**On the Distributional Effects of Conventional Monetary Policy and Forward Guidance**

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**Motivation**

- Core topic in macroeconomics: the relationship between monetary policy and economic inequality
- Set of central bank tools increased in scope and complexity. Two key ones:
  - Conventional monetary policy (CMP): changes in current policy rate
  - Forward guidance (FG): information about future path of policy rate
- Still little known about the effects of unconventional tools on households

**This paper**

- Study the macroeconomic and distributional impact of FG compared to CMP, with a particular focus on the consumption inequality between households

**Empirics I: Aggregate effects**

- **Data and approach**
  - Measure of consumption dispersion: U.S. household-level survey data from the Consumer Expenditure Survey (CEX)
  - Baseline measure: cross-sectional standard deviation of real consumption
  - Disentangle the effects of monetary policy by isolating surprise changes in the federal funds rate and in forward guidance announcements (Swanson, 2021)
  - Quarterly structural VAR model for 1991Q3-2019Q2 (Cholesky decomposition)
    - Variables: Policy surprises, inequality measure, macrofinancial variables

- Estimation of the macroeconomic impact of CMP and FG announcements
  - Find similar and significant effects on the aggregate economy
  - A contractionary monetary shock of either type leads to
    - a persistent decrease in real activity and a gradual fall in prices
    - tighter financial conditions

**Empirics II: Distributional effects**

- Estimate the heterogeneous impact on total household consumption inequality
  - Immediate countercyclical (left) or procyclical (right) cumulative response
    - Responses on impact are around the same size as the peak impact on output

- Zoom into the heterogeneity across consumption percentiles

- Different sensitivity at the two tails of the consumption distribution
  - CMP: Low consumption households reduce spending significantly more \( \Rightarrow \) inequality ↑
  - FG: High consumption households decrease spending considerably \( \Rightarrow \) inequality ↓

**Empirics III: Transfers as explanatory factor**

- **Idea**: Policy rate ↑, interest payments on government debt & borrowing costs ↑
  - Fiscal adjustment ↓, transfers to HHs ↓, consumption (inequality) ↑, ↓

- Significant differences for both total fiscal transfers (top) and average transfer income of households at the left tail of the consumption distribution (bottom)
  - CMP: Bottom 10% contributes considerably to the negative response of total transfers
  - FG: Lowest-consumption households almost unresponsive

**Model**

- **Tractable DSGE model** with household heterogeneity and nominal rigidities (TANK)
  - Goal: Rationalize empirical evidence & illustrate mechanism through fiscal policy
  - Agents: Households, firms, government, monetary authority
  - Two household types, heterogeneous in access to financial markets
    - **Savers**: smooth consumption, save in bonds, earn labor and dividend income, get transfers
    - **Hand-to-mouth**: own no assets, consume total labor income plus transfers

- Key element for households’ consumption response: tax and transfer scheme
  - (1) Redistribution of (countercyclical) firm profits from richer to poorer households
    - Higher profit share of hand-to-mouth agents \( \Rightarrow \) consumption inequality ↓
  - (2) Lump-sum transfers to both household types. Example for hand-to-mouth:
    - Fiscal channel: Larger debt implies a cut in transfers \( \Rightarrow \) consumption inequality ↑
    - Automatic stabilizer: Lower GDP entails more transfers \( \Rightarrow \) consumption inequality ↓

- **Study increase in real interest rate** today (CMP) or eight periods from now (FG)

- Replicated evidence on heterogeneous response of consumption inequality

- **Adjustments in fiscal policy** after shocks determine cyclical behavior of inequality
  - Timing of real interest rate change matters for government debt burden
  - Redistribution through transfers stabilizes fluctuations in hand-to-mouth’s income

**Policy implications**

- **Fiscal-monetary policy coordination shapes heterogeneous effects of conventional and unconventional policy tools**
  - Key role of fiscal response to demand shocks for cyclical austerity of inequality
  - Targeted redistribution can reduce (consumption) inequality
  - Inequality matters for the transmission of monetary policy