The Forward View Australia: Dec 25

Missing the approach

NAB Economics and Markets Research

Overview

- The economy looks to be ending 2025 with private sector growth strong and the labour market healthy.
- Inflation is expected to track above 3% for a number of quarters with the Q4 trimmed mean likely to surprise the RBA again.
- We now expect rates to rise in H1 2026, in a modest recalibration of policy.

Over the past month, the data flow has confirmed a further strengthening and broadening of private sector growth in Q3, and ongoing strength in consumer spending in early Q4, despite a pullback in business conditions. Labour force data also continue to show that employment growth has slowed but the unemployment rate remains low. While the activity side of the economy remains encouraging, the inflation data for October suggest that pressures evident in Q3 have persisted into Q4 and point to a 0.9% qoq outcome for the trimmed mean. This is consistent with the NAB business survey which shows that capacity utilisation remains elevated. The RBA also struck a much more hawkish tone at its last meeting, noting that the strength in activity suggests no further easing is needed.

Accordingly, we have tweaked our near-term forecasts for growth and inflation. Factoring in revisions, the Q3 outcome, and strong consumer partials, we have revised up our Q4 forecast of GDP to 2.2% (yoy). On inflation, we have upped our Q4 trimmed-mean forecast to 0.9%. We continue see the quarterly inflation pulse cooling modestly through 2026, but year-ended underlying inflation will be above 3% for the next few quarters and is likely to remain above the mid-point of the RBA's target band well into 2027. Given uncomfortable strength in recent inflation outcomes we have also realised the risk on our rate view and now formally pencil in two rate increases in H1 2026. We have nudged up our unemployment rate peak to 4.6%.

The economy looks to be ending 2025 in much stronger shape than at the end of 2024. Following the cyclical trough in growth of 0.8% yoy in Q3 2024 (when private demand had stalled) growth has accelerated through 2025, driven by a recovery in household consumption, dwelling investment and more recently a rise in business investment. Public sector investment also rebounded in Q3 after falling in the 3 prior quarters as large projects were completed.

Indeed, the key issue for early 2026 will be whether growth has outpaced the supply side of the economy amid a still low unemployment rate (and high capacity utilisation more generally) and a higher inflation starting point.

Contents

Key Economic Forecasts

	2024	2025(f)	2026(f)	2027(f)
Domestic Demand (a)	1.9	2.3	2.4	2.2
Real GDP (annual ave)	**1.0**	**1.9**	**2.1**	**2.2**
Real GDP (year-ended)	**1.3**	**2.2**	**2.0**	**2.3**
Employment (a)	2.3	1.9	1.6	1.4
Unemployment Rate (b)	4.0	4.3	4.6	4.6
Headline CPI (b)	2.4	3.8	3.2	2.5
Trimmed-mean CPI (b)	3.3	3.3	2.8	2.5
RBA Cash Rate (b)	4.35	3.60	4.10	3.60
$A/US cents (b)	0.62	0.67	0.71	--

(a) annual average growth, (b) end-period

Chart 1: RBA Cash rate forecast

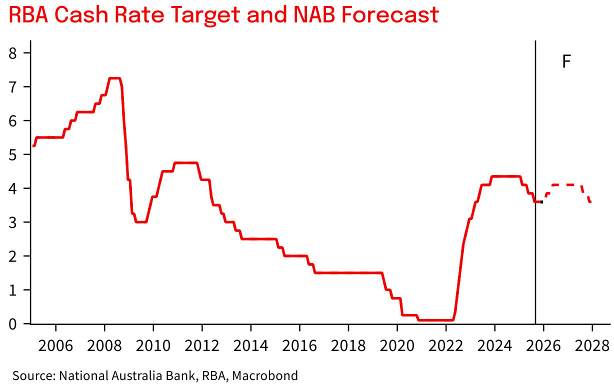
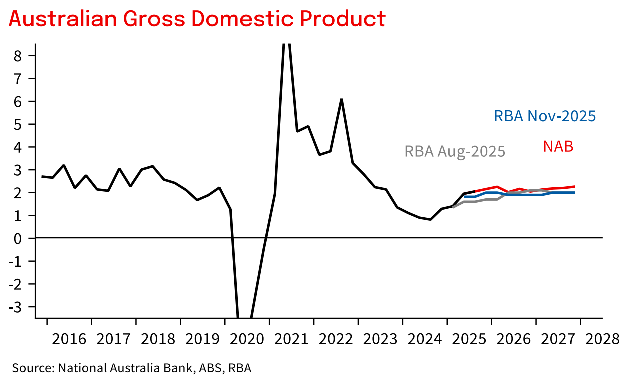


Chart 2: GDP forecasts



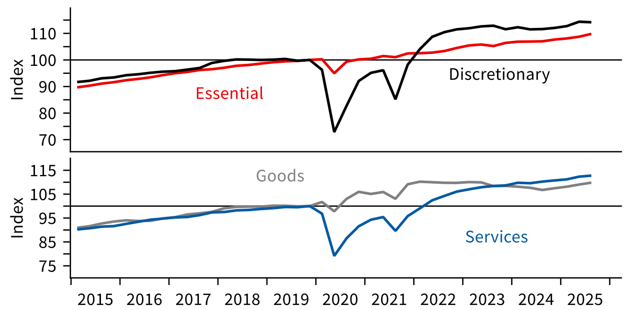
18 December 2025 | Authors: Gareth Spence, Taylor Nugent, Jessie Cameron, Michael Hayes, Sally Auld

Consumption

Household spending remained robust in Q3, with partial indicators pointing to further strength in Q4.

Following a strong Q2 outcome, household spending growth moderated in Q3 to 0.5% qoq (2.5% yoy), which was slightly above NAB's and the RBA's November SoMP forecast. Growth was led by essential categories, with higher spending on insurance and other financial services following the increase in the superannuation guarantee to 12% as well as electricity, gas & other fuels, as electricity subsides continue to unwind.

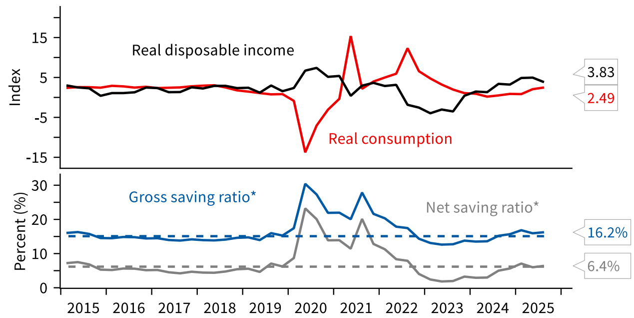
Real Household Consumption*



Source: National Australia Bank, Australian Bureau of Statistics, Macrobond
Note: * Q4 2019 = 100

The recovery in consumption has been supported by solid growth in real household disposable income, which has increased by 3.8% over the past year. Recent higher real income growth reflects the combined impact of an easing in inflation, Stage 3 tax cuts, and lower interest rates. However, these tailwinds have begun to fade and are expected to diminish further. Households appear to have restored their savings rates with the national accounts measure stabilising in recent quarters after rising through 2024.

Household Income and Consumption



Source: National Australia Bank, Australian Bureau of Statistics, Macrobond
Notes: * Dotted line represents the ten-year average to the end of 2019.

Partial indicators for Q4 point to continued strength in household consumption. The ABS Household Spending Indicator shows nominal spending rose sharply in October, increasing by 1.3% mom, which was the largest monthly increase since January 2024. The gain was broad-based across all categories and most states (excluding Tasmania). NAB's Consumer Spend Trend data also points to a further rise in spending of 0.6% mom in November. While the Westpac-MI consumer sentiment index fell 9% in December, it largely unwound the prior months strength and remains around 21% higher than its late 2022 low.

Combined with the solid Q3 outcome, these suggest that the recovery in consumer spending growth has been sustained even as the tailwinds to income growth have eased. We expect household consumption growth to continue to underpin economic activity, growing by over 2% over 2026 following a similar outcome over 2025, and a marked increase in pace compared to growth of just 0.9% over 2024.

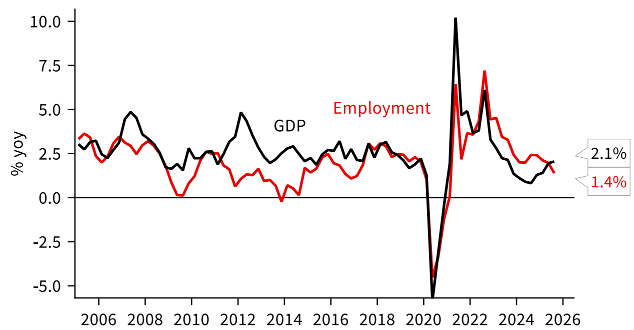
Labour market

The unemployment rate remains low, but the labour market has not shown the same reacceleration evident in CPI and economic activity.

Employment growth slowed to 1.4% over the year to Q3 despite the pick-up in activity growth. Over the first half of 2025, there was a marked slowdown in social assistance employment, which includes child & aged care, disability assistance services as well as slower growth in healthcare employment. Market sector employment growth remained steady alongside the pickup in private sector demand.

Industry outcomes can be volatile on a quarterly basis, but Q3 data did challenge some of those trends, with little market sector employment growth, despite still healthy labour demand indicators.

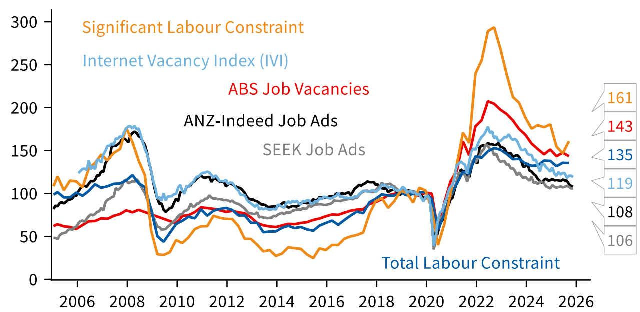
Employment and Activity



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

The unemployment rate was unchanged at 4.3% in November, continuing to show that despite slower employment growth over the past year there has been only a marginal lift in the trend unemployment rate. Firms continue to indicate that they are constrained by the availability of suitable labour.

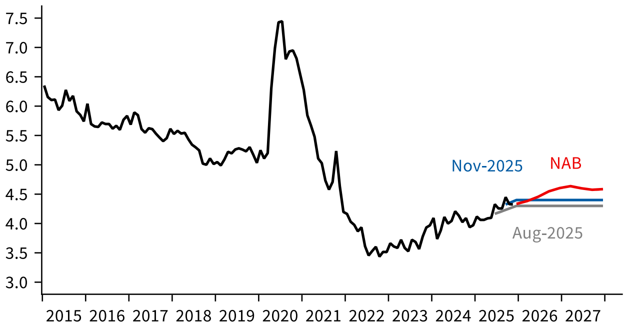
Measures of labour demand



Source: National Australia Bank, Australian Bureau of Statistics, ANZ-Indeed, SEEK Australia, National Australia Bank, Jobs & Skills Australia, Macrobond

Despite the pickup in growth, we do not expect the labour market to re-tighten. Although job advertisements and vacancies are still at healthy levels, they have either been steady or declined slightly in the past few months. We expect the pickup in private sector activity to support labour demand going forward but anticipate a modest further rise in the unemployment rate alongside still solid working-age population growth. We now see the unemployment rate peaking around 4.6% in late 2026, a level we see as a bit above its long run sustainable level of closer to 4.25%.

Unemployment Rate Forecasts



Source: National Australia Bank, RBA

Businesses

Business investment rose strongly in Q3 as investment in data centres drove growth in machinery & equipment.

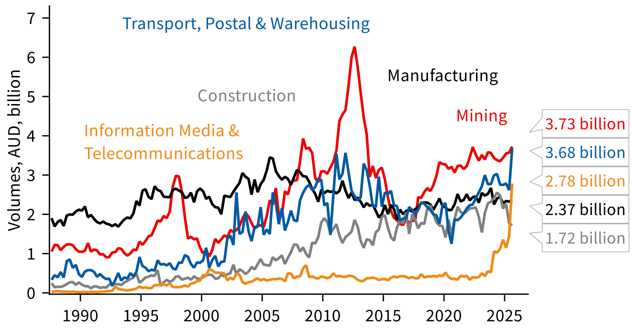
Underlying business investment rose 3.4% qoq in Q3, led by a 7.5% qoq rise in machinery & equipment investment. Non-residential construction rose 0.5% qoq as a 0.7% qoq fall in new engineering investment was offset by a 2% qoq rise in non-residential new construction. In year-ended terms, underlying business investment rose 3.8% after softer results over the previous 4 quarters.

Data centres have remained a fundamental driver of business investment growth which has been evident in strong capex and work done results in Q3. The forward-looking element of the capex data adjusted for the long-run realisation ratio suggests that investment in machinery & equipment will remain strong over the next 3 quarters and will be supported by an investment of around $10bn in nominal terms over FY26 from the information media & telecommunications sector alone.

Meanwhile, the NAB November Business Survey showed that both business conditions and confidence fell in the month. Other key indicators also eased in November, with forward orders and exports falling 2pts and 1pt respectively. While activity indicators eased in the month, capacity utilisation reached an 18-month high at 83.6%, with 6 of 8 industries sitting above their long run average in trend terms (up from only 3 in April). Although capacity utilisation has trended up since its post-pandemic low and availability of suitable labour has continued to be flagged as a key constraint for businesses, the employment index has tracked broadly sideways and labour cost growth has continued to ease.

We expect further growth in business investment over 2026, partially supported by sustained momentum in the data centre build out.

Equipment, plant and machinery (selected industries)



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

Foreign exchange

AUD/USD has appreciated over the past month and is expected to rise further in 2026.

AUD/USD and the trade weighted index have appreciated by around 1% over the past month, to be 6% and 3% higher respectively since the start of the year. The recent move has been largely driven by a widening in the interest rate differential between Australia and other advanced economies, while a move lower in USD/CNY has also provided some support.

We continue to see the Australian dollar appreciating US0.70c by the end of 2026. The policy divergence between the RBA and the Federal Reserve is likely to remain a key tailwind for the AUD over the next 12 months and the move higher will depend on a renewed downturn in the USD (see FX Strategy Forecast Update).

NAB Forecasts, AUD/USD

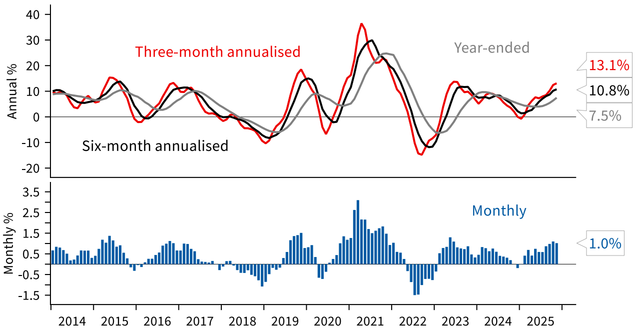
Source: National Australia Bank, Account in-house

Housing

Housing price growth has begun to diverge across the states while dwelling investment growth strengthened in Q3.

Dwelling prices rose 1.0% mom in November, easing marginally from 1.3% mom in October, as growth in Sydney and Melbourne moderated. In year-ended terms, prices have risen by 7.5%, with strength across both houses and units (8.1% and 5.2% yoy, respectively). Meanwhile, growth in advertised rents remained steady at 0.5% mom for the fourth consecutive month in November.

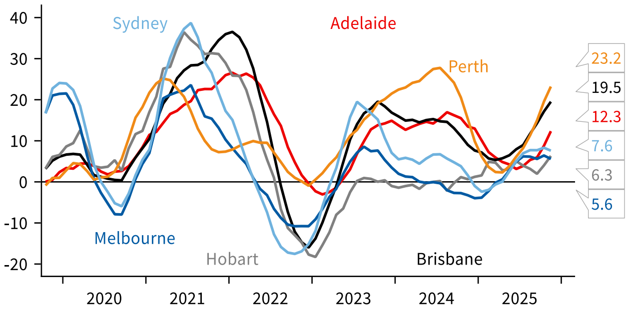
Australian Dwelling Price Growth



Source: National Australia Bank, CoreLogic

Rates of growth across the state capitals have diverged. Melbourne and Sydney were the only state capitals where dwelling prices rose less than 1% mom in November, and early December weekly data suggest this pattern will persist. Meanwhile, prices in Perth, Brisbane and Adelaide continue to gain momentum, with 6-month annualised growth in these cities reached 23.2%, 19.5% and 12.3% respectively.

CoreLogic Hedonic Dwelling Price Growth by Capital City (6-month-ended Annualised,%)



Source: National Australia Bank, Cotality Australia, Macrobond, Account in-house

We continue to see growth of around 6% growth for prices over 2026 for the 8-capital city dwelling price index. Though the level of interest rates will be less supportive, income growth (and the labour market) is expected to remain healthy, while the supply demand imbalance in the housing market will persist.

Dwelling investment in Q3 was stronger than expected, rising 1.8% qoq to be 6.5% higher in year-ended terms. This was led by new builds, which rose 2.6% qoq, while alterations & additions increased by a more modest 0.5% qoq. The preliminary release of the building activity survey showed growth in private residential construction was driven by detached dwellings, up 5.8% qoq. Residential work done in QLD rose around 12% in the quarter while NSW, VIC and SA lagged, but still rose 3%.

Drier weather across the east coast supported the pickup in dwelling investment and saw average completion times for houses fall back. Looking forward, building approvals have steadied over recent months after rising through the first half of 2025, suggesting that new housing starts can continue to improve.

Inflation

Inflation is outpacing the RBA's November forecast.

The monthly CPI confirmed that inflation remained high and broad-based into October (AUS: October CPI keeps the pressure on the RBA). The share of the basket running more than 1ppt above the RBA's target midpoint was 64%.

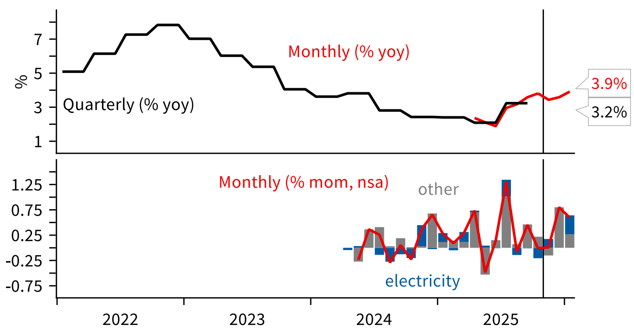
The October CPI suggests the extent and breadth of the recent strength in inflation is a little more material than was evident in the Q3 data. While there was no further acceleration evident across the housing or market services components that supported the lift in Q3 underlying inflation, consumer durables inflation was much stronger.

The post-meeting statement from the RBA's board meeting in December noted "*recent data suggest the risks to inflation have tilted to the upside, but it will take a little longer to assess the persistence of inflationary pressures.*" We expect an upside surprise to the RBA's November SoMP forecast to be realised and forecast 0.9% qoq for Q4 trimmed mean.

Further information from the November monthly data (released on 7 January) will reduce the error bands on this forecast. Note, however, that the calculation of the quarterly trimmed mean is based on the historical collection frequency of underlying CPI component data. Because monthly data is too new to seasonally adjust, the RBA will not be able to confidently interpret the timeliest CPI outcomes.

As for headline CPI, near term dynamics continue to be dominated by electricity rebates. Measured electricity prices will rise in November after a temporary drop from overlapping NSW rebates in October, but by less than a year ago. This means base effects should weigh on headline inflation and could see a fall back to around 3.5% in November, before the end of rebates sees headline CPI again move higher in January. In quarter average terms, we forecast headline CPI of 0.6% qoq and 3.6% yoy in Q4. That upward contribution in January will continue to add around 3 tenths to year-ended headline through 2026.

Headline CPI and Electricity

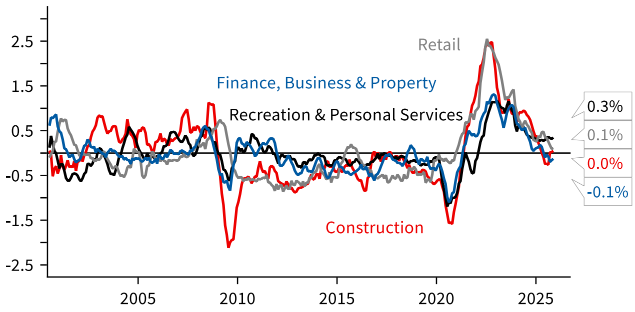


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

While much of the pickup in headline inflation can be attributed to electricity subsidies, the data have shown a much more broad-based challenge than that, with reacceleration evident across housing, services and consumer goods components. We see some of the recent increase in inflation as an echo of earlier pipeline inflation pressures that had not been passed all the way through to consumer prices.

Final prices measures in consumer facing industries from the NAB Business Survey have not shown the same reacceleration evident in the CPI data and have largely returned to near long run averages. However, disinflation in Australia into the first half of 2025 had been supported by margin pressures, and some easing of that squeeze alongside the pickup in private sector demand growth likely allowed some further passthrough of earlier cost pressures.

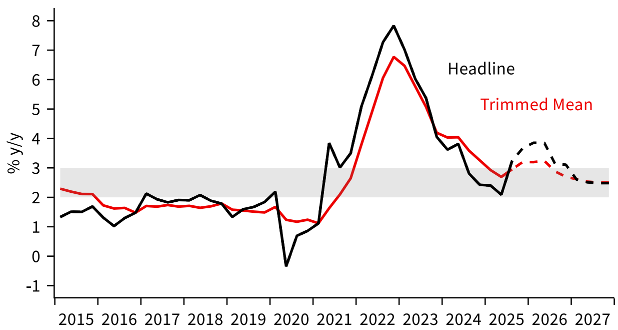
NAB Survey Final Prices (deviation from average)*



*3 month moving average
Source: National Australia Bank, Macrobond

We anticipate gradual moderation in core inflation back towards the RBA's target over 2026 and 2027 as a labour market near balance and growth near trend do not alone sustain the strength seen in recent outcomes.

Inflation Forecasts



Source: National Australia Bank, ABS, RBA

Monetary Policy

We now expect the RBA to lift rates in H1 2026, pencilling in 25bp increases in February and May.

We consider this a modest re-calibration in the stance of policy that will take the RBA's setting back into more restrictive territory. Accordingly, this means that after a period in restrictive territory, the RBA will eventually need to restart the normalisation of rates to nearer 3%. Therefore, after a period of rates at just above 4% we expect the RBA to ease twice in mid-to-late 2027.

Our formal shift in view comes after having previously noted that the RBA would likely remain on hold for an extended period with the economy not requiring any additional support. Amid the challenges of capacity constraints, the clear risk was that the next move in rates would be up. We now expect that risk to materialise.

Firstly, the inflation backdrop is now meaningfully different than 3 months ago. The breadth and strength in the acceleration in Q3 was further reinforced in the October CPI and means that the RBA will now see core inflation track above 3% and well above the 2.5% over the next five quarters. While inflation data continue to be volatile, for all but two quarters over the past three or so years, inflation has tracked above the top of the RBA's target band.

Secondly, growth has accelerated and broadened across the private sector. This means that the labour market will likely remain healthy in the near-term (though we don't expect a retightening). The rebound in household spending also points to the risk that businesses will be able to pass on cost pressures and defend (or expand) margins, directly adding to inflation pressures.

Third, with growth now back near trend and above target inflation as starting point, signs of little-to-no slack in the economy mean that persistence in inflation pressure is a significant risk. Our survey's measure of capacity utilisation remains 2ppts above average, and 6 out of 8 industries also report above average capacity utilisation. Despite the gradual easing in the labour market, the reported difficulty finding suitable labour remains elevated, at levels last seen pre-GFC when the labour market was tight.

We think that at around 4.3%, the unemployment rate is consistent with full employment, and wage price data do not suggest that wages growth is a material source of inflation pressure at present. However, there is little room for retightening or an acceleration in wage growth.

With current policy at most only marginally restrictive in our view, the RBA will also need ensure that policy is sufficiently restrictive to bring inflation back to around 2.5% in a timely way.

Given higher inflation in the near-term, we see the RBA acting relatively quickly. The balance of risks have shifted, and moving sooner reduces the risk that more is needed to be done later. However, rates will eventually need to come down as the supply/demand imbalance is corrected in the economy. For now, we pencil in an eventual, gradual normalisation beginning in mid-to-late 2027.

Key Forecasts

Australia forecasts

	% Growth q/q					% Growth y/y			
	Q2-25	Q3-25 (f)	Q4-25 (f)	Q1-26 (f)	Q2-26 (f)	2024	2025 (f)	2026 (f)	2027 (f)
GDP and Components									
Private Consumption	0.9	0.5	0.6	0.4	0.4	0.9	2.6	1.8	1.9
Dwelling Investment	0.4	1.8	0.7	0.5	0.5	5.3	5.3	2.0	2.2
New Business Investment	-0.9	3.7	0.5	0.3	0.3	-2.3	3.5	1.4	2.3
Underlying Public Final Demand	0.0	1.2	0.4	0.4	0.4	5.6	1.3	1.6	1.6
Domestic Demand	**0.5**	**1.2**	**0.6**	**0.5**	**0.5**	**2.2**	**2.6**	**2.0**	**2.2**
Stocks (Cont. to GDP)	-0.3	-0.3	0.0	0.0	0.0	0.1	-0.2	-0.3	0.0
Gross National Expenditure	**0.5**	**0.6**	**0.6**	**0.4**	**0.5**	**2.3**	**2.4**	**2.0**	**2.2**
Exports	2.3	1.0	0.4	0.4	0.4	1.7	3.5	1.7	1.7
Imports	2.3	1.5	0.6	0.4	0.4	6.2	4.5	1.6	1.5
Net Export (Cont. to GDP)	0.0	-0.1	0.0	0.0	0.0	-0.9	-0.2	0.0	0.1
Real GDP	**0.7**	**0.4**	**0.6**	**0.5**	**0.5**	**1.3**	**2.2**	**2.0**	**2.3**
Nominal GDP	0.7	1.7	1.5	1.2	1.2	3.5	5.2	4.6	4.3
Labour Market									
Employment	0.6	0.2	0.5	0.4	0.4	2.2	1.6	1.4	1.6
Unemployment Rate (Q-Ave, End of Period)	4.2	4.3	4.3	4.4	4.5	4.0	4.3	4.6	4.6
Wage Price Index (WPI)	0.8	0.8	0.9	0.8	0.8	3.2	3.5	3.2	3.2
Inflation and Rates									
Headline CPI	0.7	1.3	0.7	1.2	0.7	2.4	3.8	3.2	2.5
Trimmed-mean CPI	0.7	1.0	0.9	0.8	0.7	3.3	3.3	2.8	2.5
RBA Cash Rate (End of Period)	3.85	3.60	3.60	3.85	4.10	4.35	3.60	4.10	--
10 Year Govt. Bonds (End of Period)	4.17	4.34	4.45	4.50	4.50	4.48	4.45	4.55	--
$A/US cents (End of Period)	0.66	0.66	0.67	0.69	0.71	0.62	0.67	0.71	--

Data are percentage growth rates over the quarter or year as noted, except where specified otherwise.

NAB Economics & Markets Research

Sally Auld	Group Chief Economist	+(61 0) 422 224 752	Sally.Auld@nab.com.au
Australian Economics			
Gareth Spence	Head of Australian Economics	+(61 0) 422 081 046	Gareth.Spence@nab.com.au
Taylor Nugent	Senior Economist	+(61 0) 452 671 752	Taylor.Nugent@nab.com.au
Jessie Cameron	Senior Associate Economist	+(61 0) 491 380 013	Jessie.Cameron@nab.com.au
Michael Hayes	Associate Economist	+(61 0) 411 186 777	Michael.Hayes@nab.com.au
International Economics			
Antony Kelly	Head of International Economics	+(61 0) 477 746 237	Antony.Kelly@nab.com.au
Gavin Friend	Senior Markets Strategist	+(44) 207 710 1588	Gavin.Friend@eu.nabgroup.com
Behavioural Economics			
Dean Pearson	Head of Behavioural Economics	+(61 0) 457 517 342	Dean.Pearson@nab.com.au
Robert De lure	Associate Director Economics	+(61 0) 477 723 769	Robert.De.Iure@nab.com.au
Economics Analytics			
Brien McDonald	Senior Economist	+(61 0) 455 052 520	Brien.McDonald@nab.com.au
Thao Nguyen	Associate Director Economics	+(61 0) 451 203 008	Thao.Nguyen5@nab.com.au
Rocky Facciolo	Analyst	+(61 0) 416 586 554	Rocky.Facciolo@nab.com.au
Markets Research			
Skye Masters	Head of Markets Research	+(61 0) 467 767 604	Skye.Masters@nab.com.au
Barbara Leong	Research Assistant	+(61 2) 7226 7382	Barbara.Leong@nab.com.au
Credit Strategy			
Evy Noble	Senior Associate Credit Strategy	+(61 2) 7226 7336	Evy.Noble@nab.com.au
FX Strategy			
Ray Attrill	Head of FX Strategy	+(61 2) 9293 7170	Ray.Attrill@nab.com.au
Rodrigo Catril	Senior FX Strategist	+(61 2) 9293 7109	Rodrigo.H.Catril@nab.com.au
Rates Strategy			
Kenneth Crompton	Head of Rates Strategy	+(61 0) 439 411 709	Kenneth.Crompton@nab.com.au
Gregorius Steven	Senior Associate Rates Strategy	+(61 2) 7209 8133	Gregorius.Steven@nab.com.au