The US Federal Reserve Perfects the Art of Cluelessness

"Construction in the residential market remained solid, though the shortage of labor and intense price pressures for building materials continued to act as headwinds."

The above paragraph is from the <u>May 30 Beige Book</u>, the Fed's periodic wrap up of economic conditions in its 12 districts.

Can you guess which of the 12 districts the Fed is describing? Dallas, perhaps?

No, the above is the Fed's most-recent synopsis of housing markets in the Fed's San Francisco 12th District, which is the West Coast.

What is odd about the Fed's resolute myopia is that there is a broad, bright-red common thread that runs from San Diego to Los Angeles to San Francisco, to Portland to Seattle: Property zoning and other regulations prevent residential construction. In even a merely good economy, rents and house prices are exploding. Vast portions of Los Angeles and Seattle (56% and 69% respectively) are zoned for single-family detached housing only, and NIMBYism is run riot in other neighborhoods.

The Fed devotes not a jot to the foregoing, but copiously covers "labor shortages." Remember the price signal, and supply and demand? The Fed has evidently forgotten.

But there is more.

The median house-price in Seattle is now \$820,000. The average apartment rent in San Francisco, as of April 2018, is \$3552.

Shrewd econo-detectives might have an inkling to worker availability on the West Coast: It is too expensive to live there, mostly due to housing costs. Nearly half of San Francisco Bay Area residents plan to leave, citing housing costs.

Inexplicably, these obvious observations about the West Coast economy are absent in the Fed Beige Book. But why?

Regulatory Capture?

About <u>one-half of US commercial bank loan volume</u> is extended on real estate, and in America that means zoned real estate. Un-zoning property would mean declines in property values, and possibly spell trouble for banks, who have borrowed short to lend long. In other words, the US financial system is deeply wedded to and even dependent on the artificial market scarcity created by property zoning. Free enterprise? What has that to do with it?

One might posit this industry dependency is why the Fed is so acutely concerned about labor rates, and so mute on rising housing costs.

Outlook

For investors, the outlook is much as it has been for several years. The Fed is tight, and will get tighter, and has promised to do so. The Fed even recently declared the "sustainable" rate for <u>US</u> real GDP growth is 1.8%.

The qualification is that the Fed does not want to trigger another 2008-style property collapse, a result it did not anticipate when it tightened the US into the Great Recession. Not for nothing that Fed Chair Jerome Powell has lately discussed softening the 2% inflation target.

Unfortunately, in divining prospective Fed policy, one not only has to ponder macroeconomics, but also institutional biases and compromises. In the end, the Fed practices politico-economics.

Invest accordingly.