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German households benefit from low interest environment

Calculations of the Halle Institute for Economic Research (IWH) – Member of the Leibniz Association show that the average household in Germany has benefited from the low policy rate environment. The average return on their portfolio was higher than in the pre-crisis period while at the same time, they benefited from lower interest on new loans. Households in Germany had a total Euro benefit of more than 364 billion Euro over a five-year period relative to 2003 to 2007. Increases in stock prices and real estate prices over-compensate lower interest rates on savings accounts, despite their relatively low share in households' portfolios. There are benefits across the income distribution. Households that do not own real estate lost though, but their losses are very small at on average about 100 Euro per year.

The return on the portfolio of the average German household was significantly higher from 2010 to 2015, i.e. in the low policy rate environment, than in the pre-crisis period of 2003 to 2007. The reasons for this effect include that interest rates on savings accounts and other deposits did not benefit very much from the high interest environment. Hence, the reduction in yield in the low interest environment is relatively small. At the same time, returns on equity and, most importantly, real estate increased substantially in the low interest environment. Despite their relatively small share in the portfolio of average households, this increase in returns over-compensates the losses on savings accounts.

These benefits accrued to households across the income distribution in Germany, i.e. it holds for low income as well as for high income households. However, due to higher home ownership rates and a higher share of equity in their portfolios, high income households benefited disproportionately. 66% of the total benefit of 364 billion Euro accrues to high income households. Losses accrued to households that do not own their home, but there are small at on average 500 Euro per household over the five-year period.

Households also benefited from lower interest cost on new loans taken out in the period. These effects are small (less than 20 billion Euro for all households during the five-year period), because the lower policy rates are not fully reflected in retail interest rates, especially for overdrafts and consumer loans.

The results show that it is incorrect to directly infer from low policy rates that retail rates change proportionately. It is of crucial importance to also consider how quickly and to which extent banks pass on lower policy rates to their customers. At the same time it is not surprising that stocks and real estate prices may significantly rise in a low interest rate environment. Ultimately, for each individual household what matters is the composition of its portfolio. Households with a balanced portfolio including real estate and equity did better than those with savings exclusively in savings accounts and life insurance assets. The low share of homeownership and the low participation rate in the stock market hurts the return German households are able to obtain on their savings.

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