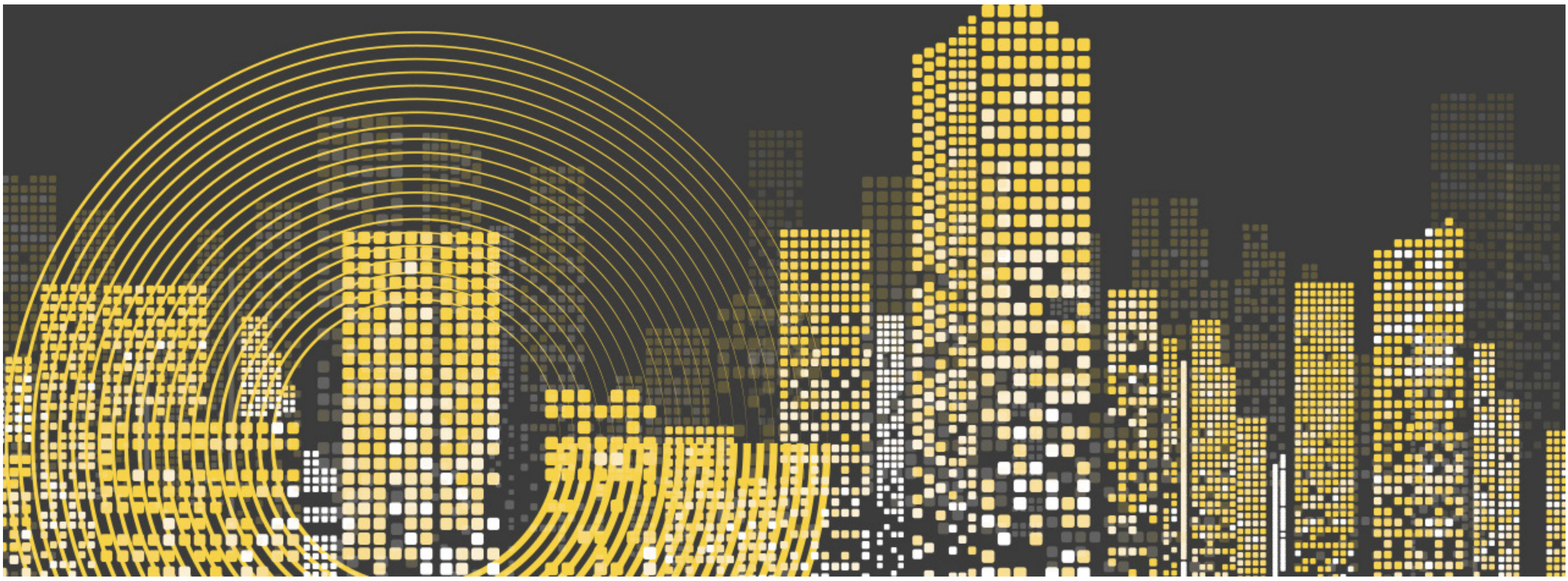
BF Marktradar



BF direkt
Unternehmensgruppe

High Level of Core Inflation Dims Prospects of Interest Rates Peaking any Time Soon

Over the past twelve months, interest rates rose faster and more drastically than they had ever done in the history of the EU's common currency. Last week, the European Central Bank (ECB) increased its key lending rates for the ninth consecutive time, up to a level of 4.25 percent, after having raised them by 25 basis points as recently as June. There is a chance that the ECB may opt for another interest rate move this autumn.

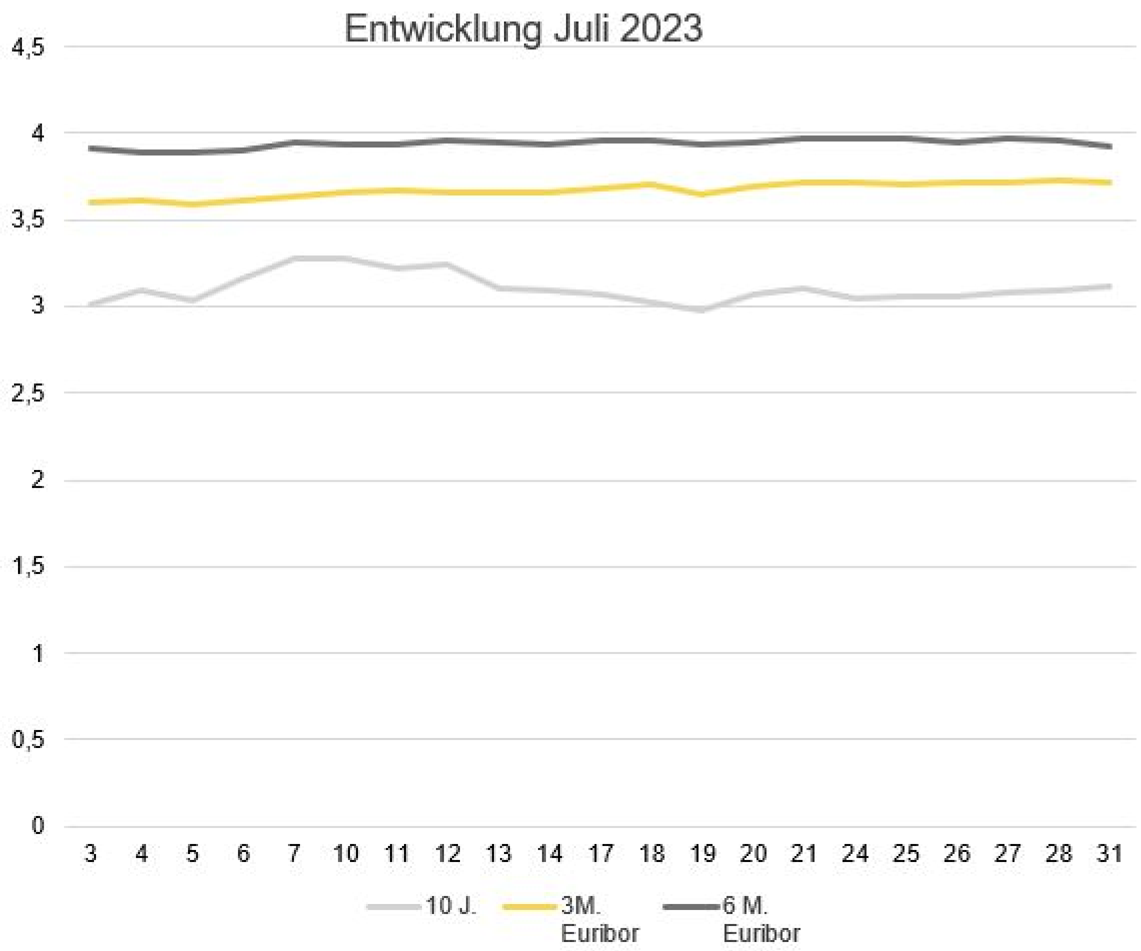
With its latest interest rate hike, Europe's central bank responded to the persistent inflation level. Especially the core inflation rate, which ignores the strongly fluctuating food and energy prices, remains high, having averaged 5.5 percent in July. It is explained not least by the wage pressure, which has taken the place of external factors as the main price driver. There is a lingering danger of second-round effects or of a wage-price spiral. The strain on the inflation front is not expected to ease before 2024. The ifo Institute for Economic Research expects the inflation rate to drop by half, down to 2.1 percent, in 2024, which would put it back in line with the target corridor of the central bank. But other institutes predict significantly higher levels. The Bundesbank, for one, projects an inflation rate of 3.1 percent for 2024, which would justify further key rate hikes.

Germany's economy is going through a recession as it is. Tightening interest rates will exacerbate the recession risks. Leading banks assume that lending rates will be raised once more in September, but also believe that this will mark the end of the cycle. The prospect of an interest rate peak would improve predictability and ease the strain on the real estate market.

But for the time being, many property developers and property asset holders whose fixed-interest periods are about to expire feel under pressure. The decline in the number of transactions and falling property prices in 2023 suggest as much. In the case of residential real estate, prices have softened by 5 to 6 percent, according to the VdP Association of German Mortgage Credit Banks. But there is a bright side to the crisis, too: Tradesmen and building materials are readily available again, unlike during the boom times.

Interest Rate Development

Long-term interest rates perked up slightly in July. The 10-year interest rate swap, for instance, rose from 3.01 percent at the start of the October to 3.09 percent in the course of the month. Short-term interest rates were also subject to modest growth. The 3-month Euribor, which stood at 2.78 percent at the beginning of the month, climbed to 3.04 percent by the end of the month. The 6-month Euribor also made gains, rising from 3.91 percent at the beginning of the month to 3.95 percent by its end.



Outlook

It is yet too early to say how the real estate market will be trending in the coming quarters. But long-term, persistent demand makes it reasonable to assume that rents will keep going up and that prices will bounce back as well. The currently stalled construction activity and demographic growth will stabilise prices for standing properties. Assuming that prices and interest rates maintain the current level, returns on tenant-occupied properties will go up. According to a survey the ifo institute conducted among experts, prices can be expected to increase by 7.2 percent over the next ten years.

Then again, the situation on the real estate market remains uncertain for the time being. The ECB will keep a close eye on the inflation trend, and move ahead with further interest rate hikes if it perceives a need to do so. For contractors and the building industry in general, the slowdown is visible and palpable. At this time, there is hope that the inflation will lose momentum.