# NAB Monetary Policy Update 16 Dec 2025

## Expecting 50bps of hikes in H1 2026

## NAB Economics and Markets Research

## Key points

- We now expect the RBA to increase the policy rate by 25bps in February. This is likely to be followed by another 25bp increase in May, taking the cash rate to 4.1%.
- The economy is already at trend growth, and private final demand is running stronger than the RBA anticipated.
- The NAB business survey shows that capacity utilisation is elevated and that there is breadth to this dynamic at an industry level. The survey also suggests that business report less pressure on margins over recent months.
- And the RBA has expressed uncertainty about the stance of policy, no longer comfortable that a policy rate of 3.6% is "*…a little on the restrictive side*."
- Inflation accelerated in Q3, and we forecast a 0.9% qoq for trimmed-mean in Q4, suggesting inflationary pressures have persisted.
- Taken in conjunction with stronger growth outcomes and evidence of capacity constraints starting to bind, we believe an inflation outcome of this magnitude will force the RBA to execute a modest recalibration of monetary policy in 1H26.

## The final chapter

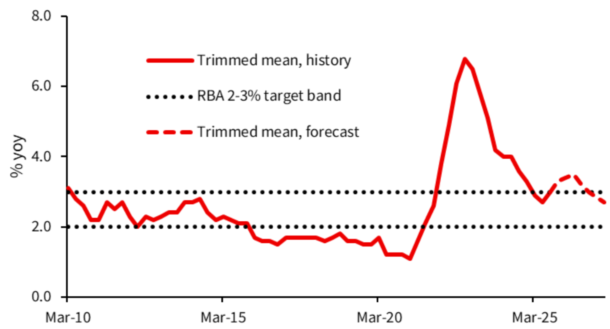
**In recent weeks, we have noted some of the challenges associated with delivering a soft landing** for the economy (see ***here***) as well as some of the **challenges facing the RBA as it approached the last Monetary Policy Board meeting of the year** (see ***here***).

**Our change of view on the RBA represents the logical conclusion in the evolution of our thinking in the past month**. It was clear from the Governor's press conference last week that a run of stronger-than-expected outcomes on activity and prices data in recent months have forced the RBA to reassess the outlook for the Australian economy, with the distribution of risks to both inflation and growth shifting in a more hawkish direction.

**The Governor was unusually forthright in her press conference, stating that evidence of persistent strength in inflation could prompt a policy response from the RBA**. Comments of a similar ilk were also made at the Governor's recent appearance before the Senate Economics Committee earlier in the month.

**After further consideration of the Q4 2025 inflation data to hand, we have now settled on a modal forecast of 0.9% qoq for the trimmed mean measure in Q4**. If realised, this will imply a period of 5 quarters in which the annual rate of core inflation runs at 3% or higher (see Chart). Moreover, it would represent a 15bp surprise relative to the RBA's most recent forecast for the Q4 outcome.

Potential Trimmed Mean trajectory

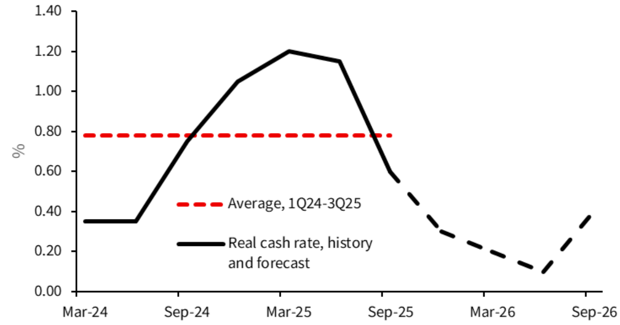



Source: NAB and ABS.

**In our view, the message from the monthly October CPI is that the upside inflation surprise seen in Q3 appears to be a bit bigger and somewhat more broad-based than the third quarter inflation data initially suggested.** In particular, strength in durable goods has added a new dynamic to the inflation data, suggesting that goods inflation is not as benign as the RBA may have anticipated.

**Aside from the obvious issues associated with another period of above target inflation, one of the impacts of a less favourable trajectory for core inflation is a lower real cash rate.** Assuming core inflation above 3% for the next year, it is now quite possible that the real cash rate sits somewhere between 0.10-0.30% over the same period. This looks too low for an economy already at trend growth, pushing up against capacity constraints and with accelerating credit growth and house prices.

Real cash rate

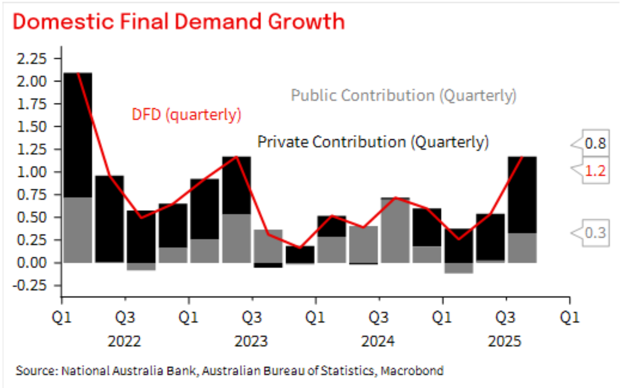



Source: NAB, RBA and ABS.

**When viewed in the context of a central bank that has expressed concern about upside risks to inflation and uncertainty around the stance of policy at present, we think the RBA will need to make a modest recalibration of monetary policy in the first half of this year.** 50bps of tightening should see the real cash rate align to a more appropriate level, taking monetary policy to a setting better able to sustain an economy growing at trend but no stronger.

## The recovery in private demand is more than just an output gap story

**Domestic final demand growth was strong in Q3, rising 1.2%** with the private sector accounting for the bulk of the growth (see Chart). It is clear that growth in aggregate demand has accelerated, which raises the risk of a positive output gap in coming quarters. **Recent data** – such as the ABS monthly household spending indicator for October and our NAB Consumer Spend Trend for November (see ***here***) **suggest that the momentum in consumer spending remains solid in 4Q**.



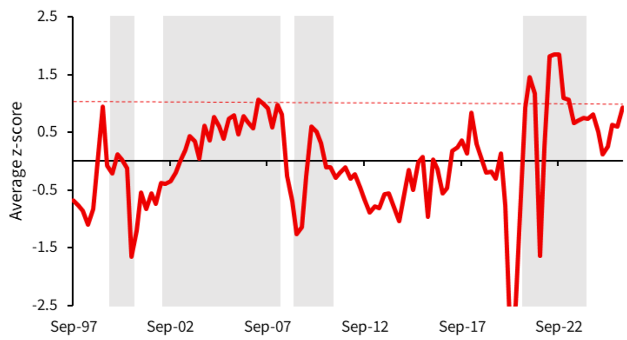

Indeed, the economy – at least on the headline GDP measure – is back to its trend growth rate (annual growth rate of 2.0-2.25%). While this doesn't on its own portend an acceleration in inflation, it leaves the RBA with little cushion. And, as the RBA Governor noted earlier this month, "*Costs are biting on businesses and that they're able to pass them on doesn't necessarily mean that we're operating beyond potential, but it does mean that demand is recovering enough to allow businesses to pass on costs.*"

**Indeed, our NAB business survey suggests that firms have taken the opportunity to expand margins in recent months**, with data elsewhere in the survey suggesting the possibility that this dynamic continues into the future.

So whether it is the risk of a positive output gap or the possibility of margin expansion or both, the recovery in domestic demand evidenced in recent quarters has meaningful implications for policy. **That the starting point for this is higher-than-expected inflation helps to underscore why the policy of least regret for the RBA is likely to be a modest tightening of policy in coming months.**

**In addition, capacity utilisation is elevated.** We have written in detail in recent months about this aspect of the economy in our NAB Business Survey. There is no need to cover this again, but we think the Chart below makes the point clearly – when a broad index reflecting the level, breadth and speed of increase in capacity utilisation rises to an average z-score of ~1, it has historically been synonymous with a hiking cycle.

Capacity utilisation index*




Source: NAB and RBA. *Index is the average of the z-scores of 1) capacity utilisation index; 2) 6-month change in capacity utilisation; and 3) the number of industries registering above average levels of capacity utilisation. Grey bars are RBA tightening cycles. Q4 reading uses November monthly data.

## A stitch in time…

Economics is famous if for nothing else than teaching us about trade-offs. So it shouldn't be surprising that the choice facing the RBA in early 2026 very much reflects the essence of a trade-off. The decision is whether to essentially act early and by a little, versus waiting and risking having to act by a lot more. **By acting early, the RBA will maximise its chances of executing a modest recalibration of policy that returns inflation onto the appropriate trajectory, keeps growth close to trend and the labour market close to full employment**. Pre-emptive action should also minimise the amount of tightening needed and allow scope for a gradual return to more neutral policy settings in the mid-to-late 2027 – where we have pencilled in 50bps of cuts taking the cash rate back to 3.6% by the end of the year.

**Not acting early** – or waiting (hoping) for better inflation outcomes to appear – **runs the risk that a larger adjustment to policy is required at a later date**. By definition, this risks less optimal outcomes for both growth and the labour market.

Expressed another way, this is the difference between tapping the brakes and executing a gentle slowing or trying one's luck, losing and having to slam on the brakes with potentially undesirable consequences.

## Why might we be wrong?

**There are a couple of risks to our view. The first is that the hikes might come later than we expect.** The Bank has displayed caution as it has eased policy this year, and may continue in that vein in 2026. All forecasters face wider-than-is-usual error bands around point forecasts in the current environment. This naturally leads to some risk aversion and may help to explain any reluctance on the RBA's part to pre-commit strongly to a particular course.

**Second, we could be wrong on our 4Q inflation forecast.** For example, if the Q4 trimmed mean measure prints at 0.8% qoq (or lower), then this could allow the RBA the possibility of remaining on hold in 2026, albeit retaining a hawkish bias for the first half of the year.

**Third, the market is already doing some of the RBA's work for it.** Financial conditions have tightened – since September, AUD 2Y swap yields are ~70bp higher, the $A trade weighted index is 2.5% higher and the ASX200 is 3.8% lower. In recent weeks there have been anecdotes about softness in Sydney and Melbourne house prices as potential buyers act with greater caution in response to a changed rate outlook.

## Conclusion

**In our view, the shift in the distribution of risks to both growth and inflation requires the RBA to deliver a modest recalibration of monetary policy in the next six months.** We think this recalibration is probably in the order of 50bp of hikes and will help to restore the real cash rate to more suitable levels. Acting early will maximise the chance that policy makers can return inflation towards the appropriate trajectory while keeping growth at trend and the labour market close to full employment.

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