

# Australian central bank hikes rates again as stagflation threat grows

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The Reserve Bank of Australia (RBA) has followed the strident demands of the financial establishment by raising its base interest rate yesterday for the third time this year, wiping out all the cuts of 2025. An interest rate rise was always on the cards even before the war on Iran but the spike in fuel and other costs it has produced made the increase a certainty.

The RBA lifted the rate by 0.25 percentage points (25 basis points) to 4.35 percent, taking the hike so far this year to three quarters of a percent. And there could be more to come. The central bank's own statement on monetary policy noted that "market participants expect the cash rate to increase by 60 basis points to 4.7 percent by the end of 2026."

Others believe it could go even higher. The chief investment officer at Mutual Limited, Scott Rundell, said the RBA could raise its rate by a further 50 basis points from its present level to 4.85 percent. He noted a shift in sentiment at the central bank from "watching inflation risks build" at its meeting in March to "actively responding to an inflation shock" in May.

This hardening was reflected in the change in votes. In March the vote by the nine-member monetary policy board was a narrow 5-4 vote in favour of a hike rather than no change. This time it was 8-1.

But as RBA governor Michele Bullock acknowledged a number of times during her press conference following the decision, the interest rate hikes would do nothing to lessen the impact of the price hikes from the Iran war, and it was "reasonable" that firms would seek to pass them on.

Her main concern was that "inflationary expectations" would become embedded. While it is always referred to obliquely, what Bullock meant by this was that workers, whose living standards are being hammered both by the price rises and the increase in

mortgage repayments imposed by the banks, would press forward with wage demands.

She noted that in the wake of the COVID-induced inflation, while workers received pay increases, real wages actually declined. The RBA is clearly fearful that with the delivery of two inflationary shocks in the space of five years, this situation may not continue.

In its overview of monetary policy, the RBA said inflation expectations had risen and if this persisted it "could feed into actual price- and wage-setting behaviour and pose the risk of inflation above target for even longer."

There was a clear shift by Bullock from previous comments she had made on government spending. Back in February, when speaking to parliament, she had been anxious not to comment directly on fiscal policy and not to join claims that government spending was a key source of inflation.

There was a significant change in tone at her press conference.

"When demand is too high it does not take much additional spending to make the task of reducing inflation to target more challenging. This means spending will need to grow more slowly for a time to help restore the balance between supply and demand," she said.

Bullock later made clear that this applied to the states as well as the federal government and came down against compensation measures declaring that "the extent to which governments make up the shortfalls for households by giving them more money makes it harder to dampen demand."

The RBA was under fire from sections of the financial press before the decision. An editorial in the *Australian Financial Review* on Monday said Australia was more exposed to the effects of the war "because of

the central bank's narrow path strategy of protecting jobs and delaying the return of inflation to the 2 percent to 3 percent band."

But with the decision yesterday, editorials in both the *Australian* and the AFR were broadly supportive of the RBA's action, calling on the Albanese government to follow through in next week's budget. Both took note of Bullock's remark that providing relief to households only made the RBA's job harder.

While doing nothing to bring down prices, as Bullock herself acknowledged, the decision will bring an immediate cut in the disposable income of the millions of households struggling to pay off mortgages. This piece of reality even managed to find its way into Bullock's press conference when one reporter prefaced a question by saying she has been told by a woman that the rate rise meant she would have to start skipping on meals.

It has been estimated that the increase in payments on a \$750,000 loan, as a result of the 0.25 percent hike, will be \$130 per month, making a total increase of \$390 per month over three hikes since February. The increase for a mortgage of \$1 million or more, increasingly common in Sydney, where the median house price is around \$1.75 million, and Melbourne, where the median house price is \$1.08 million, is at least \$170 per month and likely much more.

The Australian Broadcasting Corporation reported that since the start of the year more than 65,00 people had contacted the National Debt Helpline seeking assistance with mortgage stress the main reason.

It cited research by Roy Morgan showing that the number of people at risk of mortgage stress will rise to 1.64 million as a result of the latest rise and noted the case of a woman who had bought a house when interest rates were low during the pandemic and was now paying \$600 a fortnight more on her mortgage.

On the economic outlook, the RBA's "baseline" forecast, predicated on the assumption that the war on Iran would be over in the next one to two months—back in March it was thought it would only last weeks—was essentially one of stagflation, rising prices and a slowing economy, for the foreseeable future. Bullock repeated the demand of all sections of the financial elite that productivity had to be increased.

Economic growth for this year was downgraded from 1.8 percent to 1.3 percent, a level characterised by

Bullock as "anaemic," with no sign of improvement. The growth rate was cut from 1.6 percent to 1.4 percent in mid-2028, the end of the bank's forecasting period.

As the AFR commented: "This is the lowest medium-term growth the RBA has predicted in its forecasting history."

The forecast also showed a rise in the official unemployment rate from 4.3 percent to 4.7 percent over the next two years. But the real increase will be much higher because someone who works only one hour a week is deemed to be employed. In the baseline model, inflation will hit 4.8 percent with signs that "many firms" are "looking to increase prices of their goods and services."

But under what it called "adverse scenarios," in which the oil price rises to as high as \$145 per barrel and the global economy experiences a significant downturn, the jobless level could rise on official data to 5.1 percent with the real level significantly higher than that.



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