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Expansionary monetary policy and its side effects

Introduction

While assessing the effectiveness of anti-crisis macroeconomic policy from the point of view of the length and depth of the recession induced by a crisis, it can be concluded that governments and central banks have fulfilled their role correctly (Mishkin, 2009) – the recession measured by a decrease in the GDP was relatively shallow and short, obviously with some exceptions, such as Greece, where the symptoms of recovery in the real sphere are still not visible today. On the other hand, however, there are many doubts about the future effectiveness of monetary policy instruments – nominal rates of a central bank cannot be further reduced; the policy pertaining to the establishment of the level of minimum reserves of banks has practically ceased to be of any importance in view of the enormous funds amassed by banks. These are dilemmas pertaining to the required reaction of the central banks upon the appearance of speculative bubbles (Mishkin, 2011). Many controversies arise in connection with the side effects of the expansive monetary policy implemented by the main central banks in the world (BIS, 2012). An exceptionally loose monetary policy constitutes a serious hazard for the appearance of speculative bubbles in some markets, and emerging economies must face challenges connected with investors' actions who, within the so-called 'carry trade', destabilise the exchange rates and increase the inflation pressure in countries such as Brazil and India.

The aim of this paper is to indicate that the monetary policy conducted since 2008 by the most important central banks in the world is significantly contributing to the deepening of the level of income inequality in contemporary economies. In the first part of the text, apart from preliminary remarks, the structural reasons for macroeconomic inequities, which have accumulated since 2007, will be presented. Next, the channels of influence of this monetary policy on the income structure in the current situation of the global economy will be analysed.

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MONETARY POLICY AND INCOME DISTRIBUTION – PRELIMINARY REMARKS

A traditional analysis of the relationships between the policy of a central bank and the division of income in the economy does not include a set of so-called 'non-standard monetary policy tools' implemented as a result of the 2008 financial crisis (Coibion, Gorodnichenko, Kueng, Silvia, 2012). The main channels of impact of monetary instruments on the income structure are mostly a central bank's attitude to inflation and the influence of the interest rate level on the returns obtained by owners of savings. Consent to increased inflation usually leads to increasing income inequality (Bulir, 1998; Sieron, 2017). This happens because, due to higher prices, employers' and high-ranking managers' income increases and their salaries depend on their companies' financial results, which improve quickly as a result of increasing revenues. At the same time, the salaries of ordinary employees remain at the same level or at best are increased, but with a considerable delay. One should also mention social transfers here, which are usually indexed by the inflation rate but always by using the ex post approach. In summary, the redistribution effects of increased inflation work in favour of increasing income inequality – the income of ordinary employees and those who receive social benefits grow more slowly than the income of 'better-off' social groups, i.e. entrepreneurs and managers.

What is interesting is that the disinflation policy also has a negative influence on the level of social cohesion. The cost of a restrictive monetary policy aimed at limiting the inflation level is usually a decrease in the GDP dynamics and even recession. For example, this happened in the United States at the beginning of the 1980s when Paul Volcker, the FED head at that time, announced that inflation was "Public Enemy Number One". Over a few years, it was possible to reduce the scale of inflation fundamentally (from 13.5% in 1980 to 3.2% in 1983 – further data for the same period), but it happened at the expense of the recession and an increase in unemployment, which increased from 7.2% to 9.7%. A deterioration of the situation on the labour market always leads to income inequality (Gini increased in the US from 34.7 to 36.8), as persons with low qualifications are the first to lose their jobs and, as a consequence, their income.

The central bank's focus on controlling inflation not only decreases the total level of outcome (GDP) on the economy but also determines its structure. A higher interest rate, by increasing the cost of production, transfers income from the industrial to the financial market. In this situation, corporations try to deal with the higher cost of capital by reducing wages or increasing the prices of produced goods. Both channels (higher prices and reduced wages) lead to income distribution – a share of the wage income in the economy declines in the nominal or real term (Argitis, Pitelis, 2001).

In summary, monetary policy influences the distribution of income mostly during so-called 'monetary shocks', i.e. periods of loose monetary policy when inflation is accelerated and at a time when the central bank conducts a restrictive policy aimed at reducing the inflation rate. Both situations usually translate into an increase in income inequality, despite the fact that economic mechanisms are quite different. Thus, from the point of view of social cohesion, a monetary policy, which stabilises the price dynamics without unnecessary costs in the form of weakening the real sphere, is measured here mostly by the unemployment rate. There are some suggestions to include social cohesion issues into the central bank's mandate of what can be done via supporting non-profit financial institutions (Dow, 2017), but it would mean that the central bank is allowed to conduct a structural policy that is quite controversial.

Globalization, financialisation, income distribution and crisis

Serious arguments can be listed that show that increasing income inequality is responsible for a growing macroeconomic imbalance (Rajan, 2010; Stiglitz, 2012; Kumhof, Lebarz, Ranciere, Richter, Throckmorton, 2012).

The past three decades in the world's economic history is a period of accelerated globalisation of the economy understood as the progressive integration of the goods markets, capital and work. A dominant China and the entire area of the world previously belonging to socialist countries are included in the global economy. Thus, we have a combination of demographic factors (a large increase in the labour force in developing countries), technological factors (a decrease in costs of transport, development of telecommunications techniques), cultural factors (common knowledge of English, standardisation of work tools) and political tools (inclusion of further previously "closed" economies in the global economy), owing to which the bargaining power of the majority of employees decreases, which narrow social groups then have a very quick increase in income (IMF, 2007; OECD, 2011; ILO, 2008). As a result, the share of salaries in GDP decreases (work efficiency grows more quickly than salaries) at the expense of the growing role of capital income (Piketty, 2014; Tridico, 2018); on the other hand, income inequity grows fast both among employees (salary inequity) and the entire economy, as measured at the household level.

If production grows faster than pay, the demand barrier is created – households cannot afford to buy the goods and services which are produced in the economy. Thus, there are two ways out – the consumption can grow faster than their income, but it is connected with an increase in private and/or public debt, or an export surplus must be achieved. The US, UK and Greece are examples of the first model, while China and Germany have been following the other route.

The situation of the German economy requires an additional comment because this economy has an image of a crisis-proof one. In Germany, the difference between an increase in work efficiency and an increase in salaries is exceptionally high – in the 2000s, the level of remuneration increased nominally at a rate of 1.1% annually, which meant a real decrease. The fact that the traditional German thriftiness did not lead to an increase in household debt does not mean that no negative processes, which are a threat to macroeconomic stability, occur there:

– pay stagnation and the resulting deficiency of domestic demand, which means the necessity of keeping a surplus in the current account, which makes the economy dependent on foreign demand – thus, it is not an accident that the recession in Germany in 2009 (-5.1%) was deeper than in the US (-2.8%), which was the "centre" of the financial crisis;
– income inequity measured at the household level remains at a stable level (Gini in 2000s is stable at the level of about 30), but during this time, a growing share of the national income is taken over by companies' profits; this, on the scale of the entire economy, the income structure is changing quickly to the disadvantage of households gaining income from labour – share of salaries in GDP declined from 75% in 2000 to 65% in 2007 (OECD data);
– a high level and positive dynamic of GDP does not translate into affluence of households – despite the highest GDP per capita level among the countries listed below, the median of the household effects is three times lower than in Spain and Italy, household assets that were more than twice as high were collected by households in France and Greece[2] (ECB data);
– it is difficult to say that the financial surpluses of companies invested on the global financial market increased the affluence of the German economy – in view of the collapse of financial markets, losses on foreign financial investments were 20% of GDP (estimates by the DIW institute), which required support from the financial sector in the form of public funds at an amount of 12.8% of GDP, i.e. on a scale larger than in the US or UK, where taxpayers had to pay 4.8 and 6.7% of the GDP, respectively to rescue financial institutions (IMF data).

In summary, it is impossible not to combine the accumulated macroeconomic imbalance, which led to the financial collapse in 2007, with trends in income division. Low household income dynamics make it necessary to finance growing consumption by contracting debt, and at the same time, quickly growing profits of companies reach the financial market, leading to the formation of speculative bubbles and shaping so-called 'global imbalances'. Even if households avoided an increase in debt, as happened in Germany, such a situation also contributes to a growing imbalance; this time, it is an external imbalance by the necessity of maintaining an export surplus and the transfer of capital abroad.

[2] The most important component of household effects that results in Germans' low ranking in the statistics is real property, as real property ownership is relatively uncommon in Germany.

It can be clearly seen that the crisis did not change the trend involving an increase in income and wealth inequity, mostly in highly-developed countries. Despite the decrease in the inequity scale from 2007–2010, which resulted from a deep decrease in capital profits caused by a collapse of financial markets, the latest data show that the income stratification began to grow again (ILO, 2013; Piketty, Saez, 2013; OECD, 2014; Lavery, 2017). A rebound in inequalities after the crisis is even bigger in the case of wealth distribution – in the US, the wealth share of the top one per cent shot up by 2.9 percentage points in the period 2010–2016 (Wolff, 2017).

Side effects of a loose monetary policy

Looking at the current picture of the status of the economy in the most important countries of the world, one might get the impression that the reaction of central banks to the financial crisis in 2008 was appropriate, as the following facts can be pinpointed:

- the recession in the most important economies was relatively shallow and short-lived,
- no deflationary pressure was observed, except for the exceptional situation in eurozone economies: for example, in Greece prices were declining from 2013–2015,
- after a temporary panic attack on the financial markets in September 2008 (just after the bankruptcy of Lehmann Brothers), the situation calmed down and a non-conventional monetary policy was quite effective in easing financial conditions (Rogers, Scotti, Wright, 2014),
- there was no run on the banks, the loss of depositaries' funds did take place in Cyprus and Iceland, but certainly it cannot be regarded as a lack of social trust in the banking sector,
- a low level of interest rates allowed a loose fiscal policy to be conducted, which allowed for the operation of automatic stabilisers, which made the recession shallower and shortened it.

On the other hand, however, it can be seen more and more clearly (BIS, 2012; Hamilton, Wu, 2011) that a loose monetary policy, and mostly the so-called 'non-standard instruments of the central bank' are connected with a whole range of risks:

- the level of interest rates at an amount of '0' means that we have practically lost this most important instrument of the central bank – in the case of another slowdown, it will be very difficult to reduce the interest rate. It is possible to set a negative interest rate that takes place in Switzerland and the eurozone, but the efficiency of this kind of policy option is still *terra incognita* (Rogoff, 2017);
- liquidity provided by central banks does not go to the real economy, as the majority of funds are invested in the capital market thereby putting pressure on the rise of financial assets prices;

– an increase in the balance sheet of central banks as a result of monetary expansion does not translate into an increase in lending action – a large amount of funds provided by the central bank is "settled" in commercial banks' reserves, as these banks have collected reserves considerably exceeding the required levels. As a result, another instrument of the central bank – the minimum reserve – becomes useless;
– collected reserves of commercial banks are a potential threat for future inflation: the lending action may begin to grow very quickly, which will be translated into a growing demand and inflation pressure;
– financial markets depend more and more on quantitative loosening policy – markets respond to the announcements made by central bankers of the forthcoming limitations of liquidity provided by falling indexes,
– the low cost of capital makes it necessary to conduct so-called 'carry trade' (search for yield), i.e. taking a short position in a currency with a low percentage rate and investing borrowed funds in assets with a higher return rate, which leads to the formation of speculative bubbles.

POST-CRISIS MONETARY POLICY AND INCOME INEQUALITIES

An important consequence of the monetary policy implemented by central banks as a result of the crisis is the deepening of income inequity. The Bank of England (2012) says that supporting the economic recovery expansionary policy affects social cohesion in a positive manner by decreasing unemployment. First, a review of the data does not support this approach. Expansionary monetary policy, first of all, affects asset prices and their impact on the labour market in a positive manner, which is quite limited (Watkins, 2014). At the same time, a few issues must be taken into consideration.

First of all, the loose policy of the central bank means access to cheap capital, but only for entities from the financial sector. Only financial institutions make direct transactions with the central bank, while other economic entities must use financial intermediation. As a result of such a situation, the financial sector may attain high profits practically without taking any risks. ECB actions are a good example of this situation. For example, in December 2011 and February 2012 within the LTRO operation, the ECB granted a "long" (i.e. three-year long) loan with an interest rate of 1% to banks. The funds obtained were invested in bonds of eurozone countries and, as a reminder, the yields of Spanish and Italian bonds at that time was at the level of 5.11% and 5.55% (Eurostat data).

A policy outlining clear preferences for the financial sector, compared to other sectors, does not take into consideration recent research (Arcand, Berkes, Panizza, 2012), which shows that as long as an efficient financial sector is necessary for the development of economy, its excessively large size may contribute to the formation of speculative bubbles, which destabilise the economy if they burst and require rescue actions on the part of the State.

Table 1. Selected data on income distribution in the USA and UK

USA					
Year	Top 1% income share-including capital gains	Return on SP 500 shares in 2009–2014 (in %)*		Nominal wage dynamics in 2009–2014 (in %)	
2007	19.9	Total return	Annual average return	Total growth	Annual average growth
2008	19.5	137.3	15.7	12.2	1.02
2009	18.5				
2010	19.8				
2011	19.6				
2012	20.8				
2013	19.6				
2014	20.2				
UK					
Year	Top 1% income share-including capital gains	Return on FTSE 100 shares in 2009–2014 (in %)*		Nominal wage dynamics in 2009–2014 (in %)	
2007	15.4	Total return	Annual average return	Total growth	Annual average growth
2008	n.d.	48.3	6.8	10.8	1.01
2009	15.4				
2010	12.6				
2011	12.9				
2012	12.7				
2013	14.5				
2014	13.9				

* Return on change price; dividends are not included.

Source: Author's own preparation based on data from The Top World Incomes Database and USA, UK national data.

The aforementioned pressure on the increase of prices of financial assets allows for obtaining a high capital income, which is the speciality of financial institutions and owners of large savings. At the same time, owners of modest savings who do not have the possibility of managing their portfolio in an active manner, practically do not have any income from their capital. The interest rate on bank deposits and current accounts is now practically at the level of 0, which, considering the inflation and fees to financial institutions, gives a negative return on small amounts of savings. Income inequity is thus increased in two ways – income from capital grows faster than remuneration and, at the same time, the diversification of

income from capital increases for larger rates of return for those who have capital that is large enough to be managed actively. The data presented from the USA and UK (Table 1) show that the process of growing income inequalities has been taking place. Returns on the financial markets are much bigger than wage dynamics, so wealthier households that, to a greater extent, rely on capital income, benefit much more than those who live on salaries.

Similar results to the data presented above have been noted in Japan. The expansionary monetary policy conducted by the Bank of Japan led to an increase in income inequalities due to the portfolio channel. Wealthier households that hold equities benefit more from capital market increases than poorer ones that rely on wages (Saiki, Frost, 2014).

One of the reasons for the financial crisis, i.e. a careless lending policy of banks, which granted subprime loans on a mass scale, i.e. the ones where the borrower's creditworthiness was doubtful, had a fundamental influence on the bank's approach to lending action. Today, this situation looks quite different. Despite the loose monetary policy of central banks, access to loans by entities outside the financial sector is very difficult. In addition, today it can be seen much more clearly than before the crisis as to how the financial market differentiates capital cost according to the borrower's economic power. Before the crisis (in mid-2007), the difference in the interest of 5-year corporate bonds between an issuer with an AAA rating and a BBB rating was approx. 1.2 percentage points, while at the beginning of 2016, it was as much as 3 percentage points. A similar conclusion results from the research conducted by the ECB, which regularly analyses access to the capital of small and medium enterprises – compared to 2007, despite a reduction in the interest rates of the central bank, the cost of capital acquired by small entities on the financial market increased, and at the same time, its availability decreased as a result of collateral required by banks.

The differentiation of capital costs from the point of view of economic power can also be seen in financing the public sector. It is here too that the advantages of low interest rates are used by the largest and strongest economies enjoying the trust of the financial markets.

Table 2. Yields (in %) of treasury (10-year) bonds of selected Euro-zone countries

Country/time	XII 2007	XII 2017
Italy	4.54	1.80
Spain	4.35	1.44
Greece	4.53	4.44
Germany	4.21	0.30
France	4.35	0.67

Source: Author's compilation based on Eurostat data.

The changes observed above largely result from a specific return to normality – such a small difference between the profitability of German and Greek bonds certainly did not take into account a much worse fiscal policy conducted in Greece for years. Quantitative easing operations conducted by the ECB have their own specifics. In purchasing government bonds on the secondary market, the ECB needed to adopt a strategy concerning structure treasuries that are being bought. To avoid the accusation of national sentiments and direct involvement in the member state's national fiscal policy, the ECB buys government bonds according to the structure of Euro-zone GDP, which has its obvious consequences. The biggest ECB demand (almost direct support for national fiscal policy) goes to the German bonds, so the strongest economy benefits the most.

The privileged position on the debt market of the richest countries is also connected in other ways with the monetary policy conducted by central banks. Apart from the obvious influence of increased money supply on the profitability of treasury securities, it is worth paying attention to other regularities as well, which can clearly be seen in the world's financial system.

Large-scale integration of the global financial sector reduces the effectiveness of monetary policy with regard to the regulation of the money supply on the domestic market. As there are no limitations in capital movements, increased liquidity in the financial sector, which is provided by the central bank within the quantitative loosening policy or by granting loans directly to commercial banks, as happened in the case of the LTRO operation, can be used very quickly for the purchase of foreign assets. It is particularly visible in the eurozone, where no foreign exchange risk occurs between its individual members (Turner, 2014). International transmission of monetary expansion has also been observed in the case of the Fed. The American quantitative easing policy affected both equities and treasury bonds issued in the UK and Germany (Lutz, 2014) in a positive way, so again, the strongest benefit the most.

Another factor that facilitates the fiscal policy in the most financially reliable countries involves the behaviour of the central banks of other countries, which must respond to actions by the Fed, the ECB or the Bank of England. On the one hand, increased money supply in the USA or Europe leads to involvement in carry trade transactions, which increases the inflow of capital to emerging markets. On the other hand, it can be seen that safe deposits are being sought, i.e. currencies that are connected with a low risk of depreciation and increased inflation. The Swiss franc is an example of such a currency. It began to appreciate very quickly against EUR and USD, which forced the Bank of Switzerland first to block the exchange rate at the level of 1.2 francs for EUR 1 and then move to a negative interest rate. It should be noted that in both cases (capital inflow to emerging markets and to Switzerland), the balance amount of the central bank increases by means of an increase in foreign exchange reserves. Foreign exchange reserves of the central bank are invested in liquid secure assets, which, as a result, leads to an

increased demand for the bonds of countries offering securities nominated in the world's reserve currency so the ministers of finance in Germany, the USA or UK do not have any problems with financing their borrowing needs.

The differentiation of the costs of financing the borrowing needs of the public sector clearly increases income inequity at the international level. The richest countries have lower costs of public debt serving and, as a result, they are able to conduct a loose fiscal policy that accelerates economic growth. In Spain or Greece, the cost of debt financing imposed by the market imposes quick fiscal adaptations which, under the current conditions, must be of the post-recession type (Perotti, 2011), so the income gap between individual countries is growing.

Conclusions

The outbreak of the financial crisis showed that the global economy was far from equilibrium. If salaries are lagging behind labour productivity, it must lead to economic imbalances, e.g. growing household debts such as those in the USA or an unsustainable trade surplus, which occurs in China and Germany.

Unfortunately, it is hard to say that the financial crisis made it clear to politicians that growing income inequalities are unsustainable, so radical changes in economic policy must be implemented to balance the global economy. A more likely scenario is the continuation of the above-mentioned trends and a long period of wage stagnation that could endanger the social and political stability of the world economy.

One of the most important dilemmas for policymakers is the role of contemporary monetary policy. On the one hand, a set of non-standard monetary instruments brought short-term stabilisation for the global economy. On the other hand, structural causes of macroeconomic instability are still there. There is more and more evidence that the income distribution structure is an important source of economic and social instability. Contemporary monetary policy conducted by the most important central banks contributes to the growing income inequalities by giving preference to the financial sector and capital holders over the working class.

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Summary

The goal of this paper is to show that, although a non-standard monetary policy conducted by the major central banks is quite efficient in stabilising the post-crisis economy, there are a few important side effects of such policy. One of the most important side effects of a super-expansionary monetary policy is creating an economic environment that favours the financial sector and capital owners over the working class, leading to higher income inequalities. The low level of the central bank's interest rate does not mean that every economic unit has access to cheap capital. The ultra-low cost of capital can be experienced by only the few selected players – financial institutions and strong corporations. The same can be said about the financing borrowing needs of the state – only a few governments are able to borrow very cheaply and others have to face the huge power of the financial market, which leads to a growing income gap between societies. The text has a mainly descriptive character but a few statistics are provided to support main paper's thesis.

Keywords: financial crisis, macroeconomic policy, social cohesion.

Ekspansywna polityka pieniężna i jej skutki uboczne

Streszczenie

Celem tekstu jest wskazanie, że polityka pieniężna wdrożona przez banki centralne w następstwie kryzysu finansowego osiągnęła swoje zasadnicze cele głównie w zakresie stabilizacji makroekonomicznej, ale coraz wyraźniej widać skutki uboczne tej polityki. Jednym z najważniejszych skutków ubocznych ekspansywnej polityki pieniężnej jest stworzenie warunków, które sprzyjają sektorowi finansowemu i właścicielom kapitału osłabiając pozycję przetargową pracowników, co w sumie pogłębia nierówności dochodowe.

Ekspansja monetarna w dużej mierze ogranicza się do zwiększania płynności w sektorze finansowym, a tylko w małym stopniu w sferze realnej. Taka sytuacja oznacza zwiększenie popytu na instrumenty finansowe, co prowadzi do szybkiego wzrostu ich cen, na czym zyskują przede wszystkim właściciele kapitału.

Niskie stopy procentowe banku centralnego nie oznaczają równego dostępu do taniego kapitału, na który mogą liczyć tylko najsilniejsze ekonomicznie podmioty, więc w sumie nierówności (zarówno między firmami, gospodarstwami domowymi, jak i państwami) rosną. Różnice w koszcie kapitału dla poszczególnych podmiotów się powiększyły w porównaniu do sytuacji przed kryzysem. Dotyczy to zarówno sektora prywatnego jak i publicznego, co można zmierzyć różnicami w rentowności papierów dłużnych emitowanych przez poszczególne podmioty. Tekst ma głównie charakter opisowy, ale podstawowe dane statyczne są przytaczane w celu zobrazowania opisywanych mechanizmów.

Słowa kluczowe: kryzys finansowy, polityka makroekonomiczna, spójność społeczna.

JEL: E63, E64, F2.