RESEARCH REPORTS

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RESEARCH REPORTS

AIER publishes over 100 articles per month that are distributed in digital form. Research Reports contains Business Conditions Monthly plus 10 of the most representative, chosen here for popularity, variety, and relevance. These articles are often reprinted in venues around the web, including *Seeking Alpha*, *Intellectual Takeout*, *Mises Brasil*, and dozens of other outlets. To read all of them, go to

www.aier.org

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BUSINESS CONDITIONS MONTHLY

Peter C. Earle
RESEARCH FACULTY

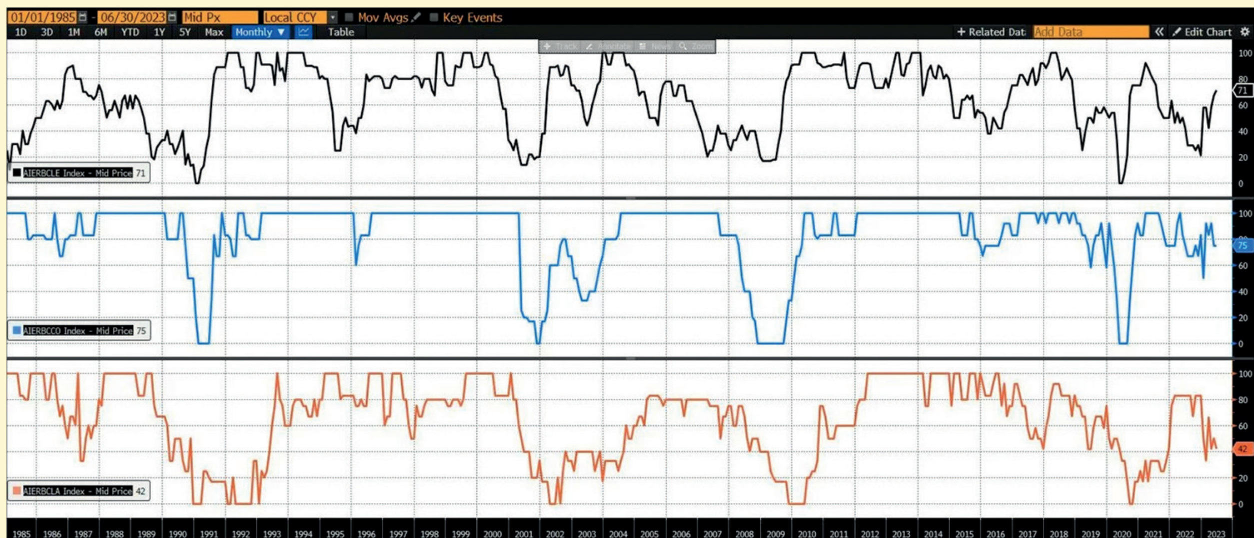
June 2023 saw expansion in both AIER's Leading and Roughly Coincident Indicators, with the Lagging Indicator falling to a slightly contractionary bias.

AIER's Leading Indicator rose to 67 in May to 71 in June, its highest value since July 2021. After languishing at contractionary levels for the second half of 2022 with levels below 30, with the exception of March 2023 the index has expanded in most categories. Our Roughly Coincident Indicator has, since October of 2020, remained above 50 but bounced between 58 and several readings of 100. More recently, since mid-2022, the index has averaged in the mid-60s, with February and April 2023 generating readings over 90. It maintained a level of 75 from May to June 2023.

The AIER Lagging Indicator rose from 42 in April to 50 in May, shifting from mildly contracting to a neutral bias. In June 2023 it returned to 42.

AIER Business Conditions Monthly (5 years)

AIER Business Conditions Monthly (1985 – present)



Leading Indicators (71)

Among the twelve Leading Indicators seven increased, two decreased, and three were essentially unchanged. Among rising components were the University of Michigan Consumer Expectations Index (11 percent), US Initial Jobless Claims (7.8 percent), the Conference Board US Leading Index of Manufacturing New Orders for Consumer Goods and Materials (0.1 percent), the Conference Board US Leading Index of Stock Prices of 500 Common Stocks (4.8 percent), the US Census Bureau's Adjusted Retail and Food Services (0.2 percent), the 1-to-10 year US Treasury spread (4.2 percent), and debit balances in brokerage margin accounts (5.8 percent).

The Bureau of Labor Statistics US Average Weekly Hours (All Employees, Manufacturing), the Conference Board Leading Index of Manufacturers New Orders for Nondefense Capital Goods ex Aircraft, and the Census Inventory to Sales Ratio (total business) were unchanged from May to June 2023.

The declining components of the Leading Indicators were the US New Privately Owned Housing Units Started by Structure (-8.0 percent) and the Bureau of Economic Analysis' US Heavy Truck Sales (-4.9 percent).

Roughly Coincident (75) and Lagging Indicators (42)

From May to June 2023 four of the six components of the Roughly Coincident indicators rose, one was unchanged, and one declined.

The three Conference Board components of this index increased: Coincident Manufacturing and Trade Sales up 0.26 percent, Coincident Personal Income Less Transfer Payments up 0.25 percent, and the Consumer Confidence Present Situation up 4.3 percent. Total US Employees on Nonfarm Payrolls, published monthly by the Bureau of Labor Statistics, also rose by 0.13 percent.

The Federal Reserve's Industrial Production Index declined by 0.54 percent, and the US Labor Force Participation Rate was unchanged in June.

Among the six Lagging Indicators, core CPI, 30-day average yields, and the Conference Board's US Lagging Commercial and Industrial Loans declined by 9.4 percent, 1.0 percent, and .42 percent respectively. The Conference Board's US Lagging Average Duration of Unemployment rose by 2.3 percent while the US Census Bureau's US Manufacturing and Trade Inventories increased by 0.2 percent. And the Census Bureau's US Private Construction Spending (Nonresidential) for June fell 0.03 percent.

June 2023 saw expansion in both AIER's Leading and Roughly Coincident Indicators. The Leading Indicator has been in a general uptrend since December 2022 after a long, sloping downtrend which began in March 2021. The Roughly Coincident Indicator, meanwhile, has been in positive territory since the start of 2023, while the Lagging Indicator has generated monthly values alternating between neutrality and contraction in its constituents with the exception of March 2023 (66).

Discussion

In light of strong consumer spending, historically low unemployment, a construction boom, and a steady disinflationary trend, a growing number of economic forecasters have dialed back their predictions of a late 2023 recession in favor of soft landing scenarios. Another, smaller camp has shifted sharply and is now forecasting a reacceleration of the US economy. Last week's unexpectedly strong 2.4 percent 2nd quarter

2023 US GDP has added to hopes that the Fed's contractionary policy regime, now entering its sixteenth month, will soon have the general price level back to its target range without a substantial (or to some, any) economic slowdown.

In the March 2023 Business Conditions Monthly (Volume LXXXIV), we expressed the following view, citing trends in our three indicators as well as employment diffusion, the growing gap between consumers' present confidence and expectations, the rate of economic growth versus short-term interest rates, the decline in the quality of corporate earnings, and a handful of other economic metrics:

> US economic fundamentals are now clearly deteriorating, with risks compounding to the downside. The current baseline estimate is for an economic recession within the next twelve to eighteen months [September 2024].

Despite the rapid embrace of these altered projections, we maintain the above position for the reasons which follow.

2nd Quarter GDP

The first estimate of the 2nd quarter US GDP number (2.4 percent) mandates a look under the hood. Consumer spending contributed 1.1 percent to the reading, despite falling from 4.2 percent in the 1st quarter of 2023 to 1.6 percent in the second. Durable goods spending, however, fell from 16.4 percent in the 1st quarter of 2023 to 0.4 percent in the 2nd quarter. With pandemic savings dwindling, the student loan payment moratorium ending in September/October 2023, and delinquencies on car loans rising, American consumers are likely to be hard pressed to continue their acquisitive ways in the remainder of 2023 and into 2024.

Nonresidential fixed investment added 1 percent to 2nd quarter GDP. But a substantial amount of the 7.7 percent increase in new private structures and equipment spending is tied to three legislative measures passed under the Biden administration. The Bipartisan Infrastructure Act (signed in November 2021), which provides up to $550 billion over the next five years on transportation, broadband, and public works; the Inflation Reduction Act (signed in August 2022), which provides up to $500 billion in Federal spending and tax breaks for green/sustainable projects; and the CHIPS and Science Act (also August 2022) which will provide up to $280 billion in spending on semiconductor foundries over the next decade.

The Biden administration's industrial policy foray, ostensibly to reverse the decline of American industrial heft in the global marketplace, is a superficiality. The rapid slide in the percentage of the US workforce employed in manufacturing over the past five decades has vastly more complex origins than the number of physical structures that exist.

Investment in physical plant and equipment paid for/spurred on by industrial policy and dwindling consumer firepower thus account for roughly 2.1 percent of the 2.4 percent 2nd quarter GDP number. Whether viewed as a representation of current output or a foundation for future growth, the disproportionate contribution of two questionable sources of growth to that measure do not paint a particularly encouraging picture.

The Senior Loan Officers Opinion Survey (SLOOS)

According to the Federal Reserve's 2nd quarter SLOOS results, banks are tightening credit standards. The percentage of banks reporting tightening standards for commercial and industrial loans increased from 46 percent in the 1st quarter of 2023 to just under 51 percent in the current quarter. The top reasons for tightening among respondents were: 1) Less favorable/more uncertain economic outlook; 2) Reduced risk tolerance; and 3) Deterioration in current or expected liquidity position. The number of respondents citing "concerns about legislative changes" jumped from 38.3 percent in the first quarter to 54 percent in the second quarter. Just over 40 percent of respondents expressed their intention to tighten lending standards sometime during the second half of 2023. The ability to tap credit in support of continued consumption is likely to deteriorate in the coming two to four quarters.

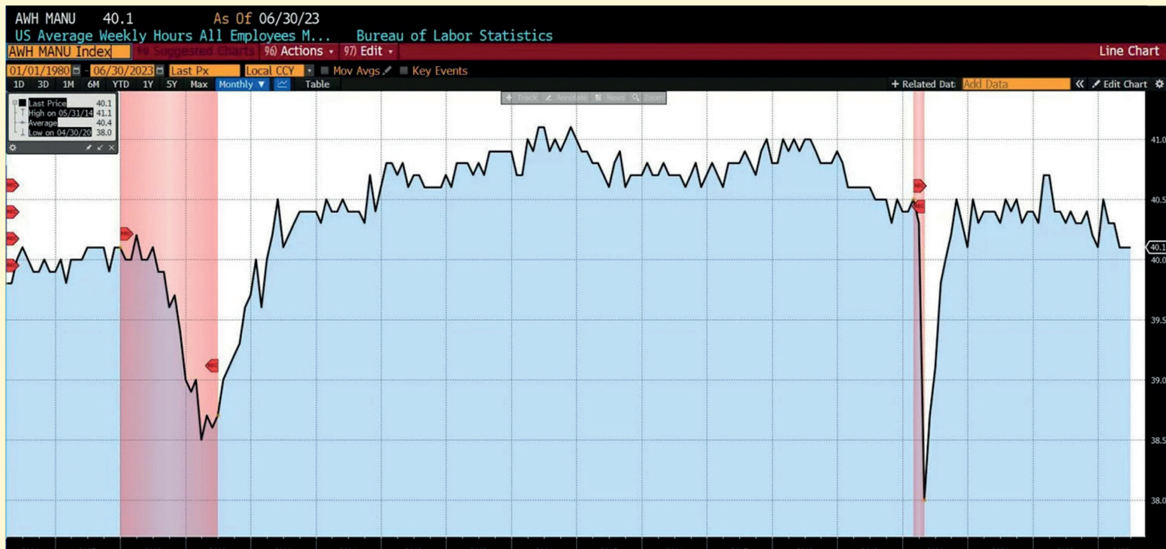
Manufacturing weakness

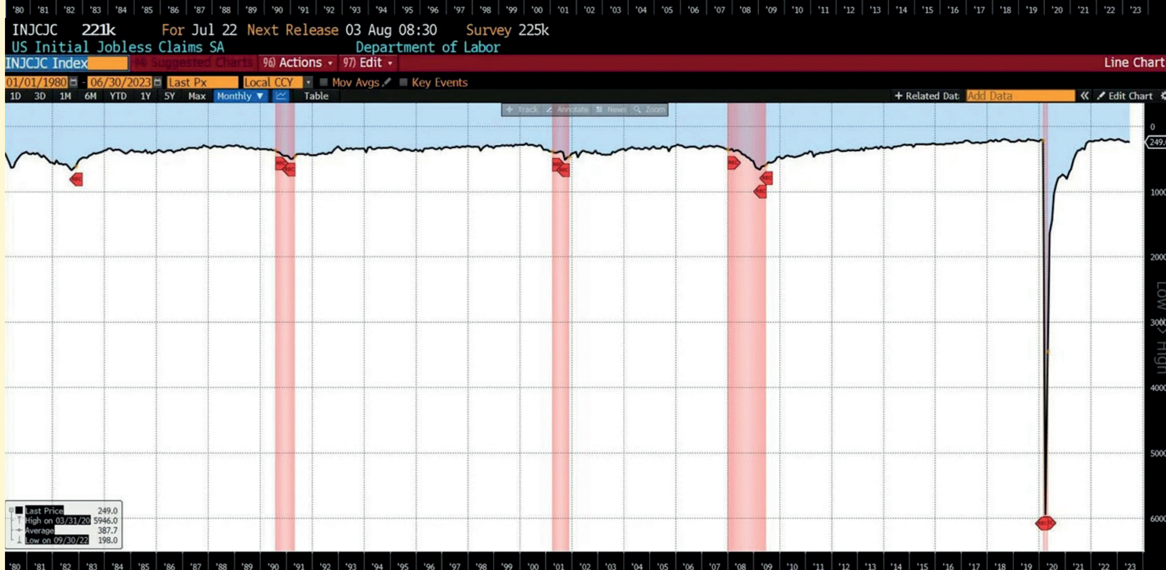
The Institute for Supply Management's (ISM) Purchasing Managers' Index fell for a ninth straight month in July to 46.4. While new orders and production improved slightly in July, the indices remain in contractionary territory. Also in July 2023 the ISM Index of Factory Employment fell to its lowest reading (44.4) since July 2020. Industrial production fell from September 2022 to December 2022, recovered a bit through April 2023, and has fallen since. As demand for durable goods has declined, factory output has slowed with wholesalers and retailers accumulating less inventory.

The recent trend in the overall ISM Purchasing Managers' Index as well as five regional totals (Empire/New York, Philadelphia, Dallas, Kansas City, and Richmond) are displayed below. Weakness in manufacturing is seen across all areas and spreading.

The recession forecast made in March 2023 was cast with a longer time horizon than most others at the time (18 months versus six to 12 months). This was a purposeful choice made on account of our expectation that in the post-pandemic era the combined effects of pent-up demand, extended policy lags, and other factors might take longer to manifest. At present we continue to believe that the US will enter a recession by September 2024, but will adjust our perspectives if and when necessary as new data and facts become available.

LEADING INDICATORS





LEI NWCN 123132.00 As Of 06/30/23 MILLIONS
Conference Board US Leading Index Manuf... Conference Board
LEI NWCN Index
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LEI MNO 34967.00 As Of 06/30/23
Conference Board US Manufacturers New O... Conference Board
LEI MNO Index
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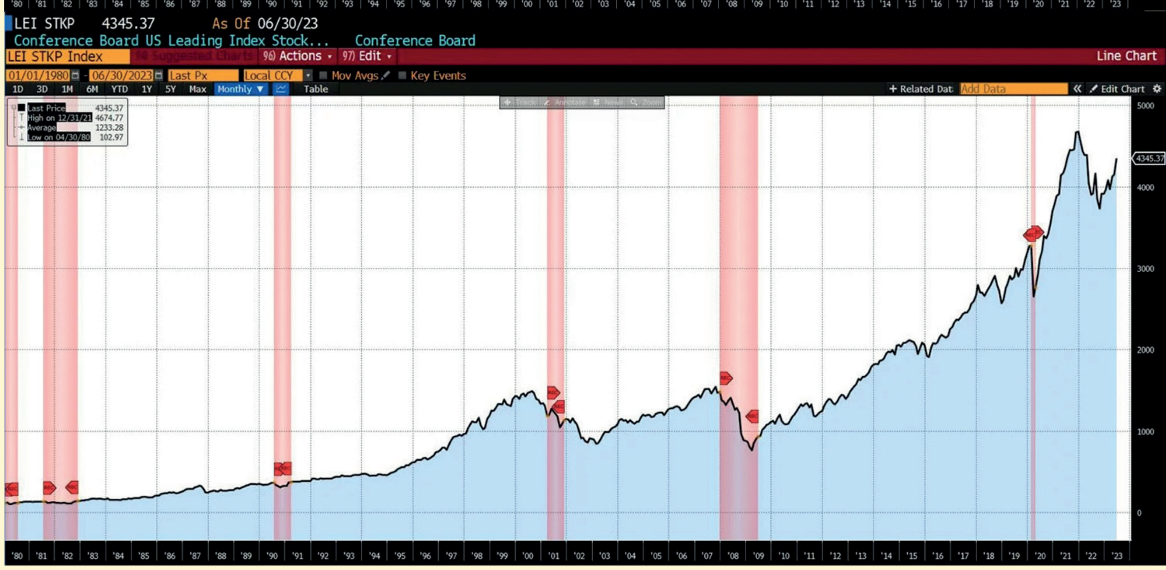
LEI STKP 4345.37 As Of 06/30/23
Conference Board US Leading Index Stock... Conference Board
LEI STKP Index
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Line Chart
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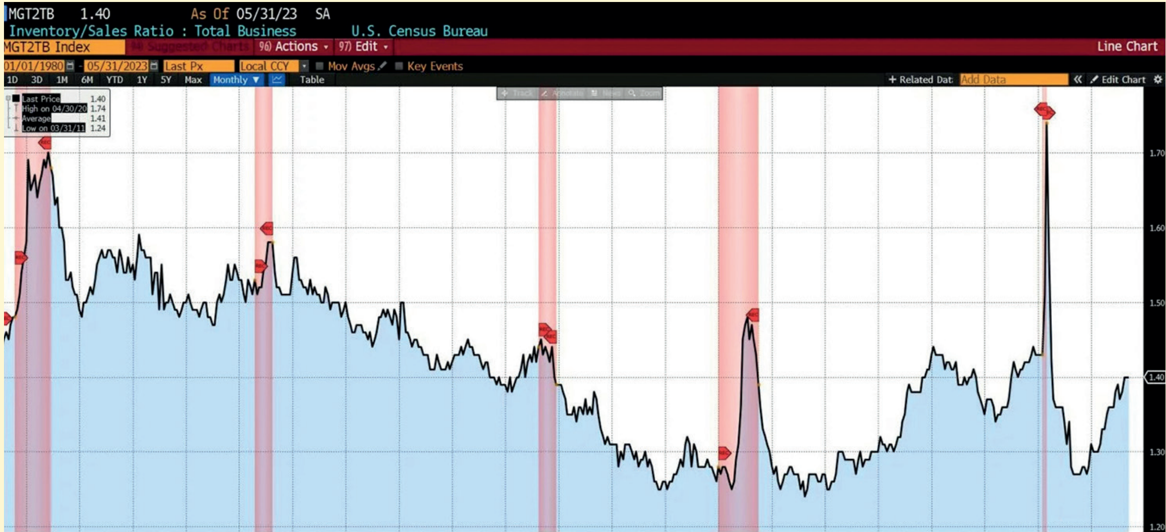
MGT2TB 1.40 As Of 05/31/23 SA
Inventory/Sales Ratio : Total Business U.S. Census Bureau
MGT2TB Index
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Line Chart
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Last Price 1.40
High on 04/30/20 1.74
Average 1.41
Low on 03/31/11 1.24
1.70
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1.40
1.30
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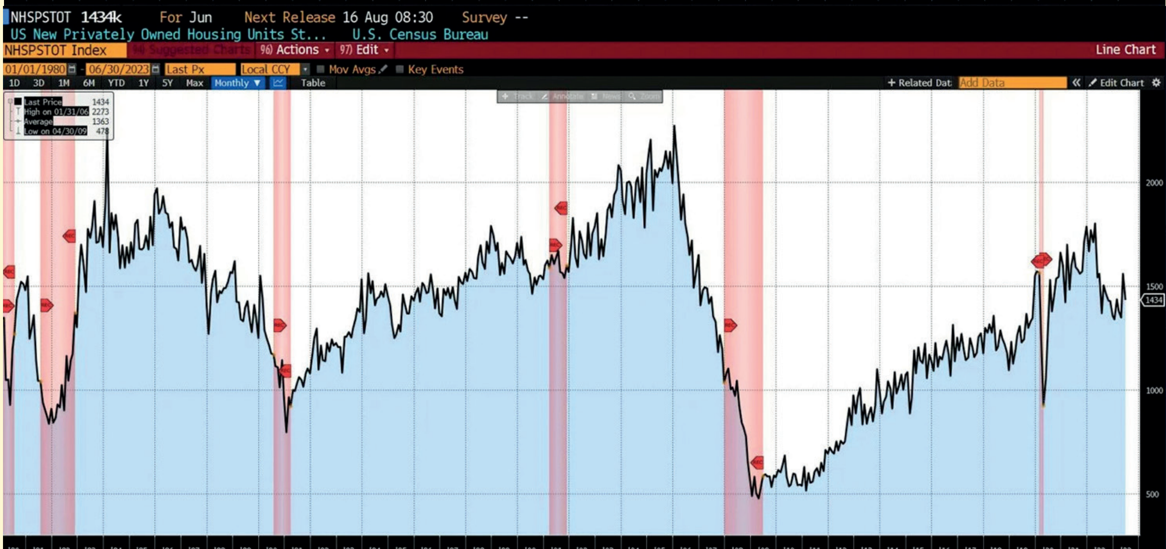
NHSPSTOT 1434k For Jun Next Release 16 Aug 08:30 Survey --
US New Privately Owned Housing Units St... U.S. Census Bureau
NHSPSTOT Index
96) Actions
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Line Chart
01/01/1980 - 06/30/2023 Last Px Local CCY Mov Avgs Key Events
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Last Price 1434
High on 01/31/06 2273
Average 1363
Low on 04/30/09 478
2000
1500
1434
1000
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RSTATOTL 689.499 As Of 06/30/23 BILLIONS
Adjusted Retail & Food Services Sales T... U.S. Census Bureau
RSTATOTL Index
96) Actions
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Line Chart
01/01/1980 - 06/30/2023 Last Px Local CCY Mov Avgs Key Events
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High on 01/31/23 692.501
Average 363.628
Low on 03/31/92 163.721
689.499
600
500
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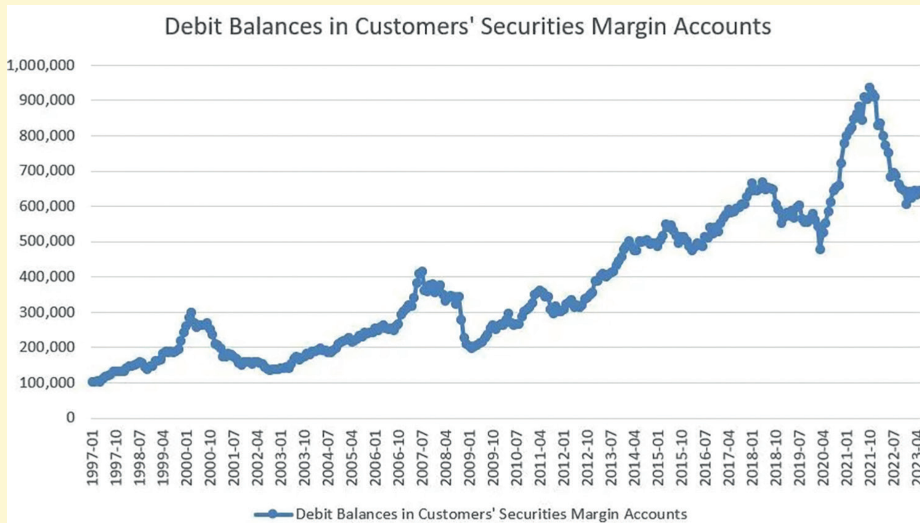
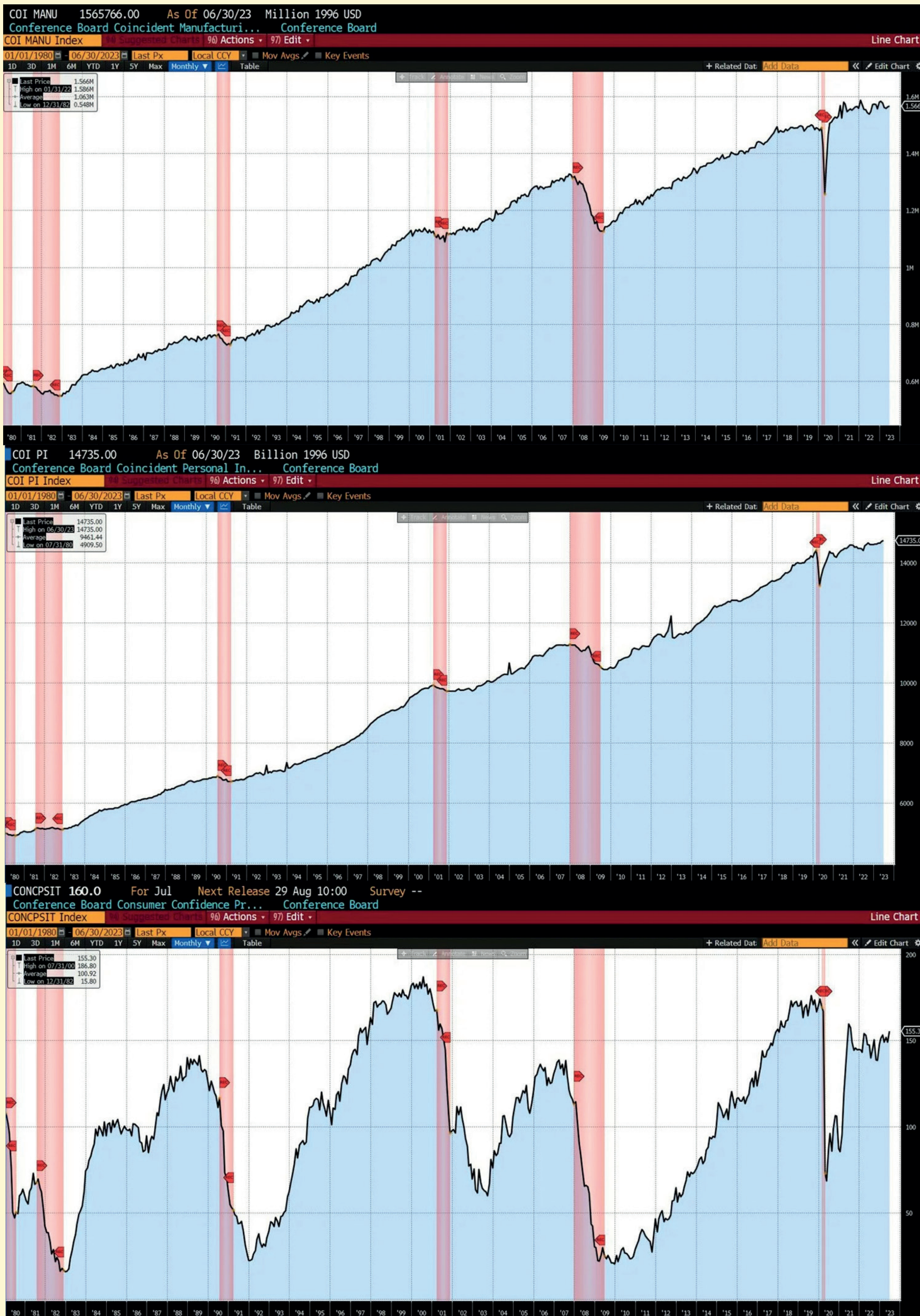
200
1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019 2020 2021 2022 2023

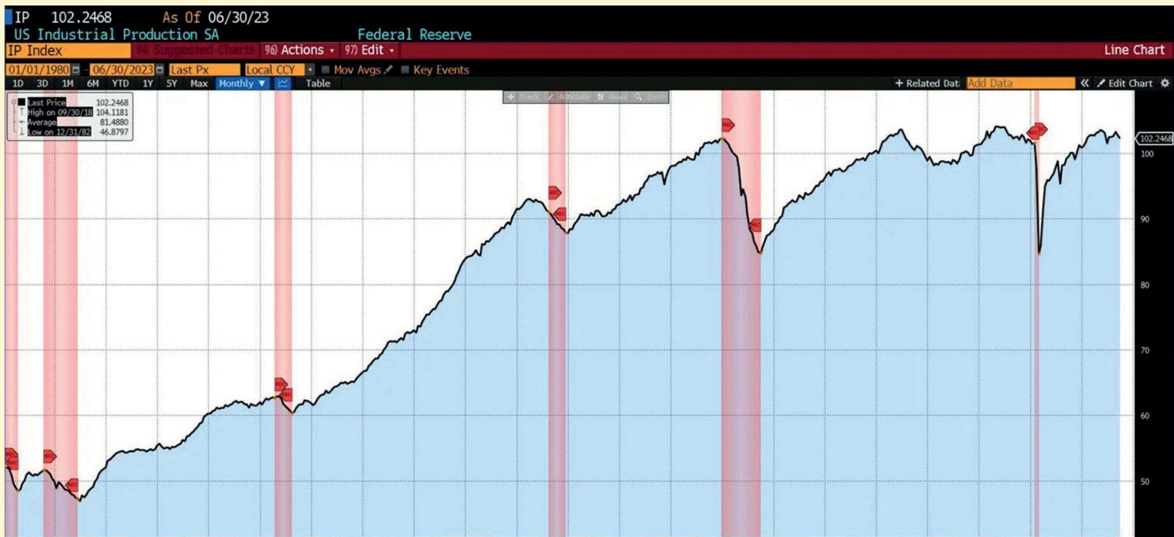
USASHVTK 0.582 As Of 07/31/23 Millions
United States Heavy Trucks Sales SAAR Bureau of Economic Analysis
USASHVTK Index

USYC1Y10 ↓ -128.129 +8.951 -128.129 / -126.628
At 11:14 Op -139.928 Hi -127.115 Lo -144.315 Prev -137.080
USYC1Y10 Index



ROUGHLY COINCIDENT INDICATORS




IP 102.2468 As Of 06/30/23
US Industrial Production SA
Federal Reserve
IP Index
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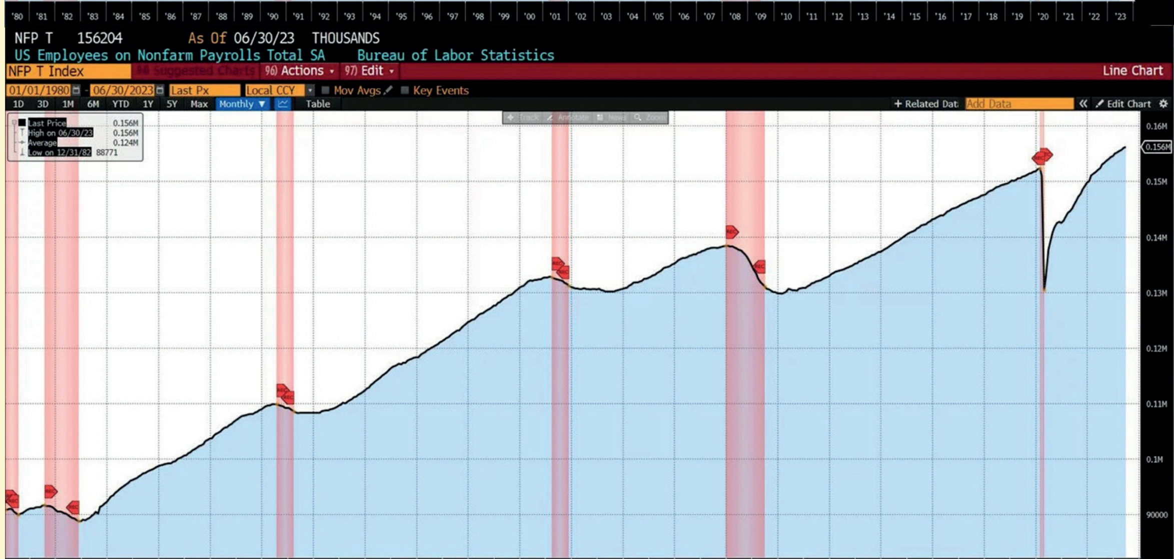
NFP T 156204 As Of 06/30/23 THOUSANDS
US Employees on Nonfarm Payrolls Total SA
Bureau of Labor Statistics
NFP T Index
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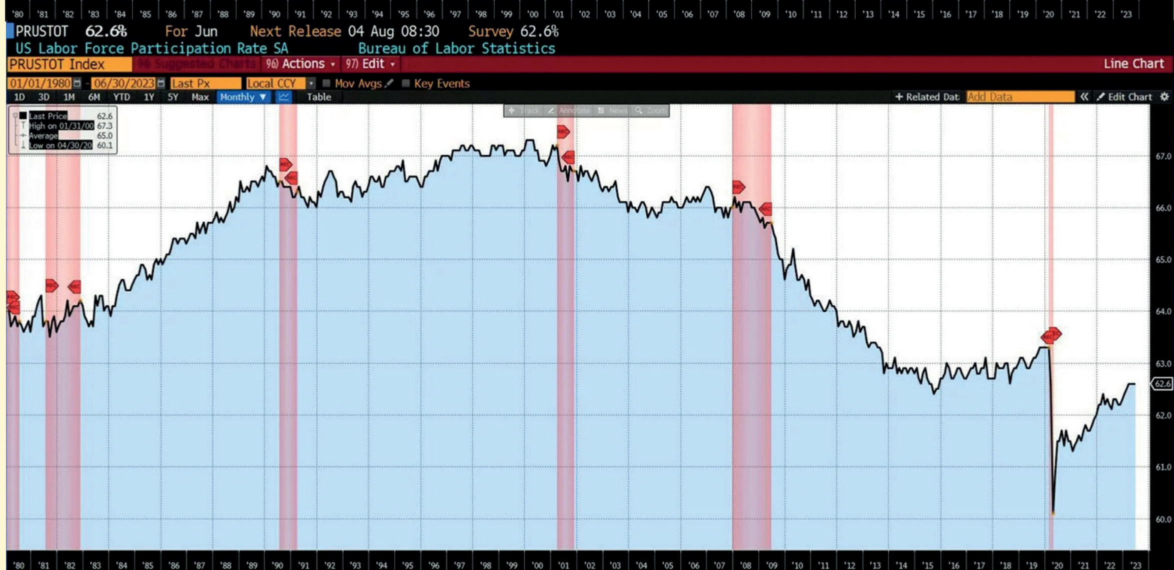
PRUSTOT 62.6% For Jun Next Release 04 Aug 08:30 Survey 62.6%
US Labor Force Participation Rate SA
Bureau of Labor Statistics
PRUSTOT Index
96) Actions
97) Edit
Line Chart
01/01/1980 - 06/30/2023
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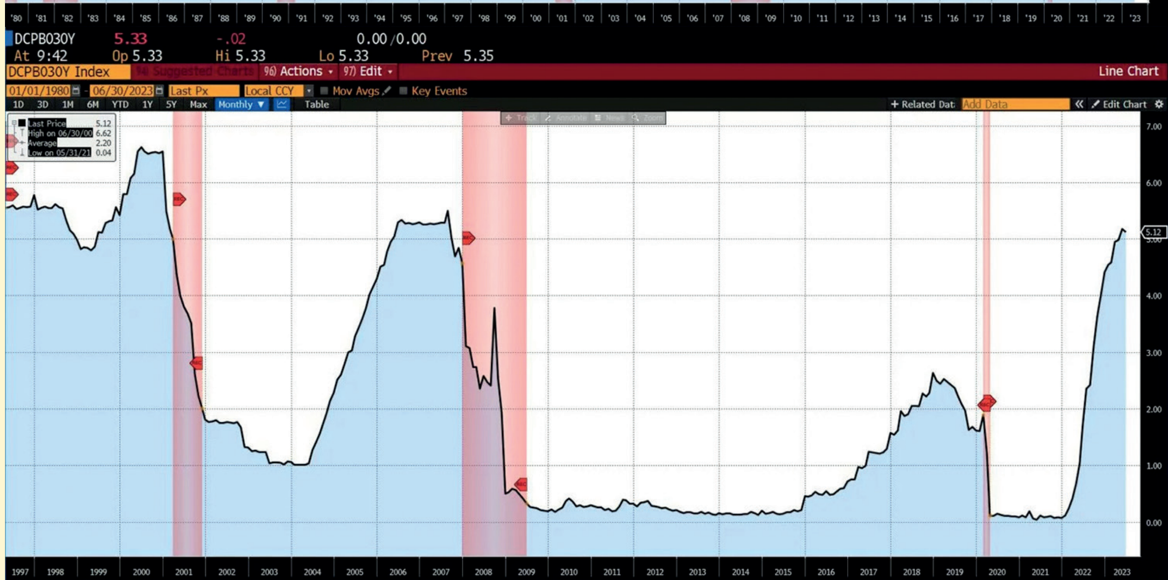
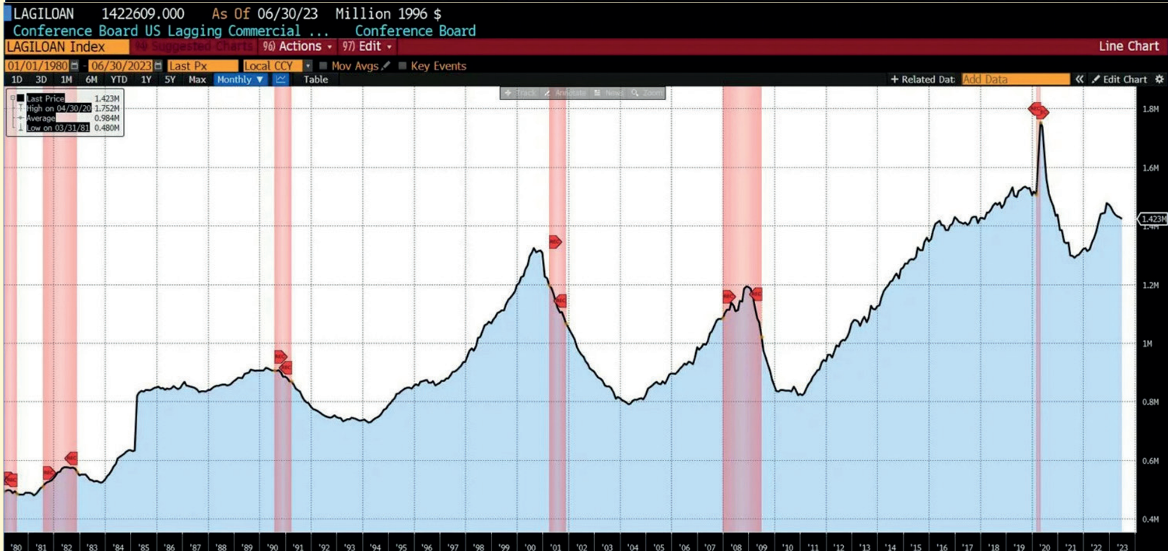
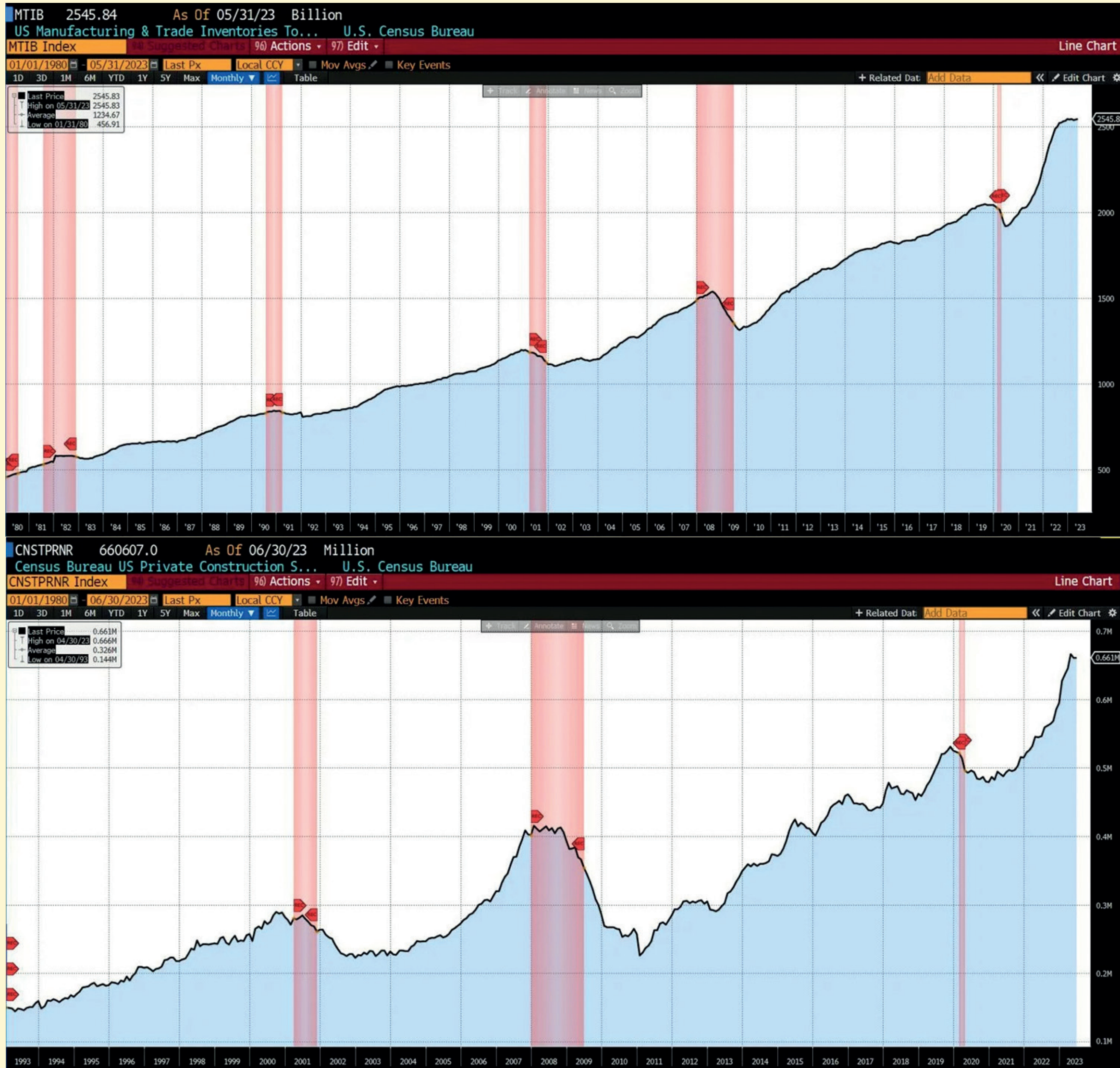
LAGGING INDICATORS







CAPITAL MARKET PERFORMANCE

▸ SPR	S&P 1500 Composite Index	+1.76%	+9.86%	+10.24%	13.7211	11.7117	12.3799
▸ SPXT d	S&P 500 Total Return	+2.94%	+11.55%	+13.79%	13.6026	12.1529	12.6520
▸ SPX d	S&P 500 INDEX	+1.54%	+9.69%	+10.46%	13.5815	12.1354	12.6364
▸ MID d	S&P 400 MIDCAP INDEX	+2.36%	+9.35%	+7.90%	15.1148	8.2650	9.9640
▸ RTY d	RUSSELL 2000 INDEX	+3.86%	+13.25%	+4.21%	11.7999	4.9776	8.1410
▸ SXXP d	STXE 600 (EUR) Pr	-.33%	-.15%	+5.58%	12.9903	7.1056	8.2362
▸ TLT US d	ISHARES 20+ YEAR	-6.24%	-8.69%	-17.86%	-15.1175	-1.6238	1.6661
▸ QLTA US d	ISHARES AAA - A	-1.93%	-3.03%	-6.24%	-5.3006	1.0594	2.0621
▸ CRY d	TR/CC CRB ER Index	+7.20%	+7.75%	-1.01%	25.0038	7.9390	-.0623
XAU	Gold Spot $/Oz	+.67%	-4.08%	+9.89%			
XAG	Silver Spot $/Oz	+3.41%	-6.58%	+18.64%			
ILM3NAVG	Bankrate 30Y Mortgage Rates Na	+2.24%	+6.25%	+38.71%			
ILM1NAVG	Bankrate 15Y Mortgage Rates Na	+1.39%	+5.11%	+43.36%			
MB301ARM	5 Year ARM	-1.59%	+12.77%	+35.82%			
ILA3NAVG	Bankrate 30Y Fixe Mtg Refis Na	-4.10%	+4.01%	+43.20%			

How AIER Helped to Hobble Fauci's "Ministry of Truth"

PHILLIP W. MAGNESS (F.A. Hayek Chair in Economics and Economic History)
& ROBERT E. WRIGHT (Senior Research Faculty)

On Independence Day 2023, Federal judge Terry A. Doughty of the Western District of Louisiana issued a preliminary injunction in the case of *Missouri v. Biden,* ordering a slew of top Biden administration officials to stop cajoling social media companies into silencing criticism of their COVID-19 lockdowns and other policies. AIER played a key role in this important check on Federal encroachment of Americans' civil liberties.

On 17 December 2021, a Freedom of Information Act (FOIA) request by Ethan Yang and Phil Magness revealed evidence that, contra the First Amendment, the federal government sought to squelch lockdown critics. As Magness and James Harrigan revealed, senior officials at the National Institutes of Health (NIH) coordinated a media pressure campaign targeting lockdown critics, including the three authors of the Great Barrington Declaration (GBD).

Those three scientists – Martin Kulldorff, Jay Bhattacharya, and Sunetra Gupta – had convened a small conference at AIER in October 2020 to discuss the devastating consequences of the COVID-19 lockdowns. The conference produced a brief statement, the GBD, that argued against lockdowns as a pandemic response policy and espoused instead a scientifically-based "focused protection" protocol. Four days later, as the GBD began to gather momentum, then-NIH Director Francis Collins ordered Fauci to wage a "quick and devastating published take down" of the GBD and its authors.

Fauci immediately ordered subordinates to compile a list of political op-eds attacking the GBD. Coordinating with Collins, he then waged a media campaign to brand the GBD authors as "fringe" and to describe their anti-lockdown arguments as "dangerous" and "nonsense."

Social media companies followed Fauci's cues:

- Google de-boosted search engine results for the GBD website. Instead, the search engine giant promoted political op-eds by lockdowners, even prioritizing false attacks on the GBD by conspiracy websites over mainstream news coverage.
- Reddit followed suit by removing links to the GBD from discussions about COVID-19 policy.
- As the Twitter Files later revealed, Twitter also suppressed the GBD and effectively shadow-banned the accounts of its authors.

The "devastating take down" achieved exactly what Fauci and Collins intended, the suppression of dissenting scientific viewpoints on the relative cost and benefits of their own lockdown policies. Its "chilling effect" on speech included muting criticism of the John Snow Memorandum, a hasty and ill-conceived pro-lockdown counter to the GBD.

Federal courts rarely issue decisions on federal holidays, so it's likely that Judge Doughty wanted his 155-page ruling understood as a veritable declaration of independence from over two years of COVID censorship, stoked and promoted by bureaucrats such as Fauci and the politicians who enabled him. Citing the products of AIER's email FOIA request, the ruling meticulously documents how government officials advanced their smear campaign against the GBD, its authors, AIER, and other critics.

Judge Doughty says the case "arguably involves the most massive attack against free speech in

United States' history." If the facts alleged are true (and there is little doubt about that), the government has "blatantly ignored the First Amendment's right to free speech." Its actions raise issues that "go beyond party lines" because its suppression threatens to replace "an uninhibited marketplace of ideas in which truth will ultimately prevail" with a "monopolization of the market."

The government threatened the existence, and impeded the efficiency, of the market for ideas by colluding with and/or coercing social media platforms, through the federal regulatory system, to suppress what it called disinformation, misinformation, and malinformation ("dismisinfoganda"). Doughty notes, however, that the government does not know what is true or false and that the First Amendment protects even false speech. The "principal function" of that protection "is to invite dispute," not to squelch debate or opposing viewpoints.

The Founders and Framers put protection of speech and the press first in the Bill of Rights because, as the ruling notes, it "is the indispensable condition of nearly every other form of freedom."

George Washington said without free speech, people could be "led, like sheep, to the slaughter."

Benjamin Franklin argued that "whoever would overthrow the liberty of a nation must begin by subduing the free acts of speech."

Thomas Jefferson noted that "reason and free inquiry are the only effectual agents against error."

To protect free speech and the marketplace of ideas from additional encroachments, and to shield Americans from what he considers "an almost dystopian scenario" in which the United States government assumes "a role similar to an Orwellian 'Ministry of Truth'," Judge Doughty granted the plaintiff's motion for preliminary injunction. Specifically, the Department of Health and Human Services, the National Institute of Allergy and Infectious Diseases, the Centers for Disease Control and Prevention, the United States Census Bureau, the Federal Bureau of Investigation, the Department of Justice, the Cybersecurity and Infrastructure Security Agency, Homeland Security, the State Department, and numerous named administration officials "are hereby enjoined and restrained" from "meeting with" or "engaging in any communication of any kind" with "social-media companies for the purpose of urging, encouraging, pressuring, or inducing in any manner the removal, deletion, suppression, or reduction of content containing protected free speech," and other actions detailed in the preliminary injunction.

The matter will likely end up at the Supreme Court, but for now major federal agencies can be held in contempt of court if they continue to indirectly subvert free speech through social media proxies.

– July 5, 2023

The Harmonizing Sentiments of the Day

JAMES R. HARRIGAN
Senior Editor

The Second Continental Congress named the Committee of the Five, a group who drafted what would become the United States Declaration of Independence. This committee operated from June 11, 1776, until July 5, 1776, the day on which the Declaration was published, and was composed of John Adams, Benjamin Franklin, Thomas Jefferson, Robert Livingston, and Roger Sherman.

As with most committee work, the lion's share of the task fell to one man: Thomas Jefferson. Jefferson was brilliant to be sure, and that surely had something to do with his being saddled with authorship of the Declaration. He was also young, only 33 years old at the time. And that clearly had a lot to do with it too.

What emerged from his pen was a document that would, in short order, change the world.

We typically think of Jefferson inventing the Declaration from whole cloth, but this is not how things went. As he began the high-minded opening of the document — the part most people are most familiar with — he borrowed liberally from Virginia's Declaration of Rights written by George Mason. It wasn't a contest. Jefferson wasn't trying to be unique; he was trying to be right. And he captured the American mind perfectly when he wrote:

> We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty and the pursuit of Happiness.–That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed, –That whenever any Form of Government becomes destructive of these ends, it is the Right of the People to alter or to abolish it, and to institute new Government, laying its foundation on such principles and organizing its powers in such form, as to them shall seem most likely to effect their Safety and Happiness.

No sooner had he offered what is likely the most philosophically polished political statement of all time than he switched gears entirely in order to offer a protracted constitutional argument, wherein he assessed the colonial perspective of the nature of the British Constitution, which was, suffice to say, an animal of an entirely different stripe than the British understanding of their own constitution. Jefferson railed away at the English and their unwillingness to remain a nation of laws.

And only after this did he allow himself to conclude the Declaration with some of the most high-minded political rhetoric of all time.

> We, therefore, the Representatives of the united States of America, in General Congress, Assembled, appealing to the Supreme Judge of the world for the rectitude of our intentions, do, in the Name, and by Authority of the good People of these Colonies, solemnly publish and declare, That these United Colonies are, and of Right ought to be Free and Independent States; that they are Absolved from all Allegiance to the British Crown, and that all political connection between them and the State of Great Britain, is and ought to be

> totally dissolved; and that as Free and Independent States, they have full Power to levy War, conclude Peace, contract Alliances, establish Commerce, and to do all other Acts and Things which Independent States may of right do. And for the support of this Declaration, with a firm reliance on the protection of divine Providence, we mutually pledge to each other our Lives, our Fortunes and our sacred Honor.

When was the last time a politician of any description used the phrase "sacred honor" with a straight face?

So we go from a statement of philosophical truth, to constitutional analysis, to sacred political honor, in one document written by a 33-year-old man on the eve of the unlikeliest of revolutions.

But again, Jefferson wasn't trying to be unique; he was trying to be right. How do we know? He told us. Or more precisely, he told Henry Lee in 1825.

> With respect to our rights and the acts of the British government contravening those rights, there was but one opinion on this side of the water. All American whigs thought alike on these subjects. When forced therefore to resort to arms for redress, an appeal to the tribunal of the world was deemed proper for our justification. This was the object of the Declaration of Independance. not to find out new principles, or new arguments, never before thought of, not merely to say things which had never been said before; but to place before mankind the common sense of the subject; [. . .] terms so plain and firm, as to command their assent, and to justify ourselves in the independant stand we [. . .] compelled to take. Neither aiming at originality of principle or sentiment, nor yet copied from any particular and previous writing, it was intended to be an expression of the American mind, and to give to that expression the proper tone and spirit called for by the occasion. All its authority rests then on the harmonising sentiments of the day, whether expressed, in conversations, in letters, printed essays or in the elementary books of public right, as Aristotle, Cicero, Locke, Sidney Etc.

The harmonizing sentiments of the day provided the foundation for the Declaration of Independence, and thus the nation itself.

So we are left with one important question in our own time: What are the harmonizing sentiments of our day?

– July 4, 2023

Zoned Out: How Housing Regulation Drives Young Americans Toward Socialism

JASON SORENS

Senior Research Faculty

The generational gap in partisanship is as wide as it has ever been. Generation Z and millennial Americans are far more Democratic and left-wing than older Americans, and this gap remains as millennials are getting older. A 2019 poll even found that socialism is as popular as capitalism among young US adults, although "free enterprise" remains popular among all generations.

While social and environmental issues are part of the reason why young people lean left these days, economics also plays a role. It is hard not to notice that young Americans especially began to move left in the 2010s, a decade marked by rising costs in the key sectors of housing, higher education, and healthcare. Younger Americans are partly insulated from problems in the healthcare sector by their better health than other adults, but expensive housing and higher education have hit them particularly hard.

Around the 2022 midterms, a combined 60 percent of voters under 30 saw inflation, housing costs, or both as one of their top three issues. There's a great deal of resentment among Gen Z and millennials against Baby Boomers' perceived "opportunity hoarding": they benefited from cheap college and cheap houses, and now they're pulling up the ladder.

Housing costs have indeed risen a lot since the early 2010s. Looking at either the sticker price of a house or the monthly cost of a mortgage is misleading, since mortgage costs vary with interest rates, mortgage standards tightened substantially after 2007, and minimum down payments vary with sticker price. It's better to look at rents, and we should also try to correct for the quality of housing. The United States Bureau of Labor Statistics tries to do this with their "cost of shelter" index, which in addition to observed rents includes the imputed rents that owner-occupiers could have earned by renting out their homes. They also try to adjust for changing product quality. Figure 1 shows how the cost of shelter has changed since January 1980 compared to the cost of other goods and services.

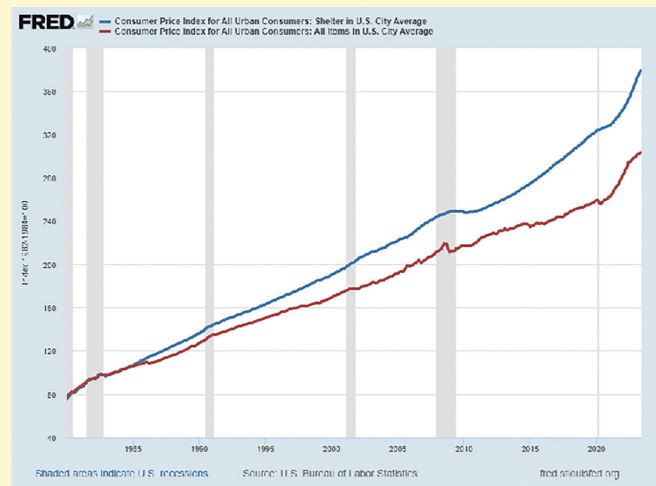


Figure 1: Cost of Shelter vs. Total CPI

Shelter has been rising in cost more quickly than other goods and services. Since the 1982-1984 average, shelter has gone up by 280 percent, compared to 204 percent for all goods and services. The growing difference accelerated in the mid-2010s, with shelter going up 38 percent since January 2015, while all goods and services have gone up by only 29 percent.

But these national numbers are misleading, because the housing crunch for most of the last decade has been concentrated in a few metropolitan areas. Figure 2 shows the index of rental cost produced by the Bureau of Economic Analysis for four metropolitan statistical areas (MSAs) and the year 2021: Boston, Houston, Miami, and San

Francisco. San Francisco is notoriously restrictive of new housing: No new housing development is allowed by right. The Boston area has a patchwork of policies but is generally among the more restrictive metro areas. Houston famously has no zoning, although some of its suburbs do. Miami is a place that had strong pandemic demand plus some geographic constraints on building (the Atlantic Ocean and the Everglades).

The numbers here are percentages of the national average. Rents in San Francisco are therefore over 210 percent of the national average, while Houston is down around the national average, and Boston and Miami are between the two. The problem of housing cost is a different conversation in different places.

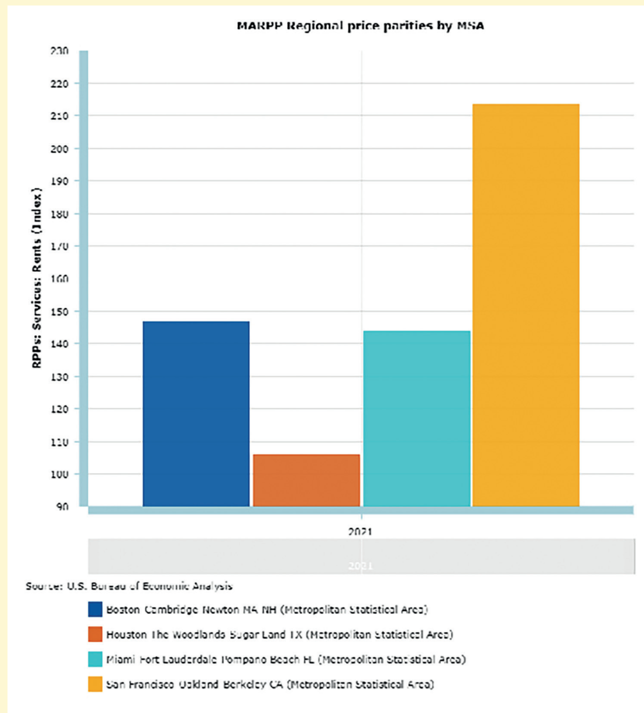


Figure 2: Rents by MSA

Government zoning regulations that limit homebuilding are a big factor in housing costs over the long run. A lot of research has shown this, but so does common sense. Look at the populations of Boston, Houston, Miami, and San Francisco over time. Between 2010 and 2020, Boston's county (Suffolk) grew 2 percent, Houston's county (Harris) grew 16 percent, Miami-Dade grew 7 percent, and San Francisco County grew 8 percent. Clearly, San Francisco's huge expense is not solely a result of hot demand; otherwise, its population growth rates would be much higher than those of the others. Boston also looks pretty bad when you compare rents to population growth, while Houston looks amazing. It has accommodated rapid growth at moderate rents.

Figure 3 shows how states with stricter land use regulations have higher cost of living. Correlation doesn't automatically imply causation, but in combination with the other evidence, this chart looks like a smoking gun.

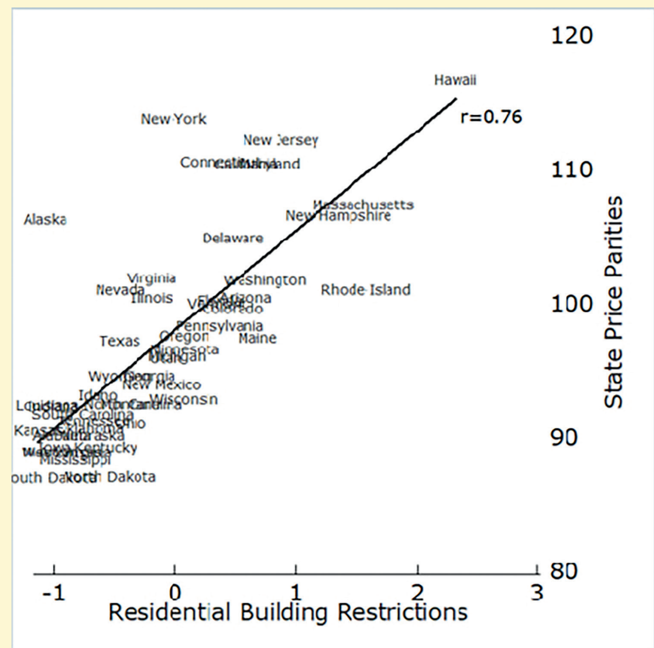


Figure 3: Land Use Regulation and Cost of Living

The Yes in My Back Yard (YIMBY) movement is trying to change the dynamic whereby high-demand areas start restricting building, ultimately causing housing costs to go way up. There's good reason to think that if they succeed, they'll reduce the demand for radical left-wing policies among

those who resent their struggle to pay rent.

Right now, left-of-center states and localities are experimenting with rent control and public housing, would-be solutions to the problem of rising rents that economists know are incredibly costly. Simply reforming zoning would be a better solution.

There's also evidence that strict zoning makes areas more left-wing over time. Figure 4 shows the relationship between state-level inflation and movement toward the left in presidential elections. (The data series end in 2007 and 2008 because this particular dataset of state cost of living doesn't go past 2007, and new datasets don't go before 2008.)

Figure 4: State Inflation and Left Ideology

My research shows that the effect is causal and consistent: A standard-deviation increase in housing regulation makes a place shift toward the Democrats about three percentage points over the next eight years, because noncollege voters, who are becoming the Republican base, move out.

"But won't building apartment high-rises bring in more Democrats than Republicans?" I often hear. Yes, usually, but by increasing housing supply these high rises will make single-family homes cheaper in the suburbs, keeping blue-collar families from moving to Texas or Florida. And building tract subdivisions in the suburbs directly helps blue-collar families stay put.

Many Democrats and progressives are at least somewhat free-market on housing, because they want to keep rents down. That's admirable. On the other hand, democratic socialist types insist on harmful "solutions" like rent control and public housing. Republicans and conservatives have largely sat on the sidelines of zoning reform so far. But the data strongly suggest that to fight the radical left, we need to build more homes.

– July 24, 2023

The SEC's Illegal War on Crypto

THOMAS L. HOGAN
Senior Research Faculty

The Securities and Exchange Commission (SEC) is waging an illegal war on the cryptocurrency industry.

The SEC recently charged crypto exchanges Binance and Coinbase with facilitating the trade of unregistered securities. Yet the opacity of the statute, as it pertains to crypto and the SEC's arbitrary and contradictory application, have made compliance with the law impossible.

Despite charging multiple parties with issuing and trading unregistered securities, the SEC has failed to formally define what is or is not a security. Rather than an official definition, the agency relies on legal precedents, primarily the Howey test, to determine whether financial instruments are considered securities. The proper application of these rules to crypto tokens, however, remains unclear, and the SEC refuses to provide further guidance.

To create a formal definition, the SEC would need to follow a notice-and-comment process by which they make a public rule proposal, get feedback from the public, and then issue a final rule based on those comments. So far, the agency has refused to do so.

SEC Chair Gensler claims that the legal definition is clear, but industry participants disagree. In fact, Coinbase has sued the SEC in an attempt to learn whether the agency plans to provide a formal definition through the rulemaking process, but the agency refuses to say. If the law is clear, then why can't SEC lawyers say whether a formal rulemaking is needed?

The SEC has contradicted itself multiple times regarding which crypto tokens are securities. Chair Gensler has suggested that all crypto tokens other than bitcoin are securities, but the SEC's lawsuits, and even Gensler's own statements, imply otherwise.

Consider ether, the base token of the Ethereum network. Ether is the second largest crypto in terms of value, with a current market capitalization of more than $200 billion. If all tokens other than bitcoin are securities, as Gensler claims, then presumably ether is too. Prior to becoming SEC chair, however, Gelser stated that ether was not a security. When asked in recent congressional testimony whether ether is a security, Gensler refused to say.

Another example is the crypto token EOS, which is listed by the SEC as one of the allegedly unregistered securities traded on the Binance exchange. The SEC settled a lawsuit with EOS issuer Block.One. The settlement did not require EOS to be registered as a security. How can the agency now claim that it is one?

Similarly, Coinbase's 2021 initial public offering (IPO) was approved by the SEC. The agency now accuses Coinbase of dealing in unregistered securities "since at least 2019." Why did SEC officials approve the company's IPO if they believed it was trading unregistered securities?

The SEC's past allegations have already been rebuked by the courts. When the SEC attempted to block the acquisition of crypto lender Voyager by Binance's American subsidiary Binance.US, the judge said the SEC had not offered "any evidence or even any reason to think that Binance.US actually is doing anything for which it requires further SEC registrations."

Members of the House Financial Services Committee argue that Chair Gensler misled Congress and the public by saying that crypto companies are refusing to comply with SEC regulation and should

simply “come in and register.” In reality, there is no legal path to registration. Yes, Binance.US and Coinbase could register as securities dealers, but even then there would be no way to know which tokens are considered securities.

Coinbase, in particular, has gone out of its way to comply with regulations, but it has been rebuffed by the SEC. Chief Legal Officer Paul Grewal says that Coinbase “met with the SEC more than 30 times” but has received “basically zero feedback on what to change, or how to register.”

This problem is not unique to Binance and Coinbase. Former SEC Commissioner Daniel Gallagher testified that Robinhood, where he is now Chief Legal Compliance and Corporate Affairs Officer, has made no progress toward registration after “over a dozen meetings and calls with the SEC.”

SEC officials have relied on opaque and discretionary enforcement actions. They have charged companies for not complying with the law without clearly stating what the law is. This approach is likely to push legal crypto exchanges to offshore jurisdictions with less regulatory scrutiny.

The SEC must stop this illegal war on crypto. They should provide a clear, legal path for crypto exchanges to operate in order to protect American investors and the U.S. economy.

– July 14, 2023

Is There Any Such Thing as Legislation Anymore?

RYAN M. YONK (Senior Research Faculty)
& LAURA ARCE (Graduate Research Fellow)

The attention given to the recent decision in *Biden v. Nebraska* rests fundamentally on political differences that have become increasingly stark, and that will no doubt continue to be the source of much disagreement. At its core, the question asked is primarily one of the wisdom of a policy decision made by a President, grafted onto a congressional statute granting him emergency powers, and then decided by the Court on what would ordinarily be viewed through the lens of narrow administrative law. The political stakes are high, and as a result the core policy issue that underlies the political debate is left unresolved by the Court's decision.

On June 30th the Supreme Court of the United States ruled against the Secretary of Education´s use of the Higher Education Relief Opportunities for Students Act of 2003 (HEROES Act) to forgive student loan debts of 430 Billion Dollars on the basis that the Secretary of Education does not have the authority to enact this plan. While the ruling focuses on the Secretary's authority, the plan itself emerged from a series of political promises made first by Candidate Biden, and later by President Biden to forgive student debt. With congressional opposition to a legislative approach clear, the Administration decided to work through the Department of Education to use the HEROES Act to accomplish administratively what they had been unable to do legislatively.

The plan, as laid out by the Department of Education and endorsed by President Biden, would have given up to $20,000 in debt forgiveness to students. Most borrowers would qualify for $10,000 in forgiveness as long as they were making less than $125k a year, or less that $250k in annual household income in 2020 or 2021. Those who received Pell Grants could qualify for another $10,000 of forgiveness. This plan would have completely eliminated the debts of 20 million borrowers, and lowered the median amount owed by another 23 million from $29,400 to $13,600.

In response to this administrative action, six states (Arkansas, Iowa, Kansas, Missouri, Nebraska, and South Carolina) challenged the plan, claiming the Secretary was exceeding his statutory authority. Last week's decision held that "…the HEROES Act provides no authorization for the Secretary's plan when examined using the ordinary tools of statutory interpretation–let alone 'clear congressional authorization' for such a program."

The Secretary argued that by using the HEROES Act and title IV of the Education Act, the Department of Education could cancel student debt in order to assure that its recipients are not placed "in a worse position financially because of the national emergency." The emergency they reference is the COVID-19 pandemic. To bolster this argument, the Secretary claimed that because the Act allows him to "waive or modify" regulatory provisions applicable to financial assistance programs, those abilities could be extended to fully cancel student loan debt. Chief Justice Roberts, writing for the majority, dismissed this notion observing "The Secretary's plan has "modified" the cited provisions only in the same sense that "the French Revolution 'modified' the status of the French nobility"—it has abolished them and supplanted them with a new regime entirely. "With less rhetorical flourish the majority plainly states "it does not allow him to rewrite the statute completely"

The decision and the argument surrounding it have been derided by those who support action on student loan forgiveness as political activism. In one sense they are right. The question emerged primarily from the political reality that meant loan forgiveness was legislatively impossible. The majority cites convincing precedent that requires Congress to enact major changes like those the Secretary unilaterally proposed. Instead, they push the responsibility back to the legislative branch to enact legislation that explicitly gives the department such power.

The dissent adopts a wide reading of the authority granted by the HEROES Act. They, like the majority, rightly point to congressional action as the necessary source of the power in question, and regardless of the wisdom of the plan, Congress has given that power to the Secretary in order to alleviate the effects of a national emergency.

The Court is remarkably consistent in its view that at its core, congressional authorization is necessary, but diverge widely on the meaning of the statute, and how far undelineated grants of authority range. That the case is one with clear political undertones is clear, but those undertones were present from the day it became clear executive fiat would supplant legislative action, and not on the day the Court issued its ruling.

– July 9, 2023

Imperial Monetary Policy and the Independence Movement

ROBERT E. WRIGHT
Senior Research Faculty

America's 250th birthday is just a few years away but Americans are still not entirely clear about why their ancestors told Mother that they had to move out of her house and into their own place. If pressed, most will mutter something about taxation without representation. That is not so much wrong as woefully incomplete. Even the mighty Declaration of Independence elides much of the story.

The road to independence, the Imperial Crisis as some term it, began with resistance to the Stamp Act, which indeed was a type of tax but not, on its face, a particularly onerous one. So the key to understanding the independence movement is to understand why the colonists reacted to the Stamp Act as vigorously as they did. With the sort of luck that aids the diligent, I unearthed 15 years ago an unpublished and mis-cataloged contemporary history of the Stamp Act that accorded well with a theory that I had been developing with my former colleague at the University of Virginia, economist Ron Michener.

After the usual pleasantries, it began:

> I must observe that it is not the Stamp Act or New Duty Act alone that had put the Colonies so much out of humour tho the principal Clamour has been on that Head but their distressed Situation had prepared them so generally to lay hold of these Occasions, and how they came to be so I must trace back to commencement of the late War.

The full text of the document, which was anonymously penned in 1768, will be published for the first time in my forthcoming chapter "Consequences Unintended: The Bubble Act and American Independence" in Helen Paul and D'Maris Coffman's *The Bubble Act: New Perspectives from Passage to Repeal and Beyond*. The document is a difficult slog for the uninitiated but once you get past the old timey language and long-forgotten allusions, its message is clear: The colonists were mad at Mom because her trade and monetary policies were hurting them, a lot, but she did not care. The Stamp Act taxes constituted the last straw, the last silver straw as we will see.

Although the details are tricky, the story can be easily told. During the French and Indian War (1754-1763), money flooded into the colonies from 1) British wartime expenditures in the colonies made in specie (gold and silver coin); 2) colonial privateering (specie earned by seizing and selling French merchant ships); 3) colonial trade with the enemy in the West Indies (also resulting in specie payments); 4) the emission by each colony of bills of credit (fiat paper money) to fund the war effort. More money meant higher prices, including for real estate, which tripled in price by 1760.

During the boom, many colonists borrowed to fund new businesses or to speculate in real estate. Trade credit and mortgages generally had to be repaid within a few years. But soon French prizes became scarce, British military expenditures shifted, it became more difficult to trade with the West Indies, and bills of credit emissions slowed. When the war ended, money flow reversed, and with it business prospects.

The colonists had suffered from postwar depressions before, but this one was much worse than

expected because British authorities cracked down on illicit colonial trade, and in the 1764 Currency Act forbade the colonies from emitting new bills of credit or slowing the redemption of the outstanding bills. Real estate and merchandise prices plummeted in 1763 and 1764 as mortgage and trade debts fell due. Unable to repay or refinance, many borrowers defaulted, were sued, and had their assets sold at sheriff sale for pence on the pound (pennies on the dollar). Back then, that meant languishing until death in a debtors' prison worse than "the French Kings Gallies, or the Prisons of Turkey or Barbary."

The colonists begged to be able to trade with the French West Indies and the Spanish once again in order to replenish their specie stocks, but the British responded by redoubling their trade enforcement measures. The middle colonies, which had always issued fiat money responsibly, pleaded to be allowed to make new emissions or allow bills issued during the war due to be called in to continue to circulate. Again, the British denied them. When the colonists tried to form commercial banks they were denied charters and met with stern warnings about the consequences of violating the Bubble Act.

Instead of relief, the British offered the Stamp Act, which mandated a tax to be paid in specie, of which the colonists had little remaining. Colonists wailed in newspaper op-eds that they were being crushed by their own parent. "Another Farmer," for example, blamed Pennsylvania's "bankruptcies, poverty and want" on Parliament for passing the Currency Act and other laws "incompatible … with the rights, liberties, and privileges of English subjects."

The Stamp Act could not stand, and it did not. Mom backed down but she refused to give her babies more autonomy so tensions continued to escalate until Thomas Paine gave the colonists a dose of common sense and convinced them it was time to move out and move on. Thereafter, Americans controlled their own money policies. From the end of the Revolutionary War until 1933, the policies they chose were often sound, and hence a great boon to a growing nation and a maturing economy. Since then, well, that's a whole other story.

– July 3, 2023

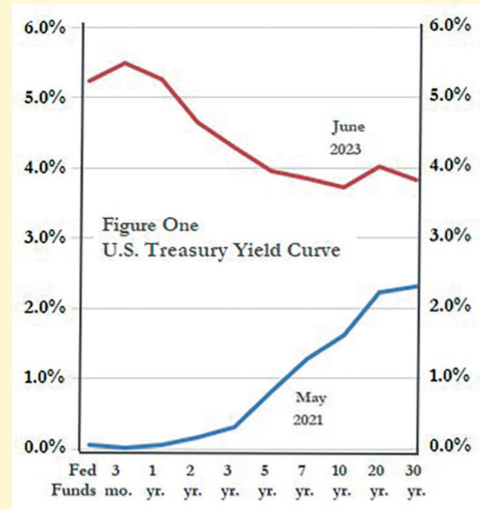
The Inverted Yield Curve and Next US Recession

RICHARD M. SALSMAN
Senior Fellow

No better, more reliable forecaster of the US business cycle has existed in recent decades than the initial shape of the US Treasury yield curve, and since last October it's been signaling another US recession that's likely to begin in 2024. This is important, because recessions have been associated with bear markets in stocks and bull markets in bonds. Moreover, if a recession arrives early in 2024 it may affect the US elections in November.

Typically, the yield curve is upward sloping (longer-term rates are higher than shorter-term rates) and precedes economic expansions; but an *inverted* curve, which occurs more rarely (only eight times over the last six decades), signals a recession with a lag of roughly 10-13 months. Counting from October 2022, a contraction will probably start in early 2024.

Figure One depicts the yield curve as it stands today (inverted), and as it stood in May 2021 (upward-sloping) before the Fed embarked on a series of rate hikes that brought its overnight Fed Funds rate to above 5 percent. Longer and medium-term interest rates have also increased over the past two years, but not by as much as short-term rates. History reveals that it doesn't matter how or why the yield curve inverts; as long as it does so, it signals trouble ahead.



Since the late 1960s US yield-curve inversions have predicted *all eight US recessions*, beginning roughly a year in advance (Table One). The yield curve's forecasting record since 1968 has been *perfect*: Not only has each inversion been followed by a recession, but no recession has occurred in the *absence* of a prior yield curve inversion. There's even a strong correlation between the initial duration and depth of the curve inversion and the subsequent length and depth of the recession. The current inversion will likely be long and deep. The Fed isn't likely to materially cut its policy rate over the balance of 2023, which means not only that the next US recession will be relatively more severe, but it may also extend into 2025.

Table One

Lags from Yield Curve (YC) Inversions to Recessions

U.S., 1969-2022

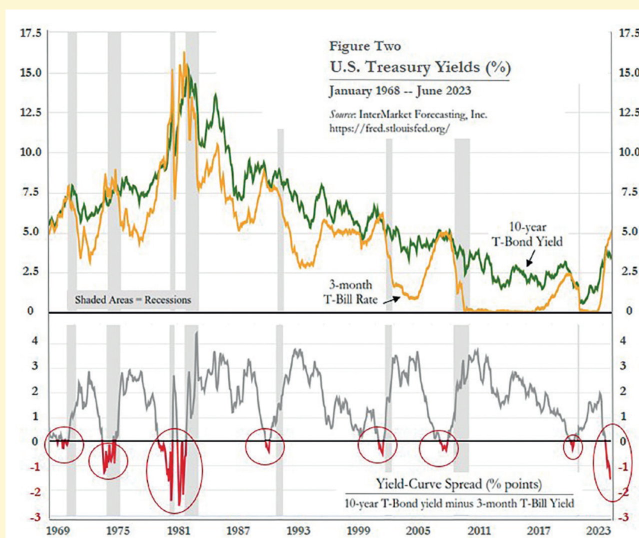
Beginning of		Lag in Terms of	
YC Inversion	Recession	Days	Months
6/18/69	1969.12	166	5.5
6/1/73	1973.11	153	5.0
11/1/78	1980.01	426	14.0
10/27/80	1981.07	247	8.1
5/24/89	1990.07	403	13.2
7/7/00	2001.03	237	7.8
7/17/06	2007.12	502	16.5
5/22/19	2020.02	255	8.4
10/26/22			
	averages, pre-1985:	248	8.2
	averages, ALL YEARS:	299	9.8
	averages, post-1985:	349	11.5

The US yield curve also provides reliable forecasts of economic-financial results abroad, especially when coupled with signals from local yield curves. Most major yield curves today are also inverted because major central banks tend to mirror each other on rate policy.

Relevant empirics and reliable quantitative models are crucial, but it's also important to understand the theory and logic behind this relationship. In 2019, while forecasting the most recent US recession (five months before it began in February 2020), I explained in some detail "Why the US Yield Curve Reliably Predicts US Recessions." Here's what I wrote:

> First, a sharp decline in bond yields means a sharp rise in bond prices, which suggests a big demand for a safe security, reflecting a desire by investors to immunize against trouble ahead. Second, the longer the maturity at which one lends, the greater (normally) is the yield one receives (due to credit risk and/or inflation risk), so if bond yields are below bill yields it signals materially lower short-term yields in the future (i.e., Fed rate-cutting), which occurs during recessions. Third, the essence of financial intermediation is institutions "borrowing short (term) and lending long (term)." If longer-term yields are above shorter-term yields, as is the normal case, there's a *positive* interest-rate margin, which means lending-investing is fundamentally profitable. If instead longer-term yields are *below* shorter-term yields, there's a *negative* interest-rate margin and lending-investing becomes fundamentally *unprofitable* or is conducted (if at all) at a *loss*. When market analysts observe credit markets "seizing up" before (and during) recessions, it reflects this crucial aspect of financial intermediation.

The yield curve spread that most accurately forecasts recessions is that between the 10-year Treasury bond yield and the 3-month Treasury bill rate. Figure Two depicts the US bond yield, bill yield, and yield-curve spread since 1968. Negative spreads preceded all recessions, regardless of whether yields generally were high or low, and regardless of whether inversion resulted from short-term (bill) yields rising above long-term (bond) yields (due mainly to Fed rate hiking) or instead (and less frequently) from bond yields declining below bill yields.



Some wonder whether Fed officials know about this relationship, and if so, why they don't act to avoid or *prevent* curve inversions and subsequent recessions. Matter of fact, they *do* know about the relationship; in recent years various Fed researchers and board members have documented it and discussed it, and for many decades the New York Fed has maintained a sophisticated website about the relationship ("The Yield Curve as a Leading Indicator"). But Fed economists and policymakers are also predominantly Keynesian, so they believe in the Phillips Curve – in some imagined "tradeoff" between inflation and economic growth. They attribute higher inflation to real factors, whether to a growth rate that's "too high" ("overheating") or a jobless rate that's "too low" ("wage-push" inflation). They deny the principle that inflation is always and everywhere a monetary phenomenon; they certainly don't wish to be held accountable for the inflation they alone cause (by overissuing money).

In retrospect I think it'll be important to acknowledge that the next US recession (2024-25) will result from Fed rate-hiking (2022-23), which was undertaken to "fight" fast-rising inflation (2021-22), which the Fed alone caused by massive money issuance and debt monetization (2020-21) in response to inadvisable COVID lockdowns (2020-21). When a crisis fosters phobias and policymakers become panicky, a cascade of tragic failure can result. When will the start of the next recession be recognized? On average since 1980 the NBER has waited eight months before assigning a starting date (and fifteen months to assign ending dates), so if the next recession were to begin in early 2024 it might be publicized by August.

That the yield curve's predictive prowess is chronically misunderstood and misapplied, even by forecasting pros and the supposedly sophisticated financial media that cover them, is illustrated best in two recent essays by James Mackintosh at the *Wall Street Journal* – "Economists Think They Can See Recession Coming – For a Change" (December 4, 2022) and "Where's the Recession We Were Promised?" (June 23, 2023). In the first essay Mackintosh recounts how "a survey of economists and investors by the Federal Reserve Bank of Philadelphia shows expectations that GDP will fall in three or four quarters are by far the highest since the survey started in 1968," but adds that since that survey began, "*not a single recession* was spotted a year in advance." Huh? Not a single recession – of the eight that have occurred since 1968? Why then bother mentioning that survey or trusting its signals? In the same essay Mackintosh declares that "the yield curve isn't magic." What's that got to do with anything? What about cold, hard empirics? In his more recent essay Mackintosh devotes more space to the meaning of the inverted yield curve – even admitting that "each of the eight recessions (since 1966) was preceded by an inversion, with no more false signals" – yet insists it has "failed" just this time because recession didn't occur within six months of his first essay.

Many economists and investment strategists, if they use market-price signals at all or rigorously to forecast recession, tend to use less reliable yield spreads, or miscalculate the lags, or focus on particulars that make them insist "it'll be different this time." That's been the refrain for many decades. But *eight for eight* since '68 is better than just good – it's great.

– July 8, 2023

An Academic Footnote for Florida's Slavery Curriculum

PHILLIP W. MAGNESS
F.A. Hayek Chair in Economics and Economic History

The state of Florida has found itself embroiled in a controversy over a new set of classroom standards on slavery. As with most K-12 curricula, the new standards are heavy on formulaic "lessons" to check boxes about names, dates, and subjects being covered. This approach often lacks the nuance and complexity that are needed to examine historical subjects such as slavery, but it is also endemic to our public education system in red and blue states alike.

The Florida curriculum came under fire for one such bullet point. Section SS.68.AA.2.3 stipulates that, in a unit on American slavery, "Instruction includes how slaves developed skills which, in some instances, could be applied for their personal benefit."

The passage set off a firestorm of controversy, with Vice President Kamala Harris denouncing the provision as an attempt to place a positive spin on slavery. The charge entailed a deeply uncharitable reading of the curriculum's text, which is more a product of linguistic bureaucratese than revisionist history. At the same time, Florida's defenders did themselves few favors by stumbling in their response and further removing the controversial passage from its context.

While I have no particular insight into the design of this curriculum, the line appears to be an awkwardly-worded reference to a real historical practice. Before the American Civil War, some enslaved African-Americans cultivated skilled trades as a means of earning small amounts of money and increasing their status in the household. In time, some slaves with specific skills were able to obtain freedom for themselves or their families through the practice of self-purchase, or through negotiated manumission from the persons who enslaved them. Others used their skills as leverage for better working assignments and living conditions than could be found among field hands.

In noting the existence of these curious arrangements, we must not lose sight of the abject brutality of slavery. Nor do they ameliorate the many wrongs and hypocrisies of the south's "peculiar institution." The acquisition and use of skilled trades by enslaved persons for various forms of leverage is nonetheless the subject of a well-developed academic literature going back several decades. Self-purchase arrangements, and similar mechanisms attained through negotiated manumission, gave rise to sizable free black populations in southern cities such as Baltimore and New Orleans. They also sparked a backlash from slave-owners before the Civil War, resulting in increasingly restrictive legal obstacles to manumission and black property ownership in many states.

I call attention to this academic literature because it illustrates the raw politicization of the Florida curriculum debate. Its clumsy wording aside, the now-controversial Florida classroom bullet point is not, in fact, very far from what the academic history profession has written about the same subject for decades. As an illustrative example, we may turn to Edward Baptist's book *The Half Has Never Been Told*, which makes an almost-identical claim about enslaved African-Americans being able to improve their leverage and even earn money to buy their own freedom through the acquisition of skills:

> In the Chesapeake and Carolinas, enslaved men rose in status by learning trades. They

> might be blacksmiths or coopers, teamsters or house servants. Women could become servants, cooks, or weavers. Such skills could gain one respite from incessant field labor, or even give hired-out slaves the possibility of keeping some of the earnings. Artisans were even important in Louisiana. Sugar making, for instance, required a class of trained enslaved experts who supervised the boiling process. They sold for high prices. Whites identified 5 percent of local slaves sold in New Orleans from 1800 to 1820 with a specific skill.

Baptist uses this example as a point of contrast to other brutalities arising from the domestic slave trade. Specifically, many slaves with skills found themselves reduced to field laborers on plantations when they were sold from the eastern states to the deep south. Baptist argues that "[s]kills meant that one could claim some authority over a task and tools," and points to the loss of this leverage under the brutal forced relocations of the internal slave trade. Slaves who were sold south and west, in his telling, became "hands" without regard for their skills. "[T]hey came out with those skills erased." Grueling agricultural work on the cotton plantations thus stood in contrast with the craftsmen's skills that emerged in the east and in the cities.

Baptist and other academic historians once readily admitted this distinction in their published works. Only when politics entered the equation did they begin denouncing the very same arguments that they previously made, and previously treated as uncontroversial.

The nearly identical claims about skilled labor in the Florida curriculum and in Ed Baptist's discussion of the eastern states come with an added layer of irony. Baptist is the leading figure of the "New History of Capitalism" school, a far-left branch of academic history that aims to link slavery with allegedly "capitalistic" economic development in the United States as a means of discrediting the latter. Baptist advised Nikole Hannah-Jones on the *New York Times's* 1619 Project, and his book provided the basis for Matthew Desmond's error-riddled essay on slavery and capitalism in the same series.

Florida's education department may have an easy solution to its present conundrum. To address the controversy and do so with the blessings of a leading figure from 1619 Project historiography, they only need to add a footnote to page 103 of Ed Baptist's *The Half Has Never Been Told.*

– July 31, 2023

Will Lower Inflation Halt Rate Hikes?

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The Federal Reserve raised its federal funds rate target range to 5.25 to 5.50 percent on Wednesday. In June, the median member of the rate-setting committee projected the federal funds rate would climb to 5.6 percent this year. That suggests another rate hike is on the horizon.

The Personal Consumption Expenditures Price Index (PCEPI), which is the Fed's preferred measure of inflation, grew at a continuously compounding annual rate of 2.9 percent from June 2022 to June 2023. It grew at an annualized rate of 2.5 percent over the last three months and just 1.9 percent over the last month. In other words, inflation is falling fast.

Core PCEPI, which excludes volatile food and energy prices and is therefore thought to be a better predictor of future inflation, is also falling. Over the 12-month period ending June 2023, core PCEPI grew at a continuously compounding annual rate of 4.5 percent. It grew at an annualized rate of 3.9 percent over the last three months and just 3.7 percent over the last month.

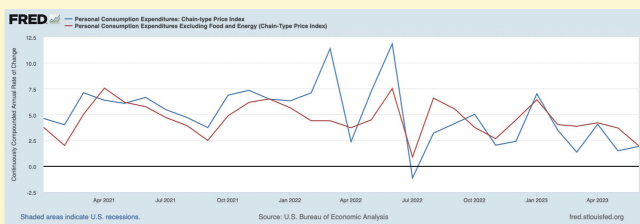

Figure 1. Headline and Core PCEPI Inflation, January 2021 to June 2023

Will lower inflation cause Fed officials to forego further rate hikes? Maybe. Disinflation passively increases the real (i.e., inflation-adjusted) federal funds rate. When inflation falls faster than Fed officials expect, real interest rates rise faster than Fed officials intended when they set the nominal interest rate target. If the real rates rise high enough, Fed officials might be able to achieve their desired level of tightness without pushing its nominal rate target higher.

Judging by interest rates, monetary policy looks sufficiently restrictive. The Federal Reserve Bank of New York estimates the natural rate of interest at 0.58 to 1.14 percent. Using the prior month's core PCEPI inflation rate of 3.7 percent as an estimate of expected inflation implies the real federal funds rate target range is 1.55 to 1.80 percent—well above the natural rate. If one were to use last month's headline PCEPI inflation rate instead, it would imply the real federal funds rate target range is even higher: 3.35 to 3.60 percent. No matter how you slice it, real rates look sufficiently restrictive to bring down inflation. Indeed, they may be overly restrictive at this stage in the tightening cycle.

Nominal spending growth also suggests monetary policy is sufficiently restrictive. In the 10-year period prior to the pandemic, nominal spending grew at a continuously compounding annual rate of 3.9 percent. Nominal spending surged in 2021, growing 11.5 percent. But it has fallen in the time since. In 2022, it was 7.1 percent. It grew at an annualized rate of 6.0 percent in Q1-2023, and just 4.6 percent in Q2-2023. Although it is not yet back to the pre-pandemic average growth rate, it is on track to normalize by the end of the year.

If monetary policy is already sufficiently restrictive, why is it not so clear that the Fed will forego further rate hikes? In brief, some Fed officials are not yet convinced they've done enough—and don't want inflation to resurge on their watch.

Governor Christopher Waller made the case for further rate hikes in a recent speech. Waller argues that monetary policy lags are much shorter following large shocks, like the 525 basis point increase in the federal funds rate that has occurred since February 2022. Whereas people might be rationally inattentive to small shocks and, as a consequence, react slowly, they cannot help but notice large shocks and, hence, respond more quickly. Waller also argues that the start of the lag beggins not when the Fed raises its federal funds rate target but rather when it announces it will raise its federal funds rate target in the future—at least so long as such announcements are deemed credible.

If monetary policy lags are shorter and start sooner than more conventional estimates suggest, "the bulk of the effects from last year's tightening have passed through the economy already" and "we can't expect much more slowing of demand and inflation from that tightening. To me," Waller concludes, "this means that the policy tightening we have conducted this year has been appropriate and also that more policy tightening will be needed to bring inflation back to our 2 percent target."

If Waller's argument carries the day, Fed officials will raise the federal funds rate target range another 25 basis points in September or November. If disinflation continues over the next few months, such a hike could prove devastating—not merely wiping out inflation, but economic growth and employment as well.

– July 29, 2023

A World Dedollarized is Gold Remonetized

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From August 22 through 24th, an extended coalition of over 40 nations which has become known as BRICS+ will meet in Johannesburg, South Africa. Among the likely topics of discussion is the feasibility of setting up a jointly-owned international financial institution. It would be funded by gold deposits, issue a currency, and extend loans tied to the spot value of gold. There are substantial reasons to doubt the workability of the growing consortium's plan. But to dismiss it summarily, whether as bad economics or rote anti-American propaganda, is to dismiss a moment five decades in the making.

Throughout the 1990s and into the early dawn of the 21st century, national governments looked down upon a world they credited themselves with creating. A Federal Reserve-engineered 'soft landing' in the mid-1990s buttressed the perception of monetary policy as a perfectable science. The Third Way – not free markets, but a hampered, highly regulated mixed economy – had outlasted and arguably defeated Communism. Technological innovation was vaulting beyond anyone's wildest expectations. Space was at the forefront of science again, with the launch of the Hubble Space Telescope and construction starting on the International Space Station. Protease inhibitors, bioengineered foods, and the first hybrid vehicles arrived.

US Dollar Index (DXY), Fall of USSR – present

(Source: Bloomberg Finance, LP)

At that time political figures all around the globe, elected and appointed, surveyed a world built upon paper money and financialization. They looked upon it with great, in many cases smug, satisfaction. And among other self-congratulatory measures, they began selling their long-held gold reserves – by the ton. England, the Netherlands, Australia, Belgium, Canada, and even precious metal stalwart Switzerland liquidated physical stocks of gold. The US did as well, a bit later. Some explained those sales as a means for diversifying central bank holdings. Others claimed that the proceeds would benefit the poor or be used to pay down government debt. A new millennium was at hand, the towpath to which was paved not by soft yellow metal but by batteries of workstations armed with Pentium III processors, silently churning out solutions to partial differential equations.

Twenty-five years later the poor are still poor, national debt is at record levels, and the price of gold in US dollars is eight to ten times the price that governments and central bankers sold almost 5,000 metric tons for. Multi-trillion dollar wars have been fought to inconclusive ends: not lost, really, but

far from won. Orders of magnitudes typically only found in astronomy textbooks, invoking trillions (and in Japan, quadrillions) regularly surfaced in the descriptions of monetary and fiscal policy measures of developed nations. Then, on the heels of a highly politicized response to a public health event, inflation returned from a four decade sojourn. One dollar printed during the Y2K scare today purchases roughly 56 percent of what it did then.

Nevertheless, the US dollar has remained the indisputable and essentially singular global reserve currency, acting as a medium of exchange, unit of account, and settlement instrument for the lion's share of daily international trading. Despite policy missteps and distractions, the Fed has arguably performed better than most of the world's other central banks: in the land of the blind, the one-eyed man is king. But the weaponization of the US dollar in 2022 has exposed greenback dependency as a vulnerability of existential proportions. With the banning of most Russian banks from the Swift (Society for Worldwide Interbank Financial Telecommunication) messaging system, and despite the dollar's advantages for use in global trade, a line was crossed.

Despite petulant insistences to the contrary by the most well-known economist today (regrettably), a wave of de-dollarization is very much underway. It would be interesting to know how Krugman, who scoffed at the description of ejecting a nation from SWIFT as "weaponization," would characterize French Finance Minister Bruno Le Maier's dubbing the move a "financial nuclear weapon."

None of this means that the dollar is "doomed," and certainly not imminently. Neither is the US dollar "dead." But its use as a sanctioning instrument likely represents the crossing of a rubicon whereby nations habitually using the dollar need to have currency alternatives ready. US Treasury Secretary Janet Yellen, even while citing the entrenched nature of the dollar in global trade, conceded that "diversif[cation]" in global foreign exchange reserves is underway earlier this month.

The argument that few if any other nations have currencies (and/or economies underlying them) that meet the requirements of a global reserve currency is a cogent one. Of course, one needn't necessarily *replace* the dollar. What matters is having a ready means of transacting outside dollar-based systems and institutions in exigent circumstances: to maintain continuity of trade, and to hedge against the policy errors of central bankers. What is the most marketable, least manipulable means of shifting away from the dollar (and possibly back to it, once tensions have abated) with the lowest switching costs? Gold.

Gold in USD, Fall of USSR – present

Source: Bloomberg Finance, LP)

Saudi Arabia, not a particular fan of the current Presidential administration, has indicated that it will invest billions of dollars into its expanding gold sector over the remainder of this decade. India recently launched an international gold bullion exchange. The imposition of (almost) unprecedented non-pharmaceutical interventions in early 2020 saw the price of gold rise to record highs. At the end of last year, central banks were buying gold at the fastest rate since 1967. As of May, 70 percent of central banks indicated believing that gold reserves

would increase over the next year. Experimentation with using gold alongside dollars, and as money, including in some innovative, familiar formats here in the US, has been growing in just the last few years.

Specific details on the proposed currency union have not yet been released. They may not yet exist outside the minds of their promoters. Suffice to say that drawing scores of nations together from different continents and cultures, with different histories and remarkably diverse resource endowments will be a heavy lift, organizationally speaking. Smaller members are likely to find their interests marginalized, with the resulting dynamic closer to what's seen in the United Nations than, say, OPEC. And few of the proposed members have confidence-inspiring track records where property rights are concerned.

The form and function of the BRICS+ financial institution, if any is indeed forthcoming, is of secondary importance. What matters is that the slow creep of de-dollarization is, on its flip side, an inexorable push toward the re-monetization of gold. And whether that means sound money through innovation or pressuring global central banks to reform their practices, those outcomes are welcome to say the least.

– August 1, 2023

US Dollar Index (DXY), Fall of USSR – present

Gold in USD, Fall of USSR – present

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