

Comments on “Should Inequality Factor into Central Banks' Decisions?”

Cyn-Young Park, *Ph.D.*
Asian Development Bank

1. Paper

- This paper investigates how inequality matters for the conduct of monetary policy within a tractable Two-Agent New Keynesian model.
 - Focus on how the initial level of consumption inequality matters for the optimal monetary
- Policy response to a technology shock: how does inequality affect desirable monetary policy in a stylized economy subject to technology shocks
- This paper finds that a central bank should place a non-zero weight on observed consumption inequality and labor share under optimal policy

Contributions to the existing literature

- (1) The paper investigates how inequality in the **steady state** affects optimal and rules-based monetary policy
- (2) It builds on Bilbiie, 2008 and Debortoli and Gali, 2018, which considers transitory inequality over business cycle.
- (3) The paper further departs from these in two important dimensions:
 - Consider a reduced form of technological bias in wages to match the responses of consumption of different agents to productivity shocks in the U.S.; and
 - Assume that both wages and prices are rigid.

Findings point to:

- CB should place a non-zero weight on stabilizing consumption inequality and the labor income share, beyond the usual objectives of stabilizing inflation and output gap.s
- While the optimal weight on consumption inequality under the optimal policy is relatively small, the optimal weight on the labor income share rises with the degree of inequality in steady state.
- Augmented Taylor rule: CB can achieve higher welfare if it places a small negative weight on consumption inequality: i.e. following a positive TFP shock that increases consumption inequality, the central bank should reduce the policy rate.

2. Model Assumptions

- (1) Earnings Heterogeneity Channel: Ricardian (with access to financial markets) vs. Keynesian (wage income only)
- (2) Income Composition Channel: Income composition varies across households and the respective income component responds to a productivity shock in heterogeneous ways
- (3) Supply Side Features: monopolistic competition among intermediate goods producers and a single representative firm that combines differentiated intermediate goods into a final consumption good
- (4) Nominal rigidities in both the goods and labor markets
- (5) Fiscal Policy: i) lump sum transfers imposed to finance subsidies to intermediate goods producers to undo monopolistic distortions; and ii) redistribution policies among households based on dividend taxes.

2.1. Monetary Policy and Income Inequality

- (1) Earnings Heterogeneity Channel: Monetary policy exerts heterogeneous impacts on the determinants of household earnings: hourly wages, hours worked, and the unemployment rate.
- (2) Income Composition Channel: Income composition varies across households and the respective income component responds to a monetary policy shock in heterogeneous ways.
- (3) Savings Redistribution Channel: An expansionary monetary policy shock which lowers the real interest rate would benefit borrowers and hurt savers.

2.2. Monetary Policy and Wealth Inequality

- (1) Unexpected Inflation Channel (Inflation Tax Channel): Unexpected inflation leads to a decline in real values of nominal assets and liabilities, and so redistributing wealth from lenders to borrowers.
- (2) Interest Rate Exposure Channel (Portfolio Channel): Net savers with long-duration assets and net debtors with relatively short-duration liabilities would benefit most from expansionary monetary policy.
- (3) Financial Segmentation Channel: Expansionary monetary policy shock tends to aggravate wealth inequality if wealthier households are more connected to stock and bond markets.
- (4) Unconventional Monetary Policies and Wealth Inequality: Evidence mixed

2.3. Income and Wealth Inequality in Korea (Hahm, Lee, and Park, 2022)

- (1) Studies show income inequality in Korea deteriorated in the years before the global financial crisis but improved after.
- (2) Some find that a contractionary monetary policy shock aggravates income inequality with a lag, and labor income plays a more important role for low-income households.
- (3) The real housing price and unemployment rate are positively associated with the measure of income inequality.
- (4) Contribution of real estate assets in total net wealth inequality is significantly high in Korea

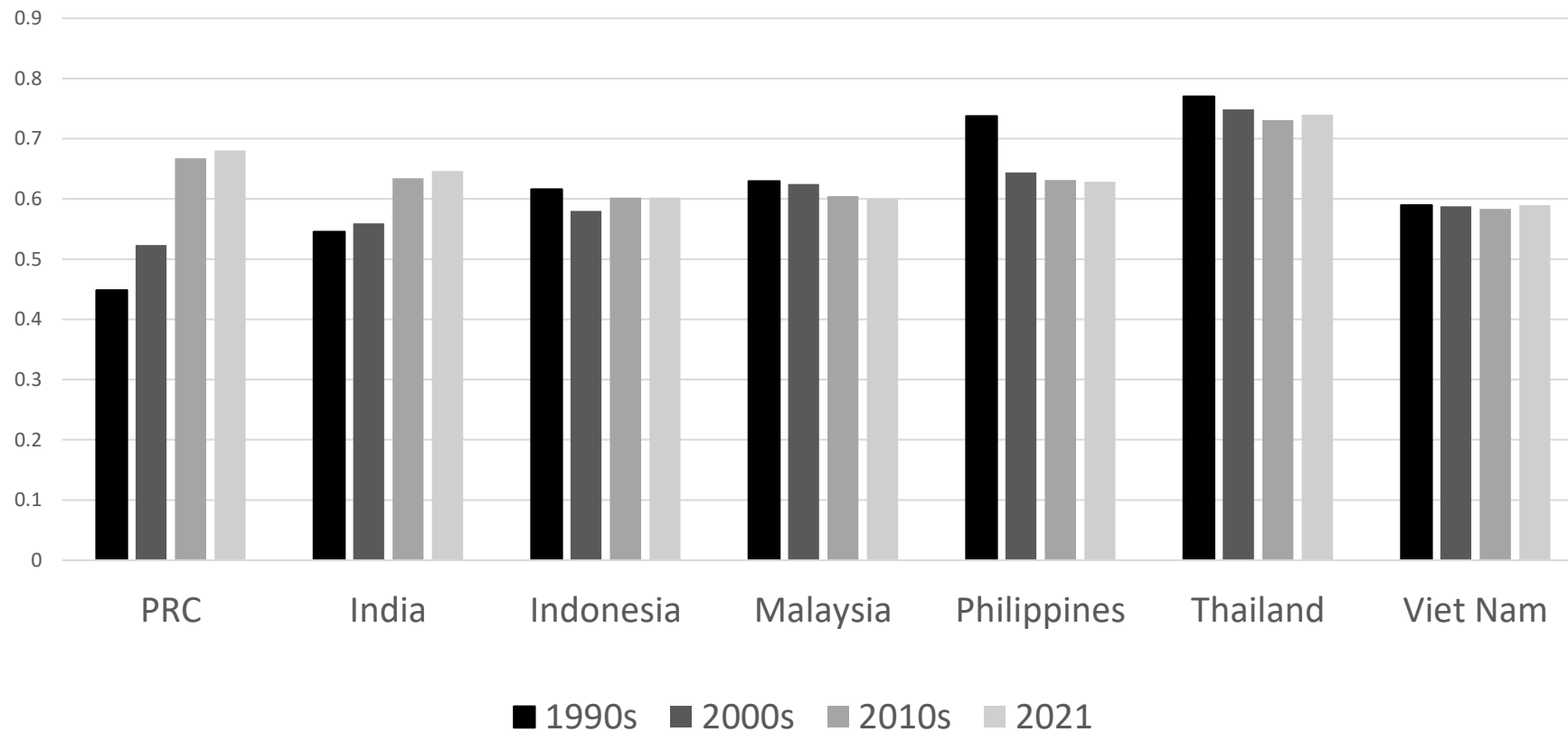
2.4a. Income and Wealth Inequality in ASEAN (Mercado, Park, and Zhuang, 2023)

Table 1: Gini coefficients and quintile ratios of per capita household consumption expenditure

	Decade average Gini coefficient					Decade average quintile ratio				
	1980s	1990s	2000s	2010s	+ or -	1980s	1990s	2000s	2010s	+ or -
Indonesia	31.5	32	32.7	38.8	+	4.7	4.7	4.9	6.6	+
Malaysia	47.3	48.4	45.6	42.1	-	10.9	11.9	10.6	8.6	-
Philippines	40.9	44.2	42.2	40.1	-	7.4	8.8	8	7.2	-
Thailand	44.5	44	41.3	37.2	-	8.9	8.5	7.7	6.3	-
Vietnam	..	35.6	36.3	36.1	+	..	5.6	6	6.4	+
China, People's Republic of	28.2	35.4	42	40.6	+	4.3	5.9	8.6	8.1	+
India	32.3	31.7	34.9	35.7	+	4.8	4.6	5.2	5.5	+

2.4b. Income and Wealth Inequality in ASEAN

Figure 1: Net personal wealth share of the top 10%



3. POLICY IMPLICATIONS

- Should inequality factor into central banks' decisions?
- An expansionary domestic monetary policy shock tends to reduce income inequality, but it has no significant effect on net wealth inequality.
- Augmenting Taylor rule with either an inequality target or a labor share target can lead to higher welfare.
- For EMEs, both domestic and external monetary policy shocks exert significant countercyclical effects on income inequality. But the wealth inequality effects of domestic and external monetary policy shocks can be very different; potentially offsetting each other's effect.