



Prof. Dr. Kerstin Bernoth, Deputy Head of the Department of Macroeconomics at DIW Berlin

EIGHT QUESTIONS TO KERSTIN BERNOTH

»Wealth inequality set to increase in the short term«

1. Prof. Bernoth, the European Central Bank (ECB) decided to implement a large-scale bond purchasing program in January 2015 to avert the risk of deflation in the euro area. To what extent might these bond purchases also affect wealth distribution? Considerable wealth distribution effects may occur through the impact channels of monetary policy because interest rate changes introduced by the central bank and their bond purchases will affect the general level of interest rates and asset prices in the relevant country.
2. What is the link here? On the one hand, the bond purchases and also the prolonged low interest rates in the euro area have the effect of increasing the prices of stocks and real estate, and asset prices in general. Demand for alternative investment products such as stocks and real estate increases because the interest rate is extremely low. These products then experience a rise in prices.
3. Who are the winners and losers? More research is definitely needed on this issue. However, investment products such as stocks, bonds, and real estate are mainly held by wealthier households rather than poorer ones. So it is likely that the distribution of wealth inequality will increase in the short term because wealthy households will benefit more from the asset price increases.
4. What long-term effects do you expect? In the long term, this widening of wealth inequality may decrease again slightly. This could happen if the ECB's bond purchases successfully revive the real economy and have a positive impact on the labor market. These are effects that are then more likely to benefit households with fewer assets. In other words, it now crucially depends on what the long-term effects on wealth distribution are and how successfully the bond purchase program can stimulate the economy.
5. However, to date, the bond purchase program has had practically no positive impact. Yes, but, yet again, we have to wait even longer. The ECB has only been purchasing bonds for ten months now and we've not yet seen any major impact in this short period of time.
6. How much longer do we have to wait? Well, the effects of bond purchases in other countries like the US and UK were quite successful and swift. However, the picture was quite different in Japan. The economic environment there was similar to the current one in the euro area and bonds were also purchased in a low interest rate environment. It took a long time before the real economic effects become evident—up to 20 months.
7. Does that mean the pay-off for these beneficial effects is increasing wealth inequality? In the short term, there is definitely a risk because the longer the interest rate remains at such a low level and the more the ECB intervenes in the bond markets, the more we will have to deal with the issue of distribution and the greater the distributional effects are likely to be.
8. Would a higher rate of inflation reduce inequality? Again, we can only speculate. If inflation rises, this will generally benefit households in debt because their debt burden in real terms decreases, the higher the debt becomes. Conversely, households with greater cash reserves will be more vulnerable, the higher the level of inflation. Wealth inequality should actually decrease again solely from this inflation effect. But we cannot be completely sure because it really comes down to which households hold the most cash assets relative to their total assets and which hold more asset securities such as stocks and real estate. The question is who will benefit from the ECB's bond purchases in the long term? We will have to research these very issues a lot more in the coming months and quarters.

Interview by Erich Wittenberg



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