

Weekly Economic Update



2 October 2026

The Reserve Bank delivered on expectations on Tuesday ... and rescued its at-risk credibility in the process. The fourth rate hike this year was fully priced and forecast by all sensible economists. It was one of those “no brainer”, unanimous policy decisions that come along every now and then.

But the 9-zip decision to hike (including by the head of the Treasury!) was an abrupt turnaround from the 9-nil vote for "on-hold" last month. What changed in just six weeks? The upside risks to inflation a month ago are materialising, which forced the Bank's hand. Tanking house prices (see below) leaned towards an on-hold decision, but this diversion was outweighed by the worsening inflation dynamics.

This was reinforced the very next day when the August inflation data came in hot at 4% over the year, up from 3.5% in July. That's above the RBA's target range and accelerating away. The persistence of inflation strengthens the case for even more hikes, even though higher petrol prices fuelled much of the latest rise. The RBA's business liaison feedback revealed that higher energy prices are being passed on to other prices. As they always are.

Indeed, the Bank has work to do - this economist forecasts that another two hikes will be needed just to get inflation back in the paddock, let alone in the stable. It's bolted. Governor Bullock agreed in her post-decision presser that the Bank may have to push the economy into recession to curb inflation although, thankfully, that's not the base case.

Australia's inflation problem is home grown. Yes, there are global factors, like the war in Iran. But our persistent inflation problem is thanks mainly to profligate government spending and our lousy productivity effort, which has slashed potential growth.

The Governor confirmed that inflation stems from "domestic capacity pressures" and that "productivity is doing nothing". Crystal ... clear.

There are domestic pressures from the data centre/AI investment boom, despite the government's simultaneous efforts to regulate AI into submission while gloating about its benefits. The nascent boom is adding to competition for labour and resources, pushing up prices. Wage rises without productivity offsets are the bitter icing on the inflation cake.

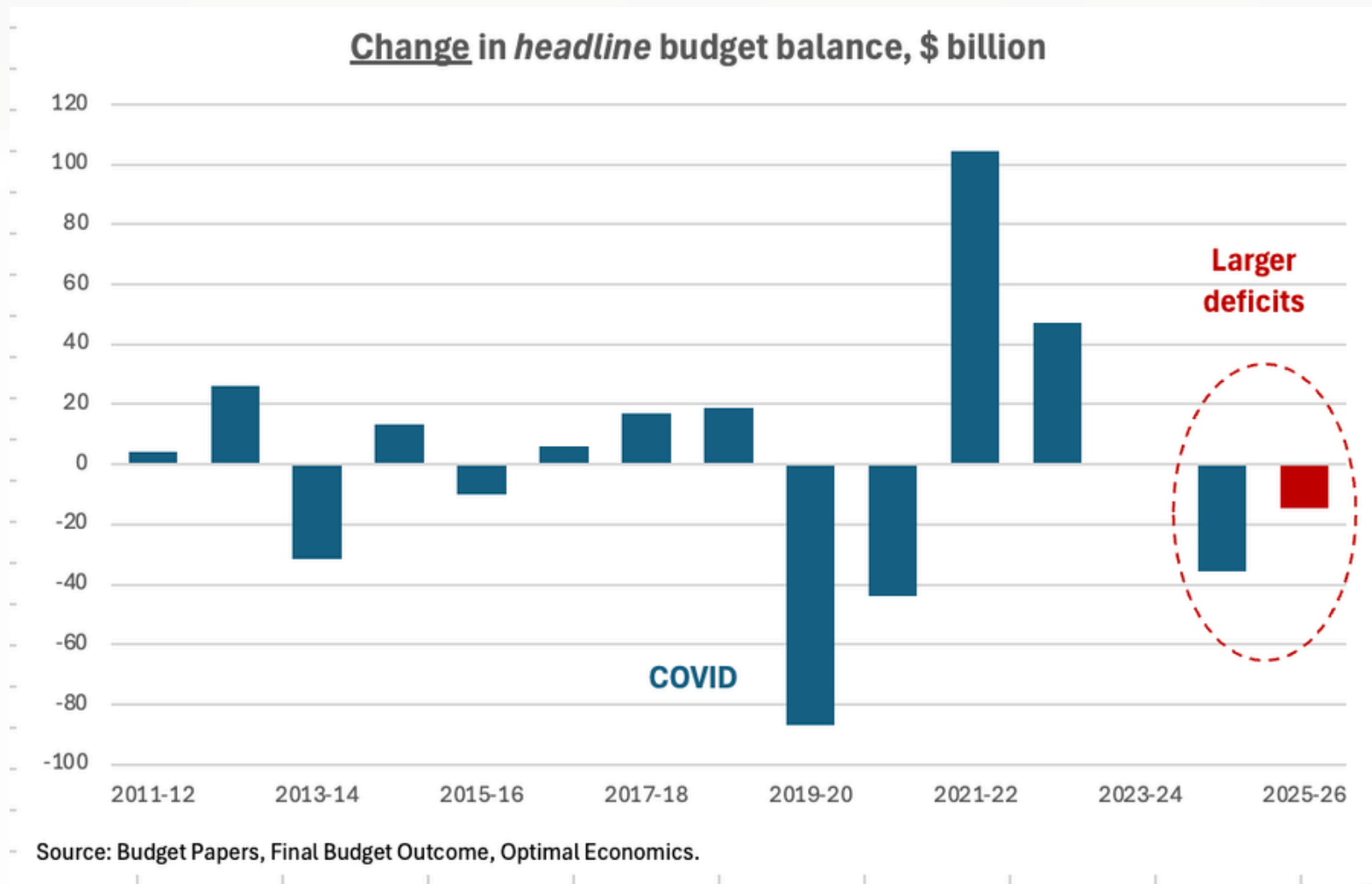
Government spokespeople again pushed back on the truism that the public spendathon is adding to inflation while announcing an improved budget outcome for 2025-26. But calling spending “investment” does not make it so. It's just spending, which adds to aggregate demand when supply is constrained. See “lousy productivity” above.

Yes, the budget ended last fiscal year in "better nick" relative to the more pessimistic budget forecast, but mainly because the tax take rose to a 20-year high. Taxes are rising to fund the highest Commonwealth spending share of GDP since Paul Keating was a novice treasurer (outside the pandemic period). The government should be running whopping surpluses, not persistent deficits. Your mission, Jim, should you choose to accept it ...

Looking past this week's spin, the headline budget deficit last year was bigger than the year before, not smaller (see chart over page). Monetary and fiscal policy, therefore, continue to pull firmly in opposite directions. This is an unsustainable tussle that will end in tears. The RBA will “win” this fight and keep raising interest rates for as long as necessary to get inflation under control.

Yesterday, the September house price data showed another 1.1% decline nationally, taking the steep fall in capital city prices to 6.4% in a matter of months. We're now three-quarters of the way to the record price decline of 8.4% in the extended correction of 2017-19. The rate hike won't help and nor will the meltdown in private credit markets, which is spreading. It's getting ugly.

Finally, household spending flatlined in August, the worst result since April. There was a big rise in outlays on transport, thanks to higher petrol prices, but most of the discretionary categories went backwards. Many of the punters are in full retreat.



Stephen Walters
Chief Economist,
Optimal Economics

Call us:
+61 499 976 196

Email:
stephenwalters@optimaleconomics.com.au

Website:
<https://optimaleconomics.com.au/>