VOLATILITY IN HOME SALES AND PRICES: SUPPLY OR DEMAND?

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Fluctuations in home sales and home price growth have important implications for economic activity, financial stability, and access to homeownership. They are also frequent targets of policy making, as governments have a variety of policy options that can affect the demand for homes or the supply of homes available for sale. To predict the outcomes of these policy choices, it is therefore important to understand the determinants of housing market volatility. This research estimates the extent to which short-run fluctuations in sales and price growth are driven by the demand for homes, or by the supply of homes for sale.

Fluctuations in housing demand explain much more of the variation in home sales and price growth than do fluctuations in the supply of homes for sale

Using data on home listings and a model of housing search, we decompose housing market dynamics into variation driven by the entry of new prospective buyers (demand) and by new homes for sale (supply). We estimate that fluctuations in demand explain essentially all of the monthly variation in home sales and 80% of the monthly variation in price growth between 2002 and 2021 in the United States.

The COVID-19 housing boom was driven by an increase in demand

Even though the supply of new for-sale listings fell sharply at the beginning of the pandemic, we show that reduction of supply was a minor factor relative to increased demand in explaining the tightening of the U.S. housing market over the first year of the pandemic. We estimate that a 30% increase in the monthly number of homes coming on to the market would have been necessary to keep up with the pandemic-era surge in demand. Since new construction typically accounts for about 15% of supply, our estimates imply that new construction would have had to increase by roughly 300% to absorb the pandemic-era surge in demand.

Implications

- Policies aimed at increasing supply, for example construction subsidies or zoning reforms, would have done little to cool the pandemic house price boom in the short run.
- Policies that target housing demand, for example those that affect mortgage rates, are an effective way to influence short-run fluctuations in the housing market.
- This research focuses on short-run fluctuations in the housing market. For longer-run changes, housing supply may play a much larger role.

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[1] The analysis and conclusions set forth are those of the authors and do not indicate concurrence by other members of the research staff or the Board of Governors.

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