Sweden

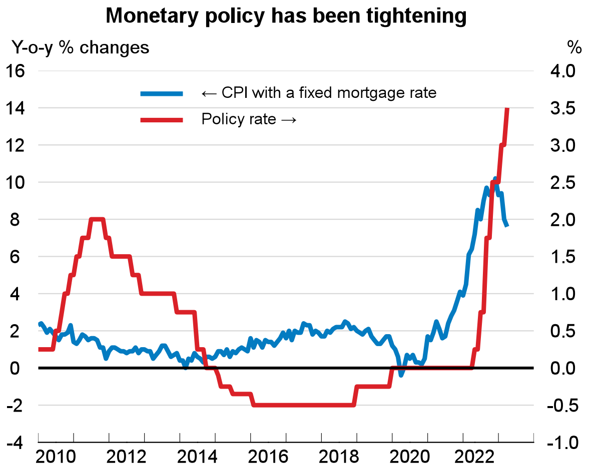
The economy is expected to contract by 0.3% in 2023 and grow by 1.4% in 2024. Private investment will decline in 2023, with construction activity set to drop significantly due to higher construction costs and falling housing prices. Elevated inflation will continue to reduce households' real disposable income in the near term. Private consumption growth is projected to pick up somewhat from mid-2023 as real disposable incomes start to recover.

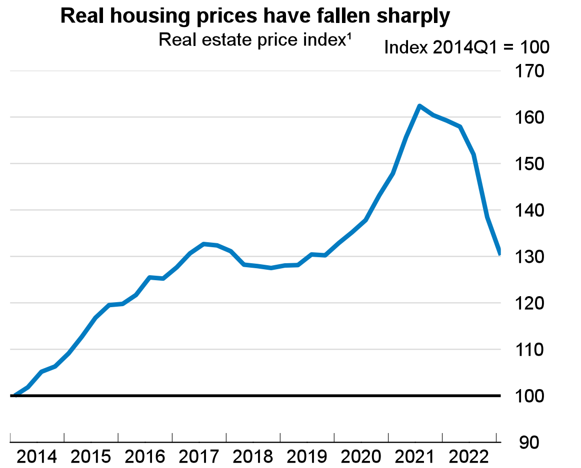
Monetary policy should be tightened further as needed to curb inflation and ensure that inflation expectations are anchored. Temporary energy support should be gradually phased out to effectively manage inflationary pressure and help meet climate targets. Population ageing calls for mobilising underutilised labour resources, notably the low-skilled and the foreign-born. Achieving this goal requires reforms to taxes and benefits to strengthen work incentives and discourage income shifting from labour to capital, as well as easing rent controls.

Weak private consumption weighs on growth

After falling by 0.5% in 2022 Q4, GDP rebounded by 0.6% in 2023Q1, mainly driven by exports and inventories. However, household consumption and residential investment continued to decline. Property prices have fallen considerably, reducing investment and household wealth. Sentiment indicators point to very depressed household confidence. Manufacturing output has held up, with considerable order backlogs, but new orders are decreasing. The labour market has remained robust, but there are signs of a slowdown, with layoff notices increasing and companies preparing to downsize their workforce. Consumer price inflation with a fixed mortgage rate (CPIF) moderated to 7.6% in April, but CPIF inflation excluding energy stood at 8.4% suggesting broad inflationary pressures. In April, the social partners in the manufacturing sector agreed modest nominal wage increases of 4.1% in 2023 and 3.3% in 2024.

Sweden





1. Real estate price index for one- or two-dwelling buildings. The index has been deflated with the CPI.
Source: The Riksbank; and Statistics Sweden.

StatLink https://stat.link/fongh5

Sweden: Demand, output and prices

Sweden	2019	2020	2021	2022	2023	2024
	Current prices SEK billion	Percentage changes, volume (2022 prices)				
GDP at market prices	5 052.5	-2.3	5.9	2.9	-0.3	1.4
Private consumption	2 268.6	-3.2	6.2	2.0	-2.7	2.0
Government consumption	1 300.5	-2.0	2.9	0.1	1.2	1.2
Gross fixed capital formation	1 235.6	1.6	6.8	6.2	-1.6	0.1
Final domestic demand	4 804.7	-1.7	5.4	2.6	-1.4	1.3
Stockbuilding[1]	34.6	-0.7	0.4	1.1	-0.3	0.0
Total domestic demand	4 839.3	-2.4	5.9	3.7	-1.6	1.2
Exports of goods and services	2 419.9	-5.9	10.8	7.1	4.0	3.3
Imports of goods and services	2 206.7	-6.3	11.3	9.4	1.6	3.2
Net exports[1]	213.2	0.0	0.3	-0.6	1.3	0.2
Memorandum items						
GDP deflator	_	2.0	2.6	5.6	6.1	2.5
Consumer price index[2]	_	0.5	2.2	8.4	7.9	2.4
Core inflation index[3]	_	0.5	2.4	7.7	6.3	2.4
Unemployment rate (% of labour force)	_	8.5	8.8	7.5	7.9	8.0
Household saving ratio, net (% of disposable income)	_	17.0	15.5	13.9	13.8	13.6
General government financial balance (% of GDP)	_	-2.8	0.0	0.7	-0.4	-0.6
General government debt, Maastricht definition[4] (% of GDP)	_	39.9	36.5	32.8	32.7	32.7
Current account balance (% of GDP)	_	5.9	6.5	4.2	5.6	5.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. The consumer price index includes mortgage interest costs.
3. Consumer price index with fixed interest rates.
4. The Maastricht definition of general government debt includes only loans, debt securities, and currency and deposits, with debt at face value rather than market value.
Source: OECD Economic Outlook 113 database.

StatLink https://stat.link/p8q219

Russia's war of aggression against Ukraine is taking a toll on the Swedish economy. Elevated energy and food prices continue to put a strain on activity. The number of Ukrainian refugees in Sweden reached about 56 000 (0.5% of the population) as of mid-May. Export growth has been significantly reduced due to weak markets in key trading partners, while tightening global financial conditions and the weakening of the Swedish Krona have heightened the risk of financial stress.

Macroeconomic policies have been tightened

In response to high inflation and the weak Swedish Krona, the Riksbank raised its repo rate to 3.5%, the highest rate in nearly 15 years. The policy rate is expected to be raised by an additional 25 basis points in June and remain at this level throughout the latter half of 2023 and 2024. The fiscal stance is set to be broadly neutral in 2023 and 2024 with discretionary spending being scaled back. The spring 2023 budget bill includes new measures of around SEK 4 billion (0.1% of GDP) focusing on defence and education. It also temporarily raises housing subsidies for the economically vulnerable. It follows three off-cycle budgets totalling SEK 2.4 billion (0.05% of GDP) related to a revenue cap for electricity producers, temporary fuel tax reductions, and military aid to Ukraine. SEK 57 billion (1.1% of GDP) of transmission bottleneck fees collected during the energy crisis is being refunded to households and businesses in 2023, but will not directly affect the fiscal balance.

Declining housing investments will further depress the economy

The economy is projected to shrink by 0.3% in 2023 before rebounding by 1.4% in 2024. Employment is set to decline as companies adjust staffing plans in response to the output contraction. Construction will decline significantly in 2023 due to higher construction costs and sluggish demand. Households will adjust their consumption further in response to declining housing wealth and real disposable income, and rising unemployment. Inflation is expected to moderate and converge towards the target by the end of 2024, as imported inflation slows and monetary tightening increasingly takes effect. A moderate pick-up of consumption is expected from mid-2023 as the inflation shock dissipates and the housing market stabilises. Lower-than-expected inflation could increase real disposable incomes and allow easier nominal interest rates, thereby boosting housing prices, private consumption and investment. Stubborn inflation and higher-than-expected interest rate increases would have the opposite effect and could lead to significant financial challenges for highly leveraged commercial real estate developers. Weaker-than-expected growth in major trading partners, notably the United States and the European Union, would weigh on the export-oriented Swedish economy.

Policy priorities for better labour market functioning and the green transition

The current pivot towards less expansive fiscal policy to hold back inflationary pressures should continue, and energy crisis support should be phased out. A return to the normal practice where spending decisions are taken in the ordinary budget process would strengthen fiscal discipline. Persistent structural unemployment is a challenge. Relaxing rent controls could improve labour mobility, especially among low-income workers. Carefully reviewing social assistance and other benefits typically taken up by inactive foreign-born women who struggle to enter the labour market due to low levels of education could improve work incentives for this group. Reducing Sweden's high labour tax wedge and the difference in tax rates on labour and capital income could boost work incentives and reduce incentives to shift income from labour to capital. Streamlining permitting procedures is essential to maintain momentum in Sweden’s ongoing green transition, which will require major investments in electricity generation, storage and transmission. The government’s intention to reduce biofuel blending requirements necessitates a general tightening of climate policies to reach its 2030 target for sectors not covered by the EU ETS.