The Swedish Economy
June 2014

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The National Institute of Economic Research (NIER) prepares analyses and forecasts of the Swedish and international economy and conducts related research. NIER is a government agency accountable to the Ministry of Finance.

The Swedish Economy is published four times a year and contains analyses and forecasts of the Swedish and international economy. It is a translation of the summary of the full report **Konjunkturläget**.

Data sets in the form of outcome and forecast data for the development of the Swedish and international economy are available on our website: www.konj.se/statistics.

Summary of the forecast

The Swedish economy has been in a prolonged slump ever since the financial crisis. Recovery will take a long time due to limited support from the rest of the world. GDP stagnated in the first quarter this year, and the recovery stalled temporarily, but there are some rays of light. Employment is continuing to grow relatively quickly, and homebuilding is beginning to pick up. Besides aiding economic recovery, this may help correct the imbalances in the housing market in the longer term.

The slowdown in the economy in the first quarter was expected after temporary factors pushed up GDP in the fourth quarter last year. The weak growth in exports in the first quarter gives some cause for concern, but rising export orders point to stronger export growth ahead. The NIER's economic tendency indicator, which reflects the mood of the economy as a whole, has fallen back somewhat in recent months, but remains in June at levels compatible with continued recovery (see Diagram 1).

GLOBAL ECONOMIC RECOVERY CONTINUES

Many other parts of the world also performed weakly in the first quarter. GDP growth faltered in many OECD countries, but – as in Sweden – survey-based economic indicators suggest that the slowdown was only temporary (see Diagram 2). Expansionary monetary policy, in many cases less contractionary fiscal policy and a cyclical upturn in investment activity mean that the economy in the OECD area as a whole will gradually recover, with GDP growing by just over 2 per cent this year and slightly more next year. Given the deep and prolonged nature of the slump, monetary policy in most countries will remain expansionary for a long time to come (see Diagram 3).

Downside risks continue to dominate. In the euro area, the spread between government bond yields in Germany and the crisis countries has narrowed this year, but this may not necessarily reflect a decrease in risk so much as an increase in risk appetite in financial markets. In addition, the banking system in the euro area is still poorly capitalised. Negative surprises could therefore threaten financial stability and impact on the real economy, especially if banks are hit by heavy loan losses.

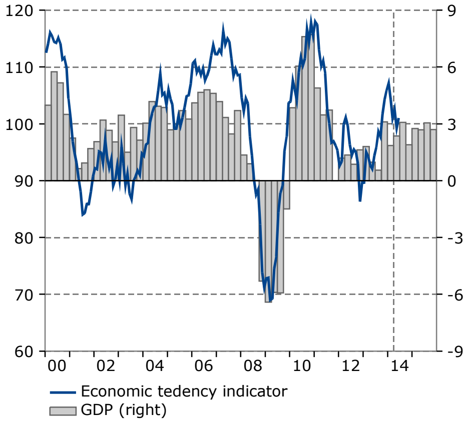
DOMESTIC DEMAND FUELLING RECOVERY

The protracted global recovery means that exports are playing a relatively minor role in Sweden's recovery. Domestic demand is therefore more important than normal.

Demand this year is being stimulated by expansionary monetary and fiscal policy, which is helping investment to take off. Housing investment is set to jump 17 per cent and approach 4

Diagram 1 Economic tendency indicator

Index mean=100, monthly values and annual percentage change, calendar-adjusted quarterly values, respectively



Sources: Statistics Sweden and NIER.

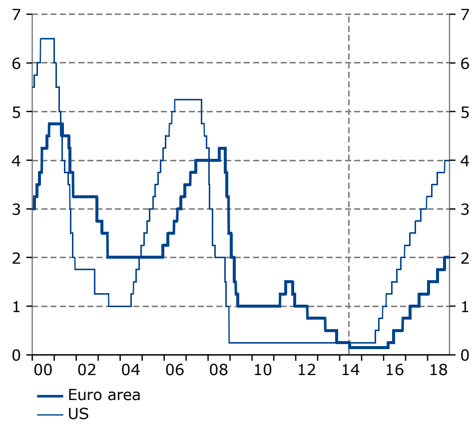
Diagram 2 Confidence indicators, manufacturing

Standardized deviations from mean, seasonally adjusted monthly values

Sources: Institute for Supply Management, European Commission and NIER.

Diagram 3 Policy rates

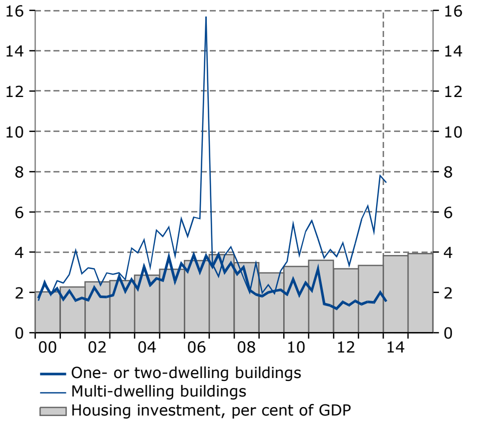
Per cent, daily values



Sources: ECB, Federal Reserve and NIER.

Diagram 4 Housing starts and investment

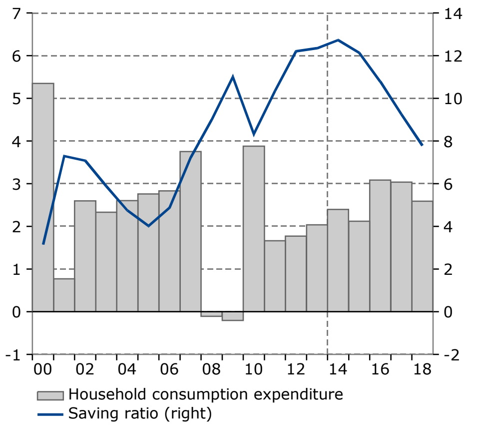
No. of dwellings, thousands, quarterly values and per cent of GDP, current prices, respectively



Sources: Statistics Sweden and NIER.

Diagram 5 Household consumption and saving ratio

Percentage change, calendar-adjusted values and per cent of disposable income, respectively



Sources: Statistics Sweden and NIER.

Diagram 6 Number of employed and employment rate

Millions and per cent of population age 15–74, respectively, seasonally adjusted quarterly values

Sources: Statistics Sweden and NIER.

per cent of GDP (see Diagram 4). The number of apartment starts has risen to historically high levels, which means that homebuilding activity will continue to grow strongly in the coming quarters. In the longer term this may help correct the imbalances in the housing market.

Household consumption will climb 2.3 per cent this year (see Diagram 5). This is a normal rate of growth by historical standards but seems somewhat cautious given the low level of interest rates and the already high savings rate. Household saving behaviour is being influenced to some extent by previous reductions in effective social insurance replacement rates and talk of new mortgage repayment schedules, and saving will rise somewhat further again this year. Next year, fiscal policy will be contractionary, and household disposable income will grow more slowly, but precautionary saving will decrease as unemployment starts to come down, and consumption will grow at roughly the same rate as this year.

GDP will grow by 2.2 per cent this year and an average of 3 per cent per year in 2015–2017, with the result that the output gap closes in 2017 (see Table 1).

UNEMPLOYMENT TO COME DOWN NEXT YEAR

Employment was unchanged in the first quarter this year, but indicators suggest that the upward trend since 2010 will resume in the second quarter. Employment will increase by around 1 per cent per year in 2014–2018, and the employment rate will continue to rise (see Diagram 6). The labour force will also continue to grow relatively quickly, however, and so unemployment will fall at only a moderate rate and will not reach the estimated equilibrium level of around 6.5 per cent until late 2017 (see Diagram 7).

The prolonged period of high unemployment has meant that long-term unemployment is high, and a relatively large proportion of the unemployed belong to "weak groups" who find it comparatively hard to obtain work. This has contributed to growing matching problems in the labour market. For unemployment to fall to 6.5 per cent without bottlenecks forming, matching must improve, and this will require active policy initiatives over a long period.

INFLATION TO REMAIN LOW FOR A LONG PERIOD

The weak economic climate in Sweden and elsewhere has meant that inflation as measured by the CPIF (consumer price index with constant mortgage rates) has fallen and was as low as 0.4 per cent in May this year.[1] Weak demand is making it hard for firms to pass on cost increases to consumers. Inflation expecta-

[1] The calculations underlying the present forecast were finalised on 11 June, and so the CPI and LFS data for May have not been taken into account.

tions for the coming years are also very depressed. Inflation is therefore expected to remain unusually low this year before rising gradually as resource utilisation in Sweden and elsewhere increases (see Diagram 8).

Table 1 Selected indicators

Percentage change unless otherwise noted

	2012	2013	2014	2015	2016	2017	2018
GDP, market price	0.9	1.6	2.2	3.0	3.3	2.8	2.3
BNP, calendar-adjusted	1.3	1.6	2.3	2.8	3.1	3.0	2.4
Current account[1]	6.5	6.8	6.0	5.6	5.1	4.9	4.5
Hours worked[2]	0.7	0.4	1.4	1.2	1.2	1.3	0.9
Employment	0.7	1.0	1.0	1.2	1.1	1.2	0.9
Unemployment[3]	8.0	8.0	8.1	7.7	7.3	6.7	6.3
Labour market gap[4]	−1.5	−1.9	−1.5	−1.2	−0.8	−0.2	0.2
Output gap[5]	−1.9	−2.3	−1.9	−1.3	−0.6	0.0	0.2
Hourly earnings[6]	3.0	2.6	3.0	2.9	3.0	3.1	3.2
Labour cost per hour, business sector[2]	3.5	2.0	2.9	3.0	3.1	3.2	3.3
Productivity, business sector[2]	1.3	1.7	1.3	1.9	2.2	2.0	1.8
CPI	0.9	0.0	−0.1	1.1	2.2	2.6	2.8
CPIF	1.0	0.9	0.5	1.3	1.6	1.8	2.0
Repo rate[7,8]	1.00	0.75	0.50	0.75	1.50	2.25	2.75
Interest rate, 10-year government bond[7]	1.6	2.1	2.1	2.5	3.0	3.5	4.0
Index for the Swedish krona (KIX)[9]	106.1	103.0	104.7	102.6	100.6	100.6	100.6
GDP, world-wide	3.2	3.0	3.6	3.9	4.0	4.1	4.1
General government net lending[1]	−0.7	−1.2	−2.1	−1.2	−0.5	0.5	1.2
General government consolidated gross debt (Maastricht debt)[1]	38.3	40.5	41.6	40.8	39.9	38.3	36.3
Cyclically adjusted net lending[10]	0.4	−0.7	−1.3	−0.6	0.0	0.6	1.2

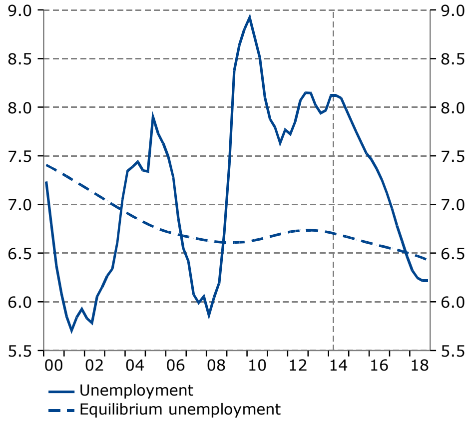
[1] Per cent of GDP. [2] Calendar-adjusted. [3] Per cent of labour force. [4] Difference between actual and potential hours worked, in per cent of potential hours worked. [5] Difference between actual and potential GDP, in per cent of potential GDP. [6] According to Short-term Earnings Statistics. [7] Per cent. [8] At year-end. [9] Index 1992-11-18=100. [10] Per cent of potential GDP.

Sources: Statistics Sweden, National Mediation Office, the Riksbank and NIER.

The weak outlook for inflation means that the Riksbank will cut its repo rate to 0.50 per cent in July. The NIER is of the opinion that inflation is weak enough to justify even lower interest rates, but the Riksbank is expected to attach some weight to household debt. The central bank also expects inflation to rise more quickly, and so it is not expected that the repo rate will be reduced further. Given our forecast for inflation, a first rate hike is not expected until late 2015. Further low policy rates abroad and low inflation expectations domestically mean that the hiking cycle will be protracted, and the repo rate will be as low as 2 per cent when the output gap closes in 2017 (see Diagram 8).

Diagram 7 Unemployment and equilibrium unemployment

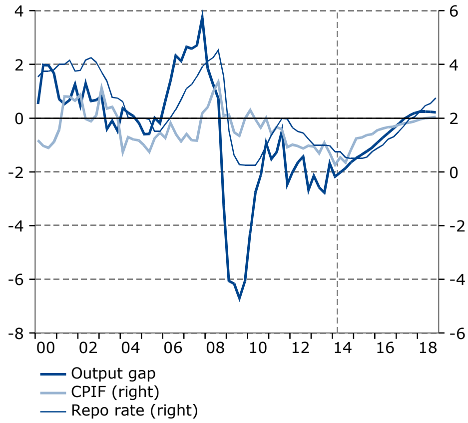
Per cent of labour force, seasonally adjusted quarterly values



Sources: Statistics Sweden and NIER.

Diagram 8 Output gap, CPIF and repo rate

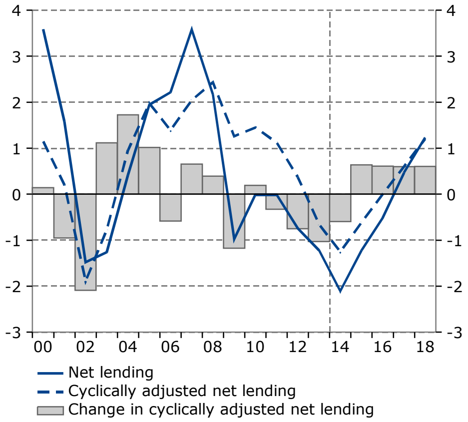
Per cent and annual percentage change, quarterly values, respectively



Sources: Statistics Sweden, The Riksbank and NIER.

Diagram 9 General government net lending and cyclically adjusted net lending

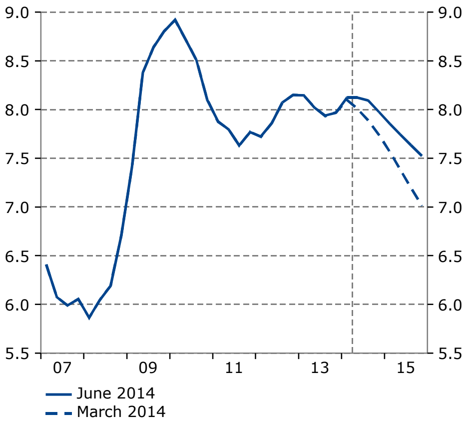
Per cent of GDP and per cent of potential GDP, respectively



Sources: Statistics Sweden and NIER.

Diagram 10 Unemployment

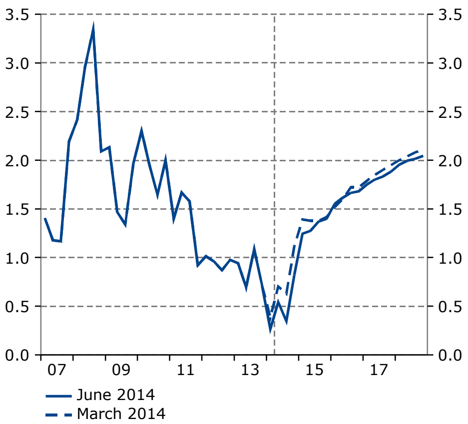
Per cent of labour force, seasonally adjusted quarterly values



Sources: Statistics Sweden and NIER.

Diagram 11 CPIF

Annual percentage change, quarterly values



Sources: Statistics Sweden and NIER.

LONG WAY OFF SURPLUS TARGET

Fiscal policy has been expansionary ever since the financial crisis (see Diagram 9). This has been justified given the prolonged economic slump. Cyclically-adjusted net lending will be a negative 1.3 per cent of GDP this year. Fiscal policy must therefore be tightened in 2015–2018 so that cyclically-adjusted net lending rises to a positive 1.2 per cent of GDP in 2018, the level considered to be compatible with the surplus target of 1 per cent over a business cycle. The NIER estimates that tax increases of around SEK 120 billion will be required during the period for the surplus target to be met, assuming an unchanged public sector commitment.

Forecast revisions 2014–2015

This section outlines the principal revisions to the forecast published in *The Swedish Economy*, March 2014. The economy has performed slightly less well than expected, resulting in lower GDP growth and inflation (see Table 2). There are no major revisions, however, and the economic recovery is expected to continue, albeit at a slightly slower rate than previously anticipated.

- GDP growth in many parts of the world was surprisingly weak in the first quarter this year, but confidence indicators suggest stronger growth during the rest of the year. The forecast for global GDP growth in 2014 has been revised down by a tenth of a percentage point. The main downward revisions are for the USA and the euro area, which are important trading partners for Sweden.
- Swedish GDP growth was also lower than expected in the first quarter. The forecast for growth in 2014 as a whole has been revised down by half a percentage point to 2.2 per cent.
- Unemployment has not been falling as quickly as assumed in the previous forecast (see Diagram 10) and will actually increase marginally this year. This is due to surprisingly strong growth in the labour force. The assessment of idle resources in the labour market as measured by the labour market gap (actual hours worked relative to potential hours worked) has been revised up.
- Inflation has been lower than expected, and the forecast for CPIF inflation this year has been revised down to 0.5 per cent (see Diagram 11). The subsequent rebound will also take longer than previously forecast.
- Lower inflation and further low inflation expectations among the general public mean that the Riksbank is

now expected to cut the repo rate to 0.50 per cent in July (see Diagram 12). The ECB's decision to lower its policy rate and introduce further expansionary monetary policy measures will also spur the Riksbank to cut the repo rate so as to avoid an overly strong krona.

- Lower central bank policy rates and other monetary policy measures have depressed government bond yields in many parts of the world. The forecast for Swedish 10-year government yields has been revised down to an average of 2.5 per cent in 2015.

Diagram 12 Repo rate

Per cent, daily values

Sources: The Riksbank and NIER.

Table 2 Current forecast and revisions compared to the March 2014 forecast

Percentage change unless otherwise noted

	2014		2015	
	June 2014	Diff.	June 2014	Diff.
International				
GDP, world-wide	3.6	−0.1	3.9	0.0
GDP, OECD	2.1	−0.1	2.6	0.0
GDP, euro area	1.1	−0.2	1.6	−0.1
GDP, United States	2.4	−0.3	3.3	0.1
GDP, China	7.4	−0.1	7.2	0.0
Federal funds target rate[1,2]	0.25	0.00	1.00	0.00
ECB refi rate[1,2]	0.15	−0.10	0.15	−0.10
Oil price[3]	107.8	1.0	104.4	−0.7
CPI, OECD	1.8	0.1	2.0	−0.1
GDP by Expenditure				
GDP, calendar-adjusted	2.3	−0.5	2.8	−0.1
GDP	2.2	−0.5	3.0	−0.1
Household consumption	2.3	−0.4	2.2	−0.2
General government consumption	1.1	0.1	2.0	0.0
Gross fixed capital formation	6.9	1.0	7.2	−1.0
Stockbuilding[4]	0.1	−0.2	0.1	0.2
Exports	3.2	−1.2	4.9	−0.7
Imports	5.2	−0.8	5.6	−0.6
Labour Market, Inflation, Interest Rates etc.				
Hours worked[5]	1.4	0.3	1.2	−0.1
Employment	1.0	0.1	1.2	−0.1
Unemployment[6]	8.1	0.1	7.7	0.4
Labour market gap[7]	−1.5	−0.2	−1.2	−0.4
Output gap[8]	−1.9	−0.6	−1.3	−0.7
Productivity, business sector[5]	1.3	−0.7	1.9	0.0
Hourly earnings[9]	3.0	0.2	2.9	0.0
CPI	−0.1	−0.2	1.1	−0.1
CPIF	0.5	−0.2	1.3	−0.1
Repo rate[1,2]	0.50	−0.25	0.75	−0.50
Interest rate, 10-year government bond[1]	2.1	−0.3	2.5	−0.5
Index for the Swedish krona (KIX)[10]	104.7	2.1	102.6	2.2
Current account[4]	6.0	−0.1	5.6	−0.2
General government net lending[11]	−2.1	−0.1	−1.2	−0.4

[1] Per cent. [2] At year-end. [3] Dollar per barrel, annual average. [4] Change in per cent of GDP preceding year. [5] Calendar-adjusted. [6] Level, per cent of labour force. [7] Difference between actual and potential hours worked, in per cent of potential hours worked. [8] Difference between actual and potential GDP, in per cent of potential GDP. [9] According to Short-term Earnings Statistics. [10] Index 1992-11-18=100. [11] Per cent of GDP.

Note. The difference is between the current forecast and the March 2014 forecast. A positive value denotes an upward revision.

Source: NIER.