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The risk of a scenario with 1970s-style stagflation may become a positive driver on the property market going forward

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Transactions amounting to SEK 16.0 billion took place during July and August, compared to SEK 13.2 billion and SEK 13.3 billion during the same months in 2019 and 2020. The rolling 12-month transaction volume has been in an uptrend since mid-2018 and increased slightly to SEK 182.2 billion (from SEK 179.5 billion in June).

The number of deals exceeding SEK 80 million ended up at 27 in July and August, in line with the 24 and 33 deals that took place during the same months in 2019 and 2020. The rolling 12-month number of transactions fell back somewhat to 379 deals (still above the long-term average). The by far largest deal of July and August was John Mattson's acquisition of 95 and 99 per cent respectively of the residential owner/developing companies Hefab Fastighets AB and Efib (which is the largest owner of Hefab). The companies' own 36 properties comprising around 100,000 sq.m. with a property value of about SEK 5.3 billion. The second largest deal was Folksam's acquisition of the office leasehold Gångaren 10 on Kungsholmen in Stockholm inner city from Invesco for around SEK 2.3 billion. The third largest deal was Aberdeen's purchase of three residential properties from Wallenstam for around SEK 1.1 billion. The portfolio includes one project property that will be finalised and leased by the seller.

The listed property companies have increased their acquisitions massively during recent months and their rolling 12-month net-acquisitions currently stand at SEK 27.5 billion (they were hovering around the zero-mark during the entire 2020 and up until April 2021). Institutions and funds were the two largest net-investors during the first quarter but have reduced their net-acquisitions during the summer. They have been net-buying properties for SEK 15.8 and 18.1 billion respectively during the last 12 months. Foreign funds have been very active on the market since mid-2020 and their rolling 12-month net-acquisitions now stand at SEK 21.4 billion.

High quality offices in Stockholm are still considered trophy assets, and there have been several large deals at good price levels both in Stockholm and the other major cities during the summer. However, investors' concern about an upcoming structural shift within the office sector (due to more WFH and increasing area efficiency) remain elevated. This has led to a massive fall in transaction volume within the office sector during the last 18 months. The rolling 12-month transaction volume has declined from around SEK 40 billion in early 2020 to SEK 16.5 billion now. The rolling 12-month number of deals initially held up relatively well but has fallen back since the first quarter 2021. Investors continue to focus on residential rental properties, public properties and logistics/mix industrial properties, where the yield compression remains powerful.

Growth expectations peaked just before the summer and economic sentiments indicators in most large countries like the USA, Germany and China (as well as in Sweden), have fallen back lately. However, economic sentiments are still at historically high levels. Sentiments are generally stronger within the service sectors than in the manufacturing sectors. There are also clear signs of a major economic slowdown in China and the average month-on-month growth rate in world trade volume has been hovering around the zero-mark since April. Trade is hampered by bottlenecks, lack of input goods and soaring freight prices. The growth rate in world trade volume has declined from a peak of almost 25 per cent year-on-year in April to just above 16 per cent in June. Sweden is an export dependent country, and our economic growth is very dependent on the trajectory of world trade. Swedish Manufacturing PMI has come down somewhat from an historic peak level in April and our exports growth is down from 30 per cent year-on-year in May to 21.5 per cent in July. The Swedish real GDP growth came out at extremely strong 9.7 per cent year-on-year during the second quarter, which can be compared to the 12.2 per cent recorded in the USA. The exceptionally strong performance was expected and can partly be explained by base effects (the drop in GDP was extreme during the same quarter last year due to the coronavirus). However, growth is now slowing down. Swedish retail sales growth has dropped from a peak of over 11 per cent year-on-year in May to 5.4 per cent in July. Catella's GDP Macro Index (which is a mix of six leading indicators for the Swedish GDP growth) is indicating that the economic growth cycle will peak during the autumn. This indication is rather broad, and four of the six underlying macro indicators are pointing at slowing growth from the late autumn and onwards. Inflation ▶

is starting to be a real headache for consumers (and central banks) and corporate profit margins are being squeezed by soaring input prices and increasing wages. CPI inflation rose to 3 per cent year-on-year in the Euro zone in August (up from 2.2 per cent in July and the highest figure for almost a decade) and steadied at 5.4 per cent in July in the USA (a 13-year high). Various types of bottlenecks and high commodity prices (some commodity prices have dropped down during recent months though) are pushing up producer prices. Although the Swedish CPI inflation fell back to 1.4 per cent in July, the Swedish PPI has increased by 13.5 per cent over the last 12 months. Catella's CPI Macro Index (which is a mix of five leading indicators for the Swedish CPI inflation) continues to point at low inflation of around 0.75–1.0 per cent year-on-year up until mid-2022. After that, three out of five underlying CPI indicators are pointing at higher inflation. However, the model does not include indicators that mirrors the current supply chain bottlenecks (because this factor has not been instrumental for inflation during the last decades, and the model is based on historical correlations).

The Swedish listed property companies have had an extremely strong development since early April and the average equity price for 37 of the largest listed property companies is up 43 per cent (compared to 7.5 per cent for OMX Stockholm 30). The melt-up peaked in mid-August as the investors started to question when and how the major central banks (and especially the Fed) will wind down their monetary stimuli. However, prices seem to have bottomed-out in the short-term and have been up again over the last week. One reason behind the strong performance during recent months is that the real interest rate has declined massively since late March. The long-term real interest rate, measured as the 30-year inflation linked US Treasury Bond (TIPS), fell from a 12-month peak of 0.21 in March to -0.37 in mid-August (close to the all-time low of -0.46 recorded in August 2020), where it has remained since that. This massive 60 basis point drop was rocket fuel for the listed property companies, and especially on the companies with focus on residential/public properties (these companies are generally very sensitive to changes in the real interest rate). Based on the strong equity price development of the companies focusing on residential/public properties (up 53 per cent since early April), as well as the logistics/industrial and mix commercial properties (up 59 per cent during the same period), there will continue to be a massive inflow of capital into these segments at the property market for at least six months ahead or so. After all, the over 50 per cent increase in equity prices that has taken place for the residential/logistics companies in the last five months represents 25–30 per cent up in the underlying asset values. The companies that focus on office/retail properties have also been performing rather strongly. However, investors remain sceptical to these segments and the group has (only) increased by around 23 per cent since early April. The equity prices for this group of companies have been supported by the large structural deals that have taken place during the recent quarters (like Corem's acquisition of Klövern, Stenhus' acquisition of Maxfastigheter, and Castellum's bid for Kungsleden).

The equity market premiums (to NAV) now stand at just below 65 per cent in average for 31 listed property companies. There are major premiums on companies that focus on mix industrial properties, well located logistics, residential rental properties (especially companies with strategies that include new production or project development) and/or public properties. There are, however, still equity market discounts for some companies with a focus on retail and/or office properties.

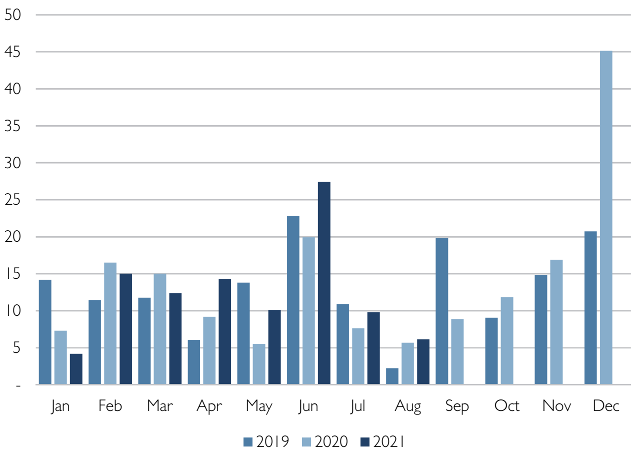
The decades from the late 1980s until the mid-2010s were marked by severe downward pressure on inflation and wage increases in the developed world. These declines where due to globalisation, technological developments, debt accumulation, increasing inequality and demographical factors. As a result of this, central banks have depressed interest rates as far as possible (as all the major central banks have inflation targets). The downward pressure on wage increases meant that purchasing power among consumers was too low to keep up economic growth and inflation. In addition, governments in the developed world were overall reluctant to raise public deficit too much (as public finances are set to deteriorate due to ageing populations). The result was that the central banks needed to take the steering wheel to boost consumer purchasing power to propel economic growth. Gradually lower interest rates inflated asset prices (including property and equities) to the extent where consumers became more willing to borrow. The development in Sweden has been very similar to the development in rest of Europe and the USA.

The major economies are now in a position where demand has largely recovered after the corona-induced recession, but it is becoming increasingly clear that the coronavirus will not disappear. The new Delta variant of the virus is spreading fast. In addition, it seems like the vaccines are only effective for around six months, after which a boosted dose is required. The access to vaccines is not evenly spread throughout the world, it is generally the developed world (and especially Europe, Israel and a few other countries) that have high vaccination rates. Several of the large developing countries have low vaccination rates and soaring infections. This is one factor that creates problems with bottlenecks as a large part of the global manufacturing is located here. The effects are a shortage of consumer goods and that the industrial production in the developed countries is suffering from shortage of input goods. In addition, the labour markets in the major developed economies are suffering from a shortage of qualified labour (despite high unemployment), as consumers have been shifting their spending from services to goods. ▶

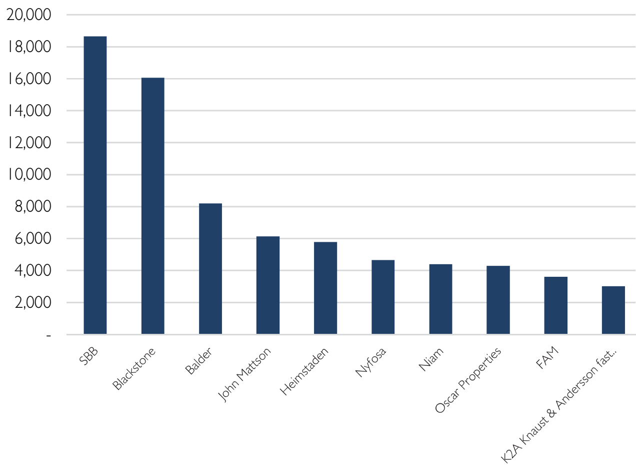
The consensus view on the financial markets (and among central banks) is that the spread of coronavirus will be curbed relatively soon. When this happens, wage increases and inflation will automatically slow down due to a recovering supply side (as the bottlenecks are being sorted out). In this Goldilocks scenario, the central banks can gradually/slowly wind down their stimuli during coming years with one eye on the asset market (the equity and bond markets are extremely sensitive to all signs of tapering and rate increases). Economic growth will remain acceptable/stable, and the record-high global debt levels (private, corporate and government debt) will gradually decline as a share of GDP to manageable levels.

However, is this really a realistic scenario? It seems like the coronavirus has not yet been defeated. In this case, governments and central banks will continue to stimulate the demand side to a considerable extent. However, they are unable to efficiently boost the supply side of the economy, which means that the stimuli will keep wage increases and inflation continuously high. This situation forces central banks to stay behind the curve, which means that they will do too little too late to curb inflation (the US will be ahead of Europe in this aspect due to their larger spare capacity). In addition, there is a large risk that central banks are overestimating their ability to depress inflation when it has risen to excessively high levels. Asset prices and debt levels are now so high that the economy cannot sustain much higher real interest rates than we have right now. If central banks remain supportive during the coming 12–18 months (which is very likely), real interest rates can remain negative although growth and inflation are high, and nominal interest rates are increasing. It is not unlikely that the global economy ends up in a period of 1970-style stagflation (a combination of increasing inflation and continuously low economic growth). This scenario is not entirely unfavourable for property, though, as investors will increasingly look beyond the bond and equity markets to real assets (like property) that can be effective inflation hedges. ■

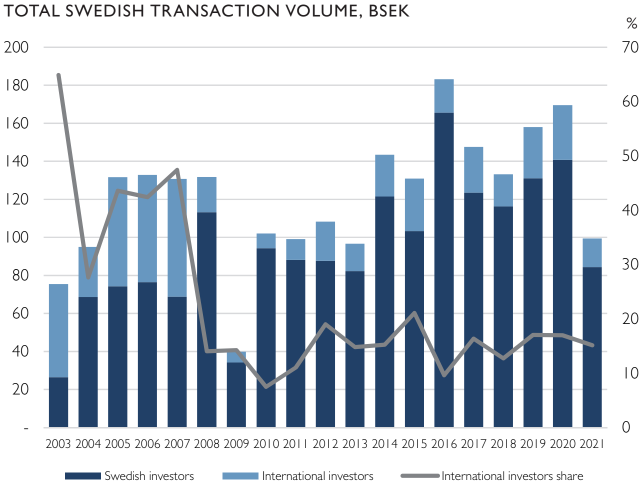
TRANSACTION VOLUME PER MONTH, BSEK



TOP 10 INVESTORS ROLLING 12-MONTH VOLUMES, MSEK



TOTAL SWEDISH TRANSACTION VOLUME, BSEK



INVESTOR TYPE AND REGION