WALKWAYS, NOT WALLS

There are benefits to better connecting macroeconomics with real estate economics

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Illustration by Cristiana Couceiro

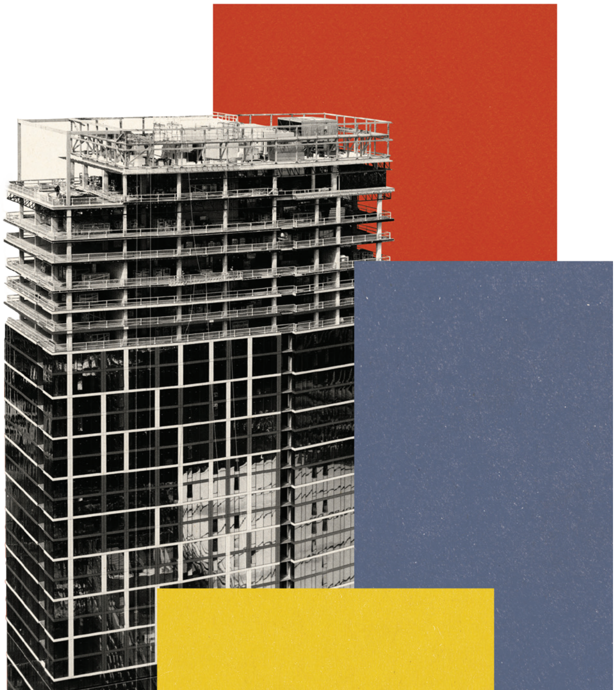
Macroeconomics, by definition, focuses on the big picture. It neglects smaller micro developments at the business or sectoral level. In 2007, Edward Leamer, an economics professor at the University of California, Los Angeles, pointed out the high costs of this neglect by arguing that it's meaningless to try to understand business cycles without paying attention to the housing sector. As he argued in a now-famous paper titled "Housing IS the Business Cycle," the housing market is central to understanding why economies go through booms and busts. He pointed out that nearly all recessions in the United States since World War II were preceded by problems in the housing sector. Macroeconomics would, in other words, be better served by building walkways to housing economics rather than simply walling it off.

After all, housing's impact on the macroeconomy is evident everywhere. Cities are among the world's most productive places, brimming with creativity and innovative ideas and powering economic expansion. Yet accommodation in many cities is prohibitively expensive even for relatively high-paid professionals, let alone essential workers on lower pay who keep cities safe, clean, and running smoothly. Many of these workers—police officers, teachers, nurses, delivery drivers—must turn up to work in person. They cannot take advantage of the shift toward remote work to find more affordable places to live and raise a family.

Across the Organisation for Economic Co-operation and Development's mostly rich countries, house prices have risen by almost 40 percent in real terms over the past decade, with the cost of a home in the United States up by about 50 percent. Demand for housing has been extremely strong in recent years, spurred by increases in population and income. At the same time, housing supply has failed to keep up, partly because of land-use regulations (such as preventing neighborhoods with single-use housing from allowing multifamily housing), which restrict how many housing units can be built on a particular plot of land. Among other effects, this risks exacerbating intergenerational inequality: 60 percent of people aged 18–29 reported being somewhat or very concerned about securing adequate housing. Affordability is a growing concern for businesses, too, as they say it's forcing them to pay higher wages and budget for higher labor costs.

And it's not just a problem for the rich world. Affordable housing is especially scarce for the poorest. In Colombia, for instance, 82 percent of renters in the lowest income quintile hand over more than 40 percent of their income to private landlords, according to the OECD.

Expensive homes and high rents can push people to take on too much debt. Household borrowing can boost economic growth in the short term, but it imposes serious costs later on: consumers cut spending to make repayments, the economy slows, and unemployment rises, as the IMF has shown. In China, for instance, a housing downturn has had a significant impact on consumption. To take it up a level, a sudden economic shock—such as a collapse in home prices—can trigger a spiral of credit defaults that shakes the financial system.



"Had walkways been in place between macroeconomics and real estate economics, we might have better anticipated developments during the global financial crisis."

Had walkways been in place between macroeconomics and real estate economics, we might have better anticipated developments during the 2008–09 global financial crisis. We might also have better understood more recent policy conundrums , as the articles that comprise this issue's cover package show.

This year, macroeconomists faced two central challenges. The first is understanding the sources and likely duration of the 2021–22 upsurge in inflation. The second is figuring out how to bring about a "soft landing" by slowing down the economy to tame inflation without tipping it into recession. Macroeconomists would have done a better job on both central policy issues with a deeper knowledge of developments in real estate markets.

The stubbornly high rate of inflation in the United States reflected a complex and shifting mix of demand and supply factors. Yet one surprise was the role of housing, which sent prominent macroeconomists scrambling to understand the minutiae of how house prices and rents are reflected in measures of the cost of living. Indeed, the increase in borrowing costs for housing contributed to the puzzling pessimism in consumer sentiment about economic conditions and led to much hand-wringing by economists determined to explain the disconnect with the consumer price index.

Central banks faced the challenge of figuring out how the increases in interest rates that they were engineering to subdue inflation would affect the housing sector and the economy overall. This is no easy task. The channels through which interest rates affect housing markets are complicated and shift over time—they require a study of housing markets with a depth of knowledge that would be rare in macroeconomics textbooks, just as Leamer noted almost two decades ago, when he lamented his failure to find a single textbook that placed real estate "front and center, where it belongs."

One channel that affects the impact of interest rates on housing is the prevalence of fixed-rate mortgages, which can vary from close to zero in South Africa to more than 95 percent in Mexico and the United States. Other factors that affect monetary policy's potency include the extent of homeowner debt, the extent of supply restrictions, and the extent of house price appreciation and possible overvaluation, which can be very difficult to measure.

As if all this did not already make for a complicated picture, the strength of these channels changes over time. The share of fixed-rate mortgages has, for instance, increased recently in many countries. The availability of refinancing also differs across economies and over time. A deep country-specific understanding of housing and housing markets is needed to calibrate monetary policy.

Food, clothing, and shelter are considered to be basic needs of humankind. Indeed, the 1948 Universal Declaration of Human Rights and other such international treaties have recognized the right to adequate housing. The eradication of hunger is very prominent in the UN's Sustainable Development Goals (SDG 2 is to end hunger). UN agencies such as the World Food Programme swing into action when food prices spike, and even the IMF launches new loan programs to help people and countries cope with the effects of food price shocks. Shelter is a poor cousin. Housing gets barely a mention in the SDGs. This is despite the fact that housing affordability is a pervasive problem, affecting many, if not most, of the world's major economies. Little wonder then that housing has surfaced as a major issue in several national and local electoral races. F&D

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