Intergenerational Redistribution through Monetary Policy*

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Abstract

How important are intergenerational heterogeneity and an aging population for the design of systematic monetary policy? We answer this question using a New-Keynesian business cycle model with overlapping generations of households. Our model features rich heterogeneity; households differ not only in their stage in the life-cycle, but also in the amount and allocation of wealth and in the size of non-financial income. Monetary policy generates redistribution of income and wealth in the model. Since retirees tend to hold larger (positive) amounts of financial assets and especially bonds, a rise in the interest rate induced by monetary policy increases their income. At the same time, working-age households tend to suffer because of falling wages and higher borrowing costs. The resulting wealth effects lead to a rise in aggregate labor supply, altering the monetary transmission channel compared to an representative agent economy. After showing that intergenerational redistribution of income and wealth can be significant when monetary policy strongly reacts to a severe recession, we study the design of implementable monetary policy in comparison to the complete market and representative agent benchmarks.

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