

THE IMPACT OF MONETARY POLICY ON INEQUALITY: Evidence from quantitative easing in the euro area

Quantitative easing (QE) did not increase income and wealth inequality in the euro area, according to research by **Michele Lenza** and **Jiri Slacalek**, to be presented at the annual congress of the European Economic Association in Manchester in August 2019. Indeed, they find, QE substantially reduced the unemployment rate, with stronger effects for those in the lower part of the income distribution. These results indicate that monetary policy helped to support vulnerable households during the last financial crisis.

In recent years, there has been considerable public debate about the effects of monetary policy on household inequality. Some commentators argue that unconventional monetary policy has increased inequality and made the rich richer, as it boosts asset prices and financial wealth. Others point out that a long period of low interest rates reduces the income of savers holding interest-bearing assets, while benefiting younger households who are net borrowers.

But when it comes to household inequality, monetary policy not only affects financial variables, such as the return to savings and the value of assets, but also employment, wages and incomes. These effects vary from household to household, depending on both the kind of financial assets owned, if any, and also – importantly – on the employment status of the adults in the household.

This research examines how the Eurosystem's quantitative easing (QE) through the asset purchase programme (APP) has affected income and wealth inequality. Regarding the effect on income, the authors find that the APP substantially reduces the unemployment rate, with stronger effects in the lower part of the income distribution.

Indeed, the aggregate decline in the unemployment rate by about 0.7 percentage point four quarters after the occurrence of the APP shock affects individuals very differently. It mainly benefits households in the lowest 20% of the income distribution, whose unemployment rate falls by more than two percentage points.

By contrast, the unemployment rate in the rest of the income distribution falls by less than 0.5 percentage points. This different impact on the unemployment rate across parts of the income distribution is the main channel behind the moderate *decrease* in income inequality due to QE in the euro area.

As for the effects on the wealth distribution, the study estimates that QE modestly increases household net wealth across the wealth distribution: the median net wealth among households in the lowest net wealth quintile increases by 2.5%, while in the other quintiles, it rises by around 1%.

House prices play a key role in these changes, as housing makes up about 70-80% of total household assets in the euro area and this share is roughly the same across the wealth distribution. In addition, the effect on stock prices appears to be small and temporary. Overall, the APP only produces quantitatively negligible effects on net wealth inequality.

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In more detail, the work combines estimates from aggregate and household-level data. First, it estimates the macroeconomic outcomes of an aggregate APP 'shock' (a sudden increase in the purchase of assets) for France, Germany, Italy and Spain. In a second stage, it distributes these estimated effects across individual households using information on their assets and income from the Eurosystem Household Finance and Consumption Survey.

The researchers study the effects of an APP shock represented by an 'exogenous' drop in the term spread – the difference between the long-term and short-term interest rates – via its effect on the long-term interest rate (as the short-term rate remained at its lower bound).

Specifically, the shock is assumed to reduce the term spread by 30 basis points on impact. The macroeconomic effects on GDP, inflation, wages, unemployment and asset prices are estimated using a multi-country vector auto-regressive model (VAR). The model includes three categories of asset prices: house prices, stock prices and interest rates (which determine bond prices). Then, the aggregate effects are fed into a micro-simulation model, which estimates the effects of QE on the income and wealth of individual households.

Two channels take centre stage when examining the impact of the APP shock on household income. First, some individuals become employed, generally experiencing a substantial increase in their income as a result. The probability of this depends on their demographics (such as their age, education, marital status and the number of children they have).

Second, the wages of all employed individuals increase (by the amount estimated in the VAR model). In addition, the researchers estimate the impact on wealth, assuming that households do not buy or sell assets because of the APP shock. So the change in household wealth is purely a result of the changes in the value of these assets (real estate, stocks, bonds) due to the APP's effects on asset prices.

The labour market impact of the APP reduces income inequality. Changes in unemployment rates substantially affect household income: incomes increase considerably as households start earning wages (instead of receiving unemployment benefits). Mean income in the lowest income quintile rises by about 3%, while mean income in other parts of the distribution increases by about 0.5%.

The reduction in the unemployment rate has a large impact on the bottom 20% of the income distribution and accounts for most of the total effect on income throughout the distribution (except for the top 20%). Overall, the APP shock described above improves the Gini coefficient (a common measure of inequality) from 43.1% to 42.9%.

In conclusion, an APP shock in the euro area decreases income inequality. It also decreases wealth inequality, though to a negligible extent. Notice however, that monetary policy has only a temporary impact on the economy, so it is likely that in the long run, the effect on the Gini coefficient would fade away.

This suggests that in the long run, other factors, such as globalisation or how particular tax systems redistribute income and wealth (for example, via the progressivity of taxation), are more important drivers of inequality than monetary policy. At the same

time, the results do indicate that monetary policy helped to support vulnerable households during the last financial and economic crisis.

ENDS

'How Does Monetary Policy Affect Income and Wealth Inequality? Evidence from the Euro Area'

Michele Lenza, European Central Bank and ECARES–ULB

Jiri Slacalek, European Central Bank (jiri.slacalek@ecb.int)

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References

Lenza, M. and Slacalek, J. (2018), 'How does monetary policy affect income and wealth inequality? Evidence from quantitative easing in the euro area', *Working Paper Series*, No 2190, ECB, Frankfurt am Main, October.
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