Economic Commentary

10 questions and answers about the distributional effects of monetary policy

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Summary

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The authors work in the Riksbank's Monetary Policy Department.

It is important for the Riksbank to monitor how the distribution of income and wealth changes as it affects the functioning of the economy, which is significant for monetary policy. Differences in income and wealth between households can affect growth and changes in the distribution can influence the effect monetary policy has on economic activity.

Income disparities in Sweden have remained roughly unchanged since 2015, but over a longer time perspective, stretching back to the 1980s, they have increased. This is because the incomes of those who are not working have increased much less than wage incomes, while capital incomes have increased significantly for those with the highest incomes. The coronavirus pandemic is likely to increase income disparities. It is more difficult to say what has happened to the differences in wealth in Sweden because there are no statistics on this since 2007.

An expansionary monetary policy affects the economy broadly and via several different channels. This applies regardless of whether the Riksbank cuts its policy rate or purchases various assets. A fall in interest rates has an expansionary effect on the economy, which in principle benefits all households but in different ways and to different degrees. Higher asset prices mean, among other things, that income from capital gains increases and that this goes, to the greatest extent, to people at the top of the income distribution. The fact that more people are employed and receive wage income instead of different kinds of benefits means that income increases to a relatively large extent for people in the lower part of the income distribution. It is therefore difficult to know what the overall effect on the income distribution will be. When asset prices rise, the wealth of the individuals who own the assets increases. Since ownership of assets, especially financial assets such as equities, is unevenly distributed, the rise in prices will usually increase differences in wealth. However, if the financial assets that are owned through collective pension savings are included, the effect will be less.

The Riksbank does not have an assigned task connected to distribution policy other than that of keeping prices stable, which does, in fact, include a distribution dimension. This is because, if inflation were high and volatile, it would cause arbitrary redistribution of income and wealth.

The active use of monetary policy for distributional policy purposes would be difficult for several reasons, not least because it affects the economy widely. A less expansionary monetary policy could contribute to restraining asset prices, but this would be at the cost of higher unemployment. So, although the overall final result could be a more

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even distribution, the situation would, in practice, be worse for groups that are already weak. Such a policy would be difficult to justify. In addition, over a longer period, covering both economic downturns and upturns, the effects of monetary policy on incomes and wealth will largely offset one another.

1 What does the distribution of income in Sweden look like and how has it changed?

There are different ways of measuring the distribution of income in a country.[2] One way is to sort all individuals by their disposable income and compare the income of the individual who has a higher income than 90 percent of the individuals (90th percentile) with the one who only has a higher income than 10 percent of the individuals (10th percentile). It is also possible to compare how large a proportion of total income goes to the various groups.[3] The most common summary measure of the distribution of income is known as the Gini coefficient. It is designed so that the coefficient is zero if the distribution is completely even, which is to say if everybody has the same income. If the situation is the opposite and one single household has all the income, the coefficient has the value of one.

Income disparities have increased in the longer term, but are still relatively small in Sweden

Almost regardless of the measure of income distribution used, income disparities in Sweden are small compared to most other countries in the EU and OECD.[4] The distribution here is roughly the same as in the other Nordic countries, several Eastern European countries, Austria, Belgium and the Netherlands (see Figure 1). In the United Kingdom, for example, and the United States in particular, income disparities are much greater.

Historically, the distribution of income has been relatively different from country to country, both in terms of size and in how it has changed. In many OECD countries, however, there is a common trend in which income distribution has become more uneven since the 1980s. This also applies to Sweden, where the trend turned in the 1980s, after income disparities fell in the 1970s.[5] Statistics, which are however difficult to compare over long periods, indicate that the differences in disposable incomes are now about the same size as before they decreased in the 1970s. Over a shorter perspective, income distribution in Sweden has been approximately the same since 2015 (see Figure 2). While the differences in income have varied slightly since then, in

[2] Below we use “distribution”, “spread”, “differences” and “disparities” synonymously. It is also common to use “inequality” in this context. The distribution of income and wealth are important measures of economic inequality in general in society but do not, of course, capture every dimension of differences in the welfare of individuals.

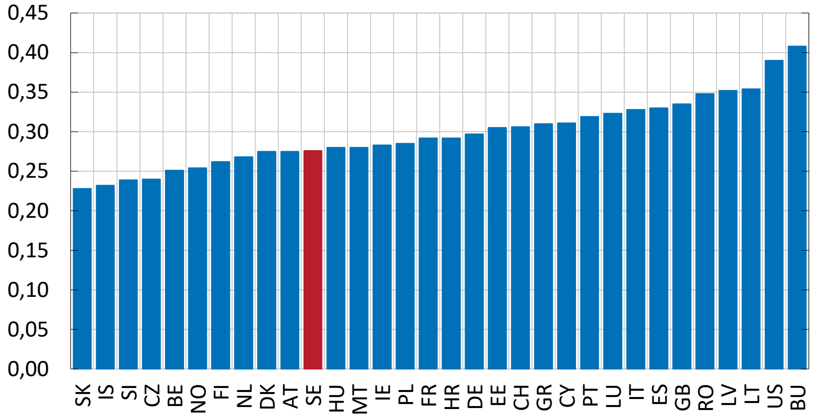
[3] One example is what is known as the Palma ratio. This compares the share of the total income of the ten per cent of households with the highest incomes and the corresponding share for the 40 per cent of the population with the lowest incomes. Another example is the top income share, which indicates the proportion of total income earned by individuals at the very top of the distribution.

[4] Distribution analysis is usually based on the so-called equivalised disposable income of a household. This means that the disposable income of the household, that is to say the sum of income from work and capital, as well as different types of transfers less taxes, is adjusted for the household's composition.

[5] The limited data makes it difficult to create a cohesive series for the Gini coefficient prior to 1995. However, the existing data indicates that the trend started in the 1980s. This is also supported by other distribution measures.

2019 – the last year for which statistics are available – the differences were, in principle, the same as in 2015.[6]

Figure 1. Gini coefficient for various countries 2019

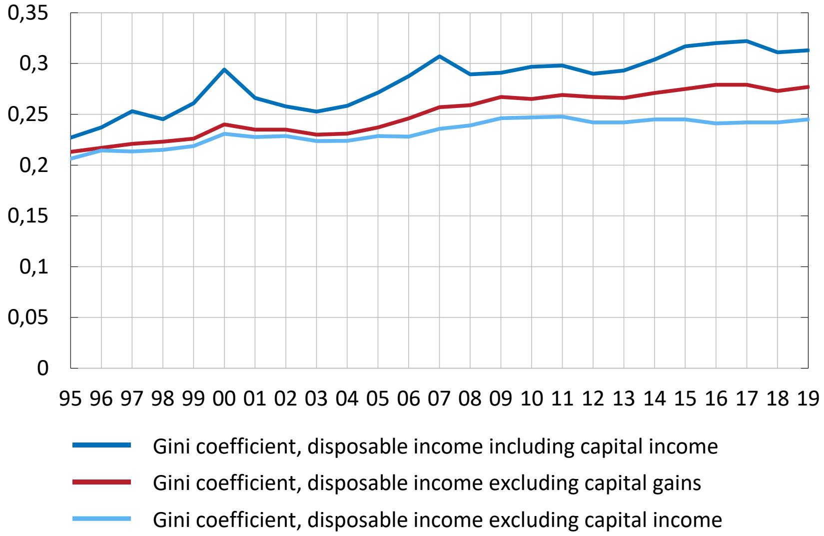


Note. Data for Iceland and the United Kingdom are for 2018 and, for the United States, 2017. The calculations take account of the varying compositions of different households. Disposable income is the sum of labour income, private income from investments and real estate, transfers between households and all social transfers including pensions.

Sources: OECD for the United States and Eurostat for the other countries.

[6] For more details on the distribution of income, see, among others, Chapter 2.2 of Long-term survey of the Swedish economy 2019 (SOU 2019:65) and Waldenström (2020).

Figure 2. Gini coefficient for Sweden, 1995–2019



Note. The calculations are based on Statistics Sweden's surveys Household finances (HEK) 2005–2011 and Income and tax statistics (IoS) 2012–2018. The calculations take account of the varying compositions of different households. Disposable income is the sum of all taxable and tax-free income minus taxes and other negative transfers (for example, paid student loans). Capital income includes all capital income, i.e. dividends, interest income and capital gains/losses on the sales of assets, such as equities, funds or real estate.

Source: Statistics Sweden.

2 Why have income disparities grown since the 1980s?

The trend toward increased income disparities that has existed since the 1980s thus exists not only in Sweden but also in many other OECD countries. One of the explanations that has been put forward is that the benefits of globalisation have gone to some groups to a greater extent than to others. Institutional factors have also been important, such as deregulation, reforms of tax and social insurance systems, and changes to the labour market and the demographic structure of the population.[7] Compared with other countries, income disparities have increased rapidly in Sweden since 1980, when we were one of the countries with the smallest income disparities. However, it is not obvious that 1980 is the most appropriate reference year, as the distribution was unusually compressed in Sweden in the 1970s.

Those who do not have jobs have fallen behind

Even though income disparities are thus still relatively small in Sweden, they have increased over the last 40 years or so. In short, this is due to two things. Incomes for those who do not work have increased much less than wage incomes – this has led to those with the lowest incomes moving further away from the middle of the income

[7] See Keeley (2015) and Bourguignon (2017), among others. Comparative analyses of the development of income distribution in the Nordic countries can be found in the Nordic Council of Ministers (2018).

distribution. In addition, capital income has increased considerably at the top of the income distribution.[8] The increase in income differentials between those not working and those with wages is due, among other things, to demographic changes (including an ageing population), to reforms in income taxation and to the fact that transfers have not increased at the same rate as average wages.[9]

Capital income has increased at the top of the income distribution

The fact that capital income has increased at the top of the income distribution is due to the fact that dividends have generated ever-greater incomes.[10] In the past decade, there have been large dividends from close companies, which, in turn, is due to the more favourable tax rules for these companies. If capital gains are also included, which is to say increases in the value of assets that are realised when the assets are sold, incomes at the top have pulled ahead even more. In recent years, these gains have primarily come from sales of housing. However, since profits often vary widely from year to year, there is good reason also to study the distribution of income excluding capital gains.[11] Differences in disposable incomes measured by the Gini coefficient have increased considerably less if capital gains are excluded (see Figure 2).

3 How will the coronavirus crisis affect the distribution of income?

It will take some time before the impact of the pandemic on the distribution of income can be seen, as these statistics are based on data from the income tax assessment in 2020 and will therefore not be available until the beginning of 2022. It is clear, however, that, despite measures to support companies, more people have become unemployed as a result of the pandemic. This means that income differentials will probably increase. Companies have also been hit by the pandemic, which is having a negative impact on capital incomes. However, asset prices have risen. As asset prices have risen, gains on the sales of assets are probably higher. This also indicates that income disparities are increasing.

Income disparities are increasing, but perhaps not by much

In the years before the pandemic, employment increased, including in the service sectors and among those born abroad. This probably contributed to restraining income

[8] Long-term survey of the Swedish economy 2019 (SOU 2019:65).

[9] See chapters 2.2 and 2.3 of Long-term survey of the Swedish economy 2019 (SOU 2019:65) and chapter 2.3 of the distribution policy report to the Budget Bill 2021 (Government Bill 2020/21:1).

[10] More details about capital incomes can be found in Björklund et al. (2019).

[11] The official Swedish statistics include capital gains in analyses of the income distribution. There are, however, various measurement problems and, as profits can vary greatly from year to year, a large proportion of the people at the top of the income distribution will be replaced each year. An analysis for the 2013 income year shows that about 40 percent of the persons at the absolute top of the income distribution (the one percent with the highest income) that year was not at the top of any of the six adjacent years. For these individuals, large capital gains were the main reason for the extra high income in 2013. Around 30 per cent were 'permanent' top income earners, which is to say they were at the top of at least four of the six adjacent years. For them, interest and dividends were the most important income from capital. The remaining 30 per cent belonged to top income earners in 2013 and one or more adjacent years. See the distribution policy report to the 2018 Spring Fiscal Policy Bill (Government Bill 2017/18:100).

disparities in those years. Since, more than others, it is those born abroad and employees in the service industries who have lost their jobs as a result of the coronavirus pandemic, this suggests the opposite effect will be seen for 2020. But perhaps the impact on the income distribution will, nevertheless, be rather small. Those who have lost their jobs had relatively low wages and the social security system gives them relatively good income protection. In addition, the number of unemployed has not increased as much as was feared.[12] However, the long-term effects of the pandemic may still affect both employers and workers. Long-term unemployment has risen and there is a risk that many who have lost their jobs will find it difficult to return to the labour market.

4 What does the distribution of wealth in Sweden look like and how has it changed?

Wealth evened out strongly when the wealthiest people's share of total assessed wealth fell sharply from the beginning of the 1900s to the beginning of the 1970s. This share then stayed relatively unchanged until 2006. If the wealth measure also includes private and public pension assets, the levelling out was even stronger.[13]

There is a lack of statistics on the wealth of individuals

Since the abolition of wealth tax in 2007, there are no longer comprehensive statistics on individuals' assets and liabilities, which means that, in principle, it is impossible to say how the distribution has changed since then.[14] Attempts to estimate developments up to 2012 indicate that the differences became greater in connection with the financial crisis in 2008–2009, but also that there appears to have been no significant trend increase in the proportion of total wealth owned by individuals in the upper part of the distribution. However, it seems that the wealth of individuals at the very extreme top of the distribution has increased more rapidly than the wealth of the rest of the population since the 2000s.[15]

[12] See also Appendix 2, Distribution policy account, 2021 Spring Fiscal Policy Bill (Government Bill 2020/21:100).

[13] Roine and Waldenström (2009) and Waldenström (2016).

[14] A government inquiry has recently initiated an analysis of how such statistics could be collected again, see ToR 2021:4, Statistik över hushållens tillgångar och skulder [Statistics on households' assets and liabilities].

[15] Lundberg and Waldenström (2018) and Waldenström (2020).

5 How does monetary policy affect the distribution of income and wealth?

In the long term, monetary policy has small distributional effects and does not control the general level of real interest rates

When discussing the effects of monetary policy on the income and wealth distribution, it is important to bear a couple of facts in mind:

- Over a longer period, which covers both economic downturns and upturns, the effects of monetary policy on income and wealth should largely offset one another.
- Real interest rates around the world have been falling for a couple of decades and are now at historically low levels.[16] This is probably an important explanation for why asset prices, seen in a slightly longer perspective, have risen and are currently high. This applies not least to housing prices. Long-term real interest rates are something that central banks need to relate to but cannot control, and as long as they are low, the policy rates will on average remain low, seen over an economic cycle.

The distributional effect of monetary policy works through different channels

When a central bank acts to change the level of interest rates in the economy, it affects the conditions for all economic agents. The effect spreads through the financial system and the economy and ultimately affects production, employment and inflation, which is the purpose of monetary policy. However, as households have savings of different sizes, own different assets and have different statuses on the labour market, monetary policy will also affect the distribution of income and wealth.

Effects of interest rate adjustments on the consumption and investment decisions of households and companies, together with the fact that individuals differ in several ways, create channels through which monetary policy affects the distribution of income and wealth. The different channels affect the distribution in different ways and it is not possible to know in advance how large the overall effect will be or even if it will be positive or negative.

The channels can be summarised as follows:[17]

- **Redistribution of savings.** Channel that goes via the net wealth of individuals. More expansionary monetary policy means that borrowers have lower interest expenditure, while savers receive lower interest income.

[16] See, for example, Lundvall (2020).

[17] This breakdown and description of the various channels through which monetary policy affects the distribution of income and wealth is taken from Colciago et al. (2019).

- **Unexpectedly high inflation.** Channel via individuals' ownership of nominal debts and cash. Unexpectedly high inflation is unfavourable to lenders and favours borrowers. It also poses problems in wage formation.
- **Exposure to interest rate adjustments.** Channel via individuals' ownership of financial assets. Lower real interest rates lead to higher prices for financial assets, which benefits those who own them. However, how much an individual is affected by interest rate changes depends on the duration of the individual's assets and liabilities.
- **Portfolio composition.** Channel via individuals' ownership of financial assets. When the interest rate is lowered, prices of financial assets increase, which affects individuals differently depending on the assets they own. Higher equity prices favour the richest, who own financial assets to a greater extent. This increases the differences in wealth (and income if realised capital gains are included). Higher housing prices mean that the value of fixed assets increases. This may contribute to larger or smaller differences in income and wealth, depending on the distribution of housing ownership.
- **Heterogeneity in earnings.** Channel via the position of individuals in the labour market. Earnings can be affected in different ways by changes in (hourly) wages and the number of hours worked. For example, those at the top of the distribution may be affected more by wage changes, while those at the bottom may be affected more by changes in hours and unemployment. To the extent that monetary policy affects these factors differently, it may have distributional effects.
- **Income composition.** Channel via individuals' income from various sources that may be influenced in different ways by monetary policy. The lowest income earners are more dependent on transfers, the individuals in the middle of the distribution mainly have labour income, while those at the top of the distribution have large capital incomes. When the interest rate is lowered, it stimulates activity in the economy, which contributes to higher wages and lower unemployment. This reduces income disparities in the lower part of the distribution. Lower interest rates also mean a fall in interest incomes, which can reduce income disparities at the top of the distribution too. However, higher asset prices contribute to higher capital gains.

6 How does the Riksbank's expansionary monetary policy affect the income of individuals?

An expansionary monetary policy affects the economy widely and through several different channels, the effects of which can partly counteract each other (see the previous question). This applies regardless of whether the Riksbank lowers its policy rate or purchases various assets. In both cases, the level of interest rates in the economy is pushed down.

Higher capital income and higher labour income

When interest rates are cut, interest incomes will be lower for households with interest-bearing assets or large bank savings. Lower interest rates normally also contribute to an increase in asset prices – this is part of their stimulating effect on the economy. Sellers of financial assets then make larger profits. Households in the upper part of the income distribution are more likely to own financial assets and it is less common for households in the lower part of the distribution to own their homes. Both factors therefore contribute to an increase in income disparities.

Low interest rates also affect individuals' interest expenditure, so that households with large loans at variable interest rates are favoured – a positive cash flow effect. Lower interest expenditure does not affect income differences, but it does affect different households' opportunities for consumption.[18] The effect on the distribution of consumption opportunities thus depends on the size of the loans taken by different groups of households.

The effects on capital income can be described as a direct distributional effect of monetary policy. There are also indirect effects, the most important of which is that low interest rates contribute to increased activity in the economy and to higher employment and lower unemployment. For the vast majority of households, income from work is the largest part of income, and this therefore has a major impact on the distribution of income. In Sweden, it is primarily the difference between incomes for those who have a full-time job and those who do not that is significant, rather than the wage differences between those who are in work.[19] Increased employment therefore contributes to reducing income disparities.[20]

7 How does the Riksbank's expansionary monetary policy affect the wealth of individuals?

How wealth changes largely depends on how the prices of different assets develop. Asset prices are affected by many different global and domestic factors, and interest rate developments are an important one of these. It is not only the interest rate in Sweden – which the Riksbank can influence – that matters, but also those in other countries. As lower interest rates normally contribute to an increase in asset prices,

[18] Debt interest is included in households' property income in the National Accounts, but not in the concept of income applied in income taxation.

[19] Wage disparities in Sweden are small from an international perspective and have remained relatively unchanged in Sweden in recent decades. However, they have increased slightly since 2011, mainly among women. See, for example, National Mediation Office (2021) and Appendix 2, Distribution policy account, 2021 Spring Fiscal Policy Bill (Government Bill 2020/21:100).

[20] It may worth noting that one of the changes to its strategy made by the US Federal Reserve in August 2020 is intended precisely to improve the conditions needed for vulnerable groups to get jobs (see, for example, Powell, 2020). Previously, the Fed formulated its strategy as being that monetary policy decisions should be guided by **deviations** from maximum employment. According to the new wording, decisions will in future be based on an assessment of the extent to which employment **falls short** of maximum employment. In practice, this means that low unemployment or high employment as such will not trigger monetary tightening, unless inflation picks up at the same time.

the wealth of the individuals who own the assets increases. It is mainly households at the top of the wealth distribution that own equities and similar financial assets. Rising equity prices therefore increase differences in wealth.

Real assets such as detached houses and tenant-owned apartments are more evenly distributed among households. However, there are relatively fewer homeowners at the bottom of the distribution. At the same time, there is a large group of people around the middle of the distribution who also own their homes. The wealth of this large group is thus also affected by higher housing prices and the net effect on the wealth distribution is therefore not obvious, especially not measured in terms of the Gini coefficient. However, there are results that indicate that the rising prices of tenant-owned apartments may have contributed to a more uneven distribution of wealth in Sweden after the global financial crisis of 2008–09.[21]

Higher wealth but collective pension savings mitigate the effects on the wealth distribution

However, it should not be forgotten that a large proportion of households' total wealth consists of collective pension savings in funds, for example in systems for occupational pension schemes and premium pensions.[22] This saving accounts for about a quarter of total wealth in Sweden. Moreover, households have pension assets linked to the general income-based pension, which are not in funds but are linked to the pension rights earned until retirement.[23] Consequently, whether or not you have a job plays a major role for the size of collective savings and the general income-based pension. It determines whether you receive an occupational pension and is also important for your income profile, which forms the basis for pension entitlements, over your working life. As monetary policy stimulates employment, it has, in itself, a levelling effect on the distribution of wealth.

8 Have the low interest rate and the Riksbank's purchases of assets increased or decreased disparities in income and wealth?

The short but honest answer to this question is that we do not know for sure. It is difficult to calculate exactly how much monetary policy affects the distribution of income and wealth. Monetary policy has a broad impact on the economy and there are several conflicting effects that need to be quantified. It is therefore no wonder that the results from the research that exists in this area are mixed. Some studies find that an expansionary monetary policy contributes to a more even distribution of income

[21] Lundberg and Waldenström (2018).

[22] See also Ohlsson (2021).

[23] See also Waldenström (2016).

and wealth, others find the opposite, and still others find that the effect on the distribution is close to zero.[24]

Difficult to assess the effects

One difficulty in calculating the distributional effects of monetary policy is determining a point of comparison. In practice, a comparison is made between how the distribution looks after a monetary policy measure and how it looked before. However, it would be preferable to compare the distribution after the measure has been taken with the distribution in the hypothetical situation in which the measure is **not** taken – not taking the measure may also have distributional effects. Another difficulty is determining what actually is an effect of monetary policy and what is instead an effect of changing external circumstances to which monetary policy, in turn, has reacted. The research attempts to separate these by analysing the distributional effects of changes in monetary policy that are unexpected, given how the central bank normally reacts to changing circumstances.

Empirical studies show no consensus

An overview by Colciago and others (2019) of the literature summarises the results of more than 30 empirical studies of the effects on the distribution of income and wealth of 'conventional' monetary policy (interest rate adjustments) and 'unconventional' monetary policy (such as asset purchases) in different countries and periods. The authors note that most studies include only a few channels through which monetary policy has distributional effects (see question 5). Several studies find that interest rate cuts reduce income disparities, as higher employment and wages benefit low-income groups to a relatively large extent. In contrast, other studies find that a more expansionary monetary policy increases income disparities by increasing capital incomes, which favours high-income earners.

The only study, as far as we know, that has been carried out on individual level data from Sweden finds support for the theory that it is indeed the effects on labour income at the bottom of the distribution and on capital income at the top of the distribution that are most important.[25] However, the study shows that it is difficult to determine the overall effect on the income distribution, partly because the results differ according to the distribution measure used.

With regard to the effects of unconventional monetary policy, Colciago and co-authors conclude that there is no consensus. Most studies focus on central banks' large asset purchases, which have two main but conflicting effects on the income distribution: higher employment reduces income disparities, but higher asset prices increase them. Some studies find that the effect of rising asset prices is dominant, others find that the employment effect is greater and a third group of studies finds that the overall effect is small. The authors also note that several studies find that central bank asset purchases have a relatively small distributional effect through the composition of

[24] See Colciago et al. (2019).

[25] Amberg et al. (2021).

individuals' holdings of assets. It is therefore not obvious that unconventional monetary policy affects the distribution more than conventional monetary policy through this channel. One explanation for this is that the effects via different asset prices counteract each other. Higher housing prices reduce wealth disparities, but higher equity and bond prices increase them.

One study that finds precisely such opposing effects is Dossche et al. (2021), who also summarise research into the distributional effects of monetary policy but with a particular focus on the euro area. They conclude that the ECB's asset purchase programme has reduced unemployment in the lower part of the income distribution, which has contributed to reducing income disparities. At the same time, the programme has caused asset prices to rise, but the overall effect on the distribution of wealth has nevertheless been small. Rising equity prices have increased the differences, but higher housing prices have also reduced the differences, as housing owners in the euro area are relatively evenly distributed among different income groups.

9 Does the Riksbank have the task of influencing the distribution of income and wealth?

It is important for the Riksbank to monitor how the distribution of income and wealth changes as it affects the functioning of the economy, which is significant for monetary policy. The Riksbank does not have an assigned task connected to distribution policy other than that of keeping prices stable, which does, in fact, include a distribution dimension. When the Riksbank announced its inflation targeting policy on 15 January 1993, the press release concluded with the following sentence: "Price stability creates good conditions for economic growth, high employment and counteracts an arbitrary distribution of income and wealth." Changes of inflation have distributional effects, as they affect the real value of assets and liabilities. Comparatively, however, this was of greater importance when inflation was high and varied greatly. At that time, there could be large redistributions between borrowers and lenders/savers from year to year and redistributions between groups with different possibilities of avoiding the negative effects of inflation.

The Riksbank should not pursue a distributional policy

The possibility of giving the Riksbank additional objectives in addition to price stability was discussed in the preparatory work for the current Sveriges Riksbank Act.[26] "Fair distribution" was mentioned as one of the traditional objectives of economic policy that the Riksbank should be obliged to support as an authority under the Riksdag. However, while monetary policy can affect price stability and, in the short term, also contribute to sustainable growth and full employment, the legislator noted that fair distribution is not an objective that is particularly well suited to monetary policy. The committee that presented a proposal for a new Sveriges Riksbank Act in 2019 also had

[26] See Chapter 7.3 of the status of the Riksbank (Government Bill 1997/98:40).

the task of discussing whether the Riksbank should take account of the distribution of income within the framework of monetary policy. The committee concluded that monetary policy has had relatively small distributional effects overall since the financial crisis. This, in the committee's view, is an advantage when monetary policy decisions are taken by civil servants who have not been elected and therefore, from a democratic point of view, should not be taking distribution policy decisions.[27]

10 What could happen if monetary policy tries to influence the distribution?

The results from international empirical research on the distributional effects of monetary policy are mixed. Furthermore, distributional policy is not normally an explicit task for central banks, but fits better into the framework of fiscal policy. The central bank contributes by keeping prices stable, mitigating fluctuations in economic activity and preventing financial crises that create deep economic slowdowns.[28] However, for the sake of argument, let us assume that an expansionary monetary policy contributes to a less even distribution of income and wealth. What would the consequences then be if the central bank were to conduct a less expansionary monetary policy than that justified by attaining the inflation target, in order to try to achieve a more even distribution?[29]

First, one central question is **how** a less expansionary monetary policy would contribute to a more even distribution. It could slow down asset prices, but at the price of higher unemployment. Although the overall final result could be a more even distribution, the situation would, in practice, be worse for groups that are already weak. Such a policy, which admittedly results in a more even **relative** distribution, but which, at the same time, makes vulnerable groups worse in **absolute** terms, would be difficult to justify.

One purpose of an expansionary monetary policy is to alleviate economic downturns that affect employment and result in lower inflation than is desirable. Regardless of the potential effects on the distribution in society, such a policy is better for practically everyone, compared with a monetary policy remaining passive in downturns.

The Riksbank could find it more difficult to attain the inflation target and counteract economic downturns

Any attempt to achieve a more even distribution would also risk overburdening monetary policy and might conflict with the objectives central banks already have, not least the objective of price stability. Following the financial crisis in 2008–2009, many central banks have had difficulty attaining their inflation targets. A tighter monetary policy with a view to achieving more even distribution would, in addition to reducing

[27] See Chapter 18.10 of A new Sveriges Riksbank Act (SOU 2019:46).

[28] See Carstens (2021).

[29] The question should be interpreted as applying to monetary policy in normal times. Most people probably agree that it is not a good idea to allow distribution aspects to govern monetary policy during crises such as the coronavirus pandemic.

employment, dampen inflation further and make it even more difficult to attain the inflation target. Why would this be a problem? Price stability is not just about avoiding high and varying inflation. The fact that the inflation target is upheld has a value in itself, since the objective is that the target should be a benchmark for price setting and wage formation – that it should be what is usually called a nominal anchor in the economy. However, it is also a prerequisite for monetary policy to continue to have room to counteract economic downturns and excessively low inflation by means of interest rate cuts.

The essential problem is that the general level of real interest rates in the world has fallen for structural reasons and is now historically low.[30] This means that all interest rates have fallen in parallel and are now, on average, at historically low levels. This also applies to central banks' policy rates, which need to be **very** low in order to have an expansionary effect. This is why the policy rates in many countries are currently at or close to their lower bounds. A key circumstance here is that the average **nominal** interest rate level is not just affected by how high the long-term real interest rate is but also by how high inflation is, on average. This, in turn, means that if inflation and inflation expectations were to fall and remain below the inflation target for a long time, the scope to cut interest rates would also become smaller. The policy rate would then sooner reach the bound beyond which it cannot be cut further.

Monetary policy works by influencing, **in the short term**, the real interest rates that govern our decisions on consumption and investments. If scope for cutting the policy rate is small and inflation and inflation expectations are very low on average, it will become more difficult to make monetary policy as expansionary – to make, in the short term, the real interest rate as low and sometimes as negative – as it would need to be in order to counteract economic recessions and excessively low inflation. Many of the proposed changes to the monetary policy framework currently under discussion and that have also been introduced in some countries, for example by the Federal Reserve, are aimed precisely at reducing the risk of such a development.[31]

[30] See, for example, Lundvall (2020).

[31] For example, see Clarida (2020).

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