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Frequently Asked Questions

On the Federal Reserve Board, monetary policy, and the proposed Full Employment Federal Reserve Act

1. Are poor retirees and savers harmed by low interest rates?

In general, no. Almost by definition, someone who is poor cannot be hurt much by low interest rates. If someone has $10,000 in savings, and gets near zero interest instead of the 2–3 percent they may have received in a more normal time, the loss comes to $200–$300 a year.

That's not trivial, but if the cost of low rates is that relatively few people lose $200–$300 a year in interest payments, while the benefits of low rates are that millions more low- and moderate-income people get jobs and tens of millions more get pay raises, then maintaining low rates would still be very good policy.

People with more savings (e.g., $50,000 or $100,000) would have more to lose, but it is difficult to call these people "poor." Also, the overwhelming majority of people with more than $50,000 or $100,000 in money market funds or other short-term accounts also have money in the stock market and/or hold long-term bonds. The prices of these assets have soared in recent years, making their holders much wealthier. Given this, we shouldn't be too worried if people holding them didn't make much on their savings accounts.

Finally, low interest rates keep inflation rates from falling even lower than they would otherwise, which is a boon to net borrowers. Unexpected declines in inflation boost the real (inflation-adjusted) burden of debt, leading to a redistribution from borrowers to lenders. By keeping inflation from falling even further, the Fed's loose monetary policy clearly helps net borrowers.

2. Did quantitative easing cause income inequality?

Highly unlikely. It is difficult to see any significant role for quantitative easing (QE) in increasing income inequality. Inequality was rising for most of the period between 1980 and 2007. And inequality increased sharply immediately following the Great Recession, as profits rose at the expense of wages due to the weak labor market. All of this massive upward redistribution of income preceded any quantitative easing by the Fed. Quantitative easing undoubtedly had some impact in raising stock prices, but stock prices would have almost certainly bounced back from their recession lows whether or not we had QE. Further, any additional job growth that resulted from QE is far more of a benefit to low- and middle-income people than any QE-related boost to stock prices is to the wealthy.

3. Do the banks and Wall Street profit from low interest rates?

No they do not. Banks benefit from paying lower interest rates to their lenders, but they also are getting less money in interest from their borrowers. In fact, margins between the interest rates at which they lend and borrow tend to fall during long periods of low interest rates. This has recently been the case with 30-year mortgage rates, which fell below 4.0 percent for the first time in more than 50 years.

The banks' biggest concern is that more job growth will lead to upward pressure on wages and prices. They fear that the resulting inflation would erode the value of loans, helping borrowers but hurting lenders. For this reason, banks have tended to favor higher interest rates and excessive vigilance against any uptick in inflation.

Finally, it's worth noting that quantitative easing was *explicitly* aimed at reducing the spread between short- and long-term interest rates, directly eating into banks' profits.

4. Has the Fed kept interest rates artificially low for too long?

No. Whatever interest rate the Fed sets is "artificial" in that the Fed is setting the rate; it does not come directly from the market. In this case the Fed has kept rates low in response to both the overall weakness of the economy and the unusually low rate of inflation. If the Fed had kept rates low for too long we would know it, because inflation would be accelerating. There is no evidence of any uptick in the inflation rate.

5. Won't strengthening the Fed's full-employment mandate impinge on the Fed's independence?

Not in historical context. The Fed was created by Congress and gets its guidance from Congress. Under the law, the Fed is supposed to pursue a policy that promotes maximum employment and price stability. Congress decided that these goals should be the basis for policy when it enacted the Humphrey-Hawkins Full Employment Act of 1978. The concern is that the Fed has placed more emphasis on the price stability portion of its mandate than Congress had intended when it passed the law. The purpose of the Full Employment Federal Reserve Act is to emphasize the need for the Fed to give more weight to the full employment part of its mandate. Passing this law would be no more of an interference with the Fed's independence than passing the 1978 law.

6. Don't low interest rates fuel speculation?

Not necessarily. Low interest rates are more conducive to speculation than high interest rates, but there is no direct relationship between low interest rates and asset bubbles. The U.S. had very low interest rates in the '40s, '50s, and into the '60s without experiencing any major asset bubbles. The 1990s stock bubble grew in a period of normal interest rates. The housing bubble of the last decade did not stop growing even as the federal funds rate crossed 4.0 percent in 2005.

While there are some markets that may be seeing bubbles, for example the housing market in San Francisco and the market for some tech stocks, it is not clear that low interest rates are a major factor. Furthermore, denying millions of people jobs and tens of millions of workers pay raises by deliberately slowing the economy with high interest rates would be a very high price to pay to bring down the price of a few overvalued social media companies.

It's important to note that the Fed has other tools that it can aim at incipient bubbles or excessive leverage. The Fed can raise margin requirements for stock purchases if the excesses are in equities, it can raise loan-to-value ratios for home mortgages if the excesses are in residential housing markets, and it can simply highlight excesses in various markets in its public comments. The Fed has other tools to target bubbles. Slowing down the entire economy by raising interest rates is not the solution.

This FAQ was prepared by Dean Baker of CEPR and Josh Bivens of EPI with valuable input from Shawn Sebastian and Jordan Haedtler of the Center for Popular Democracy.