The distributional footprint of monetary policy

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Based on chapter 2 of the 2021 BIS Annual Economic Report
Central bankers are increasingly aware of inequality

Share of speeches mentioning inequality
Outline of the talk

- Rising inequality and its structural determinants
- Central banks’ mandates and income inequality
- Inequality and the transmission of monetary policy
- The backstops against inequality
- Conclusions
Rising inequality: a bird’s eye view
Income and wealth inequality have been on the rise...

Pre-tax, pre-transfer Gini index and top 10% share of income

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AEs: Gini index (lhs)  
EMEs: Top 10% share of income (rhs)

Wealth Gini index

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AEs: FR US IN CN RU ZA
EMEs: FR US IN CN RU ZA
...especially to the benefit of the very rich

Breakdown of changes in the top 10% share of income

Breakdown of changes in the top 10% share of wealth
Central banks’ mandates and inequality
Taming inflation is associated with lower inequality

The conquest of inflation and subsequent income Gini variation

- Gini index, cumulative change

AEs: Median across events
Interquartile range

EMEs:

- Median across non-events
Recessions exacerbate inequality through unemployment

Gini income inequality and unemployment around recessions

Cumulative change in:  
- Gini (lhs)  
- Unemployment rate (rhs)
Financial recessions are particularly severe

Recessions preceded by financial imbalances are longer and deeper

Unemployment index

Quarters around beginning of recessions

- Normal recession
- Recession preceded by high debt service ratio
Inequality and the transmission of monetary policy
Inequality exacerbates business cycle fluctuations...

Recessions in more unequal countries lead to larger declines in consumption.
...reduces the effectiveness of monetary policy...

Cumulative consumption growth after an expansionary MP shock

Percentile of income inequality distribution across 20 AEs:
- 10th (low inequality)
- 25th
- 50th
- 75th
- 90th (high inequality)
...and call for low rates with offsetting effects on wealth distribution

Evolution of equity and house prices

Household wealth composition

Wealth inequality

Lhs: Stock prices  Rhs: House prices

Top 10% (lhs):

Top 1% (rhs):

France  Germany  United States
The backstops against inequality
Fiscal policy is a powerful remedy against inequality

Pre- and post-tax and transfers income inequality

Gini index in:
- Red: pre-tax, pre-transfer income
- Blue: Post-tax, post-transfer income
Different fiscal policy tools can shape different parts of the income distribution.

Evolution of tax rate progressivity and public transfers

Higher tax progressivity comes with lower inequality at the top...

...while higher transfers come with lower inequality at the bottom.
Conclusions

• Monetary policy cannot address structural inequality over the long term

• But can mitigate the amplification of inequality over business cycles

• Inequality affects the transmission of monetary policy and complicates its conduct

• Holistic framework that combines monetary, fiscal and macro-prudential policies is needed