

Home ownership in New England

It is no secret that throughout the Nation high housing costs cause many Americans who rent to worry about their capability of purchasing a home, while others who do own a home fret about their ability to continue to afford it. From 1995 to 2005, house prices in New England increased by 85 percent; only in 2006 did they begin to stabilize. Heather Brome, from the New England Public Policy Center at the Federal Reserve Bank of Boston, examines the issue of housing affordability among young professionals in New England in a February 2008 Policy Brief, “Can young professionals afford to buy a home in New England?” Brome defines young professional households as those headed by a 25- to 39-year-old who has attained a minimum of a bachelor’s degree and who is not presently a student.

Two primary calculations underlie the analysis. The first is the housing burden, which is the percentage of household income used to cover housing costs. The higher the percentage, the greater the financial burden is upon the homeowner. The second is income adequacy, which in this case is the ratio of household income to the income necessary to buy a house. This measure assesses how difficult it is for a household to purchase a home.

In New England in 2005, the median young professional household income was 14 percent greater than the median income for similar households elsewhere in the United States. Despite this fact, home-owning young professionals in New England spent a slightly larger share of their income on housing costs than their nationwide counterparts. The share of young professional households that pay over 30 percent of household income for housing is 1.4 percent greater in New England than elsewhere

in the United States. The percentage of young professional households in New England that spend over 50 percent of household income on housing is comparable to the corresponding percentage in the rest of the country.

In all large New England cities in the year 2000 (the most recent year for which data were available), the median income of young professional-headed households was sufficient to afford a median-priced house. Overall, young professionals were in fact even better able to afford homes than middle-income households. Still, New England’s high housing costs could dissuade potential migrants from moving to the region. It is important to bear in mind, however, that there is little evidence indicating that housing costs are the chief factor in the decisions of those who move from one region to another.

Okun’s Law or rule of thumb

Policymakers are fond of predictions and projections — especially when accurate. Okun’s law is a description of the relationship between the unemployment rate and the economy’s real output of goods and services. Can it be used to make forecasts?

In “How Useful is Okun’s Law?” (*Economic Review*, Fourth Quarter 2007, Federal Reserve Bank of Kansas) Edward S. Knotex II describes various forms of Okun’s law and answers a couple questions: Does Okun’s law describe a stable relationship between two important macroeconomic measures? Is Okun’s Law a useful forecasting tool?

Okun’s law — named for economist Arthur Okun who first wrote about the relationship between unemployment and GDP in the 1960s — is expressed in various equations. One equation, using many years of data available in Arthur Okun’s time, shows that each percentage point of growth in real

output was associated with a fall in the unemployment rate of 0.07 percentage point. The higher the rate of growth of output, the greater the reduction in unemployment, and vice-versa. Using data from more recent decades yields similar results.

An objection to the use of data sets spanning decades is that results obtained from such a long period might hide variations within that period. This leads to the question, has Okun’s law been stable over time? As might be expected (if one is skeptical of economists’ ability to make accurate forecasts), when Okun’s law is computed over shorter periods the relationship between changes in unemployment and real output growth vary considerably.

What might cause these variations? Changes in the relationship between unemployment and output described by Okun’s law might have been affected by young baby boomers, with higher unemployment rates typical of youth, entering the labor market in large numbers. The “Great Moderation,” a period of reduced economic volatility, seems to have had an effect. (See the Précis of May 2007.) The economic expansions and contractions of the business cycle affect calculations of Okun’s law. Also problematic is the “jobless recovery”: a recession ends, output grows, but without a reduction in unemployment.

Given the unstable nature of the Okun’s law equations, it’s not suitable for use as a forecasting tool, right? Wrong. The trick is to incorporate the factors causing instability into the calculations, thus taking its changing nature into account. Basically, the prediction that slowdowns in economic growth generally coincide with increasing unemployment holds true. However, there are exceptions in certain periods. It helps to think of Okun’s “law” as more of a rule of thumb. □