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NY Fed Paper: Easy Monetary Policy Does Little to Cut Racial Income Inequality

In new research, regional Fed bank economists says ultra-easy monetary policy may accentuate inequalities

The Federal Reserve Bank of New York building in lower Manhattan.

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By Michael S. Derby
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Ultra-easy monetary policy may not help reduce racial economic disparities anywhere near as much as many now believe, new research from the Federal Reserve Bank of New York said.

"There is little reason to think that accommodative monetary policy plays a significant role in reducing racial inequities in the way often discussed," wrote economists Alina Bartscher, Moritz Kuhn, Moritz Schularick and Paul Wachtel in the paper released on Friday. "On the contrary, [very easy Fed policy] may well accentuate inequalities for extended periods," they said.

While there is evidence that easy monetary policy helps lift employment for Black

Americans, it has a bigger impact on asset values, which benefits white Americans who are much wealthier on average and better positioned to benefit from the impact of stimulative monetary policy, the authors wrote.

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"An accommodative monetary policy shock exacerbates the wealth difference between Black and white households, because Black households own less financial assets that appreciate in value," the paper said. Compared with white families, "the median Black household has no stock holdings, nor owns a house. By definition, any effect that monetary policy has on the price of such assets bypasses the majority of Black households," according to the paper.

The New York Fed paper arrives amid a sea change in Federal Reserve thinking about how it can use its policy to help power recoveries that don't leave the less advantaged behind. Through most of the Fed's history, its leaders have argued that the institution has blunt powers that affect economic activity in only the broadest sense, and that they don't have the tools to target aid to specific parts or participants in the economy.

But over the past few years, central bankers have undergone a re-appreciation of their powers. The labor market's ability to grow strongly without creating inflation opened central bankers to the idea that running the job market "hot" could bring big benefits. Enduring labor market strength would help bring in workers who otherwise wouldn't have been able to benefit from recoveries, in turn reducing economic disparities between races and income groups.

The challenge for the Fed is that its policy actions work through financial conditions. The low rates that have prevailed over recent years, and now the aggressive stimulus efforts aimed at buying the economy through the coronavirus pandemic, have had big benefits for asset markets. The authors of the New York Fed paper cited that reason for why monetary policy's power to lift up the disadvantaged is limited.

Over a five-year period stimulative monetary policy lowers the Black unemployment rate by 0.2 percentage points more than white unemployment, the paper said. But over that same horizon, stock prices rise by 5% and house prices by 2%, while corporate borrowing costs fall.

"An accommodative monetary policy would need to have a much larger effect on Black unemployment and income than what is typically estimated in order to offset the impact of even modest changes in asset prices on wealth," the authors said.

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