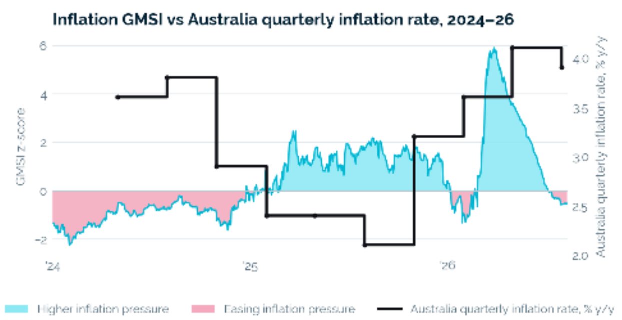
Australia has weathered the inflation shock — but the RBA is not ready to stand down

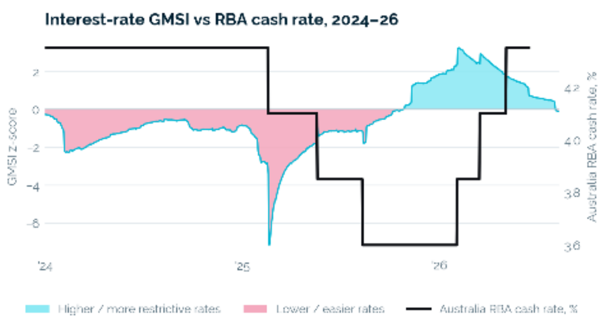
The inflation scare that drove the renewed tightening cycle has faded faster than expected, but the economy has not rolled over with it. Household spending remains resilient, employment conditions have firmed again and business capacity is still stretched.

Cash rate 4.35% · Unemployment 4.4% · Household spending +6.0% y/y · 2Y yield 4.59%

THE HAWKISH IMPULSE HAS FADED

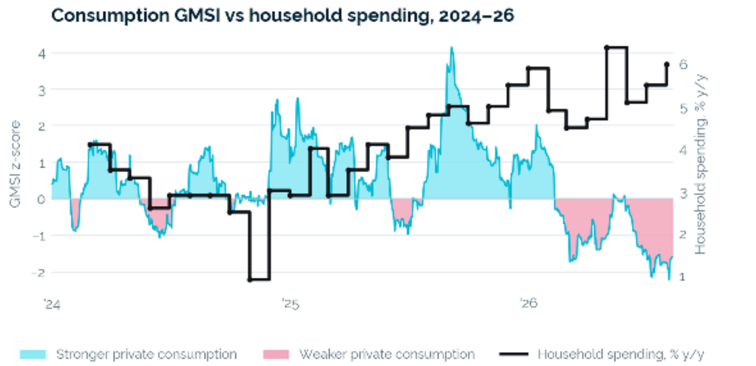
The RBA has enough evidence that restraint is working to remain on hold. Inflation outcomes have been softer than earlier feared, labour conditions have eased from their extremes and housing expectations have weakened. Another increase is no longer the natural next step; the base case is an extended period on hold.





Inflation GMSI rose to almost +6z in late March but has since fallen below zero, while the quarterly inflation-rate series has eased much less, to 3.9% year on year in June. Interest-rate GMSI has also fallen back towards neutral after its early-2026 peak, showing that the policy debate has shifted from whether further tightening is needed to how long the current restraint must remain in place. That gives the RBA time to wait; inflation close to 4% still leaves little room to ease.

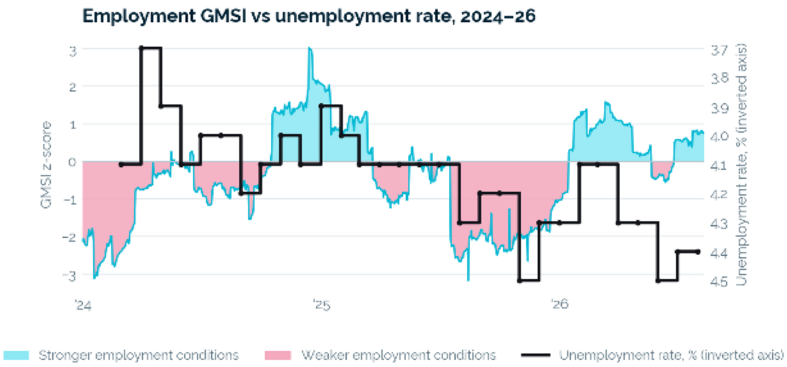
THE CONSUMER IS STILL SPENDING, BUT THE TONE HAS BROKEN



Household demand has weathered higher rates better than expected. Spending rose 0.8% in June and 1.3% over Q2, with real volumes increasing 0.7% over the quarter.

Consumption GMSI is weaker, at around −1.6z after reaching −2.2z in early August. Persistent weak coverage followed by softer spending would show that demand momentum has rolled over. For now, consumers are still spending and do not provide a reason to ease.

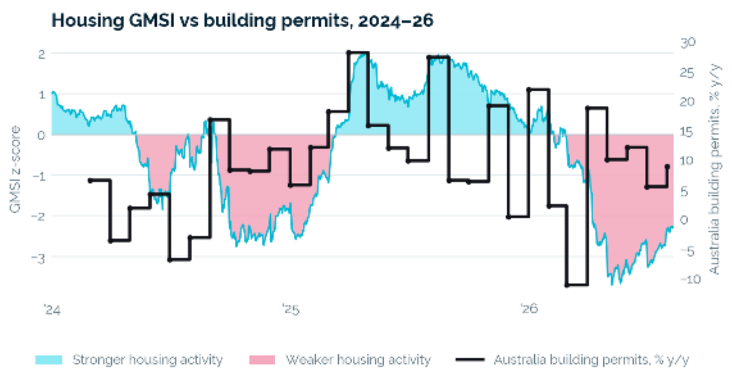
LABOUR HAS LOOSENED, BUT THE LATEST PULSE HAS FIRMED



The unemployment rate has edged back to 4.4% after reaching 4.5%, while employment GMSI has recovered to around +0.8z.

The unemployment axis is inverted so both series move in the same economic direction. Conditions have eased from their earlier extremes, but there is little evidence of the sharp deterioration that would require policy support.

BUSINESS CONFIDENCE REMAINS WEAK, WHILE COST PRESSURE PICKS UP



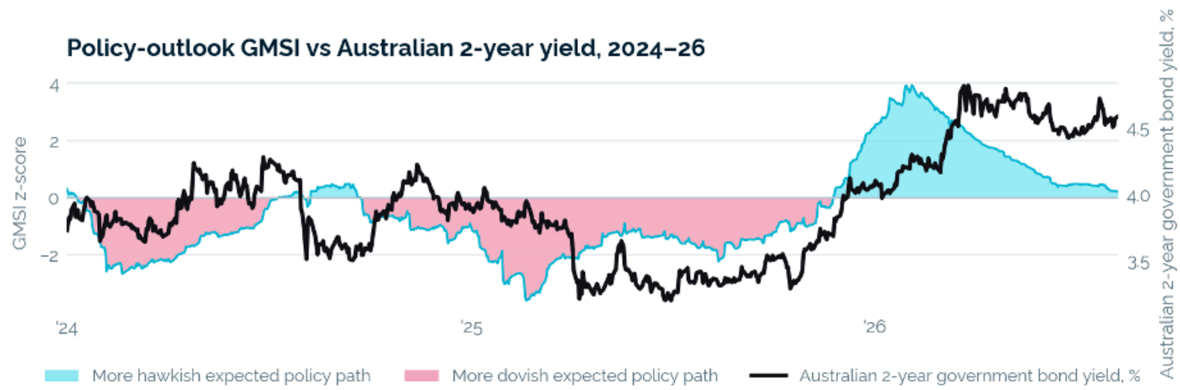
Housing GMSI remains near −2.3z, the weakest current macro signal. Home values fell 0.7% in July and are 1.6% below their March peak, while home-loan enquiries have weakened.

Building permits remain volatile and describe the construction pipeline. Housing-finance approvals are the preferred direct measure of rate transmission when a point-in-time series is available; the supplied Q1 figure was −3.8% quarter on quarter.

-6 Business confidence	**4** Business conditions	**83.0%** Capacity utilisation
+2.2% Labour costs, q/q	**+2.3%** Purchase costs, q/q	**-3** Forward orders

Business confidence held at −6 in July, even as conditions edged up to +4. The firmer activity reading was accompanied by a renewed build-up in cost pressure: capacity utilisation rose to 83.0%, while labour costs increased 2.2% q/q, purchase costs 2.3% and final product prices 1.1%. Forward orders fell to −3, however, suggesting demand remains fragile beneath the surface. For the RBA, that is an awkward mix: enough softness to justify patience, but still too much pressure on capacity and costs to support an early easing turn.

THE TIGHTENING IMPULSE HAS RUN ITS COURSE



Policy-outlook GMSI and the two-year yield both reversed sharply as the outlook was repriced in early 2026. The latest configuration is different: GMSI has fallen from around +4z to near neutral, while the two-year yield remains around 4.6%. Markets are not pricing a rapid easing cycle; they continue to embed a higher-for-longer path even though the incremental shift towards further restriction has faded.

A HAWKISH HOLD FITS THE ECONOMY

The common thread is an economy losing some momentum without becoming weak. Housing has softened first, consumption coverage has deteriorated and inflation pressure has eased substantially from its early-year extreme. Household spending remains firm, employment sentiment has recovered and capacity utilisation is elevated. That mix gives the RBA enough evidence that restraint is working to leave rates unchanged, but little justification for easier policy.

Australia has weathered the inflation storm better than feared. The RBA now has the luxury of waiting — but not yet of standing down.