Reserve Bank of Australia on track for a February rate hike

Australia's CPI beat expectations, with services and housing inflation staying persistently above target, while labour data remains resilient. Together, these strengthen the case for a cautious 25bp RBA hike in February

The Reserve Bank of Australia building in Sydney, Australia

CPI inflation for December – and therefore for the fourth quarter of 2025 – surprised to the upside. Trimmed mean CPI rose to 3.4% year-on-year, slightly above the 3.3% consensus, driven by persistent price pressures in housing (up 5.5% YoY) and in recreation and culture (up 4.5% YoY). This marks a continuation of the trend seen through the third and fourth quarters, where services inflation has remained elevated and increasingly structural, rather than transitory, keeping inflation well above the RBA's 2-3% target range.

This outcome challenges the RBA's previous assessment. In November, the Bank suggested that part of the September quarter inflation increase was likely temporary and expected quarterly inflation to moderate in the December quarter. The latest figures clearly run counter to that expectation. With inflation now looking both broad-based and persistent, it will be difficult for the RBA to attribute the rise to temporary, supply driven factors or to electricity rebates.

Labour market data reinforces the picture of underlying resilience – though not one of overheating. Total employment growth in December 2025 rose to an eight month high, with more than 80% of the increase coming from full time positions. However, the three month trend still shows that underlying momentum is being driven mainly by part time employment. This distinction matters: part time jobs – typically lower paid and offering less security, fewer benefits, and more volatile income – tend to support household spending less than gains in full time employment.

Other labour indicators also point to firmness. The unemployment rate fell 20bp to 4.1% in December, bringing the fourth-quarter average to 4.25%, below the RBA's projection of 4.4%. That said, labour data during the December–January period tends to be volatile; a similar pattern occurred in early 2025, when a sharp 25k rise in full time jobs in January was followed by several months of softer growth.

Taken together, these developments strengthen the case for further tightening. We now expect the RBA to raise the cash rate by 25bp in February, as the December CPI print confirms inflation remains consistently above target and is unlikely to moderate in line with the Bank's earlier expectations. At the same time, GDP growth of 2.1% in the third quarter is far from overheating, and recent high frequency indicators have been mixed. This suggests that if the RBA does proceed with a February hike, it is likely to be a cautious one, reflecting the delicate balance between supporting growth and containing stubbornly high inflation.

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