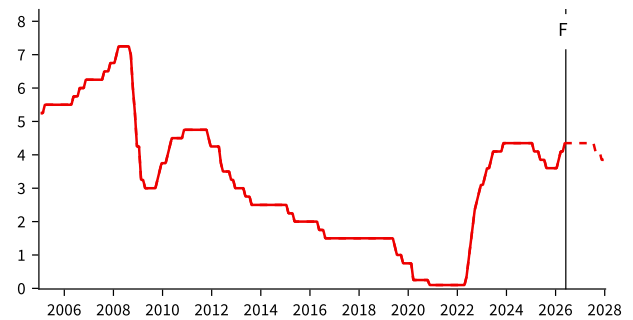


Next move in RBA cash rate is down, timing uncertain

Key points

- **We no longer expect the RBA to hike by 25bp in August**, and now see the cash rate peaking at the current rate of 4.35% for the cycle. **The next move in the cash rate is likely to be down, but the timing is uncertain.** To highlight shifting risks to the RBA outlook, we have brought forward our expected easing from H2 2027 to Q2 2027 – which now sees the cash rate end 2027 at 3.6%.
- **We are minded to view the proposed changes to taxation arrangements for housing and other asset classes as an exogenous tightening of financial conditions.**
- **Tighter financial conditions will be reflected in both a slowing in house price growth and housing credit growth.** Consequently, we have made downward revisions to our forecasts for both of these variables.
- **Both Q1 GDP data and the NAB business survey suggest momentum in the economy has slowed**, meaning that growth has likely peaked for the cycle. Should activity data weaken more quickly than anticipated, the RBA will cut earlier than we currently forecast.
- **However, we are cognisant that there is still considerable uncertainty around the outlook, both with respect to activity and inflation.** Indeed, it is possible that consumption outcomes are stronger than we forecast. Additionally, it is possible that the housing downturn is not as impactful on activity as we think.
- **On the prices side, we are still forecasting above target core inflation through to mid-2027.** This outlook is not dissimilar to that of the RBA, as outlined in last month's SoMP and is likely to keep the RBA watchful around pass through from higher input costs to final prices.
- We have been worried about a broad and rapid dissemination of inflationary pressures, but the recent slowing in momentum in the economy may short-circuit this dynamic somewhat. **If so, margins will compress and weaker labour market outcomes are a risk.**
- **In summary, we have greater conviction that the next move in rates is down, but less conviction on the timing.** In contrast, the AUD front-end is still priced for hikes. If we are correct on the direction of the RBA cash rate, there is scope for decent moves in AUD and front-end rates as the market adjusts to a more dovish view.

RBA Cash Rate Target and NAB Forecast



Source: National Australia Bank, RBA, Macrobond

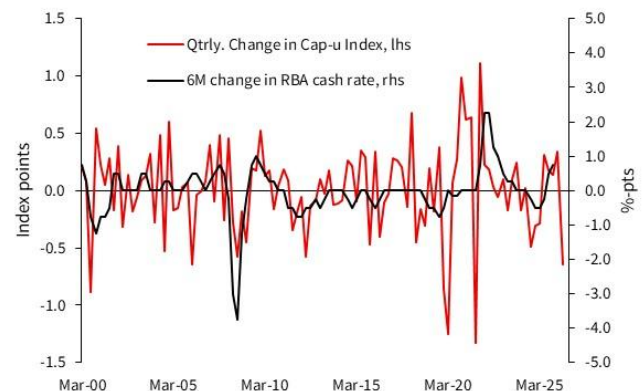
The macro starting point

In February, growth was above trend, the economy was operating above capacity and there was uncertainty over the restrictiveness of rates. None of these conditions exist today. Rates are 75bp higher, growth has already slowed and the labour market doesn't appear to be inflationary given the current trend in underlying wage growth and measures of unit labour costs.

We would summarise the macro backdrop at present as follows:

- **The labour market is close to balance** but the unemployment rate continues to gradually trend higher and we see the unemployment rate as more likely to rise than fall in coming quarters;
- **The capacity constraints picture has shifted** – the NAB Business Survey shows that activity has cooled somewhat, with business conditions and capacity utilisation having eased through 2026 (see Chart);

The capacity utilisation index has dropped sharply



Source: National Australia Bank and RBA; *The capacity utilisation index is an average z-score of capacity utilisation, the number of industries with cap-u above their long-run average and the 3M moving average of the 6M change in capacity utilisation.

- **The Q1 national accounts shows that the economy had lost some momentum in the first three months of 2026** as underlying household spending growth is now annualising closer to 1.5%, business investment is weak outside of data centres and dwelling investment continues to grow but not as strongly as demand would imply;
- **Data so far suggests that near-term inflation outcomes are unlikely to exceed RBA SoMP forecasts** and while our forecasts assume a broad and fast passthrough of cost pressures, this is not evident yet; and
- **Housing was softening pre-Budget** with house price growth slowing in all major capital cities.

In summary, recent economic data give us confidence in our already weak growth forecasts, challenge our view on the near term passthrough to inflation and while broadly in line for now, highlight upside risk to our unemployment rate forecast. Against this backdrop, we now think it likely that the RBA has finished tightening. We are confident in our view that the next move is down, but the timing is uncertain.

Some new risks to contemplate

Some new developments on the macro front reinforce our reassessment of the policy outlook. The domestic macro-economic backdrop has taken on a new dimension post-Budget, with uncertainty around the impact of future taxation arrangements for housing impacting both weekend auction clearance rates and listings in recent weeks. Beyond housing, there continues to be discontent expressed – particularly in the SME and Venture Capital sectors – around the proposed coverage of changes to the Capital Gains Tax regime.

While it might be difficult to assess what the latter implies for activity going forward, **we are minded to view this shift in policy as akin to an exogenous tightening of financial conditions.** If we are correct in this assessment, it will have meaningful implications for our (and the RBA’s) assessment of the stance of monetary policy. **Effectively, policy will be more restrictive for any given level of the cash rate than was the case pre-Budget.**

Indeed in housing, lenders have already reduced maximum loan values for investors, in the order of ~20%, in response to the proposed changes in taxation arrangements for investment properties. Given that 40c in every \$1 of mortgage lending flows to investors, this is a sizable decline in borrowing capacity in aggregate. While housing (or technically, dwelling investment) is only circa 5% of GDP, the multiplier effects are likely to be much larger. For this reason, **we are wary that a larger cycle in the housing market represents a downside risk to economic activity in coming quarters.**

Prior to the Federal Budget, we had already anticipated a modest cycle in house prices and activity, in response to the RBA’s tightening cycle. As noted above, this was reflected in our expectation for slower growth in 2026. **Now, we think it likely that a more pronounced cycle will manifest and**

we have marked down our house price forecasts and our forecasts for housing credit growth.

- **For house prices, we now expect annual growth in the capital city average house price to be -2.0% by the end of 2026.** At the beginning of this year, our forecast was +6%. The table below outlines our revised major capital city dwelling price forecasts.

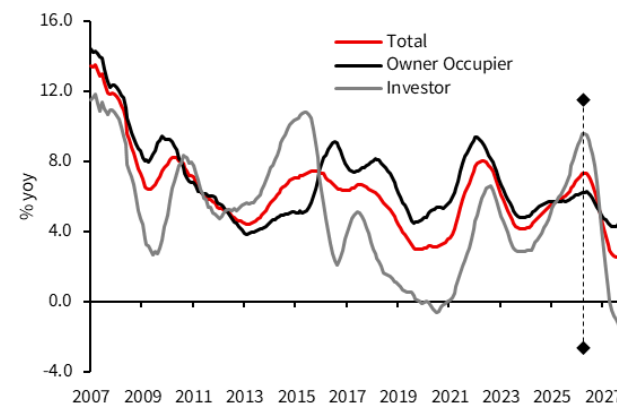
Dwelling price forecasts*

	Dec-24	Dec-25	Dec-26 (f)	Dec-27 (f)
Sydney	3	6	-6	1
Melbourne	-2	5	-7	2
Brisbane	11	15	9	3
Adelaide	14	8	7	4
Perth	18	17	14	3
Hobart	1	7	7	2
Capital city ave.	5	9	-2	2

Source: National Australia Bank; * year-ended growth rates.

- **For housing credit growth, we forecast a reasonably sharp deceleration in the headline measure, and expect a decline towards 2.7% yoy by the end of 2027.** In the main part, this will be driven by a significant decline in the growth of investor mortgage lending. We expect the annual growth rate in this series to decelerate towards -1.4% by the end of 2027 (see Chart).

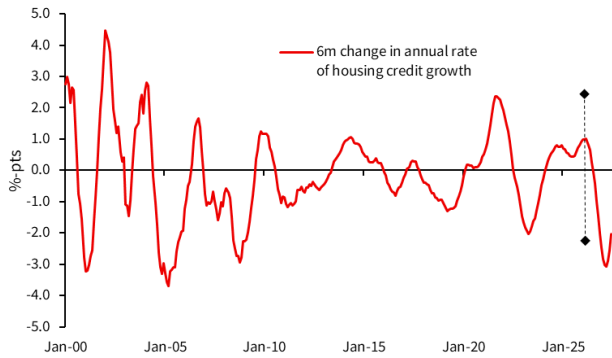
Housing credit forecasts



Source: National Australia Bank; * year-ended growth rates.

Looking at the “credit impulse” (calculated as the 6m change in the % yoy rate of housing credit growth), we observe that our forecasts envisage a sharp retracement in the coming year (see Chart). The magnitude of this retracement looks broadly similar to the (exaggerated) credit cycles experienced in the early 2000s, but worse than the cycle experienced in the GFC.

The credit “impulse” looks reasonably sharp



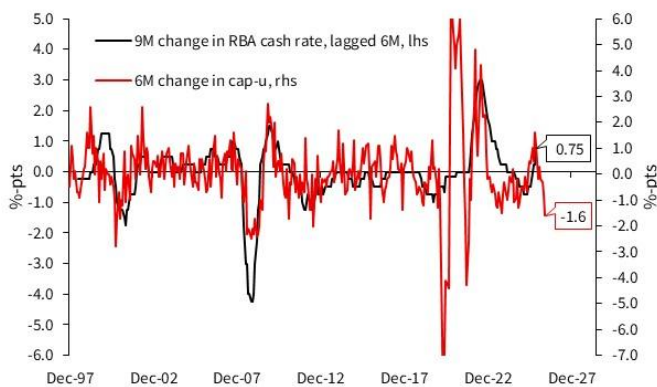
Source: National Australia Bank.

It is important to remember that there are some unique drivers of this housing cycle. In recent decades, drivers of the housing cycle have largely been the interest rate cycle and on occasion from 2014, changes in macro-prudential settings. **This cycle is unique in that it will be driven by the combination of tighter monetary policy and a one-off exogenous shift in the taxation arrangements with respect to investor-owned housing.**

RBA outlook

As we have detailed above, we think the macro backdrop has changed quite a lot since February this year. National accounts data for the first three months of the year show a slowing in activity (particularly household consumption) and the NAB business survey shows a softening of business conditions and a sharp 6M decline in capacity utilisation in the second quarter of the year. As the Chart below illustrates, the latter can often be a useful signal on RBA policy direction.

Changes in capacity utilisation and the RBA cash rate



Source: National Australia Bank and RBA.

In addition, it is likely that the economy will face into a more pronounced housing cycle in coming quarters, which is a new risk to the activity outlook. To the extent that the impact of the Middle East conflict has been less than we anticipated, we are not changing our GDP forecasts to account for this new risk.

While we are confident that the RBA is now on hold and that the next move in rates is down, we are less certain on the timing. Indeed, there are reasonably large uncertainties on both the activity and prices outlook at present. In particular:

- We may have misread the consumer with ongoing seasonality issues clouding the assessment. Consumption outcomes may be better than we anticipate in coming quarters;
- Forward indicators of labour demand look reasonable thus far, and haven’t yet weakened in line with softer momentum in the domestic economy;
- Inflation passthrough may come later, but is still broad-based;
- Alternatively, if inflation passthrough doesn’t eventuate, margins compress and manifest in weaker labour demand;
- Commodity prices remain high (supporting national income) and equity markets remain buoyant, mitigating the impact of the housing downturn; or
- Our NAB business survey stabilises and capacity utilisation and business conditions settle at levels broadly consistent with trend growth or a touch below.

For now, we believe the economy will likely still require a period of restrictive rates while there is uncertainty around the extent to which inflation is moderating towards a quarterly run rate consistent with the 2-3% inflation target. This suggests a period of policy stability is likely in the near term.

However, we do think the RBA will be sensitive to shifts in the activity side of the mandate, and as such, we wouldn’t be surprised to see RBA commentary take a more dovish tone at next week’s meeting. And with the market still priced for hikes in H2 2026, risks look somewhat asymmetric to front-end rates and AUD FX. To signal this shifting risks to the policy outlook, we have brought forward the start of the easing cycle from H2 2027 to Q2 2027.

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