27. SWEDEN

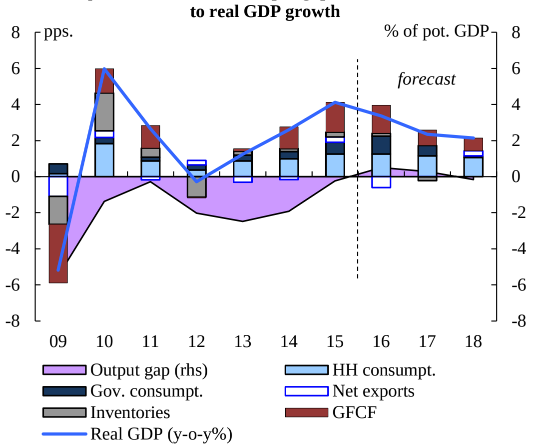
Growth decreases but remains robust

After a strong performance this year and last year, the pace of real GDP growth in Sweden is expected to fall back in line with the economy's potential rate. Domestic demand is expected to be the main driver, while net exports, which are set to be negative in 2016, should turn broadly neutral. Unemployment is projected to decrease before stabilising. Inflation has picked up and is set to rise gradually. The general government balance is expected to remain broadly balanced.

Domestic demand the main growth driver

Following broad-based real GDP growth of 4.1% in 2015, Sweden's economy is forecast to lose steam in 2016. While domestic demand, in particular housing investment, is set to be robust, net exports are expected to lower real GDP growth to 3.4% in 2016 due to subdued growth in some of Sweden's major trading partners. Going forward, economic growth is forecast to slip to 2.4% in 2017 and 2.1% in 2018 on the back of flattening domestic demand, while net exports are set to turn positive only in 2018.

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



Public and private consumption growth to slow

While the large inflow of migrants in 2015 is set to increase government consumption by 3.8% in 2016, the significant drop in 2016 is expected to result in a lower government consumption growth at 2.2% in 2017 and 0.3% in 2018. In particular, the payments from the central to local governments to accommodate asylum seekers are set to be reduced as of mid-2017.

In parallel, continued employment growth and increasing wages on the back of a tighter labour market are expected to support disposable income and ultimately private consumption over the forecast horizon.

Investment to shift into a lower gear

Strong investment growth is forecast to continue in 2016 at a rate of 6.6%. Housing investment has been strong, growing at double-digit rates, but R&D, machinery and equipment investment have also expanded. However, the growth in housing investment is set to decline in 2017 and 2018 as the construction sector is likely to face shortages of labour and building land. At the same time, local authorities have been granted additional funding to cope with demographic challenges and therefore public investment growth is projected to peak in 2017. Overall, investment is expected to grow moderately at 3.5% in 2017 and 2.9% in 2018.

Net exports only supportive in 2018

Buoyant domestic demand boosted imports in the first half of 2016, while exports stalled due to the weaker global environment. Exports of goods decreased in the second quarter of 2016 for the first time since the end of 2013 but exports of services are expected to continue outpacing exports of goods. Overall, net exports are projected to detract from growth in 2016. For 2017 and 2018, exports are forecast to pick up again by 3.4% and 3.8% respectively, as demand in Sweden's main export markets is set to rise. In parallel, import growth is expected to slow in line with domestic demand. Thus, net exports are set to make a small, positive contribution to growth in 2018, while the current account surplus relative to GDP is expected to remain broadly stable.

Robust employment growth

The labour market is forecast to strengthen, with employment growing and unemployment falling in 2016. However, the unemployment rate of non-EU born and low-skilled people is expected to remain elevated. Due to the gradual expansion of the labour force (notably the integration of refugees from the high 2015 influx) and reported labour shortage and skills mismatch, unemployment is set to stabilise at 6.4% in 2017 and 2018.

Inflation gradually approaching 2%

Inflation started to pick up slowly in the first half of 2016, driven particularly by prices in the services sector. It is expected continue rising due to higher oil prices, rising cost pressures due to high capacity utilisation rates and tighter labour market conditions. Despite this and an increase in inflation expectations, wage increases are forecast to remain relatively modest in 2017 as long as exporting industries continue to set the benchmark for the annual bargaining negotiations. Overall, HICP is projected to reach 1.1% in 2016, 1.6% in 2017 and 2.0% in 2018.

Risks are broadly balanced

On the positive side, a stronger-than-expected external environment in Europe could induce larger demand for Swedish investment goods which represents a large proportion of the country's exports. In addition, the economy could benefit in the medium term if migrants are successfully integrated into the labour market. On the downside, a correction in house prices could dampen business confidence, household consumption and construction investment.

Resilient public finances in spite of new welfare expenditure

After a surplus in 2015, the general government balance is expected to be balanced in 2016. The effect of somewhat weaker economic growth is set to be cushioned by strong corporate tax payments and lower expenditure for the reception of asylum-seekers (due to a lower number of arrivals). In 2017, lower spending related to the reception and integration of refugees (included in the Budget Bill) and to fewer people eligible for sickness leave benefits are set to partly compensate for the budgeted new welfare spending. Overall, the general government balance is projected to show a slight deficit of 0.1% of GDP. Under a no-policy-change assumption, public finances are expected to improve in 2018 with the general government reaching a surplus of 0.1% of GDP. The structural deficit is projected to worsen in 2016 while staying below the medium-term budgetary objective of 1.0% of GDP over the forecast horizon. The debt-to-GDP ratio is set to decrease from 43.9% in 2015 to 38.2% in 2018.

Table II.27.1:

Main features of country forecast - SWEDEN

		2015			Annual percentage change					
	bn SEK	Curr. prices	% GDP	97-12	2013	2014	2015	2016	2017	2018
GDP		4180.5	100.0	2.5	1.2	2.6	4.1	**3.4**	**2.4**	**2.1**
Private Consumption		1884.2	45.1	2.5	1.9	2.1	2.7	**2.8**	**2.6**	**2.4**
Public Consumption		1084.5	25.9	1.0	1.3	1.5	2.5	**3.8**	**2.2**	**0.3**
Gross fixed capital formation		990.7	23.7	3.1	0.6	5.5	7.2	**6.6**	**3.5**	**2.9**
of which: equipment		305.5	7.3	4.1	0.1	-1.1	6.2	**5.2**	**2.6**	**2.5**
Exports (goods and services)		1906.2	45.6	5.1	-0.8	5.3	5.6	**2.3**	**3.4**	**3.8**
Imports (goods and services)		1707.7	40.8	4.9	-0.1	6.3	5.5	**4.1**	**3.8**	**3.5**
GNI (GDP deflator)		4274.2	102.2	2.7	1.1	2.5	4.1	**3.3**	**2.3**	**2.1**
Contribution to GDP growth:	Domestic demand			2.1	1.3	2.6	3.6	**3.8**	**2.6**	**1.9**
	Inventories			0.0	0.2	0.2	0.3	**0.2**	**-0.2**	**0.0**
	Net exports			0.4	-0.3	-0.2	0.3	**-0.6**	**0.0**	**0.3**
Employment				0.8	1.0	1.4	1.5	**1.8**	**1.3**	**0.9**
Unemployment rate (a)				7.3	8.0	7.9	7.4	**6.8**	**6.4**	**6.4**
Compensation of employees / head				3.5	1.9	2.2	3.5	**3.1**	**3.3**	**3.2**
Unit labour costs whole economy				1.8	1.7	1.0	0.9	**1.5**	**2.2**	**1.9**
Real unit labour cost				0.2	0.6	-0.7	-1.1	**-0.7**	**0.0**	**-0.3**
Saving rate of households (b)				10.7	17.7	18.3	18.7	**18.6**	**18.0**	**17.2**
GDP deflator				1.6	1.1	1.8	2.0	**2.3**	**2.2**	**2.2**
Harmonised index of consumer prices				1.6	0.4	0.2	0.7	**1.1**	**1.6**	**2.0**
Terms of trade goods				-0.8	0.5	0.9	1.9	**1.6**	**-0.1**	**-0.1**
Trade balance (goods) (c)				6.5	3.2	3.1	3.0	**2.7**	**2.6**	**2.6**
Current-account balance (c)				6.2	5.1	4.8	5.4	**5.0**	**4.9**	**4.9**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				6.0	4.9	4.7	5.2	**4.6**	**4.5**	**4.6**
General government balance (c)				0.6	-1.4	-1.6	0.2	**0.0**	**-0.1**	**0.1**
Cyclically-adjusted budget balance (d)				0.8	0.1	-0.4	0.3	**-0.3**	**-0.3**	**0.1**
Structural budget balance (d)				-	0.1	-0.4	0.3	**-0.3**	**-0.3**	**0.1**
General government gross debt (c)				47.8	40.4	45.2	43.9	**41.6**	**39.9**	**38.2**

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