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Inclusive Monetary Policy: How Tight Labor Markets Facilitate Broad-Based Employment Growth

Based on BFI Working Paper 2022-03, "Inclusive Monetary Policy: How Tight Labor Markets Facilitate Broad-Based Employment Growth," by Nittai K. Bergman, Tel Aviv University; David Matsa, Northwestern University; and Michael Weber, Chicago Booth

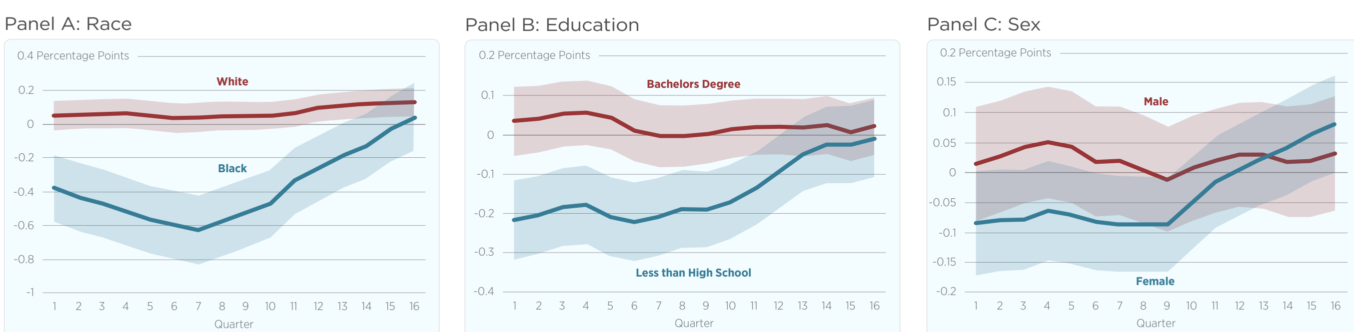
Expansionary monetary policy benefits the employment of workers with weak labor force attachment—Blacks, the least educated, and women—more in tight labor markets than in slack ones; this effect is economically sizeable and long lasting.

The Federal Reserve has recently emphasized the importance of understanding the labor market experiences of various communities when assessing its goal of maximum employment. Aggregate employment numbers, in other words, hide a lot of heterogeneity among groups, and the Fed has committed to addressing those differences.

However, there is little understanding of monetary policy's effects on different segments of the labor market. Does monetary policy, often described as a blunt instrument, impact different communities in different ways? If so, are there certain economic conditions under which the Fed can effectively target labor outcomes across different types of workers and demographic groups?

To address these and related questions, the authors of "Inclusive Monetary Policy: How Tight Labor Markets Facilitate Broad-Based Employment Growth," employed data from 895 local labor markets in the US between 1990 and 2019 to explore monetary policy's heterogeneous effects with respect to workers' race, education, and sex. Their key finding is that for demographic groups with low average labor market attachment—Blacks, the least educated, and women—monetary expansions have a larger effect on employment growth in tight labor markets. Importantly, this effect is economically large and persistent. For example:

Figure 1 • Impact of Monetary Policy on Employment Growth Over a One-Year Horizon
One-year horizon starts at different time periods following monetary policy rate change



Note: This figure depicts the temporal dynamics of the differential impact of monetary policy on employment growth in tight versus slack labor markets. The figure shows the impact of monetary policy over a one-year horizon starting in different quarters following the monetary policy rate change for different demographic groups within three categories: race (Panel A), education (Panel B), and sex (Panel C). For each quarter, beginning one quarter to 16 quarters out, the figure plots the coefficient on the interaction term between the federal funds rate and the local prime age employment-to-population ratio in equation (4). Shaded areas present one standard deviation confidence intervals.

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- A one standard deviation drop in the federal funds rate in tight labor markets increases subsequent two-year Black employment growth by 0.91 percentage points, women's employment by 0.39 percentage points, and 0.37 percentage points for workers who did not complete high school.
- This additional impact of monetary policy in tight labor markets is sizable, corresponding to 9% and 18% of the mean employment growth rates for Blacks and high school non-completers over the sample period, respectively.
- Monetary policy's incremental effects on less-attached workers' employment growth in tight labor markets holds over time, peaking 7 to 9 quarters after interest rates decrease. (See Figure.)
- Finally, these effects are muted or non-existent for groups with stronger labor market attachment. For example, the point estimate for White employment growth is less than one quarter of the estimate for Blacks and not statistically significant.

This work suggests that sustained expansionary monetary policy, which tightens labor markets, facilitates robust employment growth among less-attached workers. Further, the Federal Reserve's recent change in its conduct of monetary policy from strict to average inflation targeting should benefit the employment of female, minority, and low skilled workers. At the same time, policy tradeoffs exist, as expansionary monetary policy may increase inflationary pressure and foster wealth inequality by raising asset prices.

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