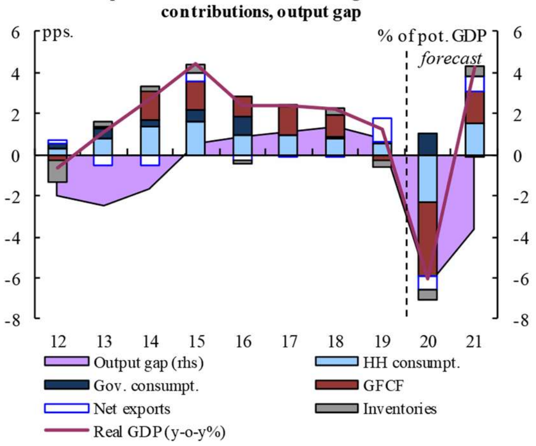
27. SWEDEN

COVID-19 will induce a sharp fall in economic activity, followed by a partial recovery from the second half of 2020 onwards, leaving the economy well below its potential in 2021. Sizable budgetary and financial support measures should limit the fall out in the economy and the labour market. Inflation is projected to edge further down. The general government balance is set to move into a deficit of more than 5% of GDP in 2020. For 2021, improved public finances are expected to stabilise the public debt-to-GDP ratio at just over 42% of GDP.

Abrupt fall in economic activity…

Short-term indicators of economic activity and sentiment in Sweden gave positive signs in early 2020 after real GDP growth fell markedly to 1.2% in 2019. With the spread of COVID-19 in March, however, economic activity declined rapidly

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



The deterioration in economic conditions is unprecedented in terms of speed and depth. At first, production, trade disruptions and plant closures affected industries highly integrated in international value chains, such as the car industry. As the virus spread so did its impact on the domestic economy. Concerns about infection risk and official advice to limit social contacts – albeit less severe than in other EU Member States – put a major dampener on household demand. Falling demand coupled with disruptions in production processes and delivery chains dealt severe blows to production, trade and investment in large parts of the business sector. Overall, real GDP is projected to fall by around 6% in 2020, before veering back over 4% in 2021.

… severely impacting consumers and firms

Real private consumption is projected to fall by nearly 5% in 2020, due to losses in jobs and income and the impact of physical restrictions. The recovery in 2021 is forecast to see relatively strong gains in private consumption, albeit not fully making up for the loss in 2020. The marked increase in government consumption in 2020 reflects a wide range of support measures, which should mostly be reversed in 2021. Uncertainty is set to exacerbate the impact of demand and supply disruptions on investment. Overall, real gross fixed capital formation is forecast to fall by more than 14% in 2020, chiefly driven by equipment investment. Companies are set to have marked drops in capacity utilisation and are likely to postpone projects. The dampened medium-term outlook is set to hold back the strength of any rebound in investment. The occurrence and likely subsequent unwinding of severe trade disruptions shape the forecast for exports and imports, which are set to abruptly fall and then recover.

Policy action to cushion the impact on the labour market

Since March 2020, labour market indicators have shown a severe deterioration, with redundancy notices soaring. Worst affected were employees on flexible and short-term contracts, particularly in the hotel, restaurant and retail sectors. Government support for firms, including for small businesses and the self-employed, is set to cushion the impact on the labour market. The registered unemployment rate is expected to rise to around 9¾% in 2020 from 6.8% in 2019 and fall slightly in 2021.

Energy and service prices drive fall in inflation

Headline inflation is set to decrease from 1.7% in 2019 to 0.4% in 2020. This mainly reflects sharply falling energy prices. By contrast, supply and distribution disruptions are expected to exert some upward impact on food prices. Social partners have deferred negotiations on a new multi-annual wage agreement and overall compensation growth is expected to remain muted. This should feed into moderate underlying inflation of close to 1% in both 2020 and 2021.

With high uncertainty, downside risks prevail

Risks to the main scenario are mainly on the downside. This reflects, among other factors, the exceptionally high degree of uncertainty weighing on investment and the export sector. Downside risks also stem from the ability of firms to restore profitability and retain access to funding.

Strong policy response to limit crisis impact

The authorities in Sweden responded to the crisis with a series of coordinated fiscal, monetary and financial support measures successively scaled up as the pandemic spread. Fiscal measures with an immediate budgetary impact are estimated to amount to around 2½ % of GDP. These include extra outlays on health care, education and social protection, as well as support for the regions and local authorities responsible for the health care system. The government has further taken steps to limit crisis-related costs to the corporate sector, employees, self-employed and small businesses. These include taking over sick pay costs, funding of short-term work schemes, reductions in social security contributions, lowering requirements to receive unemployment benefits, and contributing to rent reductions. Credit guarantees and allowing the postponement and reimbursement of tax and VAT payments should support corporate liquidity without affecting the budget. The Riksbank has decided to extend loans to companies via banks, to purchase government and municipal bonds, covered mortgage bonds as well bonds and commercial paper of Swedish non-financial corporations. It also concluded a currency swap agreement with the US Federal Reserve. The Swedish Financial Supervisory Authority reduced banks' capital requirements and allowed a temporary suspension of amortisation requirements. Against this backdrop, the general government balance is set to swing from a surplus in 2019 to a deficit of around 5½ % of GDP in 2020, which should improve markedly in 2021 under a no-policy-change assumption and assuming that the measures adopted to fight the pandemic are limited to 2020. Sweden's debt-to-GDP ratio is set to increase from around 35% in 2019 to over 42% in 2020 before stabilising.

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		4833.8	100.0	2.4	2.4	2.4	2.2	**1.2**	**-6.1**	**4.3**
Private Consumption		2158.6	44.7	2.5	2.0	2.1	1.7	**1.2**	**-5.2**	**3.4**
Public Consumption		1257.8	26.0	1.0	3.7	0.1	0.4	**0.4**	**3.9**	**-0.1**
Gross fixed capital formation		1249.7	25.9	2.9	4.1	5.6	4.2	**-1.2**	**-14.3**	**6.7**
of which: equipment		361.5	7.5	2.8	6.6	1.7	0.9	**-4.2**	**-39.3**	**19.3**
Exports (goods and services)		2213.3	45.8	3.9	2.8	4.3	3.2	**4.2**	**-12.0**	**6.5**
Imports (goods and services)		2092.4	43.3	3.7	3.8	4.8	3.6	**1.8**	**-11.5**	**5.1**
GNI (GDP deflator)		4917.8	101.7	2.4	2.2	3.6	2.3	**2.0**	**-6.4**	**3.9**
Contribution to GDP growth:		Domestic demand		2.1	2.9	2.3	1.9	**0.4**	**-4.9**	**3.0**
		Inventories		0.1	-0.2	0.1	0.4	**-0.3**	**-0.5**	**0.4**
		Net exports		0.3	-0.3	0.0	-0.1	**1.1**	**-0.7**	**0.8**
Employment				0.9	1.9	2.5	1.6	**0.6**	**-2.5**	**1.1**
Unemployment rate (a)				7.0	7.0	6.7	6.4	**6.8**	**9.7**	**9.3**
Compensation of employees / head				3.5	2.6	2.1	3.9	**3.0**	**-1.3**	**5.6**
Unit labour costs whole economy				2.0	2.0	2.1	3.3	**2.4**	**2.4**	**2.3**
Real unit labour cost				0.3	0.5	-0.1	0.9	**-0.4**	**1.3**	**1.0**
Saving rate of households (b)				11.2	16.5	16.0	17.9	**19.0**	**21.5**	**19.5**
GDP deflator				1.6	1.5	2.2	2.3	**2.7**	**1.0**	**1.3**
Harmonised index of consumer prices				1.5	1.1	1.9	2.0	**1.7**	**0.4**	**1.1**
Terms of trade goods				-0.3	0.6	-0.6	-1.1	**1.2**	**0.7**	**0.5**
Trade balance (goods) (c)				5.7	2.8	2.7	2.5	**3.8**	**3.7**	**4.3**
Current-account balance (c)				5.2	2.9	3.4	2.6	**4.4**	**3.7**	**4.0**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				5.0	2.9	3.4	2.6	**4.4**	**3.7**	**4.0**
General government balance (c)				0.4	1.0	1.4	0.8	**0.5**	**-5.6**	**-2.2**
Cyclically-adjusted budget balance (d)				0.6	0.5	0.8	0.0	**0.1**	**-2.1**	**-0.2**
Structural budget balance (d)				-	0.5	0.8	0.0	**0.1**	**-2.1**	**-0.2**
General government gross debt (c)				44.0	42.2	40.8	38.8	**35.1**	**42.6**	**42.5**

(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.