



RESERVE BANK OF AUSTRALIA

Statement on Monetary Policy

February 2025

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Overview

Key messages

Underlying inflation has continued to moderate and by a little more than expected.

Financial conditions are restrictive, which is weighing on demand and is helping to bring down underlying inflation. Growth in private demand has been subdued even though household consumption growth looks to have picked up late last year. Public demand has supported overall growth in economic activity over recent quarters.

Underlying inflation has moderated over the past three quarters. Trimmed mean inflation eased to 3.2 per cent over 2024. It is expected to reach the 2–3 per cent target range in early 2025, which is sooner than expected at the time of the November *Statement*. Headline inflation declined to 2.4 per cent over 2024. Headline inflation remains lower than underlying inflation, mostly because of the impact of federal and state government subsidies to households.

The labour market has remained strong.

The unemployment rate declined a little in late 2024 to 4 per cent. Much of the strength in the labour market has been underpinned by strong employment growth in the non-market sector, which in turn has affected labour market conditions in the market sector as both compete for labour. Employment growth has also bolstered household incomes.

Outside of the labour market, there is some evidence that capacity pressures have eased. The recent moderation in underlying inflation, alongside a persistently tight labour market and elevated growth in input costs, is consistent with many firms finding it difficult to fully pass on input cost increases in the current environment of subdued growth in demand. Demand also seems to have eased in the housing market, which has seen a material slowing in housing and rental price increases.

The outlook remains uncertain.

The announcement of tariffs between the United States and other major economies poses challenges to the global outlook. But the scale and incidence of the tariffs and their effects remain highly uncertain – which may itself delay some investment until the outlook becomes clearer. Economic activity strengthened in China but growth there is still facing structural headwinds.

Economic growth is forecast to pick up and the labour market is forecast to remain tight. These forecasts are conditioned on the market implied cash rate path, which had built in 90 basis points of easing by mid-2026. Household consumption growth is expected to pick up, which along with growth in public demand is expected to see output growth increase over the coming year. As a result, the unemployment rate is forecast to rise only a little.

If the cash rate follows the market path, underlying inflation is projected to be a little above 2½ per cent over most of the forecast period. The anticipated recovery of GDP growth and lingering tightness in labour market conditions are expected to sustain some upward pressure on inflation.

The Reserve Bank Board decided to lower the cash rate target by 25 basis points, acknowledging disinflation progress, but the Board is cautious about the outlook.

Monetary policy has been restrictive and will remain so after this reduction in the cash rate.

However, the outlook remains uncertain. In removing a little of the policy restrictiveness, the Board acknowledges that progress has been made but is cautious about the outlook.

What's been going on in the economy?

Global policy uncertainty is high.

The economic environment remains challenging due to changing global trade policies and ongoing geopolitical tensions. Output growth in China picked up towards the end of last year, while US growth has remained robust and the unemployment rate there has stabilised at a low level. Growth in other advanced economies has remained subdued. However, the announcement of higher tariffs between the United States and some of its major trading partners, along with broader geopolitical tensions, has created a highly uncertain global environment.

Most advanced economies have seen further reductions in inflation, but the imposition of tariffs could undo some of this progress, particularly in the United States. Underlying inflation has eased further in most advanced economies, with services inflation still elevated but easing towards levels consistent with historical averages. Goods inflation has picked up gradually, returning to around historical averages. Having reduced policy rates noticeably, some advanced economy central banks have now signalled that any further policy easing is likely to be more gradual. Market participants have pared back their expectations for future policy easing in the United States as progress on disinflation has slowed and the unemployment rate has stabilised.

Financial conditions in Australia are restrictive and are weighing on private domestic demand.

Monetary policy is restrictive, although some indicators of financial conditions have eased over recent months. Market participants brought forward the date at which they expect the cash rate to be lowered following the December Board meeting, as the Board noted it was gaining some confidence that inflation was moving sustainably towards target, and in response to lower-than-expected inflation and GDP. Reflecting this, and the uncertain global outlook and broad-based US dollar strength, the Australian dollar has depreciated somewhat against the US dollar and on a trade-weighted basis. Lending rates to households and businesses are elevated, and households' debt-servicing payments remain high as a share of household income. Despite the high cost of financing, housing and business credit growth have picked up a little further, and wholesale market funding conditions remain favourable and supporting issuance.

Restrictive financial conditions have weighed on private demand, while public demand has supported growth in economic activity and employment. GDP growth remained subdued in the September quarter and household consumption growth continued to be modest. There was evidence of an increase in household spending toward the end of 2024, though it is difficult to assess how much is genuine momentum following a pick-up in real income growth and consumer confidence, and how much reflects a concentration of spending around large sale events. Growth in public demand has remained strong, supporting overall growth in real activity during 2024.

Despite subdued growth in output, strength in the labour market has persisted. The earlier easing in labour market conditions stalled in the second half of 2024 with some key indicators tightening a little towards the end of the year. In particular, the unemployment rate declined to 4 per cent in late 2024, showing more strength than expected at the time of the November *Statement*. Also, demand for labour, especially in the non-market sector, remains strong; employment growth has continued to outpace population growth and vacancies are elevated. The participation rate has also reached historically high levels.

Labour cost growth has eased but remains high. Private sector wages growth eased in year-ended terms in September, but was steady at 0.8 per cent in quarterly terms. This is consistent with the recent stabilisation in labour market conditions. Public sector wages growth remained solid though it has been volatile, in part reflecting the timing of when enterprise bargaining agreements take effect. Overall, solid growth in wages along with still-weak productivity – which is around pre-pandemic levels – has kept growth in unit labour costs above rates consistent with inflation being at target.

How do we see the economy developing?

Changing trade and fiscal policies could significantly alter the trajectory of global growth.

The outlook for global growth is uncertain because of unpredictability around government policies. In the absence of clear information, Consensus forecasts are little changed since November. The central forecast for growth in Australia's major trading partners is unchanged at 3.4 per cent in 2025 and is slightly lower for 2026. In North America, growth for 2026 has been revised lower due to the prospect of tariffs in the region. But our outlook for growth in China has been revised up, reflecting expectations of additional fiscal stimulus more than offsetting the effects of increased tariffs. These forecasts could change quickly and significantly.

Growth in Australia is expected to return to its trend rate.

GDP growth is forecast to pick up over 2025, with a broadly similar profile to that in the November *Statement* from the middle of the year. An upward revision to the outlook for public spending growth and a small lift to net exports from the depreciation of the Australian dollar are expected to be broadly offset by a softer outlook for growth in consumption. Household spending in the December quarter looks to have been a little stronger than expected, but this was underpinned by retail promotions and discounting, and some of this is not expected to persist. At this stage, given the still-evolving international environment, we assume there are limited effects on domestic growth and inflation from recent announcements related to international trade. But there are significant uncertainties around this central case, and prolonged uncertainty may itself bear down on growth if households and firms choose to delay planned spending.

The unemployment rate has been revised down over the forecast period in light of the unexpected recent strength in labour market indicators. The unemployment rate is expected to increase slightly in the near term, reflecting subdued growth of economic activity in late 2024, and to remain at this rate over the next couple of years as the pick-up in GDP growth provides support for labour demand. Growth in labour productivity is expected to remain weak over the coming year, which will weigh on the economy's supply potential, before picking up. Growth in unit labour costs is expected to moderate from elevated levels as productivity growth picks up.

Underlying inflation is expected to return to the 2–3 per cent target range this year and, if the cash rate follows the market path, to be a little above the midpoint over the forecast period.

On the back of lower-than-expected CPI data in the December quarter, the near-term outlook for inflation has been revised a little lower for 2025. Some of this revision is also based on subdued growth of demand, with an easing of capacity pressures in some parts of the economy and what appears to have been compression of margins for some firms. However, the pick-up in GDP growth and tight labour market conditions are expected to keep underlying inflation a little above 2½ per cent for most of the forecast period.

Headline inflation is expected to be volatile over the coming year, before settling in the target range in 2026. Governments' cost-of-living support measures to households – such as electricity rebates – are legislated to end in 2025, which is forecast to lead to a temporary increase in headline inflation.

The outlook remains uncertain.

An escalation of current global trade tensions could lead to an economic slowdown in Australia. This would probably occur through the effects of weaker growth in China and other major trading partners, disruption of supply chains, and the negative impact of trade policy uncertainty on business investment and household spending in Australia. The Australian dollar would be likely to depreciate, acting as a shock absorber to some extent by supporting the competitiveness of Australia's exports while also adding some inflationary pressure from higher import prices in the near term.

In Australia, the recent run of domestic data have provided mixed signals about the economy. The paths of unemployment, activity and inflation from here are uncertain. The unemployment rate could decline a little further in the near term, consistent with some indicators, or it could increase by more than expected if the recovery in private demand does not materialise. The outlook for consumption is complicated by uncertainty around seasonal patterns and the extent of underlying momentum.

There are uncertainties around our assessment of the degree of balance between supply and demand in the economy and in the labour market. Weaker parts of the economy that face fewer capacity constraints could have a greater bearing on the path of inflation. There is also a risk that we have overestimated the extent of excess demand in the labour market. These factors would see inflation declining more quickly and by more than forecast.

What did the Board decide?

At its February 2025 meeting, the Reserve Bank Board decided to lower the cash rate target by 25 basis points to 4.10 per cent. Monetary policy has been restrictive and will remain so after this reduction in the cash rate. Some of the upside risks to inflation appear to have eased and there are signs that disinflation might be occurring a little more quickly than earlier expected. Nevertheless, upside and downside risks to the outlook remain. If monetary policy is eased too much and too soon, disinflation could stall and inflation would settle above the midpoint of the target range. In removing a little of the policy restrictiveness, the Board acknowledges that progress has been made but is cautious about the outlook.

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	1.1	2.0	2.4	2.3	2.3	2.2
(previous)	(1.5)	(2.3)	(2.3)	(2.3)	(2.2)	(n/a)
Unemployment rate ^(b)	4.0	4.2	4.2	4.2	4.2	4.2
(previous)	(4.3)	(4.4)	(4.5)	(4.5)	(4.5)	(n/a)
CPI inflation	2.4	2.4	3.7	3.2	2.8	2.7
(previous)	(2.6)	(2.5)	(3.7)	(3.1)	(2.5)	(n/a)
Trimmed mean inflation	3.2	2.7	2.7	2.7	2.7	2.7
(previous)	(3.4)	(3)	(2.8)	(2.7)	(2.5)	(n/a)

	Year-average					
	2024	2024/25	2025	2025/26	2026	2026/27
GDP growth	1.0	1.4	2.1	2.4	2.3	2.3
(previous)	(1.2)	(1.7)	(2.2)	(2.3)	(2.3)	(n/a)

	Assumptions ^(c)					
	2024	2024/25	2025	2025/26	2026	2026/27
Cash rate (%)	4.3	4.0	3.6	3.4	3.5	3.5
Trade-weighted index (index)	61.5	60.4	60.4	60.4	60.4	60.4

(a) Forecasts finalised on 12 February. 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 12 February and the daily exchange rate (TWI) is assumed to be unchanged from its level at 12 February 2025 going forward. See notes to Table 3.1: Detailed Forecast Table in Chapter 3: Outlook for other forecast assumptions.

Sources: ABS; LSEG; RBA.



Chapter 1

Financial Conditions

Summary

- **Australian financial conditions overall are assessed as being restrictive.** The cash rate remains above estimates of the neutral rate, consistent with the ongoing weakness in private demand. Lending rates to households and businesses have been little changed, but remain at a high level, while households' debt-servicing payments are still high as a share of household income. Even so, some determinants of financial conditions have eased since November. Market participants' expectations for the timing of monetary policy easing have been brought forward, contributing to the depreciation of the Australian dollar. Wholesale market funding conditions remain favourable, supporting strong issuance. Housing and business credit growth have picked up further, although measures of leverage have been stable or have declined.
- **Market participants now see a very high likelihood of a reduction in the cash rate of 25 basis points at this meeting, following lower-than-expected trimmed-mean inflation in the December quarter.** Participants also anticipate close to two further cuts in 2025 and another one in early 2026 – a moderately faster cutting phase than they expected in November. This has contributed to bond yields declining in Australia relative to most other economies. The expected peak-to-trough easing remains smaller than in most other advanced economies, consistent with policy rates having reached less restrictive levels here.
- **Central banks and market economists have acknowledged a high degree of uncertainty about the policies of the new US administration and hence the outlook for the global economy.** However, yields on US government debt have risen only modestly since November, while equity and credit risk premia remain low in advanced economies. With markets pricing in a low probability of policy measures leading to negative outcomes for economic growth and earnings, financial conditions could tighten noticeably, including in Australia, if current assumptions about the potential negative effects of these measures prove incorrect.
- **The Australian dollar has depreciated by 5 per cent against the US dollar and 2 per cent on a trade-weighted basis since the November *Statement*, leaving it at the bottom of its range since 2022.** This has occurred against the backdrop of broad-based US dollar strength, which has been supported by the anticipated impacts of higher tariffs and other policy changes in the United States, including on the Chinese economy. The depreciation has also occurred alongside a decline in the difference between interest rates in Australia and those of the major advanced economies.

-
- **Most advanced economy central banks lowered their policy rates further over recent months, and financial markets expect additional easing – albeit at a slower pace in the United States.** Market participants now anticipate the US Federal Reserve (Fed) will cut rates just once or twice in 2025 as economic activity and the labour market have remained resilient, and the policies of the new administration are expected to add to inflation. This, as well as the effects of increased policy uncertainty and expectations that public debt will increase further, has contributed to long-term bond yields in the United States rising relative to those of most other economies.
 - **In China, authorities have said that both monetary and fiscal policy settings will be loosened further in 2025** to support economic growth against the background of a potentially sustained increase in US tariffs. Though the renminbi has depreciated by about 3 per cent against the US dollar since the November *Statement*, the authorities have continued to lean against larger declines in the currency.

1.1 Interest rate markets

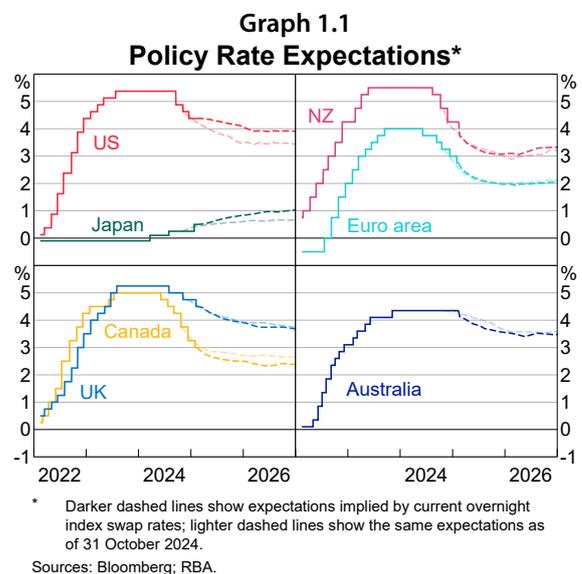
Most advanced economy central banks reduced their policy rates further in recent months.

Having lowered their policy rates materially from peak levels, some advanced economy central banks are signalling that further reductions may be more gradual or dependent on favourable data. Many have highlighted US trade policy as a significant source of uncertainty to the economic outlook (see Box A: Implications of US Policy Settings for Financial Markets).

The Fed kept its policy rate on hold at its January meeting and said that it will be looking for confirmation of further progress on inflation or signs of a weakening labour market before considering further adjustments, while noting that its current policy rate remains restrictive. The Bank of Canada (BoC) has also signalled a more gradual approach following its most recent rate cut and stressed the difficulty of assessing the appropriate future path of monetary policy, given uncertainty about potential tariffs. Meanwhile, the Reserve Bank of New Zealand cut its policy rate by a further 50 basis points and signalled it expects to do so again in February. The European Central Bank has also reduced rates in the face of ongoing slow recovery in growth. The Bank of Japan increased its policy rate in January in response to upside inflation risks.

The BoC announced the end of its passive quantitative tightening program as it nears its estimate of the level of reserves required to meet underlying demand. Other central banks that pursued asset purchase programs during the COVID-19 pandemic have indicated they intend to continue reducing the size of their asset holdings.

Market participants' policy rate expectations now point to fewer rate cuts in the United States compared with the November *Statement* but are little changed in most other advanced economies (Graph 1.1). The increase in the United States reflects generally strong data on the labour market and economic activity more broadly, as well as the potential inflationary impacts of the new administration's trade, fiscal and immigration policies. In other economies, economic data has generally not been as strong as in the United States, and there is concern about the negative growth implications of potentially higher tariffs.



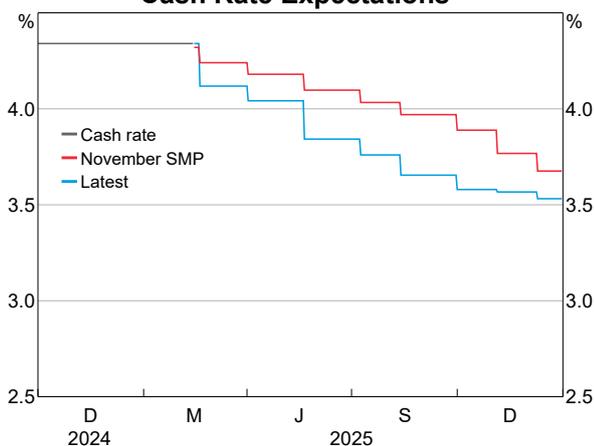
In Australia, market participants have brought forward their expectations for cuts to the cash rate.

Market participants are pricing a very high likelihood that the Reserve Bank Board will cut the cash rate target by 25 basis points at the February meeting. The expected path for the cash rate has shifted down since the November *Statement*, with roughly three rate cuts priced in for 2025 and another one early next year (Graph 1.2). While the cash rate is anticipated to decline faster than it was in November, expectations for the cash rate at the end of 2026 are little changed. This followed the December policy decision, and associated communication; the expected path declined further following lower-than-expected GDP and inflation data. A reduction of 25 basis points in February is expected by almost all market economists we track.

Long-term government bond yields have increased in the United States but are little changed in Australia since the November *Statement*.

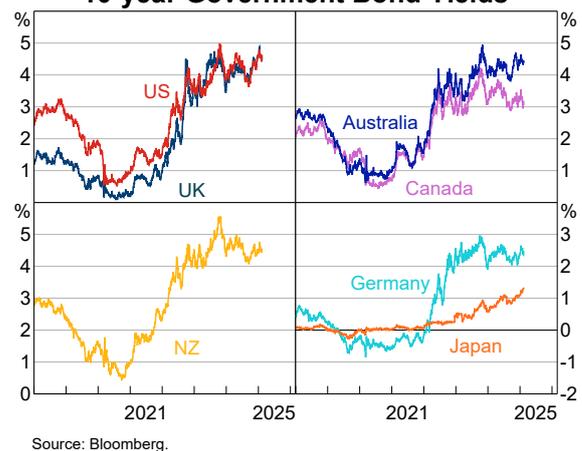
The increase in government bond yields in the United States reflects expectations for fewer cuts to the policy rate and uncertainty around US trade, fiscal and immigration policies and their potential impact on inflation and growth (Graph 1.3). Real yields have risen moderately, and the US yield curve has steepened (Graph 1.4). This also reflects an increase in measures of term premia, albeit to still low levels by historical standards. Measures of short-term market-based inflation compensation have also risen over this period (see Box A: Implications of US Policy Settings for Financial Markets).

Graph 1.2
Cash Rate Expectations*



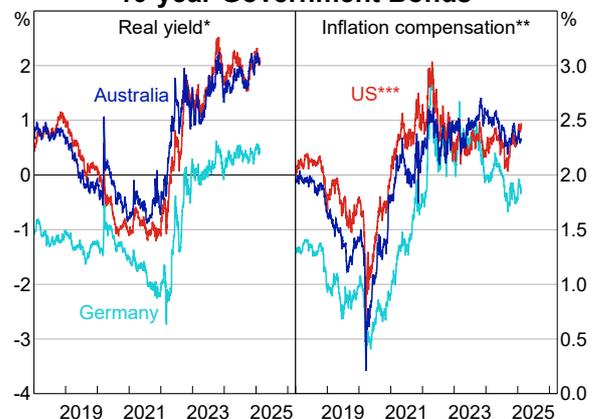
* Cash rate expectations are implied by OIS.
Sources: LSEG; RBA.

Graph 1.3
10-year Government Bond Yields



Source: Bloomberg.

Graph 1.4
10-year Government Bonds



* The yield on inflation-linked bonds.
** Spread between yields on nominal and inflation-linked bonds.
*** Over the longer term, the price index referenced in US inflation-linked bonds has averaged 0.5 percentage points more than the PCE deflator targeted by the US Federal Reserve.

Sources: Bloomberg; RBA.

Long-term bond yields have also increased in Japan as market expectations for future policy tightening have risen. In most other advanced economies – including Canada, Germany, New Zealand and the United Kingdom – yields have risen by less than in the United States or are little changed, in part reflecting fewer upside surprises to economic activity data and a perception that those economies are more vulnerable to downside risks to growth from potential US tariffs.

In comparison, yields on Australian Government Securities (AGS) are little changed since the November Statement, and have moved below US Treasury yields for the first time since mid-2024.

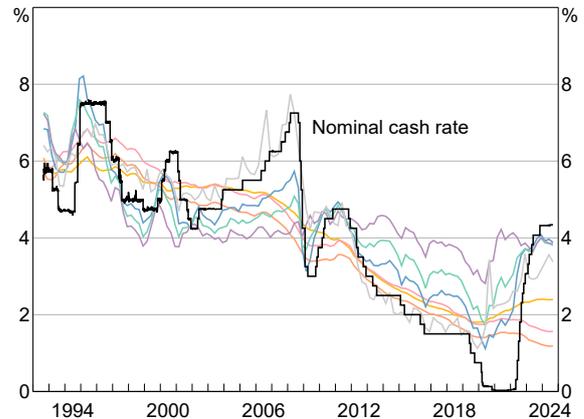
This is consistent with the relative change in expectations for policy rates in Australia and the United States. Long-term AGS yields have moved below US Treasury yields for the first time since mid-2024.

The cash rate is currently above central estimates of the neutral rate.

The cash rate is above the RBA’s and market economists’ central estimates of neutral (Graph 1.5).

However, there is a large degree of uncertainty about these estimates. There is a wide range of model estimates, and each individual estimate is subject to its own uncertainty. Accordingly, the neutral rate is difficult to identify and incoming data and refinements to models can lead to significant revisions. The RBA has recently refined how the models account for the pandemic period, following the techniques of other central banks. This has led to a shift downward in some estimates of neutral and is consistent with our assessment, based on a broader range of indicators, that financial conditions remain restrictive and the observation that private demand has been weak for some time.

Graph 1.5
Nominal Neutral Rate*
Estimates from the full model suite



* The estimates of the neutral rate are from a suite of models and their alternative specifications, including a semi-structural model, a vector autoregression and a financial market-based model.

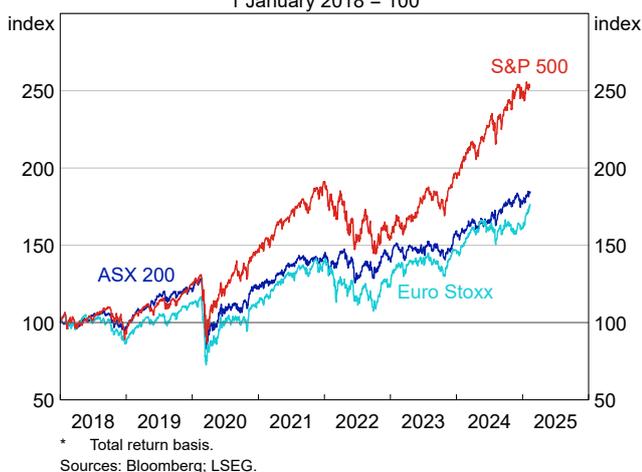
Source: RBA.

1.2 Other measures of financial conditions

Several measures of private sector financial conditions have eased further in advanced economies, with the pricing on some riskier assets reaching new highs.

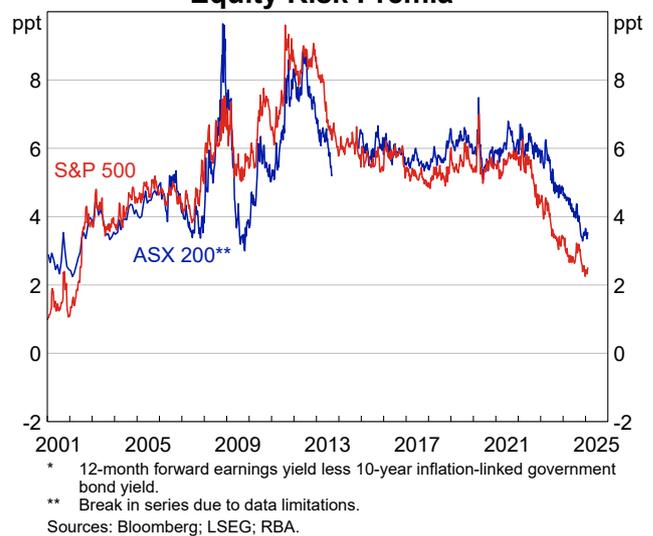
Equity prices in most advanced economies, including Australia, have risen since the November Statement (Graph 1.6). US equity prices have increased on strong economic data and expectations that the positive impact of corporate tax reform, deregulation and fiscal stimulus will outweigh the negative effects from more restrictive trade and immigration policies. In the United Kingdom, euro area and Japan, equity prices have risen despite tariff concerns and broader geopolitical risks. This is partly because the depreciation of local currencies has contributed to an improvement in the local currency earnings outlook for export-focused companies and the offshore operations of multinationals, which constitute a large proportion of these indices (see Box A: Implications of US Policy Settings for Financial Markets). In Australia, broad-based gains have offset tariff-related declines in the materials sector.

Graph 1.6
Equity Prices*
1 January 2018 = 100



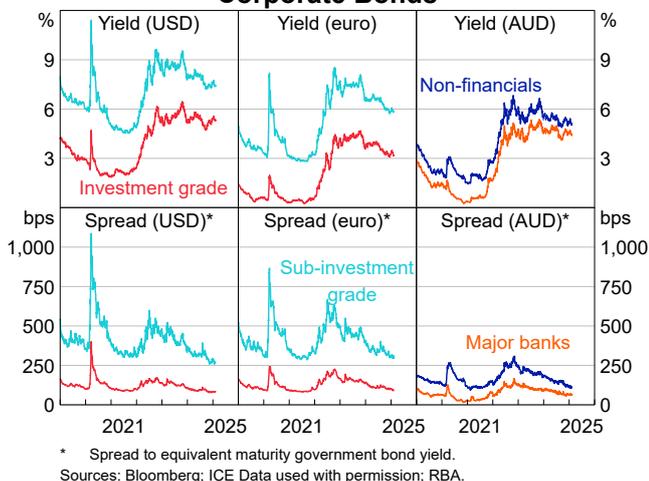
The equity risk premium remains around its lowest levels since 2009 in Australia, is at its lowest level since 2002 in the United States and near recent lows for most other advanced economies (Graph 1.7). These low-risk premia have been sustained despite the escalation of trade tensions. This suggests that markets consider the likelihood of scenarios that lead to material decline in economic activity and earnings to be low. However, equity prices could fall sharply in response to developments that challenge these assumptions.

Graph 1.7
Equity Risk Premia*



Spreads on corporate bonds in the United States and euro area have narrowed a little further since early November, particularly on sub-investment grade debt (Graph 1.8). Consistent with the low pricing of risk in equity markets, spreads on corporate bonds in the United States and euro area are near 15-year lows. This reflects market expectations of a relatively benign credit cycle, as well as an elevated appetite for risk and strong investor demand. As a result, corporate bond yields in the United States and euro area have generally declined or increased only modestly despite the increase in risk-free rates. Yields on corporate bonds in Australia are little changed.

Graph 1.8
Corporate Bonds



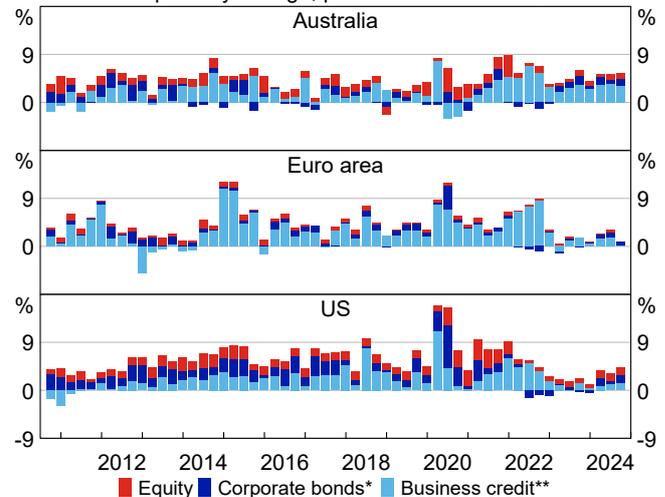
Credit growth has picked up in many economies and remains relatively strong in Australia.

Growth in total external funding of non-financial corporations (NFC) has increased since the start of 2024 in the United States and euro area, due to strong corporate bond issuance and increased credit growth (Graph 1.9). Equity issuance has also picked up in the United States, consistent with positive investor risk sentiment. Growth in external funding has been a little stronger in Australia relative to GDP, in part reflecting robust investor demand for non-financial corporations' bonds and strong lending competition among banks.

Graph 1.9

NFC External Funding

Net quarterly change, per cent of nominal GDP



* Includes domestic and offshore issuance, REITs and hybrids.
** Seasonally adjusted, includes securitisation. Australian data includes lending reported to APRA and lending to large businesses not reported to APRA.
Sources: ASX; Bloomberg; Dealogic; LSEG; national sources; Private Placement Monitor; RBA.

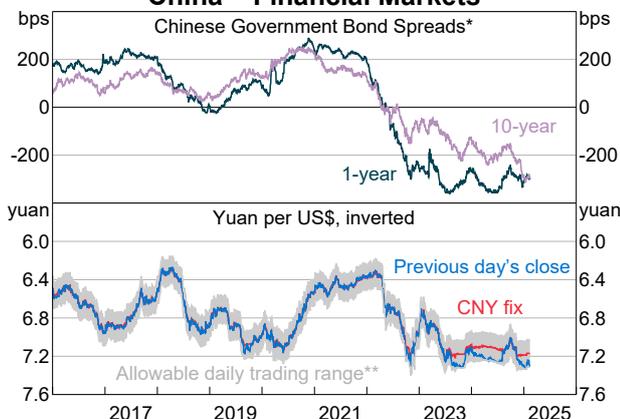
Credit growth for households has also increased over 2024 in the euro area but has remained steady in the United States over this period. Lending surveys suggest that banks are generally no longer tightening lending standards for households or firms, and in some cases are starting to ease lending standards in the United States and euro area. In Australia, the RBA's liaison program suggests that lending conditions have been little changed in recent quarters.

Although the Chinese authorities have signalled additional monetary policy easing, asset prices continue to reflect a challenging domestic and external economic environment.

Since the November *Statement*, the Chinese renminbi has depreciated by 2.7 per cent against the US dollar amid broader US dollar strength, higher US tariffs on Chinese exports and an uncertain outlook for the Chinese economy. That said, the renminbi has been broadly unchanged on a trade-weighted basis. Authorities have actively leaned against the pace of depreciation and continue to emphasise the importance of currency stability, which may be a constraint on further monetary policy easing.

The People’s Bank of China (PBC) has committed to easing monetary policy further to help achieve the authorities’ growth objectives amid concerns about ongoing headwinds to growth (such as the weakness in the property sector) and the impact of the US administration’s trade and technology measures on China (see Chapter 2: Economic Conditions). Longer term Chinese Government bond (CGB) yields have declined to around historical lows amid strong demand for bonds and persistently low inflation (Graph 1.10). Household credit growth has increased in recent months alongside some signs of stabilisation in the property sector but remains at a low level.

Graph 1.10
China – Financial Markets



* Spreads to equivalent US Treasuries.
 ** Since early 2014 the CNY has been allowed to trade in a daily range of +/- 2 per cent from the CNY fix.
 Sources: Bloomberg; CEIC Data; RBA.

The US dollar has appreciated against most major market currencies over recent months.

The US dollar trade-weighted index has appreciated by 3 per cent since the November Statement, reaching multi-decade highs (Graph 1.11). Several factors have supported US dollar strength over the long term, including strong relative productivity gains and economic growth more broadly relative to other economies (which is reflected in higher US yield differentials), and improvements in the US terms of trade. More recently, market participants have pushed back their expectations for further US monetary policy easing. The US dollar has also been supported by expectations that the currencies of countries targeted by US tariffs may depreciate further to offset their impacts and the potential for global trade tensions to escalate further (see Box A: Implications of US Policy Settings for Financial Markets).

Graph 1.11
US dollar Trade-weighted Index*
1 January 2020 = 100

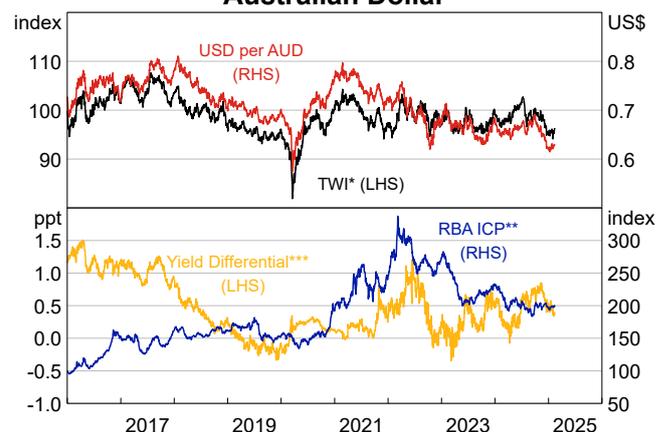


* Broad-basket nominal currency index. Data before January 2006 reflects traded goods only.
 Source: Board of Governors of the Federal Reserve System; RBA.

The Australian dollar has depreciated alongside broad-based US dollar strength.

The Australian dollar has depreciated by 5 per cent against the US dollar since the November Statement and by 2 per cent on a trade-weighted basis (Graph 1.12). This has largely reflected broad-based US dollar strength over this period. In addition, the yield differential between Australian and both US and Japanese government bonds has declined.

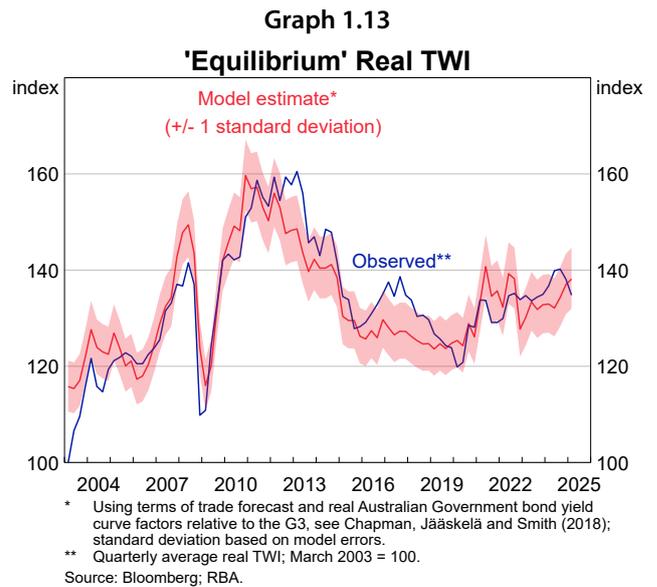
Graph 1.12
Australian Dollar



* Trade-weighted index; 31 December 2015 = 100.
 ** Index of Commodity Prices (USD terms); 31 December 2015 = 100.
 *** Three-year Australian sovereign yield less yields of the United States, Japan and Germany, weighted by GDP.
 Source: Bloomberg; RBA.

The Australian dollar trade-weighted index (TWI) is now at the bottom of the range observed since 2022. This is consistent with the Australian dollar's tendency to be more sensitive to movements in the US dollar and global growth cycle. Uncertainty around the outlook for the Chinese economy – exacerbated by the possibility of higher US tariffs on Chinese goods – has further weighed on the value of the Australian dollar against the currencies of other major trading partners. In addition, Chinese authorities have leant against the depreciation of the renminbi over recent months, contributing to the 2 per cent depreciation of the Australian dollar against the renminbi since early November; the Chinese renminbi holds a 30 per cent weight in the Australian dollar TWI.

In real terms, the Australian dollar TWI has depreciated over the March quarter to date but remains close to the model estimate implied by the long-run historical relationship with the forecast terms of trade and real yield differentials (Graph 1.13).

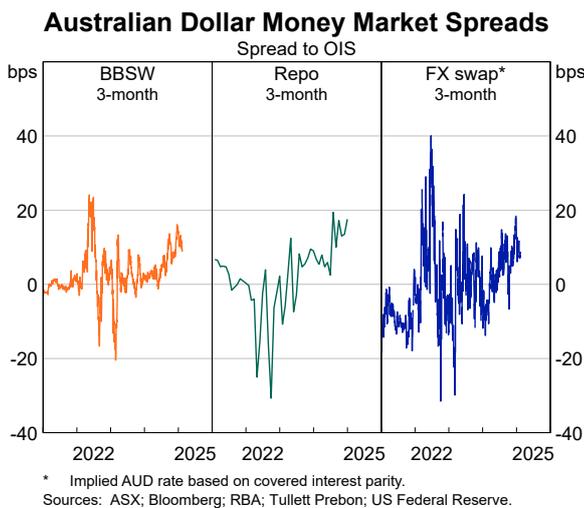


1.3 Australian banking and credit markets

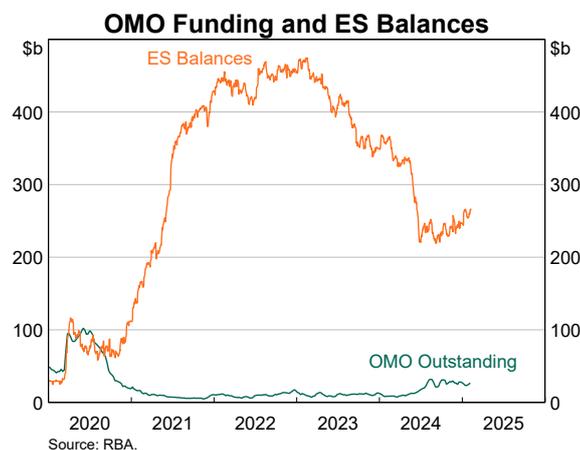
Conditions in money markets have been stable and key rates remain consistent with the Reserve Bank Board’s policy stance.

Short-term funding markets functioned well over year-end. Rates in short-term funding markets remain within recent ranges and the cash rate has continued to trade close to the cash rate target (Graph 1.14). Exchange Settlement balances held by banks have risen modestly in recent months, in part reflecting the usual seasonal pause in bond issuance by the Australian Government over year-end (Graph 1.15). As a result, demand by banks for borrowing from the RBA’s overnight market operations (OMOs) has declined slightly.

Graph 1.14



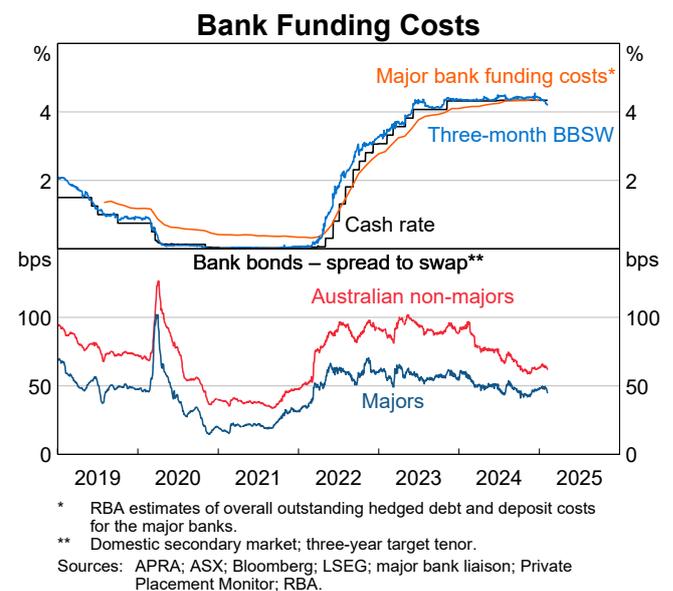
Graph 1.15



Banks’ funding costs were little changed in the December quarter, and wholesale funding market conditions remain favourable for financial institutions.

Banks’ estimated funding costs were stable in the December quarter, reflecting no change in the cash rate and little change in short-term market rates. Bank bond spreads relative to the swap rate – a reference rate for the pricing of securities – declined over 2024 and remain close to their lowest levels since early 2022, despite a small increase since November (Graph 1.16). Bank bond issuance (both domestic and offshore) has been steady alongside ongoing strong investor demand.

Graph 1.16



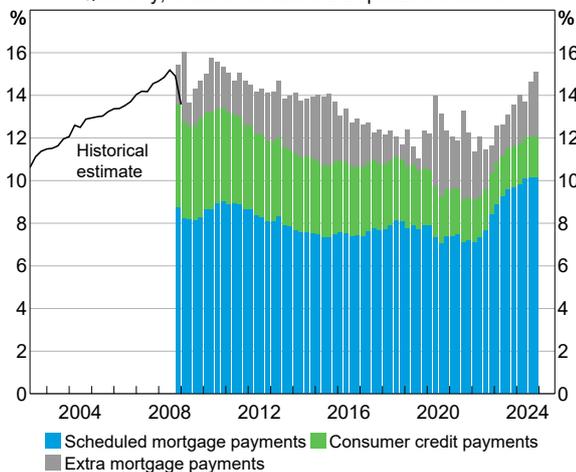
Conditions in the Australian asset-backed securities (ABS) market – a key source of funding for non-bank lenders – continue to be favourable for issuers.

Issuance of ABS has been strong, supported by elevated investor demand, with 2024 recording the highest level of issuance relative to GDP since the global financial crisis (GFC). Spreads remain narrow across asset-backed markets, particularly for lower rated tranches of securities.

Financial conditions for households have been little changed since the November *Statement*.

Scheduled mortgage and consumer credit payments remain high as a share of household disposable income. The value of scheduled mortgage repayments as a share of household disposable income stabilised over the second half of 2024 (blue bars in Graph 1.17). While nominal repayments increased alongside higher credit growth and remaining fixed-rate expiries, this has been offset by growth in household disposable income. Variable mortgage rates have also been little changed over recent months. A few banks have reduced advertised interest rates on new fixed-rate housing loans in recent weeks alongside a slight easing in benchmark (swap) rates, but the fixed-rate share of new housing lending remains low. The rise in household interest payments since 2022 has put pressure on household budgets, which has contributed to weak consumption growth over the past few years and an increase in housing loan arrears to around their pre-pandemic levels.

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

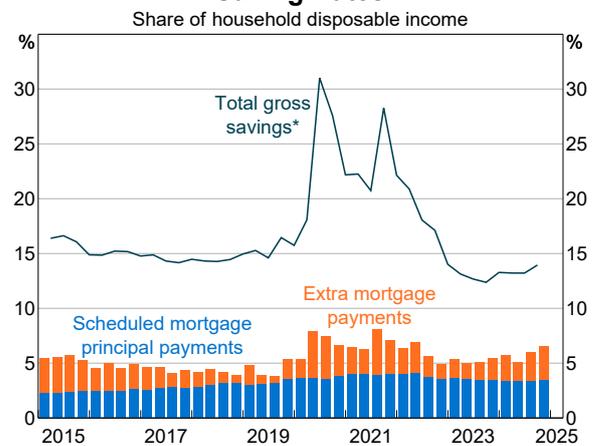


Sources: ABS; APRA; RBA.

Payments into mortgage offset and redraw accounts picked up over the second half of 2024 and are a little above their pre-pandemic average (Graph 1.18).

The increase in excess payments over the second half of 2024 (grey bars in Graph 1.17) might reflect a higher rate of overall saving from mortgagors over this period, though other factors can also influence the aggregate flow of excess payments (e.g. funds transferred from other sources of savings). Indeed, the overall rate of saving across all households increased slightly in the September quarter of 2024 but remained below its pre-pandemic average (see Box B: Consumption and Income Since the Pandemic).

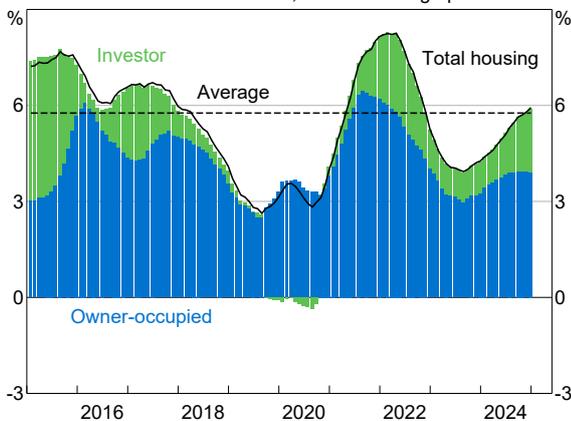
Graph 1.18
Saving Rates



* Total gross savings for all households.
Sources: ABS; APRA; RBA.

Housing credit growth has increased further to a rate above its post-GFC average, though household credit has been declining as a share of household disposable income. Housing credit growth has increased by 2 percentage points since its mid-2023 trough, to be slightly above its post-GFC average (Graph 1.19). While owner-occupier credit growth is showing signs of moderation, investor credit growth has continued to increase. This is despite housing price growth and turnover – which typically move closely with investor lending – having trended lower in recent months. If this relationship holds, investor credit growth could slow over coming months. New lending remains divergent across states and territories (similar to trends in housing prices), driven by differing economic fundamentals, relative affordability and state policy settings. Despite the increase in housing credit growth, total gross household debt (net of offset balances) has broadly declined as a share of household disposable income since 2018 and remains in the relatively narrow range seen over the past two decades or so (Graph 1.20).

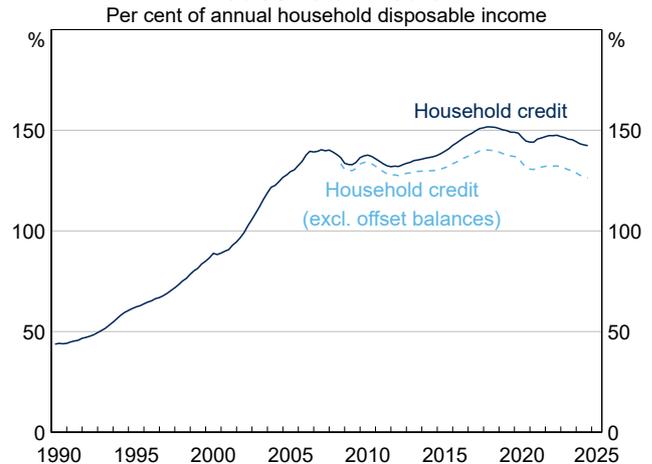
Graph 1.19
Contribution to Housing Credit Growth*
Six-month-ended annualised; dashed average post-2008



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

Graph 1.20

Household Credit*



* Seasonally adjusted and break-adjusted; including securitisation. Includes housing and personal credit. Data to September quarter 2024.
Sources: ABS; APRA; RBA.

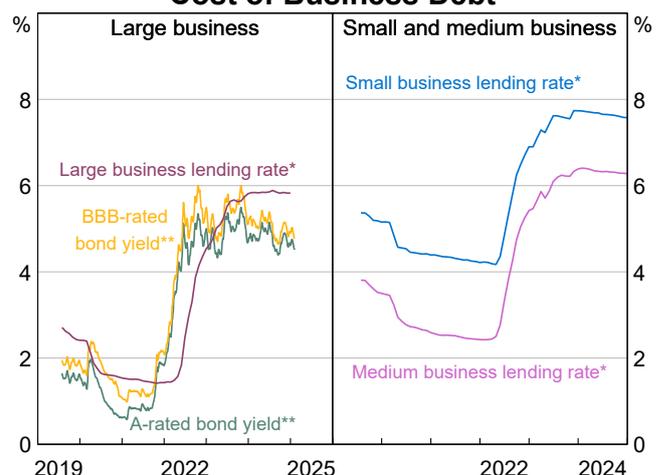
Growth in business debt has increased further and is above its post-GFC average.

Business lending rates and corporate bond yields increased substantially over the tightening phase but have been little changed recently (Graph 1.21).

Credit spreads remain around their pre-pandemic levels, supported by strong demand in both domestic and offshore markets.

Graph 1.21

Cost of Business Debt



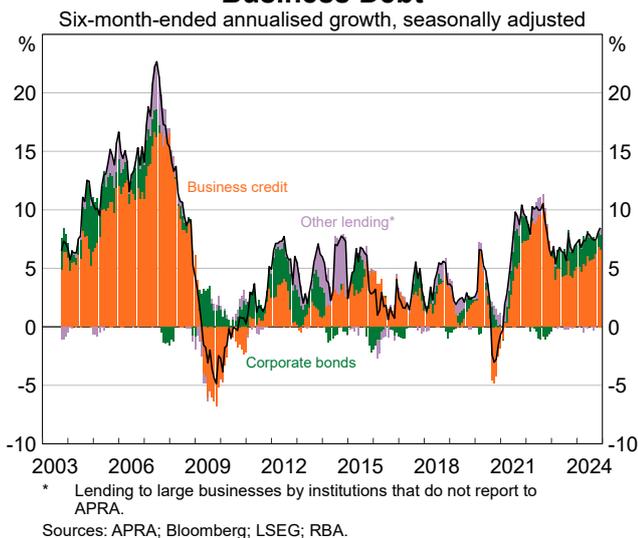
* Average variable rates on credit outstanding. SMEs are businesses with less than \$75 million of revenue. Small businesses include businesses with loan sizes of less than \$1.5 million, while medium businesses includes businesses with loan sizes larger than \$1.5 million.
** Secondary market, three-year target tenor, includes domestic and offshore issuance by Australian NFCs.

Sources: APRA; Bloomberg; RBA.

Business debt growth remains above its post-GFC average, driven by strong business credit growth, though measures of aggregate business leverage remain relatively low (Graph 1.22). Business debt has increased slightly as a share of nominal GDP since mid-2023. Business credit growth has been robust and picked up further in the December quarter, with banks noting that competition in the business lending market is strong. Demand for corporate bonds from wholesale investors remains robust, following strong issuance over 2024. Profitability for most businesses remains around pre-pandemic levels, which has supported businesses' ability to borrow despite higher interest rates. Recent robustness in debt growth has been broadly based across industries, with the real estate and industrials industries contributing strongly to total business debt growth since early 2022.

The cost of equity for businesses is estimated to have declined since late 2022, partly offsetting the above-average costs of debt funding for businesses' overall cost of capital. However, equity issuance has remained below decade-average levels, following a period of elevated economic uncertainty and high interest rates. Listed companies' internal funding flows remain around historical average levels relative to GDP, which may limit companies' need to raise external equity.

Graph 1.22
Business Debt



Box A: Implications of US Policy Settings for Financial Markets

The election of the new US administration has the potential to lead to significant changes in policy settings. This Box considers how financial markets have responded to policy news and announcements to date, as well as the implications of the uncertainty about future US policy changes for financial conditions.

Developments in US government policy can affect Australia via financial market channels – such as movements in exchange rates, global bond yields and global asset prices, as well as the ease of access to offshore funding – alongside any direct economic effects (e.g. via trade channels). In the lead-up to and following the US election, financial market participants have been weighing the prospect of higher tariffs, more expansionary fiscal policy, deregulation of banking, energy and other product markets, and more restrictive immigration policy in the United States. In response to these developments, the US dollar has appreciated relative to other currencies, including the Australian dollar, and sovereign bond yields have risen, particularly in the United States, while equity and credit risk premia have remained very low, including in Australia. There is considerable uncertainty about how policy settings will change in practice, how other countries will respond, and thus the outlook for the global economy and financial markets. Current market pricing is consistent with an expectation that these policies will boost US growth and inflation for a time, with less weight placed on downside risks to global growth from tariffs or the potential for a less sustainable trajectory of US government debt.

Tariff announcements have had modest impacts on financial markets to date.

Market participants have so far factored in only modest effects on US and global growth and inflation from the risk of higher tariffs, consistent with most economists' forecasts (see Chapter 3: Outlook). In part, this may reflect views among most market participants that tariffs could end up being smaller or less expansive than suggested before the election or when first announced, following negotiations with affected countries. Nevertheless, the potential for a further rise in US tariffs has contributed to the appreciation of the US dollar, including against some of the currencies of some countries included in the initial round of tariff announcements.

While China is the only country where proposed increased tariffs have come into effect, Chinese authorities have so far acted to limit the depreciation of the renminbi. The appreciation of the US dollar and relative stability of the renminbi have contributed to the depreciation of the Australian dollar in trade-weighted terms. While tariff concerns do not appear to have materially weighed on overall equity prices in the United States, valuations have declined modestly around some tariff announcements, with the largest moves for highly trade-exposed companies such as car manufacturers dependent on cross-border supply chains. Despite brief periods of volatility, markets have overall continued to function well.

Trade and immigration policies have the potential to lead to a noticeable decline in prices of riskier assets if tariffs prove larger, more broadly based or more persistent than currently anticipated by market participants. Such a fall could be amplified if it causes a reassessment of the positive risk sentiment underpinning historically low equity and credit risk premia. This could sharply tighten global financial conditions, with potential spillovers to the functioning of key global funding markets. The overall effect on financial conditions in Australia would depend, in part, on the extent to which the Australian dollar depreciates further to offset any such spillovers; all else equal, a depreciation of the Australian dollar represents a loosening

of financial conditions in Australia. A repricing of riskier assets could also occur if restrictive immigration policies have a larger-than-expected effect on US population growth, labour supply and inflation, given the potential to affect the outlook for US interest rates.

Expected tax cuts and deregulation have boosted prices of riskier assets while supporting higher yields.

Market participants anticipate that the new administration’s fiscal and deregulatory policies will support near-term growth in the United States, while modestly raising near-term inflationary pressures. Fiscal policy is expected to be expansionary overall, with the effect of anticipated declines in individual and corporate taxes outweighing potential higher tariff revenues and spending cuts. The strength in equity prices in recent months in part reflects this anticipated boost to growth as well as expectations of higher after-tax earnings from corporate tax cuts. Financial corporations’ equity prices have risen particularly strongly, in part due to expectations of decreased regulation under the new administration. For equity markets outside the United States, the positive effects of spillovers from expectations of stronger US growth and risk sentiment, and the effect of a stronger US dollar on earnings of exporters and multinationals in local currency terms, appear to have outweighed concerns about tariff risks. In Australia, lower interest rate expectations owing to domestic factors have also supported equity prices.

The uncertainty around fiscal policy poses risks to US inflation and growth expectations.

Concerns about the inflationary impact of fiscal policy could be contributing to a rise in shorter term market measures of inflation compensation in the United States. Concerns about the implications of higher government debt for future fiscal settings, interest rates and inflation have contributed to an increase in measures of the term premium, though the still-low level of term premia suggest these concerns are only modest at present. The full details of changes to taxes, which require congressional approval, and spending proposals are likely to take several months to emerge. This poses risks in both directions – a more stimulatory-than-expected fiscal policy could provoke a sharp upward move in yields, while an outcome in which tax cuts are more modest, or spending cuts more severe, than anticipated could weigh on riskier asset prices, particularly if coupled with trade or immigration developments that are also perceived to be negative for growth.



Chapter 2

Economic Conditions

Summary

- **Global trade policy uncertainty has increased in an environment of already elevated geopolitical risks.** The new US administration has announced tariffs on Canada and Mexico, implemented additional tariffs on China, and indicated that it will levy tariffs on the European Union. It has also said it will introduce reciprocal tariffs that could directly affect many economies and announced new tariffs on all steel and aluminium imports. Some targeted jurisdictions have indicated their willingness to retaliate, with China imposing new tariffs on a number of US exports.
- **Economic growth in the United States has been surprisingly robust, whereas the recovery in several other advanced economies has been more gradual than expected.** Disinflation has continued in line with, or slightly ahead of expectations across most advanced economies since the November *Statement*. Economic activity in China strengthened towards the end of 2024, with the economy achieving the authorities' growth target of 5 per cent.
- **Since the November *Statement*, data on domestic output and inflation have been a little softer than expected, while labour market data have been stronger than expected.** Our assessment is that overall conditions in the labour market remain tight – as evidenced by elevated growth in labour costs and by firms across a range of industries reporting ongoing difficulties finding suitable labour. At the same time, the recent easing in inflation at a time of subdued growth in activity suggests that firms' profit margins may have been compressed or capacity pressures may have eased in some parts of the economy, including the housing market.
- **Underlying inflation eased in the December quarter.** Trimmed mean inflation was 0.5 per cent in the quarter and 3.2 per cent over the year. There has been a broad-based easing in underlying inflation over the past year, though temporary factors have also contributed. Services inflation eased but remains elevated alongside ongoing cost pressures.
- **Headline inflation eased to 2.4 per cent in year-ended terms**, remaining below underlying inflation. This mostly reflects the impact of changes to government subsidies to households, which lowered year-ended headline inflation by around 0.6 percentage points.
- **Price pressures in both new and established housing markets have eased considerably compared with six months earlier, as growth in underlying demand has eased.** New dwelling investment has been relatively steady over the past year as weaker demand for new building has been offset by support from the existing pipeline of dwelling construction. Liaison contacts report that builders are offering discounts in some cities in response to weak demand and amid improved labour availability for some tradespeople, which has led to an unexpected easing in new dwelling inflation. Inflation in advertised rents has also continued to moderate and by more than expected.

-
- **The easing in labour market conditions since late 2022 has stalled, and some key indicators suggest that conditions tightened a little in late 2024.** The unemployment rate edged lower in the December quarter to be around the same level as in mid-2024, and the underemployment rate has declined since May. Also, overall employment growth remains strong, largely owing to the health care industry, and continues to outpace population growth.
 - **Quarterly wages growth remained steady over 2024.** Private sector wages growth eased gradually over the first half of the year in quarterly terms but was unchanged in the September quarter, consistent with our view that the labour market remains tight. Public sector wages growth has been volatile in recent quarters but continues to show underlying strength, partly in response to inflation outcomes over recent years. Unit labour cost growth has also eased but remains higher than is consistent with inflation being sustainably at target.
 - **GDP growth remained well below estimates of potential growth over the year to the September quarter, though quarterly growth looks to have picked up more recently.** While growth in overall private demand was subdued in the September quarter, household consumption (excluding the effect of energy rebates) increased alongside growth in real household disposable incomes; partial indicators suggest that consumption growth picked up further in the December quarter. Public demand has continued to grow strongly in recent quarters. Measured productivity declined further in the September quarter; weakness in productivity is weighing on supply, contributing to ongoing capacity and cost pressures despite subdued growth in overall demand.

2.1 Global economic conditions

Elevated geopolitical risks and global policy uncertainty are creating a challenging economic environment.

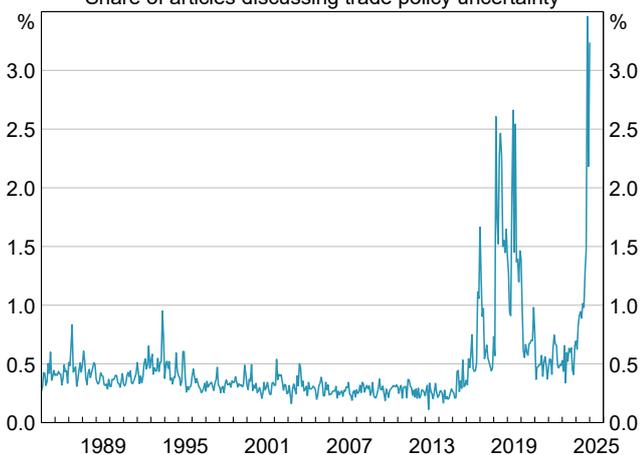
Global trade policy uncertainty has increased and is adding to broader policy uncertainty (Graph 2.1).

The tariff policies of the new US administration are evolving rapidly, with a wide range of outcomes possible. Other economies' responses to potential tariffs also add to the uncertainty. In addition, changes to fiscal and immigration policies and deregulation are under active consideration by the US administration and have the potential to materially affect the US growth and inflation outlook if implemented, with likely spillovers to the global economy including Australia (see Chapter 3: Outlook). Uncertainty about the outlook for policy is also elevated in major economies outside the United States, with elections underway or anticipated in Europe, Asia and Canada, and uncertainty about the fiscal policy outlook in China. While financial markets are currently pricing in benign policy impacts, particularly in the United States (see Box A: Implications of US Policy Settings for Financial Markets), uncertainty is creating a challenging environment for businesses and households.

Graph 2.1

Trade Policy Uncertainty*

Share of articles discussing trade policy uncertainty



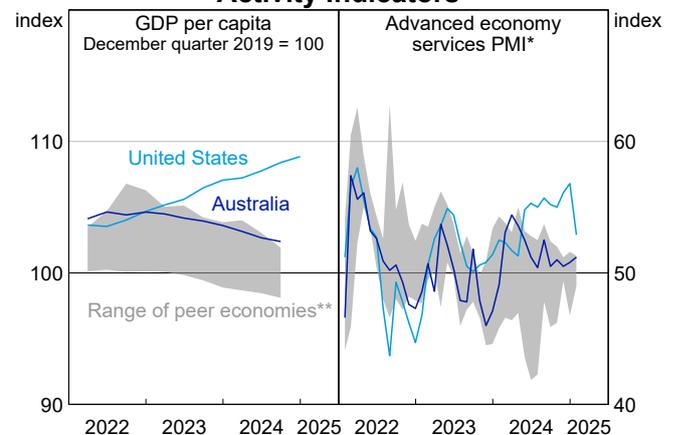
* Share of articles mentioning trade policy uncertainty in automated text searches of mostly US newspapers: Boston Globe, Chicago Tribune, Guardian, Los Angeles Times, New York Times, Wall Street Journal, and Washington Post.
Sources: Caldara et al (2019); RBA.

These developments are taking place against a backdrop in which US growth has been surprisingly robust, whereas the recovery in several other advanced economies has been more gradual than expected.

US GDP growth remained robust and surprised to the upside relative to Consensus forecasts at the time of the November Statement. Quarterly growth slowed slightly in the December quarter, but by less than previously expected; consumption and real income growth remained solid. Timely indicators such as surveyed business conditions are still pointing to overall strong growth (Graph 2.2). Business investment intentions have also continued to improve in recent months, consistent with expectations for changes to US tax policies and deregulation. US labour market conditions appear to have stabilised at a level consistent with the Federal Reserve's assessment of full employment, and earlier downside risks of a deterioration in the labour market have diminished substantially. Stronger-than-expected employment growth over recent months has supported a slight decrease in the unemployment rate despite an uptick in labour force participation.

Graph 2.2

Activity Indicators



* Purchasing Managers' Index.
** Range of peer economies includes Canada, euro area, United Kingdom and New Zealand; services PMI data missing for Canada in January 2022 and New Zealand in January 2025.
Sources: ABS; BusinessNZ; LSEG; RBA; S&P Global.

Growth in other advanced economies remains sluggish. GDP growth in the euro area and Sweden slowed slightly in the December quarter and was weaker than expected at the time of the November *Statement*. Partial data point to weaker growth in the United Kingdom as well. Consistent with ongoing weakness in GDP growth, labour markets have continued to ease in most peer economies as growth in demand for labour remains low. Business conditions also remain subdued, and, despite solid income growth, consumption growth remains subdued in most of these economies. By contrast, earlier cuts to policy rates in Canada and Sweden appear to be starting to support a pick-up in employment and consumption growth in these economies.

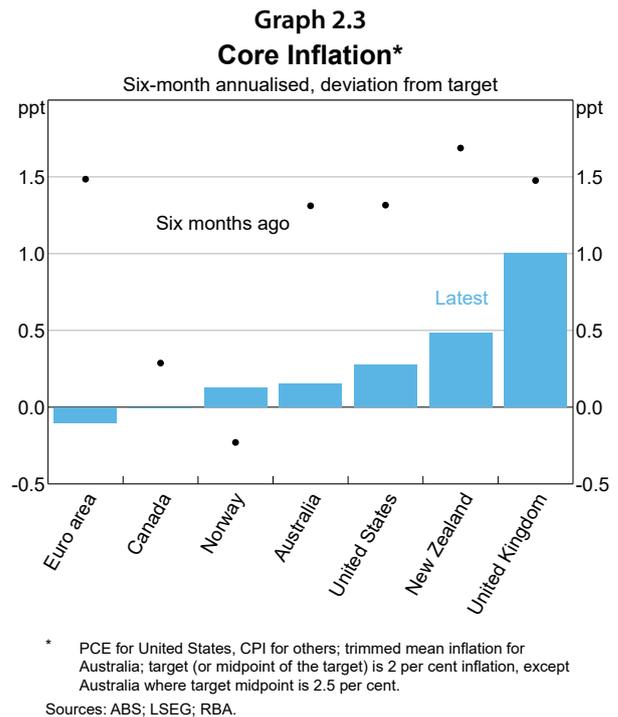
Disinflation has progressed mostly in line with, or faster than, expectations, but prospective US tariffs pose new upside risks to US inflation in particular.

Underlying inflation has continued to ease in most advanced economies, and in some cases has declined more quickly than expected (Graph 2.3).

Non-housing services inflation – which is most closely tied to domestic economic conditions – has continued to ease, and on a quarterly basis is now close to historical averages in several economies. Housing services disinflation has been slower, although rental inflation appears to have passed its peak in most countries and leading indicators point to further easing.

Goods inflation has continued to increase gradually and is generally at around its historical average. The prospect of additional US tariffs presents an upside risk to goods inflation there and – together with recent strong growth and inflation data and prospects of more stimulatory fiscal policy – has raised the US inflation outlook.

The stronger US inflation outlook has seen both market-based measures of inflation expectations and policy rate expectations revised up in the United States (see Chapter 1: Financial Conditions). Elsewhere, inflation risks are more balanced. Some central banks (such as the Riksbank, Bank of Canada and European Central Bank) view inflation as having returned sustainably to target, or being close to doing so, and consistently undershooting the inflation target remains a risk in those economies if growth does not pick up.

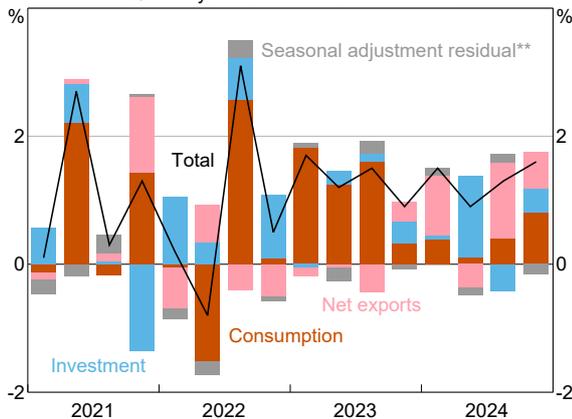


Economic activity in China strengthened towards the end of 2024.

China achieved its 5 per cent year-average growth target in 2024, following strong growth in the December quarter and upward revisions to growth in previous quarters. Net exports made a significant contribution to growth in the December quarter, in part reflecting a large pick-up in merchandise exports to the United States in December as US importers brought forward shipments ahead of expected tariff increases. Growth in consumption also strengthened, supported by government subsidies to trade in durable goods including cars and appliances (Graph 2.4). Authorities have announced further fiscal stimulus measures aimed at boosting consumption, such as an expansion in the range of consumer durable goods eligible for household subsidies and civil servant pay increases. Robust growth in the manufacturing and infrastructure sectors continued to offset the drag from declining real estate investment.

Graph 2.4
China – GDP Growth*

Quarterly with estimated contributions



* Components seasonally adjusted by the RBA and their contributions calculated by the RBA.

** Reflects the difference between RBA and NBS seasonal adjustment.

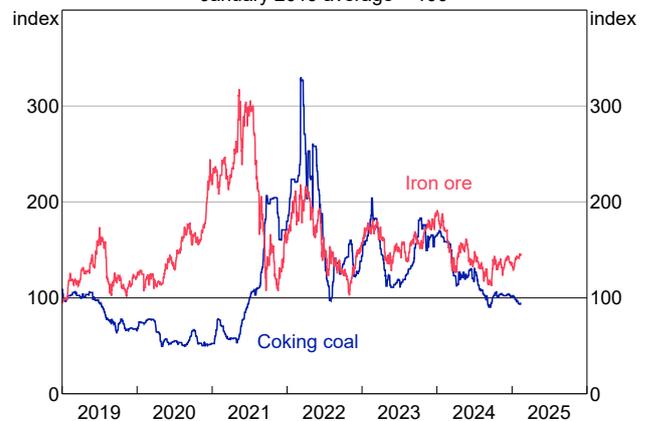
Sources: CEIC Data; RBA.

Conditions in the Chinese housing market have improved after recent policy support, but they remain weak and there are still headwinds to a sustained recovery. National new housing sales in December were 8 per cent above their recent trough, and their prices increased for the first time in over a year. However, the pick-up in new housing sales has been concentrated in a few larger cities, and Chinese developers remain under significant financial pressure, limiting their ability to begin new work. New housing starts are yet to pick up materially and land purchases by developers remain at very low levels.

Commodity market sentiment has been resilient despite concerns about the outlook for Chinese growth, including from higher US tariffs. Iron ore prices have increased, though they remain well below levels seen in recent years. Coking coal prices have declined, though this partly reflects strong production growth in China (Graph 2.5). The impact of tariffs on steel and aluminium imports announced by the US administration on iron ore and bauxite prices is uncertain but likely small, as is the impact on Australian exports of these commodities.

Graph 2.5
Steel Raw Materials Prices

January 2019 average = 100



Sources: Bloomberg; McCloskey by OPIS; RBA.

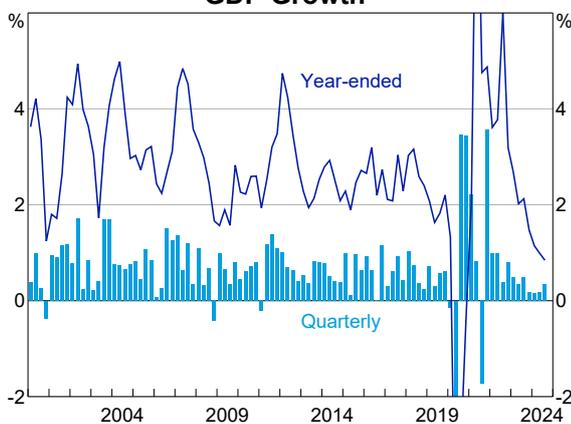
2.2 Domestic economic activity

Australian GDP growth picked up a little in the September quarter, but remained below estimates of potential growth.

GDP growth was 0.3 per cent in the September quarter, a touch below our expectations in the November *Statement* of 0.4 per cent (Graph 2.6).

The ABS also downwardly revised growth slightly over the preceding three quarters, such that year-ended GDP growth was 0.2 percentage points lower than had been expected in November; the revisions suggest that momentum in domestic activity earlier in 2024 had been a little weaker than previously thought. Partial indicators suggest that quarterly GDP growth picked up further in the December quarter, led by an increase in household consumption. Recent flooding in North Queensland will weigh on economic activity in the affected regions in the March quarter but the effects are not expected to be large enough to impact aggregate GDP growth.

Graph 2.6
GDP Growth*



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

Public demand has grown strongly in recent quarters. Recent growth in public consumption largely reflects an increase in the provision of government services as well as subsidies to households. Public investment also grew strongly in the September quarter, more than reversing a decline earlier in the year, although much of this strength reflected import-intensive spending on defence projects. Private demand picked up a little in the September quarter, but growth remained subdued. Abstracting from the

effect of electricity rebates, household consumption picked up modestly but by a little less than expected, alongside growth in real household disposable income following the Stage 3 tax cuts. New dwelling investment was relatively flat over the year and growth in business investment has moderated sharply from the rapid growth rates seen in recent years.

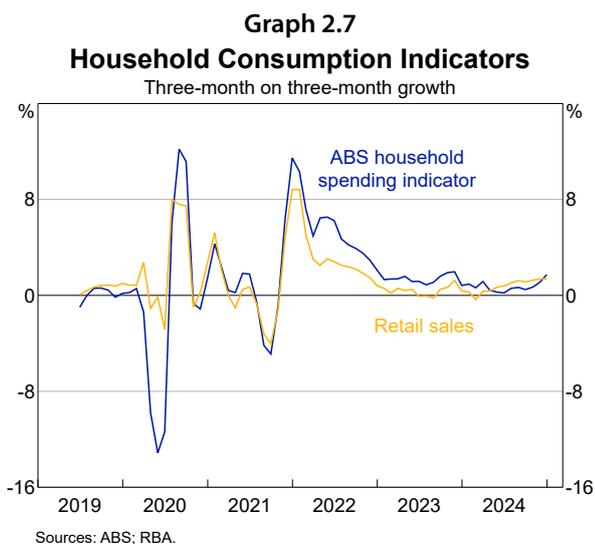
Export growth was weaker than expected over the year to the September quarter, largely driven by services exports. Education exports were weaker than expected due to a tightening in student visa requirements and an unexpected decline in the average expenditure of international students. The ABS upwardly revised the level of imports over recent years to reflect greater use of digital services, though offsetting upward revisions to household consumption left GDP little changed.

Underlying household consumption growth edged up in the September quarter and has shown signs of picking up further in December.

While household consumption was unchanged in the September quarter, underlying consumption growth – which strips out the effect of energy rebates from household spending – picked up.

This increase in underlying consumption was consistent with the pick-up in real disposable income growth seen in this period, as the Stage 3 tax cuts reduced income tax payable. Analysis suggests that households typically spend around 20 to 30 cents of every extra dollar of income (such as due to a tax cut) over the following year or so. While consumption growth in the September quarter was broadly as expected, growth over the year was weaker than expected following historical data revisions (see Box B: Consumption and Income Since the Pandemic).

Timely indicators suggest that consumption growth increased a little further in the December quarter, although evolving seasonal spending patterns are making it difficult to gauge underlying momentum (Graph 2.7). It remains uncertain how much of the recent strength in the partial indicators reflects price-sensitive consumers concentrating spending around sales events in the December quarter or a genuine improvement in underlying momentum following the earlier stabilisation of real income growth and the boost to incomes from the Stage 3 tax cuts. Our current assessment is that the December quarter outcome reflects a bit of both; the pick-up in growth in categories not impacted by late-November Black Friday sales (such as eating out, transport, and recreation and culture) provides some evidence that underlying momentum has improved. Liaison contacts generally expect little change in conditions over coming months, with demand expected to be boosted by any interest rate cuts. Contacts continue to report that consumers remain price sensitive, and this is expected to persist for some time.



The level of business investment has stabilised, and firms expect it to remain relatively steady over 2025.

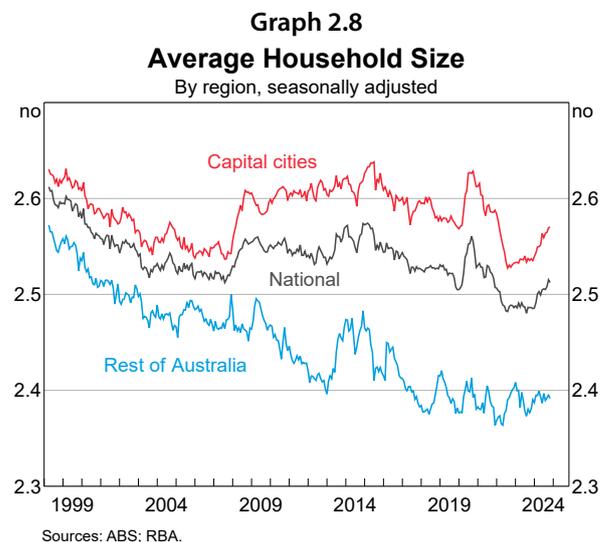
The level of business investment was broadly unchanged over the year to the September quarter, although there were notable differences across components. Non-mining construction and machinery and equipment investment has been steady in recent quarters. By contrast, non-mining software investment has continued to grow strongly, while mining investment has declined. As of the September quarter last year, firms were expecting investment over

2024/25 to remain around similar levels to last financial year, although their expectations could be affected by international developments. Further out, growth in investment is expected to be supported by the large pipeline of renewable energy investment as the Australian energy sector decarbonises, investment in data centres as Australian businesses continue to migrate services to the cloud and take up artificial intelligence, and investment in computer software and related products.

Growth in both housing prices and advertised rents has been subdued in recent months, following a slowing in underlying demand for housing.

A further increase in average household size and a slowing in population growth have contributed to subdued growth in advertised rents (Graph 2.8).

Advertised rents inflation has eased noticeably since July 2024 in monthly terms and this has contributed to an easing in CPI rents inflation (see section 2.4 Inflation). In the December quarter, advertised rents were relatively flat in Sydney and Melbourne. Advertised rents continued to increase in Adelaide, Perth and Brisbane, but at a slower pace than earlier in the year.

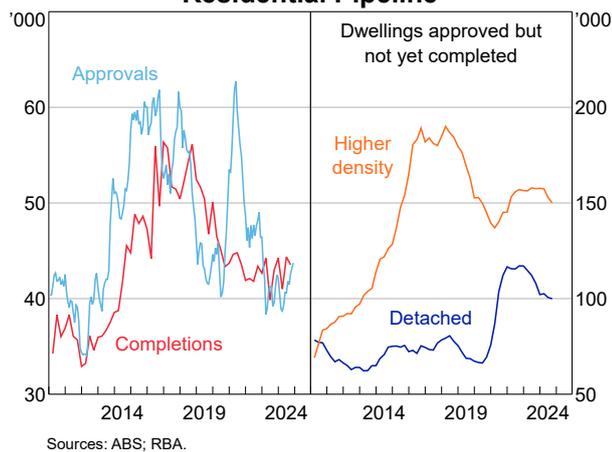


New dwelling investment has been relatively steady over the past year, although the level has been revised higher. Relatively weak demand for new buildings has been offset by support from the pipeline of dwellings to be completed; the pipeline of dwellings has continued to decline gradually but remains much higher than prior to the pandemic amid ongoing capacity constraints for tradespeople employed towards the end of the construction process (e.g. plasterers and tilers) (Graph 2.9). Liaison contacts report that builders are offering discounts in some cities in response to weak demand, which has contributed to an unexpected easing in new dwelling inflation (see section 2.4 Inflation). New demand remains weakest in the higher density sector, with liaison contacts continuing to note that construction costs remain too high relative to selling prices, while detached commencements picked up over 2024.

Housing price growth was weak in the December quarter and has moderated by more than expected.

This is consistent with weaker housing activity indicators in late 2024, such as the decline in auction clearance rates and expectations of future housing price growth. While the easing in established housing price growth has been relatively broadly based by capital city, there continues to be variation across states.

**Graph 2.9
Residential Pipeline**



2.3 Labour market and wages

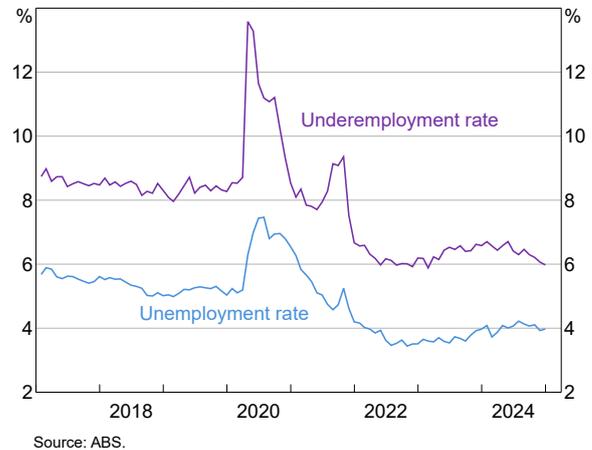
Labour market conditions are assessed as remaining tight and unit labour cost growth remains high.

The easing in the labour market stalled in the second half of 2024, with conditions assessed as remaining tight relative to full employment. Employment growth has been strong over recent quarters, largely reflecting rapid growth in non-market sector employment, particularly in the health care industry. It is likely that this has contributed to tight labour market conditions in other industries. Market sector employment was flat in the first half of 2024 but picked up in the September quarter (the latest data available). Consistent with strong employment growth and the easing in the labour market having stalled, private sector wages growth was steady in the September quarter. Recent rates of wages and productivity growth imply that labour cost growth has eased but remains above rates consistent with inflation being at target. These key trends in the labour market are explored further in this section.

The easing in the labour market that had been underway since late 2022 has stalled and some key indicators suggest that conditions tightened a little in late 2024.

The unemployment rate edged lower in the December quarter to 4 per cent, around its mid-2024 level (Graph 2.10). That was in contrast with our expectation in November for a slight increase following subdued economic growth. The underemployment rate has been trending lower and is now 0.7 percentage points below its level in May 2024. Other measures of labour underutilisation, including the hours-based underutilisation rate – a broader measure of spare capacity – and the medium-term unemployment rate also declined or were little changed in late 2024.

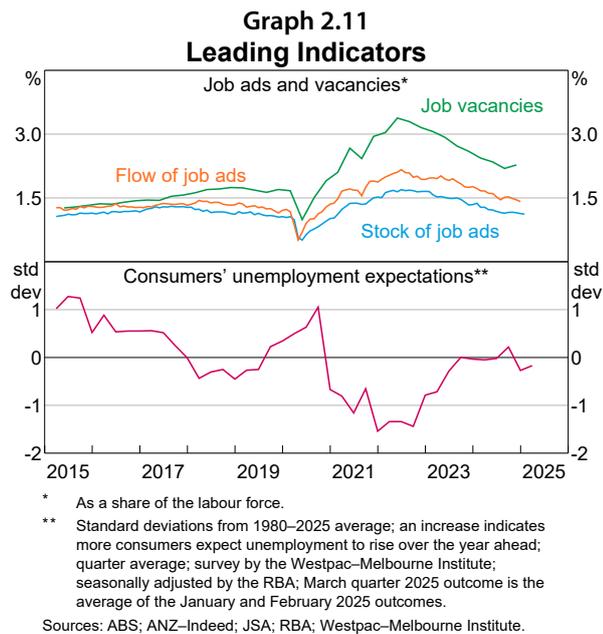
Graph 2.10
Labour Underutilisation
Share of the labour force



Employment growth remains strong and has continued to outpace population growth. The employment-to-population ratio rose noticeably over 2024 to reach a record high in December, consistent with labour demand remaining solid in aggregate. By contrast, employment-to-population ratios in peer economies generally declined over this period. The strength in Australian employment growth in late 2024 looks to have coincided with subdued economic growth, consistent with ongoing weakness in labour productivity.

The participation rate – the share of the working-age population either employed or searching for a job – has also reached historical highs, though it has increased by less than expected over recent months. The strength in the participation rate has likely reflected a combination of a still-tight labour market and ongoing cost-of-living pressures. The increase in the aggregate participation rate over 2024 was broadly based across most age and sex cohorts. Longer run trends of higher female and older worker participation have also likely supported recent participation rate outcomes.

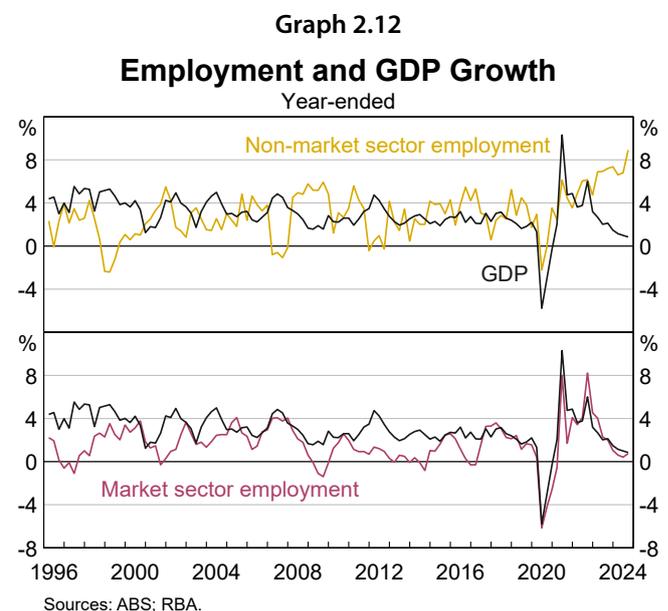
Most near-term leading indicators do not point to much further easing in the labour market. The job vacancy rate remains elevated and increased a little in late 2024, pointing to a modest tightening in labour market conditions. Further, a survey of households suggests that expectations for the unemployment rate remain slightly below the long-run average. By contrast, measures of job ads have either steadied or declined slightly (Graph 2.11).



Much of the recent strength in employment growth has been driven by the non-market sector, but this has affected labour market conditions in the market sector.

The non-market sector accounts for around three-quarters of aggregate employment growth since mid-2023. Employment in the non-market sector, which is primarily made up of the health care and education industries, is typically less sensitive to the business cycle and has been growing strongly in recent years (Graph 2.12). By contrast, year-ended employment growth in the market sector, which is more cyclical, has been much softer, though still positive, over the past year. This is consistent with the observed easing over 2024 in measures of employment intentions from business surveys, which tend to better capture developments in the market sector. However, employment growth in the market sector picked up in mid-to-late 2024 alongside a tick-up in market sector vacancies.

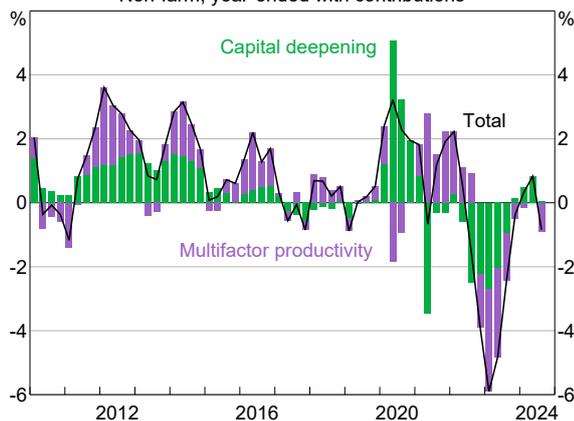
Strong labour demand in the non-market sector has likely contributed to tighter conditions in the market sector. While growth in employment has been concentrated in the non-market sector, and in particular the health care industry, the market and non-market sectors draw from the same pool of labour. The strong growth in health care employment has affected broader labour market conditions, drawing in workers and contributing to tight conditions facing firms in other industries (see Box C: Health Care Employment and its Impact on Broader Labour Market Conditions). This emphasises the need to look at aggregate labour market conditions when assessing the outlook for wages and inflation.



Productivity growth remains weak, weighing on the growth of the economy’s supply capacity and incomes.

Total labour productivity decreased by 1.1 per cent over the year to the September quarter. Looking through pandemic-related volatility and taking account of recent data revisions, labour productivity is around its pre-pandemic level (Graph 2.13). The recovery in the capital-to-labour ratio has slowed over the past year, contributing to weak labour productivity growth. Over the past year, multifactor productivity – which captures how efficiently the economy is using all its inputs – has also been weak.

Graph 2.13
Labour Productivity Growth
Non-farm, year-ended with contributions



Sources: ABS; RBA.

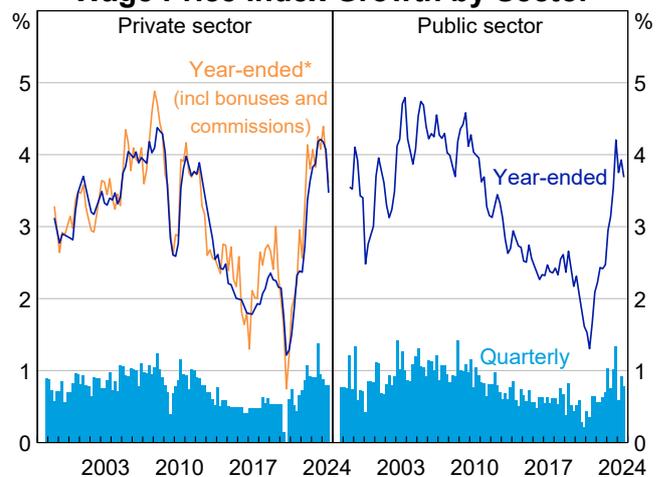
Wages growth in the September quarter of 2024 was 0.8 per cent, the same as in the March and June quarters and a little weaker than expected.

Private sector wages growth was steady at 0.8 per cent in the September quarter as expected but eased further in year-ended terms. The pace of quarterly private sector wages growth – as measured by the Wage Price Index (WPI) – was unchanged in the September quarter, following a period of moderation as labour market conditions were easing (Graph 2.14). Reports from liaison continue to suggest that some firms are offering larger wage increases than otherwise to attract and retain staff, consistent with tight labour market conditions. However, the rate at which workers

have been moving between jobs – as reflected by the number of quits as a share of filled jobs – has continued to decline recently to be below its trend (Graph 2.15). This decline in job-switching has been driven by lower job mobility within the market sector and suggests that inter-firm competition to attract and retain staff has eased. As a result, there may be less upward pressure on wages in the near term than implied by other measures of labour market tightness, such as the unemployment rate (see Key risk #1 in Chapter 3: Outlook.)

Graph 2.14

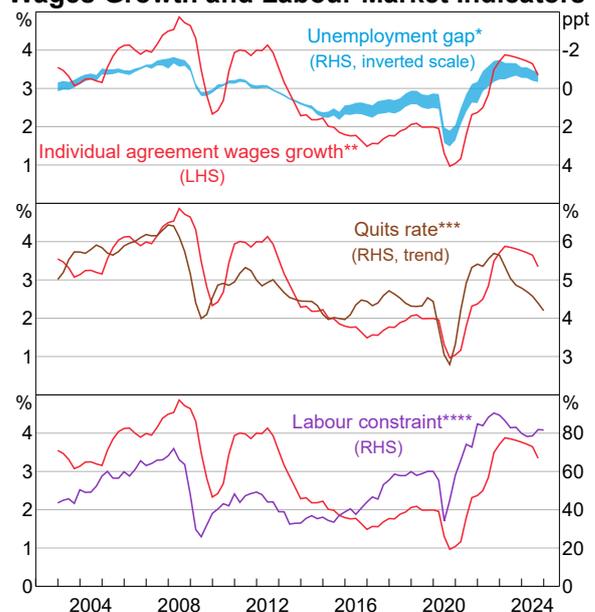
Wage Price Index Growth by Sector



* Non-seasonally adjusted.
Source: ABS.

Graph 2.15

Wages Growth and Labour Market Indicators



* Unemployment gap is the unemployment rate minus the range of estimates of the NAIRU.
** Year-ended; non-seasonally adjusted.
*** Voluntary separations as a share of total filled jobs; seven-term Henderson trend.
**** NAB survey; share of firms reporting labour availability as a constraint.
Sources: ABS; NAB; RBA.

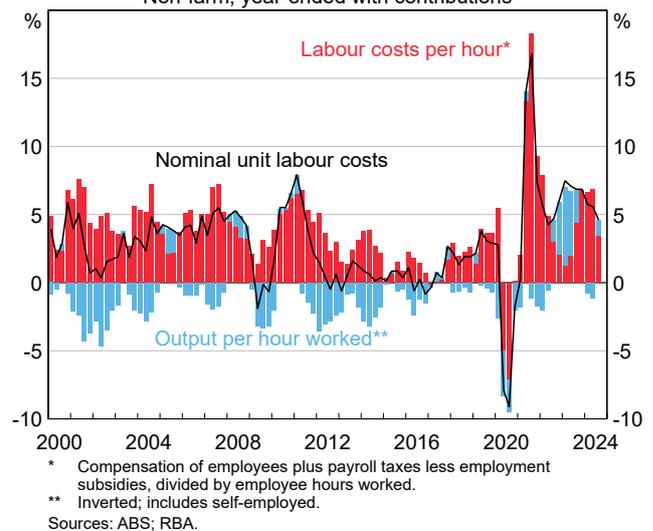
Public sector wages growth has been volatile and was weaker than expected in the September quarter. Public sector wages, which are mostly set through enterprise bargaining agreements (EBAs), typically take longer to respond to changing economic conditions than private sector wages. Wage negotiations in the public sector have often referenced increases to the cost of living over the past three years. Public sector wages growth eased by more than expected in the September quarter, with recent volatility partly reflecting delays around the finalisation of some major agreements. These agreements are now expected to flow through in coming quarters, which would see public sector wages growth pick up in the near term and may also contribute to volatility in quarterly WPI outcomes (see Chapter 3: Outlook).

By method of setting pay, the easing in year-ended wages growth in the September quarter was more pronounced for those on award wages and EBAs. This was largely because the 3.75 per cent annual increase to modern award wages was lower than the 2023 increase of 5.75 per cent, and there were no additional one-off administered wage increases in the quarter. Workers paid under individual agreements, whose wages tend to be the most responsive to current labour market conditions, have experienced a more gradual easing in year-ended wages growth. Consistent with the stabilisation in labour market conditions recently, the quarterly pace of wages growth for individual agreements has also been steady recently.

Unit labour cost growth continued to ease in the September quarter but remains higher than is consistent with inflation being sustainably at the midpoint of the target range.

Year-ended unit labour cost growth eased to 4.6 per cent in the September quarter. Year-ended growth in nominal unit labour costs eased significantly in the quarter, although growth on a quarterly basis tends to be volatile (Graph 2.16). The lower outcome reflected lower growth in the compensation of employees per hour (despite increases to the superannuation guarantee), which outweighed upward pressure on labour costs from continued weakness in productivity growth.

Graph 2.16
Nominal Unit Labour Cost Growth
Non-farm, year-ended with contributions



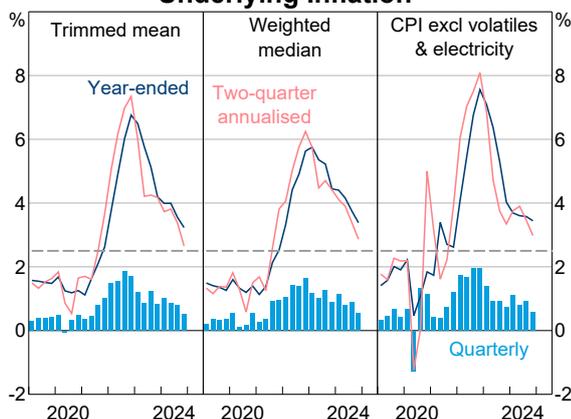
2.4 Inflation

Underlying inflation eased by more than expected in the December quarter.

Trimmed mean inflation was 0.5 per cent in the December quarter and 3.2 per cent over the year.

The two-quarter annualised rate was 2.7 per cent (Graph 2.17). The easing in the quarter was broadly based but also reflected some temporary factors. Several components experienced faster disinflation in the quarter than expected. New dwelling costs declined in the quarter, after growing at a quarterly pace of between 1 and 1½ per cent since the March quarter of 2023. Inflation for market services and private rents (excluding the effects of rent assistance) also eased by more than expected. The easing in trimmed mean inflation was also partly driven by government cost-of-living measures, as well as an adjustment made by the ABS to the child care inflation series to correct for past errors; we estimate that these temporary factors caused quarterly trimmed mean inflation to be around 0.1 percentage points lower than otherwise.

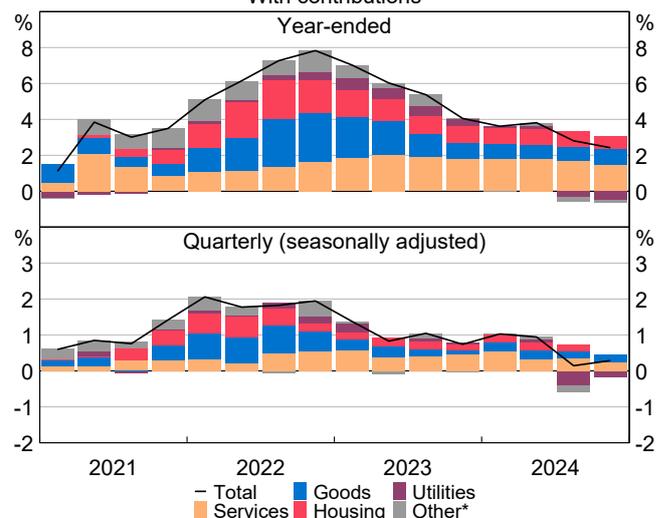
Graph 2.17
Underlying Inflation*



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

Headline inflation eased in year-ended terms, mostly reflecting the impact of government subsidies to households. Headline CPI inflation was 0.3 per cent in the December quarter (seasonally adjusted) and 2.4 per cent over the year, down from 2.8 per cent over the year to the September quarter (Graph 2.18). Changes to federal and state government subsidies, including electricity rebates, are estimated to have subtracted around 0.6 percentage points from year-ended headline inflation in the December quarter. Nonetheless, year-ended headline inflation is expected to increase in the September quarter of 2025 to be above the target band as some of these rebates unwind (as currently legislated).

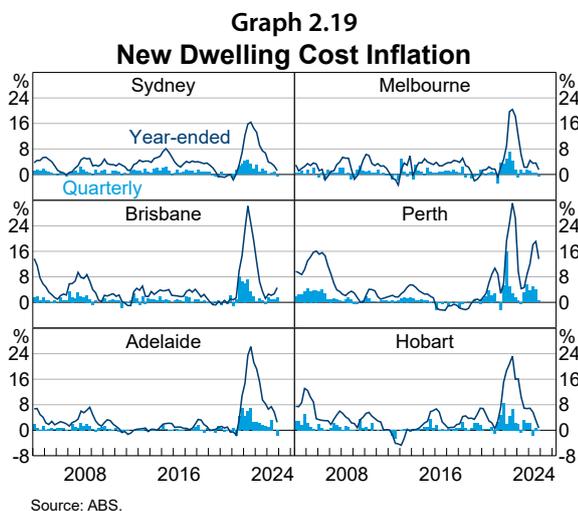
Graph 2.18
CPI Inflation
With contributions



* Primarily holiday travel & accommodation and automotive fuel.
Sources: ABS; RBA.

Housing inflation eased in the December quarter, owing to a slowing in inflation for new dwelling costs and rents.

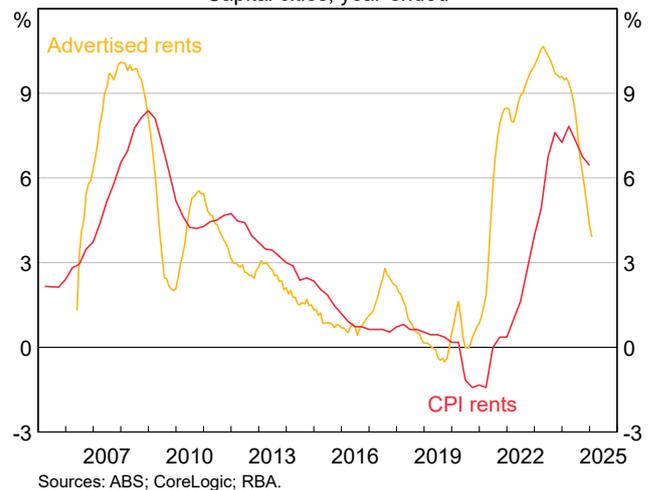
New dwelling cost inflation eased significantly to 2.9 per cent over the year to the December quarter, from a rate of around 5 per cent that had prevailed since the September quarter of 2023. Information from liaison suggests that weakness in demand to build new houses is contributing to builders offering discounts, particularly in Sydney and Melbourne. All else equal, this discounting may have contributed to lower new dwelling inflation than would have been expected based on the elevated, but declining, pipeline of work to be done. Information from liaison partially attributes the weak demand to consumers' uncertainty around future interest rates. Improvements in labour availability in residential construction have been observed in eastern cities, while trade shortages persist in Perth, Adelaide and Brisbane. As a result, the disparity in new dwelling cost inflation across capital cities remains large (Graph 2.19).



CPI rent inflation slowed in the December quarter due to the effects of Commonwealth Rent Assistance (CRA) and the recent slowing in advertised rents growth. Rent inflation – for the stock of rental accommodation captured in the CPI, which excludes regional areas – was 0.6 per cent in the December quarter and 6.4 per cent over the year, down from 6.7 per cent. Rent inflation, excluding the effects of the CRA, has continued to moderate in recent quarters from an elevated level, reflecting the gradual pass-through of the slowing in advertised rents inflation (Graph 2.20).

The recent easing in advertised rents inflation is consistent with softening demand for housing through an increase in average household size (possibly due to affordability constraints) and slowing population growth.

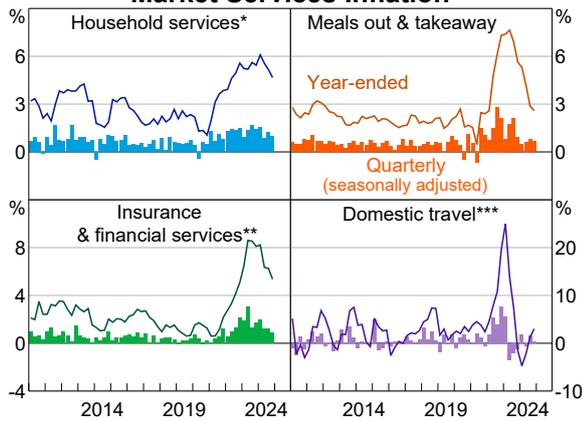
Graph 2.20
Housing Rent Inflation
Capital cities, year-ended



Services inflation moderated further in the December quarter.

Market services inflation (excluding domestic travel and telecommunications) eased by more than expected but remained elevated at 4.1 per cent over the year to the December quarter. This disinflation has been broadly based across different types of market services (Graph 2.21). However, input cost pressures persist, with liaison suggesting that some services firms – in industries such as hospitality – are having difficulty in fully passing on cost growth to prices, resulting in compressed margins. Easing in insurance price inflation, reflecting some easing of input cost pressures in this sector, also contributed to disinflation.

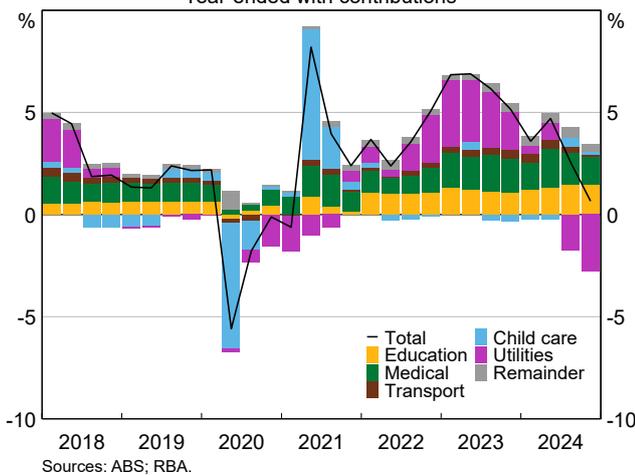
Graph 2.21
Market Services Inflation



* Includes home cleaning, vehicle repairs, hairdressing, veterinary services, sports and leisure services.
 ** Excludes deposit & loans to June quarter of 2011.
 *** Imputed using headline CPI in the June and September quarters of 2020 and September quarter of 2021.
 Sources: ABS; RBA.

Inflation for goods and services with administered prices eased significantly over the year to the December quarter (Graph 2.22). Administered prices are those that are (at least partly) regulated or relate to items for which the public sector is a significant provider. The easing was partially driven by discretionary government subsidies for electricity, public transportation, and motor vehicle registration, as well as a one-off correction from the ABS to address errors in the treatment of child care subsidies made in earlier CPI releases.

Graph 2.22
Administered Price Inflation
Year-ended with contributions

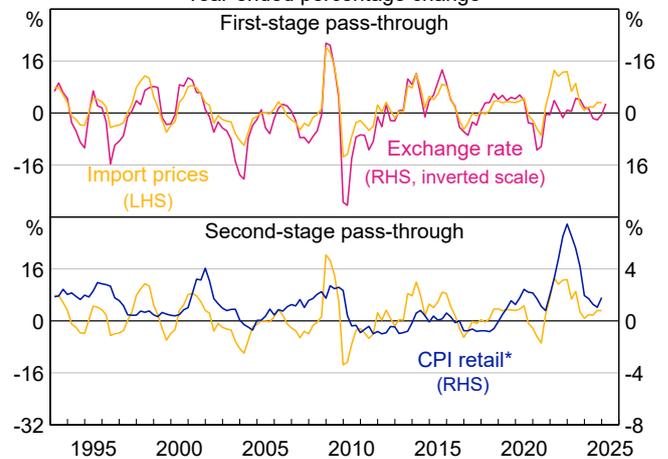


Sources: ABS; RBA.

Retail goods inflation picked up in the December quarter.

Inflation for retail goods picked up in the December quarter and is above its average rate of recent decades. The increase was driven by a pick-up in inflation for consumer durables items. The Black Friday sales appear to have had a smaller effect on price inflation than in 2023, possibly because they occurred later in the quarter. Despite the pick-up in inflation, information from liaison continues to note that subdued demand is making it difficult for firms to pass on higher input costs (in whole or in part) to final prices and that retailers' final prices do not appear to be impacted by the increase in shipping costs over the past year. The recent depreciation of the Australian dollar could cause the price of imported consumer goods to increase in coming quarters; movements in the exchange rate pass through to import prices and then retail prices with some delay (Graph 2.23). It is too early to see an impact on either import or retail prices (see Chapter 3: Outlook).

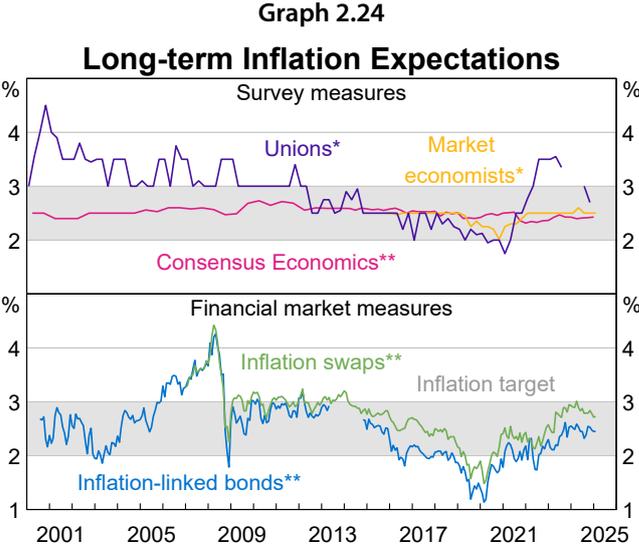
Graph 2.23
Retail Import Prices and the Exchange Rate
Year-ended percentage change



* Adjusted for the tax changes of 1999–2000.
 Sources: ABS; RBA.

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. Financial market measures of inflation compensation remain close to survey measures of medium- and long-term expectations; unions' long-term inflation expectations have now declined to be close to the midpoint of the inflation target range (Graph 2.24). Our assessment is that long-term inflation expectations remain anchored at the target.



* 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.

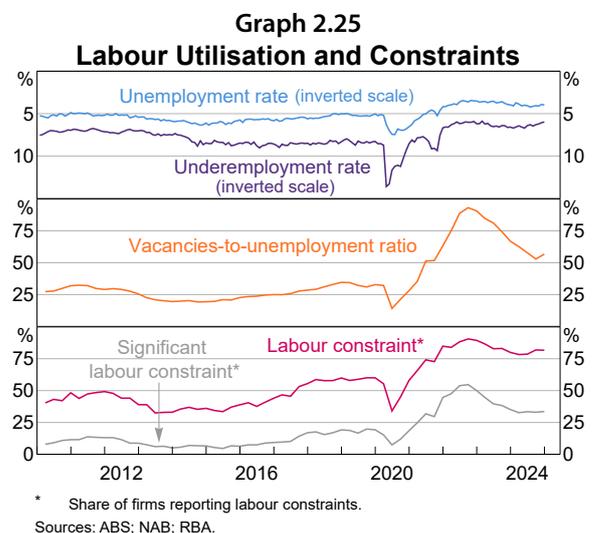
2.5 Assessment of spare capacity

We continue to assess that there is excess demand in the labour market, but progress towards better balance has stalled recently. However, there are indications that capacity pressures may have eased further in other parts of the economy.

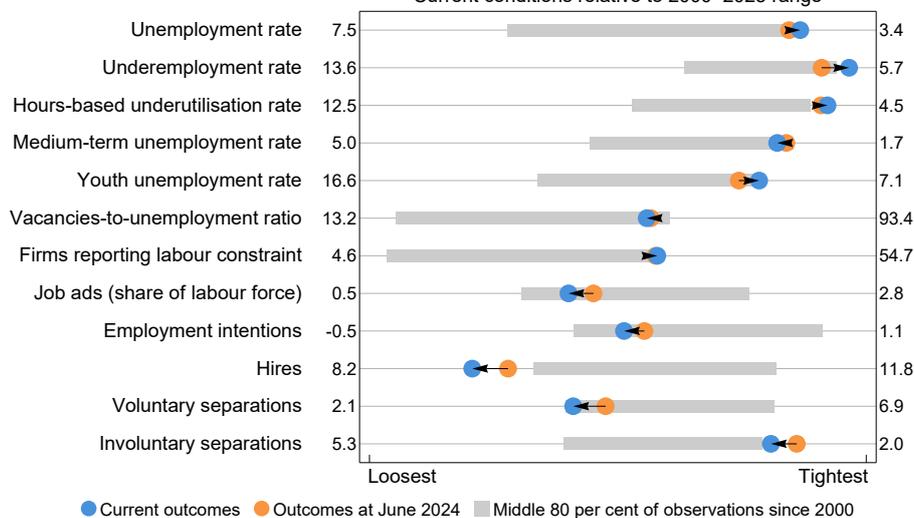
A range of information – including labour market and labour cost data, business surveys and model estimates – continues to suggest the labour market is tight. Also, developments since the November *Statement* provide further evidence that the earlier easing in the labour market stalled over the second half of 2024 (see section 2.3 Labour market and wages). By contrast, our assessment is that the output gap, which reflects economy-wide capacity pressures, continued to move closer to balance over that period, consistent with the recent easing in underlying inflation.

A range of indicators suggest that the labour market remains tight relative to full employment and that conditions have either stabilised or tightened a little in recent months. Indicators of spare capacity in the labour market, such as the ratio of vacancies to unemployed workers and the share of firms reporting

labour as a significant constraint on output, have stabilised in recent months after a period of easing (Graph 2.25). Similarly, the unemployment rate is little changed from the middle of last year, while the underemployment rate has fallen since then. These and a range of other labour market indicators are tight relative to historical ranges (although structural trends can affect the interpretation of these historical comparisons) (Graph 2.26). Based on this broad set of indicators, labour market conditions are assessed as being little changed from six months ago.



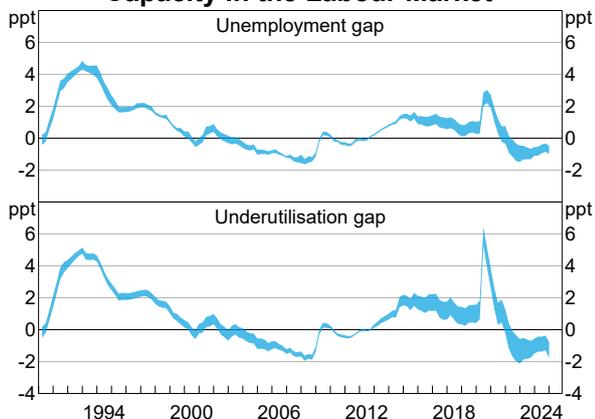
Graph 2.26
Full Employment Indicators
Current conditions relative to 2000–2025 range



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 (Graph 2.27). The gaps between these series and their full-employment levels narrowed over the first half of 2024, but estimates suggest that no further narrowing occurred in the second half of the year. Estimates of the gaps for the September quarter are broadly consistent with the assessment in the November *Statement*; however, given the stabilisation we have seen in indicators of labour market conditions, our current estimate of the December quarter gap is larger than was expected in the November *Statement*. There is substantial uncertainty surrounding estimates of full employment, although each of the model estimates in the suite that we consider implies that the labour market is tighter than full employment. The possibility that our estimate of the sustainable level of unemployment (the NAIRU) is too high is considered in Chapter 3: Outlook.

Graph 2.27
Model Estimates of Spare Capacity in the Labour Market*

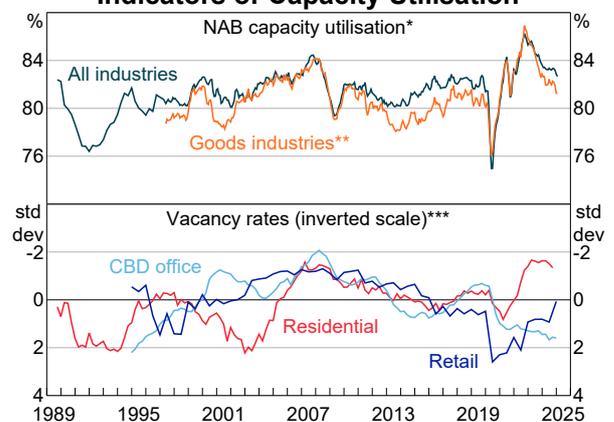


* Blue-shaded region shows illustrative range of central gap estimates from a selection of models; December quarter 2024 values are partial estimates; estimates are subject to substantial uncertainty, as well as revision due to data and model refinements.

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

Outside of the labour market, some indicators of capacity utilisation have eased a little. The NAB measure of capacity utilisation ticked down in January, particularly for goods industries, but remains above its historical average. This suggests businesses are still using their labour and capital resources at higher-than-normal rates to meet demand. Residential vacancies data show utilisation of the housing stock has eased slightly in recent quarters but remains elevated, consistent with subdued growth in housing supply over recent years. Retail vacancies data suggest utilisation of retail property has returned to its historical average, supported by demand in regional centres by large retailers (Graph 2.28).

Graph 2.28
Indicators of Capacity Utilisation



* Quarterly data prior to May 1997, three-month moving average thereafter; excludes mining.

** Goods industries include manufacturing, construction, wholesale and retail.

*** Series are standardised to measure the number of standard deviations each series is from its mean value; retail refers to regional retail centres.

Sources: ABS; JLL Research; NAB; RBA; REIA.

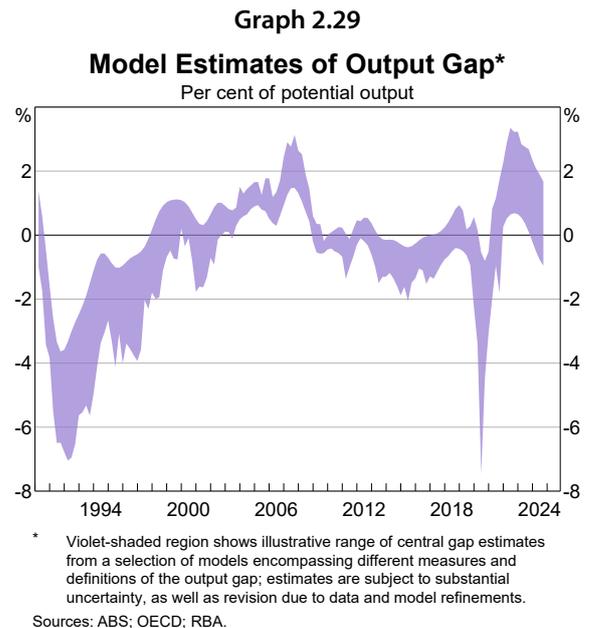
A range of model-based estimates suggest the output gap was positive in the September quarter but continued to narrow. Recent outcomes for the level of output in the economy remained higher than estimates of potential output, suggesting that aggregate demand continued to exceed the capacity of the economy to sustainably produce goods and services (Graph 2.29). Nonetheless, estimates indicate the output gap continued to narrow in the September quarter, reflecting subdued growth in output relative to potential. This narrowing was broadly as expected in the November *Statement*.

Our judgement is that the output gap continued to move closer to balance in the December quarter. However, our assessment of the gap is uncertain. The range of model estimates for the output gap remains wide, reflecting differences in how individual models interpret the data. Given that demand and supply appear closer to balance, and the substantial uncertainty surrounding the estimates, it is becoming more difficult to assess the sign of the output gap.

Declining housing inflation and downward pressure on firms' margins could help reconcile a tight labour market and strong unit labour cost growth with the recent easing in underlying inflation.

While there is uncertainty around our assessments of both the labour market and output gaps, the different signals they are giving about spare capacity over the second half of 2024 suggest that capacity pressures outside of the labour market may have eased, for example in the housing sector or within firms in some industries. Relatedly, it is possible that a decline in profit margins could reconcile strong unit labour cost growth with the recent easing in underlying inflation.

Declining housing inflation has been a significant driver of the recent moderation in underlying CPI inflation (see section 2.4 Inflation). This largely reflects weaker underlying demand for housing (see section 2.2 Domestic economic activity). The recent increase in average household size and easing in population growth have caused a slowing in rental inflation, while the decline in new dwellings inflation reflects the balance of demand and supply in that sector, rather than in the



economy as a whole. As such, conditions in the housing sector can help to account for a decline in inflation despite continued tightness in the labour market.

Firms in the market sector have faced weak growth in demand and may not have been able to fully pass through increases in input costs. Firms' labour costs, and some non-labour input costs, increased strongly over the past year, partly reflecting stronger conditions in the non-market sector. However, weak demand growth facing firms in the market sector may have limited the extent to which they can pass these costs through to output prices. While there are limited data on firms' margins in aggregate, evidence from liaison and business surveys provides some support for margins having been compressed.

Alternatively, easing inflation could be telling us that the labour market is not as tight as implied by our central estimate of the NAIRU. Estimates of the extent of spare capacity in the labour market and broader economy are inherently uncertain. Our assessment draws on a range of information that supports the view that the labour market is tight. However, there is a risk that we have misjudged the extent of excess demand in the labour market. This possibility, and its implications for the outlook, is explored in detail in Key risk #1 in Chapter 3: Outlook.

Box B: Consumption and Income Since the Pandemic

Understanding developments in household consumption is critical for the RBA’s assessment of the economy. This Box reviews the adjustments that households have made to their consumption and savings in response to changes in income since the pandemic, in light of data revisions over the past year. Households have taken a little longer to adjust to the recent improvement in real incomes than previously assessed and this finding has contributed to a softer consumption outlook in the first half of 2025.

Following strong growth early in the pandemic, household disposable income has declined in recent years ...

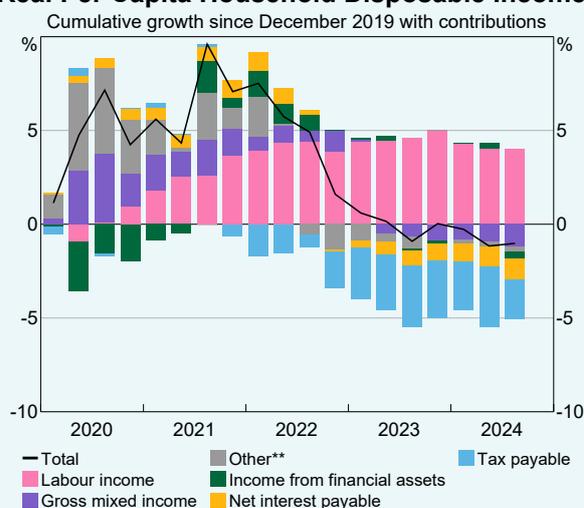
Real household disposable income per capita – a broad measure of income – is around 1 per cent lower than prior to the pandemic (Graph B.1). This has been among the weakest periods of real income growth since the 1960s and has occurred alongside a period of historically weak productivity outcomes. While the RBA typically focuses on aggregate outcomes as these are most relevant to the balance of supply and demand in the economy, this Box focuses on developments on a per capita basis as these provide a clearer illustration of how household consumption has evolved at the household level.¹

Real labour income has grown over the past five years, but this has been more than offset by lower income from other sources, higher interest rates and higher tax payable.

The largest component of household income – labour income – has contributed around 4 percentage points to per capita household income growth since December 2019, after accounting for inflation. While growth in real base wages has been weak over this period, labour income has been supported by other forms of compensation (e.g. promotions and bonuses), as well as switches to higher paying jobs and an increase to the employment-to-population ratio. However, the combined drag from higher interest rates, lower gross mixed income (mainly small business income) and tax has reduced disposable income by 5 percentage points since December 2019; most of the increase in tax payable in recent years reflects the strong growth in labour income. Gross mixed income per capita is lower than prior to the pandemic (after accounting for inflation), which may partly reflect the continuation of a downward trend that began in the second half of the 2010s.

Relative to what was reported a year ago, the level of household income from around early 2021 has been revised higher. Revisions to data are common as more information becomes available and, in this case, the revisions lifted disposable income per capita by around 2 per cent over the past few years. However, the trends over this period were little changed, with the decline in real incomes starting in late 2021 in both vintages of the data.

Graph B.1
Real Per Capita Household Disposable Income*



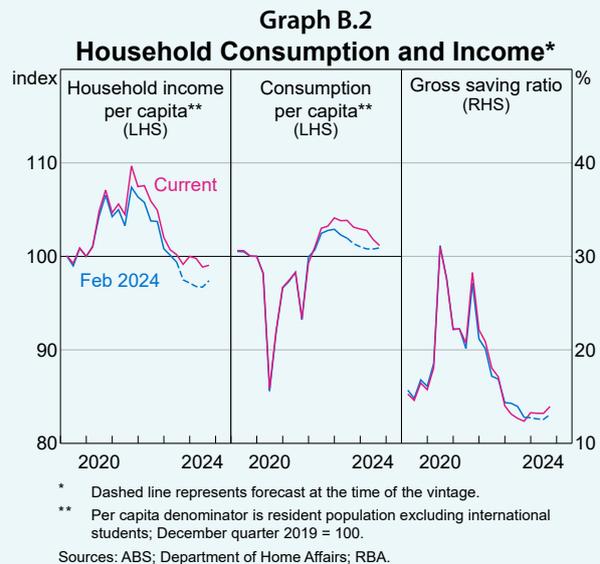
* Each component of income has been deflated using the consumption deflator; per capita denominator is resident population excluding international students.
** Includes dwelling gross operating surplus, social assistance payments, all other gross income and income payable excluding interest and tax payments.

Sources: ABS; Department of Home Affairs; RBA.

... and has weighed on household consumption.

After rebounding strongly in both 2020 and 2022 as pandemic-related restrictions were eased, consumption growth has been soft over the past couple of years and the level has declined in per capita terms. This weak growth has been driven by the weakness in household disposable income discussed above, the impact of which on consumption has more than offset the impact of the 25 per cent increase in real wealth since the start of the pandemic.

The revised consumption data suggest that it took longer for households to adjust their spending patterns following the decline in incomes (compared with the data available a year ago). These revisions were material, lifting the level of household consumption per capita by up to 2 per cent over the past couple of years. The cumulative size of the revisions over the past year are towards the upper end of the historical range. The current data suggest the consecutive declines in per capita consumption started from mid-2023 and accelerated through 2024 (Graph B.2). By contrast, data available at the time of the February 2024 *Statement* suggested per capita consumption started to decline earlier, in late 2022. The gross savings ratio was also revised downward, indicating that households were reducing saving to smooth their consumption through 2023 to a greater extent than previously apparent. The savings ratio in 2024 was a little higher than what was expected a year ago.



The recovery in consumption has occurred more slowly than expected.

The expected timing of the anticipated pick-up in consumption has been pushed out since late 2023 as noted in the November 2024 *Statement*.² Household income per capita stabilised from late 2023 but consumption per capita continued to decline through to the September quarter of 2024, in contrast to earlier expectations that it would also stabilise over this period. The underlying cause of these weaker-than-expected outcomes for consumption growth is difficult to determine but could possibly reflect an increase in precautionary savings motives as the persistence of weakness in income growth has become more apparent over time. While data in the December quarter of 2024 suggest that the recovery in consumption is now underway, this reassessment of the historical data has contributed to our judgement that some of the recent acceleration will be temporary, and that growth momentum will slow a little in the first half of 2025 (see Chapter 3: Outlook).

Endnotes

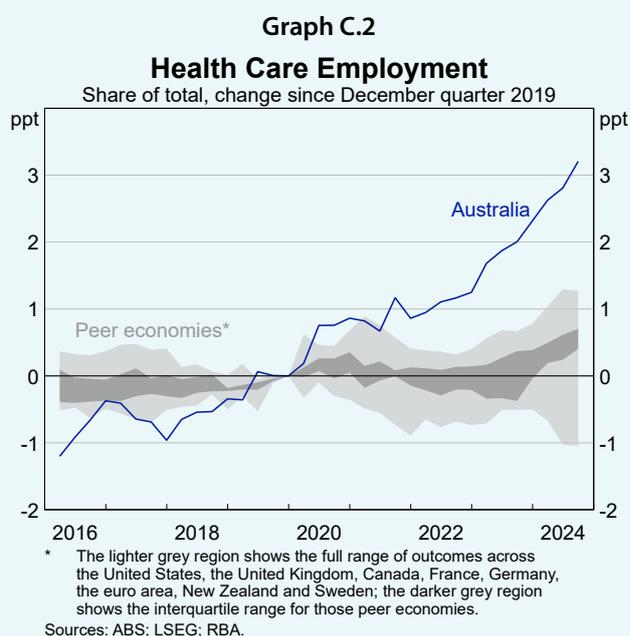
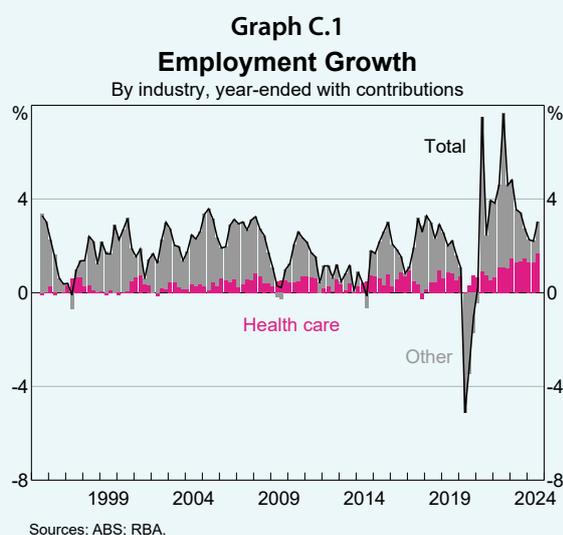
- 1 The experience of individual households can differ substantially from these per capita figures. See Beckers B, A Clarke, A Gao, M James and R Morgan (2024), 'Developments in Income and Consumption Across Household Groups', RBA *Bulletin*, January.
- 2 See RBA (2024), 'Box D: Annual Review of the Forecasts', *Statement on Monetary Policy*, November.

Box C: Health Care Employment and its Impact on Broader Labour Market Conditions

The health care industry has contributed significantly to aggregate employment growth over the past year. This Box discusses the interlinkages between the health care industry and other parts of the labour market, which suggest that the growth in health care employment has likely contributed to tight labour market conditions in other industries. This emphasises the need to consider aggregate labour market conditions when assessing the outlook for wages and inflation.

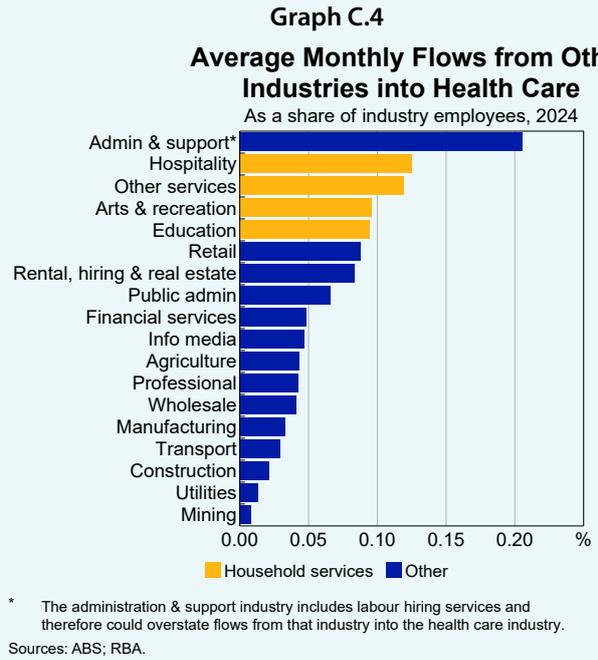
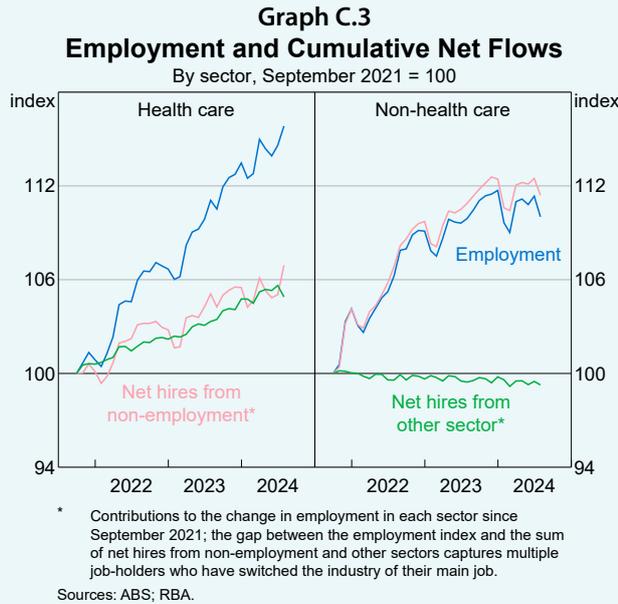
The health care industry has been a key contributor to aggregate employment growth in recent years.

Employment growth in the health care industry has trended up since the COVID-19 pandemic and has now reached a historically high rate. This has supported aggregate employment outcomes, with over half of overall employment growth over the year to the September quarter of 2024 attributed to health care (Graph C.1). Strong employment growth in the health care industry has also been observed overseas in recent years, and health care employment has risen as a share of total employment in a range of peer economies, such as the United States, the United Kingdom and Germany. That said, the rise has been considerably faster in Australia in the post-pandemic period (Graph C.2).



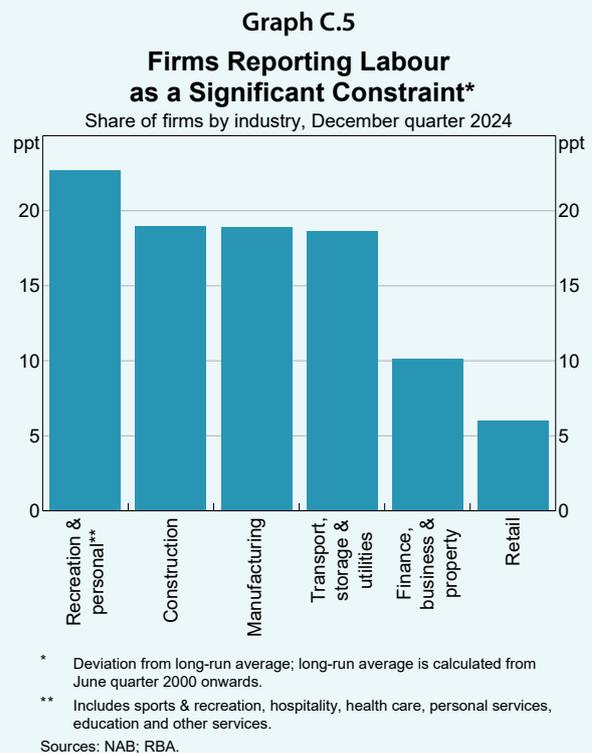
Rapid employment growth in the health care industry has affected the broader labour market.

Strong demand for labour in the health care industry has drawn in workers from other industries, as well as some who were not previously employed. Growth in health care jobs has partly reflected inflows of workers from other industries (Graph C.3). These workers have tended to come from the administrative services and household services industries, including hospitality, arts and recreation, and education (Graph C.4). This movement of workers between industries has also been noted by some firms in the liaison program.



The strength in employment growth in the health care industry has likely contributed to tighter conditions in competing industries.

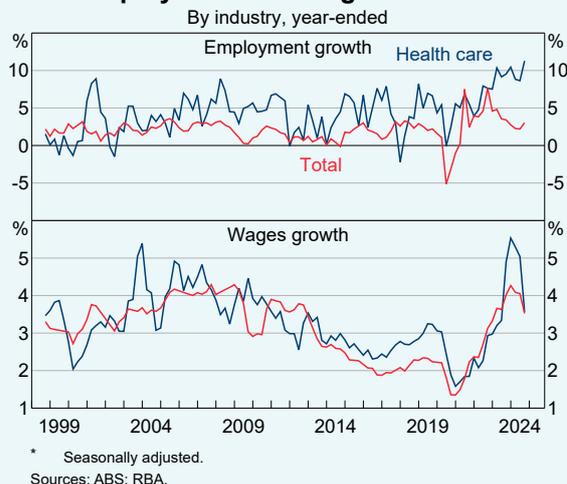
The share of firms reporting that availability of labour is a significant constraint on output remains above average in all industries (Graph C.5). This is most pronounced for firms in the 'recreation and personal services' category, which includes the health care industry as well as the industries that have been competing most with the health care industry for labour (yellow bars in Graph C.4). Job vacancy rates also remain above pre-pandemic levels in most industries including hospitality, other household services and arts and recreation, where there have been greater outflows of workers to the health care industry. However, firms in other industries have also reported difficulty finding labour, consistent with the overall labour market being tight.



Despite strong labour demand in the health care industry, wages growth has been similar to aggregate wages growth recently.

For the past few years, looking through the award wage increases in the September quarter of 2023, wages in the health care industry have been growing at around the same pace as the aggregate Wage Price Index despite labour demand growth having been significantly stronger (Graph C.6). Taken together with the evidence noted above on the flow of workers between industries, this is consistent with a well-functioning labour market in which tightness in one industry spills over to other industries as firms compete to attract and retain workers, helping to reduce the extent of disparities in wages growth. That in turn emphasises the importance of focusing on conditions in the labour market as a whole when assessing wage and inflationary pressures, in addition to industry-specific developments.

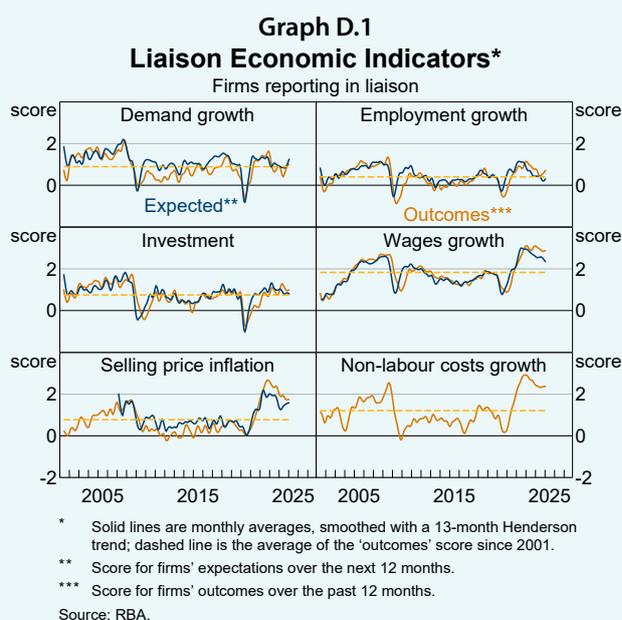
Graph C.6
Employment and Wages Growth*



Box D: Insights from Liaison

This Box highlights key messages collected by teams based in Adelaide, Brisbane, Melbourne, Perth and Sydney during discussions with around 230 businesses, industry bodies, government agencies and community organisations from the beginning of November 2024 to mid-February 2025.

Since the November *Statement*, liaison contacts across a range of industries have reported that economic conditions have picked up a little and an increasing number of firms are observing signs of improving demand (Graph D.1). Household spending remains subdued but has lifted since mid-2024. Investment intentions for the year ahead are around average. Firms reported an increase in employment in recent months and while their hiring intentions for the year ahead have also picked up, they are still a little below average. Firms report non-labour cost growth has been little changed in recent months and remains elevated. Wages growth has slowed and is expected to slow further over the year ahead, but also remains above its long-run average. Overall, firms generally report that growth in costs has been above growth in selling prices, with many firms reporting downward pressure on margins. Selling price inflation has eased over the past year, but contacts do not expect growth in their selling prices to ease much further over the year ahead. By state, economic conditions are softer in New South Wales and Victoria than in Queensland, South Australia and Western Australia.



Household spending has picked up a little, though conditions remain challenging for many retailers and household services firms.

Retailers report that trading conditions have improved since mid-2024. However, conditions remain challenging as consumers are still very price conscious, shopping around to compare prices and waiting for items to go on sale. There was strong participation in Black Friday promotions, though this partly came at the expense of sales in the rest of December.

Demand in the hospitality and tourism industries has also picked up in recent months. Nevertheless, households are still choosing more affordable options for their holidays, spending less and trading down to cheaper options when eating out. International tourism has also been slower to recover than many contacts expected a year ago.

International student commencements declined at some universities in 2024, reflecting changes to government policies and visa processing times. Contacts are very uncertain about the outlook for international student enrolments in 2025, reporting that some prospective students are preferring to apply to other countries given higher uncertainty about whether they will be granted a place in Australia.

Community service organisations continue to report strong demand for assistance, as they did throughout 2024. This is most frequently attributed to the higher cost of living and a lack of affordable housing. These organisations continue to support a broader range of clients than was the case a few years ago, including many people who are seeking assistance for the first time. Contacts have highlighted the challenges posed by the heightened demand for their services and expect this to continue over the year ahead.

Home building activity is expected to fall in the near term, but builders are cautiously optimistic about the outlook.

Home builders generally expect a decline in their building activity over the year ahead as the completion of homes currently under construction outstrips new home sales. Builders report that sales of new detached homes have remained below average in New South Wales and Victoria in recent months. Demand and sales in Western Australia, South Australia and Queensland remain stronger than other parts of the country. Builders tell us that they expect their sales to improve if interest rates are reduced.

Shortages of finishing trades (such as painters and tilers) are still constraining building activity, although the availability of starting trades (such as bricklayers and concreters) has improved in New South Wales and Victoria. A growing number of home builders in Victoria and New South Wales reported using discounts and incentives in the December quarter to entice sales, with improved labour availability for starting trades in these states having somewhat lessened building times and cost pressures.

Construction activity for new apartments remains low, with firms reporting that many new developments are currently on hold due to the high costs of construction relative to selling prices.

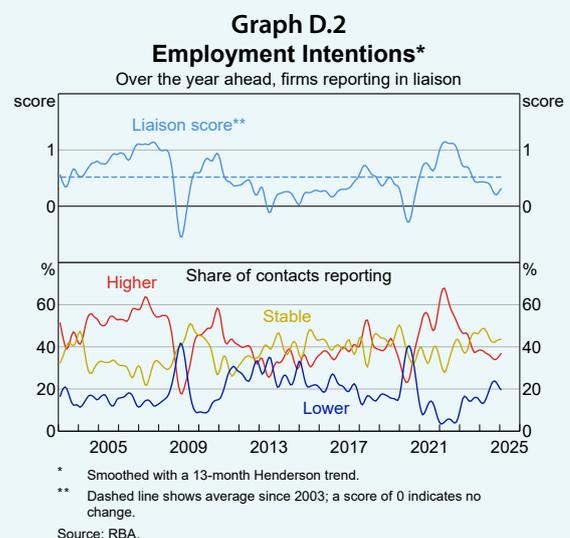
Investment intentions for the year ahead are around average.

Investment intentions for the year ahead drifted down through 2024 and are now around average.

Contacts planning to invest more over the year ahead tend to be investing in industrial property, automation and digital transformation projects, which include software, AI, cloud migration, and e-commerce upgrades. Contacts planning to invest less over the year ahead relative to the prior 12 months continue to attribute this to high construction costs and a relatively subdued outlook for demand.

Hiring and hiring intentions have picked up recently.

Firms have reported an increase in hiring in recent months, particularly in the services sector. Firms' hiring intentions for the year ahead have also picked up recently, but remain below average (Graph D.2). Firms continue to report that staff turnover has declined over the past 12 months and it is easier to fill vacancies than it was a year earlier, though many suggest it is still difficult to find suitable staff.

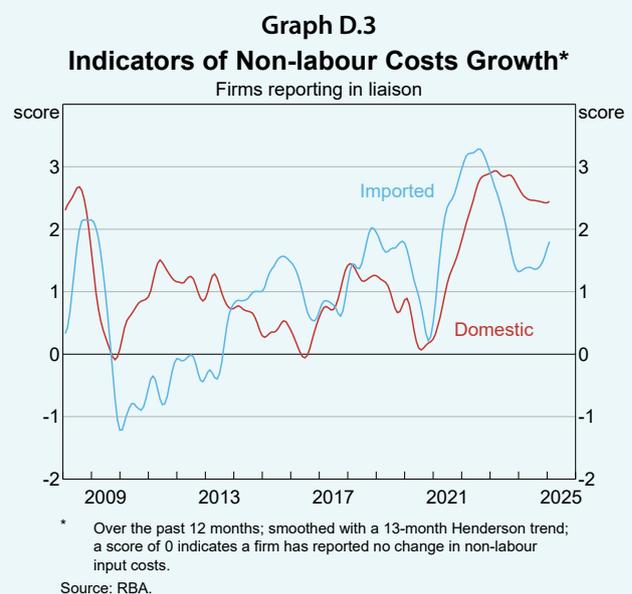


Firms report that growth in costs remains above growth in selling prices; selling price inflation is not expected to ease much further over the next 12 months.

Wages growth has slowed over the past year and is expected to slow further, but remain above its long-run average over the year ahead.

Growth in non-labour costs has been little changed in recent months and remains above average. The earlier easing in imported cost growth appears to have stopped and some contacts are concerned that imported cost growth may pick up further if the recent depreciation of the Australian dollar is sustained (Graph D.3). Growth in domestic costs such as rents and insurance has eased for some firms. Nevertheless, firms continue to report strong growth in fees from other professional services and subcontractors, as well as energy, software and regulatory costs. Contacts generally tell us that they expect non-labour cost growth to remain elevated over the next 12 months.

While growth in selling prices has eased over the past year, contacts are not expecting growth in their selling prices to ease much further over the next 12 months. Retail, household services, agriculture and manufacturing contacts commonly report that they have not been able to pass through growth in labour and non-labour costs fully into selling prices, with many attributing this to weak demand conditions. In response to reported pressure on margins, contacts have been focusing more on cost management over the past 12 months and have been aiming to improve productivity. Conditions are particularly challenging for many smaller businesses, especially those providing goods and services to households.





Chapter 3 Outlook

Summary

- **Potential large changes to global trade and fiscal policies could be a key driver of the global economic outlook but their scale and implementation remains highly uncertain at this point.** Increased US tariffs on China present a headwind to growth in the two largest economies and the possibility of higher or more widespread tariffs (or other barriers to trade) poses further risks to the global economy. Various other US policies proposed by the new administration could potentially have material effects on the economic outlook there, adding to uncertainty about the global outlook. At this juncture, however, forecasters are yet to put through material changes to global growth forecasts.
- **Domestic GDP growth is expected to pick up over the next year as consumption growth recovers and growth in public demand remains strong.** The forecast for GDP is broadly similar to that in the November *Statement*. The forecasts are conditioned on market expectations for a cumulative 90 basis point easing in the cash rate over the forecast period; the timing of the start of the easing cycle has been brought forward since November. At this stage, it is assumed that the effects on domestic growth and inflation from international trade ructions are limited; however, we explore the effects of a more pronounced trade conflict in the risks section below.
- **The labour market is not expected to ease much further.** Unemployment and underemployment are at or below their mid-2024 levels. For the near term we have taken signal from recent economic activity and labour market outcomes, as well as the leading indicators, and now forecast the unemployment rate to rise to around 4¼ per cent, which is lower than expected in the November *Statement*. The expected recovery in GDP growth will provide support to the labour market over the next year.
- **We judge that the labour market will likely still be operating above capacity over the next couple of years, though there is considerable uncertainty around this assessment.** At the time of the November *Statement*, we expected the economy and the labour market would gradually move towards balance by 2026. While capacity pressures in some parts of the economy look to have moderated, our central forecast is now for labour market conditions to remain tight. A key risk we explore in detail is that we are over-estimating the degree of tightness in the labour market or that economic activity does not pick up as much from here, in which case inflation will fall more quickly than forecast. While we do not view this as a central scenario, we remain alert to the possibility.

-
- **Underlying inflation in year-ended terms is expected to return to the 2–3 per cent range earlier than previously expected, but to settle a little above the November forecast if the cash rate follows the market path.** We have taken some signal in the near term from the weaker-than-expected December quarter inflation outcome, which may indicate more spare capacity in parts of the economy than previously judged (such as in new housing construction). However, the central forecast is now for year-ended underlying inflation to be a bit above the midpoint of the 2–3 per cent range from late 2025 onwards, rather than for inflation to gradually moderate to the midpoint as was forecast in November. This is based on our judgement that the pick-up in momentum in domestic activity will maintain tight labour market conditions and sustain some upward pressure on inflation.
 - **Year-ended headline inflation is expected to increase over the second half of 2025 to be above 3 per cent, before returning to a little above the midpoint of the target range in the latter part of the forecast period.** This volatility is due to the currently legislated unwinding of cost-of-living measures, such as electricity rebates, which will boost inflation over 2025.

3.1 The global outlook

The global economic outlook is highly uncertain; various US policies and responses by other countries could materially affect trading partner growth and inflation outcomes.

Increased tariffs between the United States and its major trading partners, along with proposed US fiscal and deregulation policies, pose material risks to the global economic outlook over 2025 and 2026.

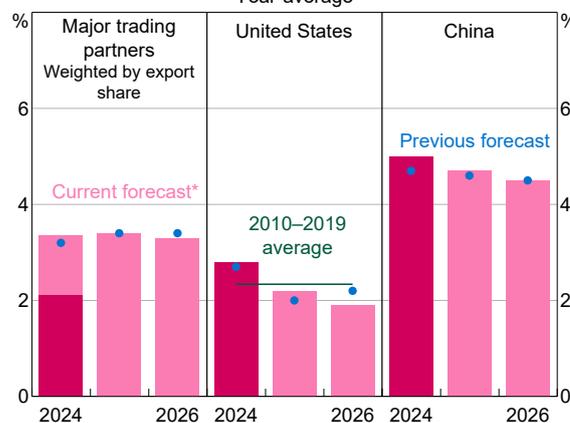
Higher tariffs between the United States and China are expected to cause some disruption to global trade and supply chains (see Box A: Implications of US Policy Settings for Financial Markets). However, there is considerable uncertainty about the breadth and extent of tariffs and retaliatory measures, as well as the extent of fiscal support that affected economies may use to offset the effect of the tariffs on growth. This uncertainty is likely to weigh on business conditions. Changes to US fiscal and immigration policies are also expected, but the range of possible outcomes is wide.

Because of the high policy uncertainty, there has so far been little change in Consensus forecasts since November. Year-average forecast GDP growth for Australia's major trading partners is unchanged in 2025 at 3.4 per cent and slightly lower in 2026 (Graph 3.1). Consensus forecasts for US and Canadian growth have been revised downwards modestly next year on the back of the risk of higher tariffs, though more stimulatory fiscal policy appears to have provided a partial offset. Most forecasters appear to have incorporated at least some increase in tariffs on China and the prospective extension of the US tax cuts in the 2017 *Tax Cuts and Jobs Act*; however, there is likely wider divergence about the impact of other government policies, the effect of uncertainty on spending and investment decisions, and the size and extent of any additional US tariffs.

We have revised our China growth forecast for 2025 higher, although growth is expected to be a little slower than last year. The upward revision brings our forecast to 4.7 per cent and reflects the authorities' recent shift to a more pro-growth stance and a likely growth target this year of 'around 5 per cent'. Our central forecast assumes the average tariff rate on US imports from China will continue to increase gradually by another 10 percentage points from what has recently been announced, but the negative effects of higher US tariffs and elevated uncertainty on growth in China are expected to be more than offset by increased fiscal policy support. 2026 growth forecasts are unchanged at 4.5 per cent, implying a small further step down in growth.

We have undertaken illustrative scenarios on larger increases to US tariffs on Chinese imports and different policy responses by Chinese authorities to outline the key channels through which there could be downside risks to Australian growth (see Key risk #2, below).

Graph 3.1
GDP Growth
Year-average



* Darker bar indicates the contribution to 2024 year-average growth from realised quarterly outcomes; 2024:Q3 latest data for most economies, 2024:Q4 latest for the United States and China.

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

3.2 Key domestic judgements

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

Key judgement #1 – Labour market conditions are not expected to ease much further.

At the time of the November *Statement* it was expected that the unemployment rate would continue to edge higher through the December quarter and over the first half of 2025 as the labour market continued to adjust to the weak GDP growth in 2024. However, the unemployment rate declined a little in the December quarter and leading indicators suggest that the earlier easing in labour market conditions has largely stalled. We judge that the unemployment rate will increase a little further, before stabilising at 4¼ per cent; this is around ¼ percentage point lower than forecast in November.

But there are risks around the outlook. Some labour market indicators suggest the unemployment rate may actually decline a little further in the near term, whereas the labour market may ease more than forecast if the expected recovery in private demand does not materialise.

Key judgement #2 – Household consumption growth has started to recover alongside the ongoing pick-up in real household incomes.

The recovery in consumption appears to be underway, but there are material uncertainties around the scale and timing of that recovery. Consumer spending (abstracting from the effects of electricity subsidies on household consumption) appears to have picked up in the December quarter by more than we previously expected, according to timely but partial indicators. But changing seasonal patterns driven by the increasing prevalence of discounting make it difficult to gauge how much of this pick-up was temporary, and how much will be sustained. Consistent with our updated assessment that it has taken households a little longer to adjust to the recent lift in real incomes, we have assumed that some of the increase was temporary and driven by Black Friday and end-of-year sales. This assumption has contributed to the downward revision to consumption growth in the first half of 2025.

It is possible that more of the pick-up in spending in the December quarter reflects underlying momentum than we have assessed, and that consumption picks up more strongly than expected in the period ahead. There is also a risk that the December quarter outcome mostly reflects consumers concentrating their spending around promotional periods more than they have in the past. If this is the case, spending growth may be softer than expected in 2025, continuing the trend from the past year (see Box B: Consumption and Income Since the Pandemic).

Key judgement #3 – Notwithstanding recent progress on disinflation, conditions in the labour market are expected to remain tight, which (on the market path for the cash rate) would keep inflation a little above the midpoint of the target range.

The outlook for wages growth and inflation is sensitive to our assessments of the degree of balance between aggregate demand and supply in the economy and in the labour market; however, these assessments are subject to considerable uncertainty. Our central assessment is that the labour market is still tight, while the broader economy is estimated to be closer to balance.

The forecast anticipates there would be capacity constraints in the labour market over the forecast period if policy followed the market path. By contrast,

our forecasts for GDP growth and the outlook for potential output would suggest that some parts of the economy will be closer to balance (or have spare capacity). Weighing all of this together, the central forecast is for inflation to stabilise at a bit above the midpoint of the target range. This is a change from the judgement at the time of the November *Statement* where we had forecast that the labour market and economy would gradually return to balance this year, bringing inflation gradually back to the midpoint of the target range.

However, there are risks around this judgement. It is possible that we should be taking more signal in the inflation forecast from the parts of the economy where there are fewer capacity constraints. The combination of stronger-than-expected labour market outcomes but weaker-than-expected inflation may also mean there is more capacity in the labour market than embodied in the central projection (see Key risk #1, below). These would see inflation decline more quickly and by more than forecast.

3.3 The domestic outlook

GDP growth in Australia is expected to pick up over 2025.

Growth in private demand is expected to recover over the coming year, settling at around the estimated historical trend growth rate at the end of 2025. This pick-up is expected to be driven by an increase in household consumption growth following the recovery in real household disposable incomes that began in late 2023. The assumed easing in interest rates (as implied by financial market expectations) will also provide a boost to private demand. With growth expected to return to trend at the end of 2025, we judge that there will be limited further easing in capacity constraints across the economy (see Chapter 2: Economic Conditions).

The forecasts are conditioned on a cash rate path derived from financial market pricing; it is assumed that the cash rate will begin declining in early 2025 and reach around 3.5 per cent by the end of the forecast period. Compared with the November *Statement*, the market path implies policy will be eased sooner.

The pick-up in private demand is expected to be a little less pronounced than forecast three months ago, driven by a softer outlook for growth in consumption.

Recent data suggest that growth in household spending in the December quarter was stronger than we previously expected (Graph 3.2). As outlined above, some of this strength likely reflects changing seasonal patterns and we expect growth momentum to slow a little in the first half of 2025.

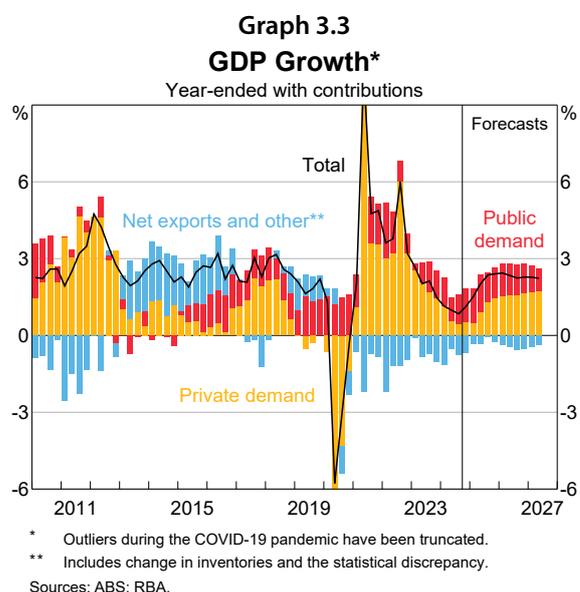
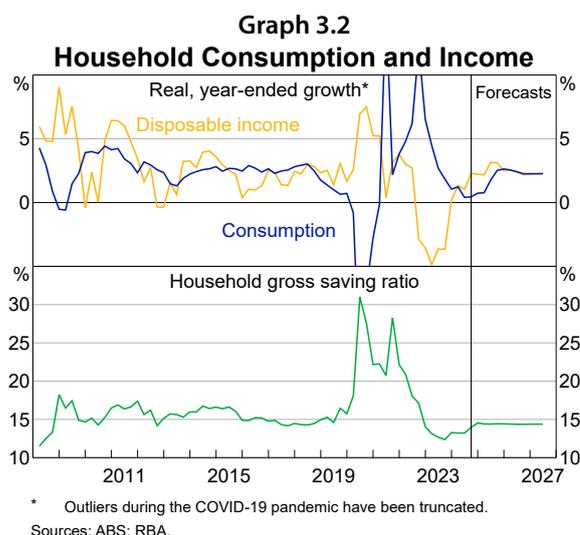
Together with a softer outlook for household wealth (owing to weaker-than-expected growth in housing prices recently), growth in consumption is expected to be slightly softer over 2025 and 2026 than was forecast in the November *Statement*.

The outlook for private investment is similar to the November *Statement*.

Business investment is expected to remain around current levels until mid-2025. Weak demand for new dwellings – partly related to the effect of earlier increases in the cash rate on households' borrowing capacity – is expected to continue to constrain growth in dwelling investment over 2025. Private investment is forecast to pick up from the end of the year, reflecting the assumed decline in the cash rate, a further easing in construction costs, continued

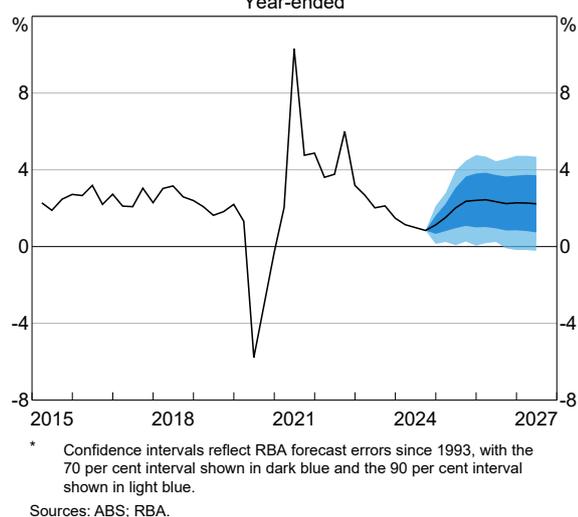
digitisation of firms' operations and a large pipeline of infrastructure work related to the renewable energy transition.

Public spending is expected to support aggregate economic growth by more than forecast three months ago. The public demand forecasts incorporate the upgrades to expenditure projections included in the most recent federal, state and territory governments' mid-year budget reviews. A significant share of the anticipated additional expenditure is for social benefits to households and employee expenses. Budgets also imply robust growth in public investment projects until mid-2026 (Graph 3.3).



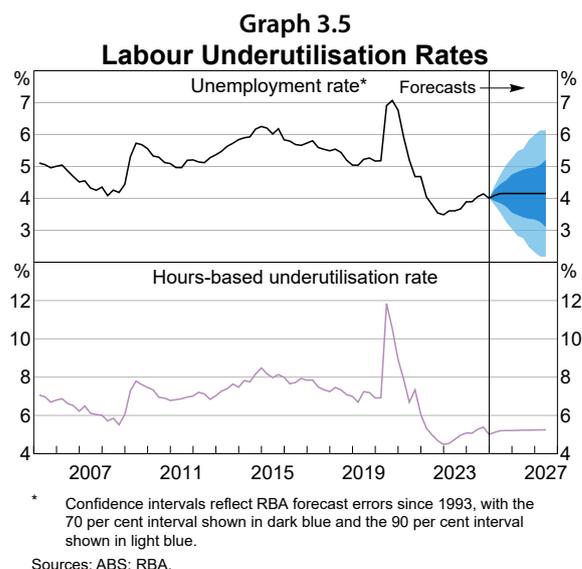
The modest depreciation of the trade-weighted exchange rate since November, if sustained, is expected to boost GDP growth a little over 2025 (Graph 3.4). The trade-weighted index has depreciated by 2 per cent since November and the forecasts assume that the exchange rate will remain unchanged at its current level over the forecast period. Other things equal, a lower exchange rate implies that imports become more expensive compared with goods and services produced in Australia, which will weigh on imports growth as domestic households and firms substitute away from foreign products. The lower exchange rate should also provide a little support to growth in exports for the same reason; Australian produced goods and services become relatively cheaper for international buyers.

Graph 3.4
GDP Growth Forecast*
Year-ended



Labour market conditions are not expected to ease materially from here, remaining tighter than levels consistent with our central estimates of full employment.

Labour underutilisation rates are expected to increase only slightly from current levels (Graph 3.5). The unemployment rate is forecast to increase marginally over the first half of 2025 and then stabilise around 4¼ per cent. Most leading indicators such as job vacancies and hiring intentions point to a stabilisation around current rates.



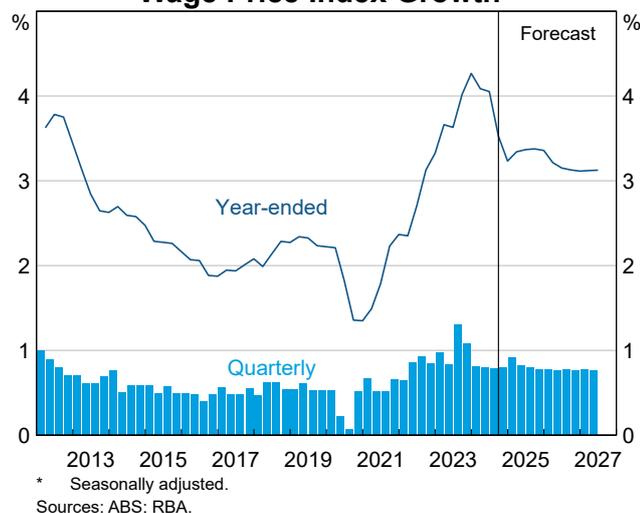
Employment growth is forecast to ease gradually to a pace consistent with growth in the working-age population. Non-market sector employment growth, which has been the driver of stronger-than-expected labour market outcomes over the past year, is expected to continue supporting employment growth in the near term before easing. However, employment growth in the market sector is expected to continue to recover in line with the pick-up in GDP growth, partially offsetting the projected easing in non-market sector employment growth. Participation in the labour force is expected to continue to increase gradually over time, supported by ongoing tightness in the labour market and the continued trend of increased participation by women and older workers.

Growth in nominal wages is expected to ease only slightly in year-ended terms over the forecast period, as the labour market eases only a little.

Wage pressures in the private sector are expected to ease only slightly over the forecast period as labour market conditions have largely stabilised and remain stronger than previously forecast. Public sector wages growth is forecast to pick-up in the near term, with several large agreements now expected to flow through in the near term, before moderating gradually over the rest of the forecast period.

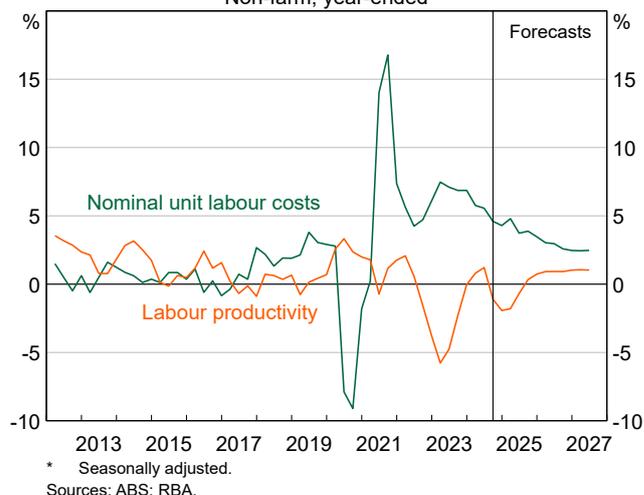
In addition, announced administered decisions for several large awards are expected to contribute around $\frac{1}{4}$ of a percentage point to total annual wages growth, on average over the next two years.¹ These increases may also contribute to increased quarterly volatility in the Wage Price Index (Graph 3.6).

Graph 3.6
Wage Price Index Growth*



Growth in unit labour costs is expected to moderate over the forecast period from an elevated rate (Graph 3.7). Growth in nominal unit labour costs (ULCs) – the measure of labour costs most relevant for firms’ cost of production and so for inflation outcomes – is expected to continue to ease. The easing in ULCs is driven by an assumption that productivity growth gradually picks up, as nominal wages growth is expected to remain broadly steady. Growth in ULCs is expected to reach the rate consistent with inflation being sustainably at the midpoint of the target range towards the end of the forecast period.

Graph 3.7
Labour Cost and Productivity Growth*
Non-farm, year-ended



Labour productivity growth is assumed to pick up gradually over the next two years but to be weaker than previously anticipated; there is significant uncertainty around the longer term outlook.

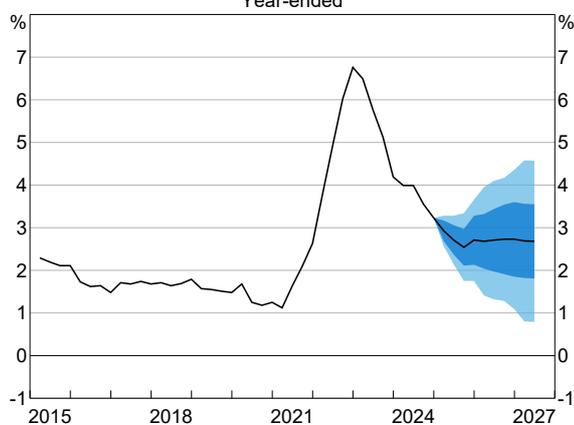
The strength in non-market sector employment growth has had a small drag on measured aggregate productivity growth in recent years, given sectoral differences in measured productivity. This effect is likely to continue. However, the health care industry is also drawing labour predominantly from lower productivity jobs in the market sector, which is likely to be muting the overall drag on aggregate productivity (see Box C: Health Care Employment and its Impact on Broader Labour Market Conditions). Productivity growth is expected to pick up to reach its long-term (excluding the pandemic) average rate. The forecasts assume multifactor productivity (MFP) growth will rebound over the next couple of years, which would be consistent with increased rates of technology adoption, improved reallocation of labour between low- and high-productivity firms, improved labour quality and improved quality of job matching. However, there are risks to the outlook for productivity that could have implications for growth and inflation outcomes (see Key risk #3, below).

Under the current market path for the cash rate, year-ended underlying inflation is expected to ease further in coming quarters, and faster than was expected in the November *Statement*, before stabilising at around 2¾ per cent.

Underlying inflation is expected to be a bit above the 2–3 per cent range from late 2025 (Graph 3.8).

The forecast moderation in year-ended underlying inflation in coming quarters is faster than was expected at the time of the November *Statement*, in part reflecting the weaker-than-expected December quarter outcome. Some of this weakness is expected to persist for a while, particularly for inflation in new dwelling costs and rents. But part of it is expected to reverse in the March quarter as several cost-of-living policies are removed and because of some known administrative price increases. Overall, if the cash rate follows the path implied by financial markets, underlying inflation is expected to be a little above the midpoint of the 2–3 per cent range from late 2025 onwards. This is higher than was forecast in November. This reflects our assessment that the pick-up in GDP growth will flow through to tighter labour market conditions than we previously expected and will sustain some upward pressure on inflation. Inflation expectations are assumed to remain consistent with achieving the inflation target over the long term.

Graph 3.8
Trimmed Mean Inflation Forecast*
Year-ended



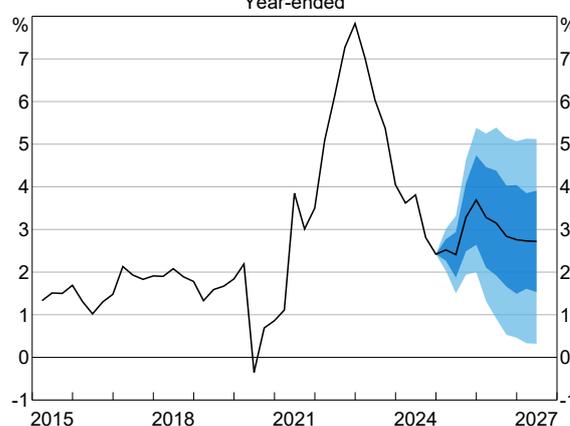
* Confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

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 the target range in the second half of 2026

(Graph 3.9). This volatility in the year-ended profile is largely due to the currently legislated unwinding of cost-of-living measures, such as electricity rebates, over 2025. 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 underlying momentum in consumer price inflation.²

Graph 3.9
Headline Inflation Forecast*
Year-ended



* 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.

Services inflation has eased and is expected to moderate further over 2025, before strengthening over the rest of the forecast period.

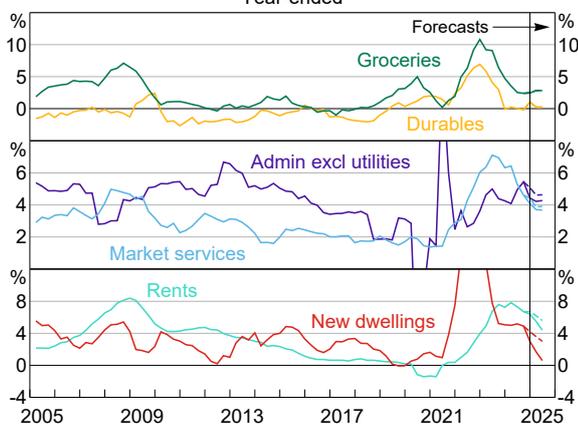
Market services inflation is expected to moderate gradually. Information from liaison suggests services firms expect non-labour cost growth to remain elevated and some gradual easing in labour cost growth over the year ahead. An increase in inflation for administered items (excluding utilities) is also expected to drive strength in services inflation over the second half of the forecast period, alongside strong input cost pressures, the unwinding of cost-of-living support and the child care correction dropping out of the year-ended calculation.³

Housing inflation is expected to moderate over the year ahead, and to ease more quickly than was expected in the November *Statement* (Graph 3.10).

Softer demand for new housing in recent quarters is expected to persist in the near term, contributing to weaker new dwelling inflation. Further out, new dwelling inflation is expected to increase alongside the recovery in new dwelling investment. Rents inflation is expected to moderate more quickly over the forecast period than previously anticipated. This largely reflects a weaker outlook for advertised rent inflation, which is expected to gradually flow through to the stock of rents measured in the CPI.

Retail goods inflation is expected to moderate gradually during the forecast period. In the near term, the moderation in retail inflation is due to soft consumer demand conditions making it difficult for retailers to pass on higher input costs. The pace of disinflation is expected to be slightly slower than in the November *Statement*, partly reflecting higher import prices of consumption goods due to the recent modest exchange rate depreciation.

Graph 3.10
Inflation Forecasts by Component*
Year-ended



* Groceries excludes fruit & vegetables; market services excludes domestic holiday travel & accommodation and telecommunications; dashed lines are previous forecasts; outliers during the COVID-19 pandemic have been truncated.

Sources: ABS; RBA.

3.4 Key risks to the outlook

Key risk #1 – We have misjudged how much excess demand there is in the labour market.

The central forecast is for labour market conditions to remain tight over the forecast period. However, there is a risk that we have overestimated the extent of excess demand in the labour market. We have incorporated some of this risk by applying a little downwards judgement on the inflation profile.

First, it is possible that we have not taken enough signal in our inflation forecasts from the weaker-than-expected inflation outcome in the December quarter (and/or too much signal from the recent stronger-than-expected labour market data). If the inflationary pulse in the economy proves to be as soft as the December quarter data on their own would suggest, it could imply that we had underestimated how much supply-side constraints were contributing to inflation over the past year and how quickly these had now unwound. It could also imply that the modest easing in the labour market over the past year or so had been adequate to bring the labour market into balance – that is, we are currently around estimates of full employment in the economy. Overall, while we have taken signal from some parts of the weaker inflation outcome late last year, such as for the housing-related components, we judge that recent disinflation has been partly driven by factors that are likely to unwind both in the near term (e.g. subsidies have played a role) and in the medium term as GDP growth picks up.

Most labour market indicators, such as the vacancies-to-unemployment ratio and the share of firms reporting the availability of labour as a significant constraint, are consistent with indications from our models that the labour market is tight. However, one factor that could be signalling less tightness in the labour market is the recent decline in the rate of job-switching in the market sector, which suggests there may have been less wage-based competition among firms to retain staff. This decline might indicate less upward pressure on wages than implied by other measures of labour market tightness. This could imply that private sector wages growth, after stabilising in 2024, could begin to moderate again. Our central forecast for wages growth to stabilise around current

rates is implicitly consistent with an increase in job-switching as market sector employment growth picks up.

Notwithstanding the overall moderation of wages growth since mid-2023, we assess that the current pace of wages growth is not consistent with sustaining inflation at the mid-point of the target band. However, if trend productivity growth is higher than we assess, or firms and workers are more forward-looking and make wage decisions based on future higher trend productivity than we expect, then recent wages growth outcomes may be signalling less labour market tightness than anticipated.

Relatedly, recent wages growth outcomes may be the result of wages ‘catching up’ to the increase in consumer prices over recent years rather than tightness in the labour market. Our models adjust for some of this (particularly around the large award wage increases) but it is possible that we have attributed too much of the recent growth in wages to labour market tightness rather than real wage catch up.

While we do not assess there is yet a compelling case to change our estimates of full employment, our central forecasts for wages growth and inflation incorporate some downwards judgement to reflect the uncertainty at this juncture.

Key risk #2 – An intensification of global trade tensions presents uncertainty to the domestic economic outlook.

Elevated global uncertainty across several policy dimensions means that forecasting global growth is more challenging than normal. To illustrate the main transmission channels through which Australia could be adversely affected by changes to global policy settings, we have run scenarios around higher US tariffs on China and possible Chinese responses, given China is Australia’s largest trading partner. We conducted this scenario analysis using the Global Economic Model from Oxford Economics and MARTIN (the RBA’s macroeconomic model) but note these modelling frameworks inherently find it difficult to quantify the effects of uncertainty or

complexities that may arise from disruptions to global supply chains, particularly in the more extreme scenarios.

The scenarios are built on our central forecast for China (described above), which includes both the already announced increase in tariffs as well as a further 10 percentage point increase, with fiscal support fully offsetting the drag on Chinese GDP growth.

- **Scenario A:** The United States increases tariffs on Chinese imports by 20 percentage points on top of what is assumed in the central forecast. The Chinese authorities choose not to respond with any policies to the tariffs.
- **Scenario B:** Chinese authorities respond to the 20 percentage points increase in the tariffs with fiscal stimulus to offset the impact of the tariffs on Chinese growth.
- **Scenario C:** This is an escalation scenario in which US tariffs are increased by 40 percentage points on Chinese imports on top of the baseline. The substantial increase in tariffs is assumed to lead to a sharper fall in sentiment and would sharply lower Chinese growth. In this scenario, Chinese authorities respond to the loss of international competitiveness with both the fiscal stimulus in scenario B as well as a 10 per cent depreciation of the renminbi against the US dollar.

The main transmission channels through which Australia would be affected are:

- **Trade – both the direct impact of weaker growth in China (and globally) on Australian trade and the resetting of trade relationships/trade dispersion.** The slowdown in Chinese growth would lead to less foreign demand for many Australian products. Commodity prices would also decline if Chinese growth declines or if the composition of growth becomes less steel-intensive, given China's outsized role in global commodity markets. This would reduce export and income growth in the Australian economy. Additionally, tariffs would alter relative competitiveness in trade, which would result in a shift in trade patterns. Given the complexity of these shifts, the modelling has not fully accounted for this channel; nevertheless, we would expect this would create near-term disruptions to supply chains and lower productivity. In the near-term, China may also look to redirect exports originally intended for the United States to other destinations, such as Australia, possibly by lowering prices.

- **Negative impact of increased uncertainty and lower confidence on investment and household spending.** The greater global uncertainty would lower equity prices and increase corporate bond spreads. Weaker global consumer and investor confidence will further dampen demand for Australian exports. As highlighted in previous RBA analysis, the MARTIN model does not include measures of consumer or business confidence, which are likely to amplify the effects on the economy over the direct channels above.⁴ We expect that risks to business investment and consumption would remain to the downside if this was fully accounted for.
- **Financial linkages, including the response of the Australian dollar.** The Australian dollar would play a key role in the adjustment to such a shock. Typically the exchange rate depreciates when there are negative foreign shocks or an increase in global risk aversion, which improves Australia's international competitiveness. The exchange rate is assumed to depreciate in all scenarios. In scenario C, the decision by Chinese authorities to depreciate the renminbi would limit the extent of the depreciation of Australia's exchange rate in trade-weighted terms. Nevertheless, the heightened uncertainty and worsening investor confidence under such an escalation of the trade conflict results in a stronger depreciation of the Australian dollar against other major trading partners than in the other scenarios. As a result, the Australian dollar depreciates by 2–3 per cent on average, in trade-weighted terms, over the scenario C period; this is a larger depreciation than in the other scenarios.

For each of the scenarios, we find the effects on Australian GDP relatively small (up to a 0.2 percentage point decline over 12 months). While this may be a surprising result, particularly given the very weak global backdrop in scenario C, this reflects the significant role the exchange rate tends to play in offsetting external shocks to trade for Australia. We also assume no change in Australian monetary or fiscal policy in response to the shock.

In scenario C, private demand declines significantly relative to the baseline, driven by declines to consumption and business investment as a result of greater uncertainty, heightened risk aversion and lower wealth. The weaker private demand is largely offset by stronger net exports, as the depreciation of the Australian exchange rate boosts exports demand and reduces imports. The downturn in consumption and

investment, which tends to be more labour intensive, results in a weaker labour market. The effect of the higher unemployment rate largely offsets some of the boost to inflation from the exchange rate depreciation.

We note our modelling does not capture all the channels through which this shock will affect Australia. Any additional shock to Australia's economy, beyond global confidence shocks, may not be adequately captured and we think there are downside risks to the scenario results.

Key risk #3 – Weak productivity growth could be more persistent than expected.

Our forecasts for output and hours worked currently imply that labour productivity growth returns to longer run average annual rates of around 1 per cent by the end of the forecast period, driven by strong growth in MFP. This is higher than rates observed over the five

years leading up to the pandemic, a time in which labour productivity and MFP grew by around 0.5 per cent per year. If this does not eventuate, the supply capacity of the economy will grow more slowly over the forecast period than currently expected.

The implications for inflation are somewhat uncertain and depend crucially on how the economy adjusts to this lower rate of productivity growth. If the growth of aggregate demand and of wages adjust quickly to this slower growth in the supply side of the economy, there will be limited inflationary effects and the implications for monetary policy will therefore also be limited. However, if demand and wages adjust slowly, there may be additional inflationary pressure.

Noting the challenges around predicting trend productivity growth, we are examining international and domestic evidence to consider whether the weak productivity outcomes are more structural and/or persistent than assumed.

3.5 Detailed forecast information

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

Table 3.1: Detailed Forecast Table^(a)

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

	Dec 2024	Jun 2025	Dec 2025	Jun 2026	Dec 2026	Jun 2027
Activity						
Gross domestic product	1.1	2.0	2.4	2.3	2.3	2.2
Household consumption	0.7	1.8	2.6	2.4	2.3	2.3
Dwelling investment	2.8	0.9	−0.4	0.3	1.3	2.5
Business investment	0.0	0.0	1.4	2.7	3.2	3.5
Public demand	4.9	5.3	4.3	4.3	4.0	3.0
Gross national expenditure	1.9	2.0	2.8	2.9	2.9	2.7
Major trading partner (export-weighted) GDP	3.5	3.5	3.3	3.3	3.4	3.3
Trade						
Imports	6.2	1.7	3.0	4.0	4.0	3.3
Exports	1.6	1.8	1.7	1.8	1.7	1.5
Terms of trade	−4.5	0.6	0.9	−0.7	−1.4	−1.2
Labour market						
Employment	2.7	2.8	2.0	1.6	1.4	1.4
Unemployment rate (quarterly, %)	4.0	4.2	4.2	4.2	4.2	4.2
Hours-based underutilisation rate (quarterly, %)	5.0	5.2	5.2	5.2	5.2	5.2
Income						
Wage Price Index	3.2	3.4	3.4	3.2	3.1	3.1
Nominal average earnings per hour (non-farm)	2.2	3.1	4.2	3.9	3.5	3.5
Real household disposable income	2.2	3.1	2.5	2.4	2.2	2.3
Inflation						
Consumer Price Index	2.4	2.4	3.7	3.2	2.8	2.7
Trimmed mean inflation	3.2	2.7	2.7	2.7	2.7	2.7
Assumptions						
Cash rate (%) ^(c)	4.3	4.0	3.6	3.4	3.5	3.5
Trade-weighted index (index) ^(d)	61.5	60.4	60.4	60.4	60.4	60.4
Brent crude oil price (US\$/bbl) ^(e)	74.2	73.5	73.5	73.5	73.5	73.5

Estimated resident population ^(f)	2.0	1.9	1.5	1.3	1.3	1.2
Memo items						
Labour productivity ^(g)	-1.9	-0.7	0.7	0.9	1.0	1.0
Household savings rate (%) ^(h)	3.9	3.9	4.1	4.1	4.1	4.1
Real Wage Price Index ⁽ⁱ⁾	0.8	1.0	-0.3	0.0	0.4	0.4
Real average earnings per hour (non-farm) ⁽ⁱ⁾	-0.3	0.7	0.6	0.8	0.8	0.8

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- (a) Forecasts finalised on 12 February.
 - (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 The Aged Care Stage 3, Early Childhood Education and Care, and Nurses Award increases are expected to materially raise wages for workers covered by those awards and will affect wages growth in both the private and public sectors.
- 2 See RBA (2024), 'Box C: Headline and Underlying Inflation', *Statement on Monetary Policy*, August.
- 3 For more information, see ABS (2025), 'CPI Release – December Quarter 2024'; ABS (2024), 'Forthcoming Correction to Child Care Costs in the Consumer Price Index', Media Statement, 19 November.
- 4 Guttman R, K Hickie, P Rickards and I Roberts (2019), 'Global Economy Spillovers to Australia from the Chinese Economy', *RBA Bulletin*, June.