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HOW CENTRAL BANKS REACT TO INFLATION?

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Content

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Historic Rate Increases of Major Central Banks to Curve Inflation

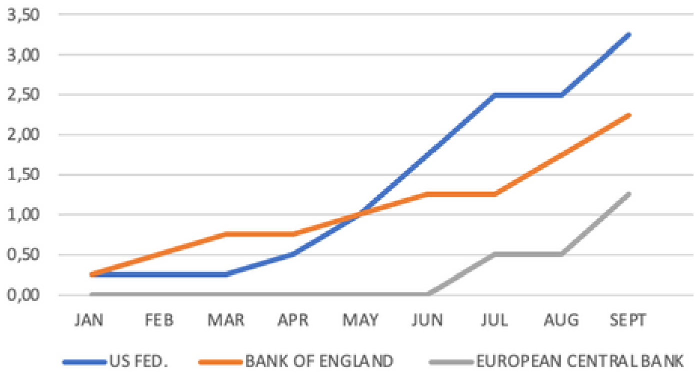
Increased efforts have been made by central banks recently to combat inflation, encourage saving, and, ultimately, result in a tendency for people to spend less and in order to tame down a relatively persisting upward inflation.

As you can see in the chart below, The U.S Fed, BoE and ECB trails an upward and hawkish stance to keep prices in check. Similar policy has been adopted by the central banks of Norway, Switzerland, and Japan stands out by continuing to pursue an expansionist policy, but lately submitted to intervene in stopping the continuous decline of JPY due to surging USD.

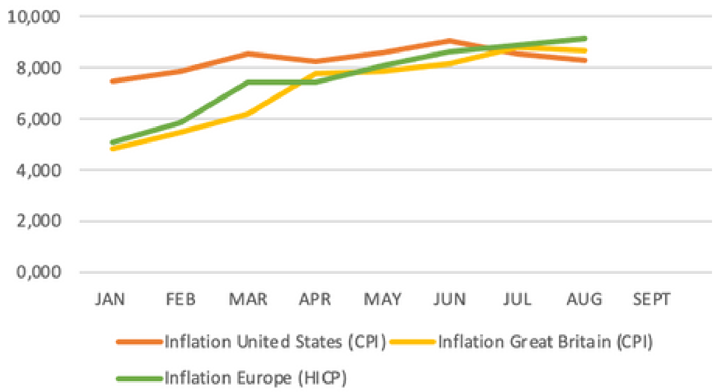
The **US Federal Reserve** raised the federal funds rate **three times in a row**, **by 0.75 pp**, **to a range of 3%-3.25%**, the highest level since early 2008, in an effort to lower inflation, which is close to its highest levels since the early 1980s.

For the **Bank of England** this is the **seventh increase in interest rates since last December**, after the Bank of England opted to **raise** them by **0.5 percentage points to 2.25%**. Being faced by the recent tax policy by the new administration, BoE now stands to act on the historic decline of GBP against major pairs.

The **European Central Bank** increased its key benchmarks by an unprecedented **0.5 of a percentage point to 1.25%** to combat the surging inflation of the currency bloc, despite worries that higher rates will exacerbate the current strain on consumers' disposable budgets and deepen an impending recession. With recent **inflation** around the **Eurozone hitting** at the region of **10%-12%** within until Q4, an expectation of hawkish rate increase by the ECB is within the horizon.
Although, an expected parity between the US and Eurozone inflation seems to widen due to the effect of energy price



CENTRAL BANK'S RATE 2022
SOURCES: GLOBAL-RATES.COM - 30/09/2022



INFLATION RATES 2022
SOURCES: GLOBAL-RATES.COM - 30/09/2022

increases in the EU(as seen on Inflation Chart above), the chart looks to have a need for ECB (lagged behind the Fed and BoE) to close the gap of rate increases to cope up in taming inflation down at least at half the current level and support its currency from further depreciating against the USD.

How does rate increases affect Property Investors into the EU

Many fear that this would drive up house values even more and further drive away new buyers as a resulting effect of higher mortgage rates and an increased cost of capital by the developers. According to Halifax and Nationwide, respectively, **house prices have shocked many by continuing to grow and generally increased by 0.4% and 0.8% in August**. **According to official data, the UK's annual rate of price increase jumped to 15.5% in July.**

The U.S Federal Reserve

The **Federal Reserve** signalled it would continue raising benchmark interest rates much above the present level when it **increased them by another three-quarters of a percentage point on the 21st of September 2022**.
According to the most recent personal consumption expenditures price index (PCE) report, prices have increased 6.3% nationwide since last year. According to Fed experts, **PCE inflation will continue to be higher, but should drop to 5.4% by the end of 2022.**

With additional rate increases on the way, we should anticipate that the Fed's policy action will soon continue to cool the housing market in the U.S. That is because of being ahead of increasing policy rates as opposed to European counterparts.

On the other hand, **house prices** in the larger Europe may soon subside due to a bleak economic outlook and reduced appetite for the GBP and EUR.

Bank of England

The increase is particularly against people who have mortgages with variable rates. According to most recent Financial Conduct Authority data, over half of them are either on a tracker directly tied to the Bank base rate or a discounted-rate arrangement.

Cheap mortgages have supported the real estate market in the past, thus increases in borrowing costs will have a downward effect for its demand.

European Central Bank

The central bank's 25-member governing council increased its key benchmarks by an **unprecedented 0.5 of a percentage point to 1.25% to combat the surging inflation of the currency bloc**, despite worries that higher rates will exacerbate the current strain on consumers' disposable budgets and deepen an impending recession.

Rising inflation in the Eurozone, which hit a record high of 9.1% last month amid skyrocketing natural gas costs, has compelled the ECB to **deviate from its custom of gradual rises**.

The ECB is prepared to announce additional rate increases to combat rising inflation and bring it down to its 2% target.

Price growth in **France** decreased from 6.1% in July to 5.8%, but climbed in the majority of other Eurozone nations.

With the arrival of cost increases, the general price rise, the recent decline of the euro in parity with the dollar (see our report "Why it's the time to Invest in Euro?"), the inflation will bring down the costs and for a **non EU investor is a great opportunity to consider hedging their portfolio with a property that has a discounted valuation**, because many attractive properties will soon be available on the market.

Opportunity for Non-EU and Non-U.S Domiciled Investors

With countries in the **Middle East** whose currency is pegged at USD and whose have a revenue windfall from oil and LNG price increases, **buying** low on **GBP** and **EUR** at these levels presents a **significant opportunity**. That is coincided by a lower valuation of properties in Europe due to a reduced demand. Moreover, a logical rate increases in the Euro area may stabilize currency value in relation to USD, hence an opportunity to acquire before U.S Fed's expected easing of interest rates which is seen to be within the later part of 2023 as and when inflation is back to their target of 2%.

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