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The Impact of Monetary Policy on Inequality in the UK. An Empirical Analysis*

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Abstract

The UK has experienced a dramatic increase in earnings and income inequality over the past four decades. We use detailed micro level information to construct quarterly historical measures of inequality from 1969 to 2012. We investigate whether monetary policy shocks played a role in explaining this increase in inequality. We find that contractionary monetary policy shocks lead to an increase in earnings, income and consumption inequality and contribute to their fluctuation. The response of income and consumption at different quantiles suggests that contractionary policy has a larger negative effect on low income households and those that consume the least when compared to those at the top of the distribution. Our evidence also suggests that the policy of quantitative easing may have contributed to the increase in inequality over the Great Recession.

Keywords: Inequality, Earnings, Income, SVAR, Monetary Policy Shocks

JEL No. E2, E3, E4, E5

1 Introduction

The latest financial and sovereign crises left Western economies with rising levels of inequality. A number of studies (e.g. Belfield, Cribb, Hood and Joyce, 2014; Blundell and Etheridge, 2010; Brewer and Wren-Lewis, 2012) present evidence of rising income inequality for the UK up to 2007-8. According to Belfield et al. (2014) the Gini coefficient for UK households' disposable income has increased over the last 45 years from 0.25 in 1967 to 0.36 in 2007-8. Similar trends appear for net labour earnings where the Gini increased from 0.32 in 1968 to 0.35 in 2008 (Brewer and Wren-Lewis, 2012).

A growing area of research is trying to explain the rising trend and to identify the contributing factors. Skill based education and technological advances, changes in the family structure, employment status and occupation, structural reforms in the labour market, globalisation and increased international trade have all contributed to wage and income inequality (see for example Card, 2001;

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