

The Mortgage Cash-Flow Channel: How Rising Interest Rates Impact Household Consumption

Abstract

How do increased debt servicing costs, resulting from monetary policy tightening, impact household consumption? Understanding this cash-flow effect is crucial for assessing the overall and disparate effects of monetary policy. By utilizing panel microdata on all mortgage holders in Israel and leveraging quasi-exogenous variation in exposure to adjustable-rate mortgages (ARMs) due to a regulatory shift, we analyze household consumption reactions. Our results indicate that the mortgage cash flow channel caused a 3.6% reduction in households consumption following a 4.65 percentage points policy hike, predominantly affecting mid to lower income households. These results underscore the significant role of the mortgage cash-flow channel in the transmission of monetary policy, with important consequences for both economic stability and inequality.