27. SWEDEN

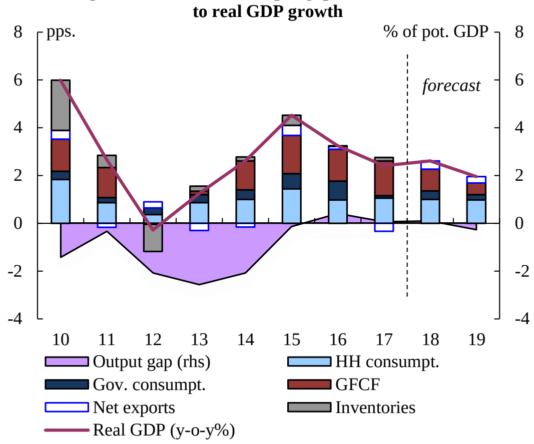
Preparing for a soft landing

Economic growth in Sweden is expected to remain solid this year on the back of domestic demand and exports, but is forecast to moderate in 2019 when construction investment declines. The unemployment rate is set to fall and stabilise over 2018 and 2019. Inflation is expected to remain broadly stable and below the Riksbank's target of 2%. Despite an increase in public consumption in 2018, the general government balance is projected to remain in surplus.

Growth to ease somewhat

Real GDP growth in Sweden cooled to 2.4% in 2017 and is set to grow at a broadly similar pace in 2018 before easing further to 2.0% in 2019. The moderation in the economy's growth rate is mainly the result of an abatement in domestic demand growth, although stronger net exports offset this effect somewhat. While economic confidence has been edging down a bit, it remains positive and above its long-term average.

Graph II.27.1: **Sweden - Output gap and contributions to real GDP growth**



Slowing domestic demand growth

Domestic demand growth is set to decelerate from 2.6% in 2017 to 1.7% in 2019, mainly due to developments in housing investment. After years of strong growth, house prices declined in the last quarter of 2017 and have broadly stabilised at a lower level. This fall seems to have negatively affected sentiment in the construction industry and production in the construction sector also decreased recently. The number of newly built homes is expected to significantly decline over the forecast horizon from a 30-year peak reached in 2017. Overall, instead of a positive contribution to real GDP growth of around 0.7 pps. in 2017, residential investment is expected to subtract some 0.2 pps. in 2019.

Capacity utilisation is set to remain high and demand prospects have increased since the autumn. Machinery and equipment investment is therefore expected to expand at a solid albeit declining pace in 2019, making overall gross fixed capital formation likely to grow by 3.7% in 2018 and 1.9% in 2019.

Private consumption growth is projected to remain broadly stable, with 2.3% in 2018 and 2.2% in 2019. While employment growth is expected to remain quite robust, wage growth is set to be lacklustre. With core inflation gradually increasing towards the end of 2019, real disposable income growth appears inadequate to spur any acceleration in household consumption growth.

General government consumption is set to increase by 1.4% in 2018, with additional spending from the 2018 budget bill compared to 2017, before slowing to 0.8% in 2019. Most of the additional spending is expected to be undertaken by local authorities to hire staff and improve infrastructures in view of a growing and ageing population.

Net exports to support growth

Goods exports rose by 3.2% in Q4-2017 quarter-on-quarter, bolstered by improvements in global trade, while exports of services were not as strong. As the import content of Swedish exports is high, goods imports also rose. Net exports are expected to turn positive in 2018, in line with the strong demand from Sweden's trading partners, notably Germany, and should remain positive in 2019 with import growth forecast to slow as domestic demand weakens.

Strong labour market activity

Employment growth was strong in 2017 and is set to remain solid, though at somewhat lower levels, as economic conditions are generally favourable. As shortages of skilled labour are increasingly acute, however, unemployment is expected to fall and stabilise at around 6.3% over 2018 and 2019.

The strong expansion in the labour force in 2017, particularly among low-skilled workers, means that the unemployment rate is unlikely to fall further.

Steady inflation

Headline inflation is expected to stay around 1.9% in 2018 and to edge down to 1.7% in 2019. The weak Swedish krona is set to exert upward pressures on import prices along with higher oil and electricity prices in 2018 but wage and rent growth remains muted, preventing a further acceleration in consumer price inflation. Agreed wage increases among exporters for 2018-2019 of around 2.2% per year are holding back core inflation despite a tight domestic labour market.

Risks tilted to the downside

While the decline in house prices seems to have come to a halt, a further decrease could lead to a stronger fall in residential construction activity. This could have potentially negative repercussions on consumer confidence and therefore household consumption, and ultimately growth.

Smaller surpluses

Sweden's general government balance had a surplus of 1.3% of GDP in 2017, up from 1.2% in 2016 on the back of strong revenues. In addition to the measures already announced last autumn for 2018, the government proposed new reforms in its 2018 spring budget bill to further improve the integration of newly-arrived migrants, as well as additional spending on security and the environment. Since these measures are forecast to be only partially financed by additional revenue growth, it is expected that net lending will decline to 0.8% of GDP in 2018.

The headline surplus is set to increase slightly to 0.9% of GDP under a no-policy-change assumption. This would be above the adopted new surplus target of 0.33% of GDP with effect from 2019. The structural surplus is projected to decline by around ½ pps. of GDP in 2018 and to increase to 1.0% of GDP in 2019. Sweden's gross debt has been falling in recent years, and should continue to do so, on the back of economic growth and budget surpluses. The debt-to-GDP ratio is projected to fall from 40.6% in 2016 to 35.5% in 2019.

Table II.27.1

Main features of country forecast - SWEDEN

	2016		Annual percentage change						
	bn SEK Curr. prices	% GDP	98-13	2014	2015	2016	2017	2018	2019
GDP	4404.8	100.0	2.4	2.6	4.5	3.2	**2.4**	**2.6**	**2.0**
Private Consumption	1949.8	44.3	2.4	2.1	3.1	2.2	**2.4**	**2.3**	**2.2**
Public Consumption	1151.7	26.1	1.1	1.5	2.4	3.1	**0.4**	**1.4**	**0.8**
Gross fixed capital formation	1059.5	24.1	3.1	5.5	6.9	5.6	**6.0**	**3.7**	**1.9**
of which: equipment	319.4	7.3	3.9	-1.1	5.1	4.8	**4.8**	**5.7**	**3.8**
Exports (goods and services)	1950.1	44.3	4.2	5.3	5.7	3.3	**3.7**	**4.7**	**3.7**
Imports (goods and services)	1737.0	39.4	4.1	6.3	5.2	3.4	**5.0**	**4.3**	**3.5**
GNI (GDP deflator)	4455.0	101.1	2.6	2.5	3.7	3.1	**2.7**	**2.5**	**1.9**
Contribution to GDP growth:	Domestic demand		2.1	2.6	3.7	3.1	**2.6**	**2.3**	**1.7**
	Inventories		0.0	0.2	0.4	0.0	**0.1**	**0.0**	**0.0**
	Net exports		0.3	-0.2	0.4	0.1	**-0.3**	**0.3**	**0.3**
Employment			0.9	1.4	1.5	1.7	**2.3**	**1.6**	**1.3**
Unemployment rate (a)			7.3	7.9	7.4	6.9	**6.7**	**6.3**	**6.3**
Compensation of employees / head			3.3	2.2	2.7	2.8	**2.1**	**2.7**	**2.4**
Unit labour costs whole economy			1.8	1.0	-0.3	1.3	**2.0**	**1.7**	**1.8**
Real unit labour cost			0.2	-0.7	-2.3	-0.3	**0.0**	**-0.4**	**-0.6**
Saving rate of households (b)			11.3	18.9	17.6	18.9	**18.2**	**18.4**	**17.6**
GDP deflator			1.6	1.8	2.1	1.6	**2.1**	**2.1**	**2.3**
Harmonised index of consumer prices			1.5	0.2	0.7	1.1	**1.9**	**1.9**	**1.7**
Terms of trade goods			-0.7	0.9	1.7	0.5	**-0.6**	**-0.9**	**0.5**
Trade balance (goods) (c)			6.2	3.1	3.0	2.7	**2.9**	**2.8**	**3.1**
Current-account balance (c)			6.2	4.7	4.6	4.7	**4.0**	**4.1**	**4.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			6.0	4.6	4.4	4.6	**4.0**	**4.0**	**4.3**
General government balance (c)			0.6	-1.6	0.2	1.2	**1.3**	**0.8**	**0.9**
Cyclically-adjusted budget balance (d)			0.8	-0.3	0.3	0.9	**1.2**	**0.7**	**1.0**
Structural budget balance (d)			-	-0.3	0.3	0.9	**1.2**	**0.7**	**1.0**
General government gross debt (c)			46.7	45.5	44.2	42.1	**40.6**	**38.0**	**35.5**

(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.