Weekly Economic Update

OPTIMAL ECONOMICS

28 August 2026

Inflation came in hot in July, which keeps alive discussions about whether the Reserve Bank will raise interest rates again (it will). Inflation was 1% in the month of July as the government's fuel excise relief ended, but the annual inflation rate dipped a touch to 3.5%. Still, that's well above the RBA's target and inflation risks remain skewed to the upside.

On the outlook, the minutes from the Board meeting held two weeks ago confirmed members did not even consider the merits of an interest rate cut when deciding to leave the cash rate steady. Futures markets price a 90% chance of a single rate hike before the end of the year. This economist thinks the risks skew toward two hikes.

The economic data this week was mixed. Households continued to spend up big time in July, with spending rising more than 1% for the third month running, although some of this reflects price rises. But the Q2 business investment data was weak, following the data-centre driven boom in the previous quarter. Firms' investment spending actually fell last quarter, although it was up over the year.

Both pieces of information will flow into next week's Q2 GDP result, out Wednesday. It looks as though Australia's economy grew only modestly over the quarter, with higher government spending again a dominant contributor. All eyes will be on the productivity result in the National Accounts – Australia is in the midst of its worst productivity performance since the 1960s.

Meanwhile, the national housing market correction continues, with auction clearance rates dipping again last weekend. The spring selling season is fast approaching, which means more properties hit the market.

With buyers spooked by the tax changes and the prospect of even higher interest rates, house prices will have to fall if the market is to clear. This price correction is nowhere near over.

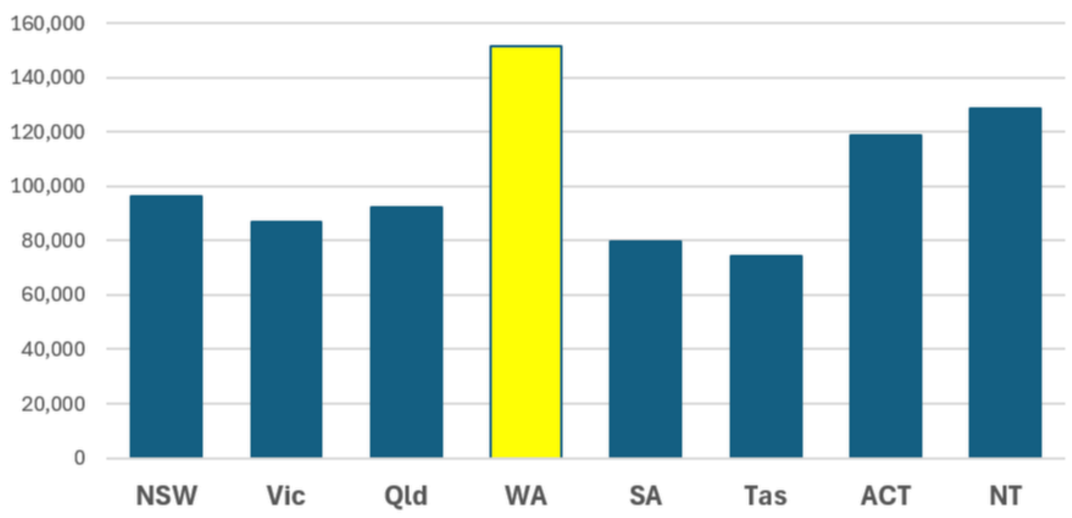
Finally, the undignified shouting match about Western Australia's generous GST distribution continues. The PM this week ruled out changes as the Productivity Commission deputy chairman pushed back against the unseemly language used in the "debate". After advocating for change, the pointy-heads at the PC variously were called "economic rationalists" and "clowns from the east" - it's not clear which is worse.

This is referring to the 2018 policy abomination under which a floor was set under GST distributions. Under this fix, a much higher share of revenue now goes west than under the Grants Commission's unbiased assessment. Federal taxpayers are on the hook for the top ups. The cost to federal coffers already has blown out to $6 billion per year ... and could yet double if iron ore prices rise.

The sweet deal for WA is despite the state having by far the highest value of output (and income) per person, as the chart below shows. The "rational" economics of this scream for change - the febrile politics demand inertia. (This economist is travelling to Perth this week - hopefully I'm allowed to enter the state of my birth, despite upsetting Sandgropers with the comments above).

See graph over the page

Per capita gross state product, 2024-25, $



Source: ABS, Optimal Economics.

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