



# Real estate correction?

Market Comment, October 2023

**An issue that is increasingly generating debate is the question of whether we might be about to see a real estate correction and, if we do, on what scale. The quick answer is that given the significant price increases observed in recent years, a certain correction should come as no surprise. The longer answer, however, is that this is a highly complex issue that is influenced by a wide range of factors. In the real estate space, both national and local characteristics play a much more significant role than they do on the equity markets. It is no coincidence that the motto often heard in the real estate business is “it’s about location, location, location”. Among other things, the available supply is likely to become an important issue, as will demand factors such as immigration levels and interest rate developments. The latter fall within the remit of the central banks, which are also facing challenges themselves against the backdrop of persistently high inflation.**

With the rise in global interest rates, especially in the English-speaking world, the risk of a further correction in commercial and residential real estate prices is increasingly becoming a topic of discussion. There is no shortage of warnings, with the situation in the United Kingdom serving as a prime example. Back in November 2022, the country’s largest mortgage lenders, namely Nationwide Building Society and Halifax, reported the sharpest fall in prices since the financial crisis of 2008/09. They expressed their concern that the UK could be facing a real estate correction of a scale not seen since 1989/90 when prices plummeted by around 20 percent. Under a worst-case scenario, they continued, a decline of 30 percent may even be seen, although it is more likely that a less pronounced correction will be experienced. A comparison of commonly applied fundamental valuation figures suggests that the real estate segment may currently be overvalued by around 20 percent. It is not difficult to identify where the trigger for a more significant correction may come from with mortgage costs having hit their highest level since the financial crisis of 2008/09.

According to the UK’s central bank, the Bank of England, around one-third of fixed-term UK mortgages will be up for refinancing in 2024. As the British population is currently struggling with a level of inflation not seen in 40 years, a real estate correction could have consequences for economic development that should not be underestimated.

In the US, too, as well as other countries such as Australia and Canada, a real estate correction of a not inconsiderable magnitude could occur. The same is also true for the Scandinavian real estate markets, in particular. Based on a comparison of important fundamental criteria, Bloomberg, for example, estimates that US residential property prices could correct by approximately 15 percent. Especially during the past few years, a period marked by the coronavirus pandemic, there has been a residential property boom that has been greater in scale than anything else seen in comparative phases over the past 40 years. Between March 2020 and summer 2022 alone, US house prices increased on average by no less than 40 percent. One positive factor, however, is likely to be the fact that since 2008 there has been a clear decrease in the number of subprime mortgage loans in relation to all mortgages. Furthermore, many global banks now also have better capital buffers. This means that although a real estate correction in the US or Europe would weigh on the economy, it would not give rise to a financial crisis of the proportions seen in 2008/09.

**“Real estate is dominated by wide-ranging and complex factors and is dependent on the policies of the central banks.”**

Gérard Piasko, Chief Investment Officer

In the US and many European countries, mortgage costs for real estate have more than doubled. During economic downturns in the past, commercial real estate, for its

part, has proven to be especially vulnerable due to its particularly cyclical nature. Until now, there have only been a few signs of a slowdown in general economic developments that can be attributed to the real estate sector. However, the experience of the Chinese economy against the backdrop of the slowdown in its real estate sector, which first emerged in 2021/22 and continues to this day, shows that a real estate correction should not be underestimated. In Europe, there are signs of overvaluation in some national real estate markets, with this being especially true in the residential segment. Whether the issue of a real estate correction and the problems it might bring intensifies further will depend on a variety of factors. Countries with high levels of structural demand, be this for demographic reasons or due to immigration, as is the case in Switzerland, could experience a less marked correction. Another important factor will be how long key and market interest rates remain so high. Ultimately, only the central banks can really provide an answer here. In addition to the important factor of real estate supply, just how long this phase of historically above-average interest rates persists will be of significance.

Overall, it can be summarised that while the likelihood of real estate corrections is increasing around the world, different situations will emerge depending on the country in question. Real estate remains dominated by wide-ranging and complex factors and continues to be highly dependent on the policies of the central banks.
















G rard Piasko

G rard Piasko is Chief Investment Officer and head of the investment committee of private bank Maerki Baumann. Before he was for many years Chief Investment Officer of Julius Baer, Sal. Oppenheim and Deutsche Bank.



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Maerki Baumann & Co. AG  
Dreik nigstrasse 6, CH-8002 Zurich  
T +41 44 286 25 25, [info@maerki-baumann.ch](mailto:info@maerki-baumann.ch)  
[www.maerki-baumann.ch](http://www.maerki-baumann.ch)