MARKET UPDATES

RBA Update May 2026

The Reserve Bank of Australia (RBA) Monetary Policy Board increased the cash rate by 25bps to 4.35% at its May meeting. The decision, which was in line with the market expectations, took the cash rate back to the peak of the previous tightening cycle from 2023-24.

The decision was made by the majority, with one voter preferring to keep the cash rate unchanged at 4.10%.

Post-meeting Statement

The rise in actual and expected inflation unsurprisingly took centre stage in the post-meeting statement. The statement stressed that the rise in fuel prices due to the war in the Middle East came on top of the impacts from capacity pressures ahead of the conflict.

The document emphasised that companies are likely to pass on rising costs to consumers, which would imply possible second-round effects. It also noted that short-term inflation expectations have risen already and, if built into longer-term inflation expectations, would imply further upside risk to inflation, especially in the event of a prolonged conflict in the Middle East.

The forward guidance was largely unchanged, with the decisions remaining data-dependent. The statement stressed that there had been three cash rate hikes in the cycle already, which could mean less appetite for further adjustment looking forward.

Statement on Monetary Policy

The updated economic projections included in the May Statement on Monetary Policy point to:

- headline inflation peaking at 4.8% in June 2026, but declining to the mid-point of the 2-3% target range in the following 12 months;
- trimmed mean inflation rising to 3.8% in mid-2026, but returning to the middle of the target range only in late 2027, roughly the same as in the previous projection;
- the unemployment rate forecasts being revised slightly upwards, with a rise to 4.7% expected towards the end of the projection horizon in mid-2028 (compared to 4.6% in February);
- GDP growth forecasts were downgraded, with a slowdown to 1.3% expected later this year, before a slight re-acceleration to 1.4% in the last year of the projection horizon.

The projections were prepared under an assumption of the conflict in the Middle East being resolved ‘shortly’, with oil prices peaking in Q2 2026, but also the cash rate target rising to 4.65%.

The RBA also prepared two adverse scenarios, in which the scale of the impact of higher energy costs to economic activity differed.

Press Conference

In the press conference, RBA Governor Michele Bullock reiterated all the above information, but added several soothing observations.

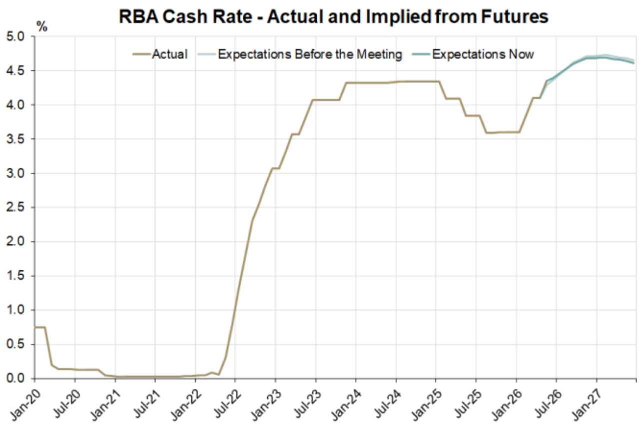
Most importantly, Governor Bullock hinted that, following the three rate hikes, the current level of the cash rate target should slow economic growth sufficiently to bring down the demand-driven component of inflation. She continued that this means the RBA now has space to focus on both sides of its mandate during the current energy crisis.

However, Governor Bullock also underscored that – while the change in interest rates will obviously have no impact on the Middle East war – the RBA needs to ensure that inflation is not entrenched on the other side of the conflict.

Market Impact

All the above communication today turned out to be slightly less hawkish than feared. This led to a slight retreat in cash rate cut expectations, though one more rate hike remains fully priced in.

In consequence, 3-year Commonwealth bond yields fell from 4.67% to 4.61% at the time of writing, while 10-year yields declined from 4.98% to 4.95%. The AUD/USD depreciated just a bit, from US$0.7159 to US$0.7140.



Comment

The RBA decision to increase the cash rate today hardly surprised anyone, though the central bank turned out to be more attentive to both sides of the risks from the evolving energy crisis than expected.

The RBA appears to be more confident that the current monetary policy settings are well set to address the causes of higher inflation from before the crisis. This leaves them well-positioned to flexibly react to outcomes of the energy crisis, including the scale of impacts on aggregate demand. Given this, we continue to view the base case for further rate hikes is finely balanced.

05 May 2026