More and more signs are pointing at an upcoming stagflation scenario – that would benefit real assets like commodities, infrastructure and property

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Transactions amounting to SEK 14.0 billion took place in February, compared to SEK 11.5 billion and SEK 16.5 billion during the same months in 2019 and 2020. The rolling 12 months transaction volume ended up at SEK 162.9 billion last month, down from SEK 165.5 billion in January.

The number of deals increased significantly in December as 84 deals exceeding SEK 80 million took place during the month. In January and February, however, only 11 and 20 deals took place respectively. The 20 deals in February were well below the 25 and 29 transactions that took place during the same months in 2019 and 2020. As a result, the rolling 12-month number of transactions fell back somewhat to 366 deals in February. This is still well in line with 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). The single largest deal of the month was Blackstone's acquisition of a logistics portfolio from Castellum for SEK 5 billion. The second largest deal was Intea's acquisition of two properties in Malmö and Kristantiad from Akademiska Hus for SEK 1.6 billion (leased to Malmö University and Kristianstad University). In addition, Niam acquired three local service shopping centres located in the Greater Stockholm from Citycon for SEK 1.5 billion. Apart from that Niam also acquired the 43,000 sq.m. suburban shopping centre Haninge Centrum from Grosvenor. There are now signs that some retail property owners are starting to adjust to the actual market prices. Prices that tend to be below many of the companies' current book values. More transactions within the retail segment is positive as many of these assets need new owners that can add new capital and perspective to develop the properties in line with the changing market conditions.

The improved rolling 12 months number of deals that we have seen during the last months may be a sign that the property market has now adjusted to the significant drop in real interest rates that occurred during the 16 months period between April 2019 and August 2020. The long-term real interest rates, measured as the yield levels of the 30-year US inflation linked bonds, declined from around 1.0 per cent in to about -0.46 per cent during that time span. Catella recently made a survey among our key domestic clients regarding what macroeconomic scenario that is most likely for the coming five years. Just as in the previous surveys in October 2019 and May 2020, the stagnation scenario (continuously low economic growth, non-existing inflation, and low long-term interest rates) was seen as the most probable development with around 30 per cent of the responses. However, the share of the respondents that believe in this scenario has fallen to from 49 and 46 per cent respectively in the previous two surveys. In addition, almost 30 per cent of the respondents believed in a scenario where the pandemic is becoming drawn-out and the economic recovery does not take off for another 18–24 months. In other words, around 60 per cent of the respondents believed in a low interest-rate scenario for the coming 2–3 years. Almost 90 per cent of the respondents also believe that either residential rental properties, logistics/industrial properties or public properties will be the best performing property segment in 2021. These property segments have really benefitted from the declining long-term real interest rates and the strong consensus view of low interest rates for long. As a result, the capital flow into the segments has been absolutely massive during the last 12 months. Ten of the largest Swedish listed property companies with a residential/public property focus have made combined property net-acquisitions of around SEK 50 billion in total during the last 12 months*. In addition, there has been a large flow of capital from institutions and funds into rental homes, logistics/industrial and public properties. The result has been major portfolio premiums and massive yield compressions within these segments. The yield compressions have been larger the further out on the risk scale you get (the compression has been largest for secondary properties in smaller cities).

However, just as the market consensus has settled, there has been a major shift in the macro environment during the recent weeks. Although there seems to be some bumps in the road, the vaccination processes are moving on in both Europa and the USA. Economic sentiments have improved markedly during recent months (especially within the manufacturing sectors in Europe and the USA) and the Chinese economy engines on at a relatively high speed. Investors expect economic growth to roar back from the spring and for the rest of 2021, propelled by the massive ►

*Amasten, Brinova, Heba, John Mattson, K2A, K-Fastigheter, Offentliga Hus, SBB, Trianon and Wallenstam.

combination of fiscal and monetary stimuli that is currently applied. The major central banks have reassured markets at multiple occasions during recent weeks that they will keep on stimulating the economy a good way into the recovery, even if inflation overshoots the targets for a good while. The US Senate will shortly vote on Biden's new fiscal stimulus package of USD 1.9 trillion (around 9 per cent of GDP), which if adopted will take the total fiscal effort since the pandemic erupted to around USD 3–4 trillion (14 –19 per cent of the US GDP). Simultaneously the Fed flushes the market with liquidity, buying USD 120 billion of securities a month (around 7 per cent of GDP). Six major central banks (the Fed, ECB, BoJ, BoE, PBoC and the Riksbank) have increased their compared balance sheet by USD 9.2 trillion since February 2020, which can be compared to the total USD 10.5 trillion that they increased their balance sheet with during the entire decade from February 2010 to February 2020. As a result, some analysts now expect the US economy to grow by up to 7–8 per cent in 2021. Sweden is a small, open and exports dependent country, and this huge increase in global demand would of course spill over to stronger growth here as well. When governments emit massive amounts of debt simultaneously as the central banks mop up this amount of liquidity, it comes very close to actual monetarisation of debt.

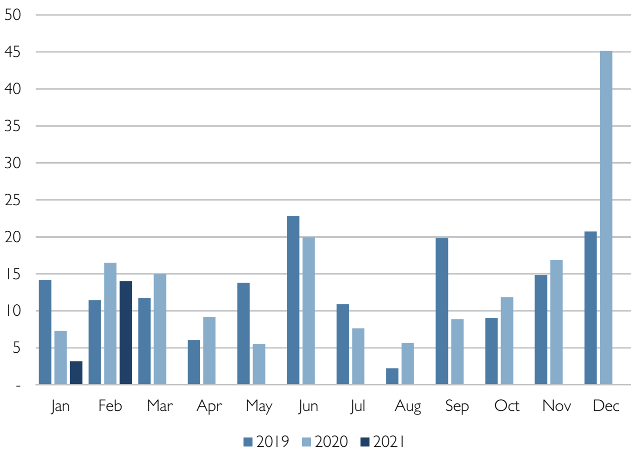
As a result of the expected higher GDP growth, interest rates have now started to increase. The Swedish 5-year swap rate has gone from 0.08 per cent in late January to 0.32 per cent now. In the USA, the 10-year government bond yield has moved from below 1 per cent in early January to 1.47 per cent now. This is partly due to higher inflation expectations, the US 10-year break even inflation has increased by 100 basis points since April 2020 to 2.21 per cent. The nominal interest rates increase is, however, also due to higher real interest rates. The 30-year US inflation linked bond yield has increased from about -0.31 per cent to 0.10 since the end of January (with a temporary peak of 0.22 last week). This massive increase of more than 40 basis points will be a real game change for the property market if it is sustained. It is quite likely, however, that the bond yields will fall back again during coming weeks or months if the higher interest rates start to bite too much on asset prices (and the central banks are forced to step up their stimulus efforts). The long-term message is however clear. The global financial markets are starting to become increasingly anxious about how the imminent economic recovery, higher inflation and increasing interest rates will affect asset prices. Although the consensus view among the domestic actors on the Swedish property market is that interest rates will remain low for years to come, the actors on the global financial markets are not that sure.

In the longer term, there are good empirical evidence that steadily higher debt levels in an economy tend to generate increasingly lower economic growth, lower inflation and also lower real interest rates (which is resulting in lower nominal interest rates). The interest rates are getting lower despite the fact that governments, households and corporations are increasing their lending. Similar trends have been observed since the dawn of the human civilisations, starting with Mesopotamia and the Roman Empire. One important factor behind this is that the low interest rates are destroying the process that was named "creative destruction" by Joseph Schumpeter. The recent decade's low interest rates and bond buying by central banks facilitate for weak companies to survive although they are not producing efficient products that are demanded by the markets (in a healthy economy these companies would vanish according to Schumpeter). The result is that production resources are not used in the most efficient way, which in turn is resulting in lower and lower economic growth. The Bank for International Settlements has calculated that the share of zombie companies (companies that earn just enough money to continue operating and service their debt) in 14 big economies had climbed from 2 per cent in the late 1980s to 12 per cent in 2016. This number has most likely increased even further since that. The long-term real interest rates are a measure of an economy's ability to grow over time. When the potential growth rate decline, so do the real interest rates. The fiscal multiplier (the ratio of change in economic output arising from a change in government spending) has also had a tendency to be very low if not negative in the Western economies during recent decades. The extra debt that the governments are taking on to stimulate their respective economies through tax cuts and benefits are generally only resulting in short-term gains in economic growth (look for instance on Trump's tax cuts in 2018). The steadily declining GDP growth rates are in turn putting a lid on inflation. Add to this the price pressure from technologic development, China and the Soviet Union's entrance into the global economy in the 1980s and 1990s, and also the quickly ageing populations in the West – and you have economies that are entering full stagnation. This development has been very visible in Japan since the early 1990s, but also in Europe and to some extent in the USA since the financial crisis in 2008.

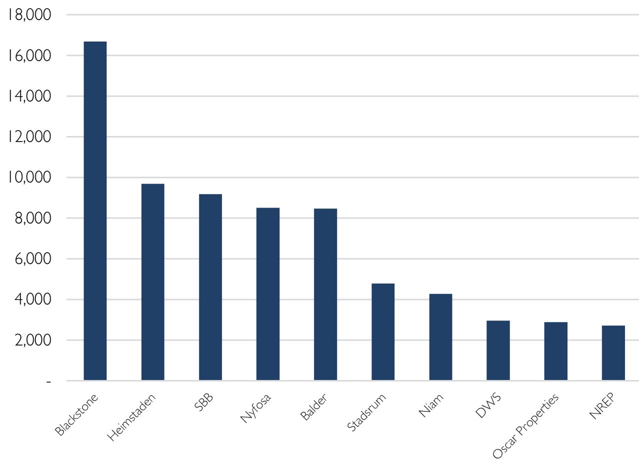
The flipside of steadily increasing debt levels is higher asset values and increasing inequality between the have and have-nots in the society. This is of course creating social tensions, which has also been clearly visible in both Europe and the USA during the last 12–18 months. When social tensions and political polarisation increase, it becomes even harder for politicians to produce reforms that actually increase economic productivity (for instance fiscal stimulus packages that have positive fiscal multipliers). This is a self-enforcing spiral downwards that will end in depression and major social unrest (think about the development in Europe in the 1930s). The politicians cannot accept this off course. They need a quick fix of the problem, or at least a fix that postpones the problems for a few years. This is where the coordination of monetary and fiscal policies comes into the picture. By combining expansive fiscal policies with central banks that are making sure interest rates remain low, ▶

the governments can keep down the costs for serving their debts while they still stimulate the economy and provide benefits for the low-income parts of the populations. This policy can be amplified if the government is also issuing loan guarantees for the corporate sector so that they can also take on even more debt (there have been more and more talk about this in the US recently). This will produce higher economic growth and also higher inflation, which will inflate away parts of the debt load. Historically, this is exactly what rulers' have done at multiple times before when debt levels have increased too much. The problem is that this is not a solution to the underlying debt problem, it is usually ending up in runaway inflation and even further declining economic growth. Whether or not the Western economies will end up in 1970s stagflation again is too early to say for sure, but all warning signs are really there. If that scenario plays, capital will flow to all types of real assets like commodities, infrastructure and property.

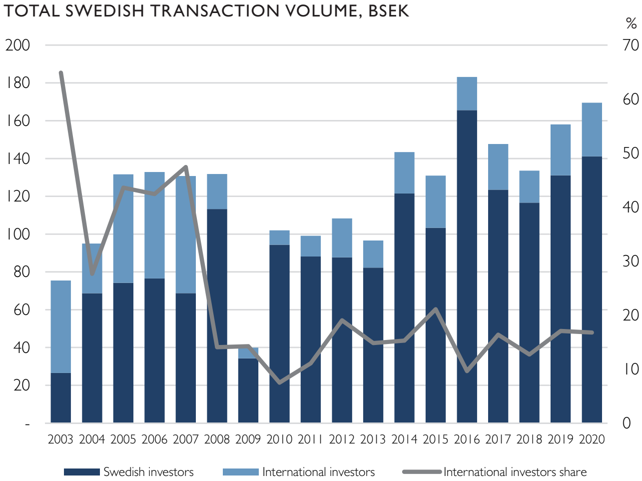
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION