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RFD 490

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

June 10, 1964

Economic Developments in Sweden:
March-June 1964

11 pages

Paul Gekker

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Economic Developments in Sweden: March-June 1964

Summary

The pick-up in Swedish economic activity which developed in the closing months of last year accelerated somewhat in the first quarter, under the influence of continued high levels of demand from consumers, from the public sector, and from abroad.^{1/} Unemployment continued to decline and labor market tightness was particularly severe in the building sector. A significant volume of local authority and municipal construction has been added to continued high levels of public and private housing construction. Because of official fears of an "overheating" this summer and fall, the authorities acted in March and April to encourage local governments to postpone some public works projects. So far, however, the inflationary potential has not been reflected in Swedish price indices, which were either stable or showed only marginal advances in the first four months of this year.

The wage settlement covering the major portion of Swedish industry, which was completed in early April, provides for average contractual wage increases of 1.3 per cent this year and 3.4 per cent in 1965. The settlement was hailed for its restraint, but the actual development of wages will depend on the upward "wage drift," which in recent years has put an additional 3 per cent beyond the negotiated wage increases to Sweden's industrial wage bill.

The revised budget for the 1964/65 fiscal year, which is little

^{1/} For a review of Swedish economy in the preceding period see "Economic Developments in Sweden: December 1963--February 1964," March 6, 1964.

changed from the generally expansionary proposals first presented in mid-January, seems to reflect anticipations of the general elections scheduled for this fall. In these circumstances, Swedish monetary policy has been called upon to carry the major burden of anti-inflationary effort in recent months. The discount rate increase at the end of January was followed by the introduction at the end of February of a penalty interest rate of 9 per cent applied to commercial bank borrowing in excess of a prescribed portion of the bank's capital; since then, this restriction has been further tightened. The Bank of Sweden has publicly maintained an anti-inflationary posture, most evidenced by repeated exhortations to the commercial banking community by its vigorous and determined head. Recently, a further discount rate increase has been widely rumored.

In its international position, the Swedish economy continues basically strong. High levels of domestic and foreign demand lifted imports and exports by roughly 20 per cent in the first quarter; but with purchases slightly outpacing sales, Sweden's trade deficit rose to \$129 million, up slightly from the \$118 million deficit registered in January-March 1963. Sweden's exchange reserves have shown only slight changes so far in 1964; by the end of April they totalled \$858 million, or \$43 million higher than at the end of last year.

Industrial output quickens

The pick-up in Swedish industrial output which developed in the final three months of 1963 accelerated in the first quarter of this year, in marked contrast to trends in the October-March period in the

two previous years. (See Table 1.) The downward trend in the index of production between October 1961 and March 1962 marked a period when the Swedish economy was entering upon a recession. One year later--between October 1962 and March 1963--the trough of the downward cyclical phase

Table 1. Sweden: Industrial Production, 1961-64
(1935=100, seasonally adjusted)

<u>Month or quarter</u>	<u>1963-64</u>	<u>1962-63</u>	<u>1961-62</u>
October	305	296	295
November	306	295	296
December	315	297	293
<u>4th quarter</u>	309	296	295
January	317	293	293
February	307	293	291
March	323	289	290
<u>1st quarter</u>	316	292	291

Source: National Central Bureau of Statistics, Statistical Reports (mimeographed); Bank of Sweden, Ur tidningarna.

had been passed but the production index had not yet commenced to rise. Moreover, the development of industrial output in this period, especially in the first quarter of last year, was adversely affected by the very severe winter weather.

The fact that the level of industrial output was depressed at that time helps to explain the remarkably good performance of the production index in the first quarter of this year: the year-to-year gain was about 8 per cent in the first quarter compared with a 4 per cent gain in the fourth quarter. In addition, there is thought to have been a slight acceleration in the pace of industrial expansion, so that, even allowing for the bad winter in 1962-63, the output increases in the first quarter have somewhat exceeded expectations. The economic forecast accompanying

the recently revised budget estimates for fiscal 1965 now project an increase in industrial production of between 4 and 5 per cent in 1964--at least equal to, and possibly a shade better than, the results for 1963.

Industrial production continued to advance in response to buoyant demand from Swedish consumers, from the public sector and from Sweden's foreign customers. So far, private investment demand is still lagging; but the component in the index of industrial production which measures output of producers' goods continued to show improvement in the first quarter. The apparent paradox is due to the fact that the upturn in investment goods demand was primarily from the export sector.

Unemployment further reduced, labor market tightens

The continued favorable pace of economic activity in the period under review further reduced the idle labor force. On a seasonally-adjusted basis, unemployment in the first four months was not only lower than in the corresponding period last year (when unemployment was pushed up by the severe weather) but also below the January-April period in 1962. By mid-May, unemployment had been reduced to 1.2 per cent, which is very low even by minimal Swedish standards.

The decline in unemployment levels as the economy continued to approach near-capacity levels was accompanied by the customary reports of labor market tightness and shortages of specific types of labor. However, labor market statistics are not available much beyond the turn of the year.

Building sector severely strained

The recent rapid pace of building activity--local authority projects as well as public and private housing--has placed an increasing

strain on resources. The value of projects started in the "controlled" building sector in the first quarter of 1964 was 28 per cent higher than in the corresponding three-month period last year. Admittedly, the comparison is with a period in 1963 when construction activity was reduced by the severe winter. Further, the data are not seasonally adjusted and they are available only in terms of current costs. Nevertheless, the evidence of mounting inflationary pressure in the building sector seems to be generally recognized. According to a recent official comment, construction costs in some areas of Sweden rose by as much as 20 per cent during 1963.

Authorities attempt to moderate boom

Efforts by the fiscal authorities to cut back local authority building programs reflect official concern about excessive demand in this sector. Late in March the Minister of Finance spoke of placing restrictions on the construction of projects such as warehouses, department stores, parking facilities, churches, swimming pools, and the like. In mid-April, the head of the Swedish Labor Market Board expressed fears that the labor market might become overheated during the coming summer and fall; he added that excessive demand for labor could not be reduced solely by labor market measures but needed to be supported by appropriate credit and financial policies.

At this time, the cabinet adopted measures to curtail construction programs of the provincial and local authorities. The action, taken "in view of the upward cyclical movement and the tendencies toward overheating in the labor market for the building sector," provided that

until October 31 authorities in southern and middle Sweden would have to meet special conditions before they would be authorized to begin new housing starts. The five northern provinces were exempted.

Mounting strains not reflected in prices and wages

So far, these strains and pressures have not been reflected in Swedish price indices, which have remained remarkably stable or continued to move up only marginally through April of this year. (See Table 2.) It is likely that the price indices, especially the consumer price index, will continue to move upward because of higher costs, especially for services.

Table 2. Sweden: Price Movements, 1962-64
(Indices, 1949=100)

<u>Year and month</u>	<u>Consumer Prices</u>	<u>Wholesale Prices</u>	<u>Export Prices</u>	<u>Import Prices</u>
1962 December	172	156	142	124
1963 June	175	159	143	128
October	176	161	144	129
November	177	163	146	131
December	178	163	147	131
1964 January	178	163	147	132
February	178	164	147	133
March	179	164	148	133
April	179	164	148	134

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

For the time being, however, the authorities are assuming that the development of prices--and of wages--this year will continue along "calm" lines. The current official forecast is for a 3 per cent increase in consumer prices this year, or by somewhat less than in 1963.

Through February, the latest period for which wage data have been published, the rise in wages has not been excessive. On a year-to-year

basis, hourly earnings in February showed an increase of 4.6 per cent for male and 6 per cent for female industrial workers. However, this movement appears to have moderated since last fall.

Central wage agreement maintains industrial peace

The important wage settlement finally reached in this period will have a significant impact on wage trends. A central wage agreement was concluded in early April but only after protracted negotiations, a stalemate between negotiating parties and the efforts of a government-appointed mediation commission. The settlement itself is for the two year period which has become customary, contrary to expectations that an agreement covering more than one year could not be concluded. In general, the settlement--which covers the major portion of Swedish industry--provides for rather modest gains in contractual wages in 1964; the major emphasis is on various non-wage benefits, such as higher employer pension contributions, higher severance pay provisions, additional vacation time, and the like. The agreement also established conditions for preferential treatment of low wage groups in the industry-wide negotiations which began as soon as the central agreement was concluded. The agreement provides for an increase of 1.3 per cent in contract wages this year and for a rather higher increase (3.4 per cent) in 1965. The agreement was generally hailed for its restraint; but the actual course of wages in 1964 will 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.

Revised fiscal 1965 budget still expansionary

The government's recent budget proposals for fiscal year 1965, revising earlier estimates presented to the Swedish Parliament in January, are still heavily expansionary and still project a sizable increase in government borrowing requirements. So far, apparently, the authorities are holding to their earlier assumption that prices and wages will not develop along inflationary lines this year. In addition, since an expansionary budget is to some extent a political necessity in this election year, chief reliance will have to continue to be placed on restrictive central bank credit policies.

Revenue projections in the revised budget proposals may be more than customarily understated; should Swedish economic activity continue at current high levels, the budget outturn could develop far more favorably than is now projected. But the official assumption of non-inflationary price/wage developments this year may contain more than a dose of wishful projection. For this reason, a high Ministry of Finance official is on record as stating that a tightening of financial policy would have to be seriously considered should the assumption of a "calmer" development of incomes prove over-optimistic.

Credit policies further tightened

The period under review witnessed some further tightening of credit policies, following the increase on January 31 from 4 to 4-1/2 per cent in the Bank of Sweden's discount rate. At the end of February, the Bank announced imposition of a penalty interest rate of 9 per cent

on commercial bank borrowing in excess of one-half of an individual bank's capital and published reserves, a device which was previously in effect from May 1961 to January 1962. In a complementary move, the central bank simultaneously announced that it would sell three-year 6 per cent bonds--the highest interest rate on government loans since 1921--in an unlimited amount. The bond was also designed to appeal to the general public, being available in denominations as low as 1,000 kronor (\$193). By the first week in March, sales had amounted almost to SKr 450 million (\$87 million).

Even though the rate of increase moderated, commercial bank lending continued to increase. Consequently, the conditions applying to commercial bank borrowing were further tightened in mid-April by reducing the basis of penalty-free borrowing from one-half to one-fourth of the bank's capital and reserves.

International position continues strong

Sweden's international position is basically strong. This is the period of seasonal deficit in Sweden's foreign trade. Nonetheless, the exchange rate for the Swedish krona unexpectedly rose in the period under review. In March, tight domestic money market conditions created by the central bank's restrictive credit measures led to some repatriation of foreign assets by Swedish commercial banks. The krona-dollar rate increased from a February average of 19.29 U.S. cents to 19.43 U.S. cents for March, and has since remained at about this level. The Bank of Sweden has not intervened, presumably in order to prevent a further increase in commercial bank kroner holdings, and in order to reinforce its tight credit regime.

Trade deficit rises slightly, reserve changes minor

The strengthening of the Swedish krona in exchange markets obviously reflected monetary policy factors rather than any underlying change in Sweden's balance of payments. The external position is fundamentally sound even though Sweden's usual seasonal first-quarter trade deficit rose from SKr 204 million (\$39.4 million) in 1963 to SKr 226 million (\$43.7 million) this year. (See Table 3.) The modest increase in the trade deficit reflected a bulge in the deficit in January, when imports rose to an all-time high. In the average of the first quarter, both imports and exports were up one-fifth over the comparable period last year. (See Table 3.)

Table 3. Sweden: Foreign Trade, 1963-64
(monthly averages, in millions of Swedish kronor)

<u>Year and Quarter</u>		<u>Imports</u>	<u>Exports</u>	<u>Trade Surplus (+) or Deficit (-)</u>
1963	I	1,342	1,138	-204
	II	1,476	1,355	-121
	III	1,373	1,427	+ 54
	IV	1,627	1,610	- 17
1964	I	1,622	1,396	-226

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

Sweden's total gold and foreign exchange holdings rose by \$46 million in January and \$16 million in February. The foreign exchange holdings of the commercial banks declined by nearly \$40 million in March and April, evidently because of repatriation of short-term funds held abroad. Official reserves however, showed little change and, at the end of April, total holdings were \$43 million higher than at the end of last year. (See Table 4.) At this level, the holdings were also still just a

bit over the previous peak of Skr 4,423 million (\$855 million) at the end of October 1962.

Table 4. Sweden: Net Reserve Position

<u>End of Period</u>	<u>Commercial</u>			<u>Change</u>	
	<u>Riksbank</u> <u>(in millions of Swedish</u>	<u>Banks</u> <u>of Swedish</u>	<u>Total</u> <u>kronor)</u>	<u>(mill. kr.)</u>	<u>(mill. \$)</u>
1962 December	3,869	492	4,361	--	--
1963 June	3,809	191	4,000	-361	- 69.7
December	3,619	595	4,214	+214	+ 41.4
1964 January	3,668	782	4,450	+236	+ 45.6
February	3,670	860	4,530	+ 80	+ 15.5
March	3,626	802	4,428	-102	- 19.7
April	3,666	662	4,438	+ 10	+ 1.9

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