Harry's Take

April 5, 2022

Fed Inflationary Policies Force a Rate Hike as Home Affordability Plunges… This Can't Possibly Work Out Well!

I'd imagine that by now, you sense that I am not a fan of central banks trying to micromanage our economies. The central banks almost always lean toward stimulus, which causes economies to over expand and, hence, sets up the next crash, due to excess debt capacity and unproductive investment. The best sign of that is crashing money velocity, which has been the case, to the greatest level in history, from 1998 into NOW! But who worries about that, other than me… and another economist I trust, Dr. Lacy Hunt?

The economy has a natural ebb and flow: it expands, and because human nature always overdoes things, it eventually slows to wring out the excesses. But such slowdowns are important, because they lead to shakeouts that force companies and workers to refocus and to get rid of inefficiencies and unproductive policies and capacities… It's a good thing, damn it! That's how free market capitalism actually works, and economists might understand that more if they ever actually ran a business.

I have always loved when American economist and social critic George Gilder has stressed that "failure" is the secret to capitalism. The state-owned enterprises in socialistic and communistic countries amount to tombs of failure, housing their undead, zombie economies. They don't let them fail, like capitalism would.

The point is that the economy is not supposed to grow nonstop in a straight line, as people and politicians naturally prefer. Failures do and must come from the process of innovation, but failures must be flushed out of the system quickly to keep it healthy. Our economy is not like a machine! It's a dynamic system that is constantly innovating and rebalancing itself.

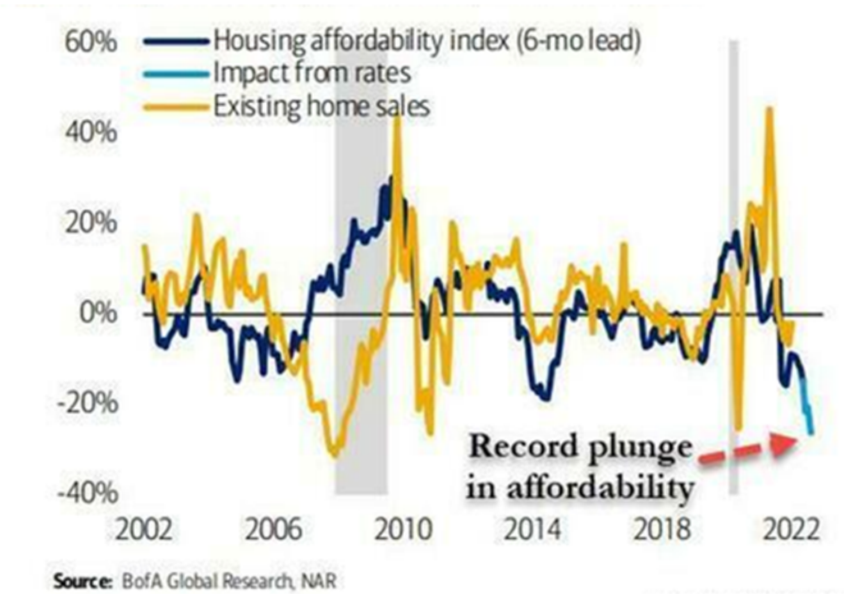
What about "recessions" and "rebalancing" is not obvious?

When governments interfere so much, they end up working against the "invisible hand" that Adam Smith so brilliantly recognized in the late 1700s, when he first espoused free market capitalism, which has been on a productive roll ever since.

Everyone praises the merits of capitalism, but everyone also fights the recessions and shakeouts that are a natural and very necessary part of productive growth. As I like to say, "If we never had a recession, we wouldn't have one honest, productive business left!" Preventing recessions takes out a big piece of that dynamic part of free market capitalism.

This chart illustrates the natural trap that the Fed and central banks have created for themselves, once again, in their tireless quest to prevent recessions.

Housing Affordability Crashing… and Then the Fed Raises Rates



Source: https://zububrothers.com/2022/03/25/us-pending-home-sales-plunge-for-4th-straight-month/

www.HSDent.com

The blue line is housing affordability, and it naturally leads the yellow line, existing home sales. When home prices or mortgage rates go up, housing affordability falls and sales follow on about a 6-month lag… which is no surprise. Both have occurred here recently.

Here's the problem: The Fed is trying desperately to stimulate the economy to avoid recessions, which it considers bad and unnecessary (which shows how little they understand about the actual dynamics of free market capitalism). Hence, the printing of a record $5.1 trillion (about 25% of GDP) in just 2 years to counter the COVID crisis, which was short term in nature. Why did the central bank overreact to this extreme to such a short-term challenge? That level of money printing created substantial inflation in housing prices and led to rising mortgage rates, both of which kill home sales—which already were falling. But inflation also will force the Fed, in its micromanagement role, to raise short term rates, which will slow the economy. That will further slow home sales, which are already crashing as a result of rising, record unaffordability.

This Fed-created trend guarantees both a continued fall in the largest sector of our economy and a recession just ahead, the very thing the Fed was trying to avoid when it overreacted to COVID! And after so much unproductive overinvestment and debt from nonstop stimulus since late 2008, the economy very likely will fall into a depression, not a recession!

The truth is that excessive government meddling in our economy creates only greater excesses and unproductive investments, which lead to deeper recessions and, ultimately, depressions down the road. If the economy isn't allowed to rebalance as it goes along, it only will have to rebalance even more later, after more damage is done from poor investments and bad debts!

Maybe the Great Depression ahead will finally convince us to end this obsession with constant stimulus and avoiding natural recessions and debt detox. The truth is that pushing off natural recessions leads only to bigger depressions from greater debt and capacity imbalances.

Here's my message to central banks: Stop playing God, let our economy manage itself, and intervene only with short-term stimulus to keep a crisis from getting out of hand. If I were in charge, I would have approved the first round of $1 trillion stimulus in late 2008 to early 2009… and then let the economy work it out from there. Instead, the Fed in the U.S. has added another $8 trillion and rising in stimulus since then. We now have much more massive debt and plunging money velocity to show how unproductive that strategy is—they now dwarf what we had back then.

If failure is the key to capitalism, then maybe the massive failures of central banks will lead to their demise, which could go down in history as the greatest thing that ever happened to free market capitalism since it first emerged in the 1770s… which would fit in perfectly with my 250-year Revolutionary Cycle, which began in the late 1700s and is hitting again in the 2020s!

Harry

Got a question or comment? You can contact us at info@hsdent.com.