

What is really driving inflation?

Prices are rising again and rates are at a 15-year high. Here is what the official numbers say.

You will have heard inflation blamed on the war in the Middle East. The war is part of it, but the official numbers say most of it is home-grown, and government is a big part of that.

4.0%	3.6%	4.60%	26.9%
inflation, year to August	underlying inflation, 3rd month running	cash rate, 4 rises this year	federal spending share of GDP, highest since 1986-87 outside COVID

The short version

- Most of it is home-grown. Prices set in Australia are up 4.5%, prices set on world markets 2.9%. The war has made fuel dearer, but the RBA says the underlying problem is domestic.
- About 70% of the rise is in things households cannot easily avoid, and 28% comes from prices governments set, regulate or largely fund.
- Government demand was a record 28.9% of the economy in 2025-26, and mostly government-funded sectors supplied most new jobs for three years. That hiring has since eased.
- The RBA's only tool is the cash rate. The lasting fix is governments easing off and Australia lifting productivity.

1. Where prices are rising

Housing alone is almost a third of the 4.0% rise.

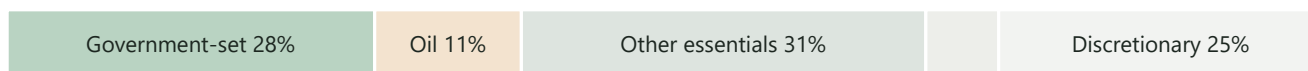
Category	Rise	Points of the 4.0%	Share
Housing (new homes, power, rents)	5.7%	1.24	31%
Transport (mainly fuel)	5.6%	0.64	16%
Food	3.0%	0.52	13%
Health and education	3.9% / 4.7%	0.49	13%
Other (clothing, furniture, insurance, phone)	1.0% to 3.5%	0.39	10%
Recreation and holidays	2.9%	0.36	9%
Alcohol and tobacco	4.8%	0.32	8%
Total	4.0%	3.96	100%

Source: ABS CPI, August 2026. Shares are of 3.96 points.

2. What is in your control, and what is not

We split the 4.0% by who sets the price. About 70% of the rise is in things households cannot easily avoid.

Where the 4.0% came from	Examples	Share	In your control?
Set, regulated or largely funded by governments	Power, water, council rates, rego, health, school fees, child care, public transport	28%	No
World oil prices	Petrol and diesel	11%	Very little
Other essentials, priced in the market	Rent, new homes, groceries, insurance	31%	Hard to avoid
Tobacco (excise set by government)	Cigarettes and tobacco	5%	Yes
Other discretionary spending	Eating out, holidays, recreation, alcohol, clothing, furniture	25%	Yes
Total		100%	



Our calculation from ABS August 2026 contributions: the RBA's definition of administered prices, then the ABS discretionary split of the rest (the narrow grey band is tobacco). Part of the government share is timing: energy rebates held prices down last year and their end is lifting them now.

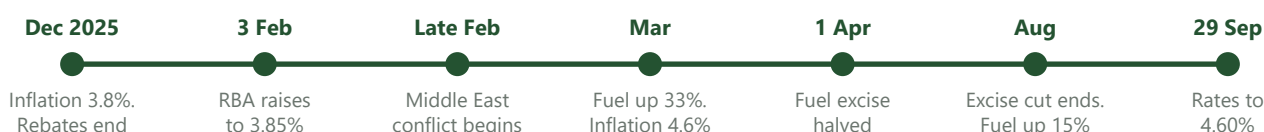
Must-haves versus nice-to-haves	Rise over the year	Share of the basket	Share of the rise
Must-haves (non-discretionary): housing, power, fuel, groceries, health, education, insurance	4.7%	59%	69%
Nice-to-haves (discretionary): eating out, holidays, recreation, alcohol, tobacco, clothing	3.0%	41%	31%

Source: ABS CPI August 2026, Table 6 (published contributions). The must-haves are rising fastest, which is why it feels worse than 4%.

3. Most of it is home-grown

Prices set in Australia supplied three-quarters of the 4.0%. The war explains much of the recent jump in fuel, but not the underlying problem.

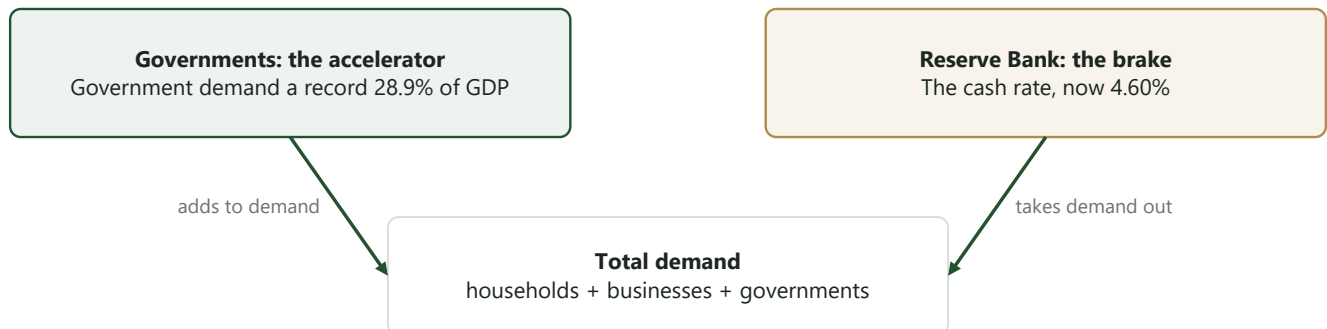
August 2026	Rise over the year
Prices set in Australia (rents, services, government charges, building)	4.5%
Prices set on world markets (fuel, cars, electronics, some food)	2.9%
Conflict's effect on underlying inflation in the June quarter (RBA estimate)	0.1 of that quarter's 0.8 points



Source: ABS CPI; RBA; Department of Infrastructure. Inflation was rising, and the RBA was lifting rates, before the conflict began. The RBA Governor: inflation "has been driven by domestic capacity pressures"; the conflict is "making things much worse".

4. The accelerator and the brake

Governments have kept their foot on the accelerator at a record level, so the RBA has to brake harder, and borrowers pay.



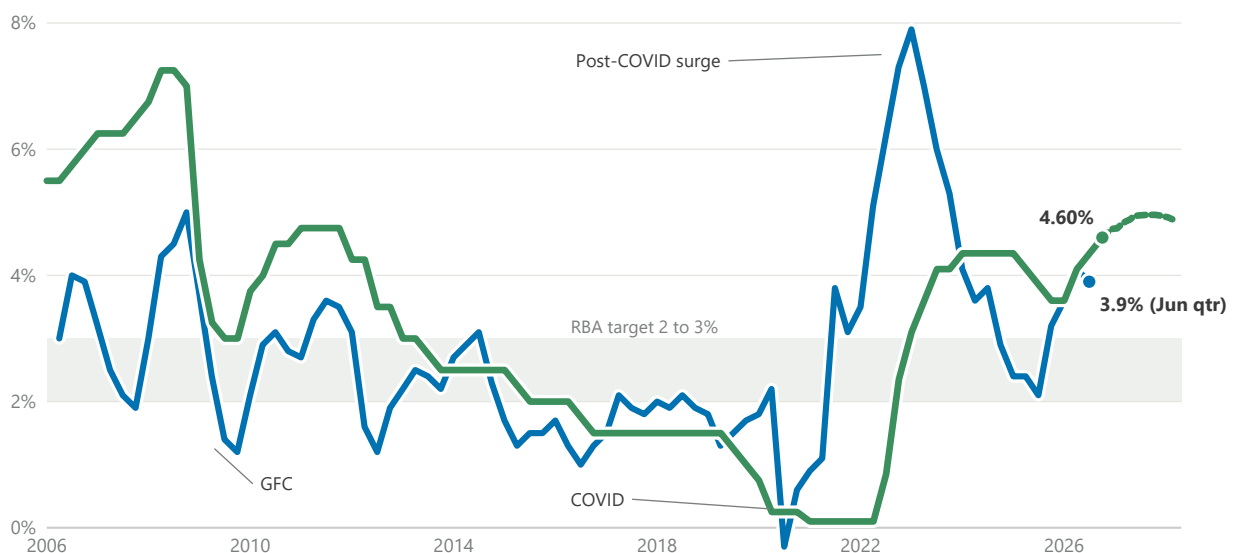
	Governments (fiscal policy)	Reserve Bank (monetary policy)
Tools	Spending, tax, subsidies and the prices they set	The cash rate only
Where it sits now	Federal spending 26.9% of GDP, a \$22.3b deficit	4.60%, up a full point in 2026
Who pays	Taxpayers later, through debt and interest	Borrowers now: about \$454 a month more than at the start of the year on a \$750,000 loan

Source: Treasury Final Budget Outcome 2025-26; ABS National Accounts (our calculation); RBA; Canstar (25-year owner-occupier loan, all four rises passed on).

RBA cash rate and inflation

Per cent. Cash rate and annual CPI inflation since 2006

— Cash rate — Inflation - - - Market pricing



Source: RBA, ABS, ASX (market pricing at 29 September). Inflation is quarterly, to June.

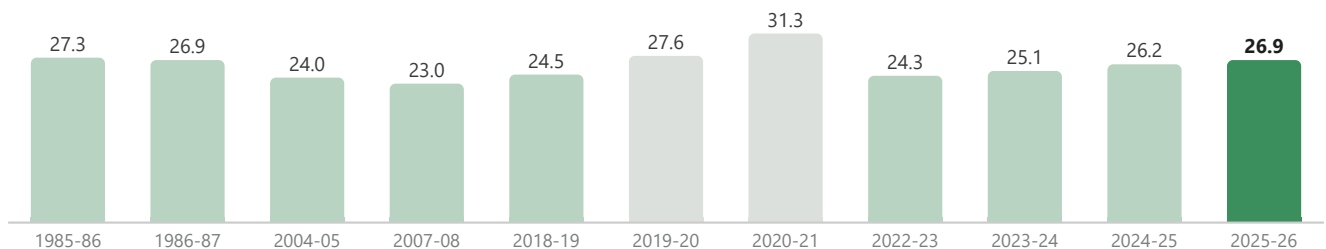
5. Government spending in numbers

2025-26	Figure	Why it matters
Federal spending (all payments, including pensions and grants)	26.9% of GDP	Highest since 1986-87 outside COVID; 24.3% three years ago
Growth in federal spending after inflation	4.3% (4.2% a year over three years)	Above the 30-year average of 3.4%
Federal tax	24.1% of GDP	Highest since 2005-06, when the budget was in surplus
Budget deficit	\$22.3b (\$36.1b counting loans and investments)	A deficit despite near-record tax
Government demand, all levels (what governments buy and build)	28.9% of GDP	A record for any financial year since 1959-60; the 40-year average is 24.5%
Growth in government demand	2.2%	Slowest in 11 years. Private demand grew 3.5% and supplied about four-fifths of new demand

Source: Treasury, Final Budget Outcome 2025-26; ABS National Accounts June 2026 (the demand figures are our calculation).

Federal government spending

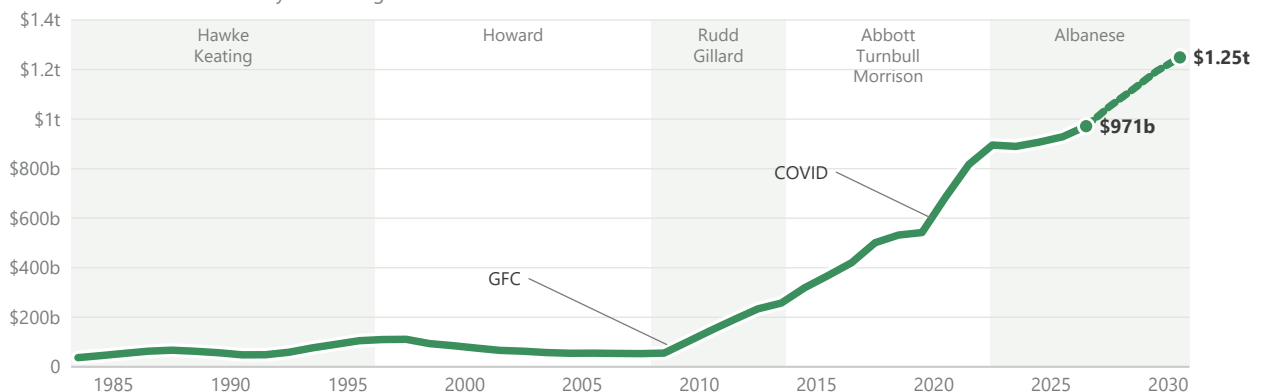
Per cent of GDP, selected years. COVID years in grey



Source: Treasury, Final Budget Outcome 2025-26.

Federal government gross debt

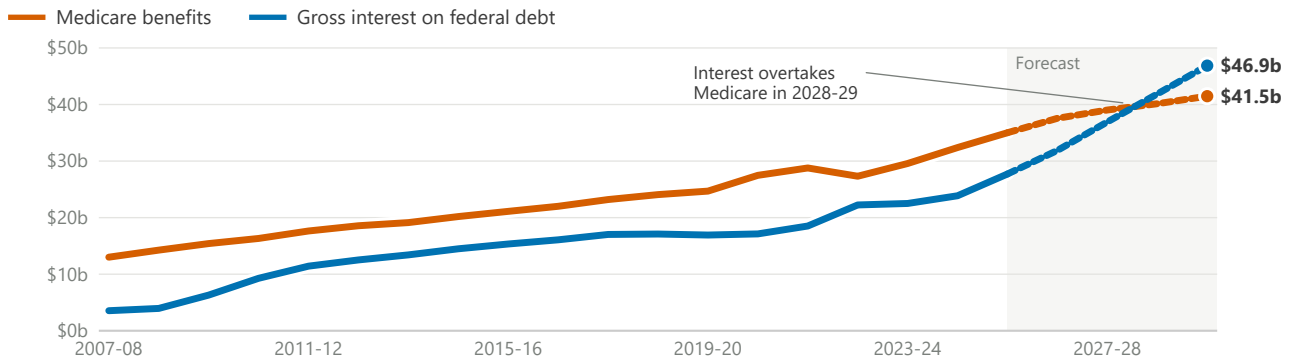
\$ at 30 June. Dashed line is the May 2026 Budget forecast



About two-thirds of the debt added since 2008 came in the GFC years and COVID, under both sides of politics. As a share of GDP it fell from 38.3% in 2022 to 33.2% now, and is forecast at 35.6% by 2030. Source: Treasury Final Budget Outcome 2025-26 and Budget Paper 1, PBO.

Interest on federal debt vs Medicare

\$ billion a year. Treasury forecasts from 2026-27; end values are for 2029-30



Source: Treasury, Budget Paper 1 2026-27; PBO; Department of Health, Disability and Ageing.

6. Government-funded hiring

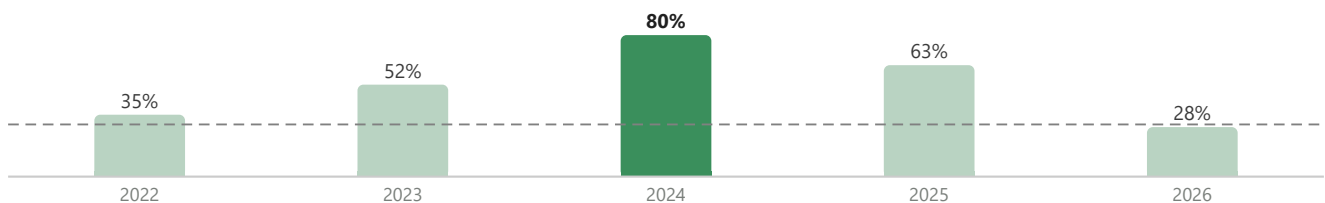
Health, education and public administration are mostly government-funded. For three years they supplied most of Australia's new jobs.

The hiring numbers	Figure	Period
Share of all new jobs from health, education and public administration	80%	Year to June 2024
Their share of all jobs	26% rising to 29.5%	2019 to 2026
Public sector jobs, all levels	+248,900 (+10.6%) to 2.6 million, three-quarters of it state governments	June 2022 to June 2025
Public versus private sector job growth	+9.8% against +6.6%	June 2022 to June 2025
Australian Public Service headcount	+21% (only +1.4% in 2025)	Dec 2022 to Dec 2025
Pay rises, public versus private	3.4% against 3.1%	Year to June 2026
NDIS costs	+10.5% to \$51.2b	2025-26

Source: ABS Labour Account and Public Sector Employment and Earnings; Australian Public Service Commission (the government says more than 13,000 of the new roles replaced contractors and labour hire); ABS Wage Price Index; NDIA Quarterly Report Q4 2025-26.

Share of new jobs from health, education and public administration

Year to June. Dashed line: their share of all jobs today (29.5%)



Our calculation from ABS Labour Account, June 2026.

Why it matters for inflation	What the evidence says
It competes for the same workers	The RBA found this hiring likely tightened the labour market for private employers
Its output per hour has barely grown	Almost no measured productivity growth in the care sector in 20 years (e61, 2024)
It is taxpayer-funded even when the employer is private	About three-quarters of health and social assistance jobs are in private businesses, much of it funded by the NDIS, Medicare and aged care
Has it eased?	Yes. In the year to June 2026 these sectors supplied 28% of new jobs, slightly below their share of all jobs; public sector jobs grew 1.1% against 2.9% in the private sector

Source: RBA Statement on Monetary Policy (February 2025); e61 Institute; ABS Labour Account; ABS Public Sector Employment and Earnings.

7. What the economists say

Who	What they said
Michele Bullock, RBA Governor	Inflation has been driven by domestic capacity pressures; the conflict is making it worse. Public and private demand are both adding to it. Productivity is 'doing nothing'.
Philip Lowe, former RBA Governor	At full employment, the budget should be in sizeable surplus (IPA podcast).
OECD	Keep reducing the deficit steadily, as planned, and be prudent with commodity revenue.
Commonwealth Bank economists	Fiscal policy should work in the same direction as the RBA.
Paul Bloxham, HSBC	Stronger-than-projected public spending in 2025 helped push demand, and inflation, back up.

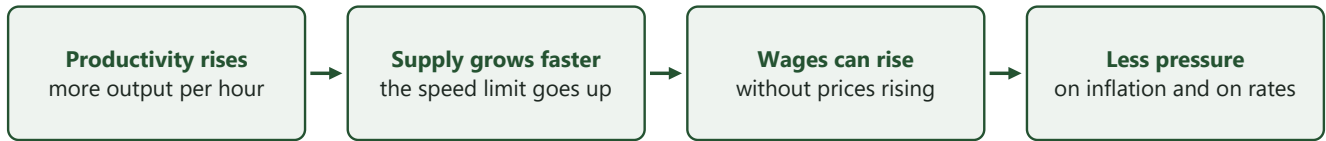
To be fair: private demand grew 3.5% last year and supplied about four-fifths of demand growth, and the RBA calls it the main driver of growth. Government demand growth slowed to 2.2%, and the AI boom and the oil shock are real. Paraphrased unless quoted.

8. What productivity is, and why it matters

Question	Answer
What is productivity?	How much we produce for each hour worked.
Why does it matter for inflation?	When output per hour rises, businesses can pay higher wages without raising prices, and the economy can grow faster without overheating.
Where is Australia?	Down 0.2% over the past year. Growth over the past decade was less than a quarter of the 60-year average.
What does the RBA assume?	0.7% a year, cut from 1.0%, so the economy's speed limit is lower.
What does it do to costs?	Labour costs per unit of output rose 3.3% over the year to March 2026, faster than the inflation target allows.
What is it worth?	At least \$14,000 a year for the average full-time worker by 2035, if productivity growth returned to its 60-year average.

Source: Productivity Commission; RBA Statement on Monetary Policy (August 2025 and August 2026); ABS.

9. What can be done



Area	What it means in practice	How it helps	Who is calling for it
Government spending	Restrain spending growth, keep cutting the deficit, bank commodity windfalls	Less demand, so the RBA can do less	OECD, CBA, Philip Lowe
Cost-of-living help	Target it to people who need it instead of paying everyone	Helps those who need it while adding less to total demand	EY, CBA
Government-set prices	Slow the growth of fees, charges and indexed prices	They have been rising faster than market prices	AMP
Housing	Faster approvals, easier zoning, more building	Eases rents and building costs	OECD, Productivity Commission
Energy	Faster approvals and more grid investment	Lower power prices over time	Productivity Commission, OECD
Tax	Shift tax from incomes towards GST and land; lower company tax with a cash-flow tax	More work and investment	OECD, Productivity Commission, Philip Lowe
Red tape and competition	Cut compliance costs, revive competition policy	Lower costs, more new businesses	Productivity Commission, OECD
Technology	Clear, light-touch rules for AI and data sharing	Faster adoption lifts output per hour	Productivity Commission

The OECD's tax package would also trim negative gearing and super concessions for high balances. Source: Productivity Commission five pillars final reports (December 2025, 47 recommendations) and Housing construction productivity (February 2025); OECD Economic Survey of Australia 2026; CBA; AMP; EY.

The bottom line

The war made fuel dearer, but it did not start this. The economy has been running hotter than it can sustain. Strong private spending, including the AI boom, is part of that, and so is government spending and hiring at a record share of the economy. Until governments ease off and productivity lifts, the RBA's brake does the work and borrowers feel it. If you have a home loan, hold cash or draw a retirement income, it is worth checking where you stand. The first conversation is complimentary.

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