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# Mortgages, Monetary Policy, and the Great Inflation of 2021–?[*]

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**Abstract**

After decades of low and stable inflation in the United States (and beyond), 2021 inaugurated a surge of rapid price growth not experienced since the early 1980s. Initially viewed by many as a transitory phenomenon that would recede on its own, inflation has surprised by proving remarkably durable, prompting both a shift in public sentiment and the policy stance of the Federal Reserve. Starting in late 2021, the Federal Reserve began engaging in forward guidance by aggressively signaling future monetary tightening, which immediately drove up mortgage rates and curtailed credit supply for housing.

This paper undertakes several tasks. First, it evaluates the aggregate and redistributive consequences of the Great Inflation of 2021 and 2022 via labor, housing, and mortgage markets. The sluggishness of wage adjustment led to a decline in real purchasing power, which hurt renters and owners alike. At the same time, existing homeowners have benefited from the erosion of the real value of their outstanding mortgage debt via high inflation. In contrast, prospective homeowners have had to contend with rising mortgage rates, forcing many to purchase a smaller home than previously desired or pricing them out of the owner-occupied market entirely, thus driving up rent pressures. The dramatic rise in mortgage rates also constrains the existing housing supply as current owners are reluctant to sell, given that doing so means they will have to give up their current ultra-low mortgage rate that they locked in before the rapid rise in inflation.

[*]The views expressed are those of the authors and not necessarily of the Federal Reserve Bank of St. Louis or the Federal Reserve System.

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These forces directly affect the consumption, portfolio choice, and housing behavior of different market participants, which are further compounded by the ramifications of equilibrium adjustments in house prices and rents. This paper quantifies these forces and examines the sensitivity of the housing market response to these forces under different initial conditions (for example, under the pre-2021 conditions of most borrowers having locked in ultra low rates vs. in the 2000s when adjustable rate loans were prevalent).

**Keywords:** Housing; Inflation; Mortgage Debt; Sticky Wages

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