The Daily Dish

The Fed and Housing

DOUGLAS HOLTZ-EAKIN | NOVEMBER 8, 2022

Eakinomics has been flagging the importance of shelter inflation for nearly a year. In January, year-over-year shelter inflation was 4.4 percent. In the September Consumer Price Index (CPI), it was 6.6 percent; in between there has been month after month of uninterrupted rise. It is even truer now than it was in January that it is awfully hard to hit an overall inflation target of 2 percent when one-third of the CPI is rising at such a high rate.

It also remains true that the Fed's anti-inflation strategy is destined to have a disproportionate impact on the housing sector. Not only do interest-rate hikes increase the cost of residential and commercial mortgages, the process of shrinking the balance sheet ("quantitative tightening," or QT) means pulling up to $35 billion of mortgage capital out of the market. That's a big swing from injecting $30 billion monthly in 2020 and 2021 and is tantamount to even higher rates on mortgage finance.

In short, the Fed has to deal with shelter price inflation and its procedures will deal with shelter inflation.

That doesn't mean everybody likes it. As detailed in Politico this past Friday: "The housing slump is the economy's biggest casualty so far from a series of Federal Reserve rate hikes designed to tame inflation."

"Groups representing builders, realtors and lenders are urging Congress and the White House to intervene to spur more home construction and boost affordability. It's an increasingly urgent plea, with mortgage demand down more than 40 percent from a year ago and rates topping 7 percent for the first time in two decades."