Updated Economic Outlook
August 2020

NATIONAL INSTITUTE OF ECONOMIC RESEARCH (NIER), FLEMINGGATAN 7, BOX 12090, SE-102 23 STOCKHOLM
+46 8 453 59 00
REGISTRATOR@KONJ.SE, WWW.KONJ.SE/ENGLISH

KI 2020:15

The National Institute of Economic Research (NIER) is a Swedish government agency accountable to the Ministry of Finance. We produce forecasts to support decisions on economic policy in Sweden, analyse economic developments and conduct economic research.

Published four times a year, our report *Konjunkturläget* contains a forecast for the Swedish and global economies as well as more in-depth special analyses of relevant economic topics. *The Swedish Economy* is an English translation of the summary and selected special analyses from *Konjunkturläget*. In August, a brief update of the economic outlook is made, which includes a handful of pages with tables and graphs. Such an update is also being made in April 2020 due to the covid-19 pandemic.

All of our reports can be downloaded from our website at www.konj.se/english. The forecast reports are available at www.konj.se/swedisheconomy and data can be found at www.konj.se/english/data-sets.

Preface

Ylva-Hedén Westerdahl, director of the forecasting, has led the work to produce this forecast update. The forecast is based on available statistics published up to and including the 10th of August 2020.

Stockholm, August 2020

Urban Hansson Brusewitz
Director-General

Updated economic outlook

According to Statistics Sweden's GDP indicator, output fell 8.6 per cent in the second quarter. This dramatic decrease was expected and is largely in line with our June forecast. The COVID-19 pandemic has hit large parts of the business sector hard, but there are now signs that demand and production are gradually beginning to pick up again. Many of the drastic lockdown measures in the euro area and elsewhere of April and May have been relaxed recently, which will benefit Swedish exporters. Domestically, the extensive government support packages for business and employment have helped curb the rise in unemployment. In line with our June forecast, we expect GDP to grow by almost 2 per cent per quarter in the second half of this year, but the economy will still find itself in a particularly deep downturn next year. Firms will therefore continue to cut their workforce, and unemployment will climb to 10 per cent during the winter.

Assumptions underlying the forecast

The COVID-19 pandemic means that the present forecast is much more uncertain than normal. The forecast is based on a number of underlying assumptions. The most significant assumptions behind our forecast for the Swedish economy are as follows:

- The COVID-19 pandemic culminates globally this year and subsides during the course of 2021, although further waves of infection may flare up in some countries and regions.
- The spread of COVID-19 in Sweden peaked in the second quarter this year. Infection will continue at a reduced rate in the second half of 2020 and in 2021.
- A safe vaccine against COVID-19 will be available in the summer of 2021, after which a vaccination campaign can begin.
- Most of the restrictions and requirements for social distancing imposed in Sweden to limit the spread of the virus will be phased out completely during the course of 2021.
- An average of around 420,000 people in Sweden will work reduced hours under the short-time work programme during the second, third and fourth quarters this year. This is consistent with far higher numbers working short-time in some months. These workers will have their hours cut by around 40 per cent on average.
- The Riksdag and the government will take more action to counter the economic downturn than decided or announced to date. Additional measures amounting to SEK 16 billion in 2020 and around SEK 80 billion in 2021 are assumed over and above what would follow from unchanged rules and policies, in the form of ordinary central and local government budgets and additional amending budgets. For example, it is assumed that the short-time work system will be activated for parts of 2021 (with a lower rate of subsidy than for the rest of this year), as Sweden will still find itself in a particularly deep economic downturn.

SWEDISH ECONOMY SHRANK SHARPLY IN THE SECOND QUARTER

As expected, the COVID-19 pandemic led to a dramatic contraction in the Swedish economy in the second quarter. According to Statistics Sweden's GDP indicator, output was down 8.6 per cent relative to the first quarter.[1] This is a slightly smaller decrease than we anticipated in June (see Diagram 1).

There has been a broad-based decline in the business sector, with production falling in manufacturing, construction, services and retail (see Diagram 2). The manufacturing downturn was driven largely by developments in the automotive industry, with weak demand and supply chain disruption leading to extensive production stoppages, especially in April. In May and June, automotive production picked up, with the result that industrial production also began to recover. Production has fallen less far in construction and services than in manufacturing. Some parts of the service sector have nevertheless been hit very hard, with restrictions, social distancing and fear of infection greatly eroding demand for hotels, restaurants, transport and some personal and cultural services. Parts of the retail trade, on the other hand, have seen an increase in demand.

Movements in the production value index suggest that production in the business sector bottomed out in April/May. The NIER's extra surveys of firms' sales also indicate that production has picked up since May (see Diagram 3), although interpretation of the results has been complicated by a much lower response rate in July than in previous rounds. The PMI suggests that activity may not have hit bottom until June and did not start to recover until July, when both the manufacturing and services

[1] The quarterly growth rates reported are seasonally adjusted values, unless otherwise indicated.

indices moved back above 50, indicating positive growth (see Diagram 4).

The abrupt economic downturn has also made its mark on the labour market. Employment fell by 1.9 per cent in the second quarter, and unemployment climbed to 9.2 per cent in June (see Diagram 5), which is closely in line with our June forecast. The pandemic has hit employment far less hard than production, largely thanks to the action taken by the Riksdag and the government to support firms and employment. During the second quarter, almost half a million people were enrolled in the government-subsidised short-time work programme. Statistics released since our June forecast mean that the number of hours worked is now believed to have fallen almost as far as GDP in the second quarter, such that the drop in productivity in the business sector was limited to around 1 per cent, well below the 3 per cent we estimated in June.

FOREIGN TRADE IN GOODS FARED BETTER THAN FORESEEN IN JUNE

Statistics Sweden's household consumption indicator shows a sharp fall in spending in the second quarter, as anticipated in our June forecast, which assumed a drop of 8 per cent. However, the monthly statistics for foreign trade in goods suggest that exports and especially imports of goods did not fall quite as far in the second quarter as predicted in June. This is ultimately good news, although it does mean that net exports will turn out even weaker than expected in the second quarter. The flipside is that domestic demand has not deteriorated to quite the same extent as anticipated in June, which also explains why imports of goods have fallen less far than expected.

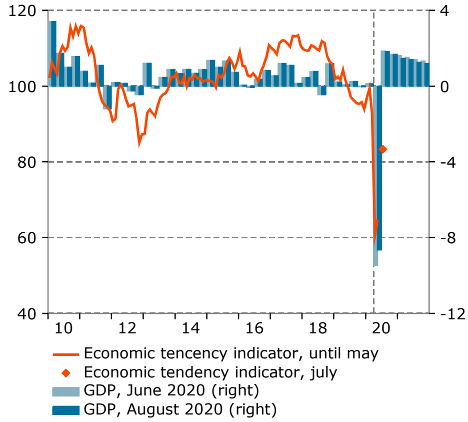
DOWNTURN ABROAD NOT QUITE AS DEEP AS EXPECTED

Preliminary statistics suggest that euro area GDP fell 12.1 per cent from the first to the second quarter. Given the drastic lockdown measures in many euro countries in April and May (see Diagram 6), it is not surprising that GDP fell further in the euro area than in Sweden in the second quarter. The relatively large tourism sector in southern Europe is likely to have contributed to the steeper fall in GDP in the euro area. In our June forecast, however, we anticipated an even greater decline of around 15 per cent. GDP also fell slightly less far than expected in the US in the second quarter, while output in China, where restrictions peaked at the beginning of the year, rebounded strongly in the second quarter to a slightly higher level than in the fourth quarter last year.

Many countries introduced very stringent restrictions to limit infection during the initial phase of the pandemic. In the euro area, many gradually eased these restrictions during the course of May and June; restrictions in France, for example, are now at levels comparable with Sweden (see Diagram 6). Reduced

Diagram 1 Economic tendency indicator and GDP

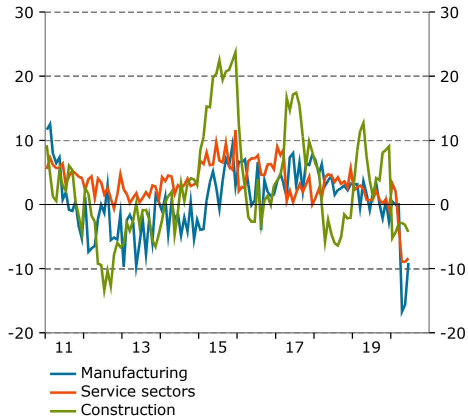
Index mean=100, monthly values and percentage change, seasonally adjusted quarterly values



Sources: Statistics Sweden and NIER.

Diagram 2 Production value index

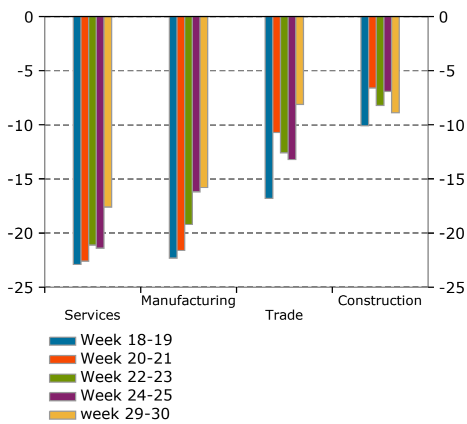
Annual percentage change, calendar-adjusted monthly values



Source: Statistics Sweden.

Diagram 3 NIER extra survey: Sales compared to normal

Per cent



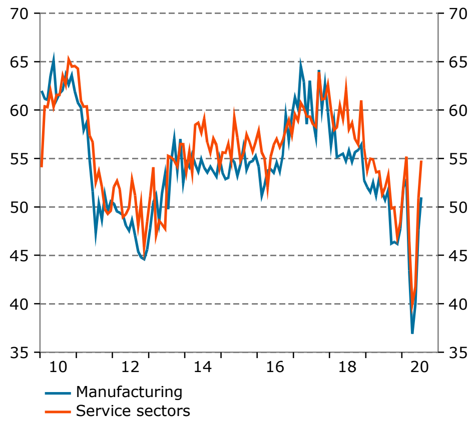
Note. The percentage loss in sales has been calculated by taking the midpoint of the response options: reduced by 1-25, 26-50 etc.

Source: NIER.

contagion, growing hopes of a safe and effective vaccine next year, government support packages and the relaxation of restrictions have together led to greater optimism about economic developments in Europe and the US, despite the pandemic worsening in some other parts of the world, such as Latin America. The somewhat brighter outlook is reflected in various survey-based indicators, such as PMIs. The euro area PMI has recovered rapidly over the summer and is now back in the positive growth zone (see Diagram 7) for both manufacturing and services. The recovery in global stock markets after their collapse during the spring reflects these improved growth prospects (see Diagram 8). Our overall conclusion is that the global economy will perform somewhat less badly in 2020 than assumed in our June forecast, which will support the recovery in Swedish exports in the second half of the year.

Diagram 5 Purchasing manager index, Sweden

Index, seasonally adjusted monthly values



Source: Macrobond.

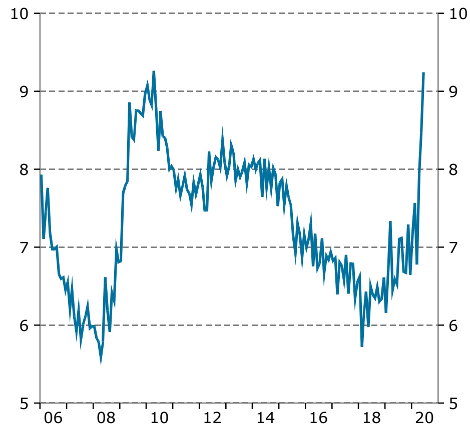
SWEDISH ECONOMY BEGINNING TO RECOVER

The Economic Tendency Indicator, which is a broad measure of sentiment in the Swedish economy, plummeted in April and remained at a very low level in May (see Diagram 1). It has picked up since, but confidence was still much weaker than normal in July. Business sentiment is weakest in the service sector, whereas the retail and manufacturing indicators approached normal levels in July. Consumer confidence has also rallied since bottoming out in April. The indicator was still much lower than normal in July, however, mainly due to a negative view of the current state of the Swedish economy.

Firms' expectations for production and demand have picked up in recent months, and the net balances for both manufacturing and services were positive in July (see Diagram 9). This means that more firms expect to increase production over the next three months than decrease production. The NIER's extra surveys of firms' sales (see Diagram 3) and the PMI (see Diagram 4) also suggest that production in the business sector is on the way up. The rise in these indicators is consistent with the economic recovery predicted in our June forecast for the second half of this year. Our overall conclusion is that GDP will grow by almost 2 per cent per quarter in the second half of the year (see Diagram 1), which is in line with our June forecast.

Diagram 4 Unemployment

Per cent of labour force, seasonally adjusted monthly values



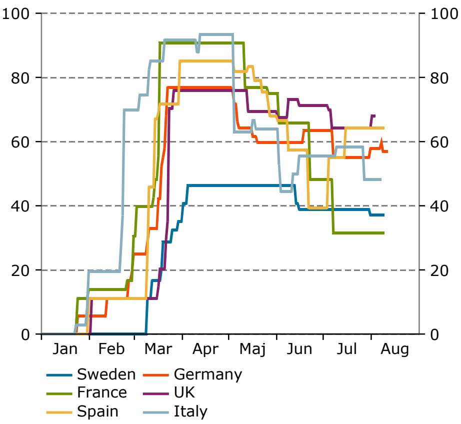
Sources: Statistics Sweden and NIER.

UNEMPLOYMENT WILL CONTINUE TO CLIMB

Despite the number of redundancy notices falling over the summer to around the normal level following the big wave in April, a turnaround in the labour market is further away. Extensive use of short-time working means that many firms have a considerable reserve of unused staff. Recruitment needs will therefore be limited in the short term, even if production recovers as predicted. This is clearly reflected in firms' employment plans in the Economic Tendency Survey, which remain negative (see Diagram 10). The weak economy means that firms will make some

Diagram 6 Stringency Index

Index, daily values



Note. The Stringency Index is a measure of government restrictions to curb the spread of infection. Read more here: https://www.bsg.ox.ac.uk/research/research-projects/coronavirus-government-response-tracker

Source: Macrobond.

of those working short-time redundant over the autumn and winter. This will be exacerbated by the temporary increase in the government subsidy for short-time working ending at the end of the year. As a result, employment will continue to fall and will not start to rise again until the second quarter next year. Unemployment will therefore continue to rise and will hit 10 per cent in the first quarter next year before heading back down (see Diagram 11). The outlook for the labour market is thus unchanged from our June forecast (see Table 1).

LOW INFLATION AND LOW-RATE POLICY TO STAY

Inflation rose to 0.7 per cent in June, which is higher than anticipated in our June forecast. It is still well below the inflation target, however, and firms' inflation expectations for the next year are at the same low levels (see Diagram 12). The krona has also strengthened considerably in recent months, which will put a damper on inflation further ahead. The higher inflation over the summer means that our forecast for CPIF inflation – the annual change in the consumer price index with a fixed interest rate – has been revised up slightly to 0.5 per cent for 2020, but it is unchanged at 1.1 per cent next year (see Table 1). As in our June forecast, we do not expect the Riksbank to lower the repo rate further, despite the deep economic downturn and weak inflationary outlook. Efforts to stimulate the economic recovery will instead focus on bringing down market interest rates through increased purchases of interest-bearing assets, such as corporate bonds.

SMALLER DEFICIT THAN EXPECTED THIS YEAR

Government net lending is now expected to be -4.6 per cent of GDP this year (see Diagram 13). This is almost a percentage point less negative than we forecast in June. The revision is primarily due to far lower claims for reorientation support from hard-hit firms than assumed in June. The upward revision of GDP in 2020 will not in itself boost public finances as would normally be expected. This is because the distribution of taxable income has been revised: households' income from employment, which is taxed relatively heavily, has been revised down, while corporate earnings have been revised up.

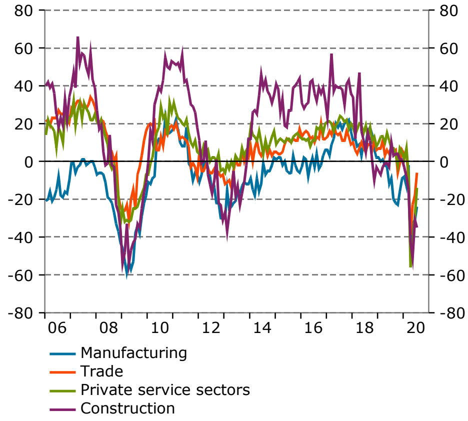
EXPANSIONARY FISCAL POLICY IN BOTH 2020 AND 2021

Active fiscal policy related to COVID-19 is expected to amount to just over SEK 140 billion this year, or around 3 per cent of GDP. The Riksdag has decided on a number of measures to reduce firms' costs and support hard-hit households. The number of people enrolled in the short-time work programme is expected to average around 420,000 in the period from 31 March to 31 December and cost around SEK 45 billion. The reduction in employer social security contributions and the government's assumption of responsibility for sick pay are together expected

Diagram 7 Hiring plans

Diagram 10 Purchasing manager index in Euro area and US (composite)

Balances, seasonally adjusted monthly values

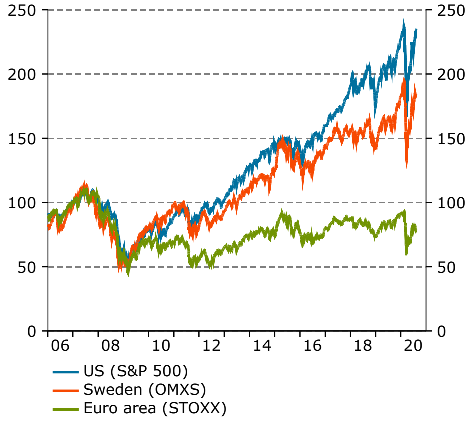


Source: NIER.

Sources: IHS Markit and Macrobond.

Diagram 8 Stock markets

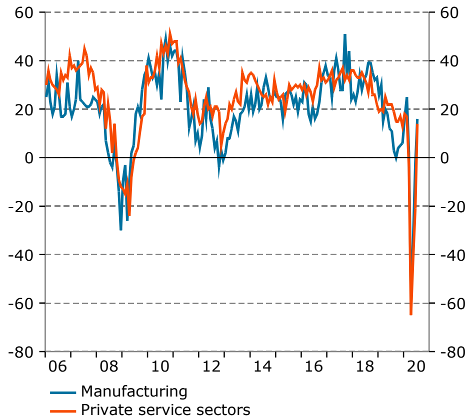
Index 2006-12-29=100, daily values, 5-days moving average



Sources: Standard & Poor's, Nasdaq OMX, STOXX and Macrobond.

Diagram 9 Production plans

Balances, seasonally adjusted monthly values



Source: NIER.

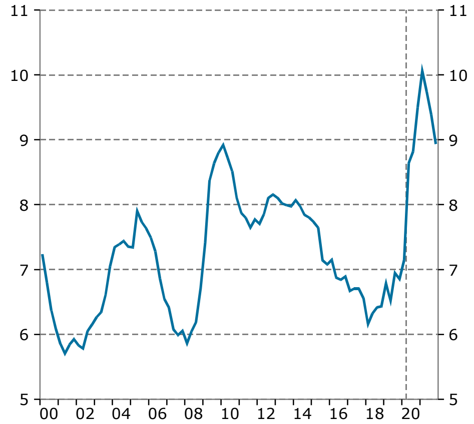
to cost about another SEK 45 billion. Firms' use of both rent support and reorientation support seems likely to be lower than assumed in June, however, and these measures are now expected to cost SEK 12 billion rather than SEK 44 billion. The number of claims to date has been small, but since the application period for reorientation support has not expired and could also be extended, the final amount is difficult to estimate. Besides measures already decided on, the NIER assumes that additional measures for firms costing SEK 10 billion will be introduced during the autumn, and that preventive sick pay will be extended for the rest of the year at a cost of around SEK 6 billion.

Net lending will be less negative next year. Maastricht debt will therefore grow somewhat more slowly to around 45 per cent of GDP (see Diagram 14). The smaller deficit next year is partly due to the stronger economy and partly due to a reduction in active fiscal policy. We estimate that measures costing around SEK 80 billion will be introduced over and above what would follow from unchanged rules. Government consumption is expected to rise more than warranted by demographic developments alone, due to the increase in spending on the labour market, education and health care. Further appropriate measures would be support for investment (above all for research and development) and a temporary increase in the tax relief for home improvements. It is also assumed that the short-time work system will be activated for parts of 2021 with the standard level of subsidy, as the economy will still be in a particularly deep downturn. The forecast assumes that households and firms each receive SEK 20 billion.

Given the uncertainty about COVID-19, it is reasonable to assume that fiscal policy in 2021 will not consist solely of proposals in this autumn's budget bill, and that additional amending budgets will be used to introduce further measures as events unfold. It is important that fiscal policy is flexible in this regard. At the same time, it is important for there to be clarity around the general direction of fiscal policy in terms of support if there is an unexpected surge in infection. Given the circumstances expected to prevail over the coming year, firms' expectations around future fiscal measures in the event of unexpectedly high contagion will be very important for whether they dare recruit and invest. The same applies to households' investment decisions. The government and the coalition parties should therefore communicate in advance the principles for fiscal policy in a situation where there is a risk of the COVID-19 pandemic stalling the economic recovery.

Diagram 11 Unemployment

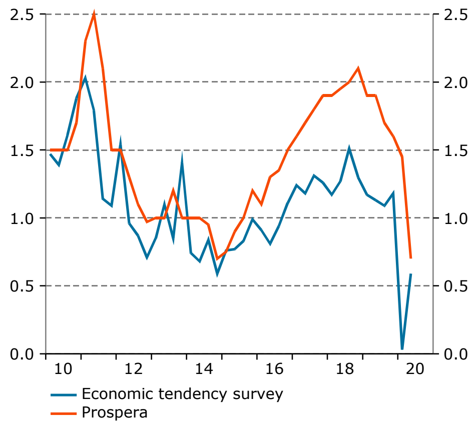
Per cent of labour force, seasonally adjusted quarterly values



Sources: Statistics Sweden and NIER.

Diagram 12 Inflation expectations one year ahead

Per cent, quarterly values



Sources: TNS Sifo Prospera, Macrobond and NIER.

Table 1 Updated forecast and revisions relative to the June 2020 forecast

Percentage change and percentage points, unless otherwise indicated

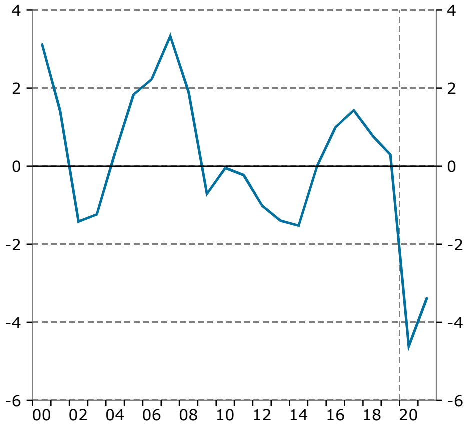
	2019	2020	Differ-ence	2021	Differ-ence
GDP, market prices	1.2	−4.8	0.6	3.4	−0.1
Employment	0.7	-1.9	0.0	-0.6	0.0
Unemployment[1]	6.8	8.5	0.0	9.5	0.0
Hourly earnings[2]	2.6	1.8	0.0	2.2	0.0
CPI	1.8	0.5	0.1	1.1	0.0
CPIF	1.7	0.5	0.1	1.1	0.0
Repo rate[3,4]	-0.3	0.0	0.0	0.0	0.0
Government net lending[5]	0.3	-4.6	1.0	-3.4	0.2
Maastricht debt[5]	35.2	42.7	-1.4	45.0	-1.5

[1] Per cent of labour force. [2] According to the monthly wage statistics. [3] Per cent. [4] At year-end. [5] Per cent of GDP.

Source: Statistics Sweden and NIER.

Diagram 13 Net lending in general government

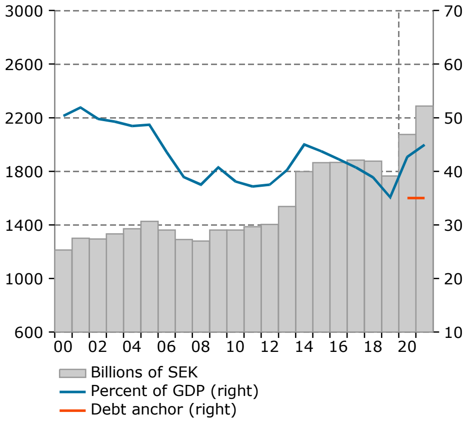
Per cent of GDP



Sources: Statistics Sweden and NIER.

Diagram 14 Maastricht debt

Billions OF SEK and per cent of GDP



Sources: Statistics Sweden and NIER.