Hutchins Center
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Little Evidence that Fed's Unconventional Monetary Policies Increased Income Inequality, New Hutchins Center Research Finds

QE reduced inequality by lowering unemployment and increasing house prices, but effects uneven with metro areas that were hardest hit by recession benefitting least

The monetary policies deployed by the Federal Reserve during the recession reduced inequality by pushing the economy closer to full employment, but it may have had uneven impacts, with middle class homeowners benefitting the most but areas with large drops in house prices the least, according to three papers released today by the Hutchins Center on Fiscal and Monetary Policy at Brookings.

In "Gauging the Impact of the Fed on Inequality During the Great Recession," Joshua Bivens of the Economic Policy Institute finds that, contrary to views from both sides of the political spectrum (ranging from presidential candidate Mitt Romney, the *New York Times'* William Cohan and former Federal Reserve Governor Kevin Warsh), the Fed's quantitative easing (QE) policies in fact reduced inequality because they pushed the economy closer to full employment. Bivens compares the distributional consequences of Fed policy to two counterfactuals, finding that the 2010 fiscal deal—which included a two-year payroll tax cut, an extension of emergency unemployment compensation, and accelerated depreciation—produced roughly the same positive effect on output and employment as all the Fed's QE program. Bivens finds that the direct impact on inequality of monetary policy seems quite small—finding it unclear if it has been slightly progressive or slightly regressive.

Drawing from other research, Bivens estimates home prices were boosted by 7 percent due to QE, stock prices by 5 percent and bond prices by 9-14 percent. Boosting house prices reduces inequality, he writes, because home equity represents such a large share of middle class wealth, while boosting stock prices increases inequality – with these two effects offsetting each other. In addition, compared to a counterfactual of no change in fiscal policy in response to a recession, monetary stimulus reduces inequality significantly, he finds. If the Fed were to tighten credit before the economy reaches full employment, Bivens argues, this would hurt low- and moderate-wage workers and increase inequality.

"In short, a central irony of the debate over the distributional consequences of Fed actions since 2008 is that this period began an episode when Fed policies seem unambiguously progressive (from a distributional point of view) after an extended period of more mixed actions," Bivens concludes.

In "Distributional Effects of Monetary Policy," Matthais Doepke and Veronika Selezneva of Northwestern University and Martin Schneider of Stanford University challenge the conventional wisdom that the wealthy gained the most from expansionary monetary policy, finding that when the Federal Reserve aims for higher inflation, it is the middle-aged, middle-class households who benefit at the expense of wealthy retirees, and that the poor and young households are the least affected. They find that the middle class tends to have big mortgages, whereas the wealthy keep their savings in bank accounts and bonds, while the poor and young are less likely to own homes and have low debt burdens—in other words, borrowers (those with mortgages) benefit from higher inflation, while others lose. The authors find this redistribution also has effects on the wider economy: Aggregate consumption declines because "winners" are likely to spend a smaller fraction of their incomes than "losers."

In a third paper, "Regional Heterogeneity and Monetary Policy," Martin Beraja, Erik Hurst and Joseph Vavra of the University of Chicago and Andreas Fuster of the New York Federal Reserve Bank conclude that expansionary monetary policy helped stimulate the U.S. economy overall during the Great Recession, but widened the disparities among regions, with the Fed's first round of quantitative easing (QE1) providing the least amount of monetary stimulus to the metro areas hit hardest by the recession.

Beraja, Fuster, Hurst, and Vavra find that QE1 boosted mortgage refinancing, and that as a result, it increased consumer spending as measured by car purchases. However, mortgage refinancing increased the most in places that needed it the least—places with the fewest underwater homeowners. They hypothesize it is because it is more difficult and expensive for borrowers with little or no equity to refinance. In the recent recession, the areas experiencing the largest surge in unemployment were also those with the largest drops in housing prices and therefore the highest proportion of underwater homeowners. This relation between house prices and unemployment shocks, which was much weaker in the 2001 recession, may also have reduced the overall stimulative effect of monetary policy, they find.