

# THE SUPPLY CRISIS, EXPLAINED...



## REPORTS ON HOUSING ECONOMICS EXPLAINED

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## THE UNEQUAL EQUILIBRIUM IN THE MARKET

In an introductory Economics 101 course, students learn about the fundamental principle of supply and demand. When it comes to housing, an imbalance between the supply of homes and the demand for them can push the market towards a new equilibrium. When demand heavily outweighs supply, this often results in skyrocketing prices and exacerbates the housing shortage, a challenge currently faced by cities across the United States. But how did the U.S. find itself in such a dire housing shortage?

The roots of the housing supply crisis are well-documented. Before the Great Recession, there was an excess of homes on the market. However, following the recession, new home construction plummeted. Fewer homes were built in the decade after the recession than in any other decade since the 1960s. By 2019, the shortage of housing units available for sale or rent was estimated to be a staggering 3.8 million.

While reduced demand in the aftermath of the recession slowed home construction, other factors also contributed. These included falling vacancy rates, declining housing affordability, and rising building costs. These challenges collectively created supply-side headwinds that hindered home construction throughout the 2010s, resulting in a net housing deficit in the U.S.

As the new decade of the 2020s began, the U.S. was hit with a recession brought on by a once-in-a-century pandemic, further aggravating supply and affordability issues. The Federal Reserve attempted to prop up the housing sector of the economy by intentionally reducing interest rates during the pandemic in hopes of stimulating the economy and home buying. Mortgage rates dropped to record lows, resulting in an onslaught of home buyers waiting to cash in on the much-improved affordability conditions.



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More people could get off the sidelines and jump into the homebuying arena. The buyers who were already looking to purchase were able to buy a significantly larger home as a result. Over the next couple of years, the country witnessed record demand levels, and home prices skyrocketed. Even with the recent slowdown of home price growth and the reduction in demand due to much higher interest rates, the run-up in rents and home prices since 2019 has been catastrophic for working families. The question remains: how do we return to a 'normal' inventory of available homes and reach a healthier equilibrium?

A recent research report titled, *The U.S. Housing Shortage from a Local Perspective*, conducted in October 2022 by Fannie Mae economists Kim Betancourt, Stephen Gardner, and Mark Palim, sheds light on this issue. They evaluated the housing supply in the 75 largest metropolitan markets in the U.S. and compared it to the housing needs of the residents in those areas. The report reveals that while the housing supply problem is a national issue, the solutions are primarily localized. Surprisingly, some of the highest shares of housing-cost-burdened households are found not just in expensive coastal cities but also in more affordable metros like Phoenix and Las Vegas. Tailored, localized strategies are required to address these housing shortages. For example, increasing affordable multifamily rental housing availability could significantly improve housing affordability in markets like Los Angeles and San Francisco. In other areas, such as Orange County, the focus is on building new single-family homes or preserving existing multifamily housing. Although the economic factors surrounding home-building, like materials and labor inflation, supply chain disruptions, and others, may take years to rectify, states and municipalities can collaborate with investors, builders, and lenders to facilitate the creation of more housing.

The home building industry is anticipated to evolve in the 2020s to enable more growth. While it may be unrealistic to expect to reach production levels from the 2000s, there's little doubt that the 2020s will see an increase in single-family construction. As Gen X reaches its peak earning years and Millennials increasingly look to purchase single-family homes, the demand for housing will likely continue growing. With the correct measures in place, the supply in the United States will increase, returning to a healthier level over the long run.