SWEDEN

Economic growth has been strong, but is projected to decline. Shortages of qualified labour and constructible land will slow residential investment, while uncertainty about global demand will slow business investment. Modest real wage gains will continue to damp consumption. The unemployment rate is levelling off as difficult-to-hire low-skilled workers make up a rising share of jobseekers. Labour market tightening will help lift inflation gradually.

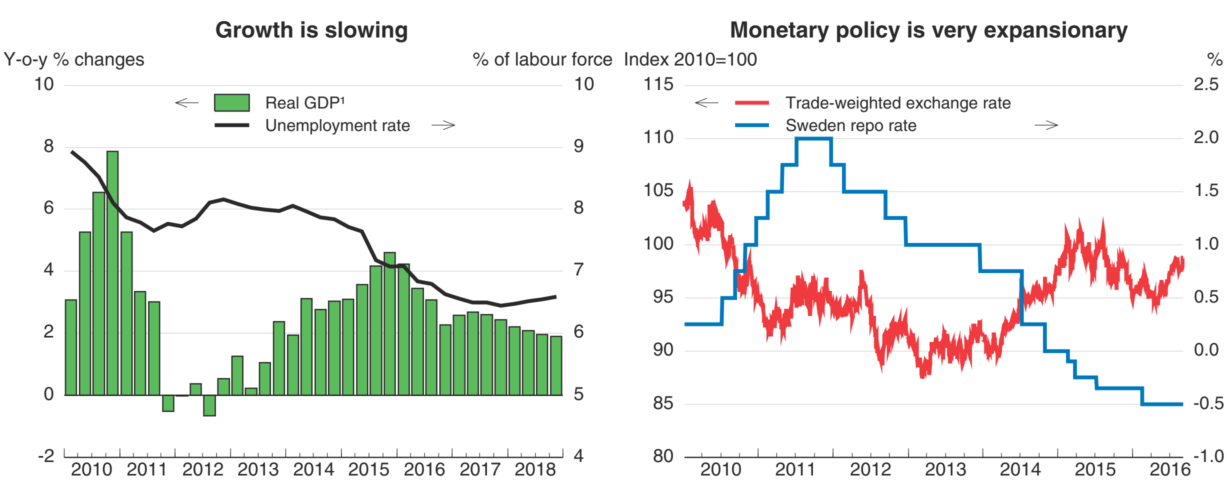
The current very expansionary monetary policy stance is a response to persistently below-target inflation, but has also fuelled a long housing boom which increasingly poses risks. Stronger macro-prudential policy, such as a debt-to-income cap, is called for to reduce financial and macroeconomic vulnerabilities. Easing planning and rental regulations and reforming housing taxation would help stabilise house prices, increase labour market mobility and improve equality.

Sweden has substantial fiscal space, as public debt is low and the budget is near balance. There is little need for further economic stimulus given the strength of the economy. However, the use of fiscal space to accommodate temporary migration-related costs is welcome.

Investment is booming, but slow wage growth holds back consumption

The domestic economy is decelerating but still growing strongly, underpinned by solid demand, labour force expansion and rising productivity. Unemployment is gradually declining, but the unemployed increasingly consist of harder-to-employ individuals, including recently arrived immigrants. Efforts to maintain cost-competitiveness in manufacturing, where weak global demand toughens competition, together with low short-term inflation expectations, hold back wage growth, which restrains private consumption growth. Inflation has stayed low and monetary policy has accordingly remained highly expansionary, which is boosting investment and asset prices.

Sweden



1. Working day adjusted.

Source: OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933437941

Sweden: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices SEK billion	Percentage changes, volume (2015 prices)				
GDP at market prices	3 773.4	2.7	3.9	3.3	2.7	2.2
Private consumption	1 759.8	2.2	2.6	2.5	2.6	2.5
Government consumption	992.0	1.7	2.2	3.5	2.4	1.2
Gross fixed capital formation	843.3	5.6	6.8	7.1	3.7	3.1
Final domestic demand	3 595.2	2.8	3.5	3.9	2.8	2.3
Stockbuilding[1]	7.7	0.2	0.3	0.1	0.0	0.0
Total domestic demand	3 602.9	3.0	3.8	4.0	2.8	2.3
Exports of goods and services	1 654.6	5.5	5.2	2.7	3.4	3.2
Imports of goods and services	1 484.2	6.5	5.0	4.5	3.5	3.5
Net exports[1]	170.5	-0.2	0.3	-0.6	0.1	0.0
Memorandum items						
GDP deflator	_	1.7	2.1	1.2	1.8	2.2
Consumer price index[2]	_	-0.2	0.0	0.9	1.5	2.0
Private consumption deflator	_	1.1	1.0	0.9	1.7	1.9
Unemployment rate[3]	_	7.9	7.4	6.9	6.7	6.7
Household saving ratio, net[4]	_	15.9	16.4	17.8	17.3	16.8
General government financial balance[5]	_	-1.6	0.2	0.2	-0.1	0.1
General government gross debt[5]	_	55.5	53.8	52.9	51.6	50.1
General government debt, Maastricht definition[5]	_	45.2	43.9	43.0	41.7	40.2
Current account balance[5]	_	4.6	5.2	4.8	4.8	4.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. The consumer price index includes mortgage interest costs.
3. Historical data and projections are based on the definition of unemployment which covers 15 to 74 year olds and classifies job-seeking full-time students as unemployed.
4. As a percentage of disposable income.
5. As a percentage of GDP.

Source: OECD Economic Outlook 100 database.

StatLink http://dx.doi.org/10.1787/888933439214

Fiscal space is being used to cover migration-related costs

Humanitarian immigration has abated since its 2015 peak. Immigration rejuvenates the Swedish population and, in the longer term, will increase employment, provided that integration is successful. The use of fiscal space to accommodate temporary costs related to reception and integration may allow for less aggressive monetary policy. The decision to lower the fiscal surplus target from 1% to 0.33% of GDP increases fiscal space slightly over the coming years. The repo rate has stood at -0.50% since mid-February, driving up prices and inflation expectations, but recent readings have been weak.

Low interest rates, strong population growth, favourable tax treatment of property and a slow supply response led to double-digit housing price increases in the past two years and household debt continues to expand. Macro-prudential measures, including a mortgage amortisation requirement, have been taken. Supplementing existing measures by a debt-to-income cap should be considered. Steps to increase housing supply and ease planning regulations are welcome. Removing the ceiling of the property tax or phasing out mortgage interest deductibility would damp housing price increases, improve capital allocation and increase redistribution. Easing rental regulations would improve the utilisation of the existing housing stock.

Growth will soften as the economy reaches full capacity

GDP growth is projected to slow significantly in the next two years. Residential investment will be held back by shortages of qualified labour and available land with building permission. Uncertain demand growth and weak exports will damp business investment. Labour force expansion will slow towards 2018, reflecting reduced immigration and ageing. Unemployment will level out, as an increasing share of the unemployed will be low-educated or recent immigrants. Real wage increases are contained by the leading role in collective bargaining of the export industry, which is exposed to tough global competition. However, nominal wages are set to accelerate, as expansionary monetary policy increases inflation expectations. The high saving rate, partly related to uncertainty and mortgage repayments, further limits consumption growth.

Sweden is a small, open economy, strongly integrated into global value chains, and hence particularly exposed to weak international trade growth and developments in its trading partners, including China and the United Kingdom. Currency movements would impact output, inflation and monetary policy. Interest rates are set to stay low for some time, and a failure to rein in household debt could heighten financial risks and households' vulnerability to house price declines and future interest rate increases.