Rabobank

Country report **SWEDEN**

Summary

The strong economic recovery came to a sudden halt in 11Q4 due to the adverse spill over effects of the European debt crisis. The outlook for the Swedish economy is highly dependent on developments in the external environment (eurozone). That said, if needed, the country has ample space to stimulate domestic demand by both fiscal and monetary policy. Amid the strong fundamentals of both the public and the private sector we remain confident about the Swedish outlook.

Things to watch:

- Reforms needed on the labor market to increase the low labor participation rate.
- Future development of elevated house prices.
- A high level of mortgage debt has increased vulnerability of banks and home owners.

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Sweden

National facts	
Type of government	Constitutional monarchy
Capital	Stockholm
Surface area (thousand sq km)	410.3
Population (millions)	9.4
Main languages	Swedish
Main religions	Lutheran (87%) Other (13%)
Head of State (president)	King Carl XVI Gustaf
Head of Government (prime-minister)	Fredrik Reinfeldt
Monetary unit	SEK

Economy		2011
Economic size	*bn USD*	*% world total*
Nominal GDP	538	0.78
Nominal GDP at PPP	391	0.50
Export value of goods and services	270	1.23
IMF quotum (in mln SDR)	2396	1.10
Economic structure	*2011*	*5-year av.*
Real GDP growth	4.0	1.6
Agriculture (% of GDP)	2	2
Industry (% of GDP)	27	27
Services (% of GDP)	71	71
Standards of living	*USD*	*% world av.*
Nominal GDP per head	56758	526
Nominal GDP per head at PPP	41229	334
Real GDP per head	43822	539

Social and governance indicators	rank / total
Human Development Index (rank)	10 / 187
Ease of Doing Business Index (rank)	14 / 183
Index of Economic Freedom (rank)	21 / 179
Corruption Perceptions Index (rank)	4 / 183
Press Freedom Index (rank)	12 / 178
Gini index (income distribution)	25.0
Population below $1.25 per day (PPP)	n.a.

Foreign trade			2010
Main export partners (%)		*Main import partners (%)*	
Norway	11	Denmark	9
Germany	10	Norway	9
UK	7	Germany	8
Denmark	7	Netherlands	6

Main export products (%)	
Machinery and transport equipment	38
Chemicals and related products, n.e.s.	12
Mineral fuels, lubricants, and related materials	7
Raw materials	7
Main import products (%)	
Machinery and transport equipment	37
Chemicals and related products, n.e.s.	13
Mineral fuels, lubricants, and related materials	11
Food, drinks and tobacco	8
Openness of the economy 2011	
Export value of G&S (% of GDP)	50
Import value of G&S (% of GDP)	44
Inward FDI (% of GDP)	2.3

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

Full report:

After the 2008-2009 recession, Sweden experienced an economic boom in 2010 and 2011. Both years combined, GDP grew by a stunning 10%. The boom was led by a strong recovery of exports, but also business investments and household consumption contributed robustly to growth. However, 11Q4 showed that the European debt crisis also has taken its toll on strong non-euro countries like Sweden. GDP contracted by 1.1% q-o-q, mainly due to a steep fall of exports (-3.9% q-o-q). Also consumer and producer confidence levels fell considerably due to the intensification of the debt crisis in the autumn of 2011. In addition to the impact of the crisis, the Sveriges Riksbank (Central bank) had started tightening its monetary policy from mid 2010 until the autumn of 2011. The gradual hikes of the official policy rate from 0.25 to 2.00 did not only curtail growth of domestic demand, but also led to a robust appreciation of the Swedish krone due to increased interest rate differentials with e.g. the eurozone. The appreciation of the krone was exacerbated by safe-haven flows due to the European debt crisis.

The start of 2012 showed some first, cautious signs of improvement of the economic momentum. Economic sentiment has stabilized, albeit on levels below its long term average. The Riksbank has, via two steps, lowered its official policy rate by 50 basis points. However, we expect consumers and companies to remain cautious this year, while export growth will be weak due to an anticipated contraction of domestic demand in the eurozone. Overall, we expect the Swedish economy to grow by around 0.5% this year (the EIU expects growth of 0.3%). The unemployment rate, which came down only slowly from a peak of 9% at the start of 2010 to 7.5% in February 2012, is not expected to fall any further going forward. Although dependent on the progress regarding the European debt crisis, we expect the Swedish economy to return to a more steady growth path from 2013 onwards. This is not only based on the country's strong economic fundamentals, but also on the ample space left for further fiscal and monetary stimulus, if needed.

The financial situation of the government is one of the healthiest of Europe. Due to strong economic growth and a budget surplus in 2011, the gross public debt ratio was already trending downwards again (to 36%-GDP). Besides that, the government owns substantial assets which results in a positive net public financial asset position (+26%-GDP in 2010). Since the Nordic banking crisis the government established a policy anchor (effective in 1997) to target for a budget surplus of 1%-GDP over a business cycle. The current government (a minority coalition of four center-right parties, elections were held in September 2010) shows their responsibility regarding public finances by having set an ambitious nominal expenditure ceiling. The recent 2012 spring budget shows this ceiling is respected despite the lower growth outlook. This policy should enable the government to lower taxes in the future, as Sweden has the second highest tax revenues from all OECD-countries (46.7%-GDP in 2009). Further, the government wants to reform the labor market to lower the high unemployment rate and to increase the relatively low participation rate (70.7% in 2009). High levels of employment protection and the existence of relatively high labor costs at the lower end of the labor market cause an increased risk of the formation of a large group of structurally unemployed people. The government already lowered the tax wedge and reduced the generosity of sickness benefits, but more action should be taken to increase the flexibility of the labor market by lowering employment protection. In the long term, aging of the population will increase the pressure on public finances and reduce potential economic growth. However, note that Swedish aging is relatively modest from a European perspective.

The financial position of the private sector is only average from a European perspective. Partly due to the high competitiveness of firms (rank 3 out of 142 countries in the Global Competitiveness Index 2011-2012), the private sector has a long history of positive contributions to the current account. Ironically, similar to the Dutch case, persistent surpluses in the current account have not translated into a substantial net foreign investment position. Despite the relatively high mortgage debt (82%-GDP in 2010), net financial assets of households (115%-GDP in 2010) are slightly above the European average. As already expected by the IMF, the steady rise of house prices came to a halt in 2011. Prices even dropped slightly in the last quarter of 2011, which can probably be attributed to the weakening of the economic momentum. Despite the regulatory cap of 85% on the loan-to-value ratio, which was introduced end 2010, the housing market remains a moderate risk to the economic recovery and the banking sector. It should be noted that the capital ratios of the major banks are favorable from an international perspective, but most banks are vulnerable to adverse market conditions due to a large dependency on wholesale funding (also covered bonds). We believe the risk on financial instability is muted amid the strength of the private sector and ample fiscal room to mitigate a harsh economic downturn if necessary.

Sweden

Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
Key country risk indicators							
GDP (% real change pa)	3.4	-0.8	-5.0	5.8	4.0	0.3	1.0
Consumer prices (average % change pa)	2.2	3.4	-0.5	1.2	3.0	1.8	1.9
Current account balance (% of GDP)	9.3	9.1	7.4	6.6	7.5	7.1	6.6
Economic growth							
GDP (% real change pa)	3.4	-0.8	-5.0	5.8	4.0	0.3	1.0
Gross fixed investment (% real change pa)	9.0	0.4	-14.7	6.7	6.2	2.8	3.1
Private consumption (real % change pa)	3.8	-0.1	-0.2	3.6	2.1	1.7	1.8
Government consumption (% real change pa)	0.9	1.0	2.0	1.6	1.8	1.2	1.3
Exports of G&S (% real change pa)	6.3	0.4	-12.4	10.5	6.8	2.8	4.3
Imports of G&S (% real change pa)	9.3	3.1	-14.1	12.3	6.1	3.7	6.6
Economic policy							
Budget balance (% of GDP)	3.6	2.2	-0.9	-0.1	0.1	0.7	0.8
Public debt (% of GDP)	40	39	43	39	38	36	34
Money market interest rate (%)	3.9	4.7	0.9	0.9	2.5	2.3	2.5
M2 growth (% change pa)	12	13	3	5	6	3	5
Consumer prices (average % change pa)	2.2	3.4	-0.5	1.2	3.0	1.8	1.9
Exchange rate LCU to USD (average)	6.8	6.6	7.7	7.2	6.5	6.8	6.8
Recorded unemployment (%)	6.1	6.2	8.3	8.4	7.5	7.9	8.1
Balance of payments (mln USD)							
Current account balance	43009	44171	29844	30407	40600	37700	36600
Trade balance	17774	15411	13043	10894	15400	19800	18500
Export value of goods	172156	185494	134232	160409	196300	192100	199900
Import value of goods	154380	170080	121190	149510	180900	172300	181400
Services balance	15446	17212	15667	17937	19400	15400	15300
Income balance	14857	17830	6479	7781	13100	9600	9900
Transfer balance	-5067	-6285	-5345	-6203	-7200	-7100	-7100
Net direct investment flows	-11057	5807	-15876	-19330	-15913	-8790	-8000
External position (mln USD)							
International investment position	-5420	-43010	-59210	-76020	n.a.	n.a.	n.a.
Total assets	1174420	1010170	1130430	1223030	n.a.	n.a.	n.a.
Total liabilities	1179840	1053180	1189640	1299050	n.a.	n.a.	n.a.
Key ratios for balance of payments, external solvency and external liquidity							
Trade balance (% of GDP)	3.8	3.2	3.2	2.4	2.9	3.7	3.4
Current account balance (% of GDP)	9.3	9.1	7.4	6.6	7.5	7.1	6.6
Inward FDI (% of GDP)	6.0	7.6	2.5	-0.3	2.3	1.4	1.9
International investment position (% of GDP)	-1.2	-8.9	-14.6	-16.4	n.a.	n.a.	n.a.

Source: EIU