

Does the Fed Pay Too Much Attention to Rents?*

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Abstract

Yes. While rent alone accounts for less than 4% of the basket of the Fed's preferred price index, adding rent attributed to homeowners increases the share of the basket tied to rent to nearly one-sixth. The combined weight in the more widely-followed CPI is one-third. I argue that rents do not adequately capture shelter inflation for homeowners and that the market structure of housing may make rent inflation a poor target for monetary policy. Other central banks target indexes with far less weight on shelter. The Fed should consider doing the same.

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1 Introduction

This paper concerns the role of rent of shelter in the objective of monetary policy. The Federal Reserve’s preferred inflation gauge is the price index for personal consumption expenditure (PCE). While rent alone accounts for less than 4% of the PCE basket, adding rent attributed to homeowners increases the share of the basket tied to rent to nearly one-sixth. I argue that rents do not adequately capture shelter inflation costs for homeowners and that the market structure of housing makes shelter inflation a poor target for monetary policy. Simply put, the Fed pays too much attention to rent.

The paper proceeds as follows. Section 2 begins by explaining the measurement of shelter inflation in the United States and its weight in the PCE price index. It then turns to international comparisons and shows that other major central banks put far less weight on rent inflation. Section 3 steps back and asks how a cost-of-living price index should capture shelter costs of owner-occupied housing. It shows that rents diverge sharply from the actual cost of owning and describes an alternative index proposed in [Chodorow-Reich et al. \(2026\)](#). Section 4 discusses two implications for monetary policy. First, the [Chodorow-Reich et al. \(2026\)](#) measure puts much less weight on rents. Instead, it links the cost of owning to elements familiar to homeowners but omitted from the CPI, such as mortgage rates and house prices. While the inclusion of the mortgage rate creates a direct feedback from monetary policy rates into inflation, the Fed could simply target a price index that excludes this component, similar to the standard practice of looking through cost-push shocks. Second, the inelastic nature of housing supply limits the welfare costs of excessive tightness in the housing market.

Before turning to these arguments, an important caveat concerning implementation. The Fed’s credibility would suffer from changing its preferred inflation gauge while inflation remains above its target. This point applies to any discussion of changes to the gauge or target. Closely related, retirees receiving indexed social security benefits, unions and firms with negotiated cost-of-living adjustments in wage contracts, inflation swap market participants, and others with financial contracts linked to the Consumer Price Index (CPI) all require ample notice before any change in methodology.

2 Background and International Comparisons

This section provides background on the measurement of shelter inflation in the United States and around the world.¹

2.1 Shelter Inflation in the United States

Shelter inflation refers to the change in the cost of occupying a home.² Occupancy may occur either by renting or owning. The Bureau of Labor Statistics (BLS) measures changes in the cost of renting using the CPI Housing Survey, which is a rotating panel survey of rental properties that collects rent information from sampled units every six months.³ Reported rents are adjusted for certain quality changes (e.g., a new bathroom) and unit aging. Vacant units receive an imputed rent equal to the last observed rent multiplied by average gross inflation of newly occupied units. Monthly inflation of rent of primary residences equals the sixth root of the six-month change in total rent or imputed rent of the sampled units. Therefore, rent inflation reflects both continued and new leases, albeit with a short lag due to the six-month sampling interval.

Measuring the cost of occupying an owned home involves additional complications. The BLS uses a concept referred to as owners' equivalent rent (the Bureau of Economic Analysis (BEA) refers to this concept as imputed-rental of owner-occupied housing), which aims to assign to each owner-occupied property the value that the property would command if rented on the open market.⁴ The conceptual rationale for owners' equivalent rent will be discussed and critiqued in the next section. The practical application involves reweighting each unit in the CPI Housing Survey to make the sample reflect the stock of owned rather than rented housing. Monthly owners' equivalent rent inflation is the sixth root of the six-month change in the reweighted rents. Therefore, owners' equivalent rent inflation is based on simply reweighting the rental properties

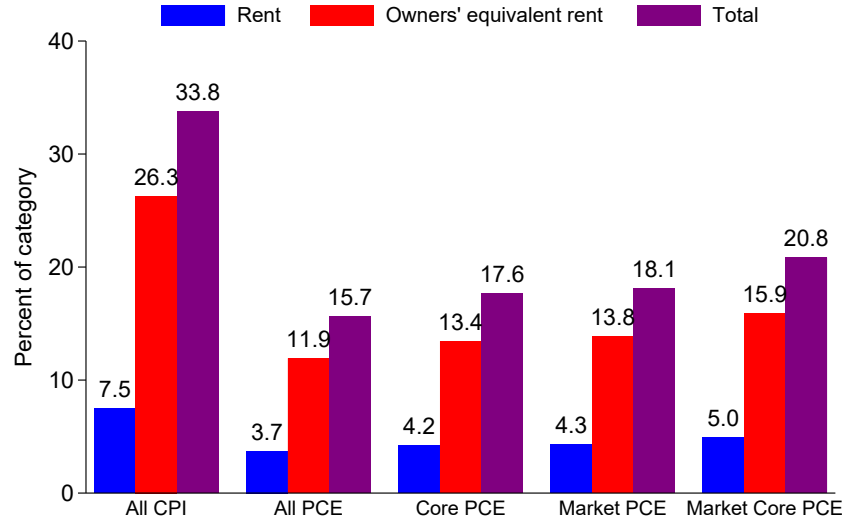
¹The text of this section draws from Chodorow-Reich and Mehrotra (2026).

²The CPI defines the category "Shelter Inflation" to include rent of primary residence, lodging away from home, owners' equivalent rent of primary and secondary residences, and tenants' and household insurance. The PCE defines the category "Housing" to include rental value of tenant-occupied housing, imputed-rental of owner-occupied housing, and group housing.

³See <https://www.bls.gov/cpi/factsheets/owners-equivalent-rent-and-rent.htm> for a description of current practice.

⁴See <https://www.bls.gov/cpi/factsheets/owners-equivalent-rent-and-rent.htm> for a description of current practice and Chodorow-Reich et al. (2026) for a history of the treatment of owner-occupied housing in the CPI.

Figure 1: Shelter Weight in Selected U.S. Price Indexes



The figure reports the 2024 index weights on rent of primary residence (CPI) or rental of tenant-occupied nonfarm housing (PCE) and owners' equivalent rent of residences (CPI) or imputed rental of owner-occupied nonfarm housing (PCE) in various indexes.

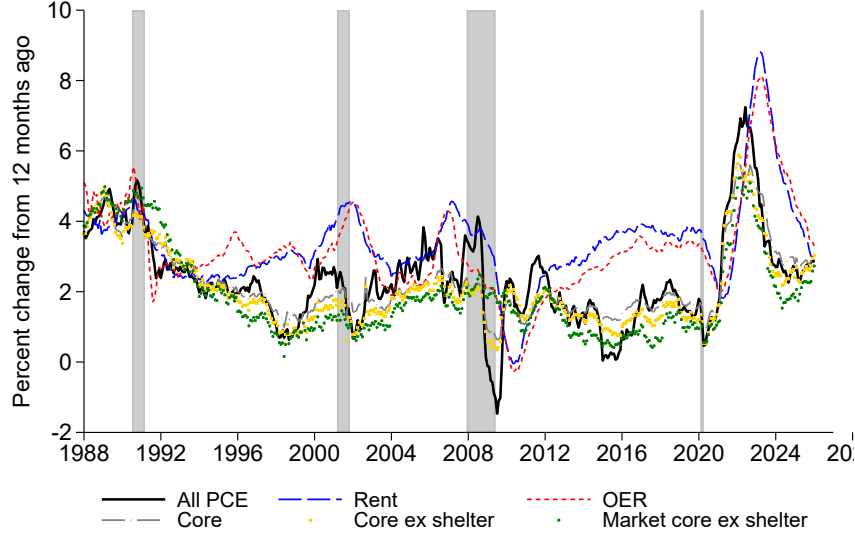
used to compute inflation in tenants' rent.

The substantial weight on shelter components in the CPI and PCE makes their behavior influential in overall inflation, and especially so in prominent sub-components followed by Federal Reserve policy makers such as core or market-based core PCE. Figure 1 reports the weights assigned to rent and owners' equivalent rent in various price indexes. The expenditure weights in the CPI for tenant and owners' equivalent rent come from the Consumer Expenditure Survey (CEX).⁵ The CPI allocates 7.5% of the expenditure weight to rent and 26.3% to owners' equivalent rent, yielding more than one-third of the overall index tied to the behavior of rent. The PCE price index expenditure weight for renters comes from multiplying average rent paid with the number of tenant-occupied units in the American Housing Survey. The expenditure weight for owners comes from applying hedonic regression coefficients (for structure type, number of rooms, number of bedrooms, and structure age) estimated in rental units to the characteristics of owner-occupied units along with an additional owner premium.⁶ The overall PCE gives 4% of weight to rent and 12% to owners' equivalent rent. For market-based core PCE, these weights rise to 5% and 16%

⁵The tenant rent weight comes from the question: "What was your total rental payment for this month for this unit?" The owners' equivalent rent weight comes from the question: "If someone were to rent your home today, how much do you think it would rent for monthly, unfurnished and without utilities?"

⁶See <https://www.bea.gov/resources/methodologies/nipa-handbook/pdf/chapter-05.pdf>.

Figure 2: PCE and Shelter Inflation



respectively, tying more than one-fifth of the basket to rent growth.

Figure 2 shows 12-month inflation in the total PCE, rent, owners’ equivalent rent, PCE excluding food and energy (“core”), core PCE excluding shelter, and market-based core PCE excluding shelter. If rent tracked non-shelter PCE, whether the Federal Reserve paid attention to rent or not would not matter. In practice, the series differ substantially at both low and high frequencies. Shelter inflation has generally exceeded non-shelter inflation, but with large differences at important points of the business cycle. For example, in 2024 12-month inflation in core excluding shelter averaged 2.4%, while 12-month core inflation averaged 2.9%.

2.2 International Comparisons

The U.S. differs from most other countries in including such a large weight on rent in the price index targeted by the central bank. At the opposite extreme, the euro area assigns zero weight to owner-occupiers, leaving only 6% of the index tied to rent, although the ECB has discussed adding imputed rent. The United Kingdom produces a price index (“CPIH”) that includes owners’ equivalent rent, but the Bank of England explicitly targets an index that does not include this category (“CPI”), leaving a weight on rent of 8%. The Bank of Canada’s preferred index includes a substantial weight of 19% on owner-occupiers, but measures inflation for this category using a weighted average of mortgage interest, depreciation, property taxes, insurance, maintenance, and

Table 1: Shelter in Price Indexes Around the World

Index	Rent concept	Weight	Owners concept	Weight
U.S. CPI	Rent of primary residence, new and existing leases	7.5%	Implicit rent that owner occupants would have to pay if they were renting their homes	26.3%
U.S. PCE*	Rent of primary residence	3.7%	Implicit rent	11.9%
Euro Area*	Rent of primary residence	5.9%	NA	0%
Canada*	Rent of primary residence	7.6%	Mortgage interest, depreciation, property taxes, insurance, maintenance, real estate commissions	18.8%
UK CPI*	Rent of primary residence	7.8%	NA	0%
UK CPIH	Rent of primary residence	6.3%	Implicit rent	16.5%
Japan*	Rent of primary residence	18.3%	Implicit rent	15.8%
Brazil IPCA*	Rent	3.6%	NA	0%

Note: * indicates monetary policy target.

commissions, not imputed rent. Of the major advanced country central banks, only the Bank of Japan aligns with the Federal Reserve in targeting a price index with such a large weight on rent.

3 What is the Cost-of-Living of Shelter?

The most recent *Consumer Price Index Manual* of the United Nations calls the treatment of owner-occupied housing “one of the most difficult issues faced by CPI compilers” ([International Monetary Fund et al., 2020](#), p. 245). The Manual endorses four approaches in use internationally, illustrated by the diversity in Table 1. The absence of convergence in recommendation or practice stands out in the architecture of economic statistics, reflecting a gap in economic theory of how to fit a durable good such as housing into the traditionally static derivation of the consumer price index. This section explores in depth the rationale for measuring shelter costs for owners using owners’ equivalent rent, the problems with that treatment, and possible alternative measures.

3.1 What Does it Cost to Own?

To understand why the correct measure of the cost of owning may differ from rent, start with the monthly mortgage payment. The typical home purchase in the U.S. is financed with a 30-year fixed

Table 2: Mortgage Payment in 2019 and 2024

	2019	2024
House price	\$300,000	\$460,000
Loan balance at origination	\$240,000	\$368,000
Mortgage rate	3.9%	6.7%
Monthly payment	\$1,132	\$2,375

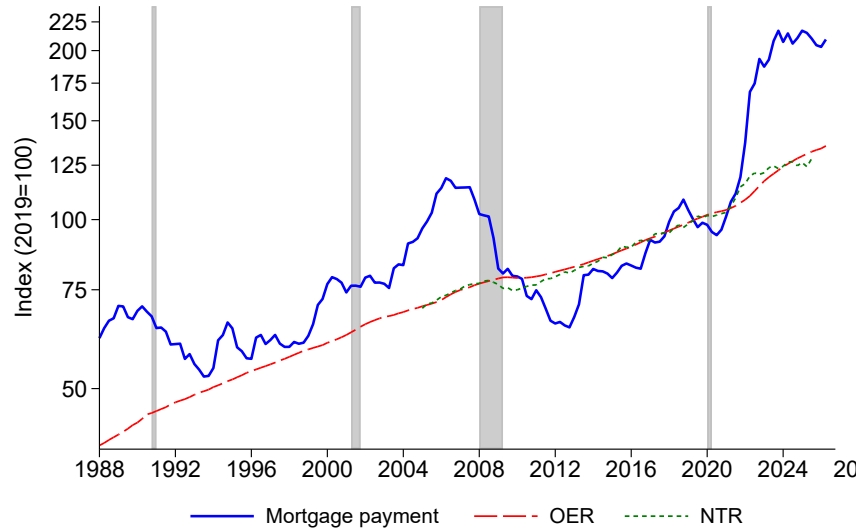
rate mortgage, with a down payment of 20%. Table 2 shows the monthly payment for a typical home for a mortgage originated in 2019 or 2024. A typical home in 2019 cost about \$300,000. Using the S&P Cotality Case-Shiller repeat-sales house price index, the same home cost about \$460,000 in 2024, a more than 50% increase over the course of the pandemic-era house price surge. The Freddie Mac 30 year mortgage rate averaged 3.9% in 2019. In 2024, after the monetary policy tightening cycle from 2022-2023, that rate had increased to 6.7%. Combining these inputs, the monthly payment on this home more than doubled, from about \$1132 to \$2375.

Figure 3 shows how this monthly payment has evolved over the past 40 years, compared to owners' equivalent rent as well as new tenant rent. For ease of comparison, the series are indexed to equal 100 in 2019. The figure illustrates that the sharp increase in the monthly payment in 2019-2024 was not matched by a commensurate increase in rent, whether measured using the official OER or the rent paid by new tenants, which arguably might be a closer conceptual match for the own/rent decision faced by a mover. Furthermore, there are several other periods with sharp divergences between the monthly payment and rent.

Of course, the cost of owning consists of more than just the monthly mortgage payment. Most prominently, owners may also expect a capital gain (or loss) on the value of their home. Unfortunately, nationally-representative survey expectations of home price appreciation do not even extend as far back as the housing crash of 2007-12. Figure 4 plots the home price expectations series from the Federal Reserve Bank of New York Survey of Consumer Expectations, which starts in 2013. The data do not show expectations offsetting the increase in mortgage rates and house prices. If anything, including expectations magnifies the difference with rent, as house price expectations fell in 2023, just as mortgage rates rose.

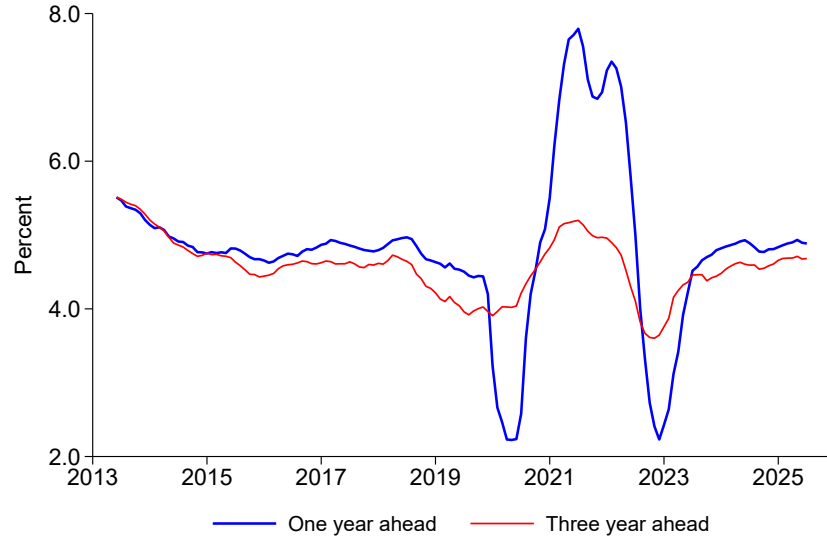
The user cost of housing provides a way to rigorously combine the time series of house prices, mortgage rates, and expectations to come up with a cost of owning for one period when people can

Figure 3: Mortgage Payment and OER



Notes: The solid blue line shows the payment on a new 30 year fixed rate mortgage for a house of constant quality, indexed to equal 100 in 2019. The mortgage rate is from Freddie Mac (FRED code MORTGAGE30US). The repeat-sales house price index is from S&P Cotality Case-Shiller (FRED code CSUSHPISA). The dashed red line shows owners' equivalent rent (FRED code CUSR0000SEHC).

Figure 4: House Price Expectations



Notes: The figure reports six-month moving averages of the one and three-year ahead median house price expectations among respondents of the Federal Reserve Bank of New York Survey of Consumer Expectations.

frictionlessly buy and sell. In this framework, the cost of owning consists of the down payment at the start of the period, plus the mortgage payment, maintenance, insurance, and property taxes, less the expected discounted proceeds from selling the property at the end of the period and paying off the remaining mortgage balance. [Gillingham \(1983\)](#) estimated this series for the U.S. and

noted striking differences with the behavior of rent, mirroring the calculations in Figures 3 and 4. Verbrugge (2008) updated and extended this calculation to use *ex ante* house price expectations and Chodorow-Reich et al. (2026) further extend the calculation through 2025. All find that the one-period user cost has very different medium and high frequency behavior from the cost of renting.

3.2 The Argument for OER, and its Discontents

Why then does the U.S. measure inflation for homeowners using rents? The intellectual case for using owners' equivalent rent rests on two faulty premises. The first premise is an arbitrage condition; if people can consumer shelter services either by renting or owning and face no frictions to changing their tenure choice or residence, then the costs of renting and owning must equate. Formally, let R_t denote the cost of rent and U_t the user cost of owning. If $R_t > U_t$, then no one would want to rent, while if $U_t < R_t$ no one would own. An interior homeownership rate thus implies $R_t = U_t$.

Unfortunately, the arbitrage condition fails both empirically and theoretically. Empirically, the time series divergence of the user cost and rents found in Gillingham (1983); Verbrugge (2008); Chodorow-Reich et al. (2026) demonstrates that $R_t \neq U_t$. This dichotomy holds whether using average rent paid by all renters or rent paid by new tenants. Theoretically, the real world obviously contains mobility frictions — search costs, real estate commissions, moving costs, and the like. As a result, more than 80% of renters and more than 95% of owners remain in their same residence for more than a year. That is, almost no one actually rents or owns for a single unit of time. These frictions mean that there is no single user cost that applies to all owners. More subtly, Chodorow-Reich et al. (2026) also provide direct evidence that households do not view owning and renting as equivalent ways to consume shelter. Instead, their survey respondents point to non-pecuniary differences such as freedom to customize the house, disutility from having an intrusive landlord, and neighborhood characteristics associated with owner-occupied homes as reasons to prefer owning to renting, holding fixed the pecuniary outlay. If households vary in this non-pecuniary component, then the pecuniary costs of owning and renting will vary with the identity of the marginal homeowner.⁷

⁷One can rescue the theoretical notion of a single allocative user cost despite infrequent mobility if a represen-

Table 3: Owner-occupied Housing in the NIPA

Table	Line	Description	2019 value	2024 value
			USD billions	
Table 2.4.5.	52	PCE: Imputed rental of owner-occupied housing	1665	2374
Equals: Table 7.4.5.	3	Housing sector output: owner-occupied	1665	2374
Less: Table 7.4.5.		Intermediate inputs: owner-occupied	222	279
Equals: Table 7.4.5.	9	Gross housing value-added: owner-occupied	1443	2095
Less: Table 7.5.	19	Consumption of fixed capital: owner-occupied	429	630
Equals:		Net housing value-added: owner-occupied	1014	1466
Less: Table 7.11.	10	Net interest: owner-occupied	394	592
Less:		Taxes less subsidies + current transfer payments	185	238
Equals: Table 7.9.	9	Rental income of persons: owner-occupied housing	526	842

The second premise is a desire to separate the cost of consumption of shelter from the consequences of asset ownership that come with owning a home. Thus, the System of National Accounts recommends and the BEA has adopted the fictitious splitting of a homeowner into simultaneous landlord and renter, with the imputed rental income included in personal income and rent paid included in personal consumption expenditure. Table 3 shows these lines in the national accounts and the values in 2019 and in 2024. Having redefined homeownership as serving as one's own landlord, it follows naturally to deflate the rental component using a rental price index.

The formulation of homeownership as equivalent to renting to oneself is theoretically elegant and internally consistent. Nonetheless, it faces major problems as the basis for a cost-of-living index. For one, most homeowners would find themselves surprised and likely confused by this accounting. As a group, their consumption of housing services rose by \$709 billion from 2019 to 2024. Their imputed rental income rose by less than half that change, \$316 billion, with the remainder absorbed by higher expenses on intermediate inputs, depreciation, mortgage interest, and property taxes. Homeowners easily recognize these expenses, but not the imputed rental

tative share of the population considers the rent/own trade-off at any point in time, as that share can still force the rent-own arbitrage condition to hold. With population heterogeneity and endogenous mobility choice, this simplification also fails.

income. Furthermore, this accounting omits elements of the standard user cost such as expected house price appreciation. More deeply, once one recognizes owning and renting as distinct activities providing different non-pecuniary service flows, the division into landlord and renter no longer makes even theoretical sense.

3.3 An Alternative Measure of Shelter Inflation

If neither rent nor the user cost adequately reflect the cost of shelter, what might? The answer requires returning to the economic theory of a cost-of-living index.

In the textbook case of a static expenditure problem, a consumer purchases from a set of goods with prices denoted $\mathbf{p}_t = (p_{1,t}, p_{2,t}, \dots)$. The consumer's expenditure function, denoted $e(\mathbf{p}_t; u^*)$, characterizes the minimum expenditure the consumer requires to achieve a utility level u^* , given the prices $\mathbf{p}_t$. Gross cost-of-living inflation across two dates, $\Pi_{t,t+1}$, equals the growth of the expenditure required to achieve a given utility level as prices change: $\Pi_{t,t+1} = e(\mathbf{p}_{t+1}; u^*) / e(\mathbf{p}_t; u^*)$. Furthermore, Shephard's lemma relates changes in the expenditure function to changes in primitive prices and the Hicksian demands: $\partial e(\mathbf{p}_t; u^*) / \partial p_{i,t} = h_i(\mathbf{p}_t; u^*)$, where $h_i(\mathbf{p}_t; u^*)$ is the Hicksian demand that gives the quantity of good i purchased given prices $\mathbf{p}_t$ and utility u^* .

The durability of housing and, especially, the mobility frictions and multi-period mortgage contracts discussed above, complicate the textbook case where each good has an observable price $p_{i,t}$ that applies at each date. For example, the expenditure outlay of a homeowner in 2026 who bought in 2021 depends on the house price and mortgage rate in 2021 and differs from the outlay of a 2025 homebuyer or a new purchaser in 2026. Nonetheless, the change in aggregate expenditure required to keep utility fixed remains well-defined. [Chodorow-Reich et al. \(2026\)](#) build on this insight to propose an alternative measure of shelter inflation.

The [Chodorow-Reich et al. \(2026\)](#) measure annuitizes the change in lifetime expenditure on housing when primitive costs such as rent, house prices, or mortgage rates unexpectedly change. The first order approximation of this procedure gives rise to a set of fixed sensitivities of shelter inflation to changes in the primitive costs. These sensitivities are the dynamic analogs of the Hicksian demands in the static version of Shephard's lemma, equal to the change in lifetime shelter expenditure when each primitive price changes.⁸ They play a role similar to expenditure weights,

⁸In the dynamic context of housing, the equivalence between the allocative and cost-of-living prices of owning

Table 4: Shelter Inflation Component Sensitivities

	Real Rent (%)	Real House Price (%)	Nominal Mortgage Rate (p.p.)	Non-shelter Inflation (p.p.)
Inflation Sensitivity	0.332	0.273	3.804	-4.372
Annuitized de-trended news				
2020	0.734	6.002	-0.028	-0.058
2021	-2.832	7.930	0.105	0.179
2022	-0.672	-3.526	0.521	0.394
2023	2.472	1.369	0.548	-0.011
2024	0.808	2.100	0.392	0.043

but do not sum to one because the primitive costs enter non-linearly into shelter expenditure. Chodorow-Reich et al. (2026) obtain the sensitivity weights from a model of tenure choice, but note that they could also be estimated from a long panel of data on owning and renting. Given these weights, a statistical agency need only measure each period the revision in the present value of each primitive price.

Table 4, adapted from Chodorow-Reich et al. (2026), shows how this process can work. It considers four primitive components of the cost of shelter: rent, house prices, mortgage rates, and non-shelter inflation. The last matters because non-shelter inflation erodes the value of nominal mortgage debt. The table reports the “sensitivity” of shelter inflation today to a permanent change in each component, along with the annuitized present value change in each year from 2020-2024. The product of the sensitivities and changes gives the contribution to shelter inflation.

3.4 Why This Time is Different

The Chodorow-Reich et al. (2026) measure resembles the pre-1983 “asset approach” of the CPI. Table 5 summarizes the pre-1983 treatment. The asset approach had three main components (see e.g. Gillingham, 1983): home purchase (1982 CPI weight: 9.9%), mortgage cost (1982 CPI weight: 9.8%), and rent (1982 CPI weight: 5.2%).⁹ These components closely resemble the first three

breaks. In this circumstance, a price index must choose between the (possibly shadow) allocative price and the full cost-of-living adjustment. This choice echoes a debate between using average and new tenant rent when rental contracts are long-term (Adams et al., 2023). The BLS CPI practice of using average rent accords with a focus on cost-of-living rather than allocative prices.

⁹The pre-1983 shelter index also included property taxes, homeowner insurance charges, and maintenance and repair costs. See <https://www.bls.gov/cpi/additional-resources/treatment-owner-occupied-housing.htm> for the CPI weights.

Table 5: Comparison with “Asset Approach”

Concept	BLS Pre-1983 “Asset Approach”	Chodorow-Reich et al. (2026)
Panel A: expenditure base		
Home purchase	Value of home purchases less sales plus transaction costs	Similar
Mortgage interest costs	Total interest promised during first half of the mortgage loan term	Steady state mortgage payments
Rent	Actual rent paid	Similar
Panel B: price measure		
Home purchase	Monthly change in FHA sales in fixed cells	Annuitized change in repeat-sales house price index plus expectations
Mortgage interest costs	Monthly house price change plus mortgage rate change	Annuitized change in present value of mortgage costs using yield curve information
Rent	CPI Housing Survey	Same plus annuitized expectations
Non-shelter inflation	N.A.	Cleveland Fed

primitive components in [Chodorow-Reich et al. \(2026\)](#).

The switch from the asset approach to owners’ equivalent rent followed decades of consideration and debate inside and outside BLS. What has changed to makes the outcome of this debate different now? Three considerations.

First, as already discussed, the time series divergence between the user cost and rents in the decades since the switch, along with direct evidence that households do not view renting and owning as providing equivalent consumption services, undermine the conceptual case for owners’ equivalent rent.

Second, the asset approach lacked a theoretical basis. This absence leads to important differences with the implementation in [Chodorow-Reich et al. \(2026\)](#). Most notably, the asset approach did not incorporate expectations. It could therefore be too sensitive to transitory changes in house prices or mortgage rates, possibly a delicate issue at the time of the transition to owners’ equivalent rent in 1982. It also makes the approach insensitive to inflation expectations, and thus unable to separate nominal and real mortgage costs or to reflect the user cost intuition that expected house price appreciation reduces the cost of owning.

Third, [Gillingham and Lane \(1982\)](#) discuss several practical implementation issues that no

longer pose difficulty. These include having a timely, quality-adjusted house price index that covers non-FHA transactions (repeat-sales indexes came only later) and obtaining mortgage costs representative of a broad class of mortgage contracts (now easily available from HMDA or private sector data sets).¹⁰

4 Shelter Costs and Monetary Policy

This section draws implications for monetary policy.

4.1 Mortgage Rates and Monetary Policy

The preceding section argued that a proper cost-of-living index for shelter should acknowledge that higher mortgage rates increase the cost of owning. The inclusion of mortgage rates in the price index nonetheless poses an awkward challenge for monetary policy, since mortgage rates typically co-move with the central bank’s policy rate. Thus, a tightening move by the Fed intended to reduce inflation would directly increase the mortgage component of shelter inflation.

However, the Fed need not target an inflation rate inclusive of mortgage costs. The case for excluding such costs is straightforward; a higher mortgage rate has the classic feature of a cost-push shock that generates a one-time increase in the price level. Central banks have an established history of “looking through” such cost-push shocks. In fact, relative to other cost-push shocks such as energy price changes or tariffs, residential mortgage rates have small spillovers to other sectors through the supply chain, limiting concerns of their effect on broader inflation expectations. Thus, the Fed could target an inflation rate that excludes mortgage costs, just as it does now.

The Bank of England and Bank of Canada offer useful models for this approach. As shown in Table 1, the United Kingdom produces two main consumer price indexes. The Bank of England targets the UK CPI, which excludes owner-occupied housing, rather than the CPIH, which includes it. The Bank of Canada targets a CPI that includes mortgage interest, but regularly communicates about the feedback effect this introduces into inflation (see e.g. [Rogers, 2026](#)).

¹⁰The [Chodorow-Reich et al. \(2026\)](#) implementation restricts attention to 30-year fixed rate mortgages, but could be easily extended to allow for other mortgage contracts.

4.2 Monetary Policy When Housing Supply Is Inelastic

[Bianchi, McKay and Mehrotra \(2025\)](#) make a complementary argument for why monetary policy should pay less attention to rents. To illustrate their mechanism clearly, it helps to momentarily ignore the distinction between the cost of owning and renting emphasized so far. Instead, their case rests on the short-run inelastic supply of housing and the observation that equilibrium in the housing market is supply, not demand, determined.

The idea works as follows. Suppose for simplicity the economy consists of two consumption goods, non-shelter and shelter. In the market for non-shelter goods, producers hire labor and meet the quantity demanded at whatever price they set, with the price subject to adjustment frictions as in the standard New Keynesian model. In the market for shelter, landlords engage in a search-and-matching process with prospective tenants, again with possibly sticky rental prices. Importantly, landlords have a fixed supply of real estate available; if demand by prospective tenants exceeds the available supply, rationing occurs. A higher monetary policy rate reduces demand for both the non-shelter and shelter goods.

The question in [Bianchi, McKay and Mehrotra \(2025\)](#) is how monetary policy should respond to higher shelter inflation resulting from a shift in demand for housing. Their answer is very little. The reasoning relies crucially on the inelastic supply of real estate, and rationing in case of excess demand. Intuitively, with fully inelastic supply the Fed cannot affect the quantity allocation in the market for shelter at all. Rather, the quantity of shelter output remains fixed at the flexible price level irrespective of demand shocks or monetary policy. In this circumstance, the Fed should tolerate fluctuations in the price of shelter and instead focus policy on preventing an output gap in the market for non-shelter goods.

This argument does not mean the central bank should ignore developments in housing markets altogether. To the contrary, in reality housing supply is not perfectly inelastic, and in fact residential construction appears to react strongly to changes in monetary policy ([Bernanke and Gertler, 1995](#)). Targeting full employment thus may require responding to shifts in construction activity. Likewise, reductions in policy rates stimulate economic activity in part by allowing homeowners to refinance their mortgages, and in other countries with primarily floating rate mortgages the reverse happens when policy tightens.

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