SVENSKT NÄRINGSLIV

Business update

Inflation soon on target

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Content

Summary - Inflation soon on target

Inflation has long been too high. This has meant that interest rates have increased significantly. The high interest rate has put pressure on households and had an effect on the economy in many industries. It has also meant that politicians have held off on major reforms in order not to endanger a decline in inflation. In recent months, the pace of price increases has decreased at the same time as the economy has deteriorated. The rate of inflation is already close to the Riksbank's target of two percent, and the more normal rate of price increase going forward will result in the policy rate being lowered several times both this year and in 2025.

There are now more bankruptcies than in a very long time and Sweden is in recession. Within certain industries, the economic situation is particularly vulnerable. This mainly applies in the construction industry, where housing construction has slowed down sharply. The economic situation is also weak in many other sectors such as retail trade and the hospitality industry, as well as in other industries close to consumers. The economic situation is likely to brighten when households once again see disposable incomes increase during the year and purchasing power improves. The future prospects have also improved both in Swedish Enterprise's business panel and in questions directed at households. However, higher consumption growth in the coming year is based on inflation coming down as forecast and mortgage rates falling. Growth in the Swedish economy will gradually increase but will remain at low levels for most of 2024. Next year, GDP will grow faster and the economy will recover. Growth is estimated to be 0.2 percent in 2024 and 2.0 percent in 2025.

As the economy has weakened over the past year, notifications have also increased. This applies in particular in the construction industry. For some time, companies have tried to retain staff despite declining demand, so-called *labor hoarding.* Now indicators of this have started to fall back and we have been able to see instead that unemployment is increasing. In 2024, more people will be forced to leave their jobs and unemployment will reach 8.4 percent. As inflation and interest rates come down to more normal levels during the year, the economic outlook will brighten and employment growth will pick up again. This means that unemployment will drop to 8.2 percent in 2025.

All in all, there are still weak economic figures as shown in the key figures table below. It is, however, a slightly brighter picture compared to Swedish Enterprise's latest forecast from December. It is largely to do with the fact that the Riksbank has now begun to speak more clearly about future interest rate cuts and that households are thereby beginning to regain faith in the future of an improved financial situation.

Key figures table, current forecast compared to the December forecast

	2023	2024	2025
GDP, actual annual percentage change	-0.4 (-0.5)	0.2 (–0.2)	2.0 (2.0)
Unemployment, percentage of the labor force	7.7 (7.7)	8.4 (8.3)	8.2 (8.4)
CPIF, annual percentage change	6.0 (6.0)	2.0 (2.0)	1.6 (1.6)
Policy rate, percentage, year-end	4.00 (4.00)	3.25 (3.25)	2.50 (2.50)

Sources: Statistics Sweden, the Riksbank and Swedish Enterprise.

Weak economy but improved future prospects

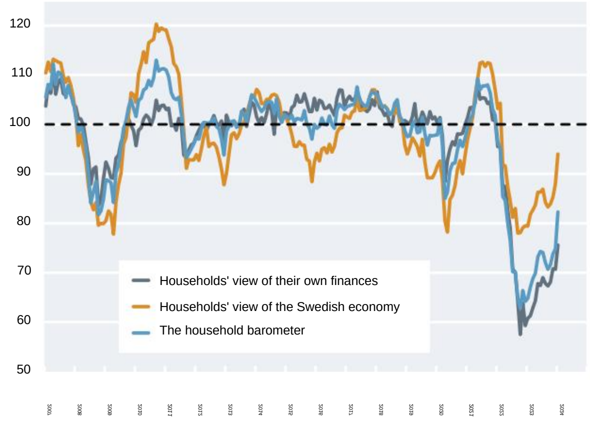
The Swedish economic situation weakened in 2023. GDP fell in both the second and third quarters, while indicators point to a sideways development at the end of the year.1 Despite continued low levels on many indicators, recent months have meant improved confidence in the future, both in the household and business sectors (see, for example, consumer confidence indicators in diagram 1).
After continued weak growth during the beginning of the year, economic activity will gradually increase during the second half of 2024.
However, it will take until 2025 before the economy recovers and the economy begins to grow at a higher rate.

The high inflation in 2022 and 2023 has hit the entire economy directly, but especially household wallets. The Riksbank has fought inflation with a higher key interest rate, which has further reduced the scope for consumption. Private consumption has been weak with falling consumption volumes in the last five quarters. In relation to the record pessimism that existed among households, however, the drop in consumption has been less than feared. In current prices, consumption has not had the same weak development (see diagram 2). An initial high level of savings and a suppressed need for consumption after the pandemic years are two factors that contributed to reducing the impact of increased prices and interest rates.
In addition, unemployment has not yet increased significantly (see the next section). This has contributed to the fact that the risks of unemployment are still perceived as relatively small for many households, which has benefited consumption trends.

After the substantial weakening of consumer confidence in the future in the fall of 2022, sentiment has improved, especially in recent months (see diagram 1). However, consumer confidence is still weaker than a normal situation, but with all sub-questions in the confidence indicator strengthened in January, a certain optimism can now be discerned. In 2024, inflation will reach the Riksbank's two percent target and interest rates will be lowered.
It affects sentiment positively and will cause the households' situation to improve. More normal inflation levels will mean that real incomes will not fall further and that households' purchasing power will be strengthened.
Private consumption is therefore expected to increase during the year.

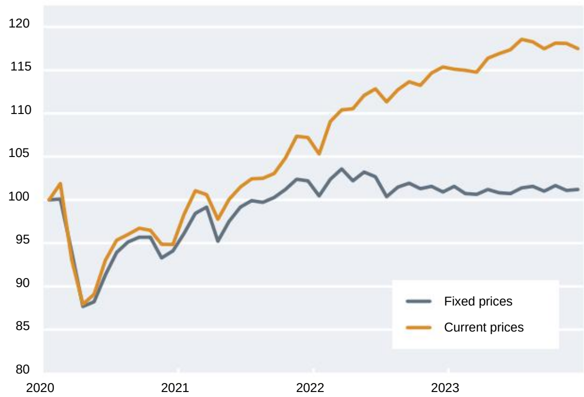
1 The GDP results in the national accounts come with some lag. Therefore, the growth rates for the fourth quarter have not yet been published.

Chart 1. Consumer confidence has started to turn around
Indicator



Note: Mean 100 and standard deviation 10.
Source: The Norwegian Economic Institute via Macrobond.

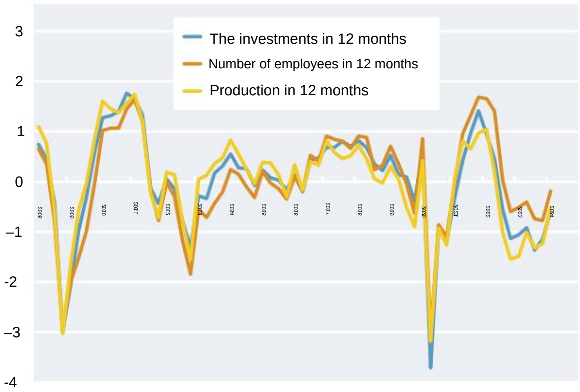
Diagram 2. Development of consumption in volumes and in current prices
Seasonally adjusted monthly indicator, index Jan 2020 = 100



Source: Statistics Sweden via Macrobond.

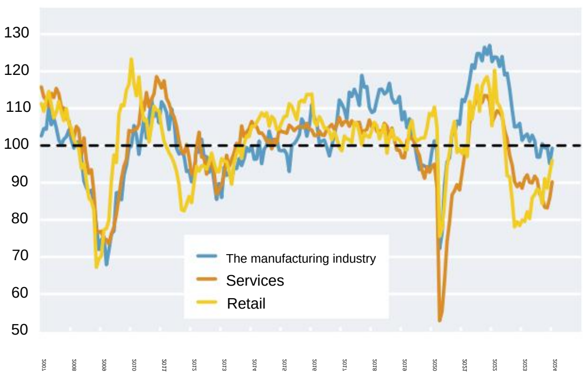
Diagram 3. Business confidence is also on the rise

Normalized and weighted net figures



Source: Swedish business enterprise panel.

Diagram 4. The economic barometer, different industries Indicator



Note: Mean 100 and standard deviation 10.

Source: The Norwegian Economic Institute via Macrobond.

Table 1. Supply balance, percentage development in fixed prices (September forecast in brackets)

	2023	2024	2025
GDP	–0.4 (–0.5)	0.2 (–0.2)	2.0 (2.0)
Household consumption	–2.4 (–2.0)	0.7 (0.1)	1.5 (1.5)
Public consumption	2.0 (1.9)	1.6 (1.7)	1.6 (1.6)
Investments	–1.5 (–1.7)	–2.2 (–2.9)	2.8 (2.8)
Export	2.6 (2.5)	2.6 (2.5)	2.9 (2.9)
Import	-1.1 (-1.1)	1.1 (1.1)	2.9 (2.9)
Inventory contribution to GDP growth	–1.4 (–1.4)	–0.8 (–0.8)	0.0 (0.0)

Sources: Statistics Sweden and Swedish Enterprise.

One sector that has been hit hard by the increased interest rates and cost increases is the housing sector. During 2023, the number of building permits has more than halved compared to the year before, and the number of apartments started is also estimated to have dropped significantly. High construction costs, falling housing prices and higher interest rates have caused both the production of and demand for housing to fall significantly. The construction industry has thus been particularly affected by the general economic situation. The demand for labor in the sector has fallen significantly and the number of bankruptcies has risen to high levels. This will weigh on housing investment throughout 2024 and contribute to negative figures for total construction investment.

As for the companies' own assessments of the business outlook, they are slowly starting to move towards a more normal level. This can be seen partly from the answers in Swedish Enterprise's business panel (see diagram 3), partly from the purchasing manager index and the Institute of Economic Research's measurements (see diagram 4). Falling interest rates and an underlying investment need will lead to continued high industrial investments, not least within the green transition.

The weak krona has contributed to parts of the export-oriented industry being able to maintain their volumes when the economy has weakened. However, the previously well-filled order books have started to thin out and export order intake is now below normal levels. This reflects, among other things, the slowdown in euro area growth. There is great uncertainty about the euro area's future growth, which affects the production trend in the coming months. Once the economy starts to improve in the outside world, especially in the euro area, which is our most important trading partner, export demand will increase. Like previous economic upswings in the rest of the world, Swedish exports will benefit with increasing export volumes as a result.

Despite improved economic prospects, Sweden will be in recession throughout the forecast period. Growth improves mainly towards the end of 2024 and during 2025. Falling interest rates mainly favor the development of consumption and investments going forward. GDP growth turns positive this year to increase more significantly in 2025 (see Table 1).

Rising unemployment – it will get worse before it gets better

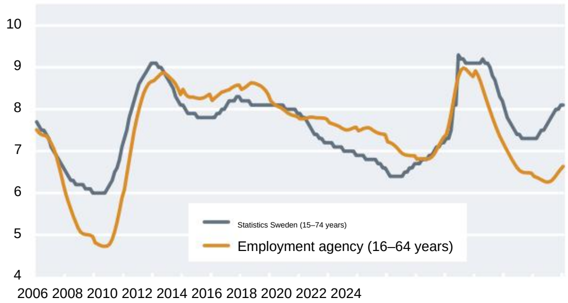
Until relatively recently, the labor market has proven to be surprisingly resilient against worse economic prospects.

Unemployment did not increase significantly until the end of 2023 (see diagram 5). One reason why unemployment has not increased more than it has so far is that companies are reluctant to lay off staff in the belief that demand will soon turn around. It is difficult and costly to find personnel with the right skills once demand returns. Despite a slight decline, Swedish Business and Industry's business panel shows for the first quarter that almost three out of ten companies have a larger workforce than the demand for the company's products justifies (see diagram 6). This so-called *labor hoarding* is one reason why unemployment has not yet increased more.

There are now fewer vacancies, a higher number of notices and more people registered with the employment service than a year ago. Unemployment has started to rise. It is mainly within the construction industry that the number of notices has been high, but the hospitality industry also sees large notice and unemployment risks in the future (see diagram 7). Despite a deteriorating current situation and many warnings, the responses in Swedish Business's business panel indicate that expectations for the future have improved somewhat since the end of 2023 (see diagram 8). Expectations for the number of employees are still weaker than a normal situation, but companies are not quite as gloomy in their faith in the future as before.

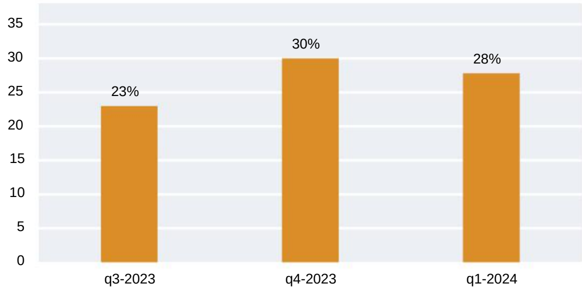
That the labor market reacts with some lag is in itself not unusual when the economic outlook changes. Therefore, unemployment is expected to continue to increase when growth rates in the economy improve towards the end of the year. Unemployment increases to 8.4 percent this year and then falls back to 8.2 percent in 2025.

Diagram 5. Unemployment according to Statistics Sweden and the Swedish Employment Agency Percentage of the workforce



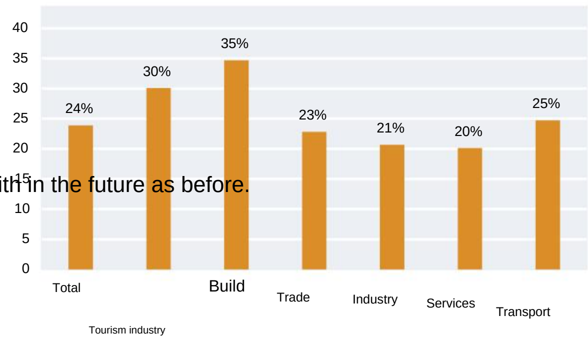
Note: Seasonally adjusted and trend-adjusted resp. balanced series.
Sources: Statistics Norway and Arbetsförmedlingen.

Diagram 6. Labor hoarding
Share of companies in percent



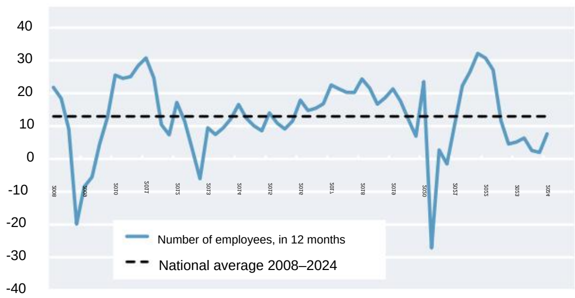
Note: The percentage of companies that state that they have more employees than the business needs in the short term.
Source: Svenskt Näringsliv's business panel for the first quarter.

Diagram 7. Industry-wise warning risks
Share in percent



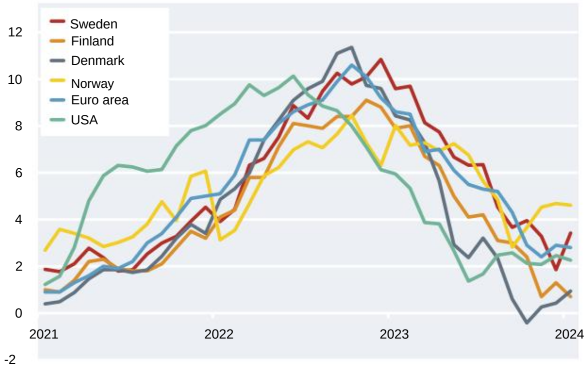
Note: Percentage of companies that see a risk of notice/redundancies within the next six months.
Source: Svenskt Näringsliv's business panel for the first quarter.

Chart 8. Expectations on the number of employees
Net number



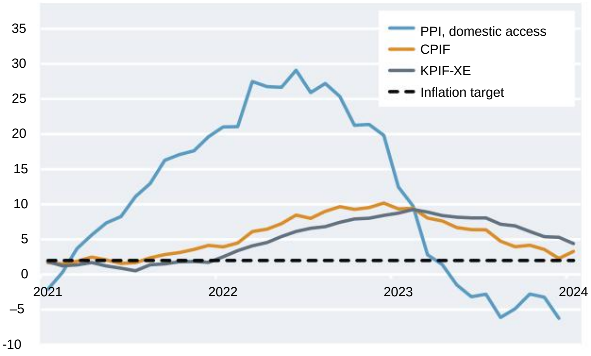
Source: Svenskt Näringsliv's business panel.

Diagram 9. Inflation rate in Sweden and the rest of the world
Annual percentage change



Note: For international comparability, inflation refers to the Harmonized Index of Consumer Prices (HICP). It roughly corresponds to KPIF.
Sources: Eurostat, Statistics Norway and BLS via Macrobond.

Diagram 10. Price index
Annual percentage change



Note: PPI domestic supply refers to producer prices for products available for sale in Sweden, including imports.
Source: Statistics Sweden via Macrobond.

Chart 11. Exchange rate forecast
Swedish kronor (SEK)

Sources: Swedish Business and Industry and Statistics Sweden via Macrobond.

The policy rate will be lowered until the summer

As a result of the disruptions that occurred in the world economy during the pandemic and after the Russian invasion of Ukraine, inflationary pressures increased sharply in 2021 and 2022. However, over the course of 2023, the impact of these disruptions has gradually subsided. Companies have adjusted to a new cost situation and adapted their value chains to the new geopolitical situation. The global excess savings and excess liquidity generated by overly generous bailouts and stimulus packages during the pandemic have been gradually drained by the policy of raising interest rates. After two years of increased inflationary pressure, the inflation rate therefore fell at the end of the year to a level close to the inflation target in both Sweden and the euro area (see diagram 9). The so-called core inflation – inflation cleared of energy prices – has also fallen back, although the rate of inflation is still elevated (see diagram 10).

In January, inflation in Sweden rose slightly again, which was partly a consequence of so-called base effects2, and partly of the unusually large rent and fee increases at the beginning of the year. Around the country, among other things, district heating, public transport and patient fees have been raised significantly more than normal as a result of municipalities and regions compensating for the new higher cost situation. Continued high electricity prices in January also contributed to increased inflation. However, these effects are temporary and the underlying inflationary pressure continues to decline. Several factors contribute to this. A stronger krona (see diagram 11) and negative producer price inflation (see diagram 10) means that the cost pressure in companies eases somewhat, which is propagated with some lag to the consumer level.
At the same time, the Riksbank's tightening monetary policy has become increasingly noticeable to households. These stick harder in the wallet, which creates price pressure in the trade.

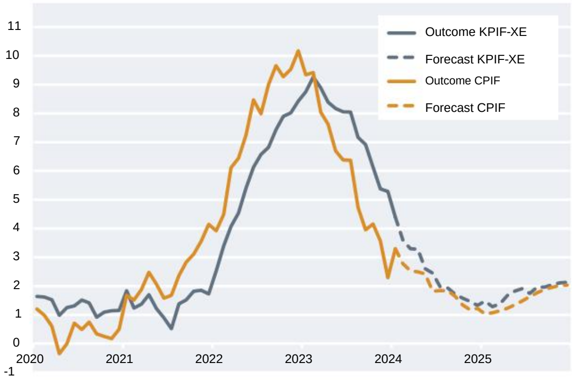
2 The base effect arises because the inflation rate is calculated as the price level in the current month compared to the price level twelve months earlier. This means that the inflation rate in December was calculated in relation to the price level in December 2022, a month when electricity prices were record high.

The above guarantees a continued rapid decline in the rate of inflation over the next six months. However, it will take until midsummer before the inflation rate permanently falls below 2 percent for CPIF and then until the autumn before the same applies to core inflation (see diagram 12). Together with the weakened state of the economy, increasing unemployment and interest rate cuts abroad, this leads to a series of interest rate cuts by the Riksbank starting in June (see diagram 13). The effect of the interest rate cuts comes with a delay, however, and for the full year 2025, inflation ends up slightly below the inflation target (see table 2). But by the end of 2025, the policy rate has been lowered from today's 4 percent to 2.5 percent and inflation has stabilized around the target again (see diagram 12).
This contributes to mortgage interest rates falling back and pessimism in the housing market diminishing. Despite reductions, the interest rate level will continue to be clearly higher than during the period 2008–2020, and both households and companies need to get used to the fact that a key interest rate level of around 2.5 percent constitutes the "new normal".

The krona has strengthened somewhat against both the dollar and the euro since the bottom in August last year. This development continues this year and next year (see diagram 11). This is explained, among other things, by lower inflation in Sweden than in the euro area[3] and by the fact that foreign investors' concerns about the Swedish commercial real estate sector have subsided as no more serious crisis materialized.
These factors make Sweden more attractive to foreign capital, which strengthens the krona. The Riksbank's increased sales of government bonds also contribute to an increased inflow of foreign capital.

Chart 12. Inflation forecast

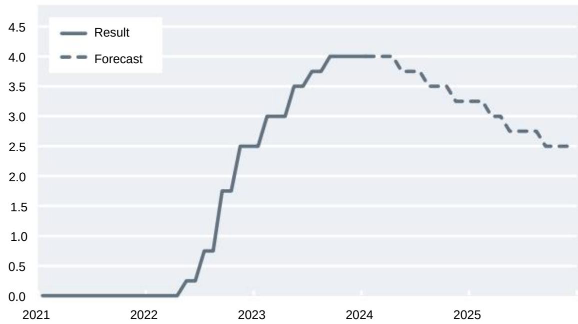
Annual percentage change



Note: KPIF-XE refers to KPIF excluding energy.
Sources: Statistics Sweden and Swedish Enterprise.

Diagram 13. Forecast for the key interest rate

Percent



Sources: Swedish Business and Industry and the Riksbank.

Table 2. CPIF inflation and the policy rate

Percentage unless otherwise stated

	2023	2024	2025
CPIF	6.0 (6.0)	2.0 (2.0)	1.6 (1.6)
KPIF-XE	7.5 (7.5)	2.5 (2.4)	1.8 (1.8)
Policy rate	4.00 (4.00)	3.25 (3.25)	2.50 (2.50)
SEK/Dollars	10.6 (10.6)	10.3 (10.2)	10.1 (10.0)
SEK/Euro	11.5 (11.5)	11.2 (11.2)	11.0 (11.0)

Note Previous forecast in parentheses. The forecast for the key interest rate refers to the ultimatum value, i.e. the interest rate at the end of the year. The exchange rate and other variables refer to annual averages.
Sources: The Riksbank, Statistics Sweden and Swedish Enterprise.

[3] According to the European Commission's latest forecast, HICP inflation in the euro area this year will be 2.7 percent while the corresponding figure for Sweden is 1.7 percent.

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