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October 2, 2019

Introduction to U.S. Economy: Housing Market

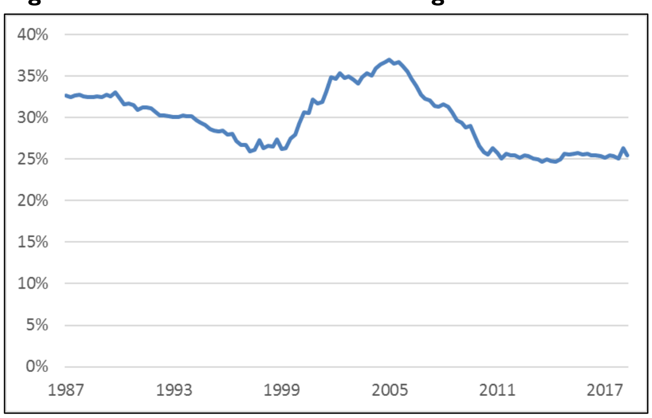
The Housing Market

Real estate and the housing market play an important role in the U.S. economy. At the individual level, roughly 65% of households are owner occupied, homes are often a substantial source of household wealth in the United States, and housing construction provides widespread employment. At the aggregate level, the housing market accounts for a significant portion of all economic activity, and changes in the housing market can have broader effects on the economy.

Household Net Worth

Purchasing a home is often one of the largest investments individuals make. Home ownership accounts for a significant portion of households' net worth in the United States. As of 2018, owner-occupied real estate accounted for about a quarter of households' net worth, according to Federal Reserve data. As shown in **Figure 1**, the share of households' net worth arising from their home has been relatively stable over the past several years, after declining significantly following the 2007-2009 recession.

Figure 1. Home Value as a Percentage of Net Worth



Source: Federal Reserve, Financial Accounts of the United States, Table B.101.H Balance Sheet of Households.

Notes: Total net worth of households measures assets less liabilities. Home value is measured as the market value of owner-occupied real estate, including vacant land and mobile homes.

Employment

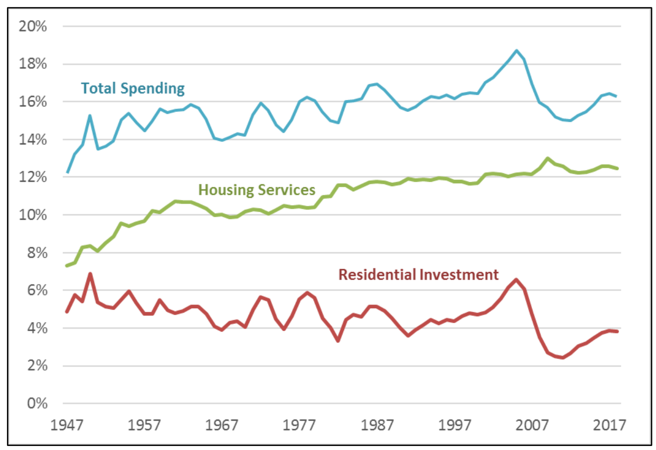
Residential construction is a significant industry in the United States, and it employs a large number of people. At the peak of the housing market bubble, residential construction employed more than 1 million individuals. However, as a result of the housing bubble bursting and subsequent recession, employment fell to a low of about 560,000 employees in 2011. Since then, employment has picked up in this industry to about 832,000 in 2019, according Bureau of Labor Statistics data.

Housing and the Broader Economy

The housing market is incorporated into gross domestic product (GDP), the prominent measure of economic activity, in two ways. First, GDP includes all spending on the construction of new single- and multi-family structures, residential remodeling, and brokers' fees, which is referred to as residential fixed investment. As of 2018, spending on residential fixed investment was about $785 billion, accounting for about 3.3% of GDP. Second, GDP includes all spending on housing services, which includes renters' rents and utilities and homeowners' imputed rent and utility payments. As of 2018, spending on housing services was about $2.6 trillion, accounting for 11.6% of GDP. Taken together, spending within the housing market accounted for nearly 15% of GDP in 2018.

Figure 2. Total Spending in Housing Market

As a percentage of GDP



Source: Bureau of Economic Analysis, National Income and Product Accounts, Table 1.1.5, and Table 2.3.5.

As shown in **Figure 2**, housing's share of economic output was generally on the rise between 1947 and 2005. Between 2000 and 2005, residential investment grew rapidly before declining even more rapidly as the housing bubble burst. Residential investment remained well below its peak, both in real terms and as a percentage of GDP. Spending on housing services continued to rise as a percentage of GDP through this period, however.

Housing's Indirect Impact on the Economy

The housing market plays an important role in the broader economy as well, as evinced by the housing bubble causing the deepest and longest recession since the Great Depression. Housing prices can impact residential investment and therefore affect economic growth. Rising home prices likely encourage additional construction spending to take advantage of higher prices, leading to more robust economic growth. A decline in housing prices is likely to depress construction spending, leading to more anemic economic growth.

Fluctuations in the housing market, particularly housing prices, can have broader effects on the economy, through so-called wealth effects. An increase in housing value encourages homeowners to spend more than they do at other times for a variety of reasons, including higher confidence in the economy, increased equity for homeowners to borrow against, and higher rental income. A decrease in prices results in the opposite. In the United States, consumer spending makes up roughly 70% of the economy, therefore changes in housing wealth can result in significant changes in economic growth.

Monetary Policy and the Housing Market

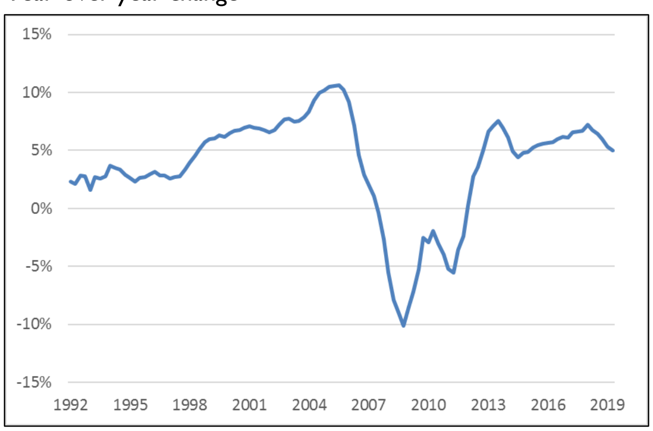
Federal Reserve decisions may also affect the housing market through the cost of financing a home purchase. Most Americans take out a mortgage to purchase a home, and mortgage debt accounts for about 70% of all household debt. The interest rate associated with a mortgage is partially determined by the supply and demand for loanable funds; however, the Federal Reserve can also influence mortgage interest rates by adjusting its benchmark interest rate, the federal funds rate. When the Federal Reserve decides to increase the federal funds rate, it puts upward pressure on mortgage interest rates as well. Higher mortgage interest rates increase the overall cost of purchasing a home, by increasing mortgage payments. The opposite occurs when the Federal Reserve lowers the federal funds rate. During the 2007-2009 recession, the Federal Reserve purposely tried to decrease mortgage interest rates more directly by purchasing mortgage-backed securities in an effort to buoy the housing market following the housing bubble bursting.

Housing Market Conditions

A number of broad indicators are used to assess the housing market. These national indicators may not capture idiosyncrasies in regional or local housing markets.

Figure 3. Nominal Housing Prices

Year-over-year change



Source: FHFA, House Price Indexes, Seasonally Adjusted Purchase-Only Index, https://www.fhfa.gov/DataTools/Downloads/Pages /House-Price-Index-Datasets.aspx#qpo.

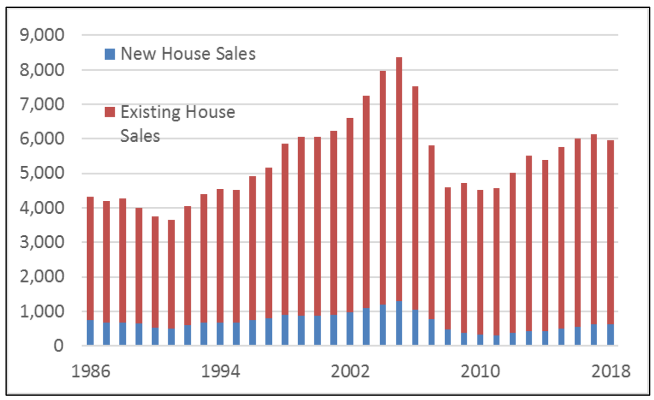
Note: Figure presents change in nominal housing prices on a year-over-year basis.

Housing prices are an indicator of the broad health of the housing market and have important implications for the economy as a whole, as discussed earlier. As shown in **Figure 3**, after falling significantly during the 2007-2009 recession, average nominal housing prices have been increasing nationally each year since the beginning of 2012, surpassing their previous nominal peak in the first quarter of 2016. Growth in housing prices peaked in the first quarter of 2018, and it has slowed each quarter since this peak.

Another common indicator of the health of the housing market is home sales. Increasing home sales is generally viewed as a sign of a strong housing market, and a strong economy, as it suggests individuals have both the income to make the purchase and a positive economic outlook. By contrast, when the economy is performing poorly, individuals are less likely to make major purchases as their income will likely grow slower or they are more concerned about losing their current job. As shown in **Figure 4**, during the 2007-2009 recession, housing sales fell dramatically. Housing sales began to recover in 2011 and 2012, but sales have still not recovered to pre-recession levels. In 2018, sales of existing houses fell by about 3.1%, whereas sales of new houses increased by about 1.5%.

Figure 4. Annual House Sales

In thousands



Source: Housing and Urban Development, U.S. Housing Market Conditions, https://www.huduser.gov/portal/ushmc/ quarterly_commentary.html#undefined.

Residential investment, shown as a percentage of GDP in **Figure 2**, is also used as a measure of the health of the housing market. If demand for housing declines or economic actors expect the housing market to weaken, residential investment is likely to slow or decline, and vice versa. Residential investment peaked in 2005 at about $884 billion (in 2012 dollars), before falling significantly following the housing bubble to about $382 billion (in 2012 dollars) in 2011. Residential investment has yet to recover to this previous peak. Residential investment began growing again in 2012, increasing by about 13%; however, growth has generally slowed in subsequent years and declined by 1.5% in 2018.

Jeffrey M. Stupak, jstupak@crs.loc.gov, 7-2344

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