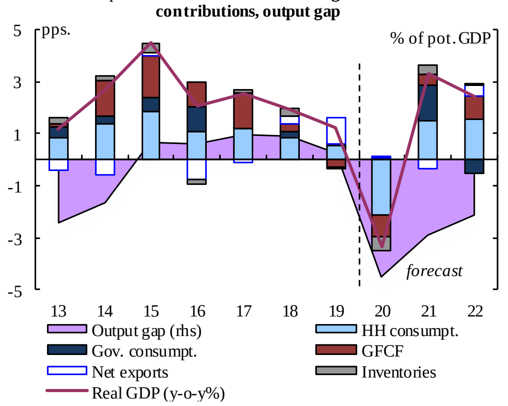
27. SWEDEN

Sweden's economy has contracted sharply due to COVID-19. Sizeable budgetary and financial support measures have cushioned the fall in GDP and the rise in unemployment. Despite a relatively rapid recovery and real GDP back at its 2019 level in early 2022, the economy is projected to operate well below potential in 2021 and 2022, with inflation set to remain low. The general government balance is expected to move into a deficit of 4% of GDP in 2020 and then improve as growth recovers and fiscal support is scaled back. The public debt-to-GDP ratio is set to stabilise at around 40% of GDP.

Steep fall in economic activity…

Sweden's real GDP had a record fall in the second quarter of 2020 due to the COVID-19 crisis, with particularly strong declines in private consumption and exports. Plant closures, partly caused by disruptions in cross-border supply chains, heavily affected production in the manufacturing sector. By comparison, the fall in investment was less severe, as a strong decline in equipment investment was partly compensated by continued growth in public and housing investment.

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



This unprecedented deterioration in economic activity was somewhat cushioned, partly because social distancing restrictions were less stringent and partly thanks to a forceful and front-loaded policy response.

… followed by uneven recovery

Short-term indicators of output, sales, employment, as well as of business and consumer confidence and expenditure expectations, suggest that the economic recovery that started in the summer is set to continue, albeit at an uneven pace across branches of activity. Real private consumption is projected to fall by 5% in 2020, as expenditure on services in particular are likely to regain only some of their lost ground. In 2021 and 2022, private consumption is expected to pick up strongly on the back of a recovery in the labour market, weak inflation, and the unwinding of the pandemic-induced rise in household savings. Government consumption is expected to be broadly unchanged in 2020 reflecting the combined effect of support measures, coupled with disruptions in the provision of some public services. In 2021, public consumption is set to increase markedly, supporting the recovery, before being scaled back in 2022. Exports are on track for a strong rebound in line with the global economic recovery in 2021 and 2022. However, investment growth is forecast to remain relatively muted, reflecting low capacity utilisation and continued uncertainty. Overall, real GDP is projected to fall by around 3½% in 2020, before increasing by 3¼% in 2021 and around 2½% in 2022.

Policy support shores up labour market

The pandemic has triggered a sharp deterioration in the labour market, particularly in labour intensive service sectors employing workers on flexible and short-term contracts and those with a migrant background. A widely used short-term work scheme, together with targeted relief measures for businesses and the self-employed, has helped to curb the rise in unemployment. The unemployment rate is set to peak at just above 9% in 2021 before falling by around one percentage point in 2022, reflecting the delayed response of employment to the expected recovery. The extensive use of short-term working would allow firms to raise production without hiring employees.

Weak cost and demand pressures lead to muted inflation

HICP inflation is forecast at 0.6% in 2020, pushed down by energy prices, and to pick up only slightly to just over 1% in 2022. Weak cost pressures reflect low resource utilisation, the strengthening of the real exchange rate, muted import prices, and moderate wage gains. Social partners delayed negotiations on a multi-annual wage agreement, which has led to a marked fall in overall compensation growth in the second half of 2020 and wage growth is expected to remain moderate over the forecast horizon. Inflation rates are likely to show stronger-than-usual variation due to the differential price impact of the pandemic on different categories of goods and services.

Risks to the main scenario are skewed to the downside. Given its strong trade linkages, Sweden's economy remains vulnerable to a weaker global recovery, which would cause negative feedback effects, also on corporate balance sheets.

Frontloaded policy support scaled down

In response to the crisis, the Swedish authorities implemented a range of coordinated fiscal, monetary and financial support measures to cushion the impact, with fiscal stimulus for 2020 adding up to more than 3% of GDP. The most sizeable measures are the funding of temporary unemployment benefits and sick pay costs, support for firms that suffered substantial losses in turnover, and increased funding for regions and local authorities, which are responsible for health care and social services.

The 2021 draft budget aims to achieve a shift from direct crisis support towards more structural measures to foster the recovery, with a gradual reduction planned for the overall amount of budgetary support in 2021 and 2022. The main fiscal measures for 2021 include enhanced public investment, extra spending on defence, education and health care, higher transfers to local governments, and lower taxes and contributions for employees. This forecast does not include any measures funded by Recovery and Resilience Facility grants.

The general government deficit is expected to amount to around 4% of GDP in 2020. It is set to improve markedly in 2021 on the back of the projected economic recovery, falling further to around 1½% of GDP in 2022, taking into account the measures included in the 2021 budget proposal for that year. The public debt-to-GDP ratio is set to increase sharply from around 35% in 2019 to around 40% in 2020 before stabilising at that level.

Table II.27.1:

Main features of country forecast - SWEDEN

	2019			Annual percentage change						
	bn SEK	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP		5021.3	100.0	2.2	2.6	2.0	1.3	**-3.4**	**3.3**	**2.4**
Private Consumption		2277.6	45.4	2.3	2.6	1.8	1.3	**-4.6**	**3.4**	**3.6**
Public Consumption		1298.2	25.9	1.3	0.1	0.8	0.1	**0.3**	**4.9**	**-1.8**
Gross fixed capital formation		1230.5	24.5	2.8	5.5	1.4	-1.0	**-3.4**	**1.8**	**3.7**
of which: equipment		354.0	7.1	3.2	2.3	0.3	-3.9	**-11.5**	**5.7**	**7.0**
Exports (goods and services)		2361.0	47.0	3.3	4.1	4.2	3.3	**-7.4**	**4.6**	**4.5**
Imports (goods and services)		2182.5	43.5	3.3	4.7	3.8	1.1	**-8.2**	**5.9**	**3.8**
GNI (GDP deflator)		5147.6	102.5	2.2	3.7	2.0	2.0	**-3.9**	**3.0**	**2.2**
Contribution to GDP growth:	Domestic demand			2.1	2.6	1.4	0.3	**-2.9**	**3.3**	**2.0**
	Inventories			0.0	0.1	0.3	-0.1	**-0.6**	**0.3**	**0.0**
	Net exports			0.1	-0.1	0.3	1.0	**0.1**	**-0.3**	**0.4**
Employment				0.8	2.5	1.6	0.6	**-1.7**	**0.0**	**1.6**
Unemployment rate (a)				7.0	6.7	6.4	6.8	**8.8**	**9.2**	**8.1**
Compensation of employees / head				3.2	2.1	3.8	3.2	**1.6**	**2.3**	**2.5**
Unit labour costs whole economy				1.8	1.9	3.5	2.5	**3.3**	**-1.0**	**1.6**
Real unit labour cost				0.2	-0.2	1.1	-0.2	**1.7**	**-2.4**	**0.1**
Saving rate of households (b)				11.4	14.9	16.0	17.6	**21.3**	**18.0**	**17.8**
GDP deflator				1.6	2.1	2.4	2.7	**1.6**	**1.4**	**1.5**
Harmonised index of consumer prices				1.5	1.9	2.0	1.7	**0.6**	**0.8**	**1.3**
Terms of trade goods				-0.1	-0.7	-1.0	1.5	**1.1**	**0.6**	**0.1**
Trade balance (goods) (c)				5.2	2.6	2.5	3.7	**4.0**	**3.7**	**4.0**
Current-account balance (c)				5.3	2.8	2.4	4.2	**4.4**	**3.9**	**4.0**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				5.2	2.8	2.5	4.2	**4.4**	**3.9**	**4.0**
General government balance (c)				0.3	1.4	0.8	0.5	**-3.9**	**-2.5**	**-1.4**
Cyclically-adjusted budget balance (d)				0.5	0.9	0.3	0.4	**-1.4**	**-0.9**	**-0.2**
Structural budget balance (d)				-	0.9	0.3	0.4	**-1.4**	**-0.9**	**-0.2**
General government gross debt (c)				43.3	40.7	38.9	35.1	**39.9**	**40.5**	**40.3**

(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.