

Accepted Manuscript

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PII: S0261-5606(17)30227-9

DOI: <https://doi.org/10.1016/j.jimonfin.2017.11.004>

Reference: JIMF 1856

To appear in: *Journal of International Money and Finance*



Please cite this article as: D. Furceri, P. Loungani, A. Zdzienicka, The Effects of Monetary Policy Shocks on Inequality, *Journal of International Money and Finance* (2017), doi: <https://doi.org/10.1016/j.jimonfin.2017.11.004>

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The Effects of Monetary Policy Shocks on Inequality

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May 2017

Abstract

This paper provides new evidence of the effect of conventional monetary policy shocks on income inequality. We construct a measure of unanticipated changes in policy rates—changes in short-term interest rates that are orthogonal to unexpected changes in growth and inflation news—for a panel of 32 advanced and emerging market countries over the period 1990-2013. Our main finding is that contractionary monetary policy shocks increase income inequality, on average. The effect is asymmetric—tightening of policy raises inequality more than easing lowers it—and depends on the state of the business cycle. We find some evidence that the effect increases with the share of labor income and is mitigated by redistribution policies. Finally, while an unexpected increase in policy rates increases inequality, changes in policy rates driven by an increase in growth and inflation are associated with lower inequality.

JEL Classification Numbers: E62, E64, D63.

Keywords: monetary policy; monetary policy shocks; income inequality.

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