Monetary Policy Transmission Through Adjustable-Rate Mortgages in the Euro Area*

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Abstract

This paper studies the role of adjustable-rate mortgages (ARMs) in monetary policy transmission within the Euro Area. Conventional wisdom holds that ARMs are relevant *per se*. This study finds that the presence of liquidity-constrained households strongly influences their impact. Using Euro Area survey data, I document that transmission is stronger in countries that exhibit high ARM shares *and* sizable shares of liquidity-constrained households. Using Italian time series data, I show that ARMs are key for transmission only when a high fraction of households are liquidity-constrained. To account for these findings, I develop a heterogeneous-agent model featuring (i) heterogeneity in marginal propensities to consume (MPCs), (ii) agents making both housing and mortgage choices, and (iii) households with ARMs. In the model, MPCs control the conversion rate of changes in mortgage payments into changes in consumption, so ARMs must be paired with high MPCs to be an important transmission vehicle. These results highlight the importance of accounting for household heterogeneity when assessing monetary policy transmission through adjustable-rate mortgages.

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