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Investor demand for prime property remain solid so far – but how long will it last?

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The activity was high on the transaction market in March and the volume ended up at SEK 12.2 billion, compared to SEK 18.1 billion and SEK 10.2 billion in 2017 and 2018 respectively.

The investor interest for Swedish property remains large and three of the largest deals were made by foreign investors. Prologis bought a prime logistics portfolio from Bockasjö and Alecta for SEK 3.8 billion, Blackstone and Scius acquired an office property in Stockholm inner city from AFA for SEK 2 billion and Scius also acquired another office property in Stockholm inner city from AFA together with Angelo Gordon.

The property market is currently driven by historically low and declining interest rates. Investors have so far shrugged of the recent downward revisions of the Swedish economy. Earlier this week the Swedish Government lowered their forecast for GDP growth in 2019 from 2.1 to 1.6 per cent. Last week, Danske Bank reduced their corresponding forecast from 1.4 to 1.0 per cent. Although Konjunkturinstitutet's March forecast of 1.5 per cent GDP growth in 2019 was slightly higher than the previous one, they made a major downward revision in their December forecast. Catella still believe these forecasters are somewhat too positive. In a scenario where the global economy keeps on growing at a reasonable pace (and thereby keep up the Swedish exports growth at around 3 per cent year-on-year), the Swedish GDP growth is expected to slow down to around 0.5 per cent for the full year 2019 – a relatively mild economic downturn mainly driven by domestic factors.

Although the markets are nervous by the ongoing slowdown in the global economy, lower interest rates are effectively pushing out capital on the risk scale. The equity market has rebound strongly since January. The Swedish equity market (OMX Stockholm 30) is up around 15 per cent so far in 2019, and has taken back almost the entire part of the fall from October to early January (which is astonishing considering that this period also includes the unfolding of the Swedbank money laundering scandal). The Swedish 10-year government bond yield has also declined from 0.67 per cent in October to 0.25 per cent in early April. Credit margins on the bond market also tend to follow the overall market risk sentiments and have declined significantly from their three-year-peak in January 2019 (according to Moody's index over AAA and BAA rated US corporate bonds). This development is also visible in Catella's Credi survey (released last week), which indicated improving credit sentiments on the Swedish property market during the first quarter (from relatively low levels in Q4). Low underlying market interest rates, lower credit margins, better access to credit and improved investor risk willingness are factors that have benefitted the Swedish property market and have contributed to the strong start of the transaction year. The weak SEK rate may also be a factor behind the recent months' large acquisitions by foreign investors in Sweden.

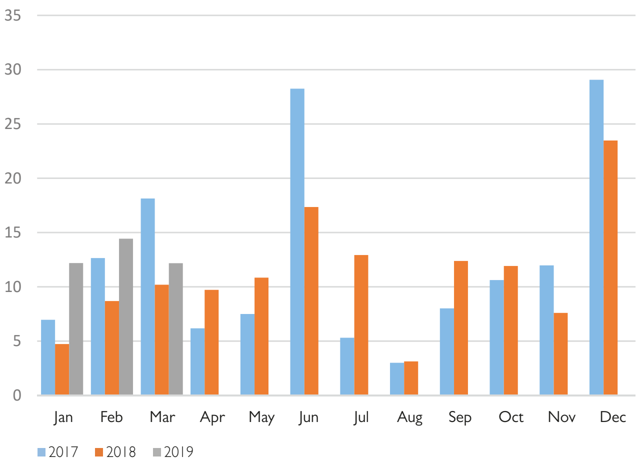
While the equity market is showing strong gains and improving risk willingness, the bond market is forecasting recession. The German government last week sold 10-year bond with negative yield and the total global volume of negative yielding bonds have increased over the USD 10 trillion-mark again. In October last year, the 10-year US government bond yield stood 100 basis points over the 3-month bill yield. The slope of the yield curve has fallen markedly since then and dropped into negative territory during the period March 25 to March 28 (the 10-year yield had bounced back to six basis points over the 3-months yield on April 2). The slope of the yield curve has been a historically reliable indicator of recession in the USA. For this indicator to be reliable, however, it needs to remain negative for a few weeks or months. Another factor is that the inversion of the yield curve also forecasts an upcoming recession within a time span of around 18 months. Several market participants are currently playing down the significance of the yield curve inversion as recent years' expansive monetary policies have pulled down long-term interest rates at unnatural low levels. However, yield-curve inversions were played down as an indicator of an upcoming recession also in 2000 and 2006.

The slowing global economy is problematic due to the major debt built up over the last decade. Global debt has increased by USD 100 trillion since before the financial crises to USD 240 trillion. The major central banks are virtually out of monetary ammunition to handle a recession (except for the Fed that have built up some ammunition lately) and the ability to provide fiscal stimulus is hampered by high public debts in most major countries. Financial risks have increased over the years specifically on the leveraged loan/corporate bonds markets (the issuance of BBB rated corporate bonds has soared during recent years). As a result, there is a major risk that the next global recession will be severe and that the authorities will have few options available to balance up the situation.

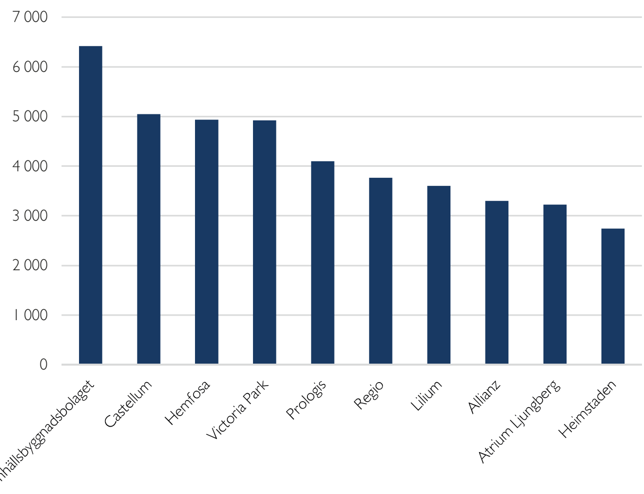
Investors know this and markets could easily switch to risk-off mode if signs emerge that the global economy is about to enter a full-scale recession. Lately, however, there have been a number of positive signs emerging. Chinese PMI figures have picked up (both regarding the service and manufacturing sectors), the consensus view is relatively positive regarding an upcoming trade deal between USA/China, consensus is on a soft Brexit and the USA economy is expected speed up again during the spring.

Looking forward, the Swedish economy will slow down in 2019 mainly due to lower residential investments and household consumption growth – and the rental markets for commercial properties in the major cities will likely follow suit. As rental growth slows down too, value growth will follow suit and property total return will decline towards the underlying historically low yield levels. The most probable scenario for the global economy is that the current dovish Fed and the recovering stock markets underpins a relatively healthy US GDP growth during the rest of 2019 (around 2–2.5 per cent year-on-year). This is above the potential growth rate of around 1.8 per cent year-on year. In this scenario, the Fed will pause for a while and then pick up the gradual monetary tightening during the autumn with gradually higher interest rates and further balance sheet reductions. The Riksbank will in this case need to follow the Fed and pursue a less expansive policy too. Weaker Swedish GDP growth and lower rental growth for commercial properties are in this scenario combined with higher credit margins and slightly higher underlying market interest rates (as above-trend growth and increasing inflation in the USA are pulling up European long-term interest rates). In this scenario the equity prices for the listed property companies are about to pass cyclical peak with gradually lower highs and lows. However, the weak economic growth will probably entail continued low real interest rates for an extended period of time, which will make property a continuously attractive asset class.

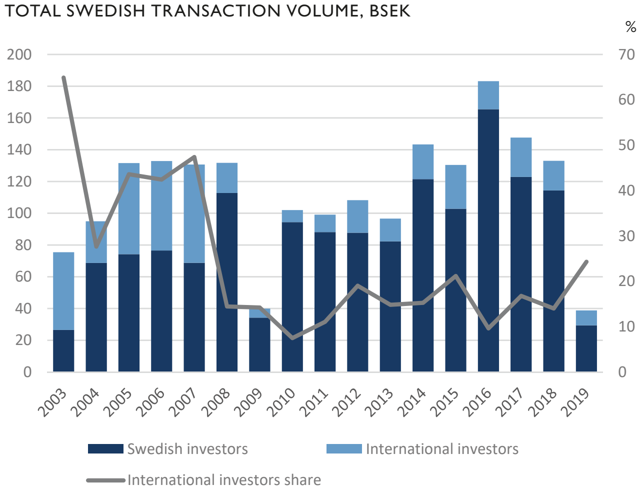
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION