Weekly Economic Brief

21 August 2026 | Senior Economist's View

Is the RBA's restrictive policy working?

What the housing market is telling us

Last week, the RBA reiterated the need for monetary policy to remain restrictive to slow demand growth and return inflation to target. Two senior RBA officials have since pointed to the housing market as one of the clearest indicators of whether restrictive monetary policy is working. Recent developments in house prices, auction markets and mortgage lending suggest the adjustment is now well underway.

Capital city house prices have fallen by 2.8% from their peak, according to Cotality, with larger declines in Sydney and Melbourne. The downturn began after the RBA signalled its intention to raise rates and gathered pace after three rate hikes were delivered over the first half of 2026. Auction clearance rates fell below their long-run averages and the weakness has now broadened beyond the largest capitals. Daily data from Cotality for August suggest the downturn in established house prices may be accelerating across the eastern capitals, while previously resilient regional markets are also starting to lose momentum.

While the RBA does not target house prices, it does care about what they mean for the broader economy. Residential property accounts for two-thirds of total household wealth and, for most Australians, the family home is their largest asset. Changes in housing wealth therefore tend to have a larger effect on household spending than changes in share market wealth. Because housing responds quickly to changes in interest rates, it also provides an early indication of whether tighter financial conditions are slowing demand.

Importantly, the RBA acknowledges that the housing slowdown is not just an interest-rate story. Recent speeches from senior RBA officials suggest housing has softened by more than interest rate rises alone would normally explain, reflecting the additional impact of the Government's changes to capital gains tax and negative gearing on investor demand. The bank reporting season suggests investor demand has been materially affected. CBA reported investor mortgage applications down 28% since the Federal Budget, compared with a 15% decline in total applications, while NAB reported a 15% fall in total mortgage applications over the June quarter. The tax changes are reducing demand for established houses and reducing the amount of work monetary policy needs to do.

The more important question is what happens next. House prices have already fallen by around 3% and we expect the correction still has further to run, with dwelling prices likely to fall around 5-10% peak-to-trough.

Whether that becomes a broader economic problem will depend heavily on the labour market. A resilient labour market would allow households to absorb lower housing wealth through rising incomes. A weaker labour market would drag down incomes and spending but would also bring forward the prospect of lower interest rates. In either case, the labour market plays a critical role in determining how the housing adjustment feeds through to consumer spending and inflation.

This week's data suggest the labour market adjustment is occurring gradually rather than abruptly. Employment growth has slowed but remains positive, while wage growth has stabilised around 3¼%. But neither has collapsed: the labour market is losing some momentum, yet it remains resilient enough to support growth in household incomes. That should help cushion the broader economy, even as restrictive monetary policy weighs on demand, while also helping to restore housing affordability.

While it is easy to feel pessimistic when the value of your home is falling, the downturn also deserves some historical perspective. The 5-10% peak-to-trough decline that we expect comes after an increase of almost 50% since the pandemic. A downturn of this magnitude would not be unusual. In the housing markets downturns since 1993, the average peak-to-trough decline was 5% and they typically lasted around one year.

More fundamentally, however, the current downturn is occurring within a market that remains structurally undersupplied. Higher interest rates and changes to investor tax settings are reducing demand, but they do little to address the underlying shortfall of housing. Population growth continues to support demand, while elevated construction costs and weak productivity continue to constrain supply. Put simply, Australia still does not have enough housing. This should limit the extent of future price declines.

For now, the message is clear. The RBA wants to slow demand growth and the housing market is providing evidence this is occurring. Higher interest rates are slowing demand, while the Government's tax changes are amplifying the adjustment and reducing the amount of work interest rates need to do. As painful as it may be for existing homeowners, the housing downturn is providing the RBA with assurance that monetary policy is restrictive, reducing the likelihood that another rate rise will be required.

Table 1: Financial market movements: 13 - 20 August 2026

EQUITY INDEX	LEVEL	CHANGE	10-YR GOVERNMENT BOND	YIELD	CHANGE	FOREIGN EXCHANGE	RATE	CHANGE
S&P 500	7,641.2	-2.0%	US	4.70%	6.1 bps	US Dollar Index (DXY)	98.90	-1.1%
Nikkei 225	66,216.8	-3.1%	Japan	2.86%	-2.5 bps	USD-JPY	159.05	-0.3%
FTSE 100	10,748.2	-0.2%	UK	5.07%	11.4 bps	GBP-USD	1.363	1.1%
DAX	25,983.0	-1.2%	Germany	3.26%	12.8 bps	EUR-USD	1.168	1.3%
S&P/ASX 200	9,083.8	-1.1%	Australia	5.01%	1.6 bps	AUD-USD	0.711	0.8%

Source: Bloomberg

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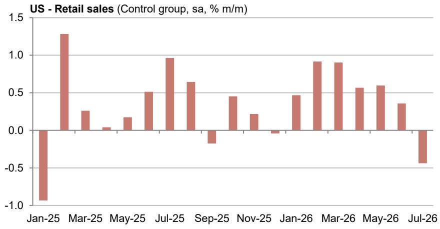
The Weekly Economic Brief is issued by QIC Limited ACN 130 539 123 ("QIC") and is compiled by QIC's Economics & Research Team.

Economic update by region

United States

US activity data softens in July

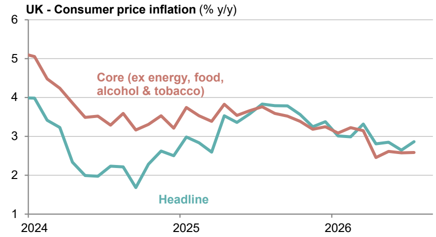
- Retail sales growth was weaker than expected in July, with nominal sales falling by 0.6% over the month. Control retail sales were similarly weak, declining by 0.4%. While shifting Prime Day sales patterns compounded the weakness in July, there has been clear evidence of a slowdown in the growth of the US consumer.
- Industrial production rose by a modest 0.2% in July following a 0.3% rise in June. On a quarterly annualised basis, industrial production growth slowed from 4.2% in the three months to June to a still solid 2.8% in the three months to July.
- The University of Michigan consumer sentiment index declined from 55.2 in July to 51.0 in August, near historic lows as the Iran conflict drags on.
- The minutes from the Federal Open Market Committee's July meeting indicated a hawkish bias amongst committee members. The minutes showed that the Fed's baseline view was for inflation to ease gradually over 2026 and 2027 as the tariff and Middle East conflict shocks dissipated. However, the minutes also highlighted that committee members viewed inflation risks as tilted firmly to the upside and that they were willing to tighten monetary policy if these risks eventuated.



Euro area/United Kingdom

UK inflation rises in July on the back of regulated price increases

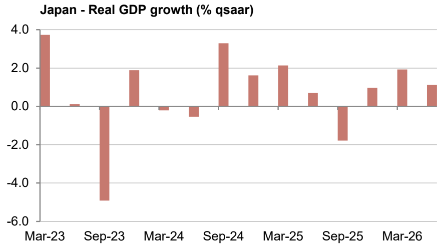
- The headline rate of UK inflation rose from 2.6% in June to 2.9% in July, driven by an increase in the regulated energy price cap. This was partly offset by lower automotive fuel prices and a smaller-than-usual rise in July airfares. Core inflation was unchanged at 2.6%. Overall, there remains limited evidence that higher fuel prices are flowing through materially to underlying inflation.

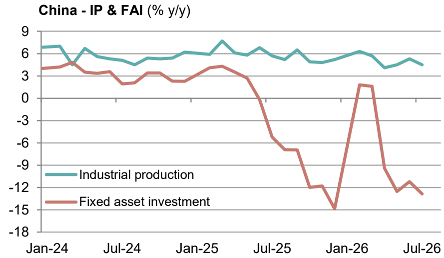


China/Japan

Japanese GDP growth surprises moderately to the downside

- Japanese real GDP rose by 1.1% in the June quarter on a quarterly annualised basis (qsaar). Some components of GDP experienced large swings due to the disruption to global oil flows and the government's response. In a sign of weakness in underlying private domestic demand, household consumption and private business investment contracted by 0.3% and 4.6% qsaar respectively. On a year-ended basis real GDP growth ticked up from 0.4% to 0.5%.
- Chinese activity data for July showed a continued slowing in economic momentum. The year-ended rate of industrial production growth slowed from 5.3% in June to 4.5% in July. Retail sales growth slowed from an annual rate of 1% in June to a modest 0.6% in July. Fixed asset investment remained deeply contractionary, with year-ended growth falling from -11.2% to -12.9%.

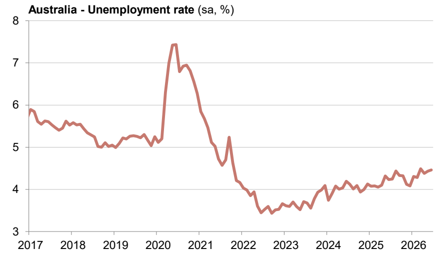




Australia/New Zealand

Australian unemployment rate ticks up in July

- Australian employment declined by 15.8k in July following a strong 80.2k rise in June. The unemployment rate ticked up from 4.4% in June to 4.5% in July, a continuation of the easing trend seen in the first half of 2026.
- The Australian wage price index rose 0.8% in the June quarter with the year-ended rate of wage growth unchanged at 3.2%. With inflation running at just under 4%, real wage growth was negative over FY26.
- The Westpac-Melbourne Institute (MI) consumer sentiment index rose from 83.9 in July to 88.9 in August. Despite the improvement, pessimists continue to outweigh optimists as the ongoing Middle East conflict, high inflation and a weakening housing market weigh on consumer confidence.



Sources: ABS, LSEG, QIC