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Updated May 3, 2021

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 occupied housing units 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, housing 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 October 2020, owner-occupied real estate accounted for slightly more than a quarter of households' net worth, according to Federal Reserve data. 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.

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 in 2006, 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 May 2011. Since then, employment has picked up in this industry and reached about 872,000 by March 2021, according Bureau of Labor Statistics data.

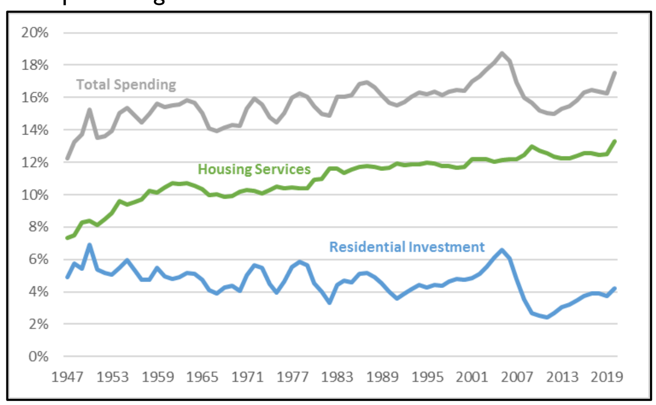
Housing and the Broader Economy

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 2020, spending on residential fixed investment was about $885 billion, accounting for about 4.2% 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 2020, spending on housing services was about $2.8 trillion, accounting for 13.3% of GDP. Taken together, spending within the housing market accounted for 17.5% of GDP in 2020.

As shown in **Figure 1**, housing's share of GDP has generally trended upwards, with the notable exception of the housing market crash in 2007. Between 2000 and 2005, residential investment grew rapidly before declining even more rapidly as the housing bubble burst. Since then, residential investment has remained well below its peak both in real terms and as a percentage of GDP. Despite a steep drop in total housing spending, 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. Housing's share of GDP has still not reached its 2005 peak.

Figure 1. 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.

Housing's Indirect Impact on the Economy

The housing market can play an important role in the broader economy as well, as evidenced by the housing bubble that precipitated the recession of 2007-2009. 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 home 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

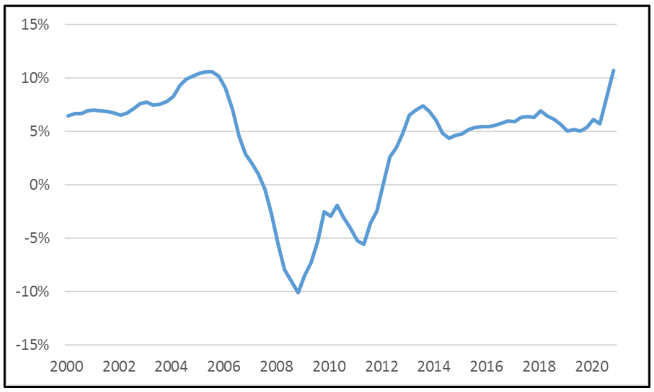
Federal Reserve decisions may also affect the housing market through the cost of financing a home purchase. Most Americans take out a mortgage to purchase a home, and mortgage debt accounts for about 70% of all household debt. The interest rate associated with a mortgage is partially determined by the 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. During the 2007-2009 recession, the Federal Reserve purposely tried to decrease mortgage interest rates more directly by purchasing mortgage-backed securities. The Federal Reserve took similar action during the COVID-19 pandemic, lowering the federal funds rate and increasing purchases of mortgage-backed securities. Thirty-year mortgage rates temporarily dropped below 3% in 2020.

Housing Market Conditions

A number of broad indicators are used to assess the housing market. National indicators do not necessarily capture the variation among local markets and, therefore, may not be indicative of any one specific locality.

Figure 2. Nominal Housing Prices

Year-over-year change



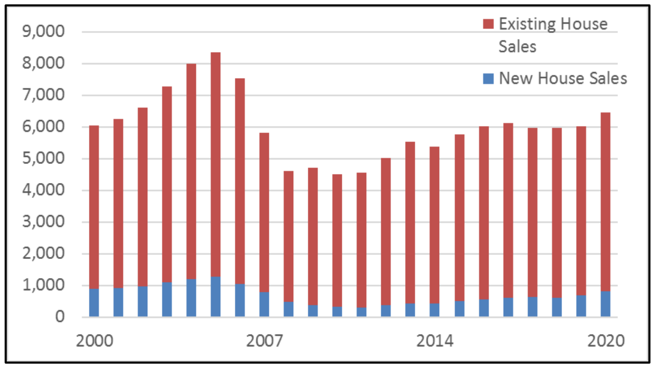
Source: Federal Housing Finance Agency, House Price Indexes, Seasonally Adjusted Purchase-Only Index.

Housing prices are an indicator of the housing market's conditions and have important implications for the economy as a whole. As shown in **Figure 2**, 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 increased rapidly in 2020 and peaked at 10.8% growth in the fourth quarter, likely due in part to low mortgage rates.

Another common indicator of the health of the housing market is home sales. Increasing home sales are 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. As shown in **Figure 3**, during the 2007-2009 recession, home sales fell dramatically. Home sales began to recover in 2011 and 2012 but have still not recovered to pre-recession levels. In 2020, both sales of existing and new houses increased, by 5.6% and 19.3%, respectively.

Figure 3. Annual House Sales

In thousands



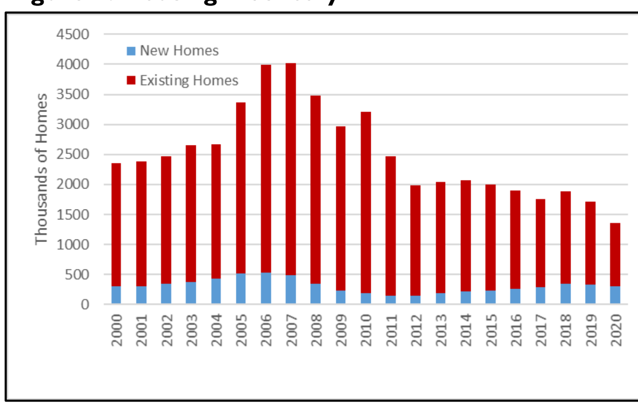
Source: Department of Housing and Urban Development, U.S. Housing Market Conditions.

Residential investment, shown as a percentage of GDP in **Figure 1**, 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.

COVID-19

As evidenced by housing market conditions in **Figure 2** and **Figure 3**, despite increased housing insecurity caused by the pandemic, many housing market indicators have thus far remained strong. Contributing to rising prices and increased sales is that housing inventory—the supply of homes for sale/on the market—decreased, as shown in **Figure 4**. Housing inventory was low even before the pandemic, although it is possible that the pandemic exacerbated the shortage by causing people to put off selling their homes, in which case supply would be expected to increase somewhat in 2021.

Figure 4. Housing Inventory



Source: Department of Housing and Urban Development, U.S. Housing Market Conditions.

(Note: This In Focus was originally authored by Jeffrey Stupak, former CRS Analyst in Macroeconomic Policy.)

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