The global economy is slowing fast

– but the property sector benefits more from lower interest rates than it loses by lower growth

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The activity on the Swedish property market has been continuously strong during the late spring/early summer. The rolling annual transaction volume was around SEK 147 billion in late May, a substantial increase from the 2018 full-year volume of around SEK 133 billion (excluding indirect transactions).

The largest deal during April was Amasten's purchase of the company Urbano, owning around 2,600 rental apartments, from ICA-handlarnas Förbund for around SEK 3 billion. Apart from that, Folksam acquired a newly constructed office property in Stockholm from Fabege and Coop acquired all Netto's Swedish grocery stores (including around 110 properties with grocery stores) for around SEK 1.4 billion.

The concerns about the health of the global economy has increased markedly over the last month and OMX Stockholm 30 has performed a negative total return of around 9 per cent since early May. The Trump administration has increased the pressure against their trading partners lately. In May, Washington announced increased tariffs on half of all China's exports to the USA (around USD 250 billion per year) and blacklisted Huawei from access to essential US technologies. This triggered Beijing to threaten to limit its exports of rare earths to the USA (a number of niche metals that are essential for production of electronics). Washington has also issued new threats of tariffs towards Mexico as a means to reduce migration through the southern border (a major problem for Mexico as around 80 per cent of its exports goes to the USA). Washington also announced that India is about to lose its preferential access to the US market (up until now India has been defined as a beneficial developing country). Above all this, the US tariff threat against European and Japanese cars and auto parts remains, as the issue is only delayed for up to six months. The trade disputes are hampering global growth, especially in Europe and the emerging markets, as these countries are more exports dependant than the USA. The Chinese economy is also slowing down and last week an official employment index hit its lowest level since March 2009. All this is happening in a situation where the global economy is hampered by record high debt levels, elevated asset prices, extremely accommodative monetary conditions and strained government finances (in most major countries but not in Sweden).

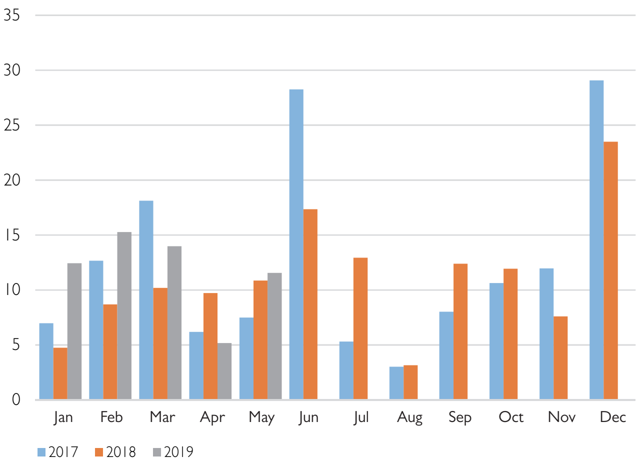
The Swedish economy performed stronger than expected during Q1 2019 with a quarter-on-quarter GDP growth of 0.6 per cent (2.1 per cent year-on-year). However, net-exports represented all growth during the quarter (due to higher exports and lower imports partly as a result of the weak SEK rate), while private consumption and fixed investments declined (residential investments fell by SEK 2.6 billion quarter-on-quarter in Q1 compared to the total quarterly GDP growth of around SEK 7.2 billion). Residential investments will keep on declining during the rest of 2019, reducing GDP growth by 0.5–1.0 percentage points on an annual basis until Q1 2020. Although the retail turnover figures for April was stronger than expected, non-durable goods represented the entire improvement on a rolling 12-months basis. When it comes to durable goods, the recent years' trend of gradually lower growth rates continues (the rolling 12-months growth rate for durable goods was 1.9 per cent in current prices in April). The domestic side of the Swedish economy is currently in decline, and will likely remain weak during the rest of 2019. As a result, the Swedish economy will be highly dependent on global demand during the coming 9–12 months. The timing of the ongoing global slowdown is not good at all for Sweden.

The bond market also clearly indicates slower global growth going forward. Last week the Swedish 10-year government bond went into negative territory and Swedish and German 10-year bond yields have eclipsed their 2016 nadirs (the German 10-year bond yield are currently just below -0.20 per cent). One important gauge of the global economy is the yield difference between short and long-dated US government bonds. The yield difference between 3-month US government bills and the 10-year bond has gone significantly into negative territory since mid-May, and is now below -0.20 (the yield difference also briefly inverted in March before going into positive territory again). The yield difference between short and long-term bills/bonds has been a reliable indicator of every upcoming US economic recession since the late 1960s (around 18 months ahead). An inverted yield curve may in fact be a self-fulfilling prophecy. The inversion may exacerbate an economic downturn as it hampers the business models of the banks (banks generally lend money long-term at higher rates than their short-term deposits). As the business model of the banks becomes less profitable, banks are providing less credit to the economy (which is constraining investments and reduces economic growth). However, the difference between the 3-months bill and 10-year bond is just one of several measures of a yield inversion. The more stable yield difference between the US ▶

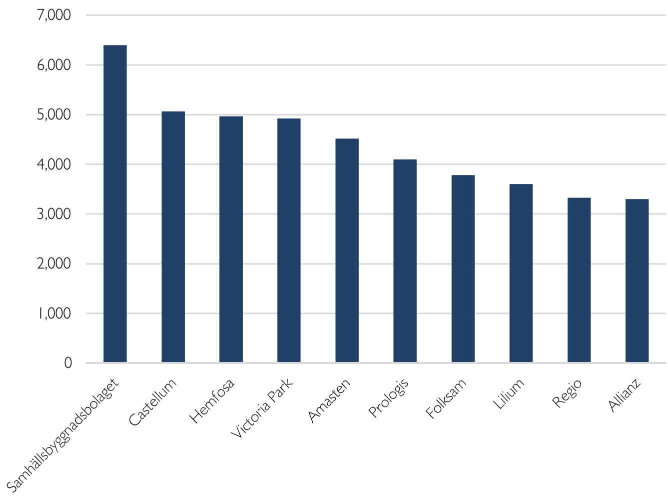
government 2-year and 10-year bonds is also a good leading indicator of recession and has been stable at around 0.20 per cent since December last year. Although it is premature to say that we are heading into a full-scale global recession, global growth is declining. The message from the yield invention is that the bond market is expecting significant rate cuts from the Fed during the coming 12–18 months and thereby a more expansive monetary policy also for the ECB and Riksbanken going forward.

The listed Swedish property companies have performed much better that the broad equity market over the last month, with a positive total return for the ten largest listed companies of over 5 per cent since early-May, mainly due to increasing market caps (lower market yields). There is an almost perfect correlation between the listed property companies' average cost of financing and the reported yield levels of their property portfolios. Since the ten largest listed companies have a fixed interest term of around three years in average, changes in the underlying market interest rates and interest margins are rolling through the companies' average interest expenses slowly. The average interest rate costs of the Swedish property companies will likely continue to decline gradually during the coming 12–18 months, which will continue to push down prime property yields in the major and regional cities. However, both Swedish and foreign investors are selective and are prioritising commercial properties (mainly offices and logistics/industrial properties) in the three main cities, as well as in the larger regional cities. Well-located residential and public properties are also particularly interesting for investors. A global recession would likely lead to significant falls on the global equity markets, declining investor risk willingness and increasing credit margins especially for property companies with high risk in their business models. A scenario with a relatively mild Swedish recession is, however, not that bad for the property sector (as long as there is not any large increases in bankruptcies and vacancies). Over a 2–3 year period, property companies with low risk in their business models generally benefits more from the lower interest rates than they lose from the lower economic growth. Over the long-term, however, the property sector will likely have major difficulties to adapt to a macro environment with improving growth potential, higher interest rates and gradual quantitative tightening from the central banks (QE is currently a major factor pushing out investors on the risk scale).

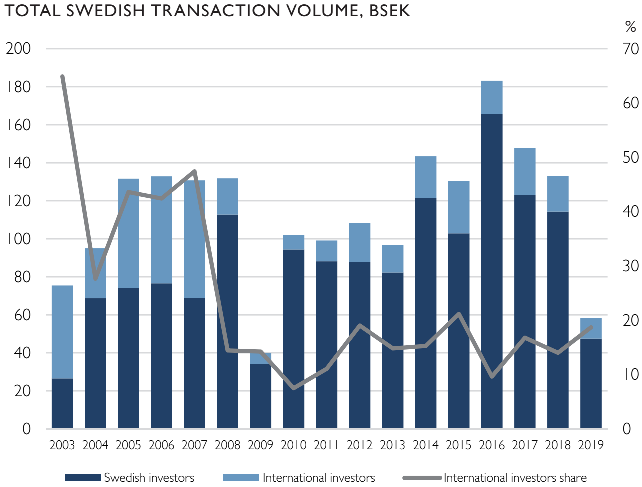
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION