



MEMORANDUM

TO: Federal Financial Analytics Clients
FROM: Karen Petrou
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August doldrums always seem to power up spirals of will-he or won't-he speculation about the Fed's Jackson Hole meeting because there usually isn't all that much else to talk about economically-speaking. This year is different because this year has revealed the Fed as a central bank without a compass at a time of extraordinarily strong winds towards the rocks. Still, in all the punditry over whether the Fed can somehow maneuver to Jay Powell's "softish landing," there's one missing, critical factor: inequality and what the Fed must do about it or, if it won't, what we must do about the Fed.

The Fed is fond of blaming fiscal policy for [economic inequality](#), but U.S. fiscal policy has been awesomely stimulative since the pandemic struck and the U.S. has still grown ever more unequal in terms of both [income and wealth](#). This is because ultra-accommodative monetary policy stokes inequality and, at the scale practiced by the Federal Reserve, towers over even trillions of [fiscal stimulus](#). As a result, the U.S. didn't get the Fed's promise of "robust growth" accompanied by only a bit of "transitory" inflation. Of course, we instead got a crushing combination of high-flying inflation that will leave long-lasting scars on vulnerable households even if it meaningfully abates as some now hope.

The Fed thinks itself aloof from any inequality accountability because it cloaks itself in the mantle of "maximum employment" as armor against any inequality-effect assertions. It was in fact this focus solely on employment that led the Fed to bless its 2020 policy shift to "flexible average inflation targeting" (FAIT) as a pro-equality policy shift.

But, employment as the Fed chooses to measure it is as mirage. As one of the latest assessments of [central banking and inequality](#) again makes clear, it is critical to assess heterogeneous data along numerous dimensions to evaluate the impact of monetary policy. As I also laid out in my [book](#), looking only at a favored unemployment index overlooks the whole point of employment: income.

It's income that drives growth and how much income households have is determined by more than whether or not they have a job. When real wages are low, as they were through the 2010s and remain even today, then households dependent on labor income have a very tough time getting by even when employment looks lush because multiple household members are working or household income seems high because wage-earners are holding down multiple jobs.

As a result, assessing the distributional impact of a new policy such as FAIT must take wages, transfer payments, and capital income into account to determine who is doing well and why. "Maximum employment" understood heterogeneously shows that employment is no security blanket for millions of households just scraping by, flunking the "general welfare" test that also defines the [Fed's mandate](#).

Monetary policy is only equitable if output is evenly shared across the income distribution measured by the equitable distribution evident when the U.S. was indeed the epitome of middle-class [economic equality in 1975](#). Employment is only good for equality if employment generates wages sufficient to ensure household financial stability without debilitating debt. Lower interest rates don't help families offset the cost of debt because only affluent families reap their benefits in lower mortgage rates. In fact, the better upper-income families do in terms of house prices, the worse everyone else does because reduced supply makes homeownership unaffordable and rent an even greater obstacle to making ends meet, let alone laying anything by. Capital income for anyone unable to play the market is also impossible as long as rates are ultra-low or negative, leading to [digital currency speculation](#) and its wealth-eviscerating results across the most vulnerable of American households.

Inflation of course only makes all this worse even if the Fed's FAIT on its own hadn't added 1.18 percentage points to the CPI as a recent [Federal Reserve Bank of Dallas study](#) concludes. Data are only now coming in about what inflation does to the most vulnerable, but statistics about how many people are going [even hungrier](#) are deeply dispiriting. Even families able to afford their groceries are increasingly doing so with less of what they like from the brands they prefer as [discretionary purchases are forgone](#). Indeed, even the middle and upper-middle class is [cutting back](#), making it clear that the U.S. has nothing like the economic resilience that allowed the nation to weather Paul Volcker's crushing recessions in the 1980s. Those were truly hard, ours could be awful.

So, what to do? In my book, I urged the Fed to judge itself and the economy by heterogeneous data, but it won't. It gathers these data and now talks a good game on racial equity, but it does nothing with these data or its worries, instead setting policy on the aggregate data and preferred indices cited in each FOMC report. Congress has a right to ensure Fed accountability and the only way to do so is to demand that the Fed evaluate policy plans such as FAIT and its own performance by understanding America as it is, not what the Fed wishes it were.

And, when it fails – as fail it has – the Fed needs to change course. Had it done so in the 2010s by terminating ultra-accommodative policy when distributional data demonstrated strong signs of a shared recovery instead of focusing solely on financial-market wealth, America would have been considerably less unequal in 2020. It thus would have been more resilient when Covid struck. Had the Fed learned from the 2010s and withdrawn emergency accommodation and financial-market backstops as soon as fiscal policy stepped in, then America wouldn't be even more unequal now and thus far too fragile to handle inflation spawned only by supply-chain disruptions, let alone that resulting from the Fed's own mistaken policy.

And, if America weren't so unequal and household financial security so fragile, then America wouldn't be so angry and our political system might function better to the greater good of the public as a whole. The Fed may think itself aloof from these political vicissitudes due to its almighty independence. The rest of us aren't so fortunate.