

Reserve Bank of Australia Raises Cash Rate to 3.85%



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The Reserve Bank of Australia (RBA) announced yesterday, February 3rd, that the cash rate will be raised by 25 basis points to 3.85%, from 3.60%. This marks the first rate rise in over two years, following three rate cuts throughout 2025 that provided relief to borrowers and stimulated the residential property market.

The decision comes as inflation figures rose over 2025. Underlying trimmed mean inflation rose to 3.4% over the year to December 2024, substantially higher than expectations from three months earlier. Headline inflation reached 3.6%, driven by broad-based price increases across services, retail goods and construction costs.

Economic growth, however, has continued upward. GDP grew by 2.1% over the year to September 2024, close to the RBA's estimated growth rate. Private demand was also strong in the second half of 2024, with household consumption and dwelling investment both exceeding expectations. The labour market remains tight, with unemployment at 4.25%.

The RBA now forecasts that inflation is expected to rise above the 2-3% target range until early 2027, and with underlying inflation projected to peak at 3.7% by mid-2026, the RBA reasoned that monetary policy needed to be more restrictive.

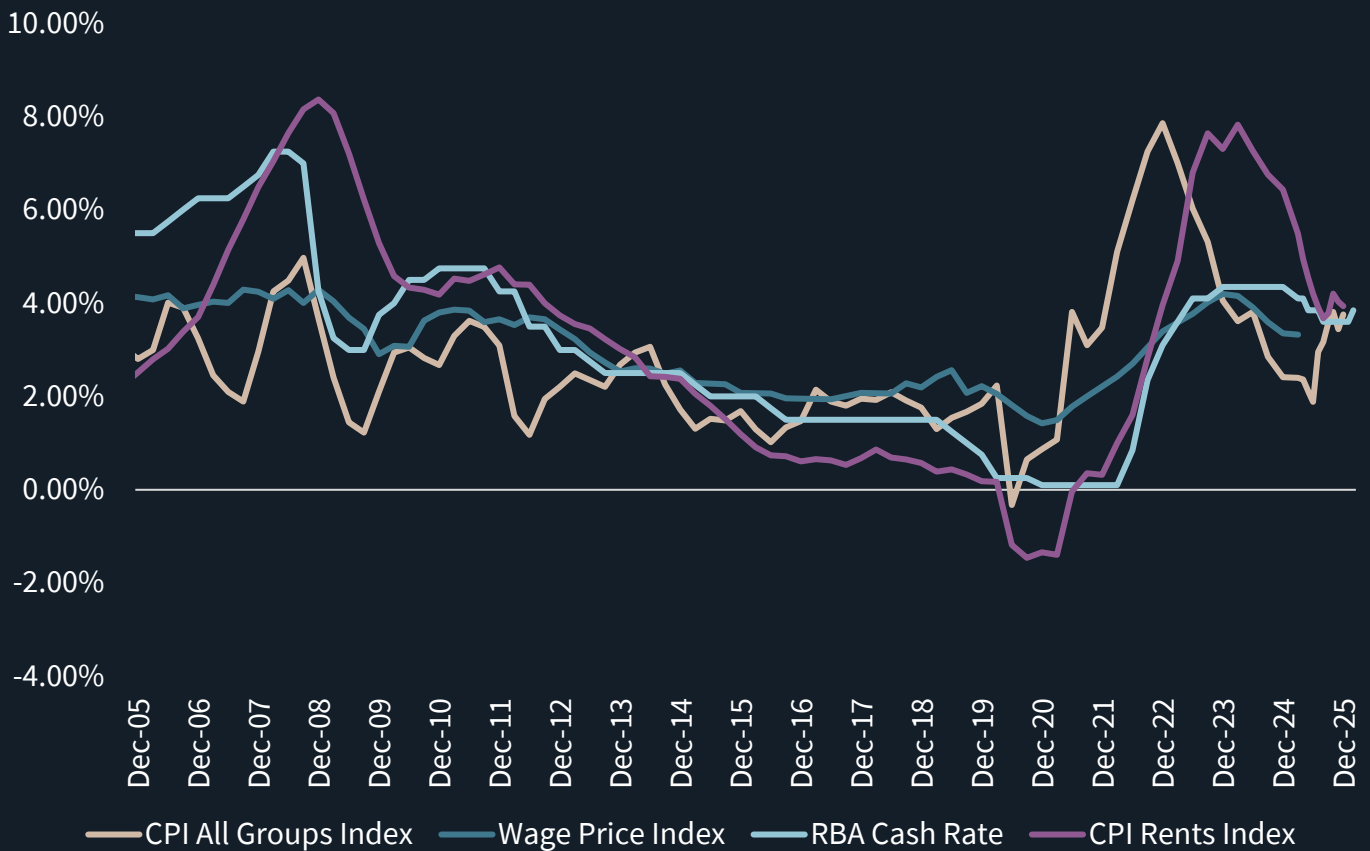
For Australia's housing market, this rate rise will directly impact borrowing costs. Homeowners with variable rate mortgages can expect immediate increases in their repayments, while those with fixed rates are likely to face higher costs when refinancing.

First-home buyers may find themselves priced out of segments of the market as affordability deteriorates, though this could moderate some of the recent price pressures in certain areas.

However, the housing market's response may be more nuanced than in previous tightening cycles, given the underlying strength in population growth and economic activity that continues to drive fundamental demand for housing.



Figure 1: Economic Indicators



Source: JLL Research, ABS

Figure 1 illustrates the relationship between key economic indicators and the housing market. While borrowing costs are likely to increase for everyday borrowers from bank lenders, investors may stand to benefit, as CPI rents often trend in parallel with the cash rate.

With the cash rate hike, the rental market is likely to see continued, strong demand for rental properties, which could drive strong rental growth to continue into 2026, offsetting increases in financing costs.

Despite this rate increase, Australia's economic fundamentals remain robust. Population growth continues at elevated levels, strongly supporting housing demand, which continues to outpace supply, while business investment and consumer spending have demonstrated resilience.

This strength suggests that while higher rates may moderate some activity, they're unlikely to derail the broader economic expansion.

The outlook for property prices in 2026 is tempered somewhat, given the relationship between interest rate hikes and buyer confidence. However, the market fundamentals that have driven price growth over the past three years in many parts of Australia, with some areas even seeing extraordinary growth, have not changed.

Population growth, demographic changes, and chronic supply shortages have not changed and will continue to maintain pressure on prices in both the sales and rental markets across Australian cities.

Australia has successfully navigated previous interest rate cycles, and while the RBA works to bring inflation back to the target range, the current economic strength provides confidence that the economy will adapt to these necessary monetary policy adjustments while maintaining its long-term growth trajectory.



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