Opinion **Property sector**

The Fed has exacerbated America’s new housing bubble

Loose monetary policy has buoyed assets but did not create meaningful supply

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Hyman Minsky would have had a field day with last week’s US inflation numbers. One of the key points in the late, great economist’s Financial Instability Hypothesis was that there are two kinds of prices — prices for goods and services, and asset prices. Inflation in the two areas should, as a result, differ. And indeed they have, quite markedly. The latest Consumer Price Index figures show that almost all core inflation, which was weaker than expected, was in rent or the owner’s equivalent of rent (up 0.3 per cent). Core goods inflation, meanwhile, was down 0.2 per cent.

Very simply, this means that the housing market is once again completely out of sync with the rest of the economy. A decade on from the subprime bubble, housing, which is not only shelter but also the biggest financial asset for most Americans, is the only major component of the CPI with a national inflation rate that is consistently above the overall number.

Why is this? Because, just as Minsky would have predicted, loose monetary policy over the past several years buoyed assets, but didn’t create meaningful new supply or, consequently, enough demand in construction and other home-related areas. The point is illustrated in an academic paper, “What the Federal Reserve got totally wrong about inflation and interest rate policy” from the Mario Einaudi Center for International Studies at Cornell University. As its author Daniel Alpert says: “What we have now is a form of inflation that’s never been seen before — it’s all concentrated in housing.”

Over the past decade, the cost of shelter has risen sharply compared with everything else, the report notes. It hit a historic high of 81 per cent of core inflation in the summer of 2017 and remains “the lion’s share”.

There have not been commensurate salary increases. Median household income adjusted for inflation remains hardly higher than it was at the turn of the century.

This asymmetry is not only something that monetary policy, as it exists right now, is unprepared to deal with. It is something the US Federal Reserve has actually exacerbated (albeit unintentionally) via low interest rates and quantitative easing that boosted housing prices in the very cities where

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the best paying jobs are located.

No wonder millennial Americans are crashing on their parents' couches even after college graduation in unprecedented numbers — they can't afford to get on the housing ladder in the same places where they are most likely to find good work.

The whole situation is made more problematic by inflation in another area — higher education. Student loan debt in the US is at a record high and the struggle to pay it off is real — 12 per cent of borrowers are currently 90 days or more delinquent on their loan payments.

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A February report from JPMorgan on the impact of student loans on the housing market estimates that high student loan drag has knocked 2m young adults out of the market, resulting in a 1.5 per cent lower home ownership rate. That means they can't build wealth, which in turn dampens demand. Bill Dudley, the head of the New York Federal Reserve, calls high levels of student debt and default a "major headwind" to future economic growth.

A prestigious university degree is an asset just as valuable as a plum property. Americans will do almost anything for it, including lie and cheat, as was shown last week in the disturbing news of rich parents paying consultants to create fraudulent credentials for their coddled kids. Is it any surprise that there is something of a snowball effect between the bubbles in higher education and housing? Rents in college towns are outpacing those in other cities, in part because luxury property developers looking to appeal to affluent students and parents are churning out apartment complexes with high-end amenities like "lazy river" water rides.

The dysfunctional divide between incomes and asset prices is not just an American problem. It is observable in many international markets as well: including Hong Kong, London, Paris and Singapore. In the US, unsustainable real estate prices have recently begun to falter in bubble cities such as New York, something which historically foreshadows a national downturn.

The economic consequences are obvious. So are the political ones. The US looks more and more like an emerging market economy in the sense that the basics of the American dream — housing, education and upward mobility — have all been compromised.

This may require a rethink of monetary policy (Mr Alpert would like to see the Fed start to separate inflation components more narrowly when crafting rate decisions). But if this housing bubble has proven anything, it is that central bankers can't fix it all on their own.

Look for Democratic presidential candidates like Massachusetts senator Elizabeth Warren to suggest major infrastructure and industrial policy proposals that would focus more on fiscal stimulus than monetary policy. They are the obvious remedy in what looks increasingly like a Minsky moment.

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