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Low Interest Rates and the Real Return of Households' Wealth in the Euro Area

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Interest rates in the euro area have now been at historically low levels for more than a decade. Due to a weak economic outlook, the turnaround in interest rates expected for 2019 has been suspended at least until mid-2020, with the option to postpone it indefinitely, if necessary. Ultra-low interest rates are therefore going to persist for the time being.

Against this background, we ask how a decade of low interest rates affects the returns that households generate from their overall gross wealth. In our analysis, we consider the four large euro area countries (France, Germany, Italy, Spain) and the euro area as a whole. Next to financial assets and their respective subcomponents (bank deposits, bonds, shares, mutual fund shares, and claims on insurance and pension funds), we are - to the best of our knowledge - the first to take non-financial assets (primarily real estate and land) into account. The inclusion of real property for household wealth analyses is an imperative as this form of wealth represents the majority of total assets. Moreover, national house price dynamics, and thus the return on total assets, differed quite substantially both before and after the start of the low-interest phase.

In order to compute the real returns on households' total assets, we first determined the nominal returns of the different asset classes and then weighted them with their respective shares in total assets. The nominal returns on total assets were then deflated with national inflation rates in order to obtain the ex post overall real return. Data on inflation rates and quantities mainly came from national and financial accounts; data gaps were closed on the basis of estimates. Data on nominal returns of the individual asset classes were estimated on the basis of a wide variety of statistics, including data from central banks, statistical offices and market data. As a result, we were able to obtain a unique data set on the real rate of return on households' overall gross wealth in the euro area between 1999 and 2018.

It turns out that, despite policy rates at zero, households generated positive real returns on their total assets in most of the years in all countries considered; the years with the peak of the crises were a notable exception. At the national level, however, developments varied considerably over time. Not surprisingly, average real returns on total assets were in most countries significantly higher in the pre-crisis years (1999-2007) than in the post-crisis era (2008-2018) with its low interest rates environment. However, it was only in 2018 that total real yields were lower than the long-term average, everywhere. This was mainly due to a negative real return on financial assets which resulted from negative real yields on almost all subcomponents. The real return on

total assets remained positive solely due to the overcompensating positive yield of non-financial assets which, however, also fell noticeably almost everywhere in 2018.

The observed changes in real yields over time resulted mainly from a different combination of price and quantity effects. On the one hand, the prices and real returns of the individual wealth components fluctuate strongly and country-specifically over time and thus - taking into account the importance of the respective asset class in the overall portfolio - contribute varyingly to the overall portfolio return. On the other hand, quantity effects in the form of changes in the asset structure vary as well from country to country. Despite significant and numerous heterogeneities regarding both price and quantity developments, a common feature of all countries throughout the whole time period considered is a clear dominance of the real yield on non-financial assets, which stresses the importance of its inclusion into our analysis. However, the overall real return shows a downward trend, everywhere.

Our results show that the level of interest rates alone is not decisive for the real return that households achieve with their total assets. The decisive factor is rather the length of time that interest rates remain at this level. As they remain low for the time being, it can be assumed that real returns will continue to fall, despite sustained increases in real estate prices in some countries. As a result, this could even counteract the intended effects of monetary policy.