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

Our national Home Value Index recorded a second consecutive month of decline in June, down -0.6%, to be -0.2% lower over the June quarter. Continued falls in Sydney and Melbourne were the primary drivers of this month's steeper drop, but housing values were also down in Hobart and regional Victoria. Every capital city and broad rest of state region is now well past their peak rate of growth as the trend of value increases eases across the remaining markets.

National housing values have been easing since moving through a peak in March last year, when early drivers of the slowdown included rising fixed term mortgage rates, an expiry of fiscal support, a trend towards lower consumer sentiment, affordability challenges and tighter credit conditions.

More recently, surging inflation and a rapidly rising cash rate have been additional headwinds for home values. Since the initial cash rate hike on May 5th, most housing markets around the country have seen a sharper reduction in the rate of growth.

Looking below the headline capital city trends, the combined regionals index remained in positive growth territory in June, albeit slightly, rising 0.1%. Its quarterly value change reduced from a peak of 6.6% in April last year, to 2.0% over the three months to June. In contrast, the combined capital cities index was down -0.8% over the June quarter, reducing from a peak of 7.1% over the three months to May last year.

Also, unit markets are holding their value a little better than houses across the largest capitals. Sydney recorded a -3.0% drop in house values through the June quarter compared with a -2.1% fall in unit values. Melbourne also showed a smaller quarterly decline in units relative to houses at -0.5% and -2.4% respectively.

The stronger performance across the unit sector comes after house values consistently outperformed units through the upswing. Since the onset of the pandemic in March 2020, capital city unit values have risen 9.8% compared to 24.7% for houses, resulting in better affordability across the medium to high density sector.

As housing conditions slow, we are seeing the market swinging back in favour of buyers. While national advertised stock levels remain 6% lower relative to 2021, in Sydney and Melbourne, where housing conditions are the weakest, total advertised supply is now well above the levels recorded a year ago and higher than the five-year average. Hobart has seen advertised stock levels jump 54% higher relative to last year and inventory is 19% higher in Canberra.

The rise in advertised supply across some markets is mostly due to a slowdown in the rate of absorption. Nationally, home sales were down -16% in the June quarter compared with the same period last year, but still holding 13% above the previous five-year average.

Tougher selling conditions are evident in weekly auction results, where the combined capital city clearance rate has held below 60% since the last week of May, while private treaty sales are experiencing longer selling times and higher levels of vendor discounting rates.

On the flip side, rental markets are doing the opposite of housing values. Rental conditions remain extremely tight around the country, with rents now consistently rising at a faster rate than housing values.

Nationally, rents increased 0.9% in June, taking the annual growth rate to 9.5%, the highest 12-month change in rents since December 2007 when record levels of overseas migration pushed rental demand higher.

At the national level, rents have been rising faster than housing values for five months now, placing renewed upwards pressure on yields. After bottoming out at a record low of 3.21% in the first two months of 2022, the average gross yield has increased to 3.33%.

With rental markets expected to remain tight, it's likely rents will continue to outpace growth in housing values, driving a rapid recovery in rental yields. Higher yields may help to offset less demand from investors, although this sector of the market is generally more motivated by prospects of capital gains than rental returns.

Let's take a look at the trends in more detail across each of the capital cities.

After housing values surged by 28% through the pandemic, Sydney's are now consistently trending lower, chalking up the fifth consecutive month of decline in June. Since peaking, Sydney housing values have reduced by -3.1% or approximately $35,200. House values are recording a sharper drop than unit values, down -3.2% and -2.9% respectively from their recent peaks, but the larger decline in house values comes after a more significant upswing. Sydney house values surged 34% higher through the growth cycle while unit values were up less than half that at 15%. As the market cools, the number of home sales has fallen by about a third in the June quarter compared with the same period a year ago, paving the way for a rise in advertised supply and more challenging selling conditions.

Housing values across Melbourne increased by 17% through the growth phase, with house values up 21% while unit values rose 11%. Since peaking in February, house values are down -3% and unit values have reduced by -1%. Taking the recent decline into consideration, Melbourne housing values are up by 8.6% or roughly $24,200 since the onset of COVID in March 2020. As conditions cool, the number of home sales is also trending lower, down by an estimated -18% in the June quarter compared with the same period last year. As buyer demand wanes, advertised supply levels have risen to be 3% higher than a year ago and 9% above the five-year average for this time of the year. With more stock, market conditions are now favouring buyers over sellers with clearance rates holding below 60% through June while days on market and vendor discounting rates trended higher for private treaty sales.

Brisbane's rate of growth in housing values has eased sharply, reducing from a quarterly trend rate of 8.5% through the December quarter to 2.7% in the June quarter. The monthly rise was just 0.1% in June. If this trajectory continues, we are likely to see Brisbane housing values declining month-on-month through July. Growth conditions are cooling more noticeably for houses rather than units. Over the quarter Brisbane house values were up 2.5% compared with a 3.5% rise in unit values. As the market slows, the number of home sales through the June quarter was estimated to be -7.5% below the same period last year. Less demand has also flowed through to a consistent rise in advertised stock levels, along with a rise in average days on market and higher vendor discounting rates.

Adelaide has continued to stand out as the nation's strongest capital city housing market, with dwelling values up a further 1.3% in June. Through the growth cycle so far, Adelaide housing values have increased by 44% adding roughly $197,000 to the median dwelling value. Most of this growth has been centred in the house market rather than units, with values up 48% through the growth cycle to date for houses while unit values are up a smaller 23%. With advertised supply levels still -16% below a year ago and -39% below the previous five-year average, it's likely sellers will continue to see prices rising over the coming months but at a slower pace as interest rate rises and affordability dampens demand.

Perth housing values were up 0.4% in June, marking the second month in a row where the rate of capital gain has reduced. The slowdown follows a temporary rebound in Perth's rate of growth that coincided with reopened state borders, however it is looking like the Perth market is losing some steam alongside the national trend. Advertised housing stock remains extremely low and is trending lower as buying activity remains elevated, implying selling conditions remain strong across the Perth market. This is backed up by rapid selling times as homes average just 18 days to sell, although such rapid selling time has occurred as discounting rates have edged higher. With the median dwelling value of $558,600 remaining the lowest across the capital cities, housing affordability is far less challenging than other capital cities, which could help to insulate the Perth market from a larger downturn.

Hobart home values were down -0.2% in June, the second month-on-month decline over the past three months. The negative results in April and June were enough to drag the quarterly result into negative territory for the first time since June 2019. As market conditions ease, buyer demand is also reducing. Home sales through the June quarter were estimated to be almost -11% below the five-year average. With fewer buyers, advertised stock levels have risen substantially, albeit from virtually record lows to be 54% higher than a year ago but still below the five-year average.

Darwin dwelling values were 2.3% higher over the June quarter, the third highest growth rate after Adelaide and Brisbane. Despite the relatively strong reading over the quarter, Darwin housing values are only 6.5% higher over the year, reflecting relatively soft conditions through the second half of 2021. Sales activity has also picked up across Darwin, with home sales in the June quarter estimated to be 28% above levels a year ago. With a median value just under $510,000, Darwin housing prices remain very affordable and continue to attract the highest rental yields amongst the capital cities.

The growth trajectory for housing values across the ACT has eased over the past 10 months, after moving through a peak quarterly rate of growth in August last year. At that time, values were rising by 7.3%, but since then the quarterly pace of growth has reduced back to 1.5%, the lowest level since August 2020. The number of home sales was estimated to be -14% lower in the June quarter compared with a year ago and listing numbers are now 19% above levels from a year ago. As buyers have more choice, homes are taking a little longer to sell and discounting rates have increased by more than a percentage point over the past 12 months.

Australia's housing market outlook is becoming increasingly skewed to the downside, with the trajectory of housing values heavily dependent on the path interest rates take.

While forecasts vary significantly it's entirely possible the cash rate could rise beyond the pre-COVID 10-year average of 2.56%. Under this scenario, the average variable mortgage rate for new owner occupier loans would be approximately 4.9%, more than double the 2.4% average variable mortgage rate in April, adding roughly $720 per month to a $500,000 mortgage or $1,445 per month to a $1 million loan.

Households are likely to be all the more sensitive to rising interest rates due to record levels of debt held by the sector. Household debt to income ratios from the RBA indicate debt levels reached new record highs in the March quarter. The ratio of household debt to disposable income was recorded at just over 187%, the large majority of which was held in housing debt.

The double whammy of high inflation is another factor likely to weigh on the household sector and ultimately housing demand. Non-discretionary inflation is rising at more than double the pace of discretionary inflation, which means households are likely to be saving less as they spend more on essentials such as food, fuel and shelter.

Lower savings and higher expenses along with rising interest rates will have an ongoing impact on borrowing capacity for households. Reduced borrowing capacity is likely to further diminish housing demand and potentially deflect more home buyers towards the middle to lower end of the pricing spectrum.

Higher interest rates and rising inflation are also both likely to continue to weigh on consumer sentiment. Housing activity and consumer sentiment are highly correlated. A pessimistic mindset among consumers implies a further reduction in home sales. If sentiment remains subdued we are likely to see the number of home sales drift lower as housing demand cools and lenders become more cautious in their approach towards borrowers.

How far housing values fall through the downturn remains highly uncertain, however a peak to trough decline of more than -10% is becoming a mainstream outlook across the various private sector forecasts. A -10% decline in the market would take national housing values back to levels similar to July 2021. A -15% decline would take the market back to April 2021 levels and a -20% decline in home values would take the national index to January 2021 levels, and only marginally above where home values were in late 2017.

Strong labour markets will be one key factor in supporting mortgage repayments and keeping distressed listings off the market. Generational lows in unemployment alongside a record high participation rate will help households meet their debt repayment obligations, despite rising rates and high inflation. A key risk for housing markets would be any material loosening in labour markets, which could be triggered if the cash rate moves to a contractionary setting, reducing economic output.

A substantial accrual in borrower repayment buffers is another factor helping to safeguard the housing market, estimated to be 21 months for owner occupiers on a variable rate mortgage, meaning most households have a significant safety net if temporarily faced with a change in circumstances.

Mortgage stress should also be minimised to some extent by mortgage serviceability assessments at the time of the loan origination. Under these serviceability scenarios it is reasonable to expect borrowers should be able to accommodate higher mortgage repayments costs, although such a rapid rate of inflation could create some challenges for borrowers on thinly stretched budgets.

Clearly the housing market is changing rapidly as rising interest rates and inflation along with low sentiment and ongoing affordability challenges dampen housing demand. You can stay up to date with all the key trends by checking out the news and research pages at corelogic.com.au.