

How Should Monetary Policy Respond to Housing Inflation?

Bianchi, McKay, and Mehrotra

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¹The views expressed are those of the presenter and not necessarily those of the Bank of England, the MPC, the FPC or PRC.

Monetary Policy and Housing Inflation

Classic Question

- How should monetary policy respond to housing market activity?
- Pre GFC: should policy *lean* again house price gains, or *clean* afterwards?
- Post GFC: *ex-ante* macroprudential policy first line of defense against housing

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This paper: how should monetary policy respond to *shelter* inflation?

- Shelter has a $\approx 17\%$ weight in US PCE inflation (Fed's Target)
- Shelter inflation accounts for a large share of recent inflation surge
- Shelter inflation responds with a lag

Overall and Shelter Inflation in US

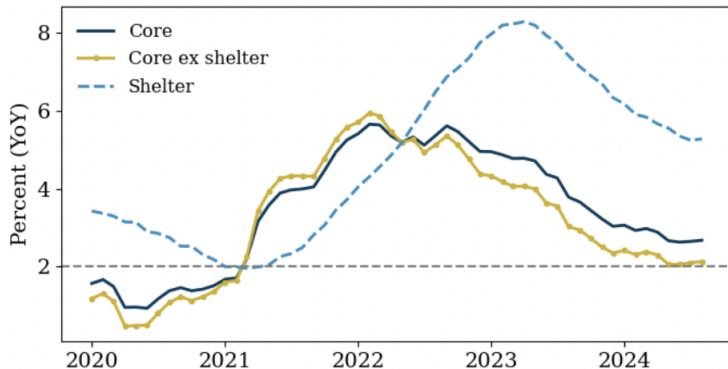


Figure 1: US PCE inflation

Summary of Findings

Classic Multi-Sector NK Model:

- In short-run, output is demand determined
- Stabilize prices in sectors with rigid prices and inelastic supply
- Inelasticity of housing supply $\implies$ target shelter inflation

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This paper:

- Assumption of demand-determined output inappropriate for housing
- Alternative: **demand rationing** when demand exceeds supply
- Static model: supply determined output $\implies$ optimal policy: ignore shelter inflation
- Dynamic model with housing search $\implies$ optimal policy $\approx$ ignore shelter inflation
- Policy has limited impact on housing consumption (flat housing welfare curve) $\implies$ ignore it

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- Great paper tackling an import & timely policy question
- Novel analysis overturns conventional NK findings
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Discussion:

- Positive vs Negative Demand Shock
- Response of rental supply to policy
- Responses of mortgagors to policy
- All point to asymmetry of effects?

Positive vs Negative Housing Demand Shock

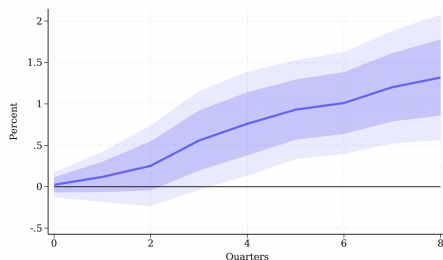
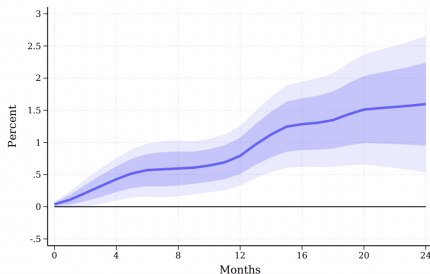
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Positive vs Negative Housing Demand Shock

- Static model: output can be demand or supply-determined
- Dynamic model: positive housing demand shock & fixed housing supply
- What happens for a **negative demand shock**?
 - Sticky rental price above clearing $\implies$ demand determined region?
 - Does policy then have power over housing consumption?
 - Back to multi-Sector NK Model & shelter (dis)inflation affecting policy?
- Is there a fundamental asymmetry? Analogous to clean vs lean?

Response of Rental Market to Monetary Policy

Abramson, Llanos and Han (2026)



- Impact of 25 bp shock to 30 year mortgage rate on
 - Nominal rents (LHS)
 - Renter-occupied housing (RHS)

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- Then contractionary policy $\implies$ rental quantities and prices up
- **Alternative rationale:** don't target shelter inflation as contractionary policy increases rents!
- Same conclusion, though different mechanism
- Impact of rates on rents may be stronger for contractionary policy
- $\implies$ Further rationale for asymmetry policy response?

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- Lock in also creates path dependency: (Berger et al AER 2021)
- Suggestion: make δ a function of gap between outstanding and current rates
- May give different rationale for not leaning against shelter inflation:
 - Policy *can* move housing consumption, but harmful, with long-term impact
 - Again, suggestive of asymmetric approach to shelter inflation

Summary

- Thought-provoking paper tackling important policy question
- Clear challenge to policy prescription from a standard model
- Alternative mechanisms suggest policy can affect rental market
 - $\Rightarrow$ May reach same conclusion for different reasons
- Is the policy recommendation fundamentally asymmetric?