



The Institute of Development Economics

Research Papers

Titles: What factors influence unsophisticated traders' expectations Evidence from the Auckland housing market

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Abstract:

This study investigates the formation of adaptive expectations among unsophisticated home buyers and the factors influencing these expectations in Auckland, a market dominated by the participants. Adaptive expectations refer to the phenomenon where buyers form future price expectations based on past market performance. This research comprehensively analyses the determinants of unsophisticated buyers' expectations using vector error correction models (VECMs) that incorporate survey-based expectations and age-weighted historical returns. The findings indicate a strong association between historical returns and the formation of expectations, while other variables have limited or short-term impacts, supporting the adaptive expectations hypothesis. This reflects that unsophisticated home buyers who dominate housing markets rely on adaptive expectations, anchoring their forecasts on past performance rather than forward-looking indicators or broader market conditions. Furthermore, the reliance on past returns also suggests the potential for self-reinforcing cycles in housing markets, which can amplify fluctuations in prices. From a policy perspective, the results imply that the effectiveness of macroprudential interventions depends on how market participants form expectations.

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