27. SWEDEN

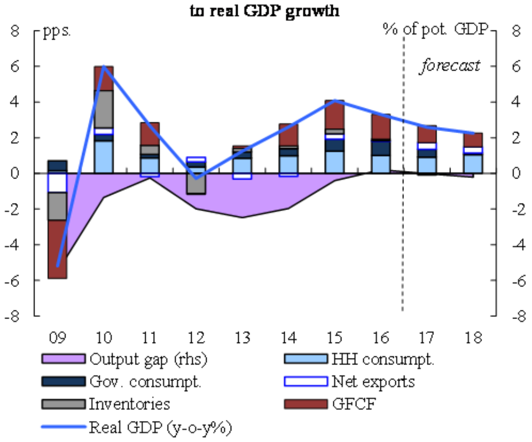
Robust growth and sound public finances continue

Economic growth in Sweden is expected to remain robust and broad-based but to moderate somewhat in 2017 and 2018. Domestic demand, the main growth driver in 2016, is set to slow while net exports are expected to provide some support to growth in 2017 and 2018. The unemployment rate is forecast to level off at 6.6% in 2017 and 2018. Inflation is set to stay below the Riksbank's target of 2%. The general government balance is expected to remain in surplus.

Broad-based growth

Sweden's economy grew by a robust 3.3% in 2016. Gradually waning domestic demand growth along with an improving external balance of goods and services are expected to provide broad-based support to economic activity. Real GDP is therefore expected to expand by 2.6% in 2017 and 2.2% in 2018.

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



Domestic demand is back to its historical average

Employment grew strongly in 2016 while wage increases remained moderate. Since inflation picked up slightly, these developments dampened real disposable income growth. Similar conditions are expected in 2017 with private consumption set to grow by only 2.1%. In 2018, a decline in the saving rate from elevated levels is expected to provide some support to private consumption growth.

Public consumption growth is expected to slow markedly from 1.7% in 2017 to 0.3% in 2018. This is largely a reflection of cost control measures in the compensation payments from central to local authorities for accommodating refugees. However, local authorities are expected to undertake additional investments in infrastructure in response to demographic challenges, i.e. an ageing population and the high number of young migrants that arrived in recent years.

The number of newly built homes reached a 30-year peak in 2016. While housing investment is set to remain strong, growth will slow to 9.5% in 2017 and 3.7% in 2018. At the same time, the strengthening of the global business cycle should spur external demand for machinery and equipment, sectors in which Sweden is relatively specialised. This is expected to trigger additional investment by Swedish companies. Overall, investment is expected to increase at a slowing pace from 2016 to 2018.

Improving exports

As a small open economy, Sweden is benefitting from the gradual recovery in the external environment. Services and goods exports, particularly automotive products, machinery, equipment and basic metals, rose at faster pace in the fourth quarter of 2016. This momentum is expected to continue with exports projected to grow by 3.9% in 2017 (even faster than demand growth in Sweden's main export markets, implying market share gains), and by 3.8% in 2018. Since import growth is forecast to slow in line with domestic demand, net exports should contribute positively to growth in 2017 and 2018.

Unemployment is levelling off

The labour market continued to improve quite significantly in 2016, with employment growing by 1.7% and the unemployment rate falling to 6.9%. Job-to-job mobility increased, indicating a strained labour market and difficulties in finding the needed skills among the pool of unemployed. While good prospects for further employment growth are expected to remain in view of sustained economic growth, the unemployment rate is set to stay broadly stable at 6.6% in 2017 and 2018 due to the expansion of the labour force.

Inflation still below 2%

The pick-up in inflation in the first quarter of this year was driven mainly by temporary factors such as higher commodity prices and imported inflation from the lagged effect of the Swedish krona's depreciation in 2016. Rising cost pressures due to high capacity utilisation rates and tighter labour market conditions are expected to gradually kick in. The wage bargaining negotiations with industry ended with an agreement for a 6.5% wage increase over three years. Deviations from this agreement in other sectors are unlikely this year. Overall, HICP inflation is projected to rise from 1.1% in 2016 to 1.4% in 2017 and 2018.

Risks are broadly balanced

On the positive side, the economy may benefit in the medium term from a successful integration of migrants into the labour market. On the downside, any correction to Sweden's housing market could dampen business confidence, household consumption and construction investment.

Sustained budget surpluses

Public finances improved significantly in 2016 and the general government achieved a surplus of 0.9% of GDP. Robust economic growth and high VAT returns linked to both the booming housing sector and a new regulation making it easier to collect tax payments helped to expand the surplus. The general government balance is expected to remain healthy in 2017, reaching a surplus of 0.4% of GDP. Strong corporate tax payments and higher taxes on capital gains are expected to contribute to this sound position. Lower welfare spending related to the integration of refugees and higher income tax payments are set to be the main drivers behind the increase in the general government surplus to 0.7% of GDP in 2018. The structural surplus is projected to decline in 2017 but should stay well above the medium-term budgetary objective of a structural deficit of 1.0% of GDP over the forecast horizon. Sweden's debt-to-GDP ratio is set to decrease from 41.6% in 2016 to 37.0% 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	4181.1	100.0	2.5	1.2	2.6	4.1	**3.3**	**2.6**	**2.2**
Private Consumption	1884.2	45.1	2.5	1.9	2.1	2.7	**2.2**	**2.1**	**2.4**
Public Consumption	1086.4	26.0	1.0	1.3	1.5	2.5	**3.1**	**1.7**	**0.3**
Gross fixed capital formation	988.7	23.6	3.1	0.6	5.5	7.0	**5.9**	**3.9**	**3.1**
of which: equipment	305.5	7.3	4.1	0.1	-1.1	6.2	**4.0**	**3.9**	**4.2**
Exports (goods and services)	1906.2	45.6	5.1	-0.8	5.3	5.6	**3.4**	**3.9**	**3.8**
Imports (goods and services)	1707.7	40.8	4.9	-0.1	6.3	5.5	**3.7**	**3.5**	**3.4**
GNI (GDP deflator)	4245.2	101.5	2.7	1.1	2.5	3.4	**3.4**	**2.5**	**2.2**
Contribution to GDP growth: Domestic demand			2.1	1.3	2.6	3.5	**3.2**	**2.3**	**1.9**
Inventories			0.0	0.2	0.2	0.3	**0.1**	**-0.1**	**0.0**
Net exports			0.4	-0.3	-0.2	0.3	**0.0**	**0.4**	**0.4**
Employment			0.8	1.0	1.4	1.5	**1.7**	**1.5**	**1.2**
Unemployment rate (a)			7.3	8.0	7.9	7.4	**6.9**	**6.6**	**6.6**
Compensation of employees / head			3.5	1.9	2.2	3.5	**2.5**	**2.5**	**2.6**
Unit labour costs whole economy			1.8	1.7	1.0	0.9	**0.9**	**1.4**	**1.5**
Real unit labour cost			0.2	0.6	-0.7	-1.1	**-0.5**	**-0.9**	**-0.4**
Saving rate of households (b)			10.7	17.7	18.3	18.6	**18.5**	**18.5**	**18.0**
GDP deflator			1.6	1.1	1.8	2.0	**1.4**	**2.3**	**2.0**
Harmonised index of consumer prices			1.6	0.4	0.2	0.7	**1.1**	**1.4**	**1.4**
Terms of trade goods			-0.8	0.5	0.9	1.9	**0.4**	**0.2**	**-0.1**
Trade balance (goods) (c)			6.5	3.2	3.1	3.0	**2.6**	**2.8**	**2.8**
Current-account balance (c)			6.2	5.1	4.8	4.7	**4.9**	**5.2**	**5.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			6.0	4.9	4.7	4.5	**4.9**	**5.1**	**5.3**
General government balance (c)			0.6	-1.4	-1.5	0.3	**0.9**	**0.4**	**0.7**
Cyclically-adjusted budget balance (d)			0.8	0.1	-0.4	0.5	**0.8**	**0.4**	**0.8**
Structural budget balance (d)			-	0.1	-0.4	0.5	**0.8**	**0.4**	**0.8**
General government gross debt (c)			48.2	40.4	45.2	43.9	**41.6**	**39.1**	**37.0**

(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.