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Monetary Policy and Racial Inequality

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The racial tensions that spread across the United States in 2020 have caught the attention of monetary policymakers and focused concern on the size and persistence of the gap between both the income and wealth of black and white households. There is widespread recognition that despite some decline in overt labor market discrimination, gains in educational opportunities, and income growth of black households since the onset of the civil rights movement, the gaps persist and have even grown larger by some measures. According to the 2019 Survey of Consumer Finances (SCF), the median wealth of a white household was $184,390, compared with only $20,730 for the median black household. The typical black household owns only about 11 percent of the wealth of the typical white household. The income gap is smaller but still large; the median income of black households ($38,688) is 58 percent of the median income of white households ($67,196).

Some central bankers argue that the Federal Reserve can play a role in addressing racial inequalities. Raphael Bostic, president of the Federal Reserve Bank of Atlanta, recently stated that the Federal Reserve "can play an important role in helping to reduce racial inequities and bring about a more inclusive economy." A prominent line of thinking runs as follows: a more accommodative policy lowers unemployment and increases labor income for workers who otherwise would have become unemployed or would have stayed unemployed for longer. Marginal workers that are drawn into the labor market by more accommodative policies are oftentimes low-income and minority households. Consequently, the gap between unemployment rates of black and white households narrows, which leads to a reduction in the earnings gap.

Yet at the same time, monetary policy has portfolio effects through its impact on the prices of assets. Asset price changes affect the wealth distribution if household portfolios differ systematically between black and white households. Using SCF data, we show that this is a very pronounced fact in the data: black households hold substantially different

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portfolios than white households. In particular, the median black household has no stock holdings and doesn't own a house. Thus, any effect that monetary policy has on the prices of such assets bypasses most black households.

This opens the possibility that the portfolio effects of a more accommodative policy will go in the opposite direction of the income gains for workers of color; that is, a more accommodative monetary policy could benefit black households by reducing unemployment and increasing labor market participation and earnings, thereby helping to reduce the racial income gap—and over time the wealth gap, if part of the additional income is saved. But at the same time, accommodative policies that increase asset prices could widen racial wealth differences if white households benefit more than black households due to their different portfolio compositions and greater wealth.

In our research, we quantify and compare the sizes of both the earnings and portfolio effects of monetary policy and find evidence that both effects are at play. We examine the effects of monetary policy changes on both asset prices and the black-white unemployment rate gap over five-year horizons. To infer portfolio effects on the wealth distribution, we first study how monetary policy affects the price of houses, equities, and other financial assets. We then link these estimated asset price changes to the portfolio compositions of white and black households using the comprehensive wealth data from the most recent wave of the SCF in 2019 and determine the effect on black and white households' net wealth.

Our estimations yield a consistent result. Over a five-year horizon, accommodative monetary policy leads to larger employment gains for black households but also to larger wealth gains for white households. More precisely, the black unemployment rate falls by about 0.2 percentage points more than the white unemployment rate after an unexpected 100-basis-point accommodative monetary policy shock. But the same shock pushes up stock prices by as much as 5 percent and house prices by 2 percent over a five-year period while lowering bond yields on corporate and government debt and pushing up inflation. The sustained effects on employment, stock, and house prices appear to be a robust feature in the data across a variety of different control variables.

Importantly, the employment and income gains of black households are small compared with the wealth gains of white households. Specifically, we find that a 100-basis-point accommodative monetary policy shock leads to capital gains from asset price changes of about $25,000–$35,000, equivalent to 20–30 percent of the mean income of an average white household. By contrast, the wealth gain that the average black household experiences is substantially smaller, about $5,000, or 10 percent of annual income. The larger capital gains for white households mainly stem from the stock market, as most stocks are owned by white households. Although housing is much more equally owned, capital gains from the housing market still fall disproportionately to white households.

Taken together, the effects of accommodative monetary policy on the wealth of black and white households are comparatively large, while the effects on employment are comparatively small, highlighting the tradeoff between income and wealth inequality of white and black households for monetary policymakers. Put differently, an accommodative monetary policy would need to have a much larger effect on black unemployment and income than what is typically estimated to offset the impact of even modest changes in asset prices on wealth. Thus, we suggest that as important as it might be to address racial income gaps and labor market inclusion of minority households, traditional tools of monetary policy may not be able to do so without substantial side effects. Accommodative monetary policies that have a small effect on racial income gaps are likely to increase racial wealth gaps through the portfolio valuation effects.

NOTE

This research brief is based on Alina Bartscher, Moritz Kuhn, Moritz Schularick, and Paul Wachtel, "Monetary Policy and Racial Inequality," Federal Reserve Bank of New York Staff Report no. 959, January 2021, https://www.newyorkfed.org/research/staff_reports/sr959.html.