The probability for a debt crisis has increased lately, but the main scenario is still that the Riksbank will increase too little and too late to rein in inflation

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The transaction volume ended at SEK 15.7 billion in May, which can be compared to SEK 5.6 billion and SEK 10.1 billion during the same month in 2020 and 2021 respectively. The rolling 12-month transaction volume reached a new all-time peak of SEK 249.1 billion (up from SEK 143.6 billion last month).

Even more interesting than the transaction volume is the number of deals exceeding SEK 80 million. This figure ended up at 38 deals in May, compared to 23 and 19 transactions during the same month in 2020 and 2021. The rolling 12-month number of deals ended at 439 in March (up from 420 deals last month), which also is an all-time high level. This is interesting because over the last 15 years the rolling 12-month number of deals has fluctuated quite strictly within an interval of 320 to 420 deals, only breaching the interval on the downside on two occasions (in 2009 after the financial crisis and in the autumn 2014 during a period of deflation). The May number is now breathing the upper boundary of this interval for the first time. The number of transactions on the property market is a good leading indicator around seven months ahead of the CPI inflation. The breach upwards in the number of deals is likely a reaction to the high-inflation environment that we have now entered.

The listed property companies have seen a correction upwards during recent weeks since hitting the last bottom in early May. Since the market nadir of May 9, the listed property companies are up around 5.7 per cent (compared to 6.6 per cent up for the Stockholm OMX 30). Since the market peak in late November, however, the listed property companies are still down almost 35 per cent, compared to 12.6 per cent for the OMX Stockholm 30. The residential/public property companies have clearly underperformed and are down around 46.9 per cent since the market peak in November, and down 0.5 per cent since early May. The equity market premiums have declined significantly during recent months. The weighted average discount to NAV for 27 of the largest property companies is currently around 14 per cent. There are, however, large differences between the companies. There are still equity market premiums on a few companies that are focusing on mix commercial, logistics/industrial and grocery store properties. However, there are discounts on almost all the companies with a focus on office and/or retail properties. There are also discounts for most of the companies focusing on residential and/or public properties in the major cities. As a result, the equity market is now indicating higher yield levels in almost all property segments on the market, except for higher yielding segments with market rents that are expected to follow inflation over time. Examples are segments like mix commercial properties and logistics/industrial properties in non-prime locations where the equity market is still indicating slightly lower yield levels.

The institutions have been the single largest net-investors on the property market since the autumn 2021 and were net-buying properties for SEK 65 billion during the 12 months to May. Although Heimstaden's acquisition from Akelius makes up more than half of that figure, their net-acquisitions are still in an uptrend since January 2020 when adjusting for this deal (in late 2019 and early 2020 the institutions where net sellers). The institution's net-acquisitions have, however stabilised on a plateau during recent months. The listed property companies have slowed down their net-acquisitions during the last year. The figures have, however, picked up somewhat recently and the rolling 12-month figure now stand at SEK 27 billion. Funds were (along the institutions) among the largest net-buyers on the market early last year, and their rolling 12-month net-acquisitions peaked at SEK 21.9 billion in April 2021. Since then, however, the figure has fallen back to just above the zero mark. Foreign investors have slowed down their investment activity and acquired Swedish properties for SEK 15.6 billion during the 12 months to May. This is in the lower bound of the interval of SEK 15–35 billion that has prevailed over the last decade. The number of deals done by foreign investors has clearly declined during the last decade as property values have increased.

Catella's GDP Macro Index (which is a mix of six leading indicators for the Swedish GDP growth) is indicating a significant economic slowdown ahead. Statistics Sweden recently released the Q1 2022 GDP figures for Sweden. The real GDP declined by 0.8 per cent quarter-on-quarter during the first quarter (which resulted in a year-on-year growth of 3 per cent). This was well in line with the prediction by the Catella's GDP Macro Index. According to the index, Swedish GDP growth will keep on slowing to a rate of around 2.0 per cent year-on-year during the second and third quarter 2022 and then go further down below the zero mark during the last quarter 2022. As a result, the index is indicating an upcoming recession (the index is though less reliable more than 9–12 month out in the future). In Sweden, CPI inflation increased to 6.4 per cent in April, driven by a broad range of goods (where soaring food prices stood out). Catella's CPI Macro Index (a leading index for inflation including a mix of macro indicators/commodities) is indicating that we are now very close to a short-term peak in inflation and that inflation ▶

will temporarily fall back towards 2–3 per cent during the summer/autumn 2022 (mainly due to falling year-on-year increases in several commodity prices). After that, the index is indicating higher inflation again (as with the GDP index, however, the index is less reliable this far out in the future). It is, however, important to notice that the model does not include indicators that mirrors the supply chain bottlenecks. It is always a risk that bottlenecks will worsen again during coming months due to the Ukraine war and the coronavirus development. Looking at the development in the USA, CPI inflation fell back slightly in April to 8.3 per cent from the 40-year peak level of 8.5 per cent in March. Looking at the personal consumption expenditures price index (which is the inflation measure preferred by the Fed), month-on-month increases are starting to fall back now. However, in the USA, the inflation pressure is to large extent demand driven and there is already an ongoing wage/price spiral evident in the economy. Eurozone inflation soared to a record of 8.1 per cent in the 12 months to May (up from 7.4 per cent in April). The inflation is widespread among goods and services, but the main underlying culprit is energy. The EU is a major energy importer (contrary to the USA, which has major coal, oil, and gas assets) and is therefore very sensitive to the war in Ukraine and the sanctions against Russia. The European domestic demand is much weaker, and the high inflation is hampering real wage growth and household consumption. Add to this that the ECB has become significantly more hawkish lately and expectations of a 50-basis points rate hike has increased lately.

The monetary support was massive in 2020–2021. Six of the major central banks (the Fed, ECB, BoJ, BoE, PBoC and the Riksbank) increased their combined balance sheet by USD 9.6 trillion during the 12 months following February 2020, almost in line with the increase of their combined balance sheet during the entire decade up to February 2020. This policy forced investors out on the risk scale and inflated assets prices like equities and property (there is a strong correlation between the aggregated central bank balance sheet and property and equity prices over the last decade). This process is now reversing when liquidity is removed from the financial markets. The Fed is expected to start to shred USD 47 billion a month from its balance sheet from now on and jack it up to USD 95 billion a month later this year (from its USD 9 trillion balance sheet). In Europe, there is less upward pressure on wages and core inflation, which means that the ECB is likely to act later and less forcefully than the Fed (but market expectations are starting to shift in this aspect). Bank of China, on the other hand, is increasing their monetary stimuli due to the fast slow-down in economic growth. All in all, the year-on-year growth rate of combined balance sheet of the six central banks above has declined from USD 9.5 trillion in February 2021 to minus USD 33 billion in May 2022 and will likely fall significantly further below into negative territory during coming months.

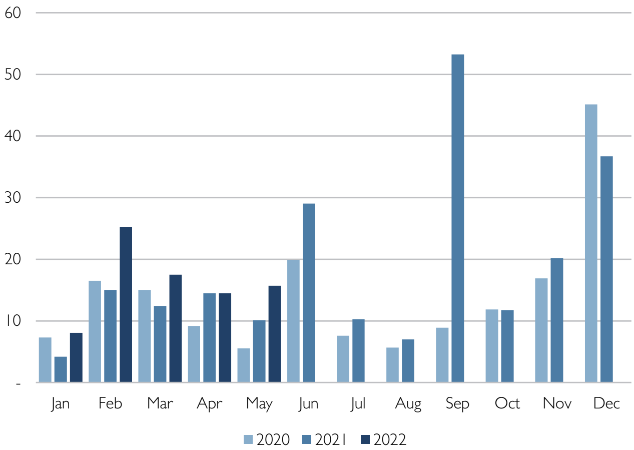
The turnaround in the monetary policy has been instrumental for interest rates, both nominal and real rates. The Swedish 5-year swap rate has gone from 0.25 per cent in late August 2021 to 2.41 per cent now. The 3 months STIBOR rate has gone from the zero mark in March to 0.53 per cent now. However, the 10-year government bond yields have fallen back during recent weeks booth in the USA and in Sweden. In the USA, the 10-year government bond yield increased from below 1.6 per cent in January to a short-term peak of 3.12 per cent in early May. In Sweden the 10-year government bond yield increased from just above the zero mark in December to 1.95 in early May. Since then, however, rates have declined again on the back of expectations of weakening economic growth (due to negative real income growth and hawkish central banks). The problem for the property market, however, is that the lion share of the long-term interest rate increases up until early May was due to increasing real interest rates. The 30-year US inflation linked bond yield (TIPS) increased from about -0.60 per cent in December to almost 0.70 per cent in early May. This massive 130 basis-point-increase has been a real game change for the property market and is a major reason behind the huge sell off on the equity market. The rate decline during recent weeks has been positive for the property sector (and there has been a recovery on the equity market). However, everything is not that positive. The long-term real interest rate has been stable during recent weeks and remained on a plateau of around 0.70 per cent. Instead, the lower interest rates have been driven by lower inflations expectations. The US 10-year break even inflation has declined by around 35 basis points since late April. One important reason behind this is likely that the Fed is now starting quantitative tightening (i.e., selling off assets on their balance sheet). The Fed is one of the major owners on the TIPS market (it owns a fifth of the outstanding debt). The market is now expecting that the Fed will shrink its balance sheet, and this is pulling up real bond yields.

Credit spreads on the bond market have increased significantly lately, and this is also the case for the listed property companies. Banks have also become significantly less accommodative in their lending and Catella's credit market indicator (CREDI) has dropped from 44.6 to 27.5 during the last quarter. A large part of this drop has probably occurred during the last 4–5 weeks. Less central bank stimuli, lower economic growth and more risk averse investors are now producing significantly higher credit spreads and the market participants believe that the situation will keep on deteriorating during at least the coming quarter (according to the forward-looking sub-index in the CREDI survey). Central banks will not be able to reduce credit spreads as they did during the coronavirus pandemic due to the high inflation. However, they will not let credit spreads increase out of control either as this would jeopardise financial stability and create a credit crunch.

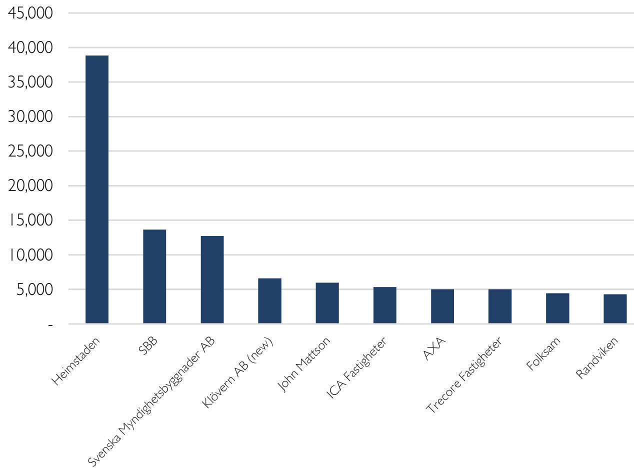
The transaction volume on the Swedish property market has been in an uptrend since mid-2018 and is now at an absolute historic peak. Both the number of deals and the average deal size is historical highs. In the short term, lower economic growth, less central banks liquidity and high long-term real interest rates (compared to the last years) are now taking its toll on the transaction market. The effects are clear in ongoing processes, especially when it comes to building rights and low yielding properties where it is hard for buyers and seller to meet up. The market is, however, functioning quite well when it comes to higher yielding grocery store properties, well located big-box retail properties, and mix commercial/industrial properties. Transaction volumes and the number of deals will likely fall back during the second half of 2022. Buyers are facing significantly high spot market interest rates and credit margins (compared to the last 12–18 months), while seller are still benefitting from extremely low financing costs (as they are having capital and interest rate maturities of around 3 years in average). The result is that it becomes harder for buyers and sellers to meet up and the result is that liquidity is declining on the property market. Catella's main scenario is that central banks will tighten too little and too late to rein in inflation. As a result, long-term inflation expectations will increase, and long-term real interest rates will decline below the zero mark again. This is a rather good macro environment for real assets like property. The parts of the market that will likely perform best in a stagflation environment are segments with somewhat higher yield levels, limited new supply and market rents that follow CPI inflation (like industrial/logistics, public, grocery store, big-box retail and mix commercial properties).

However, the probability of Catella's alternative scenario has increased during recent weeks. In this scenario, the Riksbank and ECB are implementing a series of rapid rate hikes over the next 9–12 months to bring inflation down to just under 2 per cent. Asset prices fall rapidly (the stock market and housing prices fall at the same time as credit margins are soaring) and the economy ends up in a debt crisis with a subsequent deep recession. Through the debt crisis, parts of the debt in the economy are being reconstructed and asset prices are stabilised at lower (but more sustainable) levels. Catella will look further into the impact of alternative macro scenarios on the property market in our next focus report later this month. ■

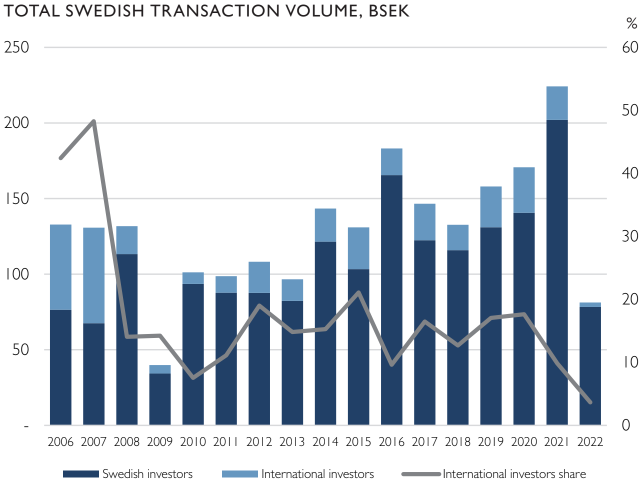
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTH VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION