Welcome to CoreLogic's housing market update for August 2022.

Australian dwelling values fell by -1.3% last month, marking the third month in a row where our national Home Value Index has fallen. This most recent three month period coincides with three months of interest rate hikes, providing the first opportunity since 2010 to observe the impact of higher interest rates on housing market conditions. Nationally, values are down 2.0% since their April peak, however the downwards trend comes after national dwelling values surged 28.6% through the pandemic growth phase.

Five of the eight capital cities recorded a month-on-month decline in July, led by Sydney and Melbourne. Brisbane also fell for the first time since August 2020, while Canberra and Hobart were also down over the month.

Although Perth, Adelaide and Darwin remained in positive growth through July, each of these markets have recorded a slowdown in the pace of capital gains since the first interest rate hike in May.

Although the rate of growth in housing values was slowing well before interest rates started to rise, its abundantly clear markets have weakened quite sharply since the first rate rise on May 5. At a national level, the rate of decline is comparable with the onset of the global financial crisis in 2008, as well as the sharp downswing of the early 1980s. In Sydney, where the downturn has been particularly sharp, we are seeing the sharpest value falls in almost 40 years.

Regional markets have also weakened, with the combined regionals index recording the first monthly decline since August 2020. Dwelling values were down across most of the broad rest of state regions, but continued to trend higher in Regional SA and Regional WA.

Overall, regional markets are still outperforming their capital city counterparts, but this month's figures show major regional centres are not immune to falling home values.

Dwelling values across CoreLogic's combined regionals index were up 41.1% from the pandemic trough to the June peak, compared with a 25.5% rise across the combined capitals index. The stronger growth reflects a significant demographic shift towards commutable regional markets, which is likely to have some permanency as more workers take advantage of formalised hybrid employment arrangements.

Regional areas recording the most significant falls tend to be the major regional centres within commuting distance of Sydney, Melbourne and Brisbane, which are also the same markets that typically recorded the largest gains through the growth phase.

We are also seeing unit values across the combined capitals recording smaller falls relative to house values. This trend is most apparent across the three largest capitals as well as Canberra, where affordability challenges may be pushing more demand towards the medium to high density housing. Additionally, firmer interest from investors should favour the unit market over houses where demand has historically been more concentrated.

Turning our attention to housing demand, CoreLogic's estimate of sales activity over the three months to July was -16.0% lower relative to the same period in 2021. The national figures are heavily impacted by an estimated -40% drop in sales across Sydney and a -26% fall in Melbourne sales, relative to the same period a year ago. Stronger markets such as Adelaide and Perth have recorded a rise in activity, with the estimated volume of sales up 22% and 7% respectively.

There is a good chance the number of properties sold in the second half of this year and into 2023 will continue to trend lower as higher interest rates, a more cautious lending environment and a reduction in household confidence continues to weigh on housing demand.

Rents continued to trend higher through July, rising 0.9% nationally over the month to be 9.8% higher over the past 12 months, which is the highest annual rate of growth since at least 2006 when CoreLogic began tracking rental markets. The trend in rising rents is evident across each of the capital city and broad rest of state markets, led by Brisbane with a 4.2% rental rise over the three months to July.

Rental markets are extremely tight, with vacancy rates around 1% or lower across many parts of Australia. The number of rental listings available nationally has dropped by a third compared to the five-year average, with no signs of a lift in rental supply. On top of already tight rental supply, it's likely demand will continue to increase as overseas arrival numbers climb.

With rents rising faster than values, yields are consistently improving, albeit from record lows. Across the combined capital cities, the gross yield has increased from a record low of 2.9% in February 2022 to 3.2% in July. The most rapid yield recoveries have occurred across the Sydney and Melbourne unit markets, where gross yields have increased by 45 and 40 basis points respectively.

Such tight rental markets, improving yields and stronger buying conditions may help to keep a floor under investment demand.

As always, housing conditions are different from city to city.

Sydney is once again leading the housing cycle, with values peaking much earlier than other cities back in January. It's also the first city to enter the downswing with housing values dropping 5.2% since that time. However, it will take a significant downturn to reverse the 28% rise in values recorded through the growth phase. House values across Sydney have accrued a much higher capital gain through the growth cycle than units, rising by 34% from the COVID trough to recent peak, while unit values have increased by less than half that amount, up 15.4%. However, the most recent trend is now seeing house values falling at a faster rate than units, as demand across the more affordable unit sector holds firmer. Sales activity has trended lower quite sharply, dropping by roughly 40% over the past three months compared with the same period a year ago, demonstrating less demand as interest rates rise.

Melbourne housing values peaked shortly after Sydney, in February this year, following a 17.3% gain in values since the pandemic. Property values are down 3.4%, since the February peak, with house values down 4.1% and units falling 2.1%. Of course, house values recorded a larger upswing, rising almost 21% though the growth cycle compared with lower 10.5% gain across the unit market. In another sign of slower conditions, the quarterly transaction volumes across Melbourne has slumped by an estimated 26% compared with the same period a year ago. As home sales have declined, listings have risen, with Melbourne recording 10% more active listings in July than a year ago.

Brisbane's housing market recorded the first month on month decline since August 2020, with values down 0.8% in July. The monthly decline was entirely due to weaker house values, which fell 1.1% in July, while unit values across Brisbane increased 0.7%. Although unit values have been more resilient so far, the softening quarterly trend suggests that unit values will probably start to trend lower over the coming months as well. As conditions cool, Brisbane home sales have also trended lower, falling by an estimated 8.5% over the past three months compared with the same time last year. Although values and the volume of sales are down, the context is important. Brisbane home

values surged almost 43% higher through the upswing, adding roughly $236,000 to the median dwelling value.

Adelaide remains one of the few capital cities where housing values are still rising, despite higher interest rates and a recent history of surging values. Dwelling values have increased by almost 45% through the growth cycle to-date, adding approximately $201,000 to the value of an Adelaide dwelling. Although the market remains in positive territory, the pace of gains is clearly losing steam. The quarterly growth rate has reduced from 7.4% over the three months to January, to 3.6% over the most recent three month period. Considering the softening growth trajectory, it looks like that Adelaide housing values will move into decline over the coming months. Home sales are holding strong though, with the number of properties sold over the past three months up 22% compared with last year.

Perth housing values were up 0.2% in July, marking Perth as one of only three capitals to record an increase over the month. Perth housing values remain at record highs, having risen by 25.9% through the growth cycle to date. Although values are still rising, the pace of growth has noticeably eased since interest rates started rising in May and, despite extremely low advertised stock levels and ongoing strong demand, the trend is pointing towards lower housing values over the coming months. Arguably Perth's strong foundations should help to insulate the market from a material downturn. Stock levels remain low, housing is substantially more affordable than other capitals, the local economy is strong and interstate migration is well and truly and record highs.

Hobart housing values have been trending lower since peaking in May, tracking lower over three of the past four months. Since moving through a peak, Hobart housing values are down 1.7%, led by a 2.9% drop in unit values. As the market cools we have also seen less buying activity. Home sales are down 5.6% over the past three months compared with the same time a year ago. At the same time, advertised stock levels have risen sharply to be 60% higher than a year ago, although a year ago stock levels were around record lows. The recent weakness comes after dwelling values rose 38% through the pandemic growth cycle.

Darwin housing values were up half a percent in July, continuing a relatively mild run of growth. Housing values have increased 5.3% over the past 12 months and 30% through the growth cycle to date. The growth trend has slowed over recent months, suggesting we could see Darwin housing values slip a little lower as interest rates rise. However, with housing values so affordable and relatively strong economic conditions, it's likely the Darwin housing market will be relatively insulated from a material downturn.

Canberra's housing values have fallen over two of the past three months, breaking a 33-month run of consistent capital gains. Since peaking, the market is down 1.1%, led by a 1.5% drop in house values and a 0.2% fall in unit values. Sales activity over the past three months has fallen by 15% relative to the same time last year, resulting in a 22% jump in advertised stock levels relative to the same time a year ago. Despite the rise in listings, overall advertised stock levels remain 5.4% below the previous five year average.

With forecasts for the cash rate ranging from the mid 2% to the early 3% range, even the best case interest rate scenario indicates variable mortgage rates will roughly double from their current level. For a household with a $750,000 mortgage, a cash rate of 2.5% implies a variable mortgage rate for a new buyer of around 4.8%, adding around $1,010 per month to mortgage repayments relative to the record low rate setting prior to May 5. A cash rate of 3.5% would add approximately $1,480 per month to the cost of a $750,000 mortgage.

As borrowing power is eroded by higher interest rates, and rising household expenses due to inflation, it's reasonable to expect a further loss of momentum in housing demand.

On a more positive note, this interest rate hiking cycle may be short and sharp, with financial markets and some economic forecasters now factoring in interest rate cuts through the second half of 2023. When interest rates start to stabilise, or potentially reduce next year, this could be the cue for housing values to find a floor. Similar to the trajectory of the upswing, this downswing phase could be a short but sharp one, depending on how high and fast interest rate settings go.

In the meantime, the housing market is set to face some near term challenges.

The spring listing season will test the depth of housing demand. Historically the flow of new listings has surged through spring and early summer, typically reaching a peak in late November. The rise in freshly advertised stock may not be met with a commensurate lift in buyer demand, resulting in higher levels of housing inventory.

By late spring or early summer, we could see advertised stock reach higher than normal levels. Vendors are likely to be more competitive across a smaller pool of active buyers, which would drive clearance rates lower across auction markets, and result in longer selling times and larger discounting rates for private treaty sales.

Borrowers who locked into a fixed term mortgage rate through the pandemic growth cycle will be facing a significant refinancing event once their fixed rate expires. ABS housing finance data shows that fixed rate borrowing peaked at 46% of mortgage originations between July and August 2021. RBA analysis is forecasting a surge in fixed loan expiries throughout the second half of next year. Many of these borrowers could be moving from mortgage rates around the high 1% to low 2% range to a mortgage rate closer to 6% or higher.

The risk of a rise in distressed property sales due to debt servicing challenges is at least partially offset by extremely tight labour markets and high repayment buffers, in the form of savings and offset accounts, accumulated over the COVID period.

However, for mortgage holders in 2022, income growth has been a little more elusive than past periods of high inflation. Income growth will be an important factor in how well the housing market performs amid rate hikes. ABS data shows the wage price index was up 2.4% in the year to March, below the series average growth of 3.0%, but growth is climbing from a low of 1.2% over the year to September 2020.

Overall, the trajectory of home values will be inversely correlated with the path interest rates take. With the RBA expecting inflation to peak towards the end of this year, we could see interest rates levelling out through the first half of 2023. If that is the case, it will probably be the cue for housing values to find a floor as well.

While housing values are set to fall further over the remainder of the year and into 2023, the silver lining will be seen in improvements to housing accessibility. Lower housing prices will help to boost home ownership in the long run and support an improvement in overall housing affordability.

I think it's going to be an interesting second half of the year. If you would like to keep up to date with our research in more detail, make sure you visit the research pages at corelogic.com.au