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German housing market

History suggests it is an inflation hedge

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We calculate a nominal and real return triangle for German house prices from 1970 to 2022. The market offered an inflation hedge in the past. This is in particular true for periods of high inflation as in these periods house prices even exceeded inflation. The huge supply shortage and rising rents are further arguments for a bottoming out of house prices in 2023.

[please click here to see complete chart](#)

Inflation affects house prices in two ways. First in the short run, interest rates and refinancing costs move with inflation. The nominal interest rate shock which started in December 2021 led to the end of the house price boom. For a few months now house prices have started to retreat. Second, house prices often rise with inflation in the long run. Our nominal return triangle shows that house prices rose from 1970 to 2022 by more than 400% and consumer prices by less than 300%. In general, falling house prices are rather the exception than the norm. So, house prices moved higher for each 20-year period and 36 of 43 10-year periods. Declining prices mostly lasted only for a few years. An exception, and the longest period of falling prices, began in 1995 after the end of the reunification, and lasted until 2012. Accordingly, investors had to wait 17 years to see their purchase price again. Inflation-adjusted, the period even extends to 2017. So, history shows that there are long phases of price declines without any or only partial inflation protection. However, in the period from 1995 to 2012, inflation was relatively sluggish and increased by only 29%. The opposite holds for phases with high inflation. Inflation surged from 1970 to 1980 by 64% and nominal house prices by roughly 85%. After reunification from 1989 to 1994, inflation shot up by more than 20% and house prices by almost 30%. Should inflation remain high, then we would expect that house prices will again offer an inflation hedge. We assume that it requires special circumstances if the price level in an economy increases substantially and prices for what is for many people the most important and largest asset class stagnate or fall. Of course, rents are also an important determinant for future house prices. Germany has very restrictive rental laws which have hindered rental growth in the past. However recently, inflation and the supply shortage may have changed this. Due to the association of Pfandbrief Banks (vdp), new lease rentals grew by 6.5% year-on-year in Q4 2022, an all-time high. Accordingly, we expect that the current price decline will come to an end over the coming months. This requires the end of further interest rate increases which DB forecasts for mid-2023. Subsequently, price dampening effects should subside. In the long run, house prices are expected to achieve new highs. This is also important for



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institutional investors who are considering extending their bond holdings. Only index-linkers can provide an inflation hedge here. However, their volume is relatively small compared to the total bond market and miniscule relative to the housing market. Large investments by institutional investors can only be partially absorbed. So, if history does not repeat itself but rhymes, the housing market should again be a key asset which offers an inflation hedge..

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