Welcome to CoreLogic's housing market update for June 2022

Housing markets lost more steam in May as a combination of higher interest rates, rising inventory levels and lower sentiment dampened conditions. CoreLogic's Home Value Index showed Sydney and Melbourne dwelling values continued to record the most significant month-on-month falls, while Canberra recorded its first monthly decline since July 2019.

Although housing values continued to rise across the remaining capitals, the growth was not enough to offset the depreciation in Sydney, Melbourne and Canberra, which pushed the combined capitals index -0.3% lower over the month.

Elsewhere growth trends remained positive in May, albeit with less momentum in most markets. Perth and Adelaide were the exceptions, where the quarterly growth trend lifted in May, although both regions remain below the peak quarterly rate of growth.

While the higher cash rate and lift in variable mortgage rates in May played a role in the weaker housing values, it is important to remember market conditions have been weakening over the past year, at least at a macro level.

The quarterly rate of growth in national dwelling values peaked in May 2021, shortly after a peak in consumer sentiment and a trend towards higher fixed mortgage rates. Since then, housing has been getting more unaffordable, households have become increasingly sensitive to higher interest rates as debt levels increased, savings have reduced and lending conditions have tightened. Add to that rising inflation and a higher cost of debt, and it all flows through to less housing demand.

With the trend rate of growth easing across most regions over the past year, the annual rate of change has eased sharply over recent months, dropping to 11.7% across the combined capital cities, down from a recent peak of 21.3% over the 12 months ending January 2022.

Although regional Australia continues to demonstrate stronger growth conditions, it's also come off peak growth rates, with the annual growth trend easing to 22.1%, down from its January peak of 26.1% and likely to trend lower through the rest of the year.

As the pace of growth eases across most regional markets, we're likely to see growth conditions softening in line with higher interest rates and worsening affordability pressures. Arguably some regional markets will be slightly insulated from a material downturn in housing values due to ongoing supply and demand imbalances as we continue to see advertised stock levels remain extraordinarily low across regional Australia.

A combination of higher interest rates, housing affordability constraints, diminishing household savings and lower consumer sentiment has also had a negative impact on home sales. Nationally, our estimate of settled sales over the three months to May was 19.2% lower than at the same time last year. The figures remain 12% above the previous five year average however it's likely housing turnover will continue to trend back towards average levels as interest rates normalise.

Lower sale volumes are being accompanied by a gradual rise in advertised stock levels. Nationally advertised inventory is 10% below levels from a year ago, but buyers in softer markets like Sydney and Melbourne have more choice, less urgency and better leverage as advertised stock levels rise to above average levels.

While housing value growth has slowed, rents continue to rise swiftly. Nationally, CoreLogic's Hedonic Rental Index increased 1.0% in May, taking the quarterly rate of growth to 3.0%, up 60 basis points on a year ago. Rents are up 8.8% in the past year across the combined capital cities and 10.8% across the combined regions.

For investors, yields are recording some upwards momentum, amidst rising rents and a general easing in home value growth, especially in Sydney and Melbourne. Despite the upwards trajectory, yields remain remarkably low, but a recovery back to average levels may happen sooner rather than later if housing values continue to be outpaced by rents.

The detail remains diverse from region to region.

Sydney housing values moved through a fourth month of consecutive declines, with the magnitude of falls gathering some pace. Values were down 1% in May, taking the market 1.5% lower, or roughly $17,300 down on the January peak. As the market moves into the early phase of a downturn, sales activity is also fading, with settled sales over the past three months estimated to be down by a third relative to the same period a year ago. With a slower rate of absorption, advertised stock levels have normalised and are slightly higher than the five-year average. With more stock to choose from, homes are taking longer to sell, discounting rates have risen and auction clearance rates are trending to below average levels. With conditions gradually favouring buyers over sellers, vendors may need to adjust their pricing expectations in order to meet the market.

Melbourne housing values have declined over four of the past six months, with the 0.7% decline in May the largest monthly fall since September 2020. Larger falls are evident across the upper quartile of Melbourne's market, where housing values are down 2.0% over the past three months. In contrast, the lower quartile of the market has seen a 1.1% rise in values over the past three months as housing demand remains stronger across the more affordable end of the market. Lower demand is reflected in our estimate of sales activity over the past three months, which was tracking 21% below levels recorded over the same period a year ago. As demand fades, advertised listings are rising. At the end of May inventory levels were 1.3% higher than at the same time last year and 8.1% above the five year average.

Brisbane housing values have continued to trend higher, although the trend rate of growth has nearly halved from the recent peak in December last year. Then housing values were rising at 8.5% over the quarter but have since eased back to 4.6% over the rolling quarter, which is still outperforming the national average growth rate of 1.1%. A key factor supporting Brisbane's ongoing price growth is that listings remain extremely low. At the end of May, total advertised stock levels were holding 28% below the five-year average in Brisbane. At the same time, home sales have eased, but remained approximately 15% above the five-year average in May. With demand continuing to outweigh available supply, homes are selling in just 20 days on average with minimal levels of discounting.

Adelaide has been leading the capital cities for growth in housing values for several months. In May, housing values were up 1.8%, well above the monthly change recorded across the other capitals. A combination of low supply and high demand is fueling Adelaide's growth. From the supply side, advertised stock levels were almost 40% below the five-year average at the end of May, while, on the demand side, home sales were estimated to be 32% above the five-year average. Although prices are continuing to rise faster than any other capital, there is some evidence that conditions are slowing down. The peak rate of growth, based on the rolling three month change in dwelling values, was recorded in January at 7.4% and has reduced to 5.7% over the most recent three month period.

The monthly rate of growth eased in Perth, reducing from 1.1% in April to 0.6% in May. The lower monthly growth rate is a surprise considering advertised listings trended lower through the month to be down 18% on levels recorded a year ago, while estimated sales activity increased over the month to be roughly in line with levels a year ago. With a median dwelling value of $555,500, Perth is the most affordable state capital. Along with an extremely tight labour market and strong economic conditions, the affordability advantage of the Perth housing market should help to keep a floor under housing demand as interest rates rise.

The pace of growth across Hobart has been easing since the city moved through a peak rate of growth in July last year. At that time housing values were rising at the rolling quarterly pace of 8.2%, but that figure has since reduced back to just 0.3%. A key factor in the softer growth rate is a sharp rise in Hobart listings, up 30% on last year. There's been a noticeable reduction in sales activity, which we estimate was down 26% in May compared with the same month last year, and an increase in new listings, up 29% on last year. With available supply starting to outweigh demand, we could see the Hobart market weakening further.

Darwin housing values were up half a percent in May, a step down in the pace of growth recorded over the past two months where the monthly growth rate was 0.8% and 0.9%. Despite the slip in capital gains, the estimated volume of sales remains well above average levels and 16% higher than year ago. Even with a higher volume of sales, advertised listings have increased by 13% relative to the same time last year, which may help to explain the recent softening in growth conditions.

Canberra housing values recorded a rare decline in May, edging 0.1% lower over the month. Although the drop was only slight, it was the ACT's first month on month fall in almost three years. Rather than a blip, this market softening looks to be a continuation in the slowing trend that has been evident since a peak rate of growth was recorded in August last year. Housing values were increasing at the quarterly pace of 7.3% but have since eased back to 2.2% with the potential for a further softening in the growth trend over coming months.

As interest rates normalise over the next 12 to 18 months, the expectation is most of Australia's capital cities will move into a period of decline brought about by less demand. The trajectory of interest rates will be a key factor in future housing market outcomes. Forecasts for where the cash rate may land are varied. After the Reserve Bank's May board meeting, the governor noted a cash rate of 2.5% wouldn't be an unreasonable expectation. Financial markets are still betting on a cash rate above 3% before mid-2023, while economic commentators show a broad range in their cash rate forecasts.

With the housing debt to household income ratio at record highs, household balance sheets are likely to be more sensitive to rising interest rates.

High inflation could be another factor contributing to softer growth conditions in the housing sector. A prolonged period of high inflation is likely to lead to lower rates of household saving and may potentially weaken prospective borrower's ability to meet serviceability assessments from lenders.

Consumer sentiment also remains low. Historically there has been a strong correlation between consumer attitudes and housing market activity.

These factors, together with stretched housing affordability and a more conservative approach from lenders, especially towards borrowers with high debt levels, are likely to contribute towards less housing demand over the medium term.

However, there are several mitigating factors to consider as well.

Labour markets are tightening, sending the unemployment rate to generational lows and placing additional upwards pressure on wages growth. As income growth outpaces housing values, the home deposit hurdle will gradually lessen, reducing one of the key barriers to entry for home buyers.

Strong labour market conditions, together with a growing economy will help to contain mortgage arrears and mitigate some risk of a surge in forced sales placing additional downwards pressure on housing values.

Mortgage stress should also be minimised to some extent by mortgage serviceability assessments at the time of the loan origination. All borrowers have been assessed under a mortgage rate scenario 2.5 percentage points higher than the origination rate, and since October last year, borrowers were being assessed with a buffer of 3 percentage points.

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 with thinly stretched budgets. With the RBA set to steadily raise the cash rate through the rest of the year and into 2023, we are likely to see falls in housing values become more widespread as mortgage rates trend higher.

As these trends evolve we will be keenly reporting all the twists and turns at the research pages of corelogc.com.au