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FED MUST ACT FAST TO ADDRESS INCOME INEQUALITY

In her dinner keynote speech, Petrou calls on the Federal Reserve Board to recognize its role – unintended, but important – in making the rich richer and the poor still worse off. Petrou says that monetary and regulatory policy now creates what she called an anti-wealth effect – the assets held by low- and moderate-income households are not gaining value as fast as those owned by richer ones. Given the magnitude of political discontent caused in part by this anti-wealth effect, Petrou argues for rapid FRB action, not just more research.

WASHINGTON, DC, November 3, 2016 – Karen Shaw Petrou, managing partner of Federal Financial Analytics, argues that central bankers are playing an important, often-unrecognized role in widening the income and wealth gap in her keynote address to the annual international-finance conference hosted by the Federal Reserve Bank of Chicago and European Central Bank. Although trillions in central-bank portfolios and ultra-low and even negative nominal rates have played a critical role reversing events that could have led to economic catastrophe, Petrou says that they have gone on too long and are thus restructuring financial markets in ways demonstrably adverse to economic opportunity and wealth accumulation for low- and moderate-income households.

Building on recent in-depth research, Petrou says that understanding the role of financial policy as an income-inequality accelerant demands considering the cumulative impact of monetary and regulatory policy. **"**How could it be that unprecedented amounts of accommodative policy combined with rates at or below the nominal zero bound have done so little to move traumatized markets back to prosperity and restore bloodied financial systems to stability," Petrou asks. "Not only do new rules redefine financial intermediation, especially in the U.S., but they also create a negative feedback loop with post-crisis monetary policy, accelerating and exacerbating other trends that widen income and wealth distribution," she concludes.

Petrou emphatically does not call for watering down new rules; in fact, she argues for making them far tougher when it comes to ensuring that big financial institutions hurt only themselves if they falter or fail. However, "Regulators combine with monetary-policy makers to define winners and losers in the financial sector and, by doing so, also the winners and losers among their customers and counterparties." Case in point – the U.S. home ownership rate has dropped eight percent since 2004, making it more difficult now for lower-income households to acquire an asset critical to wealth accumulation. Accommodative policy now favors stocks and bonds, meaning that rich people get richer and poorer people become still worse off if they can't accumulate the down payments needed to buy a house due to ultra-low rates or are frozen out of the U.S. mortgage finance system.

Petrou urges that we see financial markets not as we wish they were, but as they are. As they are is what financial institutions subject to all of the new rules are making them even though most of these financial institutions also don't like the social-welfare impact of the changes they feel forced to make to preserve what profit they can. They will, though, inexorably make them because that is what private institutions do and they will not wait for research to tell them if these changes are for good or ill from a monetary-policy, financial-stability, or social-welfare point of view. As a result, Petrou calls for incremental changes to policies with the most obvious anti-wealth impact – for example, addressing how rules affect the ability of banks to take small deposits and hold productive assets such as loans to lower-income borrowers and start-up small businesses.

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