



## GLOBAL MARKETS REPORT

“High Interest Rates and the World Economy: a macroeconomic analysis”

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## 1. Global Drivers of Rising Interest Rate

After more than a decade of borrowing costs that hovered close to zero, the world entered a high interest-rate environment beginning in late 2021, when central banks launched the most aggressive tightening cycle in decades. Although starting in 2024–25 some central banks have begun to cut policy rates again, global interest rates remain far above the levels that characterized the 2010s. Understanding why we got here is crucial for assessing how long this environment might last and what it means for the global economy.

During the 2010s, policy rates in advanced economies remained at historically low levels, while long-term yields trended downward. This low-interest rate environment was shaped by weak demand following the global financial crisis, low productivity growth, and strong global demand for safe assets.

The COVID-19 pandemic then disrupted this equilibrium with several economic pressures. To prevent further collapse, governments introduced large fiscal support programs, and central banks rapidly cut rates and expanded their balance sheets. Meanwhile, lockdowns and factory closures disrupted production and clogged global supply chains, creating shortages just as households shifted their spending from services toward goods. Labor markets were also disrupted as many workers retired early, changed industries, or remained out of the workforce due to health concerns. Demand recovered faster than the economy could keep up, paving the way for the inflation spike that followed.

Initially, many policymakers believed this inflation surge would be transitory. But by 2021–22, price pressures had moved well beyond energy and food. Just as supply chains were starting to recover, Russia's invasion of Ukraine in February 2022 delivered a second major shock. Europe in particular saw an abrupt cut in gas supplies and a spike in electricity prices. According to IMF and ECB analysis, global energy prices roughly doubled between 2020 and 2022, and gas prices in Europe rose by more than 450% at one point. These price surges increased inflation even further and pushed up transport and food costs worldwide.

This combination of pandemic-era disruptions and war-related energy and food shocks produced the highest global inflation in four decades.

The shift from high inflation to a high-interest rate environment was driven by the policy response of central banks. The world's shift into a high-rate environment really began in 2021, when several central banks in Latin America and Central Europe started raising interest rates to stabilize their currencies and contain rising inflation. By the end of that year, a number of advanced economies, such as Norway and South Korea, had also followed, marking the start of the global tightening cycle. By early 2023, more than 90% of economies had raised policy rates, a level of global coordination not seen in at least 55 years, and sharper even than during the oil shocks of the 1970s. Advanced economies alone delivered more than 3,900 basis points of rate increases from late 2021 to late 2023. The European Central Bank, for example, achieved the fastest tightening in its history by raising its main policy rate from 0% to 4.5% between mid-

2022 and late 2023. Emerging-market central banks started even earlier, tightening in 2021 as inflation pressures emerged, and in many cases raising rates at twice their historical pace.

Central banks raised rates to clearly restrictive levels in an effort to slow demand, avoid wage-price spirals, and re-anchor inflation expectations. By 2024–25, this strategy had largely succeeded in bringing inflation down, but policy rates and bond yields, although beginning to decline, remained well above their pre-pandemic levels.

As of November 2025, policy rates in many economies are slowly decreasing, and inflation has fallen substantially from its peaks in 2022. However, borrowing costs remain elevated relative to the 2010s, and there is little consensus that the world will fully return to that earlier period of persistently low rates.

## 2. Macroeconomic Impacts of High Interest Rates

The first and most direct macroeconomic impact of high interest rates lies in their impact on inflation and output growth. By raising the cost of borrowing, the central banks seek to suppress the overall aggregate demand. Consumers reduce their spending on credit-dependent purchases such as houses, cars, durable goods, while firms scale back from investments, purchases or expansion plans. This demand cuts down the prices of goods, therefore allowing inflation to fall gradually towards target prices.

However, the effects of high interests on inflation are not instantaneous. Economists emphasize the presence of monetary policy lags, typically lasting 12 to 24 months, before changes in interest rates fully start to affect inflation and output. During this lag, the economy encounters slower growth and higher financing costs.

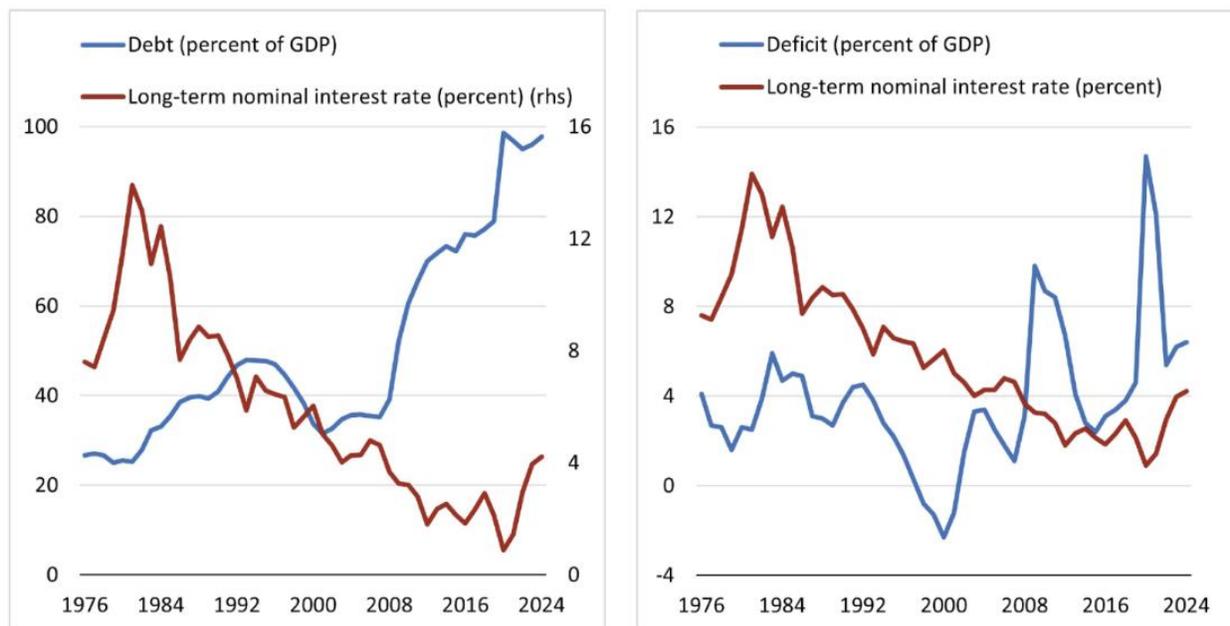


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High interest rates also influence labour-market conditions through their impact on aggregate demand and overall economic activity. With borrowing costs rise, businesses and consumers reduce spending, causing slower output growth. As firms experience lower revenues and weaker profitability, they are often determined to cut costs, stop hiring, or, in some cases, laying off existing employees. This leads to a gradual weakening of the labour markets and, in some cases, a rise in unemployment. The construction, manufacturing and the financial sectors tent to feel these effects first, as they are the most sensitive sectors to changes in interest rates.

Financial markets are highly sensitive to changes in interest rates, which affect asset valuation, credit conditions and investor behaviour. The immediate effect is seen in the bond market: as new bonds are issued with higher coupon rates, the yields on existing bonds must rise to remain competitive. This process drives down the market price of older fixed-income securities, illustrating the inverse relationship between interest rates and bond prices. Investors, therefore, demand higher returns to compensate for increased opportunity costs, which contributes to tighter financial conditions.

Perhaps one of the most radical consequences of high interest rates lies in their effect on public and private debt. Governments, corporations, households face rising cost of existing obligations when interest rates increase. For sovereigns, this means higher interest payments on both new and variable-rate debt. Countries with large fiscal deficits or heavy debt loads find their budget increasingly strained. Higher debt-servicing cost force out productive spending on education, infrastructure, healthcare, making fiscal consolidation more difficult. In addition, when interest rates are high, governments tend to borrow less, decreasing debt.



High interest rates have profound effects on the energy sector, influencing everything from investment decisions to energy demand and prices. Because the energy sector is capital-intensive

and closely related to economic activity, both short-term market conditions and long-term sustainability goals are reshaped by high borrowing costs. Rising interest rates tend to increase the cost of capital, discourage new investments, and slow down the pace of energy development, while also affecting demand for energy as broader economic activity moderates. In this sense, the energy sector reflects the dual nature of monetary policy: while high rates are intended to stabilize inflation, they can unintentionally restrain investment and innovation in industries that rely heavily on credit financing.

One of the most immediate effects of high interest rates is the financing cost for energy projects. Energy infrastructure, such as power stations, wind turbines, solar panels, pipelines, requires massive up-front investments. This can lead to project delays, downsizing, or outright cancellation, especially for renewable energy projects that rely on predictable returns over long periods. For example, developers of offshore wind and solar farms often use debt to finance construction, and when interest rates rise, the expected profitability of such projects declines sharply. As a result, some renewable energy companies have postponed expansion plans, renegotiated contracts, or sought additional government support to offset rising financing costs.

### 3. Global Spillover and Distributional Effects

The effects of central banks tightening policies are felt around the whole world. When more advanced economies such as the US or the euro area set higher policy rates, the outcome transmits through trading, finance and expectations, reshaping growth paths far beyond their borders. This has become even more observable over the last few years, where we witnessed high interest rate for a quite long period of time, which made those spillovers sharper and more persistent in many countries.

Consider, for example, US rate hikes, which reverberate through global risk premia, credit spreads and equity valuation. There exists a robust literature about the global financial cycle in which US monetary surprises tighten conditions worldwide, depressing risky asset prices and shrinking global credit. This can occur even in countries with flexible exchange rates and credible frameworks. One of the major drivers of these effects is the appreciation/depreciation of the dollar, for countries with foreign currency liabilities (both corporate and sovereign), this raises the debt burden and the financing risk. Bank of Italy evidence for 1999–2024 shows U.S. hikes tighten global financial conditions, appreciate the dollar, lower oil prices, and propagate recessionary, disinflationary impulses to the euro area, patterns that also appeared in many emerging markets.

At the same time, an increase in interest rates in advanced economies reduces import growth. For emerging markets and low-income countries that mostly relies on export, the external demand weakens even before the financial spillover has tangible effects. Furthermore, countries that are heavy commodities importers suffer from the tightening of interest rates, when this condition coincides with terms of trades shock, as they suffer both weaker demand abroad and higher financing costs at home.

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Additionally, also financial institutions (not limited to banks) are exposed to duration and liquidity risks in case of raising interest rates. The IMF warns about how a prolonged high interest rates environment raises credit losses and emerging markets face even stronger stress in case sudden stops force assets sales or currency mismatches to unwind.

In general, the burden is heaviest on low-income and frontier sovereigns with high external debt and limited market access. For those the currency depreciation and the global yields raise interest bills. According to IMF's October 2023's WEO this is pushing more than half of them into a distressed debt situation (or at high risk of it). Also, emerging markets with little developed local markets or dollarized debt balance sheet are particularly exposed, since a dollar strengthening worsens their domestic financial condition even without any policy changes at home, making the capital flows more procyclical. In case the investors start repricing according to a "higher for longer" idea on interest rates, this might lead to a strong sell off in emerging markets' assets.

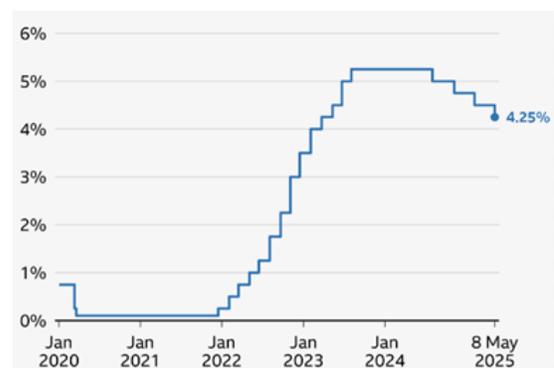
Overall, higher policy rates in advanced economies restrain inflation where they originate, but it also leads to tighter financial conditions and weaker external demand elsewhere. With an uneven effect on where those costs lands (mostly concerning emerging and low-income countries with high dollar debt), it ends up requiring domestic reforms on local currency markets, macroprudential reach and credible fiscal frameworks. Nevertheless, domestic policy alone is not enough, in order to efficiently prevent local shocks from turning into systemic crisis, then there is also the need to implement stronger international safety nets.

The lesson from this tightening cycle is that monetary decisions in advanced economies no longer stop at their borders. Their influence now extends through trade, capital markets, and investor sentiment to every corner of the global economy. The challenge is to design a system that recognizes this interdependence. Advanced economies should factor in the global repercussions of their policy choices, while emerging and developing countries need the tools to cushion themselves from abrupt financial swings. Strengthening multilateral coordination, expanding debt relief mechanisms, and enhancing access to global liquidity can help align national monetary goals with global financial stability.

### 4.High Interest Rates and The Housing Market

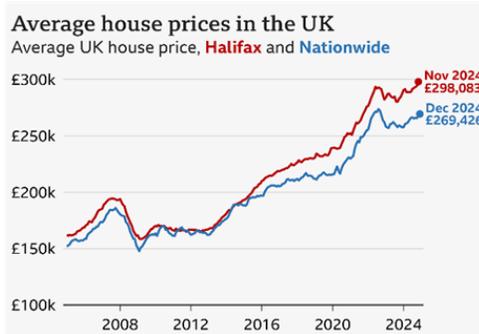
#### United Kingdom:

Interest rates across the world have risen significantly post-Covid. Higher rates on mortgages make them not only less affordable but also increase the risk of defaults: in the UK, defaults on mortgages rose for eight consecutive quarters up until Q2 2025. This rise in defaults can be explained directly by the rise in interest rates (shown on the graph on the right), subsequently, the recent Bank of England announcement that rates would fall 25bps to 4% explains the fall in defaults in 2025. However, rising mortgage defaults puts downward pressure



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on property prices, which have stagnated at £285,000 (~\$375,500) in the UK since peak levels in 2022.



The rising cost of borrowing makes it more expensive for individuals to take out mortgages in properties. Due to this, demand for houses fell since fewer and fewer consumers can facilitate the high rates on mortgages. During this period, rent in the UK has been rising between 1% and 2% per year as consumers are forced to live in rental properties and not privately owned homes.

On the flip side, low consumer and investor confidence in the UK, which has experienced persistent inflation and prepares for the November 2025 budget, has caused stagnation in the UK housing market. Furthermore, greater rates of income tax, national insurance and the non-domiciled reforms have disincentivised investment in the housing market, explaining the dip since the 2022 property price highs of £300,000 (~\$395,000).

## United States:

In the US, the Federal Reserve has set the base rate in the range of 3.75%-4%; similarly to the UK, this has remained relatively high due to persistent levels of inflation. House prices in the US peaked during Q4 2022, at a high of \$442,600, and has since fallen to \$410,800 as of Q2 2025. This represents a fall of 2.2% per year since the peak, showing the strong negative correlation of high interest rates and house prices in the US. 30-year mortgages in the US have averaged between 7.5% and 6% since 2022, far higher than the average of 4.1% during the 2010s; this shows how unaffordability has become an increasingly large problem in the US, especially with rising cost of living and childcare expenses, as well as the effect of tariffs.



Construction of new housing has also slowed down significantly in the US: single-family housing construction fell 10.8% last year. Many large-scale contractors have blamed high financing costs for making projects increasingly unprofitable in the current market, explaining why construction of new housing has slowed in recent years, despite increasing demand. Unaffordability has also put upward pressure on rent prices, with more individuals having to become tenants rather than homeowners. There were roughly 102 million renters in the US in 2024, occupying 45.3 million units; this represented 34.1% of US households but 54.5% of household growth in the same year. According to Fannie Mae, only 1 in 5 consumers in the US currently believe now is a good time to buy a property.

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Fewer buyers in the US are able to step into the market leading to a significant fall in sales volume whereas many current owners are reluctant to sell their existing homes due to low mortgage ‘lock-in’ rates. Researchers found that for every percentage that current mortgage rates exceed homeowner’s interest rates, the probability of listing the property decreases by 18.1%: with a significant amount of the 50 million mortgage owners in the US having below market rates, supply on the housing market has been significantly restricted.

## Europe:



A similar trend to the UK and the US can be seen throughout Europe: a recent study by the European Central Bank (ECB) shows that for every 1% increase in the base rate of interest, there is roughly a 5% decrease in property prices in the Eurozone. With the refinancing rate in the Eurozone being 2.15%, the effect on property prices has been weaker than in the US and the UK.

The graph on the left, published by the ECB, shows the extent to which recent interest rate hikes have affected affordability in the Eurozone. On the second graph below, we can see the contributing factors to this change in affordability since the beginning of 2022. The overwhelming cause in the decrease from the long-term average can be explained by changes in the base rate of interest.

30-year rates in the Eurozone were 3.44% on average as of Q2 2025. Furthermore, since many mortgage rates in Europe are tied to more variable rates, such as the Euro swap rate and the marginal lending facility, changes in interest result in a faster change to the housing market, dissimilar to what we saw in the US housing market. Therefore, there hasn't been a sharp decrease in supply in the housing market that we saw before. With rates in the Eurozone falling, property prices have begun to show some resurgence with the index dropping from 148 from 151 (index 100 = 2010) after the peak in 2022 and since reaching 158 in 2025. However, the effects are skewed around the whole of the EU, with high-income countries showing stagnation in the housing market similar to the US and the UK, whilst the growth figures have been boosted by many countries in Eastern Europe with a higher growth rate, wage increases and capital inflows.



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