The 2023 Housing Market: A Look Ahead

Where are home prices and mortgage rates trending?

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This article is part of our 2022-23 Housing Market Forecast series. After the series wraps, join us on February 6 for the HW+ Virtual 2023 Forecast Event. Bringing together some of the top economists and researchers in housing, the event will provide an in-depth look at the top predictions for this year, along with a roundtable discussion on how these insights apply to your business. The event is exclusively for HW+ members, and you can go here to register.

Home Prices will fall, but don't expect 2010

Median home prices have declined for four straight months. November and December will likely continue that trend of downward momentum. Heading into 2023, it seems well within reason, given current trends, that a peak-to-trough decline in home prices of 10% is possible.

This sounds dramatic, but when considering where that would put home prices, it means that if we were to see that decline fully realized by April of next year, prices would only be down about 5 percent year-over-year. While this would be a hit to homeowner equity, only 1 to 2 percent more of homeowners would move into negative equity.

There will be two key differences between 2023 and 2010. First, mortgage lending standards have remained high after the last bubble. People can afford to pay their mortgages. Second, because homeowners are well qualified, they can ride out this correction. There won't be forced home sales like we saw in the crisis.

As a result of the fallout from the great recession, mortgage quality has been far more regulated and viewed with suspicion. Economic conditions have also remained strong despite interest rates, and employment still hasn't shown any signs of weakening.

Affordable mortgage payments and employment continuing to remain at low levels mean that homeowners will have a choice to sell, while people are generally hesitant to sell assets that are declining in price. Short sales are unlikely to reemerge unless there is a serious deterioration in borrowers' ability to pay their mortgages.

The last time we saw prices decline, the combination of declining prices and bad mortgages forced inventory onto the market. This time, declining prices are likely tempering the pace of inventory going onto the market rather than accelerating.

Supply will finally have a chance to return to normal

Since the beginning of 2020, inventory levels have been historically low. The first half of this year stood out when months-supply-of-inventory hit bottom at 1.6 months nationally. As many were quick to point out at the time, the number of new listings coming onto the market had not fallen. The low levels of inventory seen in the data and experienced by homebuyers were a result of demand and rapid sales.

More recently, we've seen the opposite effect, with the pace of inventory entering the market slowing, but inventory is continuing to accumulate as the pace of sales declines rapidly.

Next year we are going to see inventory continue to accumulate as months-supply-of-inventory returns to levels in line with a balanced market (5-6 months) or possibly even buyers-market (6+months). Days on market will likely continue to stretch out and peak next spring along with supply.

There is still a supply of new homes bound for the market as a result of the substantial number of spec homes, which builders began before housing demand dropped. For those looking to buy in 2023, the market is going to feel a lot more normal than it did in 2021 or 2022.

The second half of 2023 is when we're likely to see a rebound

The "known unknowns" right now are inflation and employment. When will inflation abate and what will the impact be on employment? Right now, there seems to be positive evidence that inflation is on track to start falling in as we head into 2023.

Employment hasn't shown any sign of budging, but there's a fairly strong possibility that unemployment will have to increase as the economy slows down, a result of higher interest rates. The "soft landing" in which unemployment stays below 5 percent while inflation corrects is now looking increasingly likely but a great deal of uncertainty remains.

Presuming inflation is now on track to move toward target levels, and the Federal Reserve won't have to adopt more aggressive policies, the first half of next year will likely bear the brunt of higher interest rates on the overall economy and higher mortgage rates on the housing market.

We're likely to see year-over-year declines in home prices in the first half of the year, low unit sales and low building inventory. The latter half of the year will likely be the first opportunity for mortgage rates to trend down, and rates will almost certainly begin to be down on a year-over-year basis.

The pace of sales will likely remain slow compared to the surge following the pandemic, but sales should have the opportunity to begin trending up from the lows seen earlier in the year. If rates do in fact trend down, potential buyers will likely be met with more inventory and more time to shop than they have seen since the beginning of the pandemic.

While next year will certainly be full of challenges, particularly for real estate, we do think there is some cause for hesitant optimism in the back half of 2023.

This column does not necessarily reflect the opinion of HousingWire's editorial department and its owners.

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