

NAB Monetary Policy Update 4 Dec 2025



Prepare for a shift towards a more hawkish RBA

NAB Economics and Markets Research

Key points

- As we have observed in recent research, soft landings are to be commended, but also bring a unique set of challenges.
- We think some of these challenges are now getting meaningful for the RBA. Core inflation accelerated in 3Q and looks like it will be strong in 4Q.
- 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.
- At a minimum, we think RBA commentary is likely to take a more hawkish tone, reflecting a shift in the distribution of risks to the monetary policy outlook.
- We continue to forecast the RBA on hold in 1H26 for now, but this forecast will be under review should evidence of a tighter labour market, more persistent price pressures or a further acceleration in domestic economic activity be realised in coming months.

Domestic economic fundamentals are starting to flash amber

Last week, we noted some of the challenges associated with delivering a soft landing for the economy (see [here](#)). The broad thesis of the note was that soft landings leave the economy starting the next expansion with minimal spare capacity. As such, a return to trend growth will start to see capacity constraints bind, and potentially, present some potential challenges for policy makers.

As we approach the last RBA meeting for 2025, **we believe there is evidence that some of these constraints are starting to bind. It is thus likely that the tone of the RBA statement will turn hawkish next week.** There are a number of reasons why we think the RBA will need to reflect a

shift in the distribution of risks around the monetary policy outlook.

First, inflationary pressures have accelerated.

Core CPI (trimmed mean measure) rose 1.0% in 3Q, and based on information in the October monthly CPI release, we have lifted our forecast for 4Q trimmed mean to 0.9% qoq. Significantly, **the October CPI data showed rising durable goods prices**, adding further to the breadth in inflationary pressures relative to what was observed in Q3 data. The lift in goods prices will have been a surprise to the RBA; the November SoMP noted: *“By contrast, the outlook for retail goods inflation is broadly unchanged from the August Statement.”* In addition, among more volatile components, those that might have been expected to fall back in 4Q appear to be on track to add to the headline inflation number once again.

It was interesting to see the Governor note in her testimony before the Senate Economics Committee earlier this week that if price pressures prove *“...more persistent, and we’ll get more information on this in the next couple of months, then that’s suggesting to us that the demand pressures are persisting and that might have implications for the future path of monetary policy.”* This suggests that **inflation data (next monthly releases on 7 January and 28 January) will potentially be consequential for the near-term policy outlook.**

Should our forecast of 0.9% qoq be realised, this would be the second consecutive quarter in which core inflation has printed above the RBA’s standing forecast and would suggest the strong likelihood that core CPI will run at annual rates of 3% or higher for five consecutive quarters. Further, many nominal measures in the 3Q national accounts released earlier this week add to the sense that inflationary pressures are less benign than the earlier run of CPI data had implied.

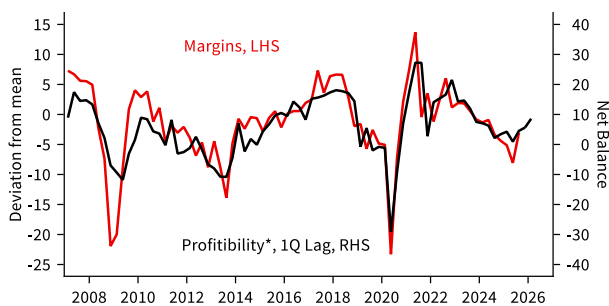
Second, the economy – at least on the headline GDP measure – is back to its trend growth rate

(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 week, “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 the Chart below suggesting the possibility that this dynamic continues into the future.

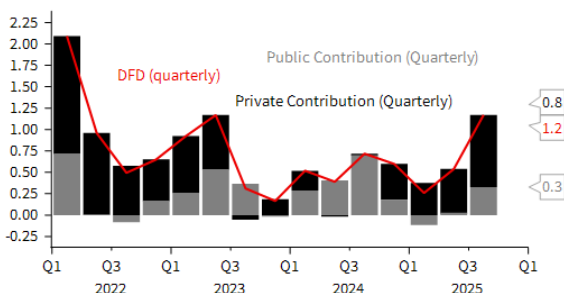
Margin Expansion



Source: National Australia Bank, National Australia Bank, Macrobond
* Final month of the quarter; October result for Q4 2025.

Moreover, **domestic final demand growth was strong in 3Q, 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.

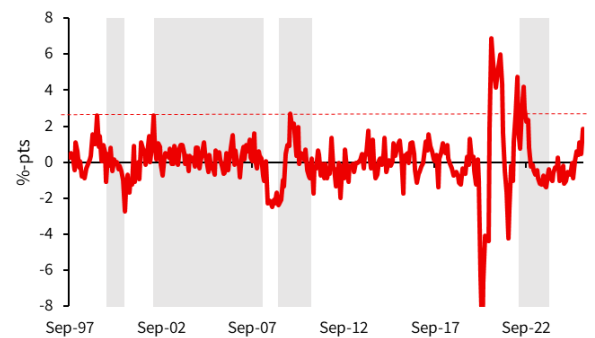
Domestic Final Demand Growth



Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

Third, our NAB business survey suggests that 1) capacity utilisation is high (2-pts above its long-run average); **2)** there is breadth to the capacity utilisation story, with 6 out of the 8 industries in our survey running at above average levels of capacity utilisation; and **3)** the speed of the rise in capacity utilisation has been quite striking (see Chart). This adds to the sense that there is little-to-no spare capacity in the economy at present.

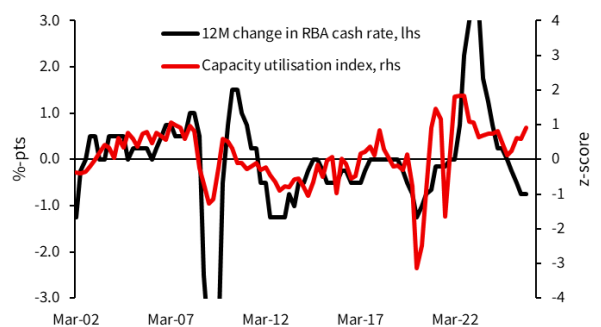
6-month change in cap-u



Source: NAB. Grey shaded areas are RBA tightening cycles.

As we noted last week, a broad index of capacity utilisation which takes the breadth, level and 6-month change into account suggests the RBA cash rate cycle should have turned already (see Chart).

RBA cash rate vs. cap-u index*

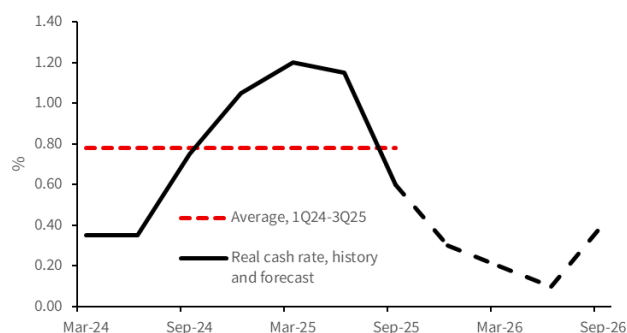


Source: RBA and NAB.

Fourth, the behaviour of house prices and investor lending in recent months suggests that the RBA may need to consider both the impact of the wealth effect on consumption outcomes and the financial stability risks of rising investor participation in the housing market. **It also feeds uncertainty around the overall stance of monetary policy**, acknowledged by the RBA in the Statement accompanying the November Monetary Policy Board decision.

Relatedly, **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 and with accelerating credit growth and house prices.

Real cash rate



Source: NAB, RBA and ABS.

Given the above, it is quite possible that the RBA may need to deliver what we would characterise as a modest recalibration of the policy stance at some point in 1H26. This recalibration is likely to be in the order of 50bps, assuming it comes at the right time. The pressing issue for the RBA is that in the current situation (supply constrained economy with inflation tracking higher than forecast), time is of the essence. It is better to move earlier, and by less, than to wait and to be forced to do more.

In this environment, it is likely, in our view, that RBA communications in coming months reflect quite a different tone. This shift may happen as soon as next week's Board meeting Statement. While the cash rate is likely to finish the year at 3.6%, it is also very possible that the RBA starts to prepare the ground for a shift in view before the end of the year.

Why might we be wrong?

There are a few reasons why the Bank might try to see the year out holding the line. The first is that the Bank have tended towards reactivity, rather than pro-activity, of late. This is a consequence of both an aversion to forward guidance and a focus on data-dependence. In this instance, the Bank may require more evidence to accumulate before it shifts in a more hawkish direction. Second, there have been offsetting forces at work since the November SoMP for the RBA's forecasts – the market has taken out the 30bp of easing assumed in the cash rate profile for the forecasts and is now pricing some chance of a rate hike, but on the other hand, private demand growth was stronger than the RBA forecast in 3Q. So on net, it might be that not much has changed at the aggregate level.

Finally, 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 a reluctance to pre-commit strongly to a particular course.

Conclusion

In conclusion, it is quite possible given our take on domestic economic fundamentals, that the RBA are not too far away from a more hawkish tone to their communications. This would simply reflect a shift in the distribution of risks to the monetary policy outlook. For now, we are forecasting the RBA on hold in 2026, but this forecast will be under review should evidence of a tightening in the labour market, confirmation of more persistent price pressures or a further acceleration in domestic economic activity be realised in coming months.

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