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Low interest rates keep on driving the property market, but lower growth is now starting to take its toll on the cyclical parts of the market

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The activity on the Swedish property market was low in October and the trend of fewer but larger deals that has been visible over the recent quarters seems to continue.

The 12-month rolling number of transactions remains below 300 deals, which is well below the lower bracket of the interval 330 to 420 deals per year that has prevailed almost all months over the last 15 years. The transaction volume in October fell back to approximately SEK 7.8 billion, which can be compared to SEK 10.6 and 11.9 billion respectively for the equivalent month in 2017 and 2018. The 12-month rolling volume remains high, however, and hoovers around SEK 148 billion in October.

There has been a number of relatively positive macro news recently, and the gloomy mood among investors that prevailed during and after the summer has improved somewhat. The US yield curve (the difference between 2-year and 10-year government bonds) has been in positive territory since early September (it currently stands at around 20 basis points, after a short period of inversion in August). There has also been positive news regarding the trade talks between the US and China lately, and the probability of a hard Brexit has declined significantly. The political turmoil in Italy has also calmed down over the last six months. The global level of political risk, however, is clearly elevated with an ongoing trade war and major popular uprisings in several places (like Spain, Hong Kong, Latin America and Lebanon). These spots of turmoil could easily spread to larger economies. The global stock markets have performed strongly lately on the positive macro news and both OMX Stockholm 30 and S&P 500 are currently standing at all-time highs (up around 24 and 22 per cent respectively year-to-date). The last 6 months' steep fall in long-term interest rates has also levelled out and bond yields have stated to increase somewhat. The Swedish 10-year government bond yields have increased to around -0.07 per cent, around 35 basis points up from its nadir at -0.42 in August. The 5-year Swedish swap rate is also back in black, having been negative since early August.

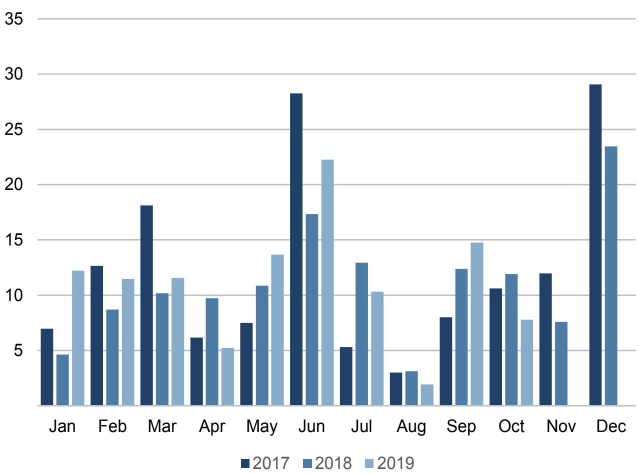
However, the long-term macroeconomic outlook does not look very promising. The global economy has entered a period of synchronised stagnation according the Brooklyn Institution as the economic growth rates are currently slowing down simultaneously in almost all advanced and emerging economies. In mid-October, the IMF also lowered its GDP growth projection for the global economy this year to the lowest level since the financial crises. In the USA, the GDP growth slowed down during the third quarter to 1.9 per cent. Even if the headline figure was better than expected, the previous stable private consumption growth cooled down, while business investments dropped by an annualised 3 per cent (the worst reading in four years). The third quarter GDP figures for the Euro zone actually came in stronger than expected, with a positive 0.2 per cent quarter over quarter growth rate (which saved the single currency area from entering a technical recession). The Euro area inflation, however, kept on falling in October and the forward-looking indicators do not look good as Economic Sentiment Indicator fell to its lowest level in five years. In Sweden, the momentum in the economy keeps on declining. Although private consumption growth has recovered somewhat during recent months, the trend growth in private consumption is only 0.8 per cent year-on-year in fixed prices (the long-term average is 2–2.5 per cent). The growth rate in the households' debts are gradually declining, which is in line with the moderation in housing prices and previous years' implementation of stricter rules of amortisation. The effect of this is that less credit is being injected into the economy, which is reducing the domestic demand. It is quite likely that the Swedish households will ramp up their savings further during the coming 6–12 months as the economic slowdown now has stated to affect the labour market. During the last 6 months, the Swedish employment growth has declined from a stable growth rate of around 80–100 thousand new jobs year-on-year to minus 10–40 thousand jobs year-on-year (although the SCB data is currently a little bit shaky in this area due to internal problems with the data quality). Opposite to both the Fed and ECB, the Swedish Riksbank has clearly indicated that they would like the repo rate to increase from -0.25 to zero in December. The Riksbank is concerned by the negative side effects on the economy if the market participants start to consider negative short-term interest rates as a natural state of order (which they probably already have done for quite a while). ▶

Another reason for the Riksbank's hawkish move may be the recent years' significantly weakened SEK-rate. At some point, our weak currency will start to produce higher inflation through higher import prices. In addition, the lion's share of the Swedish banks financing is in foreign currency. As a result, the Riksbank may thereby end up in a position where they need to change their monetary policy in a slightly less expansive direction compared to the Fed and ECB. This will reduce economic growth in an environment where the Swedish economy is slowing down relatively fast anyway.

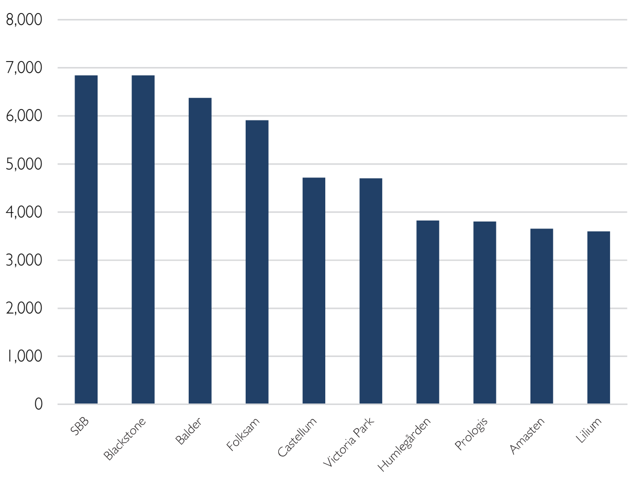
The listed property companies have had quite a mixed development on the stock market during the recent month. The property sector is highly dependent on the interest rate development and the recent months' slightly higher long-term interest rates is an important factor behind the sideway development for the listed property companies. Equity market investors have become especially concerned by the office market, after a number of property companies reported negative net-leasing figures during the third quarter. The listed companies with a clear office focus have been punished on the stock market, while most of the other companies have generally performed relatively well. As a result, some of the companies with an office focus have gone from equity market premiums to discounts on net asset values. The standstill on the labour market, in combination with an increasing amount of new office projects coming out on the Stockholm office market during recent years, have made investors starting to question the development for market rents and vacancies going forward. The year-to-date development for the listed property sector as a whole is, however, extremely strong – up 52 per cent in average, double the gain of OMX Stockholm 30.

As it looks now, most property investors assume that the economy will be in a Japan-like scenario during the coming decade/decades, with extremely low interest rates, low economic growth and non-existent inflation. As long as the economy does not end up in a recession, the property market will likely perform strongly over the coming 12–18 months, where low market interest rates and attractive interest rate margins for the major property investors will keep on pushing down property yields in the larger cities. It is, however, likely that the weakening economic growth and a changing supply/demand balance in the major cities will hamper value growth for the more cyclical sectors (like offices) going forward. ■

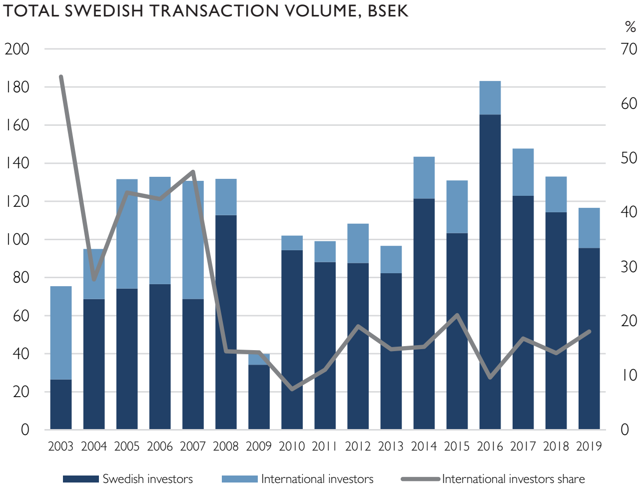
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTHS VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION