STIESIA
ICOBUSS
e-ISSN 2746-5667
2nd INTERNATIONAL CONFERENCE ON BUSINESS & SOCIAL SCIENCES
Digital Transformation Business Strategy in Post Covid-19

MONETARY POLICY TRANSMISSION AND INEQUALITY UNDER PERMANENT PRODUCTIVITY SHOCKS

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Abstract: The research investigates how monetary policy influences income inequality under permanent productivity shocks. This study is part of an extensive investigation to determine which monetary policy may be used to alleviate inequality, particularly in Indonesia. Using a Dynamic Stochastic General Equilibrium (DSGE) model, based on calibration, the study found transmission of inequality from monetary policy through interest rate instruments. When there is a monetary policy shock, heterogeneity in the household will respond differently, especially in real wages, consumption, and working hours. The impulse response function (IRF) describes that expansionary monetary policy will affect aggregate consumption levels, output, and inflation. Changes in aggregate consumption rates simultaneously illustrate changes in production costs and affect incentives to work and move the Gini index. In principle, inequality will impact the efficacy of monetary policy in the long run. Monetary policy shocks have a lower impact since they influence only a small proportion of agents. In conclusion, monetary authorities can consider inequality as an explicit aim of monetary policy without abandoning its primary goal of price stability.

Keywords: Monetary Policy, Inflation, Inequality, DSGE, Indonesia

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