BELVALOR
Vermögensbetreuung

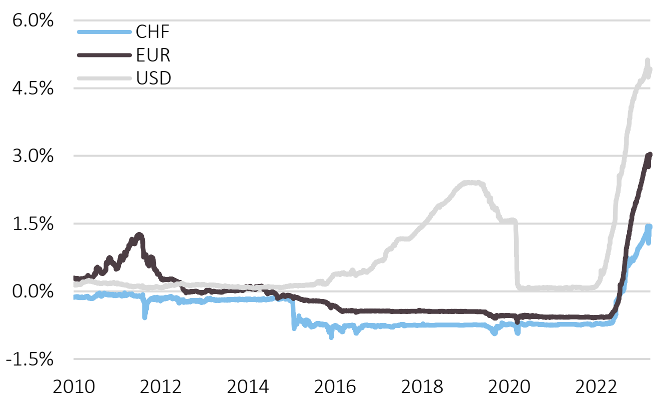
Interest rates – simultaneously a blessing and a curse

Interest rates have immense impact

We have become accustomed to low interest rates over the years. The new reality – rapidly and sharply rising interest rates – has a burdening effect. In the long run, interest can be a good thing: it gives money a value. But costs are rising. In 2022, interest rate increases directly led to asset price corrections in all asset classes. Further price corrections, e.g. for real estate, cannot be ruled out. The outcomes are revealed insidiously or with delayed effect.

Capital is becoming more expensive. Financial costs are rising for everyone – private persons, investors, companies and governments. An interest rate rise of 3 percentage points does not sound like much, but for a mortgage of CHF 1,000,000 it means additional costs of CHF 150,000 over 5 years.

Graph 1: Interest– 3 month swap rates CHF, EUR, USD

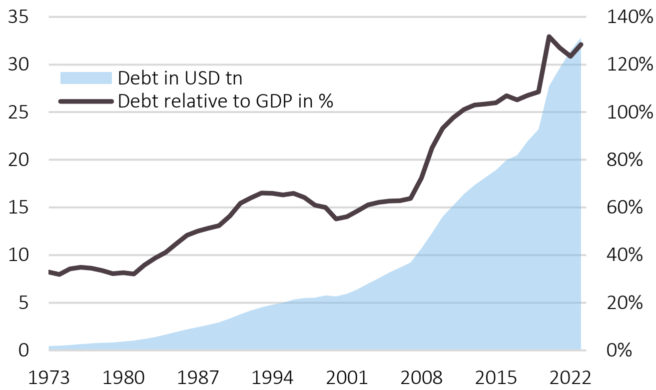


Source: Bloomberg, Belvalor

In order to cushion the pressure on profit and margin, **companies** have responded to the costs of input factors such as energy and transport, as well as for capital in the form of interest, with price increases. Quality companies have the pricing power to do this. Moreover, labour shortages and inflation compensation demands are now pushing up wage costs. The labour market is robust, as the economy is still doing well. Further price increases are the result. The wage-price spiral is turning upwards.

Countries, with record levels of debt, need to cut spending and/or increase revenues. Investment needs (e.g. for the energy transition) favour the latter as the more appropriate remedy – e.g. in the form of tax increases. The example of the USA shows how sharply government debt has risen, both in absolute terms and relative to economic output (GDP). An end is not yet in sight.

Graph 2: Debt – USA as an example over 50 years



Source: Bloomberg, U.S. Federal Reserve (FED), usdebtclock.org, Belvalor

Private persons, whose debt has increased less sharply, and **investors** must earn the interest charges – through labour (wages) and/or capital (investments).

Interest as countermeasure to inflation

Money can be earned with interest rates again. However, since inflation devalues money over time, positive **real interest rates** (interest rates minus inflation) are desirable for capital investments in the long run. Western countries are still facing negative real interest rates. In the long term, equities are the best way to maintain purchasing power.

Investment policy unchanged

Higher interest rates and prices fundamentally inhibit economic growth. Demand for goods is falling as less is invested and purchased. As a result, inflation is diminishing. As stated in our still valid investment outlook for 2023, the climate is unsettled. We remain true to our long-term **investment policy**. On the financial and capital markets, much of the negative news has been priced-in and, in the longer term, growth prospects will once again be positive. Equities as real assets are our preferred instrument. Gold and commodities offer additional inflation protection. Bonds are suitable as portfolio components.