

Stabilizing the price of assets – particularly homes – has become a favorite pastime of the Fed, but it is a pastime not to be found within the Fed’s charter. The implementation of QE1<sup>1</sup> was an attempt to repair distortions created by prior policy decisions that pushed interest rates too low for too long. When mistakes are made; institutions naturally try to fix them. This initial quantitative easing program was a direct attempt to stabilize the price of homes – as well as the associated ripple effects - that had fallen twenty-seven percent nationwide in the preceding two years. The Fed then launched QE2 in its attempt to provide a backstop to falling equity markets. And now, the recent contemplation of QE3 could continue the unintended consequence of these policies. It is understandable that the FOMC is concerned about unusually high unemployment numbers but it should be cautious in targeting one industry while unintentionally neglecting others.

Of late, the US housing market has continued its dismal performance as a wealth accumulating asset. If we exclude the bubble years for the market (roughly 2002 – 2008) we see that the market is moving to a consistent equilibrium had it grown at a steady rate from the late 70’s into the early 90’s (3-4% annually). The flat pace of existing home sales and housing starts over the past two years indicate that the market is stagnant as participants seek to flush out over-supply and homeowners struggle to make mortgage payments in today’s anemic economy. Home prices could fall further as a generation of people now see home-owning as a dream belonging to an older one and tighter lending standards shut out potential borrowers. The market is cleansing itself and the Fed would service it best by allowing market participants, who will be guided by an invisible rather than visible hand, to decide the outcome.

If the FOMC has now modernized its mandate to include the phrase “asset price stability” to its objective they should first relay that message to the public while updating their website to read “to promote effectively the goals of maximum employment, stable *asset* prices, and moderate long-term interest rates.” To this end, money can be printed in order to serve many targeted purposes; stabilizing energy prices, stabilizing food prices, lowering student loan rates, promoting US manufacturing or small business, and so on. Although unrealistic that the Fed would embark down these roads, the door has been opened with the housing market.

The Fed has the responsibility of maintaining the integrity of the institution given the power to control the most valued currency in the history of the world; the US dollar (USD). The mandate of the Fed - drafted eight decades ago - specified the need for stability of the price level. Now it appears that the Fed has taken on the responsibility of stability of asset price levels and will find

---

<sup>1</sup> November 25, 2008 Press Release: <http://www.federalreserve.gov/newsevents/press/monetary/20081125b.htm>

the need to shift its focus from homes to equities to bonds to student loans and so forth as they create imbalances throughout the economy. Interfering with asset prices is a risky, if not suicidal, maneuver the Fed is likely to lose.