Sweden

Growth slows

The robust GDP growth reported in 2018 is bound to slow this year. Sweden's main trading partners have been hit by slowdowns, which is having a negative impact on export momentum. The slowdown in job creations will also strain household consumption. Yet it is the reduction in residential investment that is expected to curtail economic activity sharply in the months ahead. Although inflation should near the central bank's 2% target by the end of the year, monetary policy will probably remain accommodating in the months ahead due to the uncertainty surrounding economic trends.

Acquired GDP growth gave the Swedish economy a big boost in 2019 thanks to Q4 2018 and Q1 2019 growth rates of 1.2% q/q and 0.6% q/q, respectively. Yet the robust growth rates reported between 2014 and 2018 are bound to slow this year. From 2.3% in 2018, GDP growth could slow to 1.8% in 2019 and hold at a similar level in 2020, which is less than Sweden's long-term potential, estimated by the OECD at 2.1% y/y in 2019.

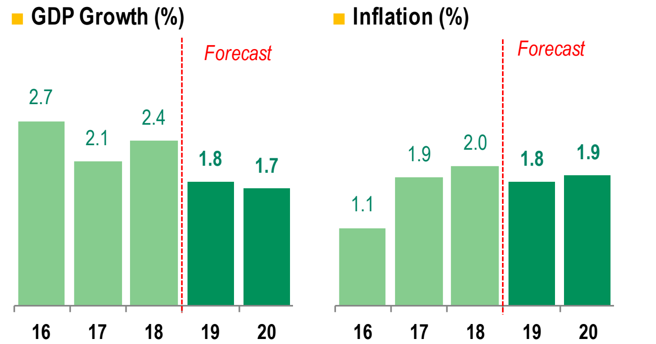
Decline in residential investment hampers growth

Sweden's main trading partners, the eurozone, Norway and the United States, have been hit by economic slowdowns that will have a negative impact on export momentum in the quarters ahead. Sweden's open economy also exposes it to the risks straining global trade due to trade tensions between the United States and its trading partners. There is also persistent uncertainty about the impact of Brexit -- the terms of which are still unknown – on the UK and the rest of the European Union. The slowdown in exports and the growing concerns of business leaders, as expressed in confidence survey, will undermine investment in machinery and capital goods. Residential investment will continue to hamper growth as well in the months ahead. After making a strong contribution to growth between 2014 and 2017, residential investment has contracted since summer 2018 due to the sluggish housing market.

The pace of private consumption is also expected to slow in 2019. Disposable household income is barely expected to rise. Wages will probably increase at a slightly stronger pace. The employment rate has reached an all-time high, and labour market tensions have picked up in recent months. Moreover, the qualifications of unemployed workers do not match those required for job openings. The slowdown in economic activity, however, is expected to slow the pace of job creations.

The slight decline in consumer price inflation is bound to be short-lived. From 2.1% y/y in May, the inflation rate is expected to ease slightly into the fall months due to the more moderate increase in energy prices this year. Thereafter, it should gradually approach the official target rate of 2%. The base effects linked to energy prices are also expected to taper off. The upturn in food prices and rental rates as well as the past depreciation of the Swedish krona are also expected to place upward pressure on consumer prices. Lastly, wage growth, as moderate as it may be, is also likely to push up consumer prices. Riksbank, Sweden's central bank, which has lifted its key rate from -0.5% to -0.25% in December 2018, should maintain an accommodative monetary policy. The Riksbank prefers to consolidate economic growth and consumer prices. It also wants to avoid weakening the position of heavily-indebted households.

1- Growth and inflation



Source: National accounts, BNP Paribas

The economic slowdown combined with new expansionary fiscal policies will strain the fiscal surplus in 2019, which declined in 2018 due to increased public spending. Sweden plans to reduce employer social charges and to increase spending on education, social services and the environment. Even so, it will continue to report a fiscal surplus of close to 0.5% of GDP this year (compared to 0.9% and 1.4% of GDP, respectively, in 2018 and 2017). Sweden is also expected to continue reducing the public debt ratio. From 38.8% of GDP in 2018, it should approach the 35% limit that Sweden imposed on itself as of 2019, thanks to a primary surplus, low interest rates and a nominal GDP growth.

Catherine Stephan
catherine.stephan@bnpparibas.com