Economics and Markets Research

Economic Comment

The implications of a housing slowdown

Key points

- We expect house prices to fall ~7% peak to trough, a sharp slowdown from the 8.8% growth over 2025.
- Declines of that magnitude are not outside recent experience, but they do support our forecast for below trend GDP growth. In this note, we identify how housing transmits to the broader economy.
- We expect weaker credit demand, especially for investors, tighter borrowing capacity, slower dwelling investment, and softer consumption. Estimates generally find a 10% fall in dwelling prices subtracts ~1ppts from consumption growth over a couple of years.
- Elevated construction pipelines in QLD, WA and SA mean near-term completions will be insulated, but also, that construction activity may respond more slowly.
- While conditions in the established market have softened, rental markets remain tight and homebuilding input costs are likely to support housing CPI this year. Cooler demand should help ease broader inflation in 2027.
- For the RBA, below trend growth is necessary amid elevated inflation. Monetary policy will not be a circuit breaker for the housing cycle this year.
- The shift in credit demand is still important. The RBA's assessment of financial conditions has been sensitive to housing lending. Housing dynamics both reflect and complement somewhat restrictive RBA policy.

Summary

In this note, we first put context around the housing slowdown, before outlining how it transmits to GDP, CPI, credit and financial conditions.

GDP

- ○ Slower turnover weighs directly on GDP via ownership transfer costs and related activity.
- ○ Falling household wealth weighs on consumption via wealth effects and credit constraints for households.
- ○ A lower price outlook slows housing investment.

CPI

- ○ Input cost pressures support New Dwelling costs in the near term, with the cooler demand environment more relevant for CPI next year.
- ○ Rents growth remains supported amid undersupply and low vacancies and changes to taxation arrangements for housing investors.
- ○ Cooler domestic demand growth feeds into broader easing in domestic pressures over time.

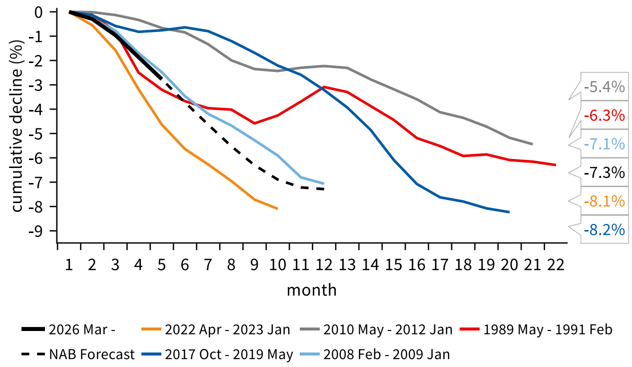
Credit and financial conditions

- ○ Tax changes are an exogenous shift to borrowing capacity and housing demand.
- ○ But broader lending standards and supply of lending remain supportive.
- ○ RBA's assessment of the policy stance has been sensitive to housing credit as a share of income. Housing will help build comfort that policy is now somewhat restrictive.

The housing market has slowed

Dwelling prices in Sydney and Melbourne continue to fall, and price declines have broadened to the mid-sized capitals. We expect peak to trough falls of ~7% nationally, comprised of ~10% falls in Sydney and Melbourne and 2-4% falls across the mid-sized capitals.

Capital city dwelling price downturns



Source: National Australia Bank, Cotality

That would reflect a sharp turn in the housing backdrop and is relevant for the macro outlook, but context is important. It would be broadly in line with the extent of price declines seen in 2018-19 and the brief interruption to strong post-pandemic price gains that came alongside an aggressive RBA tightening cycle in 2022-23.

The 2018-19 cycle had some notable differences to the current environment. It followed strength in supply on the back of the east coast apartment-building boom, whereas the

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supply response to recent price rises has been muted due to the capacity constrained construction sector and rental markets remain historically tight.

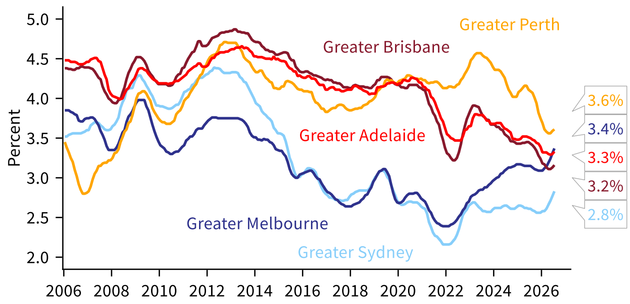
The 2018-19 cycle also came amid a tightening in credit conditions despite accommodative monetary policy due to macro-prudential changes and a post Royal Commission environment. This time, the RBA has been tightening policy, but competition among lenders remains strong.

Finally, it came after years of the RBA undershooting their inflation target amid a relatively loose labour market. The case for rate cuts was obvious. Today, a slowdown in house prices will instead be seen as restrictive monetary policy working as required. For now, monetary policy cannot be a circuit breaker.

The slowdown in price growth is driven by a combination of higher mortgage rates, affordability constraints, elevated uncertainty and the Federal budget's tax changes. Cycles are amplified by momentum and sentiment effects, making the extent of price declines highly uncertain.

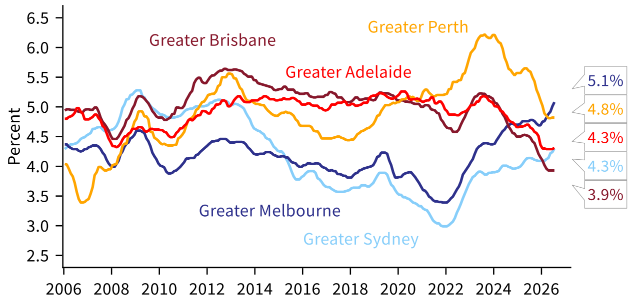
Tight rental markets and still elevated advertised rents growth are one factor leaning against the downward forces on prices. One implication of the tax changes in investor-owned property is a higher required rental yield to achieve a comparable after-tax return on leveraged property. Rental yields adjust faster in an environment of high rents growth.

Median house rental yield



Source: National Australia Bank, Cotality Australia, Macrobond

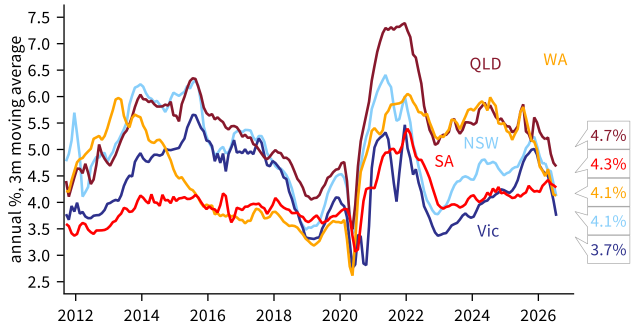
Median unit rental yield



Source: National Australia Bank, Cotality Australia, Macrobond

Alongside price declines, housing market activity is also slowing. The seasonally adjusted turnover rate fell to 4.1% in July, down from 5.2% a year ago. That remains above levels in the 2018-19 slowdown but is likely to slow further.

Turnover rates



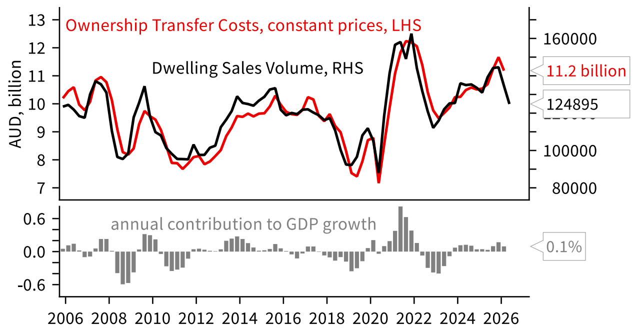
Source: National Australia Bank

The channels that matter for GDP

The direct effect of lower turnover

Slower turnover directly translates to GDP through ownership transfer costs. This alone can be material in larger cycles, subtracting 4 tenths from GDP growth over the year to Q1 2019 and 6 tenths from growth over 2008. The sharp turn in sales volumes this year is likely to subtract around 10-15bp from GDP in Q2 alone.

Dwelling Sales Volumes and Ownership Transfer Costs



Source: National Australia Bank, Australian Bureau of Statistics

Turnover-linked consumption and the wealth effect

Housing transactions also support spending through auxiliary services like removalists and via household goods purchases, while higher prices can support spending through a wealth effect.

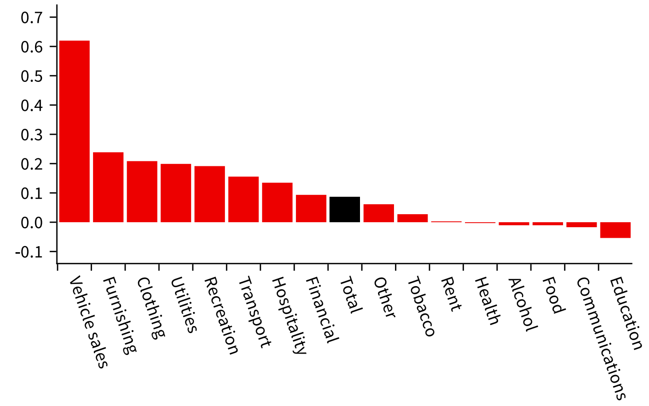
Estimates of the wealth effect tend to find that a 1% increase in housing wealth increases consumption by 0.1 to 0.2% over time (Wealth and Consumption | Bulletin – March 2019 | RBA). Over the first couple of years, the lower end of that range is a sensible baseline.

Because turnover and housing wealth tend to move together, estimates of the wealth effect can reflect both factors. Consumption tends to respond more in durable goods, including household furnishings, which can reflect turnover, but discretionary categories less related to turnover, like recreation and hospitality spending are also supported.

Motor vehicles also tend to have a particularly large response, reflecting improved borrowing capacity and higher wealth in a rising house price environment.

RBA estimates of wealth effect by category

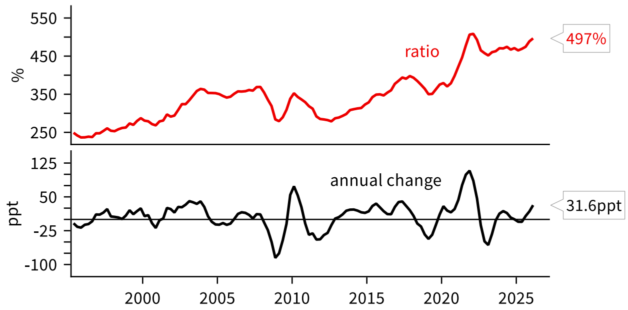
Short-run consumption response to 1% rise in housing wealth



Source: National Australia Bank; May, Nodari and Rees (RBA, 2019)

Wealth flows through to consumption much less directly than income, but housing cycles are also much larger than income cycles. The rise in net housing wealth over the year to Q1 2026 is equivalent to 32% of household disposable income.

Net Housing Assets to Income



*Housing assets less housing debt, share of disposable income
Source: National Australia Bank, Reserve Bank of Australia

A headwind to consumption growth from the housing market is built into our forecasts for below trend consumption growth this year and next, but sharper weakening in the housing market could see this shift more materially.

Housing debt and household cashflow

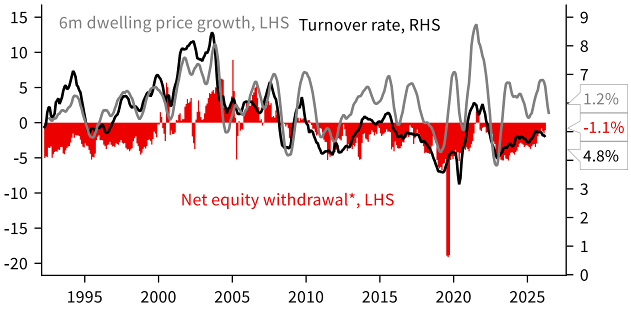
Much of the attention on monetary policy transmission in Australia focuses on the mortgage cash flow channel (i.e. higher cash rates raise mortgage servicing costs). But an RBA working paper last year found that because mortgages are liquid and households generally have buffers, there was little difference between the spending behaviour of fixed-rate mortgage holders and variable-rate mortgage holders in response to 425bp of tightening from 2022.

The broader housing debt channel also includes changes in borrowing capacity as house prices change. Improved borrowing capacity alongside strong housing market dynamics has offset some of the transmission of higher policy rates over recent years. Recent research from Bank of England staff looked at the response of mortgage holders' consumption to higher interest rates. It found a bigger effect from lower asset prices reducing borrowing power than it did from higher mortgage servicing costs.[1]

Housing dynamics also impact cash flow via the net withdrawal of equity. By changing lending arrangements, households can inject or withdraw equity from housing. Households' cash flow increases (debt increases) from trading down or borrowing more against housing collateral. Cash flow falls (debt falls) when households inject equity by paying down principal or paying for home purchases or renovations with cash.

Net equity withdrawal is correlated with prices and turnover. Australian households tend to pay down their principal faster than scheduled, meaning there is a structural injection of equity into housing. But that was falling back alongside rising turnover in the last couple of years. The very strong new lending demand in H2 2025 drove a further shift, equivalent to a cash flow boost of ~2% of household sector income.

Housing Turnover and net equity withdrawal

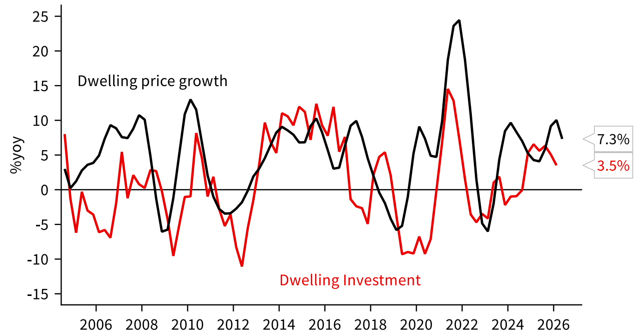


*housing credit less dwelling investment
Source: National Australia Bank, Cotality Australia

Building approvals and dwelling investment

Dwelling investment is responsive to changes in house prices, but the transmission is mediated by lags in approvals and construction timelines. Over the past few years, the usual supply response to higher prices has been slowed by binding capacity constraints and longer construction timelines.

Dwelling price growth and investment



Source: National Australia Bank, Australian Bureau of Statistics, Cotality Australia, Macrobond

The supply response to the previous price cycle is yet to fully flow through. It takes an average of 45 weeks to build a

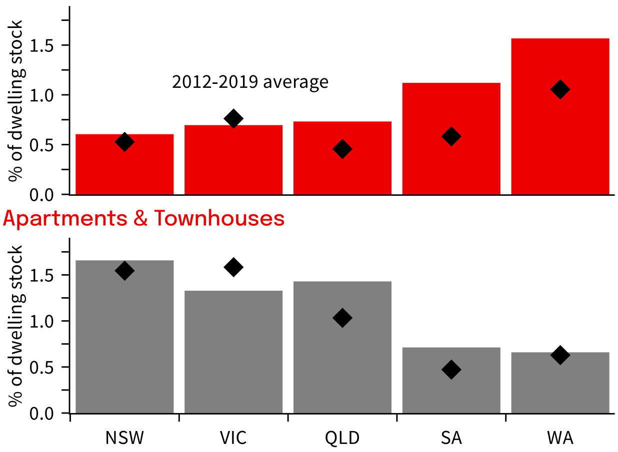
[1] In the UK, those decisions are discrete due to fixed mortgages, but they are essentially continuous in Australia through the combination of variable interest rates and offset accounts/redraw facilities

detached house, 50% longer than it did prior to the pandemic, and pipelines of work are elevated. 47% of firms in the construction industry say labour availability is a significant constraint on their output, compared to 27% in the broader economy. A sharp deterioration in residential construction demand would also flow through into construction employment, but the starting point is conditions that are tighter than the broader labour market.

Building approvals have been resilient so far but are expected to slow going forward. Even when they start to slow, elevated pipelines of work mean approvals may take longer to flow through to dwelling investment in GDP, which measures construction work done in the quarter. Demand for services earlier in the construction cycle, like architecture, surveying, designing and planning could see a more pronounced impact sooner, while finishing trades will be more insulated.

The pipeline of work also varies significantly by state. In NSW, dwellings and apartments under construction are only a little above their pre-pandemic average, while in Victoria they are a little below. In contrast, the QLD, SA and WA pipelines remain particularly elevated. Slower housing demand is likely to flow through to residential building activity more quickly in Melbourne and Sydney than in the mid-sized capitals.

Dwellings under construction (% of stock)



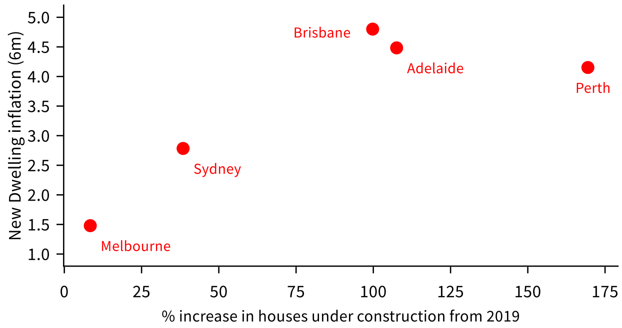
Source: National Australia Bank, Australian Bureau of Statistics

The consequences for inflation

Dwelling prices are not a consumer price for CPI purposes. Instead, the Australian CPI captures housing costs via actual rents and the cost of purchasing a newly built house (excluding land). As a result, it measures home construction costs and rental market dynamics rather than price changes in established housing.

The cost of a newly built home has surged over recent years as a result of a significant lift in the cost base for both labour and materials. But it is also sensitive to demand conditions. Inflation data by city shows it has been easier to pass through cost increases in the mid-sized capitals, where pipelines are fuller and demand is stronger.

Homebuilding inflation and pipelines

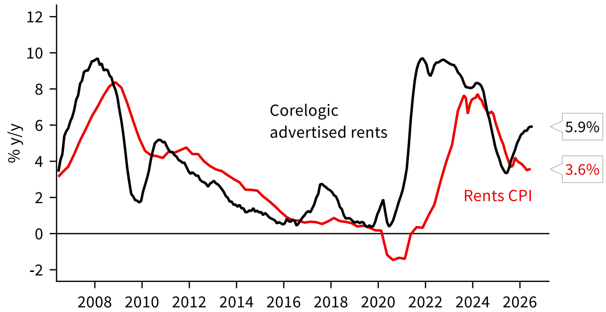


Source: National Australia Bank, Australian Bureau of Statistics, Macrobond

Looking forward, elevated cost pressures are expected to support the CPI in the near term via New Dwelling costs but should help lower inflation next year alongside a cooler demand environment and slower cost growth.

Rents dynamics are less supportive. Advertised rents, which are reflective of newly contracted rents have reaccelerated alongside low vacancy rates, and this tends to be reflected in CPI rents inflation over time.

Rents CPI



Source: National Australia Bank, Australian Bureau of Statistics, CoreLogic

Cooler aggregate demand and cost of living pressures will guard against too much further acceleration in new rents inflation, but the market remains structurally undersupplied amid exceptionally low vacancy rates.

The anticipated slowdown in dwelling investment is a headwind to supply, but that will take time to flow through. In the near term, elevated pipelines mean there is a large buffer before completions respond, particularly in the mid-sized capitals. Capacity constraints mean that the supply response to previous strength in housing markets will be flowing through even as demand for new projects slows.

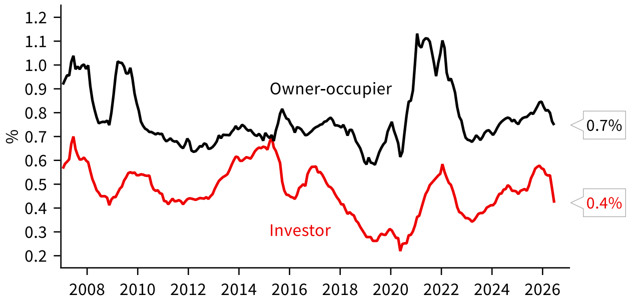
Credit and financial conditions

Housing credit and financial conditions

We expect housing credit to slow sharply, principally due to a slowing in new loan commitments, both alongside lower housing turnover and amid reduced investor demand due to the change in tax treatment of investor-owned property. Seasonally adjusted new loan commitments fell to 1.2% of the stock of credit in June, that's around 0.25ppts below 6 months ago, but new lending for both investors and owner-occupiers remains higher than 2018-19.

Housing Loan Commitments

Share of outstanding housing credit, excluding refi

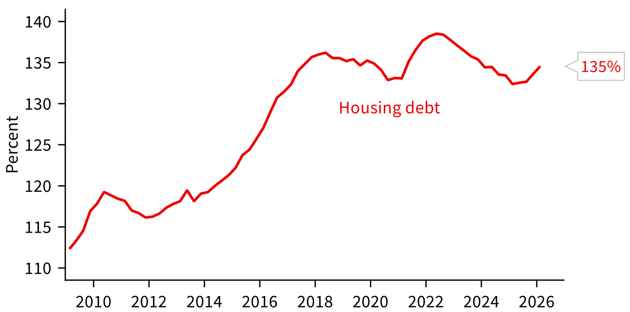


Source: National Australia Bank, RBA, ABS, APRA

Housing lending was important to the RBA's shifting assessment of financial conditions over 2025. In August 2025, the Minutes noted that "*Household credit was now growing at a similar pace to household disposable income, having risen more slowly than household incomes over the prior two or three years, when monetary policy was more restrictive*" and by February 2026, they noted that "*credit to households and businesses had either stopped declining or was rising, relative to relevant metrics of income.*"

Slower credit growth should help the RBA continue to build comfort that a policy of 4.35% is consistent with a restrictive stance of policy.

Housing debt to income*



*% of disposable income excluding interest payments
Source: National Australia Bank, Reserve Bank of Australia

Housing is far from a complete reflection of broader financial conditions, but it does matter. Governor Bullock said in a recent speech that the Federal Budget has had an effect on the Bank's assessment of financial conditions and that "*the housing market is a bit of a litmus test.*" (Monetary Policy in an Era of Shocks | Speeches | RBA).

Prior to the pandemic, then Governor Lowe noted a "*progressive tightening in lending standards over recent years*" noting maximum borrowing capacity that was 20% lower than in 2015 and an increase in caution among lenders. (The Housing Market and the Economy | Speeches | RBA).

The environment post pandemic has been different, RBA research in February noted instead that lower bank funding costs relative to the cash rate and narrower lending rate spreads may have contributed to an increase in the neutral interest rate.

In the current cycle, competition among lenders remains strong, but the changed tax treatment of investor lending has had an impact on borrowing capacity and demand for credit has slowed. We expect total housing credit to slow from current rates ~8% yoy to 3% yoy by September 2027.

How is the RBA factoring all of this in?

Since May, the RBA has acknowledged that the housing market has eased by more than expected and noted the risks associated with a "potentially material" weakening.

The RBA does not target house prices but has consistently assessed that the housing market has material and broader spillovers than direct effects through dwelling investment alone. Then Deputy Governor Guy Debelle said in 2019 that "*both the established market and housing construction, have a broader impact than the simple numbers would suggest.*"

More recently, the November 2025 SoMP, responding to the surprisingly large reacceleration in house price growth through 2025, included an upside scenario of 10% higher dwelling prices. The conclusion was that GDP would be a material 0.7% higher 2 years ahead. Research has generally found that effects of downturns are larger than those of price gains, and the RBA will be cognizant of more material growth risks if housing dynamics weaken more than anticipated.

Indeed, the RBA's August SoMP notes weaker housing markets drove a downward revision to their per-capita GDP forecasts and note further downside surprises on prices as a risk to growth expectations.

The housing story supports forecasts for slow growth and an assessment that financial conditions are now somewhat restrictive. But the relevant question for the RBA is instead whether growth will be slow enough and whether financial conditions are restrictive enough given ongoing capacity constraints and elevated inflation. Further, this downturn in housing is a story in established prices, not rental markets. The more direct flow through to housing components of CPI may be more muted than previous cycles.

Our baseline forecasts do not see housing as a trigger for easing; rather, housing dynamics both reflect and complement restrictive RBA policy. Nonetheless, a sharper deterioration in housing could shift the balance of risks towards growth, relative to inflation.

NAB expects that the RBA will continue its strategy of trying to minimise any cycle in unemployment while leaving little buffer to upside surprises. As such, we expect the Board to remain on hold, before gradual normalisation towards less restrictive policy from mid next year.

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