

## **Income Inequality, Heterogenous Sentiments, and the Dynamics of Aggregate Income**

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### **Abstract**

The effect of income inequality on aggregate fluctuations is widely researched in the economics literature. This study aims to explore this effect through the channel of heterogenous sentiment formation of households. To this end, we build a stock-flow-consistent system dynamics model in which consumer sentiment is endogenously determined as a function of the growth rate of income and its volatility. Consumer sentiment affects the consumption, saving, and borrowing decisions of households. There are two types of households in the economy: workers, who receive wage income, and entrepreneurs who receive profit income. We assume that workers and entrepreneurs are different in sentiment formation as they attribute different weights to income growth and stability. The wage rate is exogenous to the model, and along with the share of workers, it determines the level of income inequality in the economy. We simulate the model for different wage rates and present the Dynamics of aggregate income for different levels of income inequality.

**Keywords:** Income inequality, stock-flow-consistent framework, system dynamics

**JEL Codes:** E32, E37, B59