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Economic Developments in Sweden: June-December 1964

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Economic Developments in Sweden: June-December 1964

Summary

The solid expansion of Swedish economic activity continued unabated through the third quarter, the most recent period for which basic economic indicators are available.[1/] The broad expansion, which has prompted continued upward revisions in official economic forecasts in the period under review, has been stimulated primarily by accelerated export growth and--as before--by continued high levels of construction activity and domestic spending. So far, private industrial investment, as conventionally measured, has lagged behind other activity, and higher levels of demand have been accommodated by utilizing excess capacity and by drawing down inventories.

Not surprisingly, tendencies in the direction of an "overheating" have accentuated this summer and fall under the influence of the serious labor shortage, and the monetary authorities have adopted progressively more restrictive credit and monetary policies in an effort to contain inflationary pressures. A discount rate increase had been widely expected since the spring but was evidently postponed until after the Swedish national elections, held in September. Effective on November 6, however, the Bank of Sweden raised discount rate from 4-1/2 to 5 per cent.

1/ See "Economic Developments in Sweden: March-June 1964," dated June 10, 1964.

Under present circumstances, it would appear that monetary policy will carry the major burden of anti-inflationary policy because of a turnaround this year in the budgetary position. In the twelve months ending in October 1963, the combined Swedish budget was still in surplus to the tune of SKr 467 million ($90 million) and exerting a moderating influence; in the year ended this October, on the other hand, the budget is in deficit to an almost equivalent amount--SKr 409 million ($79 million)--thus marking a cumulative deterioration of over 800 million kroner.

Sweden's external position has continued strong although export growth, amounting to an impressive gain of 21 per cent in the first six months of this year, tapered off somewhat in the third quarter, resulting in a trade deficit of $47 million, half of which occurred in September alone.

Possibly because of the September trade returns, Sweden's gold and foreign exchange holdings registered the first decline in some months' time in October, when they fell by $17.6 million. At the end of October, however, Sweden's reserves totalled $929.6 million, having risen by $115 million since the beginning of this year.

Broad industrial expansion continues

Swedish industrial expansion continued its broad advance through the third quarter, when the seasonally adjusted production index rose by almost 2 per cent to a level fully 7 per cent above the July-September months last year. (See Table 1.) The expansion in this most recent period, somewhat more rapid than in the preceding quarter, also outpaced estimates by a rather substantial

margin. Sweden's very favorable industrial performance has prompted successive upward revisions of official forecasts as the year has progressed. Thus, the preliminary national budget, prepared in January, projected an increase of 4-1/2 per cent in industrial production in 1964, in line with expectations that this year would see a more moderate growth in export demand. This forecast was soon outdated by the large increase in exports in response to the general business expansion in Western Europe--an increase which was unusually large even after allowance for the much more favorable weather this year than in the winter of 1962-63. In the revised national budget the prognosis is that industrial output will register an increase of 7-1/2 per cent this year. This current forecast implies that the pace of industrial expansion will be maintained at roughly the third quarter rate in the final three months of 1964. Moreover, an increase of 7-1/2 per cent in industrial output would be a very high growth rate for Sweden; it compares, for example, with an annual average growth rate of about 5 per cent in the current long-term plan (1960-65).

Table 1. Sweden: Industrial Production, 1962-64
(quarterly averages, seasonally adjusted, 1935=100)

Quarter	1962	1963	1964	Index of Change (1963=100)
I	292	303	328	108.3
II	297	313	330	105.4
III	300	314	336	107.0

Sources: Bank of Sweden, Ur tidningarna; Affärsvärlden.

The principal stimulus to industrial expansion this year has come from accelerated export demand, together with continued high levels of domestic consumer spending and building activity. The industrial sector has evidently been able to accommodate these higher levels of demand by utilizing excess capacity and by drawing down inventories of finished goods. So far, however, business investment has not shown any signs of revival except in some branches; according to the most recent survey taken in August, and corrected for the known tendency each year for the August plans to underestimate investment for the entire year, it is now expected that investment in manufacturing industry, in current prices, will roughly match the 1963 level. In real terms this would suggest some, as yet undetermined, decline in real terms, implying a prolongation for another year of the stagnation in investment following the very steep increase in investment in 1957-61.

However, the short-term industrial prospects appear most favorable, to judge by the inflow of new orders in the second and third quarters. The latest survey by the Central Bureau of Statistics shows that the third quarter increase in new orders to the engineering industry (exclusive of shipyards) was 14 per cent higher than in July-September 1963, and that at the end of September the stock of orders on hand exceeded the level at the same time last year by 10 per cent. The new order inflow is widely distributed among those industrial branches favorably affected by the large increase in export demand and the expanding construction industry. In those key industries, the increasing difficulty of realizing further output gains as capacity

limits are approached has been reflected in larger order backlogs and lengthening delivery periods.

Construction activity and domestic consumer spending strain resources

In addition to the significant impetus conveyed by accelerated export demand, the level of Swedish business activity responded to continued high levels of construction activity and consumer spending. According to the Economic Research Institute's October report, investment this year in housing construction (exclusive of maintenance) will probably show an increase of about 8 per cent over 1963--which represents an upward adjustment of 2 per cent of the previous estimate, given in the revised national budget. Some idea of the accelerated pace of building activity is provided by the data on building starts in Table 2, in which it is also noteworthy that the very steady volume of "other" construction projects reflects primarily the high level of local authority investment. Industrial construction, on the other hand, portrays the same tone of stagnation that is characteristic of industrial investment demand as a whole.

Table 2. Sweden: Building Activity 1962-64
(millions of Swedish Kroner)

Year and quarter		Value of Project Starts			
		Total	Industry	Apt. Houses	Other
1962	III	2,250	414	947	889
	IV	2,599	377	1,202	1,020
1963	I	1,204	145	258	801
	II	1,787	169	724	894
	III	2,134	201	1,042	891
	IV	2,658	247	1,201	1,210
1964	I	1,589	213	349	1,025
	II	2,708	178	1,386	1,144
	III	2,789	262	1,338	1,189

Source: Monthly Digest of Swedish Statistics; Bank of Sweden, Ur tidningarna.

General indicators of domestic spending levels, such as retail trade statistics, are not available for any period later than June; and they show that retail trade turnover in the first six months rose by 7 per cent over the January-June period last year. Market reports indicate that the third quarter witnessed some weakening in demand for consumer durables, which was expected as a reaction after a year of sustained high spending levels. On the other hand, new passenger car sales continued to set records; for the January-October period new sales totalled just under 205,000, an increase of 9 per cent over the total of 188,000 sold in the first ten months of 1963.

Serious labor shortage intensifies "overheating"

The Swedish labor market has been characterized for some time by the existence of virtual overfull employment. Increasingly, shortages of specific skills appear to be the chief deterrent to further output gains; in the building sector, it is reportedly impossible to satisfy the sustained demand for labor. Inevitably, the serious and chronic labor shortages act to intensify strains in the economy and to realize the condition of "overheating" that is so feared by the authorities.

For a number of months unemployment has been at levels that must be considered very low indeed, even by Swedish standards. The number of vacancies in almost each month through September of this year has exceeded the very high monthly levels registered in 1963, and often by substantial margins.

The central wage settlement concluded in April provided for an average increase this year of 1.3 per cent in contract wages in industry. When the agreement was signed it was hailed for its restraint, even though it was widely recognized that the actual development of wages in 1964 would depend upon upward "wage drift," which in recent years has added an average of 3 per cent in extra-contractual increases to Sweden's industrial wage bill. Not surprisingly, however, the chronic labor shortage has evidently been pushing up noncontractual wages. According to an expert inquiry conducted by official agencies, the results of which were made known in early November, "wage drift" this year will probably amount to between 4-1/2 and 5 per cent, and will be the largest noncontractual upward wage push in 12 years.

Prices began to creep upward

The mounting signs of economic overheating have begun to be reflected in price indices, which remained relatively stable or moved up only marginally in the first few months of the year. More recently, however, the upward movement has become more pronounced. (See Table 3.) The rise in the consumer price index in September marked an increase of 2.8 per cent since the beginning of this year, and exceeded the forecast, in the revised national budget, that the consumer price index would rise by 2.7 per cent for the year as a whole. Swedish commentators are now speculating that the consumer price rise in 1964 will probably exceed by some margin the "normal" postwar increase of 3 per cent per year.

Table 3. Sweden: Price Movements 1963-64
(1949 = 100)

Item	1962	1963			1964		Percentage Changes	
	Dec.	June	Sept.	Dec.	June	Sept.	Jan.--Sept. 64	Sept. 63--Sept. 64
Cost of living	172	175	176	178	180	183	+2.8	+4.0
Wholesale prices	156	159	159	163	165	168	+3.1	+5.7
Export prices	142	143	144	147	149	150	+2.3	+4.7
Import prices	124	128	127	131	135	136	+3.8	+7.1
Terms of trade 1/	115	112	113	112	110	110	--	--

1/ Ratio of export prices to import prices.

Source: Monthly Digest of Swedish Statistics.

In the year ending in September, import prices have risen somewhat more sharply than export prices, resulting in a deterioration in Sweden's terms of trade that is in part reflected in the more adverse trade returns in the third quarter of the year.

Government budget exerts expansionary influence

As expected, the government's operations have on balance exerted an expansionary influence this year, after roughly three years of surpluses. The third quarter is a period of seasonal deficit in the government's operations, and the measure of the current expansionary influence can only be demonstrated in an approximate way. To begin with, the deficit on combined budget operations in the first three months of this fiscal year (1964-65) is roughly 40 per cent larger than in the July-October quarter in fiscal 1964. (See Table 4.) But the nature of the change is best illustrated by comparing the twelve-month periods ending in October of this year and last. The October turnaround this year results from (a) a much reduced revenue surplus on the current (working) budget and (b) a higher deficit on the capital budget. In the year ending in October 1963 the combined budget was still in surplus and permitted a reduction in the national debt, while in the twelve months ending in October 1964, the combined deficit has had to be financed by borrowing. The change from a surplus of SKr 467 million ($90 million) to a deficit of SKr 409 million ($79 million) means a cumulative deterioration in the space of a year of over 800 million kroner.

Table 4. Sweden: Budget Position, 1963-64
(in millions of Swedish kroner)

Item	July - October 1963	July - October 1964	Year ending October 1963	Year ending October 1964
Budget operations				
Current budget	-554	- 978	+1,084	+540
Capital budget	-292	- 198	- 617	-949
Surplus (+) or deficit (-)	-846	-1,176	+ 467	-409
Financing				
National debt	+847	+1,036	-459	+384
Cash position 1/	- 1	+ 140	- 8	+ 25
Total	+846	+1,176	-467	+409

1/ Cash assets (deposits) of government departments and the National Debt Office plus short-term loans; minus sign indicates increase.

Source: Bank of Sweden, Ur tidningarna

Monetary policy carries main anti-inflationary burden

For the time being, it would appear, budget and fiscal policy cannot be expected to play a restraining role appropriate to the current cyclical situation and, accordingly, monetary policy is evidently being asked to carry the main burden of the Swedish anti-inflationary effort. However, while the authorities adopted progressively more restrictive credit policies earlier this year, they too have appeared inhibited from moving more actively until after the Swedish national elections, which were held in September.

The discount rate was raised from 4 to 4-1/2 per cent at the end of January; in February the Bank of Sweden adopted a 9 per cent penalty rate (5 per cent above the discount rate) applicable to commercial bank borrowing in excess of one-half of an individual bank's capital and reserves, a device previously in effect from May 1961 to January 1962. In a complementary move the central bank began selling special 3-year

6 per cent bonds in order to mop up liquidity. In mid-April, the conditions applying to commercial bank borrowing were further tightened by reducing the basis of penalty-free borrowing from one-half to one-fourth of a bank's capital and reserves.

The continued very severe credit restrictions was reflected in a noticeable slowdown in the pace of credit extension. According to the regular semiannual survey prepared by the Swedish Bank Association, commercial bank advances rose by 6 per cent in the six-month period ending in May 1964, about one-half the rate of increase in the same months last year. Data for later months--through the third quarter, at least--show a continuation of this trend, which has been possible in part by a definite slowing in credit granted to the industrial and trade sectors. In fact, a very high proportion--about one-half--of all credit extended by the commercial banks has gone to finance the high priority housing effort.

Throughout the summer and early fall months there was no noticeable relaxation of the tight credit policies. Even in such periods when commercial bank liquidity is under severe strain because of tax payment dates, there was a noticeable absence of central bank relief; and at times in the period under review there was reportedly some commercial bank short-term borrowing sufficiently large to involve the Bank of Sweden's penalty interest rate. Accordingly, the entire interest rate structure has been under upward pressure. Thus, at the beginning of 1963, which marks the end of the last period of relative ease, the general structure of interest rates had been brought to a level more than a full percentage

point below January 1962. But since early 1963 the trend has been definitely in the opposite direction; discount rate was raised on June 14, 1963, and at the end of January this year, bringing the entire structure back up to a higher level last seen in the 1961-62 phase of restrictive monetary policy. (See Table 5.)

A further increase in the Bank of Sweden's discount rate had been widely anticipated this summer and fall, but the action was evidently postponed until after the September elections, and raised by 1/2 of 1 per cent to a level of 5 per cent effective November 6. In an accompanying statement, Riksbank Governor Åsbrink pointed to the enlarged third quarter trade deficit, the drop in foreign exchange reserves in October and the increased government deficit as factors necessitating a move to tighten credit further. Since the central bank's penalty interest rate of 5 per cent remains in effect, the applicable rate for borrowing under the existing conditions is currently 10 per cent.

Table 5. Sweden: Interest Rate Trends, 1963-64
(in per cent per annum)

Item	1963 Jan.	1963 June	1963 Dec.	1964 Feb.	1964 June	1964 Sept.	1964 Nov.
Discount rate	3.50	4.00	4.00	4.50	4.50	4.50	5.00
Security yields							
Treasury bill[a/]	2.01	4.84	3.53	4.76	4.95	5.07	[b/]5.76
Gov't. bond[c/]	4.75	4.96	5.22	5.60	5.64	5.66	n.a.
Industrial loan	5.31	5.97	5.77	6.14	6.13	6.14	n.a.
Posted loan rates							
Commercial banks	5.25	5.75	5.75	6.25	6.25	6.25	6.75
Savings banks	4.75	5.25	5.25	5.75	5.75	5.75	6.25
Deposit rate[d/]	3.25	3.75	3.75	4.25	4.25	4.25	4.75

a/ Issue rate, end of period.
b/ November 11.
c/ Issues with 15 years to maturity.
d/ Long-term deposits ("capital accumulation accounts") in commercial and savings banks.

Source: Monthly Digest of Swedish Statistics;
OECD, Main Economic Indicators;
Bank of Sweden, Ur tidningarna

Export growth slows, third quarter deficit rises

Sweden's external position remains, as before, basically very sound but the third quarter witnessed some deterioration in the foreign trade accounts. (See Table 6.)

Under the influence of the general business expansion in Western Europe, Swedish exports in the first six months of this year registered an increase of more than 21 per cent over the comparable period in 1963, while imports rose by about 16 per cent. Most of the export increase through June--unusually large even when allowance is made for the fact that the comparison relates to a period when exports were depressed because of severe weather conditions--reflected volume gains, but about

one-sixth of the increase mirrored the effect of higher prices. In addition, export prices rose somewhat more than import prices, and Sweden's terms of trade improved by about 1 per cent. In any event, Sweden's foreign trade deficit for the first half of 1964, at SKr 758 million ($146 million) was about 12 per cent below the deficit of SKr 972 million ($188 million) registered in January-June of 1963.

Normally, Swedish imports and exports both decline in July and August and it is not unusual for Sweden's foreign trade to show small surpluses in this two-month period and sometimes for the entire third quarter. In 1963, for example, the July-August surplus amounted to SKr 116 million ($22.4 million) and totalled SKr 162 million ($31.3 million) for July-September. This year, however, exports tapered off in July and August and fell more than imports, resulting in a combined deficit of SKr 120 million ($23.2 million) for the two months. This development reversed the earlier tendency toward a smaller annual deficit. Even so the excess of imports in the first eight months was still a bit smaller--by 2 per cent--than the January-August 1963 figure. Exports recovered somewhat in September but imports spurted ahead. The resulting deficit of SKr 120 million matched the July-August results, doubled the deficit for the quarter, and lifted the cumulative deficit for the first nine months to SKr 970 million ($188 million), up 18 per cent over the figure of SKr 822 million ($159 million) registered in the January-September 1963 period. (See Table 6.)

Table 6. Sweden: Foreign Trade, 1963-64
(monthly averages or total values, millions of Swedish kroner)

Year and Quarter		Imports	Exports	Trade Surplus (+) or Deficit (-)
1963	I	1,342	1,138	-204
	II	1,476	1,355	-121
	III	1,373	1,427	+ 54
	IV	1,657	1,610	- 47
1964	I	1,622	1,396	-226
	II	1,655	1,629	- 26
	III	1,544	1,463	- 81
Compare:				
Jan.-Sept. 1963		12,572	11,750	-822
Jan.-Sept. 1964		14,436	13,466	-970

Source: Monthly Digest of Swedish Statistics; Bank of Sweden, Ur tidningarna.

The unexpectedly favorable foreign trade performance earlier this year soon rendered forecasts out of date and, as in the case of industrial production, required a general lifting of official sights. The January (preliminary) national budget envisaged a growth in export volume (exclusive of ships) of about 5 per cent this year; now the projected gain has been put at 10 per cent in the October report of the Economic Research Institute. Similarly, imports were to grow by 5-1/2 per cent this year, according to the forecast prepared in January, and the increase now envisaged is in the order of 11-1/2 per cent. But these forecasts must be considered debatable, having been constructed before imposition of import surcharges by the new British government.

Reserves dip slightly from record levels

Sweden's total gold and foreign exchange reserves rose fairly steadily--except for moderate declines in March and April--through the

third quarter of this year, continuing the build-up that began in mid-1963. The combined holdings of the Bank of Sweden and the Swedish commercial banks reached a peak level of SKr 4,900 million ($947 million) on September 30, having risen by SKr 686 million ($133 million) from the beginning of the year. (See Table 7.)

Table 7. Sweden: Net Reserve Position
(in millions of Swedish Kroner)

End of Period		Riksbank	Comm. Banks	Total	Change (mill. Kr.)	Change (mill. $)
1962	December	3,869	492	4,361	--	--
1963	December	3,619	575	4,214	-147	-28.4
1964	March	3,626	802	4,428	+214	+41.4
	June	3,812	788	4,600	+172	+33.2
	September	4,224	676	4,900	+300	+58.0
	October	4,148	662	4,809	- 91	-17.6

Sources: Monthly Digest of Swedish Statistics;
Bank of Sweden, Ur tidningarna

Sweden's reserves dipped by SKr 91 million ($17.6 million) in October, probably because of the adverse trade outturn in September. Clearly, however, Sweden's holdings on October 30, amounting to SKr 4,809 million ($930 million), are more than ample to meet any foreseeable reserve needs.

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