27. SWEDEN

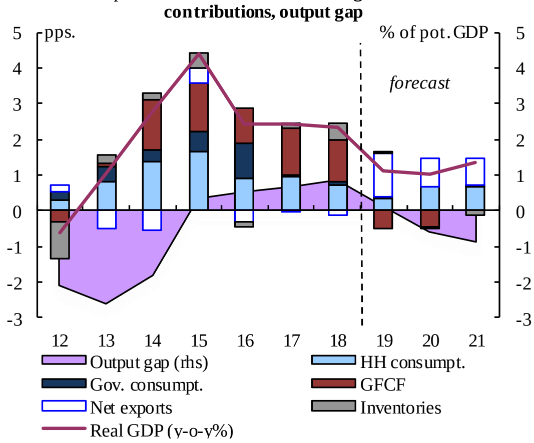
Weak domestic demand puts the brakes on growth

Sweden's economy is clearly slowing down. Domestic demand and investment in particular are weak, but exports are still holding up quite well, so net exports are set to become the economy's engine of growth. The unemployment rate is expected to rise above 7% and inflation is forecast to remain below 2%. A slightly expansionary 2020 budget bill and slower growth imply a decline in the general government surplus but the public debt-to-GDP ratio should continue to fall.

The economy is slowing…

Economic activity in Sweden slowed down markedly in the first half of 2019 after several years of relatively brisk growth. Real GDP growth is forecast to fall to 1.1% in 2019 as domestic demand growth turns slightly negative. Economic growth is expected to stabilise in 2020 and pick up modestly to 1.4% in 2021, as exports are set to weaken and domestic demand to recover slowly.

Graph II.27.1: **Sweden - Real GDP growth and contributions, output gap**



… driven by domestic demand

A pronounced fall in housing investment accounts for a large part of the deceleration in domestic demand in 2019. Equipment investment is also expected to decline, mirroring drops in business confidence in both manufacturing and services. Overall, gross fixed capital formation is set to fall nearly 2% in 2019 and only turn positive in 2021.

Private consumption growth is forecast to decrease in 2019, reflecting a deterioration in the labour market, falling consumer confidence and the associated rise in precautionary savings. It is set to recover somewhat, to 1.5%, over the remainder of the forecast period, with tax cuts and moderate inflation supporting disposable income, despite subdued wage increases.

In spite of sizeable spending needs for schools, health care and welfare services linked to demographic developments, general government consumption is set to moderate in 2019 and 2020. Costs linked to migration should decrease, whereas new defence and health care expenses, priorities of the 2019 budget, are partially compensated by cut backs on, among other items, labour market and environmental measures.

Rebalancing of net trade

Exports grew briskly in 2018 and continued their strong performance into 2019, testifying to the strong competitive position of Swedish exporters. But exports are expected to slow due to lower growth in Sweden's major trading partners. Import growth, however, is expected to decrease more sharply, mirroring domestic demand. Net trade is thus forecast to be the sole driver of growth in 2019 with a partial rebalancing only in 2021. This is a change from previous years, when domestic demand was the main source of GDP growth.

Marked worsening in the labour market

Employment growth slowed markedly in the first half of 2019, in line with the slowdown in domestic demand. According to Statistics Sweden, the recent sharp rise in the registered unemployment rate, however, had been somewhat overstated in the statistics due to methodological changes in the Labour Force Survey, and the figures will be reviewed in the period ahead. Against this background, the labour market outlook is forecast to mirror economic activity in line with prevailing trends. Employment is thus expected to broadly stagnate in 2020 and pick up only slightly in 2021, while the unemployment rate should further increase to 7.2% in 2021. Social partners have started negotiations on a new multi-annual wage agreement. Given the weak labour market, wage growth is expected to remain broadly stable despite continued shortages of skilled labour.

Inflation to remain subdued

Headline HICP inflation is set to decrease from 2.0% in 2018 to 1.7% in 2019, and reach 1.6% in 2021, close to the rate of underlying inflation. The decrease in inflation from its peak in the middle of 2018 mainly resulted from falling energy prices and the fading away of special factors, in particular the sharp rise in unprocessed food prices due to the warm summer of last year. Domestic factors are not set to generate pressure on consumer prices in view of weak economic activity, stable wage increases, and a relatively muted pass-through of the past depreciation of the Swedish krona.

Downside risks prevail

As the Swedish business cycle is closely aligned to that of its main trading partners, a deterioration of the external environment would weigh on the export sector. Downside risks also remain on the domestic side. A sharper-than-expected worsening in the labour market could have a negative impact on private consumption and delay the projected gradual improvement in corporate investment.

Falling surplus but still solid public finances

The slightly expansionary budget bill for 2020 reflects rising demand for welfare services and the constrained situation of local governments and regions, which will receive higher grants. Moreover, it includes new spending on law and order and a commitment to support a green transition. On the revenue side, sizeable tax cuts translate into slower revenue growth. Fiscal policy – expansive also in 2019 – in combination with the macroeconomic developments, is expected to lead to a smaller surplus of 0.3% of GDP in 2019, and 0.1% in 2020-2021. The structural balance is set to increase to around ½% of GDP over the forecast horizon. Sweden's debt-to-GDP ratio is expected to continue to fall: from 38.8% in 2018 to 32.0% in 2021. While the overall debt is set to decrease, its composition is changing, as local governments and regions take on more debt to finance investments linked to welfare provision. The marked debt reduction in 2019 is largely attributable to a reduction in loan-financed foreign currency reserves by the Riksbank.

Table II.27.1:

Main features of country forecast - SWEDEN

	2018		Annual percentage change						
bn SEK	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	4833.7	100.0	2.4	2.4	2.4	2.3	**1.1**	**1.0**	**1.4**
Private Consumption	2157.2	44.6	2.5	2.0	2.1	1.6	**0.8**	**1.5**	**1.5**
Public Consumption	1258.5	26.0	1.0	3.7	0.1	0.4	**0.2**	**0.0**	**0.1**
Gross fixed capital formation	1254.0	25.9	2.9	4.1	5.6	4.6	**-1.9**	**-1.7**	**0.2**
of which: equipment	363.3	7.5	2.8	6.6	1.7	1.5	**-4.8**	**-4.3**	**0.7**
Exports (goods and services)	2211.1	45.7	3.9	2.8	4.3	3.1	**4.2**	**2.3**	**2.3**
Imports (goods and services)	2093.6	43.3	3.7	3.8	4.8	3.6	**1.6**	**0.7**	**0.8**
GNI (GDP deflator)	4908.8	101.6	2.4	2.2	3.2	2.4	**1.1**	**1.1**	**1.4**
Contribution to GDP growth: Domestic demand			2.1	2.9	2.3	2.0	**-0.1**	**0.2**	**0.7**
Inventories			0.1	-0.2	0.1	0.5	**0.0**	**0.0**	**-0.1**
Net exports			0.3	-0.3	0.0	-0.1	**1.2**	**0.8**	**0.7**
Employment			0.9	1.9	2.5	1.9	**0.3**	**0.0**	**0.5**
Unemployment rate (a)			7.2	6.9	6.7	6.3	**6.8**	**7.1**	**7.2**
Compensation of employees / head			3.5	2.6	2.1	3.6	**3.1**	**2.9**	**3.0**
Unit labour costs whole economy			2.0	2.0	2.1	3.1	**2.2**	**1.8**	**2.2**
Real unit labour cost			0.3	0.5	-0.1	0.9	**-0.2**	**0.3**	**0.5**
Saving rate of households (b)			11.2	16.5	16.0	18.0	**19.1**	**19.1**	**19.6**
GDP deflator			1.6	1.5	2.2	2.2	**2.4**	**1.5**	**1.7**
Harmonised index of consumer prices			1.5	1.1	1.9	2.0	**1.7**	**1.5**	**1.6**
Terms of trade goods			-0.3	0.6	-0.6	-1.0	**0.7**	**-1.1**	**-0.2**
Trade balance (goods) (c)			5.7	2.8	2.7	2.4	**3.7**	**4.0**	**4.3**
Current-account balance (c)			5.2	3.1	3.3	2.4	**3.6**	**4.1**	**4.5**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			5.1	3.1	3.2	2.4	**3.6**	**4.1**	**4.5**
General government balance (c)			0.4	1.0	1.4	0.8	**0.3**	**0.1**	**0.1**
Cyclically-adjusted budget balance (d)			0.7	0.7	1.1	0.3	**0.2**	**0.4**	**0.6**
Structural budget balance (d)			-	0.7	1.1	0.3	**0.2**	**0.4**	**0.6**
General government gross debt (c)			44.1	42.3	40.7	38.8	**34.6**	**33.4**	**32.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.