FedFin Daily Briefing

Tuesday, September 1, 2020

FRB Staff: New Policy has No Adverse Distributional Impact

Reflecting the Fed's new awareness of the distributional impact of monetary policy, the central bank released not only the financial-stability assessment we analyzed yesterday, but also a study of its economic-equality impact. Focusing only on the new "make-up" policy, the paper generally downplays any distributional impact, concluding that hotter inflation has significant positive implications for lower-income workers when heterogeneous data is analyzed. Despite the assertion that new monetary policy has positive distributional impact, the paper reiterates the Fed's longstanding view that monetary policy has limited-to-no distributional impact compared to demographic and fiscal factors. The finding of positive distributional impact is based on the finding that the new policy makes recessions less likely and that, as is of course well understood, recessions are hardest on the most vulnerable households. However, despite the wage-multiplier impact of improved employment for black and lower-educated males, persistent low unemployment in 2018 and 2019 actually had a still-unknown impact on low-wage workers, according to this analysis. Thus, while a recession and worse unemployment is almost surely harmful to low-wage households, the converse – growth, especially if slow and inequitable – may not enhance equality, despite the paper's overall findings about the make-up policy's benefits.

Despite its positive conclusions about income inequality, the staff paper acknowledges potential wealth-inequality distributional effects – i.e., the wealth transfer from savers to borrowers. These have been addressed most recently in Karen Petrou's Friday memo. The staff paper accepts that interest-rate changes are clearly distributional based on different asset holdings and debt levels. However, perhaps due to its focus only on inflation – not also on ultra-low rates – the paper does not address the extent to which the potential for fewer recessions and thus less pain to low-wage workers would be, at least to some extent, mitigated if low-wealth households were able to accumulate precautionary savings or meet household needs without unsustainable debt. We would note also that, if the make-up strategy leads to speculative market bubbles that then precipitate business-cycle downturns, then adverse wealth effects could even cause subsequent recessions independent of the rate of inflation presumably controlled via the make-up policy. As we have noted, wealth inequality is often a leading cause of financial crises that are then anything but equality-enhancing.

Further, the paper's analysis of recession risk is only a comparison of current policy to the new, make-up one, acknowledging that any period at which rates float near the effective lower bound (ELB) in which there is significant income inequality is likely to see more volatile business cycles. From this, one might infer that the make-up strategy has fewer negative distributional effects only in comparison to current policy.

Comment Deadline Extended For Flood-Insurance FAQs

The federal banking agencies, NCUA, and FCA today extended the comment deadline on their proposal to revise flood insurance FAQs until November 3. In addition to revising existing questions

and answers to improve clarity and organization, the proposal would also add new ones regarding escrow of flood insurance premiums, the detached structure exemption, and force-placement procedures in light of 2015 changes to flood insurance. The FAQs were last updated in 2011.

Brainard Defense New Policy's Equality, Stability Impact

In her speech today on the Fed's new policy, Gov. Brainard emphasized beneficial distributional effects identified in the Fed staff study assessed earlier today. Noting that recessions hurt all low-wage workers disproportionately and that Black and Hispanic workers are even more harmed, she notes that worker characteristics have nothing to do with these phenomena. Her talk also details disproportionately lower wages for minority workers, suggesting that the new policy will support income equality. Much in her talk defends the wide discretion the Fed now gives itself to determine the right "opportunistic" inflation rate, laying out why a formulaic approach along Taylor Rule lines poses time-consistency and implementation challenges near the effective lower bound. Reflecting the Fed staff study on financial-stability assessed in our alert on Monday, Gov. Brainard echoes its call for macroprudential intervention to counter the asset-price and other risks resulting from the make-up policy in concert with "lower for longer" rates. She does not, however, renew demands for imposition of the counter-cyclical buffer, doubtless because it would be inopportune under current circumstances. She does not address the extent to which the CCyB as currently constructed (see FSM Report **CAPITAL213**) could be used to address procyclical financial-market activity rather than the credit increases for which it was designed.

Recent Files Available for Downloading

The following reports and analyses have been sent to retainer clients recently. Copies are also available to retainer clients on the Archives section of Federal Financial Analytics' website: www.fedfin.com or clients may obtain the reports/analyses by e-mailing requests@fedfin.com giving the requested item name, firm, and e-mail address. To learn more about GSE Activity Reports, click: http://www.fedfin.com/index.php?option=com_content&view=article&id=18&Itemid=18

- **COVID13.pdf**: Little Agreement on Phase Four COVID Relief, But Strong PPP Support - As anticipated, today's House Select Subcommittee on the Coronavirus Crisis hearing with Treasury Secretary Mnuchin reflected contentious negotiations over a phase four rescue package.

- **GSE-090120:** In this analysis, we continue our assessment of comment letters to FHFA on the capital proposal.

- **GSE-083120a**: In this report, we begin our assessment of the comment letters on FHFA's capital proposal that we believe carry the most weight in terms both of FHFA's final rule and what Congress may care to do about it.

- **GSE-083120:** A new Fed staff study finds wide disparities among the mortgage rates borrowers

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pay on exactly the same loan that has nothing to do with risk and apparently everything to do with borrower sophistication.

- **MORTGAGE118**: Despite its pending proposal to overhaul the entire definition of loans eligible for qualified-mortgage (QM) status, the CFPB proposes also to establish an additional class of first-lien, fixed-rate mortgages that are QMs or given a rebuttable presumption of QM status.

- **GSE-082520:** The CFPB's proposal to allow QM treatment for certain seasoned mortgages will rewrite a decade's worth of securitized lending if macroeconomic and interest-rate conditions turn favorable.

- **GSE-082020:** A new study from FDIC staff challenges the predictive models on which much mortgage underwriting increasingly depends, discrediting both workhorse predictive models used across the spectrum of consumer credit as well as the ML-based mortgage models that fare still worse as macroeconomic, policy, and borrower conditions change.

- **GSE-081920:** Weighing into the GSE-evolution question with its formidable analytical might, CBO today assesses a likely administrative solution in which the GSEs retain all of their earnings for a limited period of time following which common stock goes again on offer to the public and Fannie and Freddie go back to being Fannie and Freddie more or less as they were pre-2008.

- **OPSRISK21:** Although the Basel Committee believes that its post-crisis capital and liquidity framework significantly enhanced bank resilience evident in a robust industry response to the pandemic, this crisis and other developments are said to highlight the need for additional regulatory and supervisory work to improve operational resilience.

- **GSE-081720:** With the release late Friday of Chairman Crapo's letter to FHFA, the GSEs' refi fee announcement has taken fire from a high-impact Senate Republican along with Ranking Member Brown and HFSC Democrats

- **PAYMENT20:** Following a request for views in late 2019, the Federal Reserve has largely finalized its plans for FedNow, initiating a Fed-owned and -operated instant-payment service for domestic transactions.

- **GSE081320:** The GSEs' decision last night to charge a 50 bps refi fee epitomizes the impact of capital regulation:

- **FEDERALRESERVE58:** Senior Democrats in both the House and Senate have introduced legislation that turns a general call for a "racial-equity mandate" in campaign statements by Vice President Biden into an express directive to conduct monetary, regulatory, payment system, and other policy to reduce racial and ethnic economic disparities.

- **GSE-080420**: Earlier today, we released an in-depth assessment of a little-noticed, but ground-breaking statement released late yesterday by the Federal Financial Institutions Examination Council (FFIEC).

- **COVID12**: The four federal financial regulators along with the CFPB and a state-regulatory representative that comprise the FFIEC have issued new principles designed to guide banking

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organizations and other lenders through the challenges as forbearance deadlines loom across the spectrum of consumer and commercial loans for financial institutions large and small at a time of fiscal-policy uncertainty.

- **GSE-073120:** When we looked at the GSEs 1Q earnings, we asked if it was "curtains for CRT." The question came then because of the sudden rout in CRT counterparties caused by March's market madness.

- **FAIRLEND7:** The Bureau of Consumer Financial Protection has opened a sweeping inquiry into how credit discrimination occurs and could be averted, seeking comments and suggestions without indicating any possible policy responses.

- **CONSUMER35:** As in yesterday's Senate Banking hearing (see Client Report **CONSUMER34**), today's marathon HFSC session with CFPB Director Kraninger was highly contentious.

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