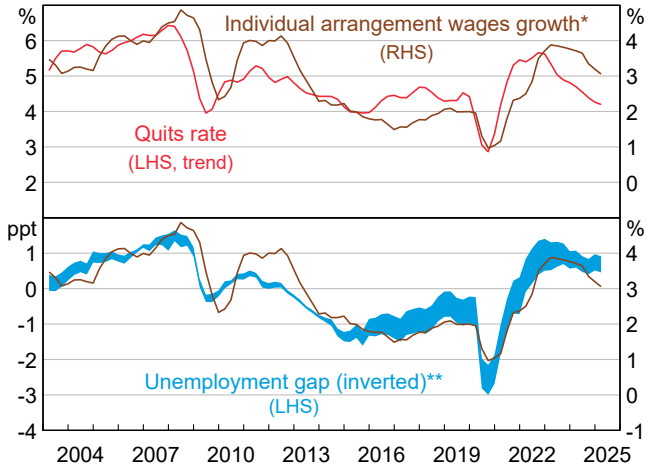
* Non-seasonally adjusted.
Source: ABS.

Looking through the effects of administered wage decisions, underlying growth in private sector wages was little changed in the March quarter but was lower than a year ago. Wages growth has eased for workers paid under individual arrangements, whose wages tend to be the most responsive to labour market conditions (Graph 3.11). The rate at which workers have moved between jobs – as reflected in the number of quits as a share of filled jobs – has declined in trend terms in recent quarters. In part, this may suggest fewer opportunities for workers to switch jobs, consistent with market sector employment growth being soft over the past year. The decline in the quits rate may also reflect reduced willingness by workers to switch jobs, consistent with weak consumer sentiment. The decline in labour mobility suggests that inter-firm competition to attract and retain staff may have eased, and so there

may be less upward pressure on wages – and less tightness in the labour market – than implied by other indicators, such as the unemployment rate (see Chapter 4: Outlook). In liaison, some firms have noted that the recent decline in inflation has contributed to slower wage growth. To date, liaison contacts report that uncertainty relating to the global trade environment has not materially affected their expectations for wages growth.

Graph 3.11

Wages Growth and Labour Market Indicators



* Year-ended; non-seasonally adjusted.
** Unemployment gap is the unemployment rate minus the range of estimates of the NAIRU.
Sources: ABS; RBA; Ruberl et al (2021).

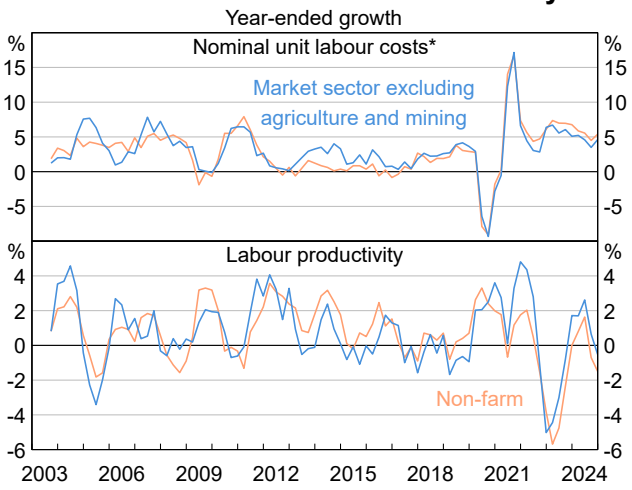
Unit labour costs growth increased in the December quarter, with the high growth rate underpinned by weak productivity outcomes.

Growth in the national accounts measure of average earnings per hour (AENA) increased slightly in the December quarter and was stronger than growth in the WPI. Growth in AENA was stronger than expected over the year to December, increasing to 3.7 per cent. Compared with WPI growth, this measure provides a broader picture of earnings growth for employees, including changes in bonuses, overtime and other payments, as well as the impact of workers transitioning to jobs with different levels of pay. These additional factors make average earnings per hour a more comprehensive indicator of labour costs, with a stronger link to unit labour costs. However, this measure is more volatile than the WPI, and so provides a noisier read on wage pressures arising from tightness in the labour market.

Year-ended growth in unit labour costs rose to 5.4 per cent in the December quarter, which is both elevated and stronger than expected in the February *Statement* (Graph 3.12). The increase, from 4.5 per cent in the September quarter, was driven by weaker labour productivity growth and the stronger-than-expected outcome for average earnings growth (as discussed above). Unit labour costs growth for the market sector, excluding the mining and agriculture industries, was a little lower than in the non-farm sector as a whole at 4.6 per cent over the year to the December quarter. That reflects the fact that measured productivity growth in the market sector has been less weak than in the non-farm sector. Elevated market and non-farm sector unit labour cost growth are both consistent with the judgement that labour market conditions overall remain relatively tight.

Graph 3.12

Unit Labour Costs and Productivity



* To calculate nominal unit labour cost growth excluding specific industries, it is assumed that the ratio of employee to self-employed hours worked is consistent over time and between industries.
Sources: ABS; RBA.

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

Non-farm labour productivity decreased by 1.5 per cent over the year to the December quarter (Graph 3.12). Market sector (excluding agriculture and mining) labour productivity fell by 0.1 per cent over the same period. Labour productivity is around its 2015 level. The earlier recovery in the capital-to-labour ratio has stalled in recent quarters. Multifactor productivity (MFP), which is the part of labour productivity growth not due to changes in the capital-to-labour ratio and which reflects how efficiently inputs are being used, remained very weak; MFP declined by 1.4 per cent over the year to the December quarter.

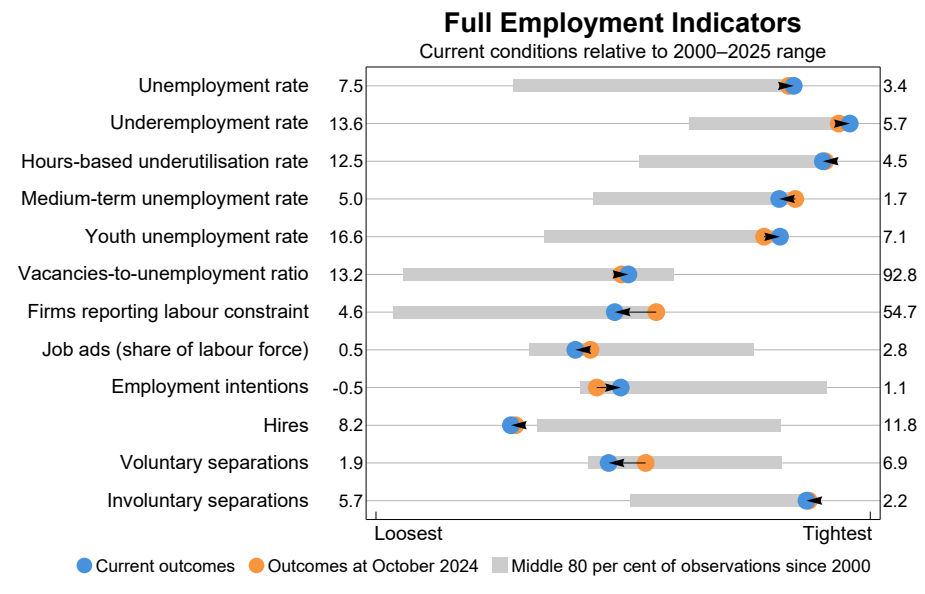
3.3 Assessment of spare capacity

We assess that labour market conditions have remained tight over recent quarters, while broader capacity pressures have eased somewhat – though these assessments are uncertain.

A range of information – including labour market and labour cost data, business surveys and model estimates – continue to suggest the labour market is tight. Looking through the monthly volatility, most labour market outcomes have remained broadly stable in recent months. Survey measures of firms' capacity utilisation and model-based estimates of the output gap indicate that ongoing economy-wide capacity pressures have continued to ease modestly. As noted in previous *Statements*, as demand and supply move closer to balance it is harder to be sure that the output gap is positive because estimates of spare capacity – in the labour market and the economy as a whole – are inherently uncertain. Although our assessment of full employment has not changed, there continues to be a risk that we have overestimated the extent of excess demand in the labour market.

A range of indicators suggests that the labour market was still tight relative to full employment, prior to the recent escalation in trade tensions. Indicators of spare capacity in the labour market, including the ratio of vacancies to unemployed workers and the share of firms reporting labour as a constraint on output, had stabilised at somewhat elevated levels (Graph 3.13). Similarly, the unemployment rate is little changed from the middle of last year, while the underemployment rate has fallen since then but stabilised since the start of the year. On the other hand, measures of job mobility have continued to decline, suggesting inter-firm competition to attract and retain staff has eased. This may imply less upwards pressure on wages growth and inflation than suggested by other labour market indicators, such as the unemployment rate. We will wait for more data to assess whether the softening in these measures and recent international developments have implications for labour market tightness. For now, labour market conditions are assessed as being little changed from six months ago.

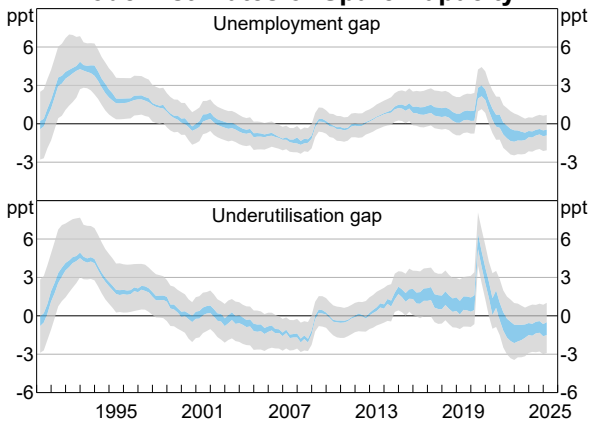
Graph 3.13



Sources: ABS; JSA; NAB; RBA.

Model-based estimates also suggest that the labour market remains tighter than full employment, with both the unemployment rate and the broader hours-based underutilisation rate remaining lower than our estimates of their full-employment levels. Estimates of spare capacity have remained broadly stable since mid-2024 and recent data have been in line with the assessment in the February *Statement* (Graph 3.14). Each of the model estimates in the suite that we consider implies that the labour market is tighter than full employment; however, there is also substantial estimation uncertainty around each estimate (indicated by the grey range in Graph 3.14).

Graph 3.14
Model Estimates of Spare Capacity*

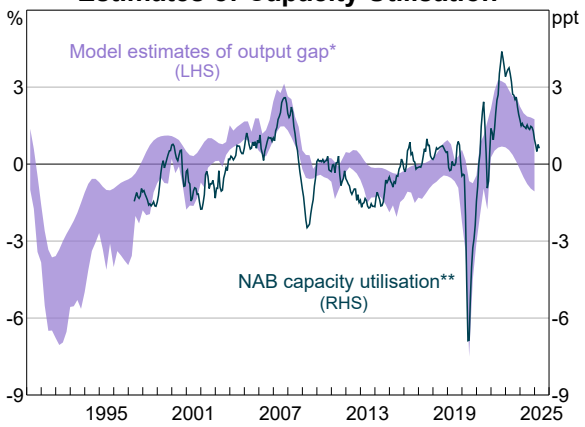


* Blue-shaded region shows illustrative range of central gap estimates from a selection of models; March quarter 2025 values are partial estimates; grey bands are the maximum and minimum two-standard-error confidence intervals from the selection of models.

Sources: ABS; RBA; Ruberl et al (2021).

A range of model-based estimates and data suggest the output gap was positive in the December quarter, though there is a high degree of uncertainty around this assessment (Graph 3.15). Recent GDP outcomes remain higher than estimates of potential output, suggesting that aggregate demand continued to exceed the capacity of the economy to sustainably supply goods and services. Model estimates indicate that the output gap continued to narrow in the December quarter, but at a slower pace than seen in previous quarters and at a slightly slower pace than expected at the February *Statement*. The change was primarily driven by tight labour market outcomes during late 2024 and is consistent with the pick-up in aggregate demand over that period, alongside weak trend productivity growth continuing to constrain growth in aggregate supply. The range of model estimates for the output gap remains wide, reflecting differences in how individual models interpret the data, with each model estimate also subject to considerable estimation uncertainty that is not captured by the range in Graph 3.15. The model-based assessment is consistent with the NAB measure of capacity utilisation, which remained above its historical average (in three-month average terms) in the December quarter, suggesting businesses were still using their labour and capital resources at higher-than-normal rates to meet demand. The monthly NAB measure has declined in early 2025, consistent with a continued gradual easing of economy-wide capacity pressures.

Graph 3.15
Estimates of Capacity Utilisation



* Violet-shaded region shows illustrative range of central output gap estimates (as a per cent of potential output) from a selection of models encompassing different measures and definitions of the output gap; estimates are subject to substantial uncertainty, as well as revision due to data and model refinements.

** Three-month moving average deviation from the long-term average capacity utilisation rate starting May 1997; excludes mining; weighted by industry using share of gross fixed capital formation.

Sources: ABS; NAB; OECD; RBA.

3.4 Inflation

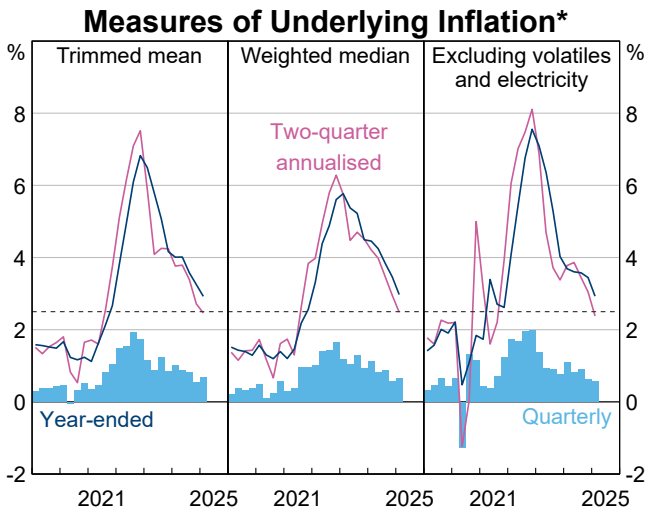
Underlying inflation returned to the 2–3 per cent range in the March quarter, as expected in the February *Statement*.

Trimmed mean inflation was 0.7 per cent in the March quarter and 2.9 per cent over the year, as expected in the February *Statement* (Graph 3.16). Quarterly trimmed mean inflation picked up from 0.5 per cent in the December quarter of 2024. The pick-up in quarterly terms reflected the unwinding of temporary factors, including government cost-of-living measures and an adjustment made by the ABS to the childcare inflation series to correct for past errors, as well as some strong start-of-year administered price increases. Market services inflation eased by slightly more than expected in the February *Statement*, with the disinflation being broadly based. As noted in the February *Statement*, downward pressure on firms' margins may be weighing on inflation at present, with some firms reporting in liaison that weak demand has limited their ability to pass increases in input costs fully through to output prices. Declining new dwelling construction prices have continued to be a driver of the moderation in underlying inflation alongside increased discounting by builders. The recent flooding events in Queensland and New South Wales have had minimal effects on inflation (see Box B: The Impact of the Recent Floods on the Australian Economy).

Over the past year the easing in inflation has proceeded broadly as expected, or a little quicker. Each of the previous four outcomes for underlying inflation has been in line with one-quarter-ahead expectations from the preceding *Statement*. Underlying inflation is nevertheless a little lower than was expected a year ago, and upside risks to inflation have not materialised (Graph 3.17).

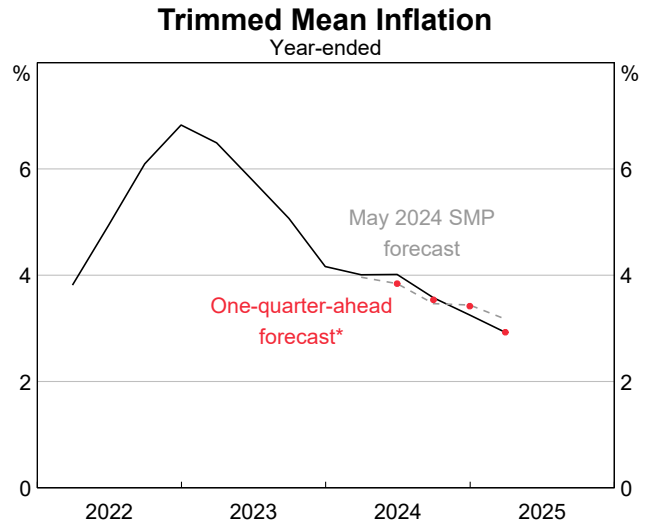
Headline inflation in the March quarter was unchanged in year-ended terms at 2.4 per cent and continued to be affected by government subsidies to households. Headline inflation increased to 0.9 per cent in the March quarter (seasonally adjusted), largely reflecting the unwinding of state electricity rebates in Queensland and Western Australia, along with the other temporary factors that also drove the pick-up in trimmed mean inflation. However, the past effects of electricity rebates continued to weigh on year-ended headline inflation, and rebates overall are estimated to have subtracted around 0.2 percentage points from year-ended inflation in the March quarter.

Graph 3.16



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

Graph 3.17



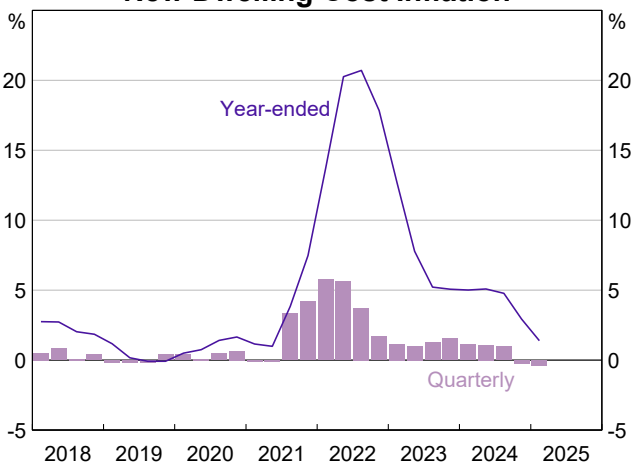
* Shows the forecast from the Statement on Monetary Policy which preceded each CPI release.
Sources: ABS; RBA.

Housing inflation continued to ease in the March quarter in year-ended terms, owing to a slowing in inflation for new dwelling costs and rents.

New dwelling construction prices declined in the March quarter, to be 1.4 per cent higher over the year (Graph 3.18). This is consistent with information from liaison that weakness in demand for building new houses is contributing to builders offering discounts and that improvements in labour availability are easing pressures on labour costs.

Graph 3.18

New Dwelling Cost Inflation

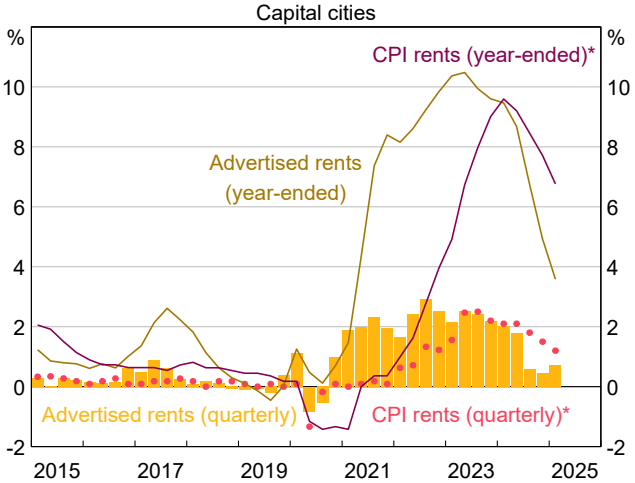


Sources: ABS; RBA.

Graph 3.19

Rent Inflation

Capital cities



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

Sources: ABS; Cotality; RBA.

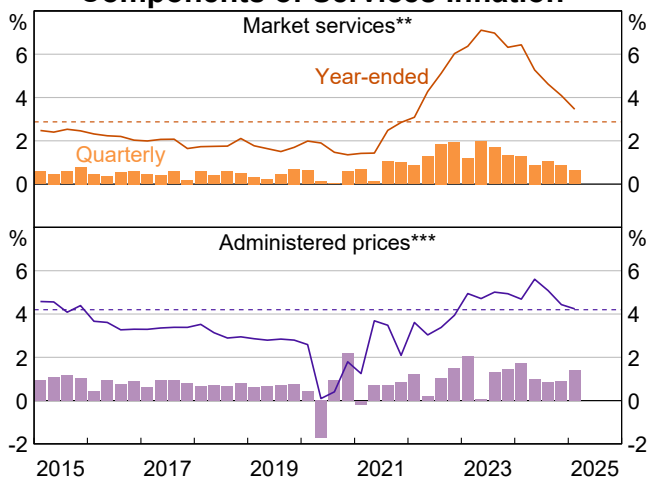
CPI rent inflation eased to 5.5 per cent over the year to the March quarter, consistent with the earlier slowing in advertised rents growth (Graph 3.19). Growth in advertised rents has stabilised over recent months, consistent with the recent stabilisation of rental vacancy rates. This suggests that CPI rent inflation could also stabilise in the period ahead.

Services inflation moderated further in the March quarter.

Market services inflation (excluding domestic travel and telecommunications) eased to 3.5 per cent over the year to March, slowing by slightly more than expected in the February *Statement* (Graph 3.20). The broad-based disinflation in recent quarters has seen the quarterly pace of market services inflation decline to around its inflation-targeting average rate. Insurance price inflation has eased notably from previously elevated rates, and absent further shocks this is likely to stabilise around historical average rates over the next year. Inflation for goods and services with administered prices (excluding utilities) rose strongly in the March quarter, partly reflecting strong start-of-year price increases in education and health, though indexation effects have lowered the year-ended rate overall.

Graph 3.20

Components of Services Inflation*



* Dashed line is the 1993–2019 average of year-ended inflation.
** Excludes domestic travel and telecommunications.
*** Excludes utilities and child care.

Sources: ABS; RBA.

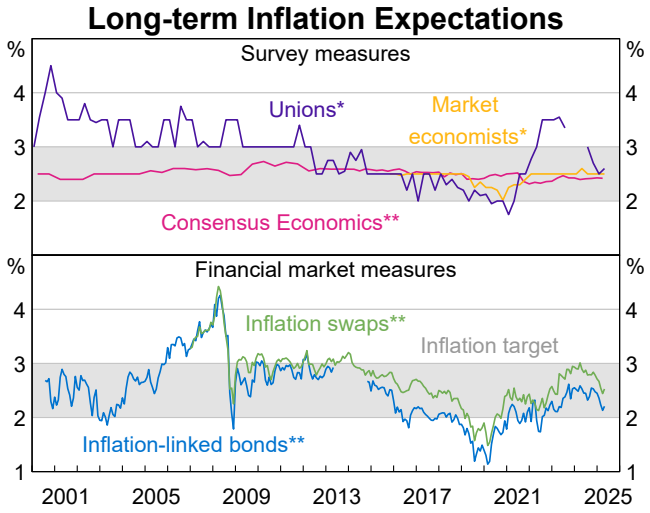
Goods inflation has eased over the past year; it is too early to see any effects of recent international developments.

Year-ended inflation for retail goods slowed in the March quarter. The quarterly pace of inflation remained broadly stable, in line with expectations in the February *Statement*. Quarterly groceries inflation remained around historical average levels in the March quarter, and quarterly consumer durables inflation has remained stable at low rates recently. Cyclone Alfred had a limited impact on these outcomes (see Box B: The Impact of Recent Floods on the Australian Economy). Retail contacts in the liaison program report that it is still too early to see any impact of global trade developments on either import or retail prices.

Inflation expectations remain consistent with achieving the inflation target over time.

Survey and financial market measures of short-term inflation expectations have declined from their mid-2022 peaks, consistent with declines in actual inflation (Graph 3.21). Survey measures of households' short-term inflation expectations appear mostly unaffected by the tariff announcements, although the series are volatile. Financial market measures of inflation compensation remain close to survey measures of medium- and long-term expectations. Unions' long-term inflation expectations have also declined to be close to the midpoint of the target range. Overall, our assessment is that long-term inflation expectations remain anchored at the target.

Graph 3.21



* Average over the next 5–10 years; data on union inflation expectations unavailable between November 2023 to May 2024.
** Average over the five years starting from five years ahead.
Sources: Australian Council of Trade Unions; Bloomberg; Consensus Economics; Employment Research Australia; RBA; Workplace Research Centre.

Endnotes

1 For example, see Bloom N (2009), 'The Impact of Uncertainty Shocks', *Econometrica*, 77(3), pp 623–685; Moore A (2016), 'Measuring Economic Uncertainty and Its Effects', RBA Research Discussion Paper No 2016-01.

2 See Saunders T and Tulip P (2019), 'A Model of the Australian Housing Market', RBA Research Discussion Paper No 2019-01.

Box A: How Might Tariffs Affect Australian Trade?

Higher tariffs and trade policy uncertainty are likely to result in slower global growth and lower global prices for traded goods, alongside changes to the pattern of trade. This Box focuses on how recent international developments may affect Australian export demand and import prices, including how the impact on Australian trade flows and prices may depend on the composition of our imports and exports.

On balance, the effect of higher tariffs on Australian exports is expected to be relatively small and largely on prices rather than volumes. This is because Australia's exports are dominated by resources for which Australia is a relatively low-cost producer, and because Chinese fiscal policy is expected to support commodity prices.

International developments are expected to weigh on the global prices of Australian imports. The relatively high share of Australia's imports coming from China suggests there is scope for the price of manufactured goods imports to decline if high US tariffs on China result in trade redirection to Australia. The relatively small size of Australia's manufacturing sector should limit the drag on domestic activity from this increased competition from imports. The small share of Australian imports coming from the United States will limit any direct exposure to higher US production costs and prices.

These judgements are uncertain; the outlook for Australian trade will ultimately depend on the level of tariffs, how trading patterns change, whether changing trade patterns induce supply disruptions, movements in the Australian dollar exchange rate, and the effect of trade policy uncertainty on global activity (see Chapter 1: In Depth – Global Economy and Financial Markets; Chapter 4: Outlook).

Slower global growth is expected to result in somewhat lower prices for Australia's exports but to have limited impact on export volumes.

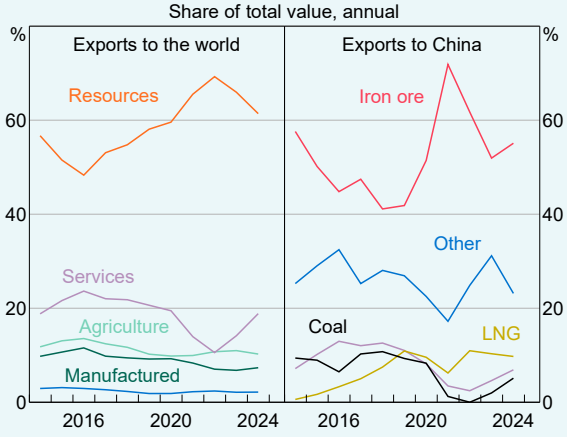
A slowing in global growth is expected to result in reduced demand for Australian exports and lower export prices, though these impacts will be mitigated by Chinese fiscal stimulus. Compared with other advanced economies, a relatively large share of Australia's goods exports is comprised of resources and agricultural goods (Graph A.1). China is the most important destination for Australian exports, accounting for 45 per cent of resource exports and 30 per cent of total exports. While weaker global demand is expected to weigh on tradable goods prices, economic policy measures in China are expected to support demand for Australian resources. The Chinese policy measures are expected to have a significant investment component, which would support demand for steel and therefore for Australian iron ore and metallurgical coal. Indeed, iron ore prices have been relatively stable since the first US announcement of tariffs in early April, and Consensus forecasts of iron ore prices have only declined a little.

Slower global growth is expected to have a limited impact on Australia's resource export volumes. Since Australia is a low-cost producer of some bulk commodities and agricultural products, many Australian exporters are expected to remain profitable and maintain production volumes even if prices fall somewhat. Volumes of services and other goods exports may be more affected by the decline in global growth, but these comprise a smaller share of Australia's exports. Overall, we expect the impact of lower global growth on Australian exports to be small and to mostly affect export prices rather than export volumes.

The increase in US tariffs on Australia is expected to have only a small direct effect on Australian export demand. The share of Australia's exports that are directly exposed to higher US tariffs is small. Total exports to the United States account for around 6 per cent of Australia's total gross exports – a relatively small share – and only around 1½ per cent of GDP. Further, while the United States has imposed a 10 per cent tariff on most Australian goods, some goods are exempt (such as gold and selected pharmaceuticals) while others are subject to higher sectoral tariffs (such as steel and aluminium). Some product categories – such as aircraft parts and medical instruments – are more exposed to the tariffs, as a large share of these exports go to the United States (Graph A.2). Australia is expected to continue to export a range of products to the United States, including those for which it is difficult for US buyers to find suitable alternatives, and those where Australian goods face a tariff rate that is similar to (or lower than) that on the same goods from some other countries. Australian producers may also redirect some exports to alternative markets, as occurred when some Australian exports to China, including coal, fell sharply in 2020.[1]

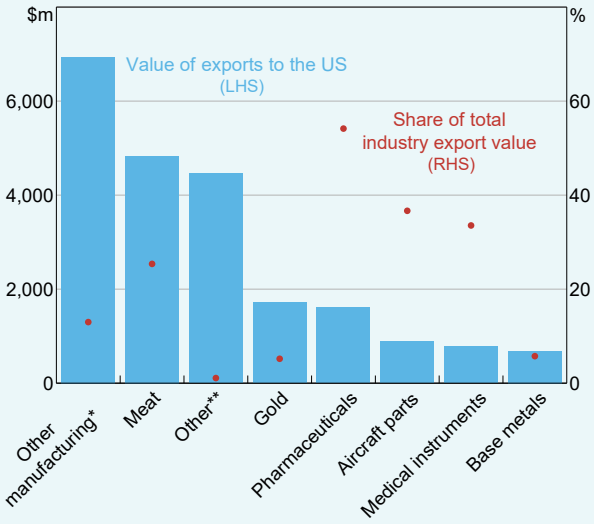
Indirect demand for Australian exports from spending in the United States is also limited. Spending in the United States also affects Australian export demand indirectly because some Australian goods are intermediate inputs in global supply chains. For example, Australia exports iron ore to China, some of which is used to make the steel components of machinery exported from China to the United States. However, Australia's 'value-added' exports to the United States, which includes this indirect demand, remain below 10 per cent of total exports (a little over 2¼ per cent of GDP).

Graph A.1
Composition of Australia's Exports
Share of total value, annual



Sources: ABS; DFAT; RBA.

Graph A.2
Australia's Goods Exports to the US
2023/24



* All goods exported to the US by the manufactures sector excluding aircraft parts, medical instruments, and pharmaceuticals.
** Includes all goods exports to the US that do not fall into categories in the graph.

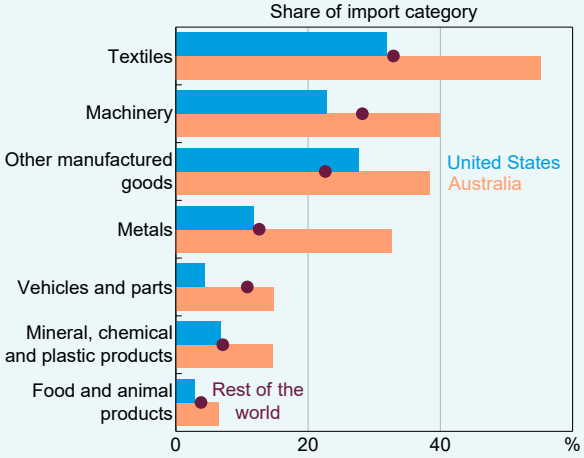
Sources: ABS; DFAT; RBA.

While international developments are expected to weigh on the global prices of Australian imports, there are risks on both sides.

Lower global demand is expected to weigh on global inflation of traded goods and therefore the global prices of Australian imports. Weaker global demand is expected to be the dominant effect of recent international developments for Australian import prices. However, a range of other channels could influence Australian import prices in both directions.

The impact of changing trading patterns on the global price of Australian imports is ambiguous, but on balance is expected to reduce them because China accounts for a large share of imports. On top of weaker global demand for tradeable goods, very high US tariffs on China could push Chinese suppliers to redirect goods to other countries, including Australia. This could increase the supply of goods from China and reduce the price that Australians pay for Chinese goods. However, US consumers will likely substitute towards imports from other countries, supporting the relative price of goods from the rest of the world. The impacts of these changing trading patterns on Australian import prices (over and above weaker aggregate demand for tradeable goods) are ambiguous and depend on a number of factors, including the composition of Australia's imports. On balance, because Australia has a higher share of Chinese products in most parts of its import basket compared with other economies, the redirection of tariff-affected exports is likely to place additional downward pressure on Australian import prices, especially in the short term while global trade flows adjust (Graph A.3).

Graph A.3
Imports from China
Share of import category



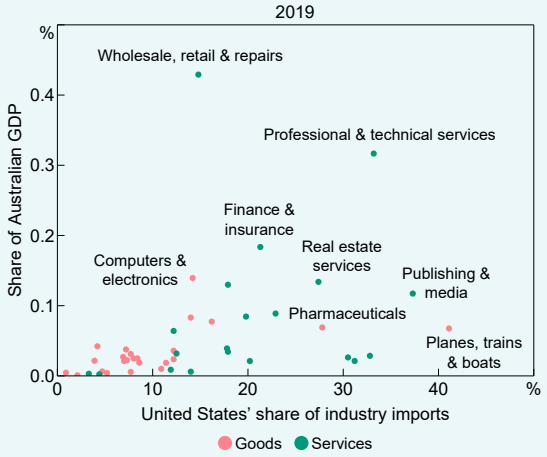
Sources: OEC; RBA.

Lower priced goods from China are unlikely to displace much Australian production, but they could benefit industries reliant on imported inputs. The United States has applied the largest tariff increase to China, so Chinese exporters may look to redirect goods to new markets or lower prices in existing markets. There is not much overlap between the tradable goods Australia produces (largely resources and agricultural goods) and those that Australia imports from China (largely manufactured goods), suggesting limited scope for lower priced imports from China to out-compete domestic production. However, there are some industries where there remains some overlap and where Australian producers could be worse off. In addition, lower goods prices relative to services could weigh on the demand for domestically produced services at the margin. On the other hand, industries that have a large share of imported inputs from China (such as clothing retailers) would benefit from lower input costs (see Box C: Insights from Liaison for more information about how Australian firms are considering global developments).

There are also several factors that could put upwards pressure on world export prices. In the short term, the reorientation of supply chains could be costly and create disruptions that put upwards pressure on prices that flow through to Australia. It is also possible that multinational corporations whose margins are compressed in markets where tariffs have been raised might seek to raise margins elsewhere, putting upwards pressure on prices in other markets such as Australia.

Higher inflation in the United States is unlikely to have a material direct impact on Australian import prices. US tariffs are likely to be inflationary for the United States in the short run (see Chapter 1: In Depth – Global Economy and Financial Markets), which could boost the prices of their goods and services exports. The effect of this on Australia is likely to be small given some Australian firms would seek alternative suppliers if prices from the United States rose materially, and imports from the United States account for only around 2½ per cent of Australian spending. However, in product categories that are highly dependent on imports from the United States, it may be more difficult to find substitutes. For example, one-third of Australia's value-added imports of professional and technical services come from the United States (Graph A.4). At an industry level, services (such as professional services) are more exposed to imports from the United States than goods industries (such as mining and agriculture).[2]

Graph A.4
Australia's Imports from the United States*
2019



* Value-added imports.
Sources: OECD; RBA.

Developments in the Australian dollar exchange rate will continue to be a key determinant of economic outcomes here.

While we expect global goods price inflation to be lower based on recent international developments, Australia's export competitiveness and domestic inflation will also be affected by movements in the Australian dollar exchange rate. The exchange rate against the US dollar is particularly important over short horizons because most of Australia's exports and around half of imports are invoiced in US dollars. Typically, the Australian dollar depreciates in response to a downgrade in global growth or increased global risk aversion, playing an important role as a 'shock absorber'. The direct effect of a lower exchange rate is an increase in the price of goods and services produced overseas, relative to the price of goods and services produced in Australia. This lowers demand for imports and increases demand for domestically produced goods, increasing Australian economic activity.[3] However, since the announcement of tariffs in early April, the Australian dollar has been little changed in trade-weighted terms amid broad-based US-dollar weakness (see Chapter 2: Australian Financial Conditions). The response of the exchange rate to future international developments, including whether the US dollar continues to depreciate during periods of heightened risk aversion, will be a key determinant of the outlook for Australian GDP and inflation (see Chapter 4: Outlook).

Endnotes

1 As discussed in Hauser A (2024), 'The Ghost of Christmas Yet to Come', Speech at the Australian Business Economists' Annual Dinner, Sydney, 11 December.

2 See Westpac (2025), 'Australian Industry Bulletin – Tariff Test: How Exposed Are Industries?', 1 May.

3 See RBA (undated), 'Exchange Rates and the Australian Economy', Explainer.

Box B: The Impact of the Recent Floods on the Australian Economy

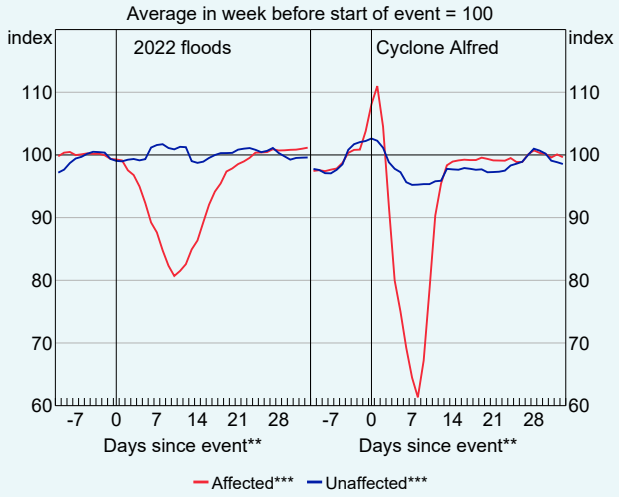
Parts of Queensland and New South Wales experienced flooding and high winds in the March quarter due to several significant weather events, including Cyclone Alfred. This Box sets out initial estimates of the effects of these events on the Australian economy.

Natural disasters such as floods and cyclones are a negative supply shock to the Australian economy as production is disrupted, and public infrastructure, homes, cars and business assets are damaged. Natural disasters can also affect the path of demand over time; typically spending is delayed but then increases as disruptions ease and the replacement of damaged assets gets under way.

Recent flooding and Cyclone Alfred likely lowered GDP growth in the March quarter.

The RBA's estimate is that the natural disasters subtracted around 0.1–0.2 percentage points from GDP growth in the March quarter. This estimate is informed by timely card spending data showing that household spending declined sharply in the affected regions during Cyclone Alfred (Graph B.1). Compared with the 2022 Queensland and northern NSW floods, there was more stockpiling of supplies ahead of the cyclone, spending declined more sharply as there were more widespread store closures during the cyclone, and power outages disrupted spending afterwards. However, there was a faster return to normal consumption patterns than in 2022, and there was less damage to homes, businesses and infrastructure. Construction activity in southeast Queensland was halted for several days around the time of the cyclone. However, builders generally plan for wet weather in the March quarter and the construction industry had the capacity to begin repairs more quickly than in 2022. Flooding in parts of northern, central and western Queensland disrupted economic activity in some areas for an extended period. Exports were also a little lower, as floods affected some coal mines and agricultural areas, and transport was disrupted.

Graph B.1
Total Card Spending*



* Underlying card spending data has been transformed into a seven-day rolling average.
** 0 indicates start of event; for Cyclone Alfred the disruptions were from 4 March 2025 and for the 2022 floods 22 February 2022.
*** Affected and unaffected areas are identified at a local government area level.
Sources: ANZ; RBA.

The fall in activity associated with the disasters could be offset by recovery spending over time. After the floods and cyclone, there was an increase in private and public spending associated with cleaning up, restocking, rebuilding and motor vehicle purchases, much of which is not captured in card spending data. Liaison with businesses suggests recovery spending commenced towards the end of the March quarter and is likely to continue into subsequent quarters, although the magnitude and timing of recovery spending is uncertain. Flooding has continued to affect activity in some areas of Queensland into the June quarter, and the recovery in some areas is likely to take some time.

The overall impact of the natural disasters on domestic prices is expected to be modest.

Replacement spending on household goods and motor vehicles is not expected to have had a significant impact on goods price inflation. There may have been some additional upward pressure on construction costs at the margin, reflecting constraints on some of the trades needed for repairs. The loss of crops had limited impact on food prices, as most of the affected produce is also grown elsewhere.

Box C: Insights from Liaison

This Box highlights key messages collected by teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 270 businesses, industry bodies, government agencies and community organisations from the beginning of February to mid-May 2025.

Firms generally report little change in domestic economic conditions over the past few months, with retailers continuing to report slow to moderate growth in demand. Headcount at most firms was relatively stable and is expected by firms to remain so. Labour availability continued to improve. Firms continued to report above-average increases in output prices over recent months but expect them to slow over the next 12 months, particularly for the services sector. Firms note that the recovery in domestic demand growth has so far been slower than hoped but they remain cautiously optimistic that growth will gather pace from here, despite heightened concerns about the risks to the outlook from global developments.

Firms in liaison report that changes to global trade policies have so far had little direct effect on revenue, their decisions or their prices. However, their uncertainty increased noticeably over recent months ahead of the Australian federal election and amid the unpredictable policy environment abroad.

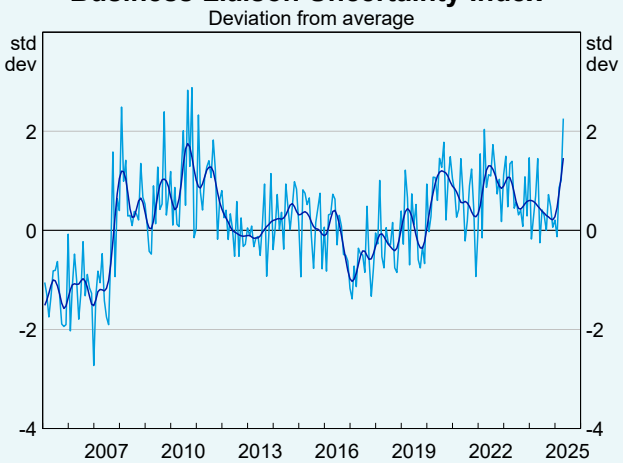
Firms reported elevated uncertainty about the domestic and global outlook.

The RBA's text-based liaison uncertainty index – which captures uncertainty expressed by firms in the liaison program – was higher in April than at any time since the global financial crisis (Graph C.1).[1] The key issues on firms' minds in discussions were heightened uncertainty related to trade, tariffs and other policies since the change in government in the United States, and uncertainty due to the federal election in Australia in the months preceding it. Following the federal election, early indications for May suggest some easing in uncertainty.

Firms see risks in both directions for their activity and prices, highlighting the extent of uncertainty about the global environment. Some firms have noted potential opportunities in the period ahead. For example, some exporters have noted upside risks to demand for Australia's exports where they become cheaper relative to other countries that face higher US tariffs (such as for some agricultural products) or where there is reduced competition from the United States (such as for tertiary education). Additionally, some liaison contacts have noted tentative signs of increased foreign appetite for real investments in Australia because investors are reassessing the relative jurisdictional risk of Australia compared with the United States. However, some exporters are concerned that lower global growth could weigh on demand and commodity prices, and in turn their sales revenue.

Graph C.1

Business Liaison Uncertainty Index*



* Frequency index based on an 83-word dictionary; darker line is 13-month Henderson trend.

Source: RBA.

Some firms hope that a reduction in US demand for goods could flow through to an easing in imported costs for Australian firms due to lower global aggregate demand relative to supply. Other firms are concerned about upside risks to imported costs should the Australian dollar depreciate. The outlook for the exchange rate is a concern raised by many retail, manufacturing, wholesale, finance and services firms.

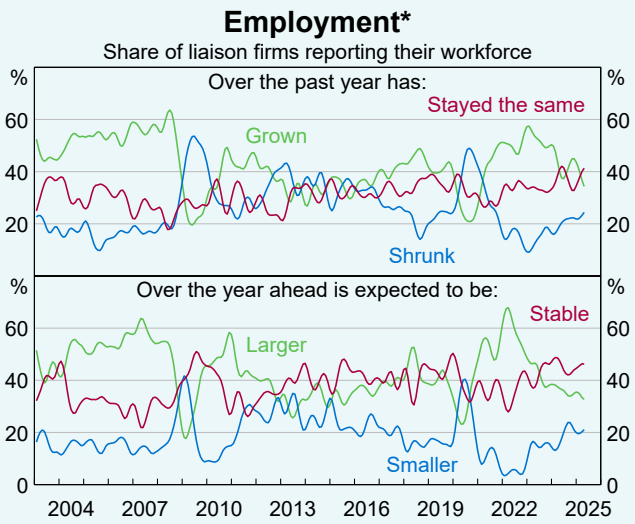
Many firms report that it is still too early to assess the full implications for their business from geopolitical developments and elevated uncertainty. While many firms are watching developments closely as part of their forward planning, firms have generally emphasised that they have faced few direct effects from these developments so far, and the overall tone in liaison has suggested the Australian economy has remained fairly stable over recent months.

Firms have mostly kept headcount stable and expect this to remain the case over the next 12 months.

The share of firms reporting that their headcount was stable over the past year has increased recently, as has the share intending to keep headcount stable in the year ahead (Graph C.2). Firms intending to keep headcount stable are generally reporting that they need to maintain existing capacity or are planning to restructure to try to achieve more with the same size workforce. Voluntary staff turnover continues to normalise, and firms are more easily able to find the workers they need than has been the case for some time.

These outcomes are at the margin a little softer than a few months ago; since then, the share of firms that had increased their headcount or intended to grow headcount over the next 12 months has eased a little. This suggests there has been a slight easing in intentions for further employment growth. Of those firms that have reported reducing their headcount over the recent period, the majority had let headcount decline through natural attrition or reducing non-revenue generating roles. A large share of firms that recently reported they had reduced headcount over the past year said they do not expect to reduce headcount any further over the year ahead. Around half of contacts intend to keep their headcount stable.

Graph C.2



* Smoothed with a 13-month Henderson trend.
Source: RBA.

Price and cost outcomes for firms were little changed over the recent period and their price growth is currently expected to slow gradually.

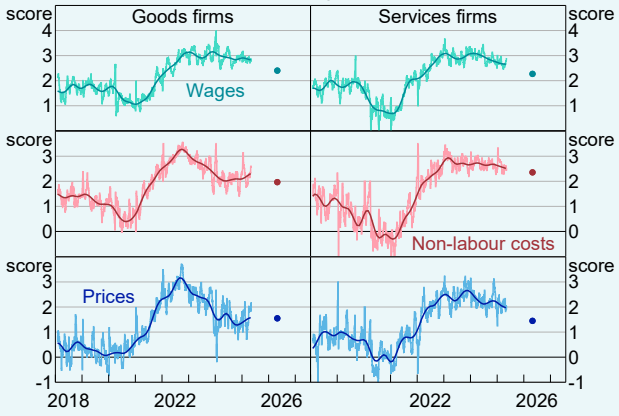
Whether geopolitical events lead to higher or lower imported cost inflation will be an important determinant of firms' pricing pressures over the period ahead. In the first few months of 2025, firms noted concerns that the lower level of the Australian dollar since mid-2024, relative to the prior period, would put upward pressure on their cost growth over the period ahead, particularly if it continued (these concerns have abated more recently, in line with exchange rate movements). Firms continue to report above-average growth

in energy prices and business insurance and technology costs, particularly subscription costs. Partly offsetting this, growth in construction costs is normalising, insurance cost growth is coming down and there are tentative signs growth in rates for land and sea freight and some technology costs will slow over the period ahead.

Liaison suggests that year-ended private sector wages growth remained at around 3¾ per cent over the past 12 months. Expectations for year-ended wages growth over the next 12 months remain just under 3½ per cent.

Average selling price inflation was little changed over recent months. For goods firms in the liaison program, reported selling price growth picked up a little alongside ongoing input cost growth. Selling price growth among services firms eased a touch, supported by the lower wage growth in the past 12 months than the year prior. Services firms expect their selling price growth to ease more noticeably than goods firms over the coming 12 months (Graph C.3).

Graph C.3
Costs and Prices*
Firms reporting in liaison



* Lines are outcomes over the 12 months before each observation; dots are expectations over the next 12 months from April 2025; the lighter lines are 30-day rolling averages; the darker lines and the dots are 13-month Henderson trends; some data points have been truncated; a score of 0 indicates a firm has reported no change.

Source: RBA.

Investment and consumption activity indicators have overall been relatively steady, though a cautiously positive tone has persisted among some contacts regarding the domestic outlook.

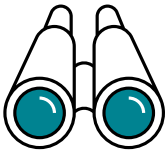
Investment intentions have been stable over recent months. Most firms report that they are planning to spend as much over the next 12 months as they had over the past 12 months. The share of firms looking to lower their investment over the year ahead has declined a little. For other firms, the level of construction costs has been a commonly cited factor weighing on investment intentions. Contacts report they expect softer growth in investment in vehicles, industrial property and new office space. Few firms have reported any changes to their investment plans in response to geopolitical tensions overseas, though uncertainty around domestic energy policy over the early part of this year was noted in some cases to be weighing on their energy investment decisions.

Information from residential construction firms suggests that completion of projects outstripped new sales and as such their pipeline for future activity has declined. Homebuilders have reported a moderate increase in speculative building activity – that is, building homes that are not pre-sold – over the past year, which has provided some support for activity. Most homebuilders expect to see a boost in home sales after the federal election and if there are further cuts to interest rates. That said, contacts remain concerned about affordability constraints.

Retailers continue to report slow to moderate growth in demand over recent months, consistent with a gradual recovery in private demand. Firms have so far seen little discernible reaction from consumers to the February interest rate cut. An increase in domestic student commencements for some universities and a further recovery in international tourism have also supported a cautiously positive tone persisting among some contacts recently regarding the domestic economy, despite rising concerns about the risks to the outlook from global developments.

Endnote

1 The business liaison uncertainty index is a text-based index that uses a dictionary of words that relate to uncertainty and the corpus of liaison meeting notes that record the views expressed by firms in meetings conducted as part of the RBA's liaison program over almost 25 years.



Chapter 4
Outlook

Summary

- **The outlook for the global economy has deteriorated since the February *Statement*. This is due to the adverse impact on global growth from higher tariffs and widespread economic and policy unpredictability.** However, with trade policies in the United States and other economies evolving rapidly, it is impossible to estimate their economic impact with any accuracy. We are therefore complementing our baseline forecast with a range of forecast scenarios to explore the possible effects on Australian economic activity and inflation under different trade policy assumptions.
- **The baseline forecast is for growth in Australia's major trading partners (MTP) to slow in 2025 and 2026.** This forecast assumes that the current set of tariffs remain in place and that policy uncertainty gradually falls over the year ahead to settle at a level higher than in the February *Statement*. As a result, MTP growth in exports, business investment and household consumption are all expected to be lower relative to the February forecast. The downgrades to GDP growth are largest for the United States and countries that have a high reliance on goods trade. The higher level of tariffs and global policy uncertainty are expected to weigh on Chinese growth, but this is expected to be largely offset by increased fiscal and monetary policy support.
- **In the baseline forecast for the Australian economy, the weaker global outlook contributes to a slightly larger increase in the unemployment rate and a slightly lower inflation rate relative to the February *Statement*.** Domestic GDP growth is still expected to pick up over the year ahead, supported by a recovery in consumption and continued strength in public demand. However, the pick-up is expected to be more gradual than previously forecast due to weaker global demand, global and domestic uncertainty and weaker momentum in consumption. The forecasts are conditioned on market expectations for a cumulative 85 basis point easing in the cash rate over the forecast period; the additional easing in the cash rate relative to the February *Statement* provides additional support to domestic activity in the face of global economic headwinds. Overall, the economy and labour market are projected to move closer to balance, although there is considerable uncertainty around this assessment. The baseline forecast for domestic inflation has been revised a little lower since the February *Statement*; underlying inflation is now expected to be around the midpoint of the 2–3 per cent range throughout much of the forecast period. The forecast for headline inflation is more volatile, largely reflecting the effects of the electricity rebates.
- **An escalation of the trade conflict is a key downside risk.** In an alternative scenario, negotiations break down and much higher levels of tariffs are imposed permanently, which would likely see global sentiment and growth fall sharply amid a disorderly fall in global and domestic asset prices. Absent a material policy response, this could see a sharp slowing in domestic GDP growth and a sharp rise in the unemployment rate.

- **By contrast, a swift easing in the trade conflict could reduce policy uncertainty and pose upside risks to the baseline forecast.** In this scenario, successful trade negotiations around the level of tariffs could lead to a sharp reduction in global and domestic uncertainty. Coupled with stronger policy stimulus overseas, this would result in a more pronounced recovery in domestic GDP growth and somewhat higher inflation. This could require less accommodative policy than is currently priced into market expectations for the cash rate.

4.1 The baseline forecast relative to the alternative forecast scenarios

Monetary policy affects the economy with a lag, so must always be set with an eye to how the economy is expected to evolve in the future. The RBA, like many other central banks, typically presents its economic outlook in the form of a central or baseline forecast. A baseline forecast can be thought of as the most likely single path for the domestic economy, given the technical assumptions on which the forecast is conditioned (such as the financial market-derived cash rate path). However, the economy is unlikely to evolve precisely as forecast. This is illustrated by the RBA's fan charts, which we use to indicate a range of plausible outcomes around the baseline forecast (see the graphs below for GDP, unemployment and inflation, notably the blue-shaded areas). The width of the fans is based on past forecast errors.[1]

However, where there are a number of different plausible outcomes, it can make more sense to evaluate the outlook using so-called 'scenario analysis', with the baseline being one of these scenarios. The heightened level of global uncertainty and the fast pace at which international trade policies have been evolving mean we are currently in such circumstances. Depending on the outcomes of current negotiations on future tariffs, the future paths for domestic activity and inflation may evolve in very different ways. Scenarios can never provide an exhaustive list of such outcomes; instead, we base our scenarios on different assumptions around how the international environment evolves that may lead to upside and downside risks to activity and inflation in Australia.

Table 4.1 provides a summary of the baseline and alternative scenarios that we examined in this round of forecasting. Each of these is discussed in turn below.

Table 4.1: Baseline and Alternative Scenario Assumptions and Key Forecasts[(a)]

	Baseline	'Trade War' Scenario	'Trade Peace' Scenario
	Higher tariffs and uncertainty relative to February *Statement*	Trade escalation provides downside risks to growth	Swift resolution provides upside risks to growth
Global assumptions			
Trade policy	Effective tariff rates remain higher than assumed in February. Average bilateral US–China tariff rates remain around their current levels. Country-level tariff rates with most of the United States' other trading partners remain at 10 per cent.	Effective tariff rates are at a higher level in 2025 than the baseline assumption. In early 2026, permanently large tariffs are implemented: 'liberation day' tariffs are reimposed and tariffs on all Chinese goods are increased to the very high levels announced in early April. All countries, including Australia, retaliate with higher tariffs.	Successful trade negotiations lead to a sharp de-escalation of the trade conflict in the near term that reduces US tariffs back to 2024 levels.
Other assumptions	Global uncertainty gradually declines. Chinese authorities mitigate the adverse impact of tariffs on economic activity using fiscal and monetary policy. Authorities in some other economies moderately ease fiscal policy, partly in response to higher US tariffs.	Uncertainty is higher and more persistent than the baseline and there is a significant shock to confidence. Fiscal stimulus in the United States and China is limited.	Global uncertainty declines sharply in the near term to around 2024 levels. Fiscal stimulus remains higher in China and the United States than expected in the February *Statement*.
Domestic forecast outcomes			
GDP	GDP growth continues to pick up over 2025 and 2026, although at a less-pronounced pace than expected in the February *Statement*.	Growth slows sharply and remains subdued in 2025 and 2026; the level of GDP is more than 3 per cent lower at the end of the forecast horizon than the baseline forecast.	Under the current market path for the cash rate, the recovery in GDP growth is more pronounced than in the baseline.
Unemployment	The unemployment rate increases a little more than expected in the February *Statement*.	The unemployment rate increases to nearly 6 per cent.	The unemployment rate remains around its current level.
Inflation	With the cash rate following the market path, underlying inflation declines to be around the midpoint of the 2–3 per cent range by the end of 2026.	With the cash rate following the market path, inflation slows continuously through the forecast period to around 2 per cent at the end of 2026.	With the cash rate following the market path, inflation remains above the midpoint of the 2–3 per cent range over the forecast period.

(a) Main technical assumptions: cash rate is assumed to follow the market path (as of 14 May) in all three scenarios. The trade-weighted index is unchanged at current levels in the baseline and 'trade peace' scenario and depreciates by 6 per cent in the 'trade war' scenario.

4.2 Key judgements for the baseline forecast

The key judgement underpinning the baseline forecasts is the assumption about the evolution of tariff policy, which is outlined in Table 4.1 and in Chapter 1: In Depth – Global Economy and Financial Markets. The three other important judgements that have been considered and debated extensively throughout the forecast process are discussed below.

Key judgement #1 – The slowing in Chinese growth will be modest, as the effects of higher tariffs and elevated uncertainty are mostly offset by increased policy stimulus.

Our baseline forecast is for MTP growth to slow in 2025 and 2026. Our baseline forecast for Chinese growth is currently towards the upper end of the range of market economists' forecasts. This reflects our up-to-date baseline assumptions around the recent easing in tariff rates as well as our judgement that Chinese policy stimulus will offset much of the negative impact of tariffs and uncertainty on GDP growth; the Chinese authorities have communicated a growth target of 'around 5 per cent' for 2025 and a high appetite to use its policy levers to achieve that target. The possibility that further tariffs are introduced and/or that Chinese authorities are unable to offset the effect of the trade conflict presents downside risks to the domestic baseline forecast.

Key judgement #2 – Elevated global and domestic uncertainty is expected to weigh a little on domestic spending decisions.

Economic policy uncertainty has increased sharply alongside the recent escalation in global trade tensions. There is empirical evidence that increases in uncertainty weigh on private demand, over and above any effects that occur through other channels (e.g. declines in equity prices).[2] Heightened uncertainty increases the value of waiting for additional information and the baseline forecast assumes that uncertainty declines only gradually over the coming year (see Table 4.1). This results in some businesses delaying their investment decisions and households increasing their precautionary saving. This assumption has contributed modestly to the downward revision to forecast growth in domestic activity over 2025.

It is unclear how uncertainty will evolve going forward, and how Australian businesses and households will respond given the wide range of empirical estimates of the impact of uncertainty. At this stage, there is little evidence of any significant adverse effects of uncertainty on households and businesses in liaison or survey data. It is possible that business and household activity proves more resilient to the current level of uncertainty, with other factors proving more consequential for spending decisions (such as the assumed easing in monetary policy or because domestic policy uncertainty tends to decline once an election outcome is known). Alternatively, the effects of heightened uncertainty that have been assumed are small and could instead turn out to be larger, particularly if the trade conflict is larger or more protracted. These effects are explored in the alternative scenarios.

Key judgement #3 – Global trade developments are judged to be disinflationary in net terms for Australia.

Overall, the softer outlook for domestic activity flows through to an easing in labour market conditions, which result in lower domestic inflationary pressures.

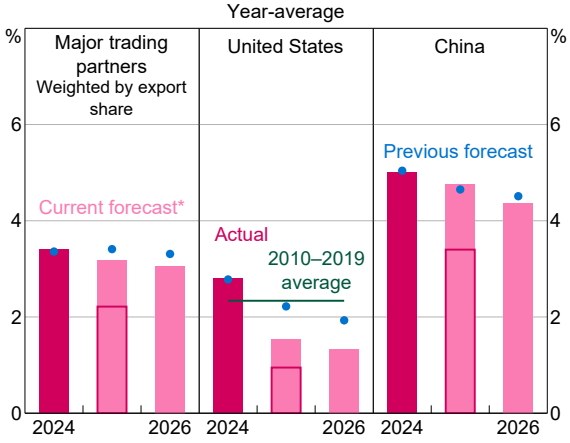
Global developments are judged to weigh on the prices of goods and services imported to Australia, although this has only a small effect on inflation in the baseline forecast. World export prices are expected to be a little lower over the next year as weaker global demand weighs on prices. There has been little change in the Australian dollar exchange rate since the February *Statement*; as such, we forecast a modest decline in imported goods prices (see Box A: How Might Tariffs Affect Australian Trade?). It is possible that an increased supply of imports to Australia leads to lower import prices as trade is diverted away from higher tariff routes. However, the trade conflict could result in substantive supply chain issues, which could raise prices for some imports. Information from the liaison program and survey data, as well as timely global trade prices data will provide guidance on this judgement over the next few months.

4.3 Baseline global outlook

GDP growth in Australia's major trading partners has been revised downwards in 2025 and 2026 relative to the February *Statement*.

Consistent with the deterioration in timely partial activity data in many countries, the global outlook for 2025 has been revised lower by most forecasters (Graph 4.1). The wide range in published forecasts is indicative of the pace at which trade policies have been evolving and their likely effect on growth and inflation. To ensure our MTP forecasts are relatively consistent with the latest trade developments, we have deviated to some degree from our usual practice of using Consensus forecasts for the MTP (excluding China) forecasts and instead applied some judgement to the forecasts.

Graph 4.1
Baseline GDP Growth
Year-average



* Border indicates the contribution to 2025 year-average growth from realised quarterly outcomes; 2025:Q1 is latest data for most economies.
Sources: ABS; CEIC Data; Consensus Economics; LSEG; RBA.

The downward revision in the baseline MTP forecast reflects the impact from the assumed set of tariffs described in Table 4.1 between the United States and its trading partners, particularly China, as well as an assumed additional effect on activity from the sharp increase in trade policy uncertainty. Growth in countries that impose and face tariffs will be most affected, while all countries will be impacted by the lower global demand from this shock. Overall, quarterly baseline MTP growth slows through 2025, before gradually picking up in 2026 as the direct effects of higher tariffs wane and uncertainty is assumed to decline, while stimulatory fiscal and monetary policy, particularly in China, is expected to continue to support growth.

Forecasts for US growth have been revised down substantially for this year and next year.

We expect quarterly growth in the United States to be weak in the second half of 2025 as the economy adjusts to higher tariffs, before picking up through 2026 as uncertainty eases. While the recent de-escalation of the US–China trade conflict likely reduces the probability, there is still some likelihood that the United States will be in recession by early 2026. Many market economists have assumed in their forecasts that the temporary personal income tax relief (scheduled to cease at the end of 2025) will be extended. Growth in most of our other trading partners, including economies in East Asia, has also been revised down but to a lesser extent than in the United States. The size of the downgrades is broadly proportional to the trade-exposure of the economy and its reliance on US demand.

The imposition of tariffs is expected to increase inflation in the United States this year. Consensus forecasters expect that this increase will be temporary and year-average inflation forecasts for 2026 have been relatively steady to date. The net impact of tariffs on inflation in most other advanced economies is expected to be relatively small, though inflation forecasts for some advanced economies were already drifting up before the spike in trade policy uncertainty (e.g. in Japan and the United Kingdom). Even if trade policy uncertainty is resolved completely, the higher tariffs will reduce the supply capacity of the global economy, weighing on potential growth and potentially adding to inflationary pressures (explored in the scenarios below).

Under the assumptions for tariffs and stimulus set out above, year-average Chinese GDP growth is projected to be 4.8 per cent in 2025 and 4.4 per cent in 2026.

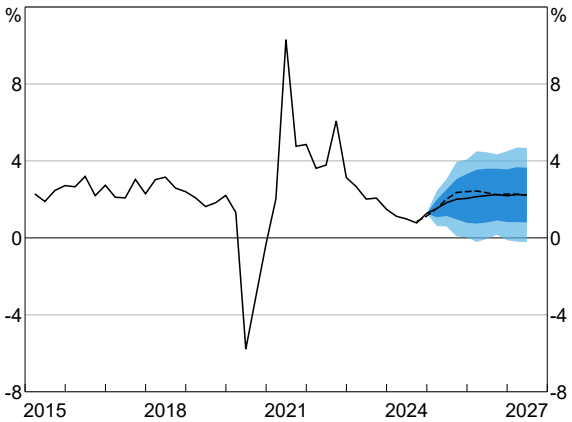
The current level of US tariffs on Chinese exports and the expected impact of these on Chinese GDP growth in 2025 and 2026 are similar to what had been assumed in the February *Statement*. However, very high volatility in the level of US tariffs since February and the associated elevated policy uncertainty is likely to weigh on manufacturing investment and household consumption by more than previously expected. Offsetting this, momentum in China's economy has been stronger than expected so far in 2025, and the assumed drag from higher tariffs on Chinese economic growth is expected to be materially offset by policy stimulus. Chinese authorities confirmed a 2025 GDP growth target of 'around 5 per cent' as well as their willingness to support growth with fiscal and monetary policy at their National People's Congress in March. The authorities have indicated they will front-load fiscal stimulus announced in their 2025 budget over the coming months and will do more to support growth if needed.

4.4 Baseline domestic outlook

Australian GDP growth is expected to recover more gradually over 2025 than forecast three months ago.

The baseline forecast is for domestic activity to pick up over 2025 as consumption recovers and public demand continues to support growth (Graph 4.2). However, the recovery is expected to be more gradual than in the February *Statement*, for two reasons. First, the weaker outlook for global growth and increased policy uncertainty internationally is expected to weigh on growth in domestic activity. The lower forecasts for MTP growth and global goods prices will, all else equal, reduce demand for Australia's exports and make imports relatively more attractive. Economic policy uncertainty has increased sharply alongside recent global developments, and this is expected to prompt some households to increase their precautionary savings and some businesses to postpone some investment decisions (see Key judgement #2 above).

Graph 4.2
Baseline GDP Growth Forecast*
Year-ended



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

Sources: ABS; RBA.

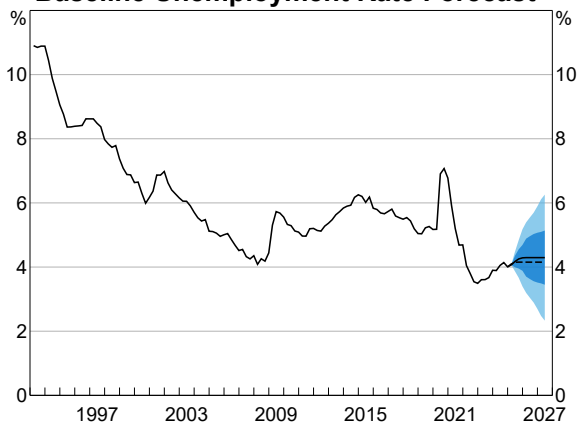
Second, the partial data for the March quarter suggest that the recovery in household consumption that is underway has been less pronounced than thought in February, even after accounting for the expected impacts of Cyclone Alfred and other flooding (see Box B: The Impact of the Recent Floods on the Australian Economy). We have therefore revised down our expectations for near-term consumption growth. Consumption growth is still expected to pick up to around pre-pandemic rates of growth over coming years, supported by growth in real household incomes and the assumed easing in monetary policy.

The assumed cash rate path is expected to provide support to activity amid global economic headwinds. Financial market pricing now implies a slightly larger easing in the cash rate over the forecast period, which is expected to support aggregate household incomes and encourage dwelling and business investment by reducing borrowing costs. The exchange rate is broadly unchanged from February and is therefore providing little support to GDP growth relative to the February *Statement*; after depreciating sharply in early April following the announcement of tariffs by the US Government, this depreciation has since unwound amid improved risk sentiment and broad-based US dollar weakness (see Chapter 1: In Depth – Global Economy and Financial Markets).

Labour market conditions are expected to ease a little over the next year before stabilising at a level that is closer to balance compared with expectations in February.

The unemployment rate is expected to increase by slightly more over 2025 than expected in the February *Statement* (Graph 4.3). The unemployment rate has so far evolved as expected, remaining broadly steady at 4.1 per cent in the March quarter. Measures of hiring intentions and job ads were stable in early 2025 and remained broadly stable in April even as trade tensions escalated. Nonetheless, we expect the softer outlook for GDP growth in 2025 will result in a bit more easing in the labour market than previously thought. The unemployment rate is forecast to increase to 4.3 per cent over 2025 and is then expected to stabilise in early 2026 as GDP growth picks up further.

Graph 4.3
Baseline Unemployment Rate Forecast*



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

Sources: ABS; RBA.

Employment growth is forecast to ease by more than expected at the February *Statement*. This reflects the downgrade to the outlook for GDP growth, which will weigh on labour demand. As a result, growth in employment is forecast to be below growth in the working-age population for a time. Average hours per employee are also expected to decline a little more than in the February *Statement*, as firms respond to weaker demand growth in part by reducing workers' hours. The participation rate is expected to be broadly flat over the forecast period, as the continued trend of increased participation by females is offset by some discouraged workers leaving the labour force in response to weaker demand growth.

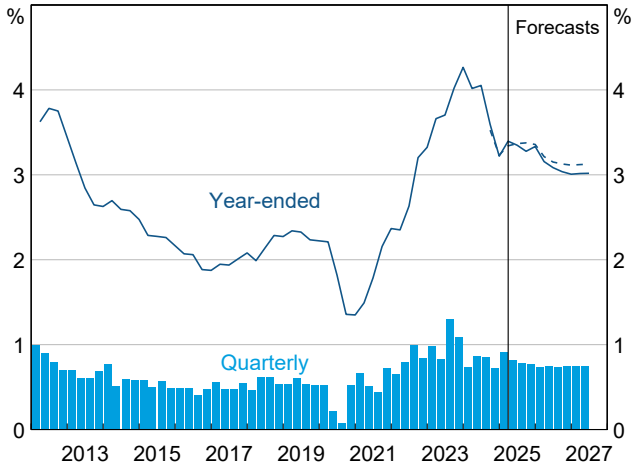
The baseline forecasts assume that the small increase in the unemployment rate brings the labour market closer to balance, though there is considerable uncertainty around estimates of full employment. Firms continue to report difficulties finding staff, and growth in unit labour costs is higher than is consistent with inflation being sustainably at target. At the same time, the observed decline in the rate of job-switching in the market sector might indicate less upwards pressure on wages growth and inflation than implied by the unemployment rate. Although our assessment of full employment has not been revised, our central forecasts for wages growth and inflation continue to incorporate some downwards judgement to reflect the risk that there is additional capacity in the labour market and economy more broadly.

Growth in nominal wages is expected to ease gradually over the coming year, alongside the easing in labour market conditions, before stabilising.

Private sector wages growth is expected to slow gradually in quarterly terms as conditions in the labour market ease. Wages growth is forecast to stabilise over 2026 at a slightly lower rate than previously forecast, owing to the softer outlook for the labour market relative to the February *Statement* (Graph 4.4). As in February, we have applied some downward judgement to the wages growth forecasts to incorporate the risk that we have overestimated the extent of excess demand in the labour market. Public sector wages growth is forecast to remain elevated over the remainder of 2025 – as several large agreements are renewed – before easing progressively over the remainder of the forecast period. Both the renewal of these large public sector agreements and announced administered decisions for several large awards may also contribute to increased quarterly volatility in the Wage Price Index.

Graph 4.4

Baseline Wage Price Index Growth Forecast*



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

Growth in unit labour costs (ULCs) is expected to begin easing in late 2025. Growth in nominal ULCs – the measure of labour costs most relevant for firms' cost of production and so for inflation outcomes – has been elevated in recent years. However, this is expected to slow in line with easing growth in nominal wages and a projected pick-up in productivity. ULCs are expected to reach a rate broadly consistent with inflation being sustainably at the midpoint of the target range by around the middle of the forecast period; this is a little earlier than in the February *Statement*.

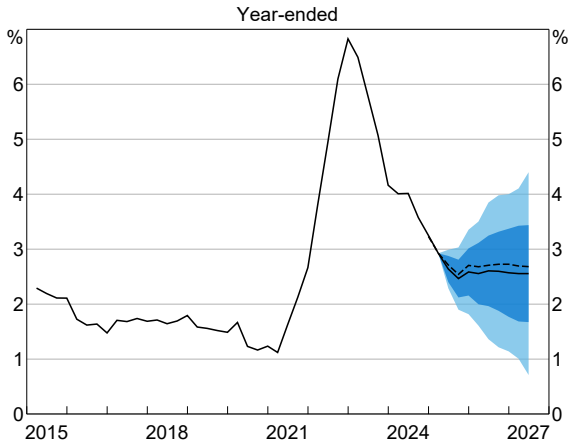
Year-ended underlying inflation is expected to remain within the 2–3 per cent range over the forecast period, and to settle at around the midpoint of that range.

The outlook for underlying inflation has been revised lower over the forecast period since the February *Statement* (Graph 4.5). This is consistent with the downward revision to the growth outlook and the small downward revision to import prices. The March quarter inflation data provided further confidence that housing inflation and market services inflation have fallen markedly over the past year. Inflation in new dwelling costs is expected to remain weak in the near term, partly reflecting the earlier softening in demand for new housing, before picking up alongside dwelling investment. CPI rents inflation is expected to ease as the earlier moderation in advertised rents growth gradually flows through to the stock of rents measured in the CPI. Market services inflation is expected to be a little weaker than previously thought, reflecting the softer outlook for the labour market. In the near term, downward pressure on firms' margins may continue to weigh on inflation until demand picks up, with some firms reporting in liaison that weak demand has limited their ability to pass on cost increases to prices.

The outlook for retail goods prices is subject to considerable uncertainty due to international developments. Under the baseline forecast, we have judged that the trade scenario set out in Table 4.1 is likely to have only a small effect on domestic inflation over the forecast period (see Key judgement #3 for the baseline forecast). Similar to the February *Statement*, we have incorporated some downward judgement to the inflation forecasts due to the risk that we have overestimated the extent of excess demand in the labour market. Inflation expectations are assumed to remain consistent with achieving the inflation target over the long term.

Graph 4.5

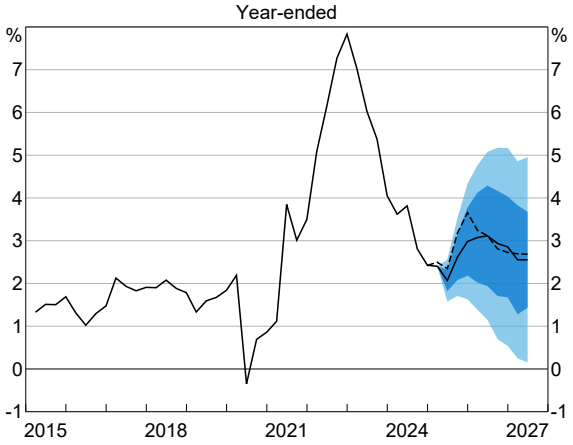
Baseline Trimmed Mean Inflation Forecast*



* 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.

Measured in headline terms, year-ended CPI inflation is expected to increase over the second half of 2025 to be above 3 per cent, before returning to around the midpoint of the target range later in the forecast period (Graph 4.6). This volatility is due to the unwinding of cost-of-living measures, such as electricity rebates (as currently budgeted). The pick-up in headline inflation has been delayed by the extension of the Electricity Bill Relief Fund in the 2025–2026 Australian Government Budget. The recent decline in oil prices is expected to weigh on headline inflation in the near term. Headline inflation is forecast to converge towards underlying inflation once these temporary factors have passed. Because headline inflation can be affected by large swings in the prices of individual items, we will continue to pay close attention to underlying measures as an indicator of momentum in consumer price inflation.[3]

Graph 4.6
Baseline Headline Inflation 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.

4.5 Alternative scenarios

Relative to the baseline scenario, the distribution of outcomes for the global outlook are judged to be skewed to the downside. There is considerable uncertainty about the wide range of possible levels that tariffs could settle at, and uncertainty about the impact on the global economy and financial markets. There is also uncertainty around the configuration of other economic policies, such as global fiscal policies or US deregulation policies in this environment. The scenarios set out in Table 4.1 can be used to illustrate the range of possible outcomes and are discussed in more detail below.

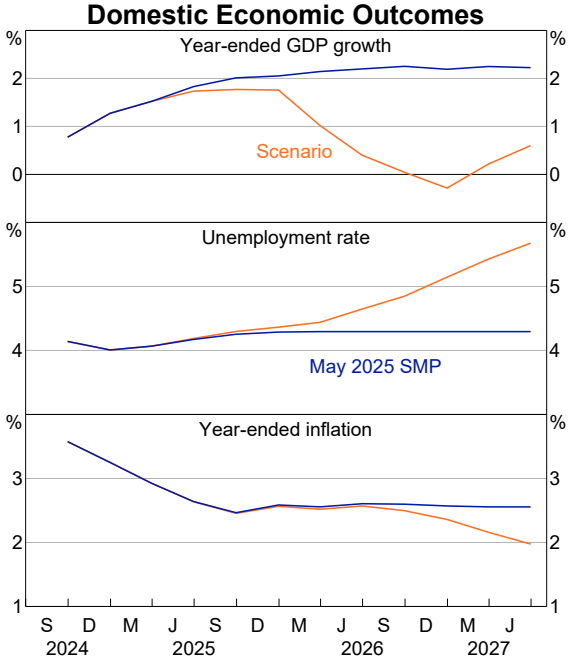
'Trade war' scenario – an escalation in the trade conflict leads to a protracted trade war.

The recent US–China trade agreement removes some of the downside risks to global growth. However, it remains very possible that the current situation deteriorates into a more widespread and protracted 'trade war', which would present large downside risks to domestic GDP growth and lead to higher unemployment.

Using the assumptions outlined in Table 4.1, we have constructed such a scenario using the Global Economic Model from Oxford Economics and MARTIN (the RBA's macroeconometric model). There are significant challenges in using modelling frameworks to quantify the effects of uncertainty or complexities from shocks that are outside the range typically seen. The outcomes of this scenario are as follows:

- The permanent and large increase in tariffs comes as a big surprise to financial markets, businesses and households, and triggers a large global confidence shock that leads to sharp declines in asset prices, business investment and consumption. There is a sharp and disorderly decline in asset prices in which the initial confidence shock is amplified in financial markets – for example, highly-leveraged trades could be unwound – leading to a cycle of further asset price declines.
- The level of MTP GDP is projected to be 3 per cent lower than our baseline forecast by the end of 2027 (which is a larger decline than during the global financial crisis). The level of Chinese GDP is around 4 per cent lower than our baseline forecast over the same period. This is because, in the scenario, the scope for trade diversion of Chinese exports is limited by the scale and increased coverage of tariffs and weak global demand, and because any fiscal response from Chinese authorities is assumed not to be material enough to meaningfully offset the weakness in demand.
- Inflation overseas is expected to increase in the near term as trade fragmentation leads to higher import prices for most economies, but this is temporary as the weaker GDP outcomes become disinflationary.
- The expected cash rate is fixed at the baseline assumption (and assumes a cumulative 85 basis points of easing by mid-2027). However, the Australian trade-weighted index depreciates by 6 per cent alongside weaker global growth. The level of domestic GDP is more than 3 per cent lower than the baseline forecast (Graph 4.7). Much of the decline is led by consumption and business investment from the confidence shock. Household wealth declines, while businesses become risk averse and reduce investment. The depreciation of the exchange rate provides some support to activity; however, the unemployment rate increases to nearly 6 per cent.
- The shock to domestic demand and higher unemployment weighs on wages growth and inflation, with inflation declining to around 2 per cent by the end of 2027.

Graph 4.7
Domestic Economic Outcomes



Sources: ABS; RBA.

It is possible that a protracted trade war leads to global inflationary pressures.

The baseline forecast and the trade war scenario described above are judged to be disinflationary for Australia as world trade prices respond to weaker global demand. However, it is also possible a protracted trade war could fuel inflationary pressures.

In a protracted trade war, a much larger share of world trade would be affected by tariffs and it would be hard for most firms to avoid the impact of higher tariffs affecting some stage of their production. Sourcing intermediate inputs would become more difficult, and it would take some time for businesses to adjust their supply chains to minimise exposure to tariffs. It is possible that, even in an environment of much weaker demand, businesses have to pass on these costs to higher prices.

There may also be inflationary pressures from a protracted trade war that take longer to appear. Higher tariffs can reduce productivity growth in affected economies via misallocation of resources, a reduction in business investment and less incentive to innovate.

Persistent inflationary pressures could emerge if incomes and demand did not moderate in line with the relatively lower supply capacity of the economy.

Finally, while longer term inflation expectations have remained relatively well anchored following the recent high-inflation period, there is a risk that a return to higher inflation before inflation had sustainably returned to the target band may see a drift higher in inflation expectations. The weaker outlook for demand and higher unemployment would make it more challenging for global central banks to tighten monetary policy to reduce inflation, which could see higher inflation expectations become entrenched.

'Trade peace' scenario – there is a swift resolution of the trade conflict.

A key upside risk to the global baseline forecast is a sharp de-escalation of the trade conflict. One scenario might be that successful negotiations between the United States and its key trading partners leads to a permanent resolution to the trade conflict which lowers tariffs back to 2024 levels and reduces global policy uncertainty. While the conflict to date has likely had some adverse effects on trade, business and household spending decisions, overseas growth could end up higher than in the baseline forecast if the de-escalation occurred alongside stronger-than-expected fiscal stimulus in advanced economies and China, or the introduction of non-trade policies in the United States that stimulate growth.

This scenario is likely to involve limited lasting scarring effects on Australian businesses and households from the (assumed temporary) escalation in the trade conflict over recent months. As such, it is possible that the expected recovery in domestic demand would be more pronounced than in the baseline forecast, as elevated uncertainty would no longer weigh on consumption and investment growth over 2025. This might see a re-emergence of the concerns outlined in the February *Statement* of excess demand in the labour market and the economy leading to inflationary pressures. In this scenario, less accommodative policy than is currently priced into market expectations for the cash rate may be required.

4.6 Detailed forecast information

Table 4.2 provides additional detail on the baseline 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 4.2: Detailed Baseline Forecast Table[a]

Percentage change through the four quarters to quarter shown, unless otherwise specified[b]

	Dec 2024	Jun 2025	Dec 2025	Jun 2026	Dec 2026	Jun 2027
Activity						
Gross domestic product	1.3	1.8	2.1	2.2	2.2	2.2
Household consumption	0.7	1.4	1.9	2.2	2.6	2.4
Dwelling investment	2.5	2.2	1.8	1.7	2.0	2.2
Business investment	0.3	0.2	0.6	1.8	2.9	3.4
Public demand	5.6	5.5	4.6	4.2	3.1	2.8
Gross national expenditure	2.3	2.2	2.5	2.7	2.8	2.7
Major trading partner (export-weighted) GDP	3.7	3.4	2.8	3.0	3.3	3.3
Trade						
Imports	5.8	1.3	3.1	3.9	4.0	3.4
Exports	1.7	1.4	1.5	1.8	1.7	1.7
Terms of trade	–4.8	–0.7	0.9	1.9	0.2	–2.1
Labour market						
Employment	2.4	2.1	1.4	1.3	1.4	1.4
Unemployment rate (quarterly, %)	4.0	4.2	4.3	4.3	4.3	4.3
Hours-based underutilisation rate (quarterly, %)	5.0	5.2	5.3	5.4	5.4	5.4
Income						
Wage Price Index	3.2	3.3	3.3	3.1	3.0	3.0
Nominal average earnings per hour (non-farm)	3.7	4.1	4.1	3.8	3.5	3.5
Real household disposable income	1.9	3.3	2.6	2.0	2.0	2.4
Inflation						
Consumer Price Index	2.4	2.1	3.0	3.1	2.9	2.6
Trimmed mean inflation	3.3	2.6	2.6	2.6	2.6	2.6
Assumptions						
Cash rate (%)[c]	4.3	4.0	3.4	3.2	3.2	3.2
Trade-weighted index (index)[d]	61.5	60.0	60.6	60.6	60.6	60.6
Brent crude oil price (US$/bbl)[e]	74.2	66.2	62.8	62.8	62.8	62.8
Estimated resident population[f]	1.7	1.7	1.5	1.3	1.3	1.2
Memo items						
Labour productivity[g]	–1.5	–0.6	0.9	1.1	1.0	1.0
Household savings rate (%)[h]	3.8	4.4	4.8	4.3	4.3	4.2
Real Wage Price Index[i]	0.8	1.3	0.3	0.0	0.1	0.5
Real average earnings per hour (non-farm)[i]	1.2	2.0	1.0	0.7	0.6	1.0

(a) Forecasts finalised on 14 May.

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

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

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

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

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

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

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

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

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

Endnotes

1 For more information on this, see Tulip P and S Wallace (2012), 'Estimates of Uncertainty around the RBA's Forecasts', RBA Research Discussion Paper No 2012-07.

2 For example, see Bloom N (2009), 'The Impact of Uncertainty Shocks', *Econometrica*, 77(3), pp 623–685; Moore A (2016), 'Measuring Economic Uncertainty and Its Effects', RBA Research Discussion Paper No 2016-01.

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