

L.5.2

RFD 392

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 28, 1962

Recent Economic Developments in Sweden

9 pages

Paul Gekker

This article was prepared primarily for internal circulation, and should not be cited or quoted. The views expressed do not necessarily represent the views of the Board of Governors of the Federal Reserve System.

November 28, 1962.

## Recent Economic Developments in Sweden

### Summary

After a decade of highly satisfactory growth, the Swedish economy experienced a levelling off of industrial output in 1962, largely because of the falling off in foreign demand for Sweden's traditional exports. Nevertheless, Sweden's balance of payments position has shown remarkable strength in the past two years, and foreign exchange reserves are at very high levels.

The government's principal current concern is over the level of unemployment, both in the branches adversely affected by reduced export demand and in sectors, like the construction trade, subject to high winter unemployment. This level is still very low in absolute terms but has lately been rising. Consequently, the authorities have gradually relaxed their previous combination of restrictive monetary and fiscal policies. Credit limitations and direct controls over building activity have been progressively relaxed. In addition, the tax-free investment funds, previously built up in blocked deposits at the central bank, are now being released for approved private investment projects which contribute to an easing of unemployment in Swedish industry.

### Favorable long-term economic growth in Sweden

During the 1950's Sweden experienced a favorable rate of economic growth, accompanied by virtual full employment and even shortages of labor. Inflationary forces were in evidence at times during the decade, but price rises on the whole have been within limits experienced elsewhere in Europe.

Economic growth accelerated during the last half of the decade, and especially during the most recent upswing (1959-61). Growing foreign demand encouraged a large volume of capital investment and raised the rate of growth in real GNP from an average of just over 3 per cent in 1950-58 to 5-6 per cent in 1959-61. A more rapid natural growth in the Swedish labor force, larger numbers of women at work, higher net immigration, and an acceleration of the movement out of agriculture also contributed to the expansion. Labor market and housing policies were designed to shift labor into more dynamic sectors of the economy. As a result, Sweden experienced structural changes which have both enhanced its competitive position in world markets and also made the economy somewhat more vulnerable to external fluctuations.

Economy has levelled off during 1962

The rapid business expansion which began in late 1959 levelled off in the last half of 1961 and production was virtually unchanged in the first half of this year. Weakened foreign demand for Sweden's traditional products--iron ore, lumber and woodpulp--have led to curtailed production and increased unemployment. The pace of expansion in the machinery and engineering branches, while still favorable, has also tended to moderate. Reduced activity in export industries and a slower rate of growth in other industries can be seen in the comparison of recent production changes in selected branches of the economy shown in Table 1.

TABLE 1. Sweden: Trends in Industrial Output, 1961-62

<u>Item</u>	Change from Corresponding Period of Previous Year (in per cent)	
	<u>Jan.-June 1961</u>	<u>Jan.-June 1962</u>
All industry	+5	+1
Capital goods	+7	+2
Consumer goods	+2	+1
Iron ore mining	+15	-5
Iron and metal works	+12	+3
Engineering	+5	+1
Timber	+3	-5
Pulp and paper	+7	-3

Source: Kommersiella Meddelanden

The levelling off in output this year has been accompanied by reduced numbers in some branches of industry and by smaller increases in employment in other sectors. On balance, insured unemployment has been higher in each month from February to September this year than in the corresponding nine-month period in 1961 (see Table 2).

TABLE 2. Unemployment in Sweden, 1961-62

Month	1961	1962
	(p e r c e n t)	
Jan.	2.1	2.1
Feb.	2.0	2.2
March	1.5	2.0
April	1.6	1.9
May	1.1	1.3
June	0.7	0.8
July	0.5	0.6
Aug.	0.7	0.8
Sept.	0.7	0.9

Source: Kommersiella Meddelanden, No. 6/7, 1962.

The rise in unemployment must be considered rather moderate in terms of cyclical experience in other countries, even if these figures may provide only partial coverage of those out of work, and may therefore understate levels of unemployment. Nevertheless, the Swedish authorities are deeply concerned over higher unemployment, particularly in the winter months. A key feature of current policy is the application of anti-cyclical financial measures designed to expand the volume of construction, for government as well as private account.

#### Wages and prices in the boom

The 1959-61 boom was accompanied by rising wage costs in Sweden and total wage and salary earnings were about 10 per cent higher in 1961 than in 1960. Higher wage costs reflected increases in rates under general wage agreements and, in addition, the upward "wage drift" resulting from local increases because of labor scarcity. Wage costs may be moderating at present, however. The general two-year wage agreement negotiated at the beginning of 1960--which sets the forms for contracts concluded on an industry-by-industry basis--provided for increases of 3 per cent in 1960 and 3-1/2 per cent in 1961. The current two-year agreement, concluded in March of this year, provides for an increase of 2-3/4 per cent in 1962-63 and of 2-1/4 per cent in 1963-64.

However, prices have not moved up as much as wage costs have risen. Wholesale prices in mid-1962 were only about 2 per cent higher than a year earlier, in part because of import competition. The rise in the cost of living index, which was 5.5 per cent higher in July 1962 than a year earlier, was not wholly an inflationary reaction, despite some increases in food prices and in rent. For the imposition and extension

of the general sales tax in this period, which was part of a major budgetary reform in Sweden, had an appreciable effect on this index. A general retail sales tax of 4.2 per cent tax was introduced at the beginning of 1960 and was raised to 6.4 per cent at the beginning of this year. (See Table 3.)

TABLE 3. Prices and Wages in Sweden

Period	Wholesale Prices	Cost of Living (1958 = 100)	Industrial Wages
1960 I	102	105 <sup>a/</sup>	106
II	103	105	111
III	103	105	112
IV	104	105	115
1961 I	105	106	118
II	106	107	122
III	105	107	121
IV	106	108	123
1962 I	106	110 <sup>b/</sup>	124
II	107	112	129
July	107	113 <sup>c/</sup>	n.a.

Source: International Financial Statistics

<sup>a/</sup> Reflects imposition of 4.2 per cent retail sales tax, effective Jan. 1, 1960.

<sup>b/</sup> Increase in retail sales tax, from 4.2 to 6.4 per cent, effective Jan. 1, 1962.

<sup>c/</sup> Third quarter.

Reserves grow with strong balance of payments position

Despite weakening markets for Sweden's traditional iron ore, pulp and timber markets, Swedish exports rose at an annual rate of 7 per cent in 1961 and 9 per cent in the first six months of 1962. By contrast, imports increased by less than 1 per cent in 1961 and by 6 per cent in the first half of this year. As a result, Sweden's customary trade deficit has declined sharply since 1960 and, in recent months, has been replaced by modest surpluses. (See Table 4.)

TABLE 4. Foreign Trade of Sweden, 1960-62

Monthly Averages  
(in millions of Kronor)

	Exports	Imports	Trade deficit (-) or surplus (+)
1960 Year	1106	1250	-144
1961 I	1090	1247	-157
II	1193	1225	-32
III	1165	1183	-18
IV	1284	1394	-110
Year	1183	1262	-79
1962 I	1178	1361	-183
II	1307	1266	+41
July	1170	1149	+21

Source: Kommersiella Meddelanden, No. 6/7, 1962

Stringent credit conditions (high money rates and credit rationing) in 1961--when the economy was working at capacity levels--contributed to a capital inflow in the form of "leads and lags" in commercial payments: exporters were encouraged to repatriate foreign exchange earnings more quickly and importers tended to delay foreign payments. The inflow of capital, combined with the reduced trade deficit, resulted in the sharp increase in gold and foreign exchange reserves shown in Table 5.

TABLE 5. Sweden's Net Foreign Exchange Position, 1959-62  
(millions of Kronor)

End of Period	<u>Riksbank</u>	<u>Commercial Banks</u>	<u>Total</u>	<u>Change</u>
1959 December	1179	881	2,060	
1960 December	1554	453	2,007	-53
1961 June	2352	222	2,574	+567
December	2385	472	2,857	+283
1962 June	2762	474	3,236	+379
August	2938	588	3,526	+290

Source: Kommersiella Meddelanden, No. 6/7, 1962

The marked strengthening of Sweden's foreign exchange reserves puts the country in a favorable position should any deterioration in the trade balance develop. In June 1962, Sweden made a modest contribution to the U.S. balance of payments by prepaying a \$16.2 million Marshall Plan loan not due until 1983. This is the only debt owed by Sweden to the U.S. Government.

Fiscal and monetary measures to maintain stability

Between 1959 and the beginning of 1962, the Swedish authorities pursued policies designed to moderate expansionary tendencies and to keep inflationary pressures under control. The methods employed included a wide range of credit measures, a major shift in the budget from deficit to surplus, security sales to nonbank investors and some direct controls, such as those on building activity.

Perhaps the principal stabilization measure was the shift in fiscal policy. A 4.2 per cent sales tax was introduced in January 1960 as part of a reorganization of Treasury finance which included major extensions of the government's social security schemes. As a result of this tax and of rising output, the overall budget outturn shifted from a deficit of Kr. 1.6 billion in 1959-60 (ending June 30) to a surplus of Kr. 350 million in 1960-61. A further large-scale tax reform was introduced on January 1, 1962 which further shifted revenue from direct to indirect taxation; the sales tax rate became 6.4 per cent and income tax relief was provided especially for lower income groups. Because tax reliefs and children's allowance payments amounted to Kr. 1.3 billion compared with higher taxes of Kr. 1.0 billion, these adjustments roughly offset the Kr. 350 million budget surplus for 1960-61. The budget for 1962-63,

introduced on January 12, 1962, provided a surplus on a cash basis of Kr. 21 million in 1962-63 compared with the realized surplus of Kr. 161 million in 1961-62.

On the monetary front, the Swedish authorities continued a restrictive credit policy. Considerable success was achieved in absorbing liquidity in 1960 and 1961 by placement of substantial proportions of several large bond issues in the hands of nonbank investors. In addition, the system of tax-free investment allowances under which business firms are permitted to deduct from taxable income funds held as blocked deposits at the central bank was extended in 1960 and 1961; these funds can be used in periods of cyclical slack when authorized by the Swedish Labor Market Board.

When the commercial banks became net borrowers from the Riksbank in early 1961 because of liquidity pressures, the central bank introduced a penal rate on excess borrowing in May 1961, under which loans for amounts exceeding one-half of a commercial bank's capital bear interest at a rate 4 per cent above the discount rate.

Throughout the period, moreover, the commercial banks were required to observe relatively high liquidity ratios. On November 16, 1961, the authorities replaced the outmoded former liquidity ratios (which were set at 43, 33 and 23 per cent for the three bank groupings) with liquidity ratios of 30 per cent for the five largest banks, the Central Savings Bank and the Agricultural Bank, and 25 per cent for all other banks.

The Riksbank reduced the discount rate from 5 to 4-1/2 per cent on April 6, 1962, and to 4 per cent on June 8.

On July 1, 1962, new banking legislation was put into effect under which the Riksbank was given legal authority to impose minimum cash

reserve requirements, and to require certain types of financial institutions to invest specified portions of asset increases in government bonds, and certain other securities. Formerly, liquidity ratios had been in effect by informal agreements with the commercial banks.

Because of official concern over the level of unemployment and the business outlook, further measures have recently been taken to expand output. Restrictions on building have been relaxed and the authorities have also moved to authorize the release of blocked investment reserves to match employment-creating projects in the private sector. Swedish attempts over past years to develop coordinated fiscal, monetary and labor-market policies oriented to counter-cyclical objectives are now being tested.

---

Material in this memorandum was assembled by:  
Paul Gekker,  
European and British Commonwealth Section,  
Division of International Finance.