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INSIGHT

The U.S. "Housing Recession"

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Economists often look to the housing market as an indicator of the health of the economy. As the COVID-19 pandemic accelerated, the housing market was relatively strong, characterized by robust demand, rising prices, and increased construction. Since the latter half of 2021, spending on residential construction has faltered, leading some to believe that the United States is or was in a "housing recession." Some have speculated that lower spending in the housing sector is a sign that overall spending in the economy will decrease and that a housing recession will lead to an actual recession. This Insight discusses the concept of a housing recession, reviews housing market trends, and considers the extent to which housing market conditions may affect the broader economy.

Background and Trends

Economists use the phrase *housing recession* to refer to a downturn in the housing market. While many housing market indicators are considered in general discussions of housing recessions, for the purposes of this Insight, a housing recession will be defined by the amount of and spending on residential construction.

Despite high home prices and rents, homebuilding has slumped. One of the main ways economists measure spending in the housing market is by tracking private fixed residential investment, a component of gross domestic product (GDP). Private fixed residential investment includes all spending on the construction of new single- and multi-family structures (both owner-occupied and rental), residential remodeling, and brokers' fees. This measure allows economists to not only track spending on housing but also tie it directly to overall economic activity. As shown in **Figure 1**, below, residential investment has been falling each quarter since the second quarter of 2021, most recently falling by 1.1% in the second quarter of 2023. Decreases in 2023 have been smaller than those throughout 2022, but as a result of nine straight quarters of decline, the level of residential investment is now about $167 billion less in real terms than it was in the first quarter of 2021. By this measure, one could assert that the United States is experiencing a housing recession.

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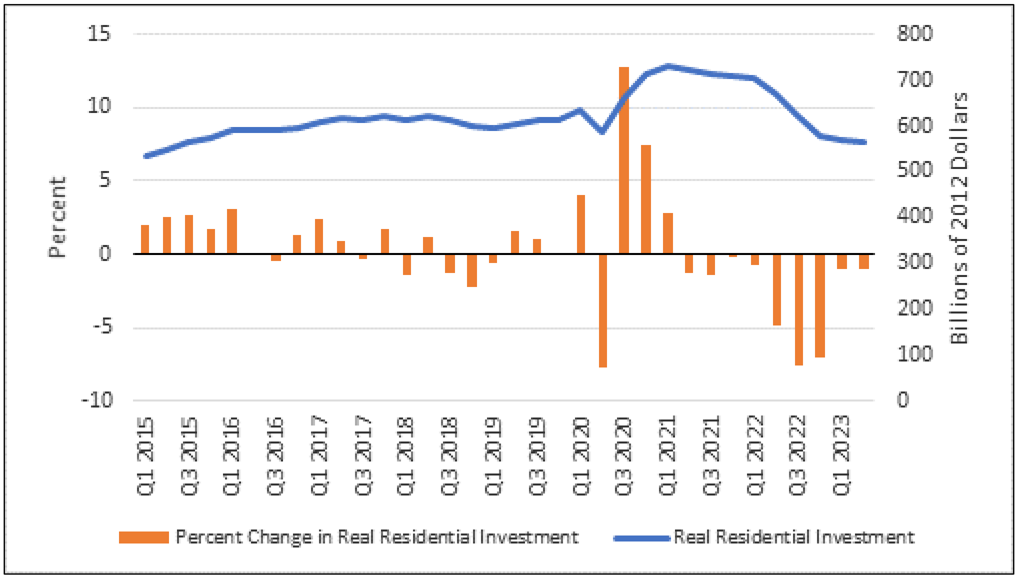
Figure 1. Real Private Fixed Residential Investment

Seasonally Adjusted Annual Rate (SAAR), Q1 2014-Q2 2023

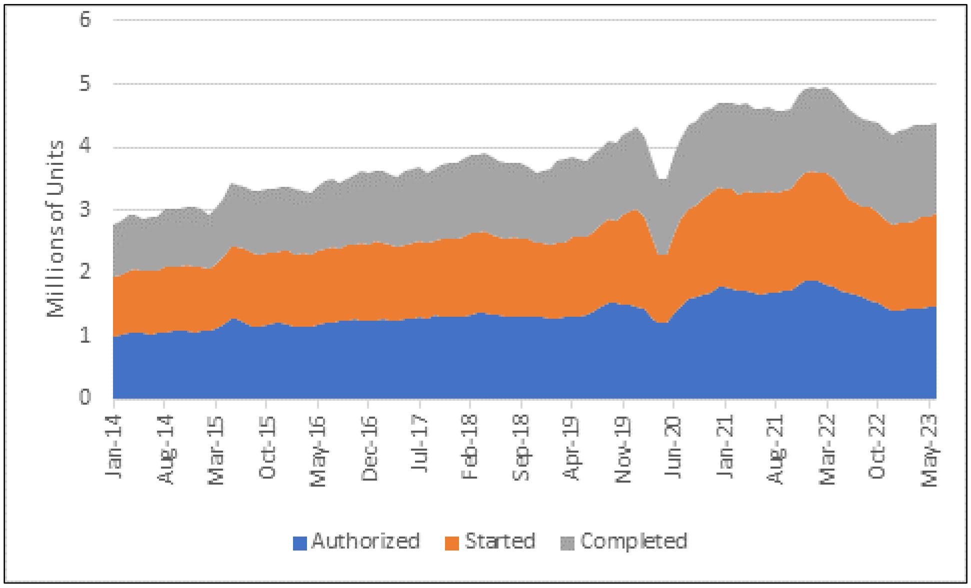


Source: Bureau of Economic Analysis.

In addition to looking at dollars spent on residential construction, economists can consider the amount of planned, current, or completed construction. To that end, **Figure 2** below shows three-month rolling averages for *new authorizations* (units that have been approved via issuance of building or zoning permits), *starts* (units for which excavation for footings or foundations has begun), and *completions* (units that have had all finished flooring installed). Each of these measures can give a sense of homebuilders' sentiment at different points in time: Authorizations are driven by expectations of what the market will be like in the medium to longer term (authorizations represent the first step that allows building but do not indicate that building has actually started), starts are driven by near-term expectations, and completions signal what expectations were in the recent past (it takes time to finish building once started). Authorizations and starts decreased throughout 2022 while completions rose, indicating activity in and the outlook for the market was turning negative at that time. However, all three measures increased on average over the first six months of 2023. Overall, the evidence of a housing recession using these measures is mixed and could indicate a housing recession in 2022 but not 2023. The upward trend in starts, in particular, would indicate that homebuilders are optimistic about the housing market in the coming months.

Figure 2. New Privately Owned Housing Unit Construction

3-Month SAAR Rolling Average, January 2014 to June 2023



Source: Census Bureau.

Will a Housing Recession Lead to an Economic Recession?

Given that there is some evidence that the United States experienced a housing recession, at least in 2022, the question arises: Will a housing recession lead to an economic recession? Many economists pay particular attention to the housing sector when considering the probability of a recession, because housing market contractions have often preceded recessions. (Decreases in nominal residential investment have preceded nine out 12 recessions since 1947.) Given that many economists had already been concerned about the economy's reaction to the Federal Reserve's interest rate hikes, the contraction in housing spending could be seen as an indication that the economy will face a similar contraction. However, despite the Fed's aggressive rate hikes since March 2022 and the apparent housing recession, the economy remains fairly robust. The labor market remains tight, real GDP growth continues to outperform expectations, and inflation—while still above the Fed's target of 2%—is significantly lower than last year's high. While many economists had previously been predicting recession in 2023, many now believe the economy will not contract this year.

Why has the contraction in spending in the housing market not led to a recession? One answer is that a recession just has not happened yet. While GDP largely beat expectations in the second quarter, residential investment underperformed, continuing to decrease quarter over quarter. Perhaps the housing recession has not passed and an economic recession is on the horizon.

Another possibility is that a housing recession has already passed and the economy was able to weather the contraction. Combined with the increased pace of construction, the recent decline in the rate of decrease in residential investment could signal that housing has turned a corner. Some also cite improved supply chains and builder sentiment as evidence for improving housing conditions.

If it is true that the economy weathered this housing slowdown, it could support an assertion made by some observers that the housing sector and larger economy are less connected than they once were. What happens in the economy may not have an outsized effect on the housing market and vice versa. For example, according to Fannie Mae, new home construction may not be as rate-sensitive as it has been historically, with new construction being driven by low supply that has been consistently lagging demand despite higher mortgage rates.

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