RESERVE BANK OF AUSTRALIA

Speech

On the Rail or Off to the Races? The Outlook for the Australian Economy

Andrew Hauser [*]

Deputy Governor

UBS Australasia Conference

Sydney – 10 November 2025

49:02

Introduction

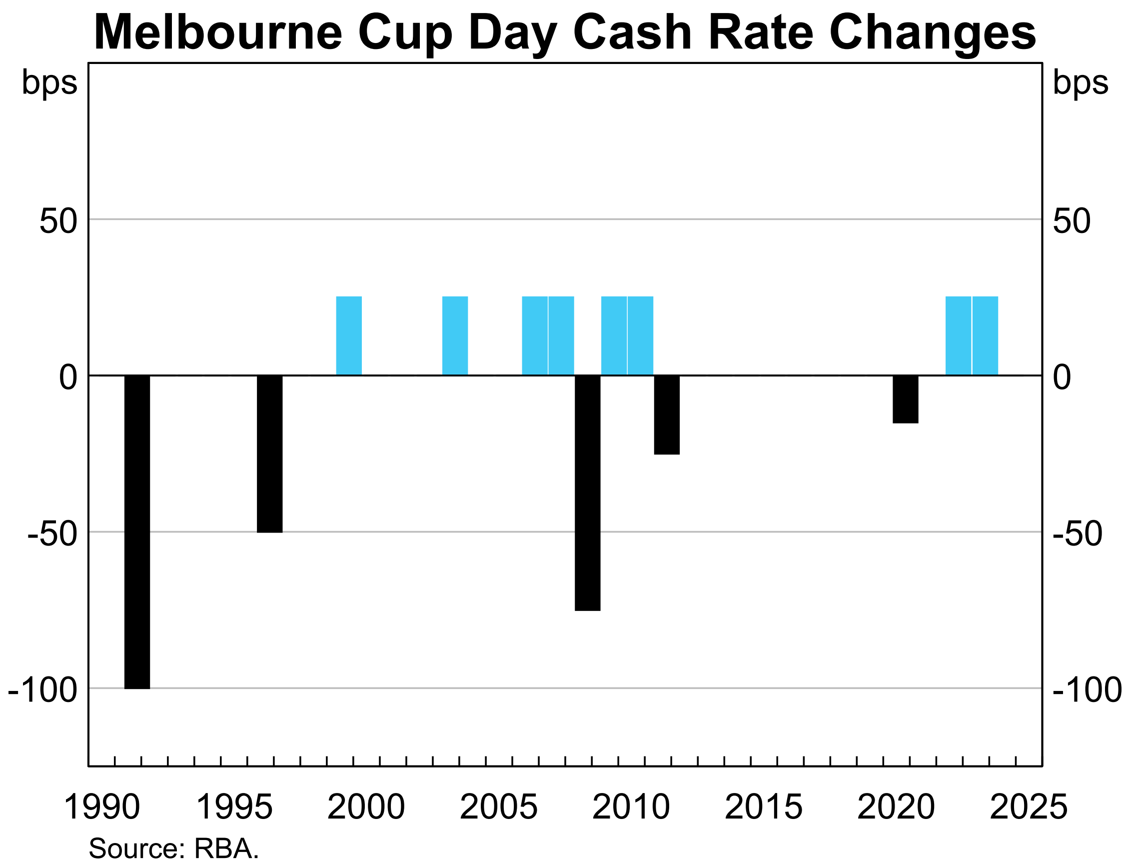
It’s great to be here with you today, to speak with, and hear from, investors from Australia and around the world.

The timing of this conference is auspicious. That's true from a global perspective, of course, as we navigate an extraordinary inflexion point in world economic affairs. But it's true locally, too, because it's just a week after Australia's most famous horse race – the Melbourne Cup. For decades the RBA has made its November interest rate decision on Melbourne Cup Day. Not to spoil the mood – but simply because, long ago, both the Reserve Bank and the Victoria Racing Club laid claim to the first Tuesday in November – and neither has yielded since.

For a time in the 2000s, the tendency to raise interest rates on the day – and even close to the time – of the race gave newspaper editors a field day: 'rates gallop ahead as Cup Day looms', the 'double gamble', or a cartoon of the entire Reserve Bank Board of many years ago precariously perched on a single horse, one member cracking the whip while another pulls on the economic reins. [1]

Over the longer sweep of history, however, increases have proved few and far between (Graph 1). Melbourne Cup Day has much more often seen rate holds or rate cuts – and some big ones at that (in 1991, 1996 and 2008). The RBA's Monetary Policy Board added another hold to that tally last week.

Graph 1



In my remarks today I want to put that decision in context, looking back at the economic events of the past year, before turning to the outlook.

Monetary policy in Australia faces an unusual challenge – the recovery in GDP growth began last year with a higher level of capacity utilisation than at the start of any other recovery in over 40 years. That's a real achievement, when it comes to making full use of the economy's available resources. But it also poses a big, and pressing, question. Could Australia find itself trapped on the economic rail like one of the riders in last week's Cup – boxed in by its own capacity constraints? Or will it find ways to break free, through higher productivity and more investment in new capacity? If it does, we could be off to the races.

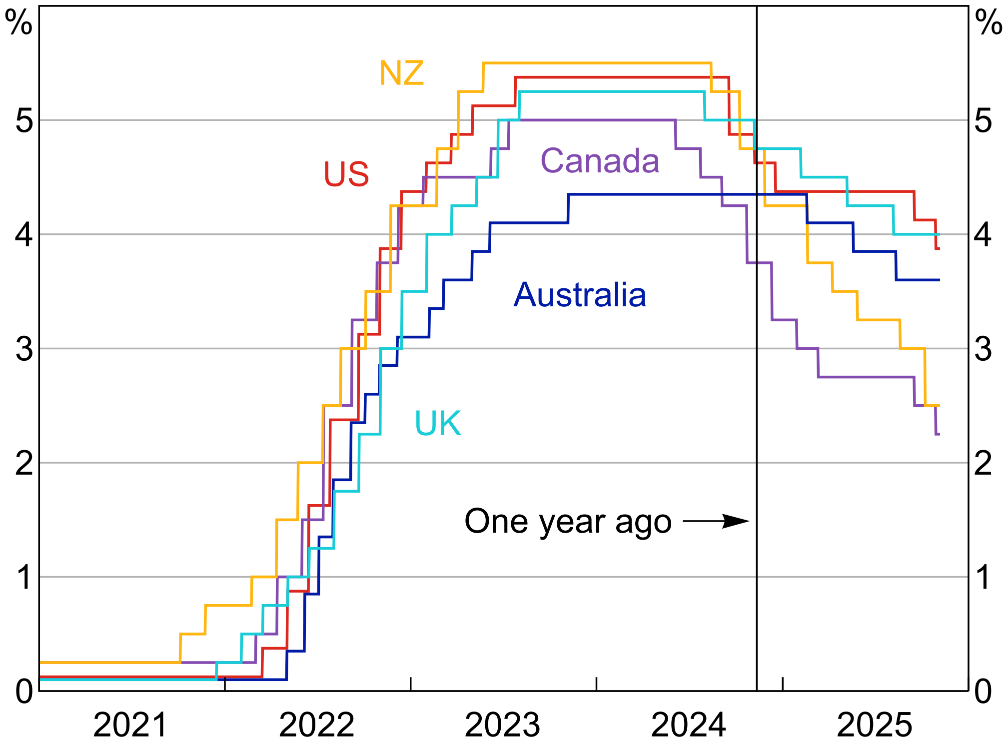
Looking back: The year in review

A year ago, GDP growth had bottomed out at just 0.1 per cent in the June quarter. With most other advanced economy central banks having already cut their policy rates several times earlier in the year, some felt we were behind the curve, anticipating that we would be forced into a sharp easing to make up lost ground. From the Board's perspective, that view underweighted three key points. First, we had explicitly adopted a different monetary policy strategy to others, in which, having not tightened as much as others, there was also less imperative to cut aggressively (Graph 2). Second, underlying inflation remained well above the 2–3 per cent range, something the Board judged required it to maintain a clearly restrictive stance until it could be confident that inflation would settle sustainably at target.[2] And, third, activity was already expected to pick up in the near term, supported by public demand and a gradual strengthening in household consumption, as real incomes were boosted by lower inflation and the Stage 3 tax cuts.

As 2024 turned towards 2025, another pessimistic lens for the Australian economic outlook emerged, in the form of a new US administration seemingly determined to use tariffs and other policy levers to reshape global trade relationships, particularly with China – Australia's biggest trading partner.[3] Some felt this added to the need for a sharp, perhaps even pre-emptive, easing in our policy settings.

Graph 2

Advanced Economy Policy Rates



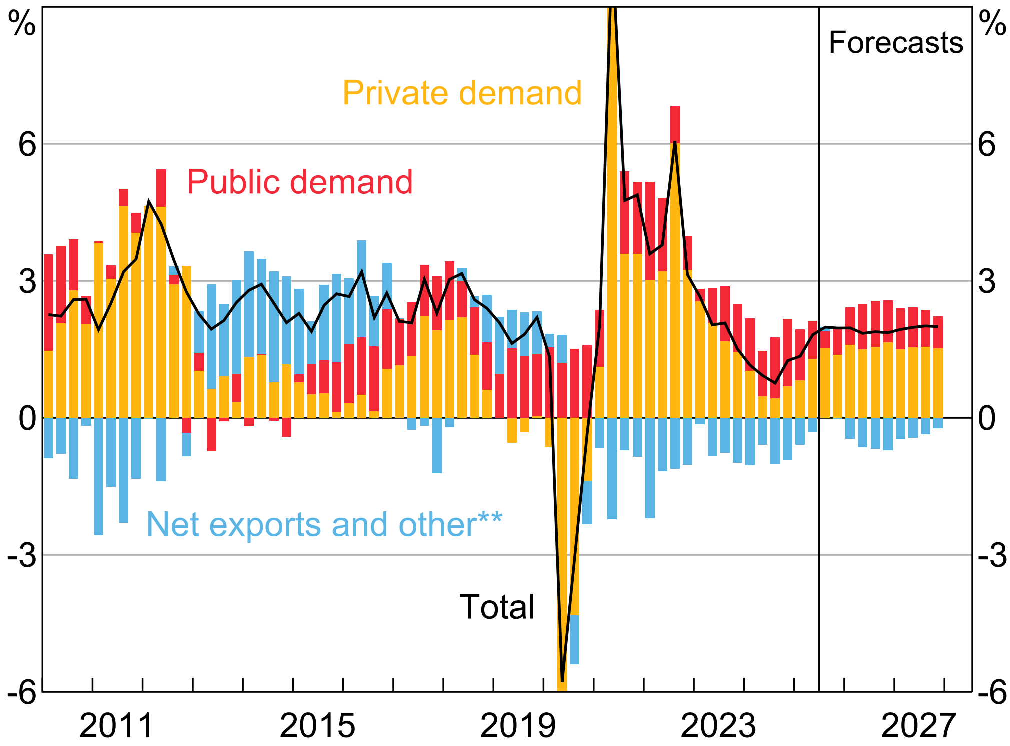
Sources: Central banks; RBA.

A year on, few of those worst fears have come to pass.[4] GDP growth did pick up from the September 2024 quarter, driven by the predicted recovery in private domestic demand (Graph 3). US tariffs have so far proved smaller and narrower in scope than feared in the wake of the 'liberation day' announcements; and the limited retaliation, widespread trade rerouting and targeted policy stimulus, including in China, have dampened, or in some cases even offset, the drag on global growth from tariffs. Commodity prices and financial markets have generally held up. And the feared impact of global policy uncertainty on Australian consumer and business confidence has so far failed to materialise.

Graph 3

GDP Growth*

Year-ended with contributions



* Outliers during the COVID-19 pandemic have been truncated.

** Includes change in inventories and the statistical discrepancy.

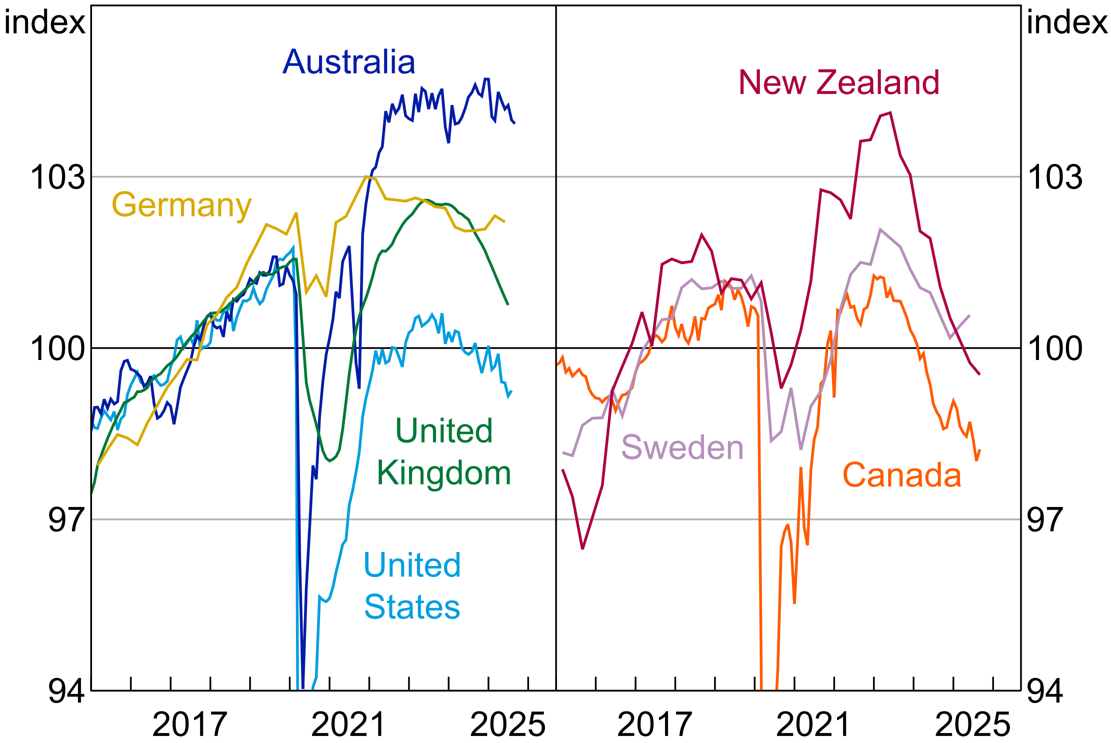
Sources: ABS; RBA.

Employment continued to grow strongly, supported by public demand in the market and non-market sectors. Indeed, normalised by population size, employment in Australia has remained higher and more stable than in any of the other advanced economies shown in Graph 4, compared to pre-pandemic levels.[5]

Graph 4

Employment-to-population Ratios*

2015–2019 average = 100



* Outliers during the COVID-19 pandemic have been truncated.

Sources: LSEG; RBA.

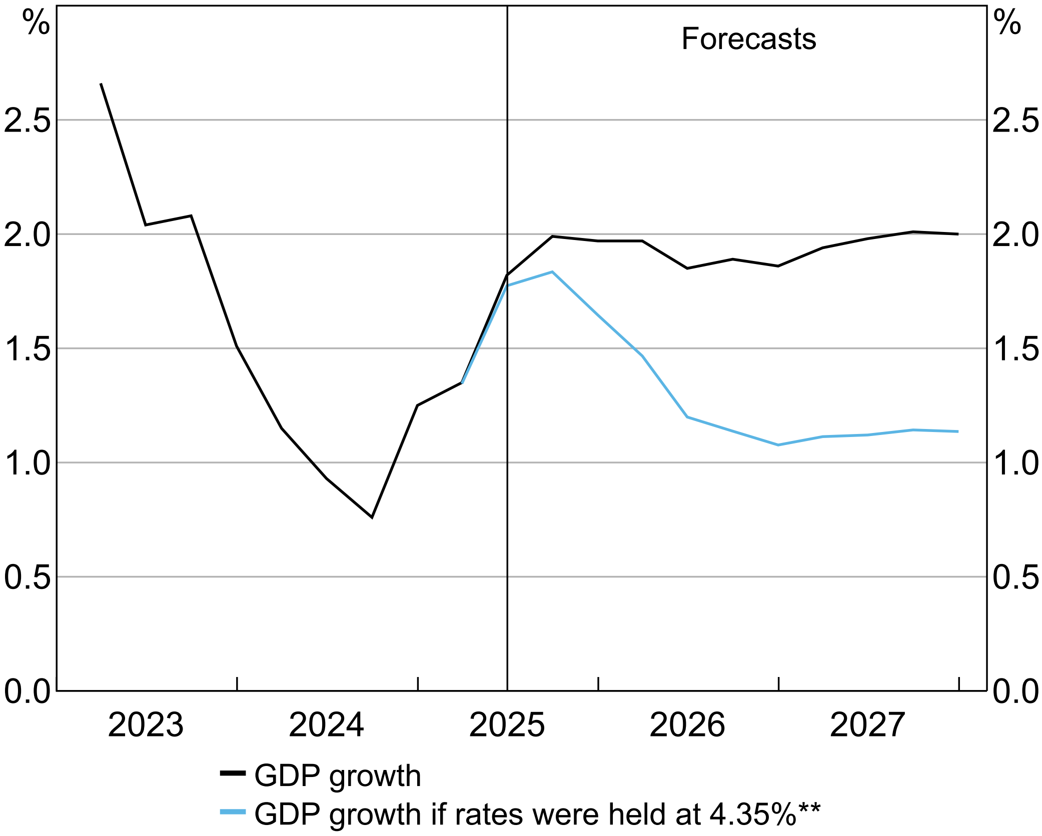
Alongside these developments, the further decline in inflation through the end of 2024 and into 2025 gave us greater confidence that it would return sustainably to target over the medium term. That allowed us to begin reducing the degree of policy restrictiveness, cutting the cash rate target by 75 basis points between February and August 2025.

The normal lags in monetary transmission mean those cuts won't have had much impact on activity during the first half of 2025. But they will play an important role in supporting growth from late 2025 as the impulse from public demand and last year's tax cuts wanes. To bring that to life, Graph 5 shows an estimate of the counterfactual path of future GDP growth if the cash rate target had been held at 4.35 per cent.

Graph 5

Effects of Policy Easing*

Year-ended GDP growth



* Difference in growth outcomes between November SMP forecast and a counterfactual scenario produced with MARTIN where interest rates are held steady at 4.35% from 2025:Q1 to the end of the forecast horizon; the impact of cash rate cuts is relative to a scenario where policy is restrictive and would have slowed the economy.

** Historical data also 'shocked'to estimate impact of rate cuts on growth.

Sources: ABS; RBA.

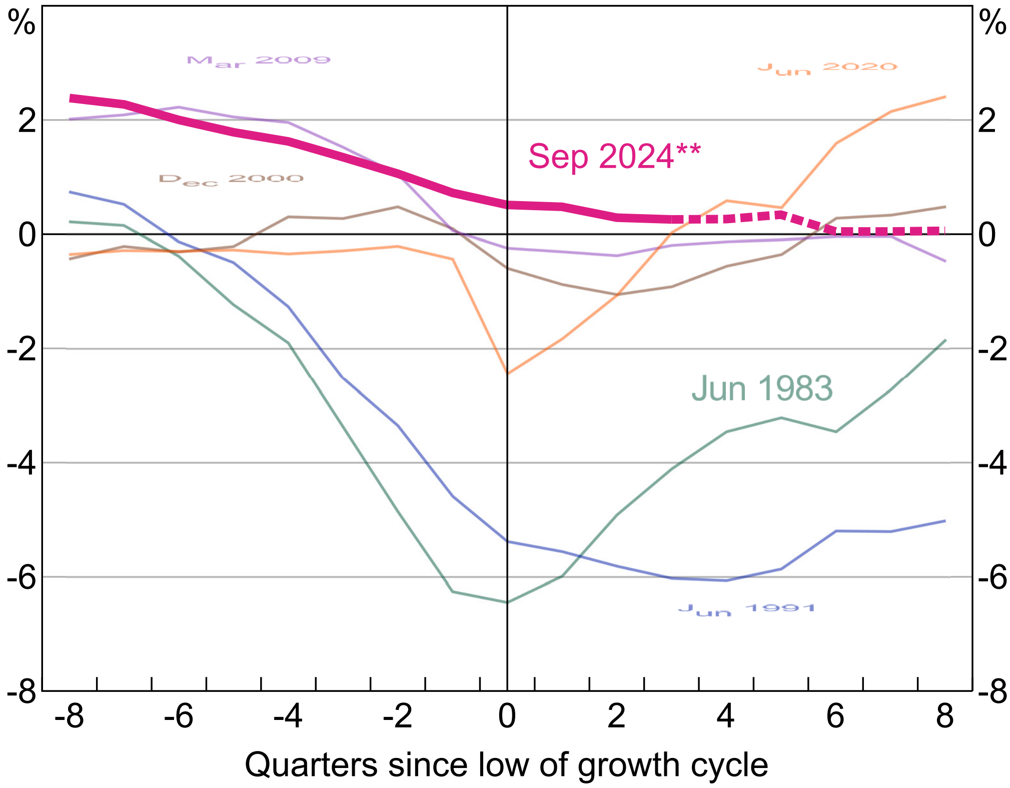
Looking ahead

So macroeconomic outcomes over the past year were less severe than some feared. But monetary policy must be set not through the rearview mirror but in anticipation of where the economy is going in the future. For inflation, that depends on the balance of demand and supply – and here we find ourselves in an unusual place.

To see that, consider Graph 6. It shows that most recoveries in GDP growth over the past 40 years typically start with some margin of spare capacity – a negative 'output gap' – as the preceding slowdown pushes the level of aggregate demand below estimates of the potential output of the economy. As the economy recovers, that buffer typically provides room for a period of above-trend growth in activity and employment, as demand rises back towards potential output, without generating excessive inflationary pressures.

Graph 6

Non-farm Output Gap*



* Output gap estimated as an average of the RBA's model suite; estimates are subject to substantial uncertainty, as well as revision due to data and model refinements; growth cycle lows represent key turning points in the year-ended growth rate of real GDP.

** Dashed line represents forecast.

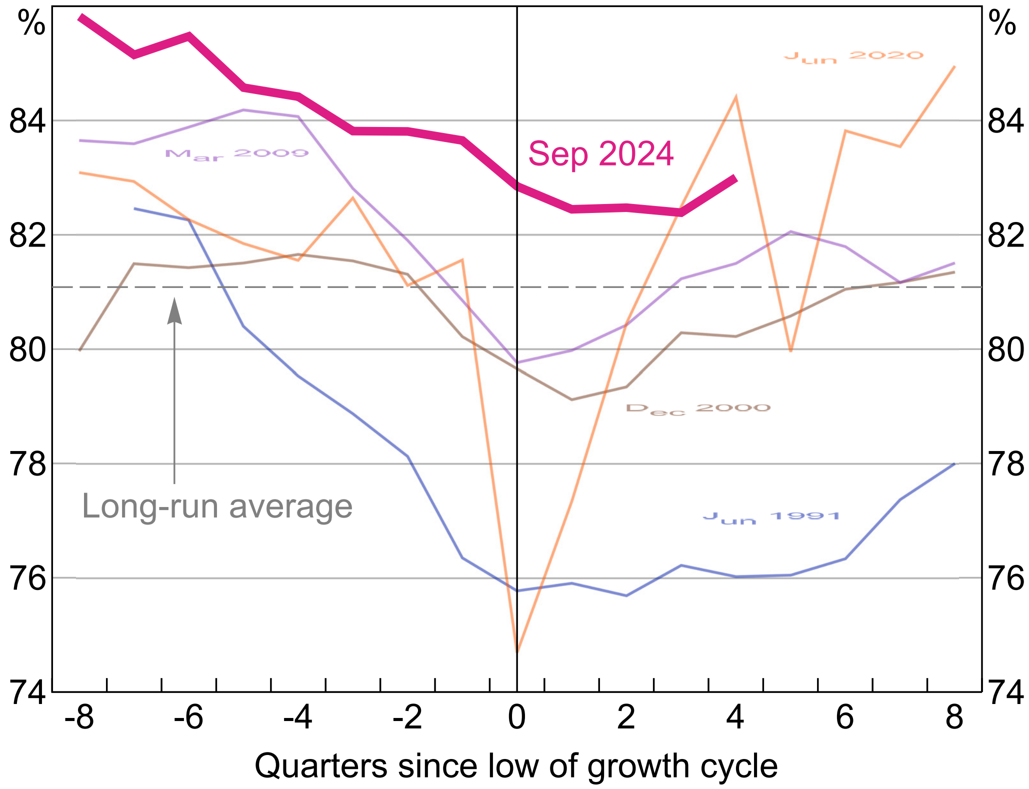
Sources: ABS; RBA.

But this time looks different. Our central estimate suggests that demand was slightly above potential output at the time GDP growth started to pick up last year – the tightest economic backdrop to a recovery since at least the early 1980s. As the November *Statement on Monetary Policy* sets out, that can still be consistent with bringing inflation back to target over the medium term.[6] But achieving that goal will require policy to be restrictive enough to keep shrinking the gap over that period. The path implied by those forecasts is shown in the dotted line on Graph 6.

The historical comparisons in the Graph are based on model-based estimates. So, although we try to control for model uncertainty by averaging across a range of alternative approaches, and also adjust for known disturbances to supply including the COVID-19 pandemic, the bands of uncertainty remain large.[7] Nevertheless, the ranking of this cycle relative to others does seem robust. To see that, Graph 7 repeats the same exercise using the NAB business survey, which asks companies directly about their capacity utilisation. No models, no equations – but the same result: capacity utilisation was higher at the start of the current recovery than in any similar situation in recent decades, and materially above the whole-period average.

Graph 7

Capacity Utilisation*



* Growth cycle lows represent key turning points in the year-ended growth rate of real GDP.

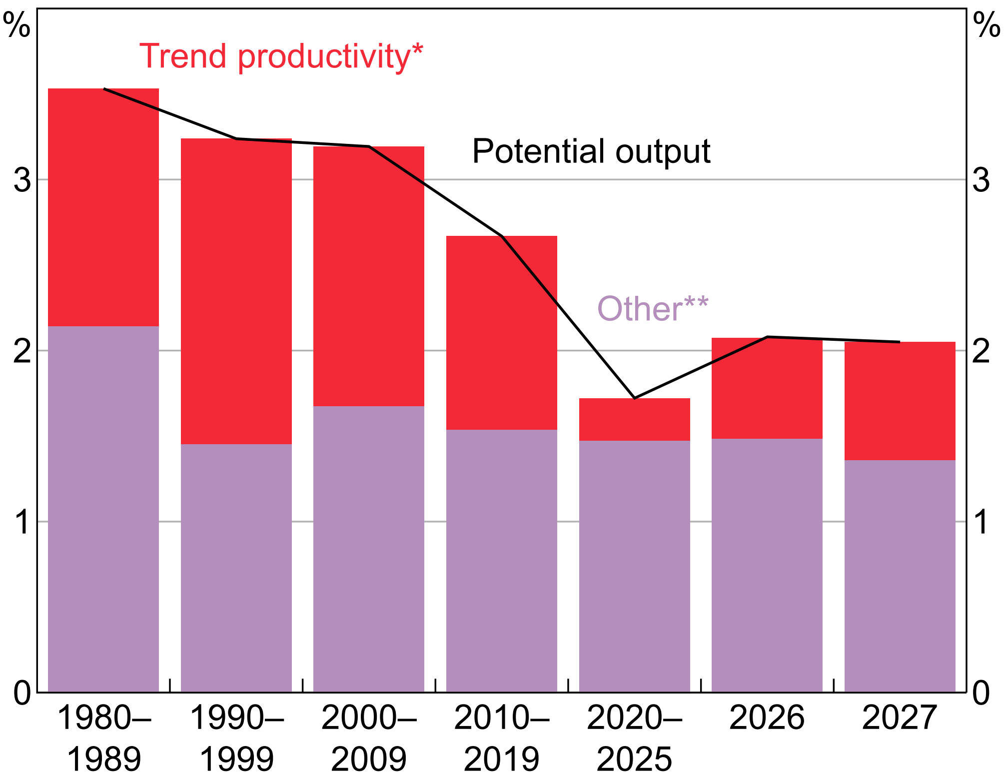
Sources: NAB; RBA.

How did this come about? It's not because demand growth in the past year or so has been particularly strong – far from it. Instead, it's the cumulative effect of rapid demand growth in 2021–2022, the deliberately cautious monetary policy strategy of more recent years, and – importantly – weak growth in supply. To make that last point explicit, our estimate for potential output growth fell from 2½ per cent a year in the decade before the pandemic to 1½ per cent in 2020–2025; and we expect it to pick up only a little to around 2 per cent in each of the next two years (Graph 8). That reflects the downward revision we made in August to our near-term assumption for annual trend productivity growth, from 1 per cent per year to 0.7 per cent.[8]

Graph 8

Potential Output Components

Annual average growth



* Using the average of the three models in the potential output model suite (SMOG-PPE, Joint-stars and Production Function model).

** Other contributions from population, participation and average hours growth.

Source: RBA.

The absence of spare capacity is good news: it means busier companies and more jobs. Achieving sustainable full employment is a key part of the Monetary Policy Board's mandate.[9] But it does pose challenges for policy setting. Those challenges were highlighted by the latest data, which showed underlying inflation rising to 3 per cent in the year to September – ½ percentage point higher than expected in our August forecasts – at the same time as unemployment also rose to 4.5 per cent in September.

How will this play out? In the spirit of the Melbourne Cup, let me sketch three different tracks the race could take.

Track A: Still ground to make up?

On one view, the pictures in Graphs 6 and 7 overstate the degree of inflationary pressure in the economy. Maybe there's more capacity today than the estimates suggest;[10] maybe the outlook for demand is weaker (opening up a larger future margin of spare capacity); or maybe capacity pressures have only a weak effect on inflation.[11] On this view, the Australian economy still has ground to make up – and further policy easing may be necessary at some horizon.

Someone taking this position might note that the pick-up in CPI inflation in the September quarter could prove entirely temporary, a function of volatile and one-off price increases with no persistent implications for inflation. The labour market may turn out to have greater capacity than currently thought, and hence may weaken further on current interest rate settings. Overall employment growth has fallen as slower growth in non-market sector jobs has outpaced the pick-up in the market sector; the unemployment rate has ticked up, and growth in the Wage Price Index has eased relative to last year. Activity may slow: consumer confidence, for example, remains substantially below historical averages. And global conditions could yet prove deflationary if tariffs and labour restrictions weigh on US demand, Chinese exporters offer bigger discounts, or stretched valuations in financial markets prove unsustainable (perhaps in a disorderly way).

Track B: Boxed in on the rail?

A second view gives more credence to the picture in Graphs 6 and 7, fearing that the economy may find itself boxed in by its own capacity constraints, like a racehorse trapped against the course fence, unable to surge forward. On that view, there may be little scope for demand growth to rise further without adding to inflationary pressures, and hence there may be little room for further policy easing.

Observations consistent with that view might include the fact that the pick-up in inflation in the September quarter was broadly based across expenditure categories. Financial conditions may no longer be restrictive: credit spreads and equity risk premia are at or close to all-time lows; banks are competing to lend to businesses and households; and the cash rate is sitting below some estimates of neutral that place most weight on world long-term market interest rates. Private domestic demand growth has picked up a little more rapidly than previously forecast, and household income and wealth are increasingly supportive of stronger consumption. In the labour market, firms continue to report recruitment difficulties, unit labour costs are growing strongly and a range of models suggest the market may be tighter – not looser – than our central case. And finally, the world economy may yet confound everyone: with investment in AI and other technologies beating the tariff effect on the US economy, supported by accommodative policy settings; the commodity and product markets most relevant to Australia, including in China, remaining strong; and financial markets surging on, at least for now.

Track C: Off to the races?

If we *do* find ourselves boxed in on the rail in this way, the only escape route is to grow the capacity of the economy.

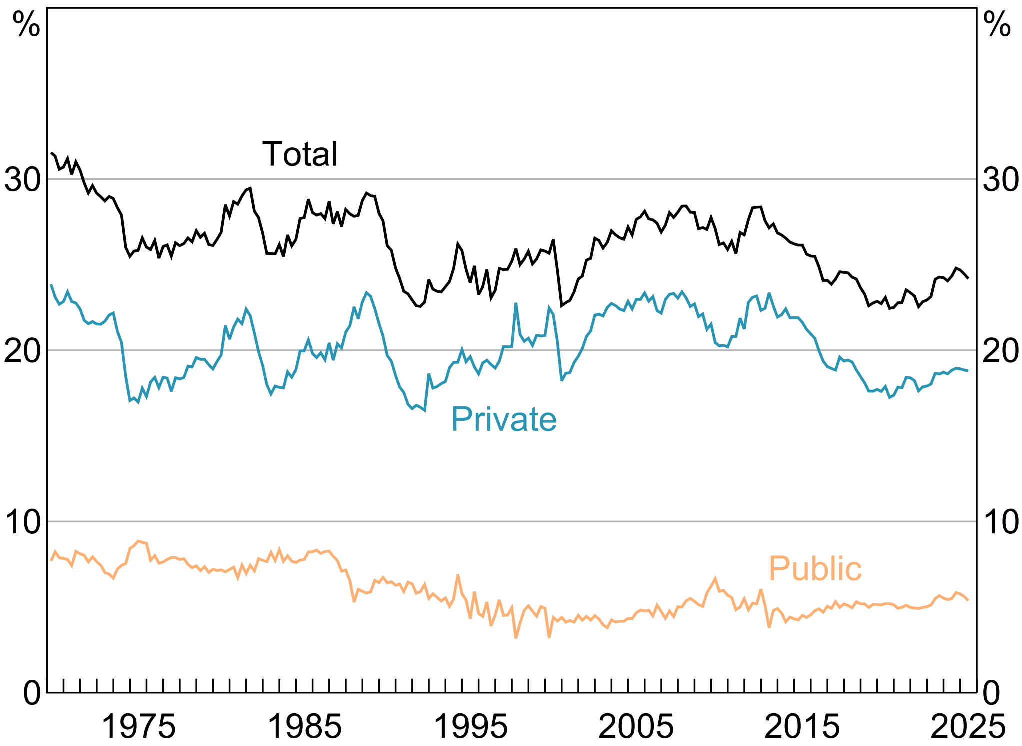
To be clear – the RBA's projections already assume some pro-cyclical pick-up in labour productivity, as firms make fuller use of existing staff and mothballed capital, and paused investment projects are brought back online.[12] But this is still assumed to cap non-inflationary growth at around 2 per cent over the next two years (Graph 3) – a far from spectacular performance by historical standards.

Expanding productive capacity further will require time and investment – and here there is work to do. Real business investment has been flat over the past 18 months, and capital expenditure intentions suggest little or no growth over the 2025/26 financial year. And private investment, which also includes housing investment, remains well below its peak of the mining boom as a share of GDP (Graph 9).

Graph 9

Investment*

Share of nominal GDP

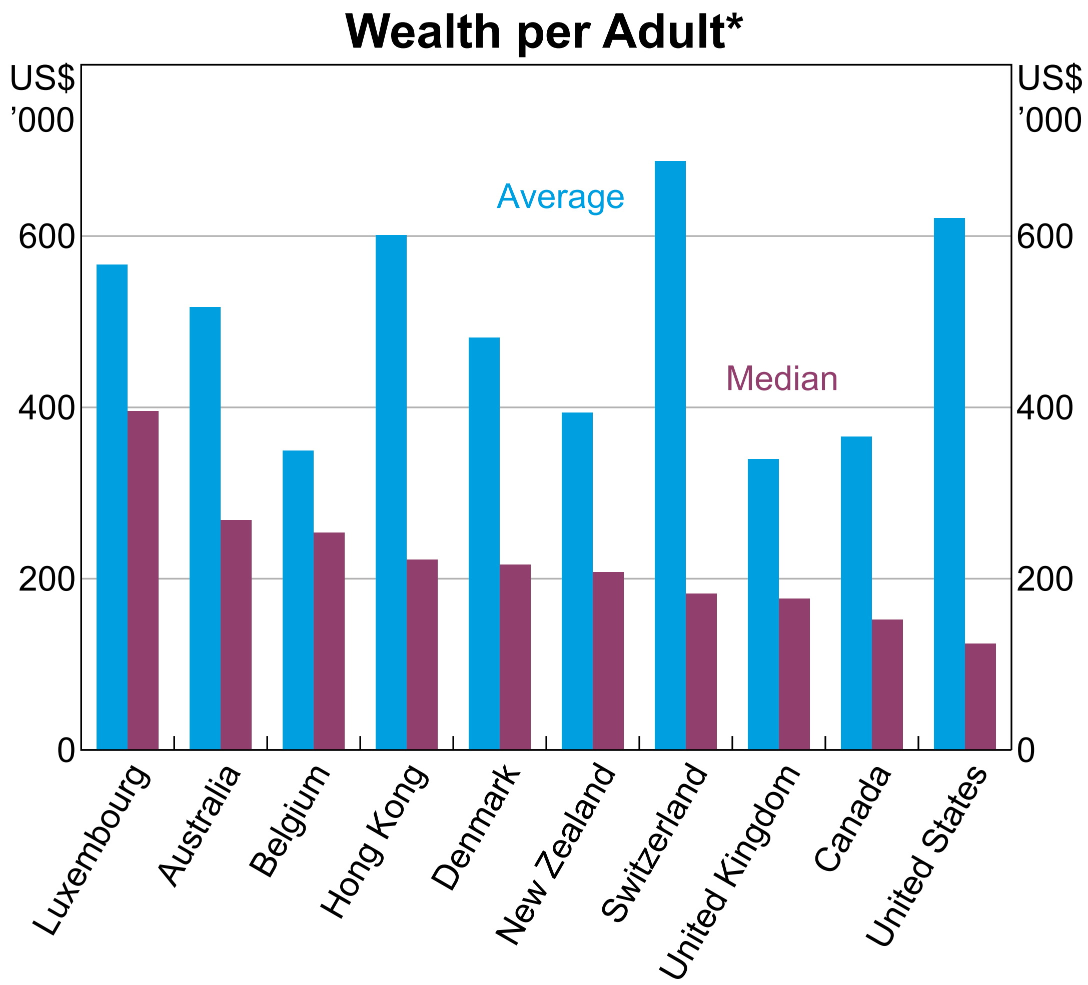


* Includes net purchases of second-hand assets.

Sources: ABS; RBA.

So here is the opportunity for this audience today. An economy already operating near full capacity. With extraordinary minerals resources, old and new. World-leading universities and human capital. A plumb geographical position in the Asia Pacific. A huge domestic savings pool – the second largest median wealth per capita in the world according to UBS (Graph 10), and the fourth (in due course, second) largest pension system globally. One of the lowest public debt burdens in the G20. A strong banking system, proven political and economic institutions, and a long track record of welcoming foreign capital and labour. [13]

Graph 10



* Based on UBS Global Wealth Report 2025.
Source: UBS.

If that doesn't scream 'investment potential', I don't know what does. Seize that opportunity, and we really could be off to the races!

Conclusion

Let me conclude.

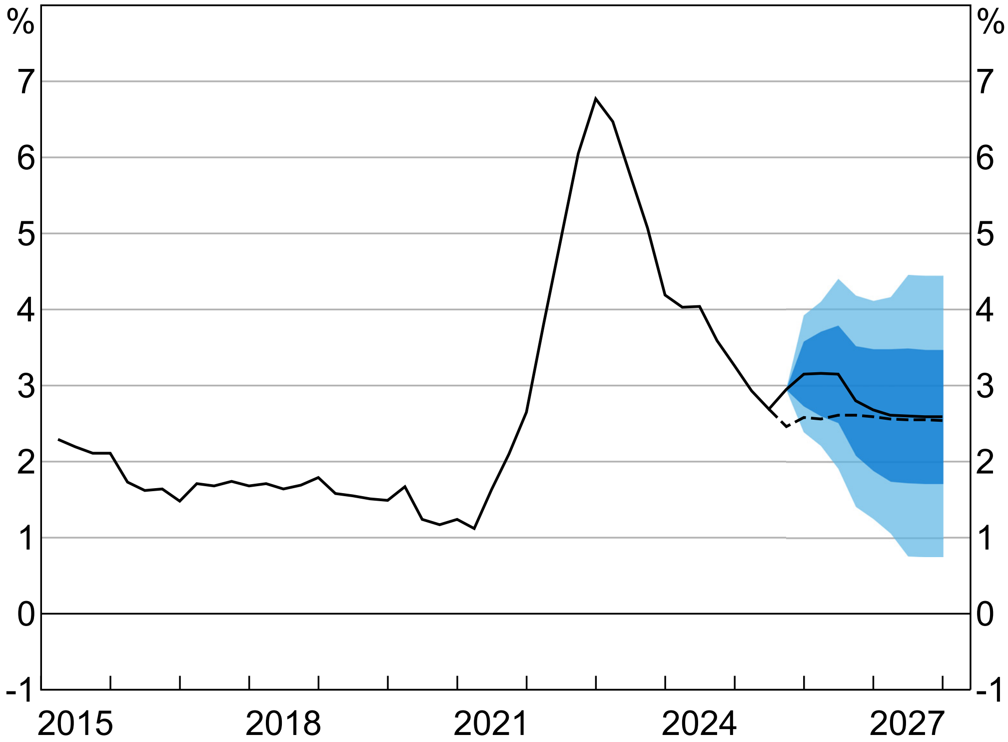
The Australian economy is in a unique situation. One of the sharpest disinflations in decades has been achieved without a decline in GDP, and with the employment share at an all-time high. That is a great outcome – but it also means that the recovery in GDP growth began last year with the highest level of capacity utilisation in any recovery over the past 40 years.

As I've set out today, there is room to debate what that means for the precise stance of monetary policy in the near term. Our latest projections show inflation settling very slightly above the midpoint of the 2–3 per cent target range if the cash rate follows a market-derived path of one more 25 basis point cut (Graph 11).

Graph 11

Trimmed Mean Inflation Forecast*

Year-ended



* Dashed line shows previous SMP forecast; confidence intervals reflect RBA forecast errors since 1993, with the 70 per cent interval shown in dark blue and the 90 per cent interval shown in light blue.

Sources: ABS; RBA.

But the bigger picture challenge for the economy over the medium term, if we are to return to the sort of growth rates we have been used to, is how to create more supply capacity. If we fail to do so, we may find ourselves boxed in on the rail. If we succeed, we could be off to the races.

You may be aware that there is a racehorse in Australia called Reserve Bank. It's so far had five wins and one place off nine starts. It's four years old, and I'm told that racehorses typically peak at ages three to five, so there's still hope for a Melbourne Cup win – for the horse, and for the Australian economy!

I look forward to answering your questions today.

Endnotes

[*] I am grateful to Fred Hanmer and Chris Schwartz for their assistance with this speech, and to Alex Ballantyne, Meredith Beechey Osterholm, Sue Black, Michele Bullock, Natasha Cassidy, Anthony Dickman, Sarah Hunter, David Jacobs, Brad Jones, Chris Kent, Kevin Lane, Jeremy Lawson, Mike Major, David Norman, Penny Smith and Tom Williams for their comments and suggestions.

[1] Nicholson P (2012), 'Reserve Bank Board Usual Melbourne Cup Day Deliberation' [Cartoon].

[2] RBA (2024), 'Chapter 3: Outlook', *Statement on Monetary Policy*, August.

[3] I reviewed these arguments in my December 2024 speech: Hauser A (2024), 'The Ghost of Christmas Yet to Come', Speech at The Australian Business Economists' Annual Dinner, Sydney, 11 December. We also described a global trade war scenario in Section 4.1 of RBA (2025), 'Chapter 4: Outlook', *Statement on Monetary Policy*, May. So far, the impact on Australia looks much closer to the optimistic scenario sketched in the left-hand side of Table 3 of the December 2024 speech.

[4] For a more detailed assessment of the current economic conjuncture, including a self-assessment of the RBA's forecast performance over the past year, see RBA (2025), *Statement on Monetary Policy*, November.

[5] Although other countries in the chart have experienced less favourable employment outcomes than Australia in the most recent period, all have been better than would have been expected given the scale of the required post-Covid disinflation: see, for example, Figure 1.3 in IMF (2024), 'Policy Pivot, Rising Threats', World Economic Outlook, October.

[6] RBA (2025), *Statement on Monetary Policy*, November.

[7] The models used at the RBA are described in Bishop J, J Hua, S Omidi, X Zhou and A Ballantyne (2024), 'Assessing Potential Output and the Output Gap in Australia', RBA *Bulletin*, July.

[8] For a more detailed discussion of this judgment, see Hunter S (2025), 'Why Productivity Matters for Central Bankers', Speech at Citi Australia & New Zealand Investment Conference, Sydney, 15 October; RBA (2025), 'Chapter 4: In Depth – Drivers and Implications of Lower Productivity Growth', *Statement on Monetary Policy*, August; Plumb M (2025), 'Why Productivity Matters', Speech at the Australian Business Economists Annual Forecasting Conference, Sydney, 27 February.

[9] The Treasurer and the Monetary Policy Board (2025), *Statement on the Conduct of Monetary Policy*, 10 July.

[10] For examples of views arguing that there is more spare capacity in the labour market, see Borland J (2025), 'Decline to Boom to Slowdown: Australia's Labour Market in the COVID-19 Era', Melbourne Institute of Applied Economic and Social Research Working Paper No 15/25; or Garnaut R and P Dawkins (2025), 'Reducing the NAIRU and Achieving Full Employment', *The Australian Economic Review*, 58(3), pp 246–250.

[11] The sharp pick-up in inflation following the Covid-19 pandemic has triggered an enormous international academic effort to re-examine the old question of whether the Phillips Curve is linear (inflation rises uniformly as capacity

utilisation rises) or non-linear (inflation rises more sharply at high levels of capacity utilisation). The consensus of this literature is that there probably is evidence of non-linearity – consistent with Bill Phillips' original insight, and longstanding RBA work on Australia, including Debelle G and J Vickery (1997), 'Is the Phillips Curve A Curve? Some Evidence and Implications for Australia', RBA Research Discussion Paper No 9706, and more recently Bishop J and E Greenland (2021), 'Is the Phillips Curve Still a Curve? Evidence from the Regions', RBA Research Discussion Paper No 2021-09. However, some recent papers argue that findings of non-linearity may reflect a failure to identify supply and demand shocks effectively, and that, properly specified, the Phillips Curve still remains quite flat. For examples of this view, see Beaudry P, C Hou and F Portier (2025), 'On the Fragility of the Nonlinear Phillips Curve View of Recent Inflation', NBER Working Paper No 33522; Mallick D (2024), 'The Phillips Curve in Australia in the Era of Inflation Targeting', *The Australian Economic Review*, 57(3), pp 272–282.

[12] Labour supply may also rise, for example, if workers discouraged by a perceived lack of job prospects during the slowdown choose to re-enter the labour market.

[13] The authoritative source on Australia's comparative advantages is McLean IW (2013), *Why Australia Prospered: The Shifting Sources of Economic Growth*, The Princeton Economic History of the Western World, Princeton University Press, Princeton. For some more recent reflections, see ABC Radio National (2025), 'Professor Justin Wolfers: Australia is Freaking Amazing', Boyer Lectures, 19 October; or Hauser A (2024), 'Strangers in Paradise', Speech at the Opening Dinner for the Citi A50 Australian Economic Forum, Sydney, 27 June.