Opinion

Do Low Interest Rates Punish Savers?

BY KARTIK ATHREYA

We typically hear the stance of monetary policy described as "easy" or "accommodative" when interest rates are relatively low, and "tight" or "restrictive" when rates are high. This language embodies a judgment that low rates are helpful to households and businesses. But in periods when the Fed keeps rates relatively low, one often hears the concern that savers are harmed by low interest rates. There is some truth to that statement: When the Fed cuts interest rates, certain types of interest income tend to fall. However, this is not the whole picture.

One way of looking at this question is by considering the counterfactual: What position would savers be in today had the Fed pursued different policies? Many readers will know that the Fed's monetary policy goals are to achieve both maximum sustainable employment and low, stable inflation. Economic models strongly suggest that the best way a central bank can support the employment side of its mandate is by achieving success on inflation, which creates favorable conditions for investment and growth over time. The interest rate policy that delivers this outcome tends to recommend rates that track the so-called "natural real rate," a conceptual interest rate that is thought to produce stable inflation and employment outcomes. Our best estimates — including a measure provided by Richmond Fed economists Thomas Lubik and Christian Matthes — indicate that the natural rate has fallen in recent years and with it, the appropriate setting for the Fed's policy rates.

In fact, over the last several years, many economic models were calling for far *lower* interest rates than the Fed was able to implement due to the so-called "zero lower bound" on interest rates. Had the Fed's policy rates instead been higher, the evidence suggests that economic outcomes would have been considerably worse. From this perspective, higher rates would likely have been detrimental to savers and virtually all households.

It is certainly true, though, that the Fed's policies have unintended distributional effects. How someone is affected depends on their situation. For example, workers obviously are directly affected by labor market conditions, and households may feel the effects of inflation differently depending on the assets they hold. Many observers note that seniors on fixed incomes may be affected by low rates without experiencing the direct benefit of a healthier labor market. The Fed pays close attention to such effects in evaluating how its policies are affecting the economy.

Fortunately, research suggests the effects of easier monetary policy on seniors are relatively limited. For example, a 2013 study by Richard Kopcke and Anthony Webb published by the Center for Retirement Research at Boston College looked at the asset holdings of households aged 60-69 as of 2007. They found that the poorest 40 percent of households headed by seniors held less than $3,000 in financial assets on average. The wealthiest 20 percent of seniors hold considerably more financial assets, but largely stocks, which pay dividends and for which returns tend to rise in response to low interest rates, all else equal. Research suggests that even the seniors whose income seems most affected by low rates — those in the middle-to-upper income categories — still receive a relatively small share of their income from investments. They tend to rely more heavily on Social Security, real estate, and pensions.

There are many ways in which the Fed tries to minimize the inadvertent distributional effects of its policies. For example, when it buys assets on the open market in the conduct of monetary policy, it purchases mainly U.S. Treasuries, which affect financial markets broadly with minimal effects on relative asset prices. The extraordinary period of the Great Recession changed this practice some, but the Fed is taking action to move back toward more normal operation in monetary policy. (See "Time to Unwind," page 30.)

Moreover, savers are not *just* savers — they are also participants in the overall economy. Many are workers: As noted, if rates had instead been higher in recent years, employment outcomes would surely have been worse, and job loss is typically a more traumatic financial event than the losses one faces when asset returns experience a cyclical decline. Savers are also consumers, and lower Fed policy rates generally mean lower loan rates for goods like homes and automobiles, as well as lower interest payments on variable rate loans. Finally, many savers also hold assets whose values tend to rise in low-interest-rate environments. Low rates tend to boost housing prices, for example, and housing comprises a large majority — nearly two-thirds — of assets for households in the middle of the wealth distribution. This is especially true of older households preparing for retirement; roughly 80 percent of households aged 65 and older own their homes, compared to roughly 64 percent for the nation as a whole, according to the Census Bureau.

In the end, the Fed is bound by Congress to focus on the macroeconomic outcomes in its dual mandate. The Fed does not have tools well-suited to targeting specific asset returns or distributional outcomes. As economic models tell us, the best way the Fed can help the greatest number of households is by pursuing the monetary policies that best support a healthy economy and price stability over time. **EF**

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