MONETARY POLICY AND INCOME INEQUALITY IN THE EURO AREA

New research by **Anna Samarina** and **Anh Nguyen** suggests that expansionary monetary policy by the European Central Bank (ECB) may reduce income inequality in the euro area by stimulating economic activity, employment and wages.

Their study, to be presented at the annual congress of the European Economic Association in Manchester in August 2019, finds that this equalising effect may be mitigated by a rise in asset prices and returns. The periphery countries of the euro area benefit more than the core ones from the distributional effects of loose monetary policy.

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Income and wealth inequality have been on the rise in most OECD countries in recent decades. Piketty (2014) notes that this is largely due to income growth being increasingly linked to capital returns rather than to wages and entrepreneurship. Against this background, the distributional effects of monetary policy have been of increasing concern among policy-makers.

This study contributes to the debate by examining how monetary policy affects the Gini coefficient of gross income inequality in 10 euro area countries during the period 1999-2014 through macroeconomic and financial channels.

The findings show that monetary policy has a significant effect on income inequality: an expansionary monetary policy shock reduces the Gini coefficient in the short run. In economic terms, the impact is small: a negative monetary policy shock of 100 basis points reduces the Gini coefficient by -1.01 (with the average Gini coefficient across the sample of 47.8). To put the numbers into perspective, the average change in the Gini coefficient in the sample between 1999 and 2014 amounted to 9.1% or 4.35 in original units.

The macroeconomic channel contributes to the inequality-reducing effect of monetary policy. Monetary easing lowers income inequality by raising wages and employment. This channel arises from the general equilibrium effects of monetary policy. A policy rate cut stimulates output, job creation, and wage growth. This benefits low- and middle-income households that rely on labour earnings as their main income source.

In addition, higher employment benefits households at the bottom of the income distribution as their earnings are mainly affected by being employed or by changing the number of hours worked.

The contribution of the financial channel is less clear. There is some indication that higher stock prices and returns weaken the inequality-reducing effect of monetary easing. Lower interest rates boost asset prices and capital returns. This increases income inequality by making top earners better off as they hold most financial assets.

This is supported by data showing that up to 90% of income from financial investments benefits high-income households in the euro area.

The euro area periphery countries benefit more than the core ones from the distributional effects of loose monetary policy. Income inequality in the periphery decreases strongly after monetary expansion, while in the core group the effect is negligible. Most core economies are characterised by lower Gini coefficients compared with the periphery ones, which could explain why the distributional effects of monetary policy in the core group are limited.

Conclusion

This study contributes to policy discussions about the distributional effects of (un)conventional monetary policy. The authors show that although monetary policy may have an effect on income distribution in the euro area, its economic size is small and evident only in the short run.

In this respect, other policies and economic forces could be responsible for the rise in inequality in recent years, such as fiscal austerity measures, skill-biased technological change, globalisation, financial development and a decline in a labour share, among others.

ENDS

Anna Samarina and Anh Nguyen (2019) ‘Does monetary policy affect income inequality in the euro area?’, DNB Working Paper No. 626, de Nederlandsche Bank.

Reference: Thomas Piketty (2014) Capital in the 21st Century, Harvard University Press.

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