Thoughts on the Redistributional Impact of Inflation on Households

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BCC Conference

Geneva, September 23rd 2022

Main Channels

- Exposure through balance sheets
  1. Access to inflation protected assets
  2. Interest rates
  3. Supply of credit
- Exposure through differential prices paid
  1. Consumption basket weighted towards high inflation items
  2. Local inflation effects
- Non-inflation adjusted sources of income
  1. Nominal wage growth lower than inflation
  2. Other sources of nominal retirement income
- Bracket creep and other tax effects

Household Balance Sheets: What Do We Know?

- Redistributional studies of inflation based on microdata on household balance sheets and individual spending patterns conducted in low inflation environments

  (Erosa and Ventura 2002, Doepke & Schnider 2006, Adam & Zhu 2016)

→ Given evidence of state dependent nature of monetary policy in other settings, this matters

  (Eichenbaum, Rebelo & Wong, forthcoming)

- Long period of low inflation likely affected household portfolios and spending patterns
- Sudden rise of inflation in 2021 may have increased uncertainty about inflation

  (Malmendier & Nagel 2016)

→ Heightened heterogeneity in inflation expectations

  (Binder & Camdar 2022)

Household Balance Sheets

	Young	Middle Aged	Senior
Poor	No debt/no assets	Some debt, Limited assets	No debt, Low assets, mostly nominal
Middle Class	Little debt other than student loans	Mortgage debt, Illiquid assets	Some debt, Substantial retirement assets, Real estate
Rich	No debt, Substantial real assets	Mortgage debt, Substantial liquid and illiquid assets, Real assets	Little debt, Sunstantial nominal and real assets

(Doepke & Schneider 2006)

State Dependent Effects

- Long period of very low mortgage rates and increasing house prices

$\rightarrow$ Middle age & middle class/rich households benefit substantially from loan balance reduction

particularly as home values are not expected to drop substantially due to low supply

- Young/middle age hold substantial education loan balances
- Retirement portfolios may have higher share of liquid nominal assets due to long period of low inflation

Access to Credit

- Credit expansions do not lead to increases in access to unsecured credit for households

→ more credit offered only to high credit score consumers with low demand (Agarwal, Chomsisengphet, Mahoney and Stroebel 2015)

- What will be the response to a credit contraction?

- Effect on interest rates?
- Effect on quantities?

- Rise in expected default risk due to recession risk may lead to contraction

Effects on Consumption

- Back to basics:

$$u'(c_t) \geq \beta(1 + i_t - \pi_t)E_t u'(c_{t+1})$$

$\rightarrow$ real rate $i_t - \pi_t$ very low (negative)

- For households who are liquidity constrained (about 35% of US households), this will not matter for consumption

- Key factors:

1 Decline in real value of liquid assets

2 Decline in real wages

$\Longrightarrow$ substantial decline in purchasing power and likely consumption

Conclusion

1. Most modern studies on redistributional impact of inflation conducted in low inflation environment
2. Given evidence of state dependent nature of effects of monetary policy in other settings, long period of low inflation preceding current episode may have a heightened redistributional impact
3. Further tightening of liquidity constraints for marginal households may adversely affect aggregate consumption
4. Role of heterogeneous exposure to inflation in forming inflation expectations and therefore responses

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