Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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As *Politico* rightly pointed out last week, the inability of anyone who doesn't already own a home to get one is turning into a significant political problem for incumbents of all persuasions. It might also come to be one for the Federal Reserve based on a call I got from a senior senator a couple of weeks ago. This is not exactly what the Fed needs given how hot a political potato it's already become.

Having read my economic-inequality book, the senator called to ask if I thought the Fed had any responsibility for the acute shortage of affordable housing. As in all too many other states, his has seen a migration of teachers, first responders, and the middle class as a whole from cities and resort areas, with these vital workers forced to live hours from their jobs and thus in a state of perpetual commuting which they fear puts their children at risk.

This isn't news, but it's worse than ever and thus not just a daily grind for many Americans, but also a serious political threat to this moderate Democrat. His state is deep purple and he believes it's getting redder by the minute thanks to Donald Trump's ability to mobilize voter anger on day-to-day economic challenges such as the critical one facing those who cannot find affordable, desirable housing within reasonable distance of their jobs.

As might be expected, the senator wasn't calling to ask an academic question; he wanted to know not just if the Fed should be held accountable for unaffordable housing, but also if he should go public and do so. In very brief, I said that holding the Fed to account can and should be done as long as the role of other federal, state, and local policies is kept firmly in mind. many factors contribute to scant supply and thus to high housing costs, but the Fed's ultra-low real rates from at least 2013 to 2023 also played a strong role.

First, the Fed helped to financialize the U.S. economy, shifting housing supply from new production to lots of private-equity dollars chasing existing supply to turn rentals into higher-priced homes they could quickly flip. These yield-chasing purchases combined with the way low rates create disincentives for long-term housing investment, spurring vertiginous house-price increases as existing home owners took advantage of low rates also to cash in high-cost mortgages to trade up. This left new and lower-income households farther and farther behind. Even if they could afford a mortgage, many couldn't float a down payment because savings under the Fed's policy actually lost value due to the long, hard spell of negative real rates.

Most Democrats don't see low rates this way, with Sens. Brown, Warren, and others last week calling on the Fed to lower rates ASAP in part to promote affordable housing. This is based on the view that lower rates make mortgages more affordable – true enough – but the prolonged structural and wealth-destroying impact of ultra-low real rates means that even lower ones now will do little

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for most households desperate for an affordable place to live who can't qualify for a loan even with somewhat lower rates. Low rates might reduce the odds of a downturn and boost wages, but any spurt of inflation they provoke will hit lower-income families the hardest, eroding the benefit of wage gains and doing little to facilitate sustainable home ownerships.

The short answer to the senator's question is that Fed policy until 2023 harmed housing affordability by undermining sustainable housing investments in new supply, driving up prices for existing supply, and making it impossible to save for a down payment without taking huge risks in cryptocurrency – the poor person's alternative to savings at the depth of the Fed's low-rate policy.

Higher rates are beginning to return economic incentives to those that support sustained home ownership, but it will take years for most families to catch up to take advantage of newly-opened opportunities if house prices drop, supply increases, savings grow into down payments, and frantic yield-chasing subsides. So, hold the Fed accountable. Scant affordable housing supply isn't all its fault, but what it did to financial markets and economic inequality have combined with all the zoning, infrastructure, and other challenges that are totally not its fault to do irrevocable harm.