

Catella Finance Focus

CATELLA

#02/23



SEEKING THE SUMMIT -

A SUMMER HIKE THROUGH EUROPE'S INTEREST RATE LANDSCAPE

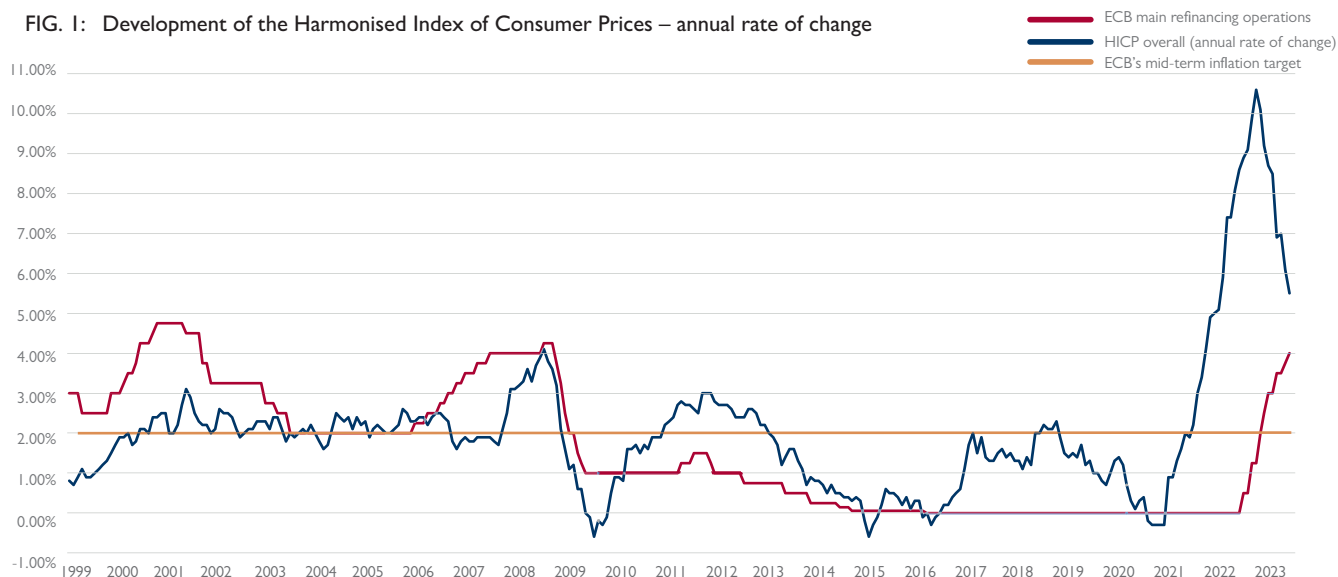
On 27th July 2023, the ECB's Governing Council unanimously decided to continue the path of a restrictive fiscal policy and raised – for the ninth time in one year – the three key ECB interest rates by further 25 basis points. ECB president Christine Lagarde underlined that the Governing Council is determined to ensure that inflation returns to the two per cent medium-term target in a timely manner. This increase of the interest rates has been no surprise for the market participants, as it was envisaged after the Governing Council's meeting in June. The ECB expects that inflation will drop further over the remainder of the year but will stay above target for an extended period. Furthermore, the upcoming interest rate decisions will continue to be based on the assessment of the inflation outlook in light of the incoming economic and financial data, the dynamics of underlying inflation, and the strength of monetary policy transmission. The ECB sees changing drivers of inflation: External sources (offer shocks; supply chain shortages; energy prices) of inflation are easing, but instead domestic price pressures, including from rising wages and still robust profit margins, are becoming an increasingly important driver of inflation. On the other hand, financing conditions have further tightened and are increasingly dampening demand, which is an important factor in bringing inflation back to target.

Our map (page 3) shows the dilemma and difficulty which the ECB is currently facing: Inflation rates differs widely in between the euro area. Austria is leading with an HICP rate of 7.8% whilst the rates of Luxembourg 1.0% or Spain 1.6% are already below the ECB's target inflation rate. The euro area's biggest economies Germany, France and Italy are reporting inflation rates between 5.7 – 6.8%.

According to the latest ECB's Survey of Professional Forecasters, headline inflation in the euro area is expected to decline from 5.5% in 2023 to 2.7% in 2024 and 2.2% in 2025.

But the ECB is not alone in Europe with its fight against inflation. Norwegian central bank raised its policy rate on 23rd June to 3.75% and Sweden's central bank followed with the same interest rate on 5th July 2023. The main lending rate in Denmark is 3.50 % effective from 28th July and the Bank of England raised its bank rate last time on 14th July 2023 to 5.00%. Only the Swiss national bank hasn't raised interests that harsh, as the Swiss inflation rate is still one of the lowest in Europe. Currently, the Swiss key interest rate is 1.75% since 23rd June 2023.

FIG. 1: Development of the Harmonised Index of Consumer Prices – annual rate of change



Sources: Eurostat, ECB, Catella Research

SEEKING THE SUMMIT -

A SUMMER HIKE THROUGH EUROPE'S INTEREST RATE LANDSCAPE

CATELLA

OUTLOOK

We assume a further interest rate hike of 25 basis points for all three key interest rates to be announced after the next ECB's Governing Council meeting on 14th September 2023. Our conclusion is based on the expectation that the (core) inflation rate will still be significantly above the ECB's mid-term target of 2.00%. As the ECB has been very straight forward in its past announcements and steadily followed its restrictive money policy path, we might even see an interest rate hike of further 25 basis points at the end of October before the peak of the interest rates should be reached. After we expect a pause in increasing and the interest rates to remain on a steady plateau until Q2 2024.

SHAKY SUMMER AND ROUGH AUTUMN: NAVIGATING THE TOPSY-TURVY REAL ESTATE CHALLENGE

The European real estate market finds itself in the midst of turbulent times, as a shaky summer gives way to an uncertain autumn. With credit demand plummeting in the second quarter due to higher borrowing rates and spending cuts, the industry faces a challenging rollercoaster ride.

Credit standards for new loans to enterprises have tightened across all major economic sectors, particularly in commercial real estate. The sector experiences a net percentage of 30% tightening, triggered by falling house prices that lead to a decrease in commercial real estate collateral values. The residential real estate and construction sectors also face substantial tightening of credit standards at 19% and 18%, respectively, in the first half of 2023. *

Looking ahead, euro area banks expect a further, albeit smaller, net tightening in credit standards and loan terms for firms across all main sectors of economic activity, including real estate, in the second half of 2023.

* Source: Euro area bank lending survey Q2 2023

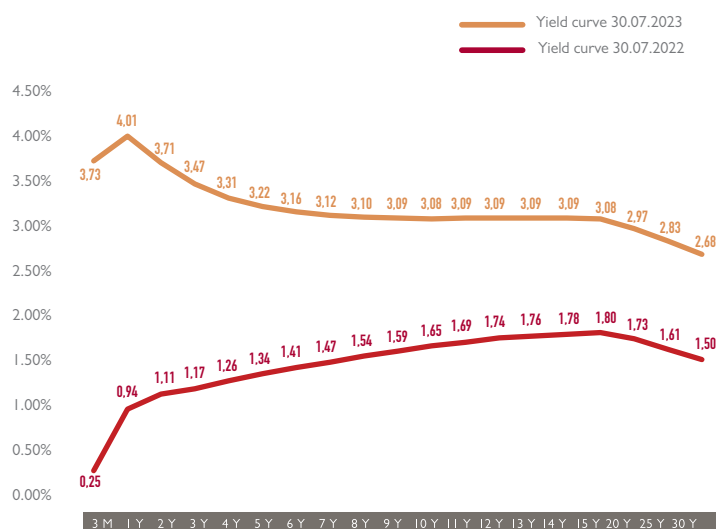
Furthermore, banks report a notable decrease in demand for loans or credit lines across all major economic sectors, with real estate sectors experiencing a particularly strong decline. The commercial real estate and residential real estate sectors witness net percentages of -42% and -41%, respectively, reflecting cautious investment reconsiderations due to falling real estate prices and rising lending rates. The construction sector also faces a decline in loan demand with a net percentage of -26%, influenced by rising lending rates and higher construction costs in the first half of 2023.

In light of the real estate market's volatility, banks are increasingly conscious of climate-related risks. Over the past 12 months, credit standards tightened significantly due to climate risks for loans to businesses associated with environmental harm, known as "brown firms". Conversely, climate change had a net easing impact on credit standards for loans to eco-conscious "green firms" and those in transition to sustainable practices.

Looking ahead to the next 12 months, euro area banks anticipate an even stronger net tightening impact owing to climate change on credit standards and terms for loans to brown firms. On the other hand, green firms and firms in transition can expect a net easing impact, suggesting the growing influence of climate-related considerations on bank lending to firms.

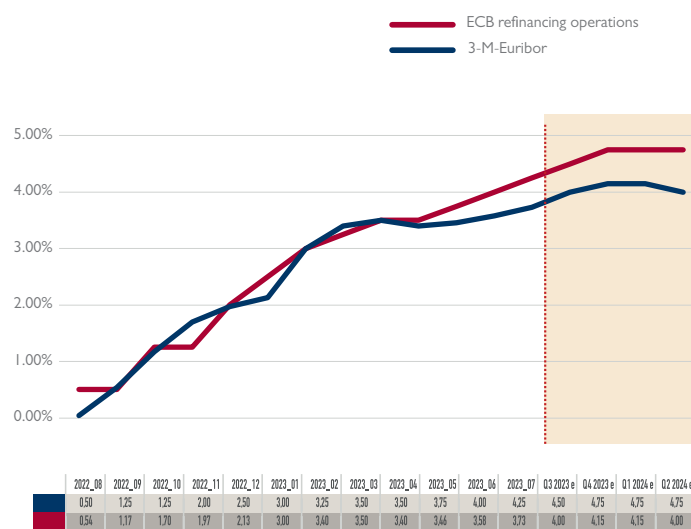
These developments underscore the critical importance of climate risks and the increasing role they play in shaping credit policies in the real estate sector. As Europe navigates the rough terrain of the current real estate challenge, banks and investors are taking a cautious approach, looking to adapt to the evolving market conditions and increasingly considering environmental sustainability as they navigate through the uncertainties of the topsy-turvy real estate landscape.

FIG. 2: Yield curve EUR



Source: Erste Group, Catella Research

FIG. 3: Development and forecast of the short-term interest rates



Source: ECB, Catella Research (e = Forecast)

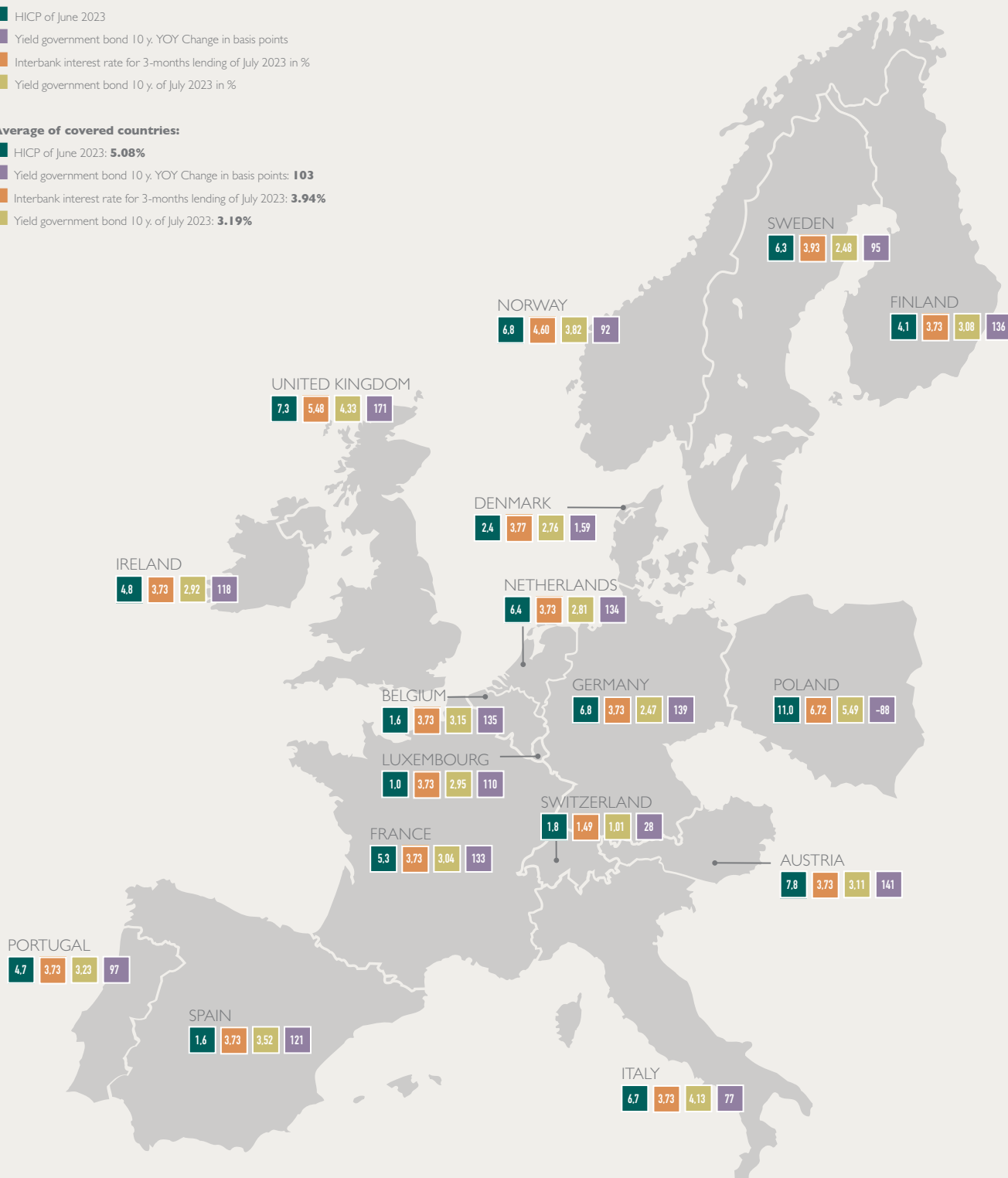
OVERVIEW OF THE EUROPEAN INTEREST RATE LANDSCAPE

CATELLA

- HICP of June 2023
- Yield government bond 10 y. YOY Change in basis points
- Interbank interest rate for 3-months lending of July 2023 in %
- Yield government bond 10 y. of July 2023 in %

Average of covered countries:

- HICP of June 2023: **5.08%**
- Yield government bond 10 y. YOY Change in basis points: **103**
- Interbank interest rate for 3-months lending of July 2023: **3.94%**
- Yield government bond 10 y. of July 2023: **3.19%**



Sources: Eurostat, ECB, national central banks, Catella Research

About Catella

Catella is a leading specialist in property investments and fund management, with operations in 12 countries. The group has over EUR 13 billion in assets under management. Catella is listed on Nasdaq Stockholm in the Mid Cap segment.

Read more at catella.com

Contact:

Prof. Dr. Thomas Beyerle
thomas.beyerle@catella-investment.com
 Stefano Hruska
stefano.hruska@catella-investment.com
 Maximilian Otten
maximilian.otten@catella-investment.com