Background and Literature Review

Background

The housing market plays a pivotal role in the economy, influencing and reflecting broader economic conditions. The sector is sensitive to interest rate changes, as mortgage rates directly affect affordability and, consequently, the demand for housing. In the aftermath of the COVID-19 pandemic, central banks worldwide implemented aggressive monetary tightening to combat inflation, resulting in significant interest rate hikes. These changes have had far-reaching implications for housing affordability, consumer confidence, and overall housing market activity.

As interest rates begin to decline, understanding the dynamic relationships between economic indicators and housing market activity becomes increasingly important. This knowledge is essential not only for real estate investors but also for policymakers tasked with maintaining economic stability and homebuyers navigating affordability challenges. By examining the interaction between these variables, our study aims to shed light on how recent interest rate fluctuations have shaped the housing market and to provide actionable insights for forecasting future trends.

Literature Review

Interest Rates and Housing Market Activity Extensive research underscores the relationship between interest rates and housing market activity. Studies suggest that rising interest rates typically lead to reduced housing demand due to higher mortgage costs and diminished affordability. For example, Chen and Leung (2018) found that interest rate increases negatively influence the volume of housing transactions, with the impact varying across regions and economic contexts. Similarly, Glaeser, Gyourko, and Saiz (2008) highlight that housing markets are particularly sensitive to monetary policy changes, emphasizing the role of mortgage rates in shaping demand.

Household Income and Housing Affordability Household income is a critical determinant of housing affordability. Ganong and Noel (2019) demonstrate that changes in income levels can either amplify or mitigate the effects of interest rate fluctuations on housing demand. A rise in median household income can offset the adverse effects of higher mortgage costs, enabling more buyers to remain active in the market. Conversely, stagnant income growth during periods of high interest rates can exacerbate affordability challenges, further depressing market activity.

Unemployment and Economic Stability Unemployment rates serve as a barometer of economic stability and directly affect consumers' ability to purchase homes. Research by Coulson and Fisher (2014) reveals that higher unemployment rates correlate with decreased housing market activity, as job insecurity and reduced disposable income dampen buyers' willingness to make significant financial commitments.

Housing Supply and Market Dynamics The availability of housing units is another crucial factor influencing market activity. Malpezzi and Mayo (1997) argue that limited housing supply during periods of high demand can exacerbate affordability issues, magnifying the impact of interest rate changes. Conversely, an oversupply of housing can moderate the effects of rising interest rates by creating a buyer's market, where sellers are incentivized to lower prices.

Inflation and Consumer Sentiment Inflation, often accompanied by interest rate adjustments, further complicates housing market dynamics. McDonald and Stokes (2013) highlight the dual role of inflation in eroding purchasing power and prompting central banks to adjust monetary policies. Additionally, consumer confidence significantly influences large purchase decisions, including homebuying. Ludvigson (2004) emphasizes that a decline in consumer confidence, often triggered by economic uncertainty, can reduce housing demand, even in periods of declining interest rates.

Research Gap and Contribution While prior studies have established the relationships between individual economic indicators and housing market activity, few have adopted a comprehensive approach to analyze the combined effect of these factors, particularly during a transitional phase from rising to declining interest rates. Our project seeks to address this gap by incorporating a broad set of economic variables, including interest rates, household income, unemployment, housing supply, inflation, and consumer confidence, to model housing market trends. By focusing on the post-COVID-19 period, our study aims to provide timely and actionable insights for stakeholders navigating a complex and evolving economic landscape.

This multifaceted analysis will contribute to the existing body of literature by offering a nuanced understanding of how key economic indicators interact to shape housing market activity, enhancing both theoretical knowledge and practical applications in real estate economics.

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