AEI Housing Center

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Bonus Panel: Research from the Housing Laboratory

A Massive increase in Aggregate Demand Explains Why the Current Bout of Inflation Has Not Been Transitory and Will Run Hot for Some Time

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Edward Pinto

(PintoEdward1@Gmail.com)

Director, AEI Housing Center

The views expressed are those of the author alone and do not necessarily represent those of the American Enterprise Institute

Tracked Credit and Debit Card Transaction volume

This chart, in near real time, tracks credit and debit card transaction volume* constituting a large component of aggregate demand.

- Starts the week of December 31, 2017 through the week of October 17, 2021 (x-axis), with volume indexed to the week of 12.31.17 = 1.0 (y-axis).
- Five Equifax Risk Score (ERS) quintiles from Low (median of 651) to High (median of 736) are shown
- ERS measures past payment behavior for 220 million scored individuals in a zip code.
- ERS is a close proxy for financial literacy and socio-economic status (including income).
  - The mean income of the Low quintile is $41,743, about half of that for the highest ($82,386).
- Up until early 2020 all the indexed quintiles generally went up in lockstep, however they grew faster as ERS quintile went from 5 (highest credit score) to 1 (lowest).

Focusing on quintile 1 (Low), volume exceeded same week 2019 levels at week of May 31, 2020 (excluding Christmas holidays and pre-pandemic bump for week of March 1, 2021) and then increased rapidly over the next 12 months, before beginning a slow, mostly seasonal, decline.

- As of early-October 2021, Quintile 1 expenditures are 30% above those two years earlier.

Shifting to ERS quintile 5 (High), it didn’t exceed 2019 levels until March 2021. It would appear that this lag reflects first the initial drop in stock market valuation and slowing HPA at the onset of the pandemic (March – May 2020), followed by a lag in wealth effect impact as stock market and HPA gains first recovered and then grew. By May 2021 quintile 5 is experiencing marked increases in expenditures.

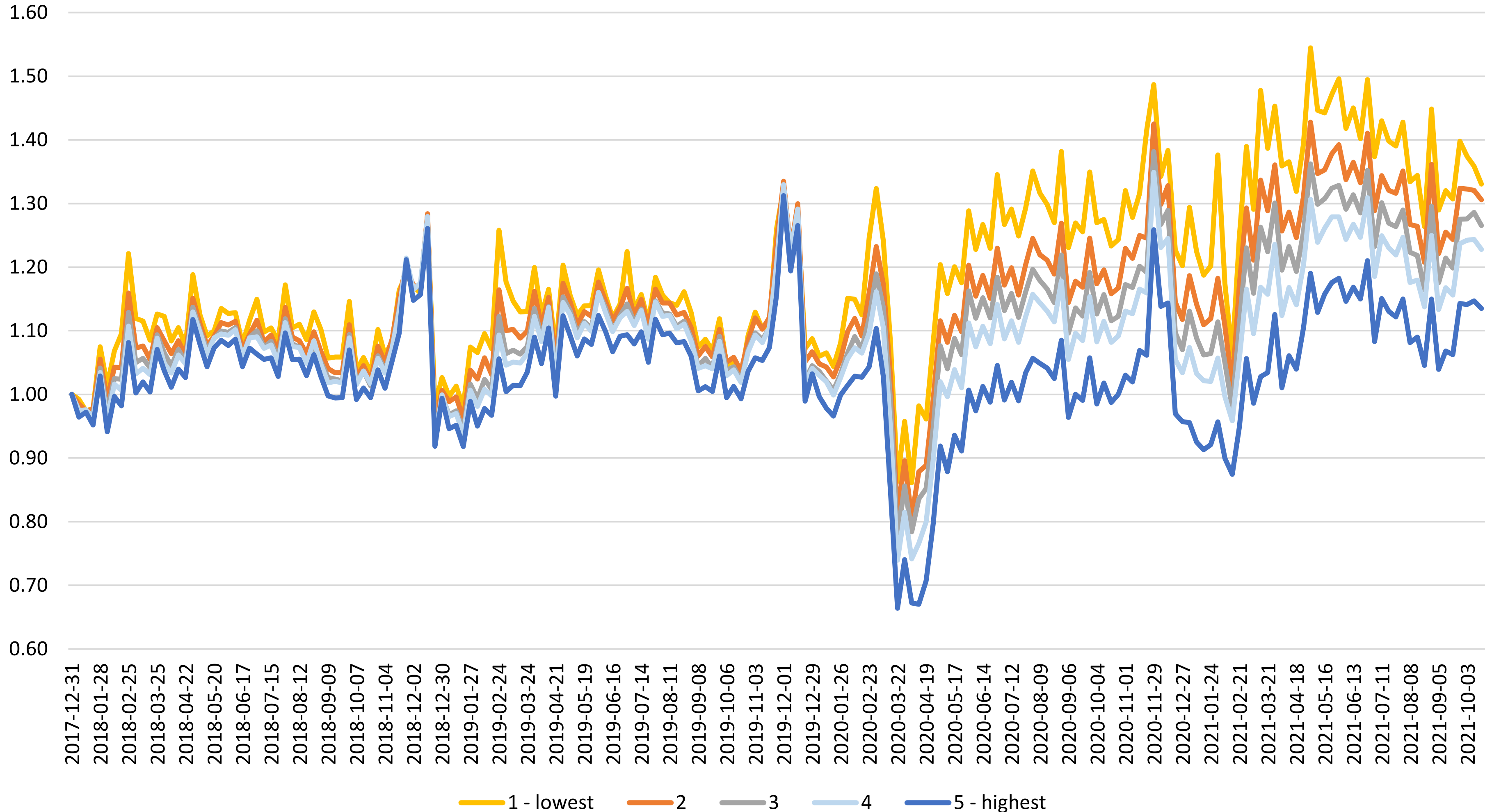
- As of early-October 2021, quintile 5 expenditures are 14% above those two years earlier.
- Quintiles 2-4 also showed marked gains, but more in line with quintile 1. This makes sense since quintile 2 also likely benefited from the relief bills, while quintiles 3 and 4 benefited from work-from-home and had less negative wealth effect from the stock market drop.

* Inflation adjusted dollars

Tracked Credit and Debit Card Transaction volume

Transaction Amount Index (week 2017-12-31 = 1) by Equifax Risk Score Quintile, adjusted for inflation.

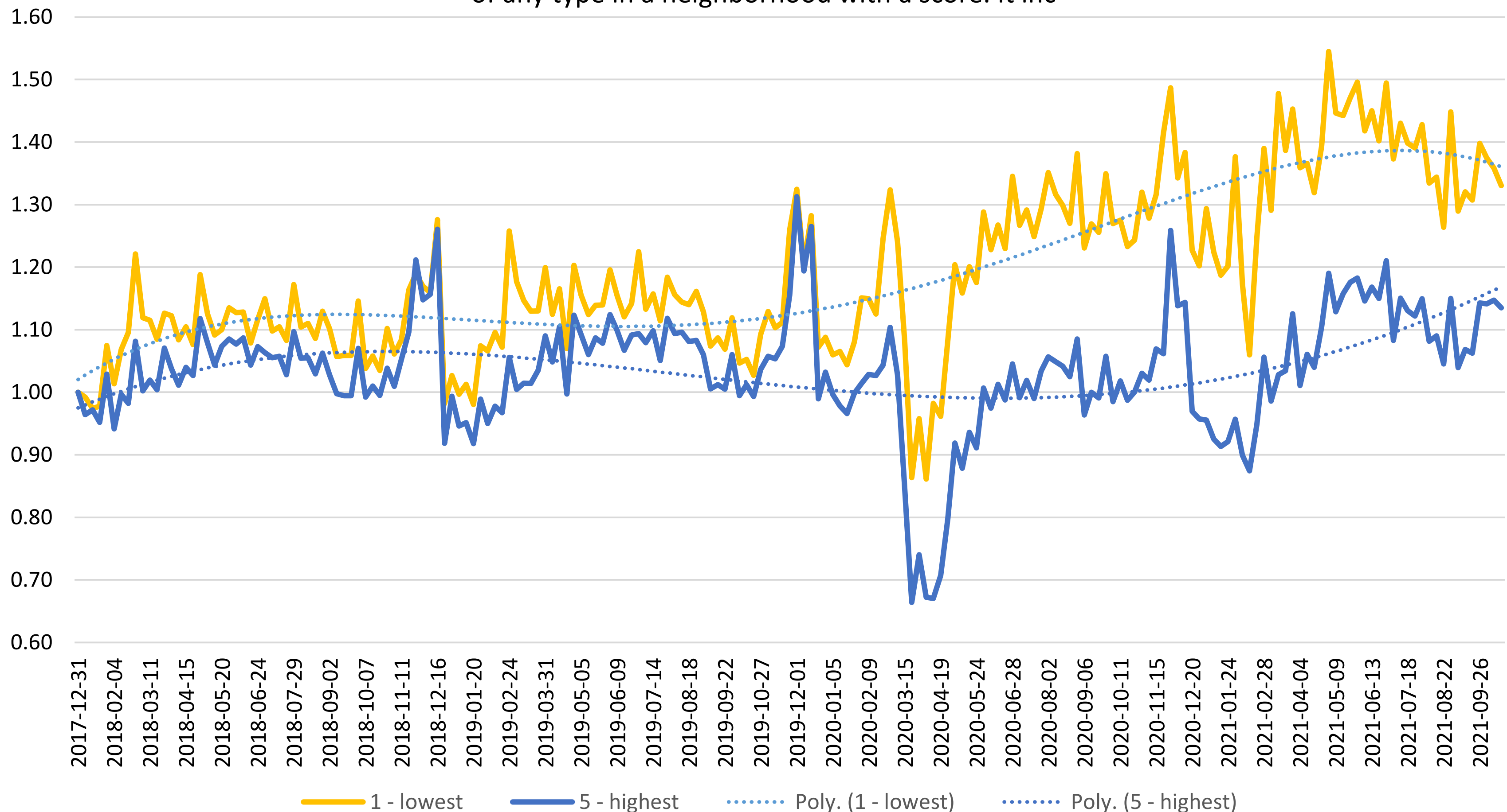
ERS is a Vantage credit score from 2013, representing a summary metric of the stock of all individuals of any type in a neighborhood with a score. It in



Source: Commerce Signals, a Verisk Analytics business and AEI Housing Center

Tracked Credit and Debit Card Transaction volume

The chart below focuses on Quintiles 1 and 5, with added trend lines.



Source: Commerce Signals, a Verisk Analytics business and AEI Housing Center

These Robust Spending Data across All SES Groups Bring into Question Chairman Powell's Narrative Dating to April 2021

> Readings on inflation have increased and are likely to rise somewhat further before moderating. In the near term, 12-month measures of PCE inflation are expected to move above 2 percent as the very low readings from early in the pandemic fall out of the calculation and **past increases in oil prices pass through to consumer energy prices.** Beyond these effects, we are also likely to see upward pressure on **prices from the rebound in spending as the economy continues to reopen**, particularly **if supply bottlenecks limit how quickly production can respond in the near term.** However, **these one-time increases in prices are likely to have only transitory effects on inflation**.

Yet even as recently as November 3, 2021 the narrative had changed little:

> With progress on **vaccinations and strong policy support, indicators of economic activity and employment have continued to strengthen**. The sectors most adversely affected by the pandemic have improved in recent months, but the **summer's rise in COVID-19 cases has slowed their recovery. Inflation is elevated, largely reflecting factors that are expected to be transitory. Supply and demand imbalances related to the pandemic and the reopening of the economy have contributed to sizable price increases in some sectors. Overall financial conditions remain accommodative, in part reflecting policy measures to support the economy and the flow of credit to U.S. households and businesses.**
>
> The path of the economy continues to depend on the course of the virus. **Progress on vaccinations and an easing of supply constraints are expected to support continued gains in economic activity and employment as well as a reduction in inflation.** Risks to the economic outlook remain.

https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20210428.pdf Emphasis added.
https://www.federalreserve.gov/newsevents/pressreleases/monetary20211103a.htm Emphasis added.

The Fed Has Misdiagnosed the Situation

Monetary and fiscal policies have created demand pressures that continue to this day.

Goods and services have increased handily since Q4:19: for the 7 quarters since Q4:19, real GDP is up by 7%, imports by 10% (nominal), durable goods manufacturing by 9% (nominal), and the CASS freight index by 13% (nominal).*

On November 16 the WSJ had these headlines: "Retail Sales Rose by 1.7% in October Despite High Inflation", "Sales up 9.2%, Walmart Raises Forecast and Says Shelves Are Stocked for Holiday Shoppers', and "Home Depot Sales Rise [9.8], Continuing Pandemic Streak".

New home sales in 2012 are up 16% compared to 2019. While demand not being met, this is still a healthy increase

These increases run counter to the story that "**supply bottlenecks [have] limit[ed] how quickly production can respond in the near term."** Rather they are largely the result of large increases in demand pressure created by the federal monetary and fiscal policies.

Yet the Fed Open Market Committee baulks at taking decisive action.

- Monetary policy remains super accommodative.
- Last Friday in a belated move, the Fed Open Market Committee announced that it will begin tapering its asset purchases this month, reducing the monthly pace of its net asset purchases by $10 billion for Treasury securities and $5 billion for agency mortgage-backed securities (MBS), meaning it will still increase its holdings of Treasury securities in November by at least $70 billion per month and agency MBS by $35 billion per month.**
- Given continued HPA of 16% (year-over-year), continuing these purchases, along with interest rate suppression, is completely unjustified.

* Change from Q4:2019 through Q:3:2021. *Source: Board of Governors of the Federal Reserve System (US)*

** https://www.foxbusiness.com/personal-finance/federal-reserve-tapering-assets-interest-rates

The Fed Has Focused on Using the Monetary Punch Bowl to Fuel a Wealth Effect Leading to Growth in Aggregate Demand

As former president of the San Francisco Fed (and former Fed chair and current Treasury secretary) Janet Yellen noted in 2005: “central bank models have long incorporated the wealth effect of house prices and other assets on spending.*

- One study found that for every dollar of increased stock market wealth, consumer spending rises by 2.8 cents per year.**
- Another found that for every dollar of increased home equity wealth, consumer spending rises by 3 cents per year.

The Monetary Punch Bowl: It has contributed about **$1 trillion** in wealth effects since the beginning of the pandemic:

- **$420 billion** ($15 trillion in stock market valuation increase since end of 2019 x 2.8%)
- **$180 billion** (home equity gains over the last 18 months yields an average $2,200 per household in additional consumption spending over the next couple years, or about $180 billion of additional spending summed up across all homeowners.***
- **$280 billion/year** from monthly payment savings on Rate and term refinances
- **$90 billion/year** from equity extraction on cash out refinance loans

* https://www.frbsf.org/our-district/files/051021.pdf
** https://www.nber.org/digest/aug19/new-estimates-stock-market-wealth-effect, June 2019
*** https://www.corelogic.com/intelligence/overall/home-equity-wealth-bolsters-economic-growth/
**** Ibid. Extrapolated from an analysis by Frank Nothaft at CoreLogic.

In Addition to the Monetary Punch Bowl, Two Other Large, Poorly Targeted Punch Bowls Are Fueling Aggregate Demand

The Housing Leverage Punchbowl:

- Leverage: GSE's weakened capital requirements, expanded Affordable Housing mandates, increased risk layering, and further crowding out the private sector. FHA MDR approaching series high.
- Government guaranteed rate and term: already noted.
  - This largely benefits Quintiles 1-3
- Government guaranteed Cash out refinance : already noted.
  - This also largely benefits Quintiles 1-3.

The Social Assistance Punch Bowl:

- Congress has enacted about $5 trillion in additional spending, with another $1.75 trillion + for Build Back Better (BBB) still being discussed.*
  - About **$4.3 trillion** was allocated to individuals, companies, and state and local governments – much of which translated into current and future demand, with BBB still possibly to come.
  - **$80 billion** in mortgage loan forbearance that was/will be tacked onto loan balances**
  - **$100 billion** in student loan forbearance over 20 months.
    - Congress has not weighed in on student loan forgiveness – stay tuned for January 2022
- Much of the assistance has been overlapping and as one size fits all.
  - Overlapping: unemployment + mortgage or rent forbearance + plus student loan forbearance + enhanced food stamps
  - One size: consider regular unemployment + $600/week in pandemic relief regardless of state cost of living or wages.

These 3 spiked punch bowls total $5.5 trillion, fueling massive growth in aggregate demand.

*The March 2020 CARES Act, for $2.2 trillion the December 2020 Consolidated Appropriations Act for $0.91 trillion, the March 2021 American Rescue Plan Act for $1.9 trillion, the November 2021 Infrastructure Investment and Jobs Act for $1 trillion, and the still being discussed Build Back better Act for $1.75 trillion+.

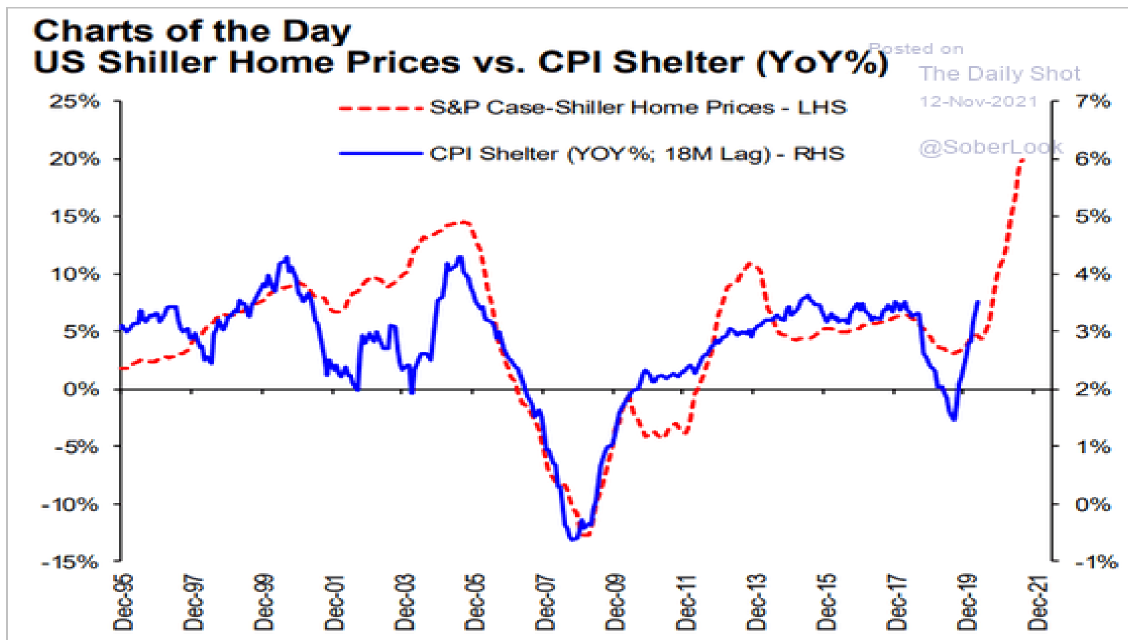
** Extrapolated from http://www.freddiemac.com/research/insight/20201117_mortgage_forbearance_rate_during_COVID-19.page

Given the Congresses' Spending Excesses and the Fed's Refusal to Raise Rates and Rapidly End QE, These Wealth Effects Will Not Dissipate Quickly

- HPA to average 10% in 2022, with additional HPA wealth effects and home equity extraction.
- Given that home prices are sticky, the rapid HPA appreciation the Fed has stoked will become the bloated base upon which future HPA will be calculated.
- Continuing impacts of Work from Home and housing arbitrage

To view the Housing Arbitrage data interactive, click here.

- Lagging Housing component of the Fed's Personal Consumption Expenditure index (16%).
  - The Owner Equivalent Rents (OER) component lags home price increases by about 18 months, so it is now just beginning to show up in inflation. and will be a source for upward price momentum for many, many months. There is about an 18 month lag before the housing component of PCE catches up with home price and rent trends.



Source: Hugo Ste-Marie, Portfolio & Quantitative Strategy Global Equity Research, Scotia Capital

Impact of Monetary Policy on Home Prices

- Tomorrow’s sessions will:
  - Build upon today’s sessions which covered the impact of the monetary and housing leverage punch bowls on home prices,
  - Focus will be on the disparate Socio-Economic Status (SES) impact of these policies.
  - Focus on how socioeconomic status factors impact poverty and upward mobility in a variety of policy areas: housing access, family structure, education access, workforce preparation and university education, and lastly, the overall state of upward mobility in America.