Households' Income and Heterogeneous Consumption Response to Monetary Policy Shocks*

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Abstract

This paper quantifies the effects of income heterogeneity on the response of consumption to monetary policy shocks using US household data. First, the paper shows empirically that the consumption response to expansionary monetary policy shocks is larger for high income than low income households. This result cannot be explained by standard Aiyagari-Bewley-Huggett type heterogeneous agent models, where low income households have a higher marginal propensity to consume due to borrowing constraints. Empirical facts related to household characteristics indicate two potential channels: heterogeneous income source and illiquid assets. Second, the paper employs a heterogeneous agent model to quantify the relative importance of the two channels. The results of the model indicate that illiquid assets are essential for explaining the heterogeneous consumption response and reflect the findings of the empirical analysis.

JEL Classification: E21, E52
Keywords: consumption, household income, monetary policy, liquidity.

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