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# **What matters for the RBA?**

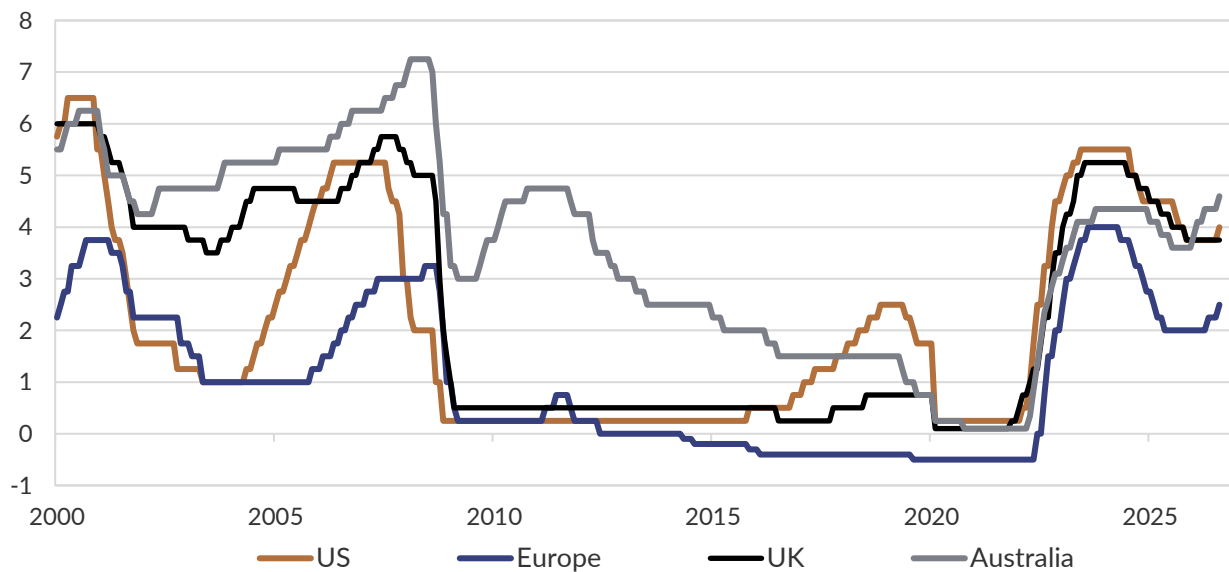
October 2026



## What matters for the RBA?

The RBA hiked rates in September. It was not alone – the US Fed, ECB and BoJ all hiked during the month. Markets expect more rate hikes. The RBA left the door open for more rate hikes, warning more pain might be necessary to get inflation under control. With the Bank already four hikes into this cycle, we look at what could cause more hikes for the RBA, and what they will look at when thinking about a pause or a cut.

Chart 1: Global central banks have started hiking rates.



Source: Bloomberg LP, Ascalon.

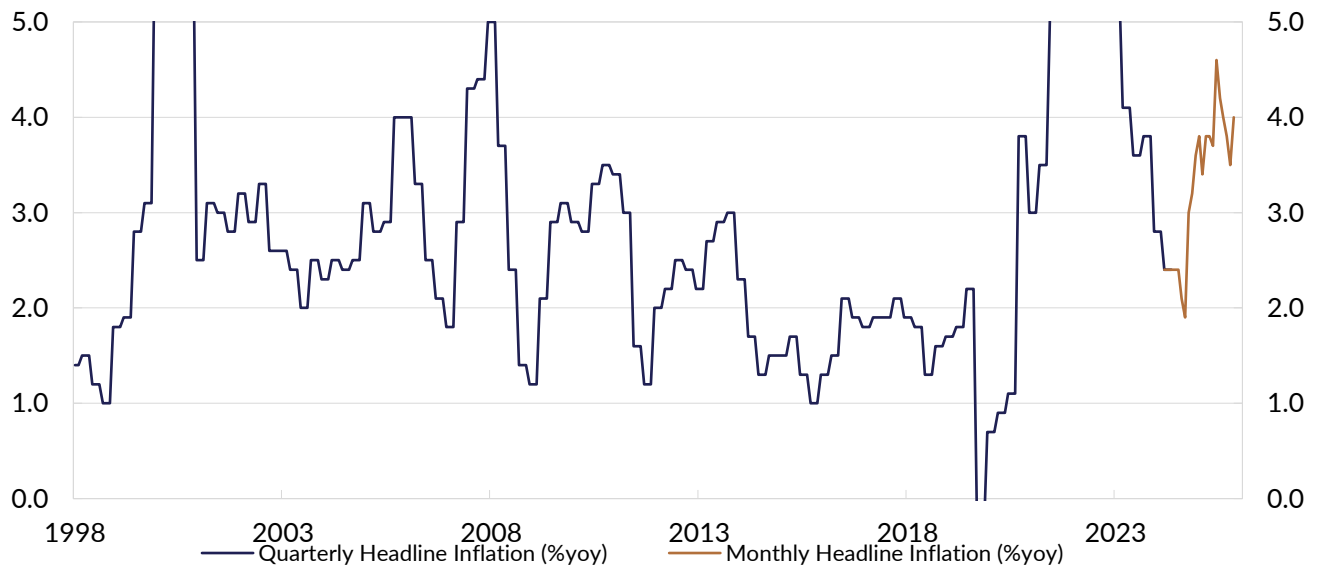
### Higher inflation means more hikes are likely.

The RBA had all but declared victory over inflation in 2025. But strong consumer demand, higher oil prices, loose fiscal spending and poor productivity has pushed inflation back well above the 2%-3% target. The most recent monthly headline read showed inflation climbing to 4.0%. Various measures of underlying inflation were also above the 2%-3% target – trimmed mean remained at 3.6% for a third consecutive month, and it has been above 3% since July 2025.

The RBA responded in early 2026 with three hikes in H1 2026. After remaining on pause since May, the Bank delivered a further 0.25% hike to 4.60% in September. The cash rate is now at its highest level since late 2011. And the commentary from the RBA warned that rates may need to rise further if inflation and demand do not moderate.



Chart 2: Inflation is well above the RBA's 2%-3% target.

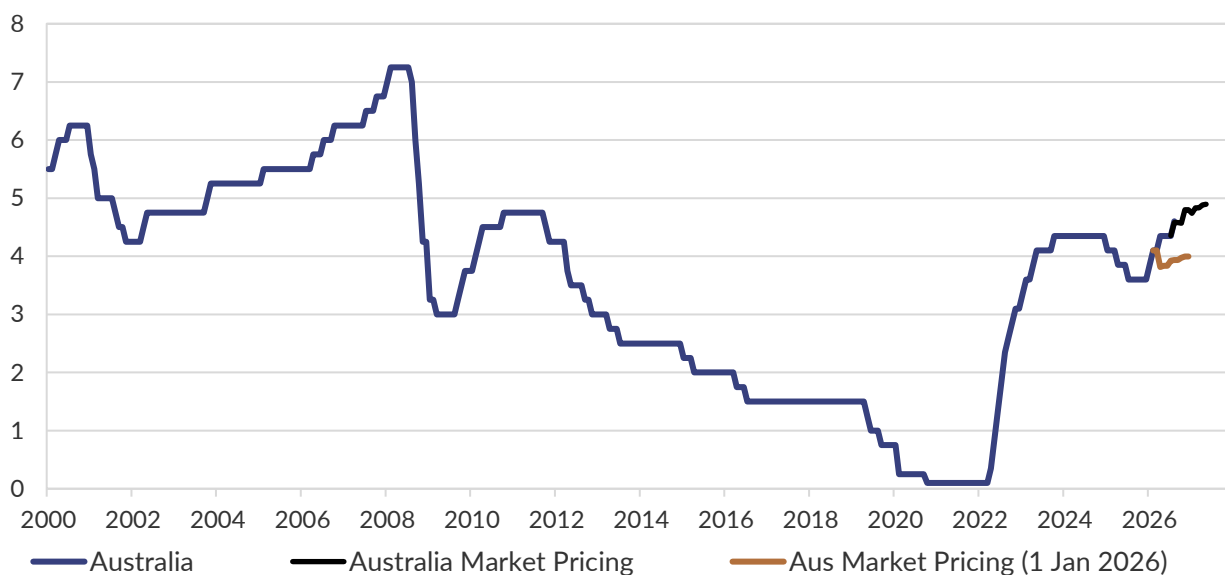


Source: Bloomberg LP, Ascalon.

### Markets have already priced hikes.

Markets had well and truly priced the September rate hike. And rates markets now expect at least two more 0.25% rate hikes over the next 12 months. The Australian government bond yield curve has sold off, moving higher across the curve, as markets priced in further rate hikes and uncertainty around inflation.

Chart 3: Markets now expect a cash rate close to 5.0% in Australia.



Source: Bloomberg LP, Ascalon.



While market expectations and higher government bond yields give the RBA a green light to hike, it does not follow that market pricing rate hikes are a done deal. The RBA has a dual mandate to contain inflation and promote full employment. Rate hikes of more than 150bps over a 12 month period are rare and increase the risk of a material economic slowdown.

## **Further hikes are a function of elevated inflation.**

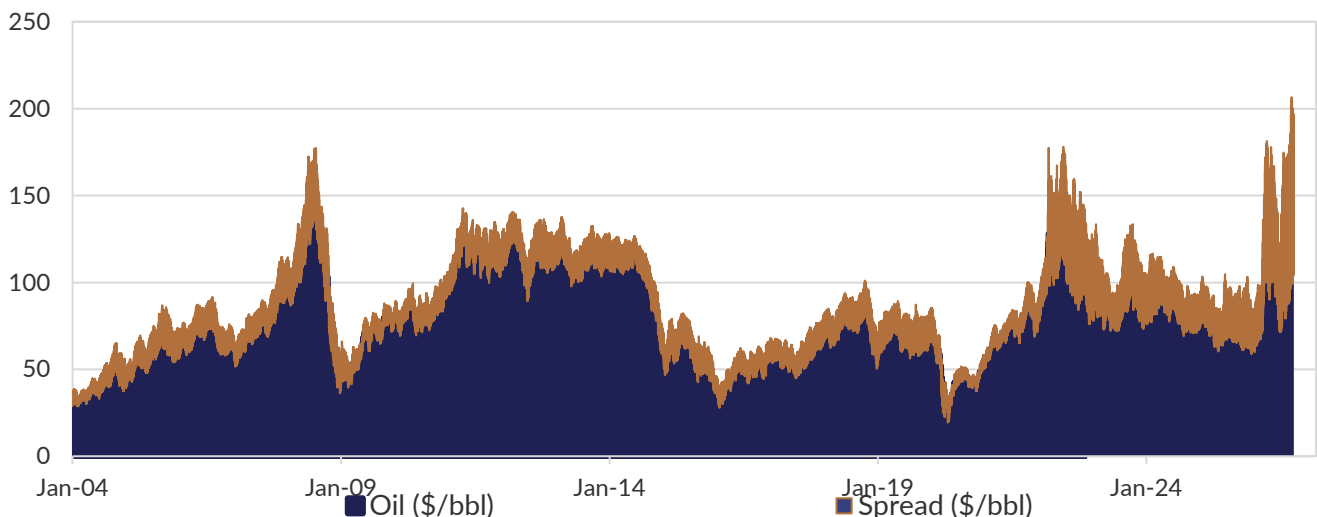
The RBA clearly has a tightening bias and is focused on inflationary pressures. These pressures are both domestic and international.

*Domestic capacity:* Persistent domestic spending has pushed the Australian economy above its speed limit, which has come down in recent years. This is keeping pressure on prices. We expect domestic spending, particularly household spending, to moderate in coming months, taking some of the pressure of prices.

*Rental prices:* Rents represent the second largest single expenditure class in the CPI basket. But rents flow through to inflation with around a 12-month lag. The existing rental challenges in Australia are likely to keep adding to inflationary pressures over the coming 12 months.

*Middle East conflict:* High oil prices and wide product spreads are contributing to consumer and producer inflation. The ongoing conflict looks likely to keep prices elevated and spreads wide for some time. A normalisation could take 12 months or more, adding to inflationary pressures.

*Chart 4: Oil and oil product prices are elevated, adding to inflationary pressures.*



Source: Bloomberg LP, Ascalon.

*AI demand:* Global artificial intelligence investments have increased supply chain and tech-related costs. This is likely to add to near-term inflationary pressures globally.

*Productivity:* Australia's productivity problems are well documented. Poor productivity reduces potential economic growth, effectively lowering the speed limit at which the economy can grow. This is a major issue for the RBA and is likely to keep the hiking bias in place for the near-term.



## Rate cuts require a catalyst.

Central banks typically need to see a catalyst before they consider cutting rates. Absent this catalyst, the tendency is to remain on pause for an extended period. An extended pause is plausible if the RBA sees inflation begin to settle, although we suspect at least one more rate hike will be implemented before a pause. However, rate cuts could be catalysed by several different shocks.

*Housing market recession:* The RBA's rate hikes and fiscal policy announced in the 2026 Budget have dented the housing market. Prices have fallen sharply in parts of Australia while housing credit and buyer demand has slowed. A weak housing market feeds through to weaker consumer spending. While we don't forecast house prices, a decline of 10% or more could be sufficient to push the RBA to a cutting bias.

Chart 5: Housing credit is slowing as rates have increased.



Source: Bloomberg LP, Ascalon.

*Private credit:* Private credit has grown as an asset class in Australia and is closely linked to the Australian property market. Recent challenges have not proven to be systemic, but several bouts of idiosyncratic weakness could sufficiently weigh on Australia's economy that the RBA moves to cut rates.

*Sharp rise in unemployment:* The RBA expects rate hikes will push unemployment to 4.5%-5.0%. The most recent unemployment rate climbed to 4.6%. We suspect further increases in unemployment over the course of 2026 and 2027. If unemployment climbed above 5.0%, we suspect the RBA would consider cutting rates.

*AI bust:* An AI bust could reverse the distinct demand and supply shocks that are currently contributing to elevated inflation and rates in Australia. A reduction in imported inflation could also be assisted by reduced pressure from the build-out phase of AI, which is further adding to domestic pressure via domestic labour and construction bottlenecks.

*Productivity boom:* Weak productivity has been a challenge for Australia for some time. AI offers hope that Australia's productivity could rapidly improve, reducing inflationary pressures. We are sceptical that this will be delivered in a timeframe that would allow the RBA to reverse its hiking cycle.



## **Take advantage of elevated rates but prepare for volatility.**

The RBA faces a challenging outlook with elevated inflation but rising unemployment. The Bank clearly holds a hiking bias, and markets have given a green light for hikes. We suspect another hike is likely this year, but market pricing for almost three rate hikes could be disappointed. That means elevated government bond yields may find a peak in coming months, at levels that are the highest point since 2011. For investors that are looking for yield and downside protection, adding some Australian government bond yields could be beneficial within diversified portfolios.

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