Points to Ponder

February 18, 2022

The First Tee...

Economic Xanadu…**the COVID crisis has seen governments adopting new economic playbooks regarding fiscal and monetary policy** **(the jury is still out if this is an idyllic situation):**

- The pandemic initiated a shift to fiscal policy as the key tool to manage the economy:
  - During the past five decades, developed countries have relied on monetary policy as a means for maintaining low unemployment and stable prices, primarily by controlling short-term interest rates:
    - During the period after the Great Depression through the 1960's (referred to the Keynesian Era) governments were tasked with keeping their economies in balance through taxing and spending (the basic tools of fiscal policy):
      - Excessive government spending created out of control inflation price pressures, damaging economic growth, ending the era.
    - As inflation surged during the 1970's and early 1980's the Fed was tasked with fighting out-of-control price increases with interest rates…Fed Chairman Paul Volker broke inflation's back by pushing borrowing costs above 20%:
      - The use of monetary policy to manage the economy was favored for removing the political aspects of fiscal policy, as the Central Bank was supposed to be apolitical, despite the Fed Chairman being nominated by the sitting U.S. President:
        - The pace of economic growth was to be managed by adjusting the cost of private borrowing rather than by spending public money.
    - After beating double digit inflation, the U.S. has gone through four decades of CPI rarely exceeding 2% per annum:
      - This low inflation era has been characterized as the period of "great moderation"…that had solved the problem of economic depressions:
        - Unfortunately, the Fed moderated a little too much during the 2000's, with ultra-low interest rates resulting in asset-bubbles forming that evolved into The Great Recession crisis…the S&P 500 stood at 1565 in October 2007 but lost 57% in value to 675 by March 2009.
      - During the Great Recession and COVID pandemic the Fed added a new monetary tool of quantitative easing, which is the Central Bank adding to its balance-sheet by purchasing longer-term Treasury and mortgage-backed securities (money creation):
        - The QE purchases were used in conjunction with negative rates in Europe…Japan's central bank now owns half of its national debt.
- **Hi-ho Stimulus**…the government has upped its check writing rescue activity to save economy:
  - During the Great Recession, government bailouts were executed in a top-down strategy:
    - Banks and large companies were given funds to avoid insolvency, with the hoped-for outcome to be a trickle-down process that would benefit workers and revive consumption (the U.S. economy is a consumer-based model):
      - The government's intervention did revive the economy (albeit slowly) and repaired the financial system, but did little to aid damaged households, creating a growing disparity in income and wealth *(viewed by some as the rich getting richer)*:
        - Wage increases were minimal, while wealth was primarily accumulated through ownership of equities and property…the lower income Classes were not benefiting from these gains as they owned little stock and were primarily renters, not homeowners.
  - The government revised its spending tact in reaction to the pandemic economic shutdown, using a bottom-up strategy, providing payments directly to unemployed workers…as well as impacted companies:
    - The spending blitz pulled the economy out of its steepest slump on record (GDP fell 31.2% during the 2nd quarter 2020) at the fastest pace ever seen (GDP rose 33.8% during the 3rd quarter 2020)…**while GDP was falling in 2nd quarter 2020, household income was actually rising**:
      - The government's stimulus efforts to replace lost income eased the job crisis and avoided morphing into a financial crisis.
  - The success of the government transfer payments was a shift from monetary to fiscal policy to back-stop the economy that is now being considered as a preferred method to combat future downturns.
- **The Piper Syndrome**…unfortunately, all these government payments are not a free lunch:
  - The resulting increases in government debt totals and inflation pressures has create new problems:
    - U.S. government debt totaled $9 trillion in 2007 (prior to the start of the Great Recession), over the past fourteen years it has increased by 233% to $30 trillion (and growing)…US debt to GDP stands at 131%, after averaging 62.3% from 1940 to 2018:
      - The Japanese government has the largest debt to GDP ratio of all the developed countries, at 237%:
        - Since 2007, Japan's GDP growth has averaged an annual gain of .2%, while the U.S. growth rate was 1.6% for this period:
          - This is a stark analysis of how rising debt levels can sap GDP growth in an economy, especially If left unchecked.
    - Several newer generations are getting their first taste of elevated inflation levels…*unfortunately, it's rather sour!*
      - The rampant growth of global money supply, combined with a spike in labor costs and supply-chain shortages have pressured the price for goods and services by the most since the 1980's…a period dominated by double-digit borrowing rates:
        - Despite the rise in wages, the increased cost of housing, utilities and gasoline are reducing the amount of disposable income.

At the turn...

The Back Nine…

Rent Revival…**housing rental rates are on the express elevator with more floors to go:**

- Rent is the largest expense for the typical household and the largest component of CPI:
  - Rent inflation exceeded an average of 4% last year, after averaging 3.3% annually for the five years preceding the pandemic… rent comprises about 32% of the consumer price index:
    - Residential rent increases spreading from new leases to existing ones has been a pattern seen in most places:
      - The rent inflation rate is forecast to rise to multi-decade highs of 5% or more this year *(time to look into buying a Big Agnes tent?)*
- **Apartment Sweet Home**…the rising cost of single-family homes has exceeded affordability for many:
  - Demand for rental housing hit a record high in 2021…driven my Millennials leaving their parents' home and establishing households:
    - Rising incomes will help many renters deal with the higher cost of rents...average hourly earnings for production and nonsupervisory workers increased by 5.8% last year, close to the fastest pace since the 1980's:
      - Rental rates tend to track the pace of wage growth as landlords do not want to price their properties beyond affordability.
- **Movin' on Down**…as the pandemic progressed, there has been a population shift, with households relocating away from high-cost cities to more affordable areas (working from home has helped accommodate this phenomenon):
  - New York and San Francisco were experiencing population declines, while Phoenix was expanding:
    - In 2021, rents in New York and San Francisco rose by 1.2% and .6% respectively, while Phoenix rents spiked 10.1%:
      - Landlords have also gained price leverage on raising rent levels as eviction bans have expired.
- **Build-It and they will Come**…unfortunately, for many areas (especially in the Sunbelt and Mountain West) they have already arrived, creating pressure on infrastructure, and creating housing shortages *(no room in the inn!)*
  - Completed new multi-family housing construction is being rented out at historically fast rates:
    - During the second quarter of 2021, 72% of rental units were leased with-in three months of completion, up from the 43% pace seen during the first quarter 2020…exceeding the 57% average lease rate seen from 2014 through 2021:
  - Many of the lower cost of living cities, people are gravitating to, do not have the institutional or organizational resources to deal with the homeless and displaced, compared to most larger cities.
- **Living off the Grid**… a growing number of people are living in their vehicles (these are in short supply as well):
  - Auto-dealer inventories are expected to remain anemic again this year as the chip shortage persists:
    - Car dealer inventories are running at about 2.5 million units less than in 2019…resulting in 18 days of inventory in December:
      - Auto sales hit 14.9 million during 2021…up from 2020's sales total of 14.4 million, but below 2016's record 17.5 million.
  - The average price of a new vehicle in the U.S. rose to a record $45,872 last year:
    - The shortage of new vehicles has increased the demand for used cars & trucks, whose price rose 40.5% last year.

19th Hole...

Advise is what we ask for when we already know the answer but wish we didn't.

Erica Jong

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