

The Forward View Australia: Feb 26

Too much demand, not enough economy

NAB Economics and Markets Research



Overview

- The economy looks to have maintained much of the momentum gained through mid-2025 and the unemployment rate remains low.
- A number of indicators point to the economy running up against capacity constraints and there is a risk that inflation pressures persist.
- With underlying inflation expected to track above 3% for most of 2026, we see the RBA lifting rates to 4.1% in May.

Data released since mid-December show that the economy has held onto much of the momentum gained through mid-2025. Household spending data suggest growth remained robust in January after a strong Q4. The NAB Business Survey continues to show business conditions at a level consistent with trend growth, while forward orders have picked up in recent months.

Alongside the pick-up in private sector growth, there are signs that the economy has been pushing up against capacity constraints. Though employment growth has slowed, the unemployment rate remains low. The NAB Business Survey measure of capacity utilisation remains well above average, and the share of firms reporting “labour as a significant constraint” remains elevated.

CPI data for Q4 confirmed that inflation accelerated notably over H2 2025. While we expect some of this strength to unwind over coming quarters, the acceleration has been broad-based across the CPI basket. That said, the NAB Survey measures of costs and prices point to some easing in inflation pressure.

Looking forward, we expect growth to slow a little through 2026, but GDP growth to still track around 2% yoy. We have also softened our forecast for growth over 2027, which is also expected to be around 2%. The unemployment rate is expected to gradually drift higher, reaching 4.5% by the end of 2026.

On inflation, we see a gradual moderation in quarterly outcomes from here, and pencil in 0.8% qoq for the trimmed mean in Q1. Despite this easing, underlying inflation will track above 3% for most of 2026. For the RBA, this implies that a further tightening in policy remains appropriate. We expect another 25bp increase in May 2026.

We continue to see the largest downside risk for the Australian economy in 2026 emanating from a global shock, with domestic conditions remaining relatively strong. However, there has been little evidence to date of global uncertainty weighing on consumption, hiring, or investment decisions in the private sector. Indeed, global conditions have proven more resilient than expected six months ago.

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Key Economic Forecasts

	2024	2025(f)	2026(f)	2027(f)
Domestic Demand (a)	1.9	2.3	2.4	2.0
Real GDP (annual ave)	1.0	1.9	2.1	2.0
Real GDP (year-ended)	1.3	2.2	2.0	2.0
Employment (a)	2.3	1.7	1.6	1.5
Unemployment Rate (b)	4.0	4.2	4.4	4.5
Headline CPI (b)	2.4	3.7	3.5	2.5
Trimmed-mean CPI (b)	3.3	3.4	3.0	2.6
RBA Cash Rate (b)	4.35	3.60	4.10	3.60
\$A/US cents (b)	0.62	0.67	0.73	0.70

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

Chart 1: RBA Cash rate forecast

RBA Cash Rate Target and NAB Forecast

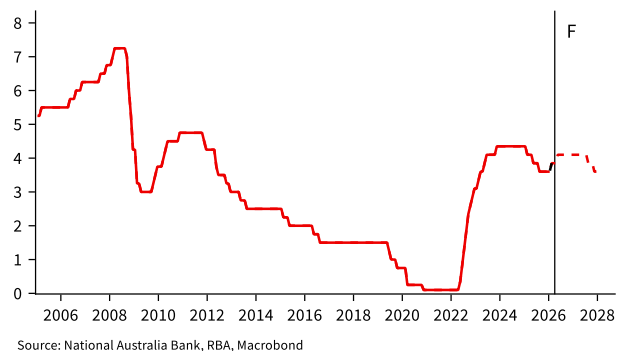
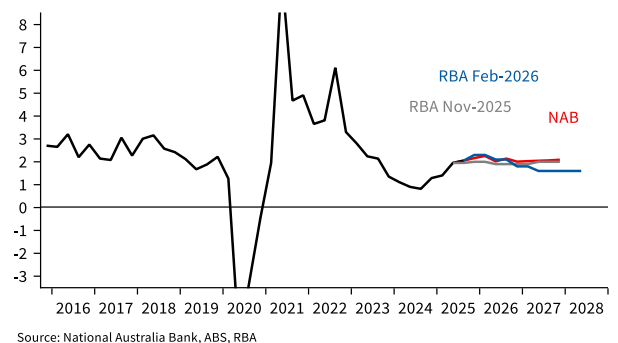


Chart 2: GDP forecasts

Australian Gross Domestic Product

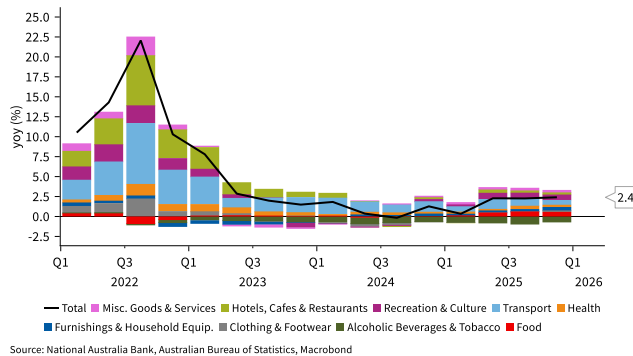


Consumption

Household spending is expected to be solid in Q4 but there is some risk of payback in early 2026.

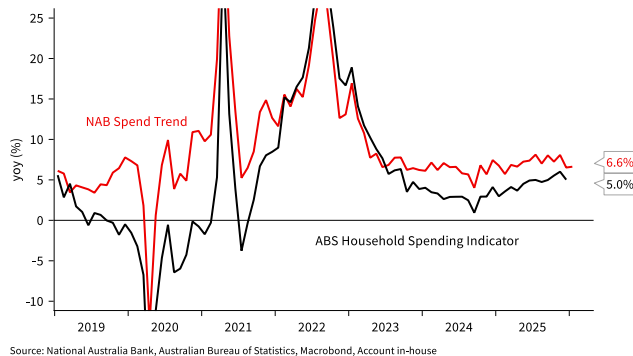
The ABS's Household Spending Indicator points to a 0.9% qoq rise in spending volumes in Q4. This was led by strength in discretionary categories, such as Furnishings & Household Equipment and Clothing & Footwear, as households pulled forward expenditure to take advantage of Black Friday sales. This suggests some downside risk to spending momentum in Q1 as demand normalises.

Contributions to Household Spending Volumes



However, partial data from [NAB's Consumer Spend Trend](#) shows no clear evidence of payback yet. Nominal spending rose 0.5% in January, with strength across personal and household goods. However, some of this strength may reflect higher prices (although Q4 price levels were higher than expected) and the data provide only a partial read on Q1 activity.

Nominal Household Consumption Indicators



Household consumption growth will be an important swing factor for GDP growth. We expect growth of 0.6% in Q4, but beyond this, momentum is likely to ease as real disposable income growth slows, reflecting the fading of key tailwinds such as the prior easing inflation and the boost from stage 3 tax cuts. As a result, we expect real household consumption growth to moderate to around 1.7% over the year to end-2026.

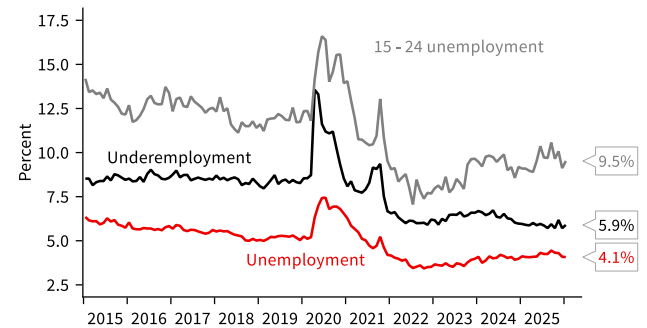
Labour market

The unemployment rate has fallen back to 4.1%, around the bottom of its 4.1 – 4.4% range of the past 12-months.

Trend employment growth slowed through most of 2025 and the unemployment rate tracked higher, but stronger outcomes late in the year have seen employment growth

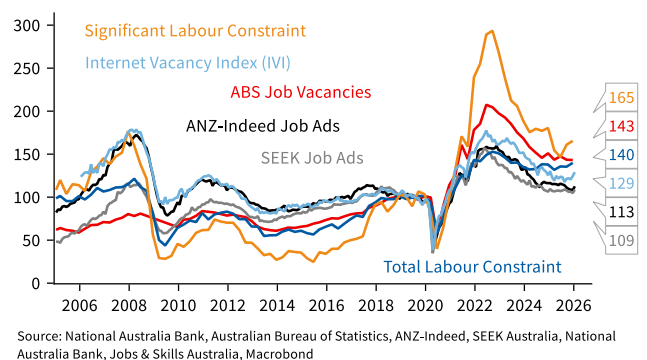
reaccelerate somewhat. Trend employment growth at 25k is just enough to keep pace with population growth, however, combined with a small decline in participation this has been enough to see the unemployment rate trend lower over recent months. This highlights a key dynamic where labour supply growth has been slower than overall population growth.

Australian Unemployment and Underemployment



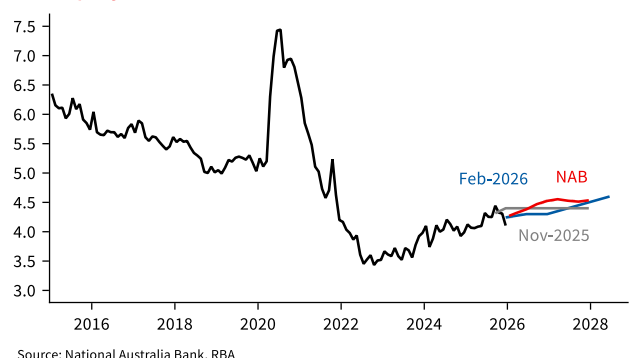
Availability of suitable labour remains a constraint for an elevated number of firms, and broader measures of labour demand have seen some stabilisation over recent months. That said some indicators, including job ads, are not particularly strong, and job finding rates for unemployed people are no longer high relative to longer run averages

Measures of labour demand



Overall, we expect the unemployment rate to gradually rise and reach 4.5% over the forecast horizon. Our view is that as the RBA leans against activity and places downward pressure on the economy it will begin to open spare capacity and labour market will loosen.

Unemployment Rate Forecasts

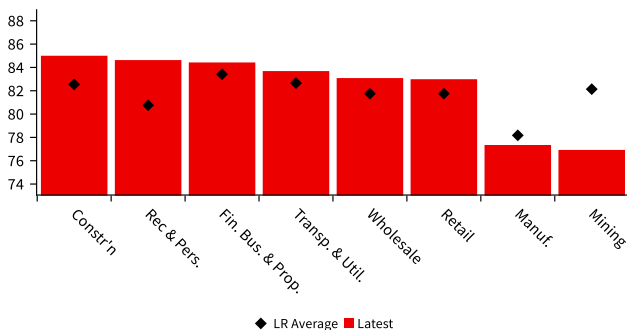


Businesses

Businesses conditions and confidence begin 2026 around their long-run averages.

The [NAB January Business Survey](#) showed that both business began 2026 in a solid position as conditions and confidence sit around their long-run averages despite easing toward the end of 2025. The prices and cost growth measures in the month reached new lows since 2021, however, labour costs remained the number one issue for firms in the December quarter survey. Capacity utilisation eased for the second consecutive month to be 0.6ppt lower than its recent peak but remains well above the long-run average and broad-based (with 6 of 8 industries above their long-run average). Overall, from the survey we continue to see the economy as having maintained most of its momentum gained through the past year.

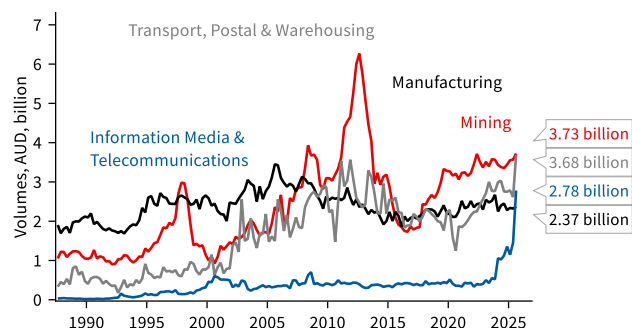
Trend Capacity Utilisation by Industry, January 2026



Source: National Australia Bank, National Australia Bank, Macrobond

In Q3 investment in data centres was a key driver of business investment growth. Using a long-run realisation ratio adjustment of the forward-looking element of the capex data we expect to see business investment remain strong in FY 2025/26. In the Q4 capex data we will be looking for further strong investment growth from Information Media and Telecommunications (IM&T), Transport and Postal and Warehousing (TPW) sectors. Over FY25/26 we expected to see a combined nominal growth of over \$9.1bn, contributing ~5% to nominal business investment growth.

Equipment, plant and machinery (selected industries)



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

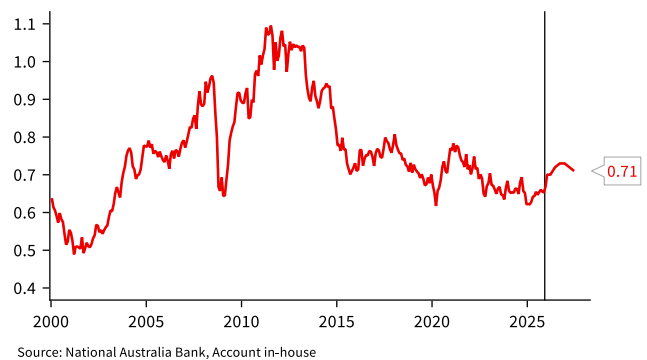
Foreign exchange

AUD/USD has appreciated to a three-year high and is expected to consolidate in a 0.70-0.73 range over 2026.

AUD/USD has reached a three-year high and is currently around US71c. The Australian dollar has been supported by several factors, including a widening interest rate differential between Australia and other advanced economies, higher commodity prices, broader weakness in the USD, and a move lower in USD/CNY.

Against this backdrop, FX Strategy have upwardly revised their Australian dollar forecasts. We now see the Australian dollar appreciating to \$US0.73c by the end of 2026 (prev. \$US0.71c, [see FX Strategy Forecast Update](#)).

NAB Forecasts, AUD/USD

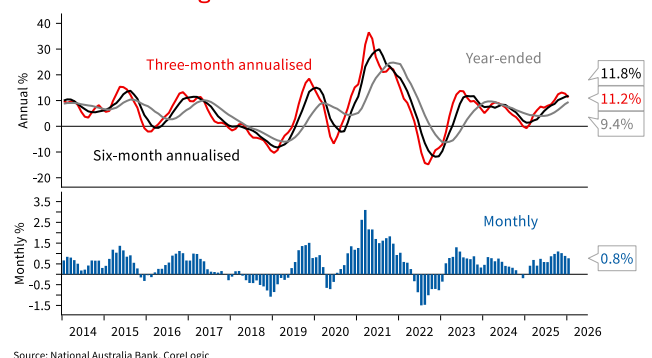


Housing

Housing price growth continues to slow but remains solid, with relatively soft outcomes in Sydney and Melbourne offset by strong gains in the other capitals.

Growth in the 8-capital city dwelling price index edged down further in January (to a still solid 0.8% mom). Gains in the month continued to be led by very strong outcomes in Perth and Brisbane, while Adelaide prices also rose by more than 1% in the month. Price growth remains much softer in Sydney and Melbourne which were up a more modest 0.2% and 0.1%, respectively.

Australian Dwelling Price Growth



Over the past 6 months price rises in Perth and Brisbane have well outpaced the gains in Melbourne and Sydney. Adelaide price growth has also accelerated over that period. Prices in Hobart have also recently gained momentum.

We have slightly revised down our forecast for capital city price growth over 2026, now expecting an increase in the 8-capital city price index of around 5%. We expect similar growth in prices of over 2027 (around 4%).

Dwelling Price Forecasts					
	Dec-23	Dec-24	Dec-25	Forecast Dec-26	Forecast Dec-27
Sydney	11.3	2.8	5.7	3.3	2.7
Melbourne	4.2	-2.0	5.0	2.1	5.8
Brisbane	13.5	11.4	14.5	12.0	4.9
Adelaide	8.8	13.6	8.5	9.5	3.7
Perth	16.2	18.4	16.2	13.3	6.2
Hobart	-1.8	0.6	6.7	2.8	2.4
Cap City Avg	9.7	4.9	8.2	5.3	4.0

We see modest price growth of around 3% in Sydney and Melbourne this year but, while slowing, we expect the mid-size capitals to see another year of solid growth. Though higher interest rates will weigh on price growth – particularly in Sydney where affordability is lower – the balance of supply and demand will mean that prices will remain well supported.

Rents growth also continues to be supported by low vacancy rates across the capitals and has re-accelerated somewhat through late 2025. The Cotality 8-Capital city new rents measure rose by 0.6% mom in January and the annual rate of increase has accelerated back above 5%. Over the past year, rents growth has been strongest in Hobart, which has seen a different cycle over recent years, followed by Perth and Brisbane on the mainland.

On the supply side, commencements rose by 6.6% qoq in Q3, driven by rise in detached houses, to be up 10% over the year. However, completions are still 1.2% below where they were a year ago, even after 7.5% growth in Q3. In rolling annual terms, completions continue to track just above 170 000 per year.

The ongoing imbalance between supply and demand will continue to support both price growth and rents this year, even as rates increase.

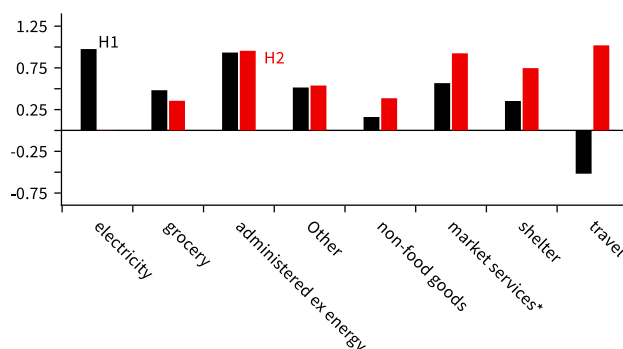
Inflation

Inflation is too high and is broad-based, but we don't think it is accelerating.

Trimmed mean inflation was 3.4% over 2025, above the RBA's target band.

While there were some swings in volatile components like electricity and travel prices, the materially higher inflation outcome over the second half of 2025 was broad based. Shelter, market services, and non-food goods all accelerated. Together, those three categories were contributing 1ppt more to annualised inflation over the second half of 2025 than they were in the first.

Contribution to 6m annualised inflation

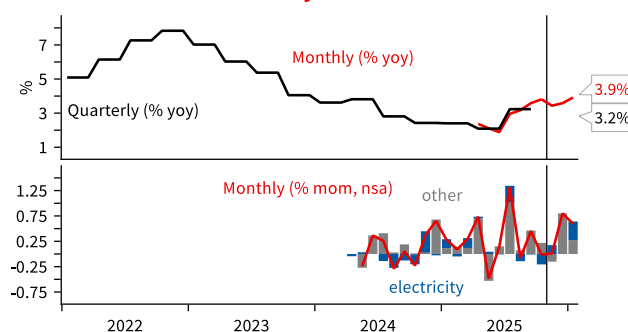


*excludes travel telco and rents, takeaway food considered a service
Source: National Australia Bank, ABS

Looking forward, trimmed mean inflation is expected to rise a little further on a year-ended basis as the more benign outcomes in the first half of 2025 drop out, but we expect some ongoing sequential slowing in quarterly outcomes.

Some of the strength in recent strong inflation outcomes reflects an easing of margin pressure for some consumer facing firms alongside the pick-up in consumption growth seen through 2025. Some discretionary service components, including meals out and takeaway, have already cooled from their mid 2025 levels, and recent consumer durables outcomes also point to a smaller contribution in Q1 than in Q4. Looking forward, the strengthening in the Australian dollar is another factor suggesting tradable goods components are unlikely to sustain inflation rates seen late last year.

Headline CPI and Electricity

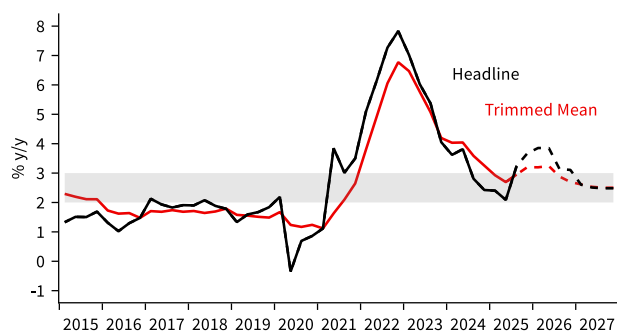


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

The NAB Business Survey also suggests some easing in final price growth for consumer facing industries, indicating that inflation is not accelerating further, but we still think that a large part of the inflation reacceleration can be attributed to the pickup in private demand in a capacity constrained economy.

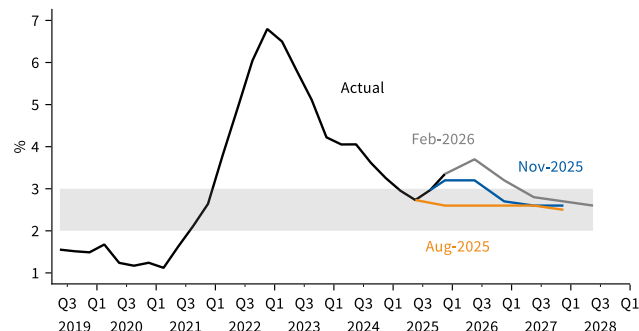
With financial conditions having tightened over the past few months and the RBA expected to follow through on some additional policy recalibration we expect those pressures to ease sufficiently for inflation to return towards target. But that process is expected to take time. We don't see year-ended underlying inflation below 3% for another 12 months.

Inflation Forecasts



Source: National Australia Bank, ABS, RBA

Trimmed Mean Inflation Forecasts, Year-ended



Source: National Australia Bank, ABS, RBA

Monetary Policy

Following the RBA's 25bps increase in the cash rate in February we continue to see a follow up increase in May, taking the cash rate to 4.1%.

Our central forecast remains for a modest recalibration of the stance of policy, returning the cash rate more clearly into restrictive territory. From there, we see rates on hold for an extended period before the RBA then once again moves to normalise rates back towards neutral by cutting twice in H2 2027.

Based on our outlook, inflation pressures are expected to remain elevated in the near term, but gradually cool – GDP growth is expected to track a little below trend and some labour market pressure is expected to ease. We see the unemployment rate increasing over 2026. Many of the tailwinds that have supported household income growth over the past year will fade, but household balance sheets are healthy. On balance while a recalibration in policy is appropriate, we do not expect a hiking cycle to extend more deeply into restrictive territory.

The latest set of RBA staff forecasts present a similar trajectory for the key economic variables. The RBA substantially revised up its underlying inflation forecasts with the trimmed mean expected to end the year at 3.2% yoy and only reach ~2.6% by mid 2028 (around 6 months later than previously).

Private sector growth has accelerated more quickly than the RBA expected and the updated staff assessment points to less supply capacity in the economy than previously thought. The RBA also continues to assess the labour market is tight, with model estimates pointing to an unemployment rate consistent with full employment in the high 4% range. The RBA's judgement-based assumption underlying their forecasts is 4.6%.

Given the higher starting point for inflation and the less favourable supply backdrop the RBA's forecasts imply the need for a period of below-trend growth (1.6% yoy over 2027) and a loosening in the labour market to bring supply and demand into better balance in the economy for inflation to return to the mid-point of the target band.

Our forecasts anticipate one further increase in the cash rate to 4.1% - which we see as a modestly restrictive stance. The RBA will need to deliver on this in order to ensure that conditions are sufficiently restrictive to bring the economy back into balance. We see a trend rate of growth in the economy that is slightly higher than the RBA's assessment of ~2%.

In terms of risks around the cash rate path, we see the near-term risk as tilted to the upside, with the RBA needing to take rates further into restrictive territory. While we expect the RBA to remain cautious and gradual, inflation has been and is expected to continue at an above target rate for an extended period. The Board's tolerance may be tested on "returning inflation to target within an acceptable time frame". Further, we agree with the RBA's own assessment that relative to history, broader financial conditions are looser than the policy rate alone would suggest.

Key Forecasts

Australia forecasts

	% Growth q/q					% Growth y/y			
	Q3-25	Q4-25 (f)	Q1-26 (f)	Q2-26 (f)	Q3-26 (f)	2024	2025 (f)	2026 (f)	2027 (f)
GDP and Components									
Private Consumption	0.5	0.6	0.5	0.4	0.5	0.9	2.5	1.8	1.6
Dwelling Investment	1.8	0.7	0.5	0.5	0.5	5.3	5.3	2.0	1.4
New Business Investment	3.7	0.7	0.1	0.3	0.2	-2.3	3.6	1.1	1.0
Underlying Public Final Demand	1.2	0.4	0.4	0.4	0.4	5.6	1.3	1.6	1.6
Domestic Demand	1.2	0.6	0.5	0.5	0.5	2.2	2.6	2.0	1.9
Stocks (Cont. to GDP)	-0.3	0.0	0.0	0.0	0.0	0.1	-0.2	-0.3	0.0
Gross National Expenditure	0.6	0.6	0.4	0.5	0.5	2.3	2.4	2.0	1.9
Exports	1.0	0.4	0.4	0.4	0.4	1.7	3.5	1.7	1.7
Imports	1.5	0.6	0.4	0.4	0.4	6.2	4.6	1.6	1.1
Net Export (Cont. to GDP)	-0.1	0.0	0.0	0.0	0.0	-0.9	-0.2	0.0	0.2
Real GDP	0.4	0.6	0.5	0.5	0.5	1.3	2.2	2.0	2.0
Nominal GDP	1.7	1.5	1.2	1.3	1.1	3.5	5.3	4.7	4.1
Labour Market									
Employment	0.1	0.4	0.6	0.4	0.4	2.2	1.3	1.7	1.6
Unemployment Rate (Q-Ave, End of Period)	4.3	4.2	4.2	4.3	4.4	4.0	4.2	4.4	4.5
Wage Price Index (WPI)	0.8	0.9	0.8	0.8	0.8	3.2	3.5	3.2	3.2
Inflation and Rates									
Headline CPI	1.3	0.7	1.4	0.8	0.7	2.4	3.7	3.5	2.5
Trimmed-mean CPI	1.0	0.9	0.8	0.8	0.7	3.3	3.4	3.0	2.6
RBA Cash Rate (End of Period)	3.60	3.60	3.85	4.10	4.10	4.35	3.60	4.10	—
10 Year Govt. Bonds (End of Period)	4.34	4.76	4.95	5.00	5.10	4.48	4.76	5.00	—
\$A/US cents (End of Period)	0.66	0.67	0.70	0.72	0.73	0.62	0.67	0.73	—

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

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