Inventories matter for the transmission of monetary policy: uncovering the cost-of-carry channel

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Abstract :
By setting interest rates, monetary policy affects the cost of carrying inventories. We build a model to capture the resulting "cost-of-carry channel" of monetary policy, finding it to yield interesting non-linearities. Our model predicts that prices should be more sensitive to the stance of monetary policy when inventory levels are higher (effectively leaving sellers with less market power). By drawing on data from the US housing market, we are able to test this hypothesis -- finding strong support for the cost of-carry channel. Central banks may therefore wish to pay close attention to inventory levels, as they could matter for the strength of monetary policy transmission to inflation.