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THE DISTRIBUTIVE EFFECTS OF MONETARY POLICY IN BRAZIL: THE ROLE OF EXCHANGE RATE DYNAMICS

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While monetary policy is most commonly assessed in terms of its effects on inflation and economic activity, it may also have important consequences for the functional distribution of income. This paper investigates the distributive effects of monetary policy in Brazil, focusing on the interaction between interest rates, exchange-rate dynamics, and the wage share. The Brazilian case is especially relevant because, as in many emerging market economies, the exchange rate is a central channel of monetary policy transmission and is strongly conditioned by international financial conditions.

The paper, therefore, asks whether a contractionary monetary policy shock has a uniform effect on the wage share, or whether this effect varies with the behavior of the exchange rate. The analysis is based on the post-Keynesian framework in which interest rates and exchange rates are both distributive variables. Through the economic-activity channel, a contractionary monetary stance may reduce the wage share by weakening aggregate demand, slowing

output growth, and diminishing workers' bargaining power. At the same time, monetary policy may affect distribution through the exchange-rate channel. Exchange-rate movements influence firms' competitiveness, pricing behavior, desired mark-ups, inflation dynamics, and real wages. An interest-rate increase may lead to a currency appreciation under stable external conditions, potentially easing imported-cost pressures and supporting real wages. Under adverse international financial conditions, however, the same increase in interest rates may fail to stabilize the exchange rate or may even coincide with depreciation, higher inflationary pressures, and a decline in the wage share. The distributive effects of monetary policy are therefore theoretically ambiguous and may depend on the prevailing exchange-rate regime.

To examine this question empirically, the paper estimates the response of the wage share to an interest-rate shock in Brazil using monthly data from 2000 to 2021. The empirical strategy relies on local projections to estimate impulse-response functions over a twelve-month horizon. Local projections are preferred to standard vector autoregressions because they are better suited to shorter time series, require fewer lag restrictions, and allow nonlinearities to be incorporated more flexibly. In the baseline specification, the effect of an interest-rate shock is allowed to vary between low- and high-exchange-rate-volatility regimes, with volatility serving as a proxy for the international financial conditions that shape exchange-rate behavior.

The preliminary results suggest that the distributive impact of monetary policy in Brazil is indeed regime-dependent. In periods of low exchange-rate volatility, a contractionary monetary shock is associated with exchange-rate appreciation and a gradual increase in the wage share over the projection horizon. In contrast, during periods of high exchange-rate volatility, the same shock is associated with exchange-rate depreciation and a decline in the wage share. These results indicate that the exchange-rate channel does not merely mediate the distributive effects of monetary policy; it may also reverse them, depending on the external financial environment.

Palavras-chave: monetary policy; functional income distribution; exchange-rate volatility.