Economic forecast for Sweden, autumn 2010
LO economists´ group
Swedish Trade Union Confederation (LO)

Summary

"Supply-side policy – nearing the end of the road?"

The International Economy

By performing better than expected the global economy has taken many observers, ourselves included, by surprise. The outlook is therefore brighter than described in the forecast the LO economists published in the spring. However, much of the growth we now see for 2010 is a rebound, and this will produce a slower growth rate in both 2011 and 2012.

It is difficult to assess future trends. Budget constraints, together with a reduction in fiscal policy stimulus measures, unemployment figures that continue to be high, and currency exchange rate imbalances, pave the way for a relatively sluggish recovery for large areas of the global economy. There are real risks of a downturn in growth.

All the Nordic countries are in a period of recovery, driven largely by increases in exports but also by rising domestic demand and expanding private consumption. There are major differences in European countries, both in economic trends and in the available scope for initiative. During the year the rise in global demand has produced an increase in demand for the Eurozone's export goods, in particular capital goods from Germany. Severe fiscal constraints are anticipated in other countries, with the attendant risk that higher unemployment and lower consumption will slow economic expansion.

Protracted high unemployment, a large current account deficit and limited latitude for an active economic policy brings uncertainty to economic trends in the USA. Strong protectionist currents have emerged in the world economy as a result of global imbalances in savings. A discussion of exchange-rate systems has developed with a view to addressing the tensions between, predominantly, the dollar and the Chinese yen.

The Swedish economy

The Swedish economy has performed relatively well throughout the global economic crisis. It is true that GDP fell very sharply in 2009 against 2008, but the effects on consumption and investment were fairly moderate and the impact on the labour market in the form of lower employment and higher unemployment was surprisingly moderate.

In the present situation, Sweden's economy is expanding very rapidly, far more rapidly than the economies of other European countries and the USA, and we anticipate GDP growth to be close to 5 per cent this year. This rapid growth can be interpreted as a rebound from a very depressed position. This is particularly true of the upswing in goods exports fuelled by international inventory movements and a flying start for trade across the world.

We expect the decline in impetus in the international economy to moderate growth in Sweden. We anticipate growth in GDP to be 3.1 per cent in 2011 and 2.4 per cent in 2012. Taken together, growth is expected to be reasonable, but weaker over the full period of the forecast than has been common in past phases of recovery.

GDP by expenditure and key indicators

Percentage change

	2009	**2010**	**2011**	**2012**
Private consumption	-0,8	3,5	3,0	2,0
Public consumption	1,7	1,8	1,3	0,8
Investments	-16,0	6,1	6,6	6,0
Inventory investments [1]	-1,5	1,6	-0,3	0,0
Exports of goods and services	-12,4	10,1	6,6	6,1
Imports of goods and services	-13,2	12,2	6,6	6,6
GDP	-5,1	4,7	3,1	2,4
Key indicators:				
Employment	-2,1	0,7	1,1	0,7
Unemployment, ILO, 15–74 [2]	8,3	8,6	8,3	8,2
Employment rate, 20-64 [3]	78,3	78,3	78,6	78,7
Hourly rate of pay	3,4	2,2	2,4	3,3
Productivity in industry and commerce	-3,5	3,5	2,5	2,2
CPI	-0,3	1,2	1,7	2,1
CPIF	1,9	2,0	1,4	1,5
Real disposable income	1,3	1,5	2,3	1,7
Current account [4]	7,2	6,1	6,6	6,8
Repo rate a [5]	0,7	0,5	1,5	2,0
USD/SEK [5]	7,65	7,15	6,47	6,47
EUR/SEK [5]	10,62	9,54	9,08	9,08

Source: Statistics Sweden, The Riksbank and our own calculations.

1 Change as percentage of previous year’s GDP
2 Percentage of labour force
3 Percentage of population 20–64
4 Percentage of GDP
5 Annual average, percentage

The expectation that growth in Sweden will outpace growth in Europe and the USA in the next few years is based on a number of factors. Firstly, the recoil is further strengthened for exports by the product mix of Sweden's goods exports, which worked against Sweden during the crisis, and which will be an advantage when deferred investments and deferred consumption bring a resurgence of activity to the market. Secondly, because of our strong government financial position, in contrast to other countries, Sweden will not need to implement any restrictive fiscal policy measures.

The Swedish Labour market fared better during the crisis than had been feared in light of the historic relationship between employment and production. Compared with the protracted decline in employment at the beginning of the 1990s, this time the downswing was speedily halted and recovery began early. The decline in the employment rate was only one seventh of the fall in the 1990s.

Employment is rising fairly rapidly through this year, even though the employment increase taken as the annual average does not exceed 30,000 people. Employment is expected to continue to rise in 2011 and 2012, albeit at a considerably slower pace than this year. Although attributable partly to the slower rate of GDP expansion, this is also related to the surprising number of companies that have opted to retain their employees throughout the downswing in production. This should allow them to deal with production increases in coming years without having to take on new employees in any significant numbers.

Since labour supply has grown at a slower rate than employment through the year, unemployment has fallen steadily. In 2011 and 2012 employment is expected to rise at only a slightly higher rate than labour supply, and unemployment is therefore expected to be more or less stable at a very high level, in excess of 8 per cent.

Moderate pay increases and fairly strong productivity development signal a low level of core inflation in the years to come. Another factor that suggests a low inflation rate is the anticipated weaker development in import prices as a consequence of low international price increases for imported goods and the relative strength of the Swedish krona. The inflation rate (CPIF) is expected to circle around 1.5 per cent in 2011 and 2012 – significantly lower than the Riksbanken's target of 2 per cent.

Economic policy

The European countries are pursuing a fiscal policy which, taken as a whole, is less than optimal, with excessively restrictive measures as a prominent feature, and which therefore runs the risk of generating lower growth and higher unemployment than is necessary.

Under the right wing government there has been a narrow focus in Sweden's economic policy on stimulating labour supply. Productivity expansion, the most important factor for prosperity and increases in real wages in the long term, has taken a back seat. There is even a risk that aspects of government policy will have a negative impact on productivity. Accordingly, a substantial and important political challenge is to shape an economic policy which both stimulates high employment and promotes a high level of growth in productivity. For this reason, the LO economists wish to introduce a Delegation on Productivity.

The purpose of the Government's economic policy is to increase employment via wage formation. The lowest wages, entry wages and the average pace at which increase are to be brought down, thereby impacting employment. The ambition to influence wage formation by means of political decisions is misdirected and carries the risk of negative consequences.

It is already known that much of the benefits of important aspects of the Government's economic policy, for example the in-work tax credit, accrue to people in the upper income bracket. However, the allocation profile of tax subsidies such as the tax credit scheme for repairs and improvements to houses and apartments (*ROT-avdraget*), clearly favours the high income bracket. This scheme does not extend to tenants, and is available only to people living in condominiums or their own properties, and thus fails to benefit many people in LO occupations, low income-earners and single people.

Stabilisation policy in Sweden should be expansive, focusing on permanent reforms that aim to boost potential growth. We recommend a lower interest rate path than that of the Riksbanken. Notwithstanding this, resource utilisation is too low and improvement in employment is insufficient. The room for reform in the national budget should be used early in this Government's term of office. Today, Sweden's public finances are among the strongest in Europe. Therefore, the LO economists recommend a reform programme aimed at increasing potential growth and supporting growth over a period of several years.

This programme should contain a mix of education, infrastructure and housing initiatives as well as a restoration of statutory and collective insurance schemes, not least with a view to strengthening the ability to withstand future economic downswings and crises. The unfinanced reforms should amount to about SEK 25 billion in 2011 and a total of SEK 60 to 80 billion from 2011 to 2014. The main thrust should be at the beginning of this period. The upswing in Sweden's economy after the dismal year of 2009 is evident, but our forecast shows that unemployment will remain at a very high level for the next few years. The unilateral supply-side policy would appear to have come to the end of the road.