Concerns have been raised about bubbles in various types of asset markets – but a positive spiral is now likely emerging in the Swedish non-cyclical property segments

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The transaction activity in December was extremely strong and in total transactions amounting to SEK 45.1 billion took place during the month. This can be compared to SEK 23.9 billion and SEK 20.9 billion during the same month in 2018 and 2019.

The full-year transaction volume for 2020 was around SEK 169.5 billion, up from SEK 158 billion in 2019 (only counting direct investments). Activity has, however, been low in January and transactions amounting to SEK 2.7 billion took place during the month, well below the SEK 14.2 billion and SEK 7.3 billion that were recorded in January 2019 and 2020. The low volume can probably be explained by the historically high market activity in December and that a large share of the ongoing deals could be finalised during that month. The number of deals increased significantly in December as 80 deals exceeding SEK 80 million took place during the month. This can be compared to 44 and 49 transactions during the same months in 2018 and 2019. The rolling 12-month number of transactions increased to 385 deals in December, which is above the long-term average and a major upswing from the previous 18 months (this number was stuck within the interval 310–350 deals from April 2019 until November 2020). Although the rolling 12-month number of deals fell back to 371 in January (still above the long-term average), the larger number of deals may be a sign that the property market has now adjusted to the last 18 months' significant drop in real interest rates. (The long-term real interest rates, measured as the yield levels of the 30-year US inflation linked bonds, have declined from around 1.0 per cent in early 2019 to about -0.3 per cent now.)

The major central banks' answer to the Corona crises has been a massive injection of liquidity into the global economy. The combined balance sheet of ECB, Fed, Bank of England, Bank of China, Bank of Japan and the Riksbank has increased by more than USD 8.9 trillion since early February 2020. That is just below the total accumulated balance sheet expansion from 2010 until spring 2020 (the combined balance sheet increased by USD 10 trillion in total during that period). An important difference from the period 2010–2017 (before the Trump tax cuts were implemented) is that the massive central bank stimuli are now combined with extremely expansive fiscal policies in most major economies. The result of this has been that the central bank liquidity has been more broadly distributed through tax cuts, benefits and cash hand-outs to households and companies. The broad money supply in Sweden (M3) increased by almost 18 per cent year-on-year in December, which can be compared to annual growth rates of just above 5 per cent during the recent years before the pandemic erupted. The money supply in the US has increased even more, by over 25 per cent year-on-year in December, also up from around 5 per cent before the pandemic. This is more liquidity than the real economy can absorb, especially during the last year when many economies have moved in and out of full or partial lock downs. As a result, large parts of the liquidity have flowed into the asset markets (equities, bonds, precious metals and property).

There has been a shift on the Swedish property market towards the non-cyclical segments since the spring 2020 (like residential rental properties, logistics/industrials and public properties). Investors have been increasingly hesitant when it comes to the outlook for the office market as concerns have grown that we may stand before a major structural shift within the sector due to more work-from-home going forward (some investors see similarities to the structural shift the retail sector has been going through during the last five years). The increasing uncertainty in the office sector has also resulted in more hesitant sellers, and as an effect the rolling 12-month transaction volume on the Swedish office market has declined by around 45 per cent over the last 12 months. Investors remain very sceptical to retail properties in general, and the only parts of the segment where there are still strong investor demand are grocery stores and well-located Big-Box properties. Traditionally, the office and retail segments have been the most liquid segments on the property market. However, investors are now to a large extent focusing on residential rental properties, logistics/industrials and public properties. The logistics/industrial and public property segments are relatively small and illiquid segments though. The residential segment has traditionally been more liquid (almost in line with the office segment), but the capital flow into this segment has been absolutely massive recently. The result has been major upswings in transaction volumes in these relatively small segments. There is also a clear trend where investors are being pushed out at the risk scale to secondary locations in the major cities and smaller cities. There has been a significant yield compression in general within these segments, and properties in secondary locations in the larger cities and in smaller cities have seen the largest yield declines. The declining market yields will result in substantial value growth for property owners in 2021, and this will further ▶

stimulate acquisitions within these segments as LTVs are declining (a positive spiral is now likely emerging here).

The massive liquidity injections have also propelled the global equity markets into record highs, and there are now clear signs of massive speculation. Economic and company fundamentals have become less important and momentum is a key market driver. Especially retail investors (that are coordinating on social media) have been active recently. During recent weeks, these investors have been buying stocks and call options in small companies (with generally high debt levels and/or weak business models) where major hedge funds have had short positions. The result has been that several of these hedge funds have been forced to terminate their positions, which have resulted in extreme spikes in the stock prices of the aforementioned companies. In addition, the hedge funds have been required to sell stocks in other companies to cover their losses. This has, in turn, resulted in overall turbulence on the financial markets. It now seems like silver is the newt target for these retail investors (silver prices have raced to the highest level since 2013).

The listed Swedish property companies have underperformed the broad equity market since early 2020. Stockholm OMX 30 is around 5.25 per cent over the previous market peak from February 21 2020 (measured as price level), while a selection of 40 listed Swedish property companies are around 11 per cent down during the same period. There are, however, major differences between the companies based on their segments and strategies. Companies with a focus on residential rental properties and/or public properties have performed well in line with the Stockholm OMX 30. The best performing companies in this category have been companies with properties in relatively small cities and with expansive growth strategies. This is a clear indication that the market is moving out in the risk scale and is very focused on building volume. Although the companies with logistics/industrial focus have only performed in line with the average for all 40 companies, it was from really high price levels from before the Corona pandemic erupted (there are major premiums to NAV within this sector). Companies with a focus on office and retail properties in the major cities have been really hard punished by the market. These companies have seen their average price levels decline by around 24 per cent in average since the market peak last February. However, the development since the autumn was quite positive for these more cyclical companies. There were clear signs of rotation on the market from November and up until a few weeks ago when companies with offices, retail and mix commercial properties were clearly outperforming the companies with a focus on residential, public properties and logistics/industrial properties. This was due to the positive market sentiments driven by the roll-out of new vaccines, the expectations of a strong economic recovery in 2021, and central banks that have made clear that they will tolerate above-target inflation to support the recovery. This process has been paused during recent weeks, however, and the equity prices for the companies with office, retail and hotel focus have declined significantly. This is partially due to the equity markets' turmoil described above, but it is also due to increasing insecurity regarding the pace of the economic recovery.

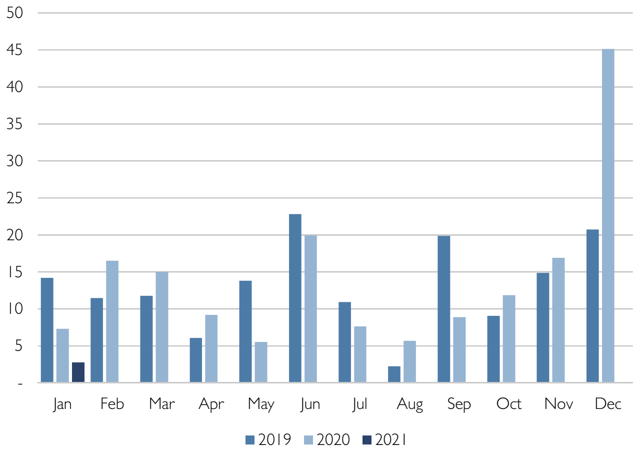
The property market has 15–20 years with an enormously strong macroeconomic tail wind. The economic growth in Sweden has been strong while there has been a global trend with falling inflation pressure and interest rates. This has benefitted property in relation to other assets like bonds and equities. The effect has been a massive flow of capital into the property sector. There has been a strong consensus view among property investors during recent years that the developed world is stuck in a Japanese scenario with low economic growth, low inflation and low interest rates for years or even decades to come. The macro trends identified behind this view include large savings by an ageing population in the developed world, fast technological development and increasing competition from China/emerging economies.

Concerns have, however, lately been raised that the low interest rates and expansive central banks have created massive bubbles in various types of assets. The recent weeks' turmoil on the equity markets mentioned above could be a sign of this. Investors are increasingly driven by speculation and retail investors are jumping on the band wagon. This is all usual signs of late-cycle markets due for corrections. In addition, the strong consensus of low inflation and interest rates for year/decades to come is now challenged. History has taught us that the current type of coordinated central bank and fiscal stimuli are extremely inflationary. Many companies have also gone into bankruptcy since the pandemic erupted, and even more companies have reduced their production capacity as a response to the economic slump. This can result in price increases when households finally increase their consumption during the late spring/early summer. In addition, the de-globalisation process that picked up in speed during the Trump administration will likely continue with Biden in the White House. China is still seen as a geopolitical rival and the main focus is to benefit domestic companies, industries and jobs. Less globalisation may result in higher consumer prices and thereby higher global inflation pressure. These are the main reasons that many investors have now started to consider a macroeconomic scenario with higher inflation going forward.

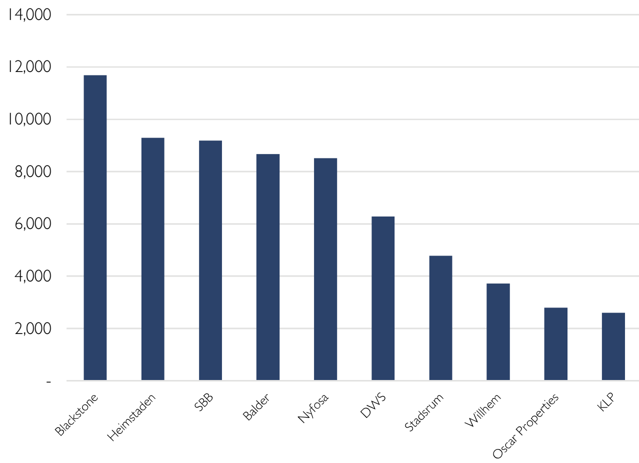
It is also likely that productivity in the US and European economies have declined significantly during recent years. Global debt levels are at levels not seen since the Second World War and the number of zombie companies (companies that earn just enough money to continue operating and service their debt) has increased significantly. The Bank for International Settlements has calculated that the share of zombie companies in 14 big economies had climbed from 2 per cent in the late 1980s to 12 per cent in 2016. That process has likely picked up in speed significantly in 2020. As a result of this, more and more investors see 1970-style stagflation (continuously low real GDP growth but higher inflation and also gradually higher long-term interest rates) as a realistic macroeconomic scenario going forward.

This is a scenario that would have sever impacts on the property market. It would be more important for property companies to focus on an efficient property management, and fast expansion strategies would be increasingly harder to pursue as nominal interest rates increase. Simultaneously, property segments with a strong connection to inflation like residential rental properties, public properties and logistics/industrial properties in good locations in the major cities, may benefit from this scenario as more and more investors would look for inflation hedges. Office properties in the major cities have rental markets that tend to follow real GDP and are therefore less efficient as inflation hedges. It is quite likely, however, that this process will not start for another 9–12 months. As long as the economic recovery is relatively slow and inflation remains low, the central banks will keep on pumping liquidity into the economy – and this liquidity will have no other place to go other than into the global asset markets.

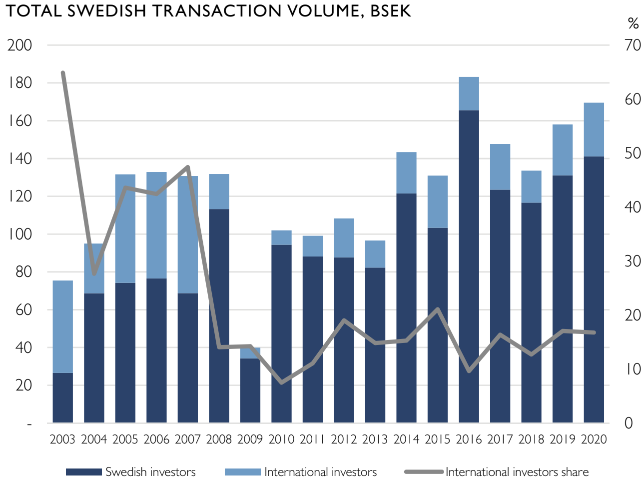
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION