Market Comment

Property as an inflation hedge? Maybe not.

Interest rates are rising, inflation has risen, the pandemic is still with us, labour is short and supply chains everywhere are creaking. Yet property prices are still rising. How come?

It depends, as ever, on which markets you are talking about, because the further you go up the market the less it is about interest rates and the more it is about supply. If you want to buy a classic country house, a communal garden in London or a lateral flat with a roof terrace, they aren't making (many) more of them. If more people want them than are selling, then the laws of supply and demand still stand. At the very top end, borrowing tends to be optional and offered by banks used to dealing with lending to rich people. The decision for the wealthy is how much of their net worth they want to spend on a house. Borrowings are oil, not fuel. It is tax, politics and currencies that provide the tripwires - the Osborne stamp duty hike is exhibit one.

As you travel down the market, credit is everything. How much, on a certain salary with certain expenses are you allowed to borrow? This is no longer at the discretion of a Captain Mainwaring style of bank manager but a highly regulated market where the computer regularly says 'no'. On the way up, the more interest rates decline, the more the property market increases - as long as inflation stays low. This has been the pattern for the last thirty years. Now interest rates are going up - maybe not by much – but that will have an effect, not so much on existing borrowers as most are on fixed rates, but on the new applicants for mortgages. It is here that you need to look to see what is going to happen to prices in any market where lending is the key factor. But the main determinant is not going to be the headline interest rate itself but the effect of inflation, particularly energy prices, on people's monthly expenditure, and hence the income available to service a mortgage. The computer will be saying 'no', or certainly 'less', a lot more. The effect on prices will be direct.

So to predict what will happen to property prices, look at the amount of leverage. The greater the percentage of debt in any market, the greater the downward pressure on prices. The number that people look at is the interest rate. The number that will have the greater effect is the inflation rate. For this reason, residential property, particularly at the lower end is not going to be the inflation protection that everyone expects.

The opposite probably.