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Economic Developments in Sweden:  
November 1964-May 1965

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Economic Developments in Sweden: November 1964-May 1965

Summary

The rapid pace of Swedish economic activity continued virtually unabated through the end of 1964 to register gains in gross national product and industrial output which generally exceeded even the most optimistic earlier forecasts.<sup>1/</sup> Economic expansion was continually stimulated by sustained export growth as well as by high levels of construction activity and domestic spending. Real gross national product rose by 6-1/2 per cent last year--well ahead of the general OECD growth target for the 1960's and of the current Swedish long-term predictions for this decade. Economic activity persisted through the first quarter of this year at a pace only moderately below the high end-of-year levels.

Despite considerable strain in the economy, especially evidenced by persistent labor market tightness, industrial production rose by about 9 per cent last year. More importantly, employment in manufacturing branches increased by less than 1 per cent, which suggests that substantial productivity growth was the key to Swedish success in maintaining and even improving its export position despite rapidly rising wages. The more balanced composition of demand, especially for Swedish exports, permitted some of the additions to productive capacity dating from the preceding investment boom (1958-61) to be more fully utilized. Private investment demand stagnated in 1964, for the third

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<sup>1/</sup> See "Economic Developments in Sweden: June-December 1964," dated December 4, 1964.

successive year, but the unexpectedly favorable production gains last year are now widely regarded as having created a more favorable climate for a revival of industrial investment.

The slight moderation in the pace of industrial expansion in the first quarter of this year is indicative of the trend generally anticipated for 1965. Industrial output, foreign trade, levels of consumer spending and gross national product are all expected to grow less rapidly, although in recent revisions of the preliminary national budget estimates presented in January, most targets for 1965 have been revised slightly upward.

At the same time, there is little present evidence that major strains in the economy are easing. The labor market is still extremely tight, and wages continue to rise. Upward price movements apparently moderated in the first quarter but consumer prices are expected to increase by more than 5 per cent this year, partly because of an increase from 6.4 to 9.9 per cent in the general sales tax which becomes effective on July 1.

The period under review witnessed a further tightening of monetary policy, which had been highly restrictive throughout 1964 and which resulted in a marked slowdown in the growth of loans and advances to the private sector. On April 9 the Bank of Sweden's discount rate was raised from 5 to 5-1/2 per cent, marking the fourth increase since tight credit policies were put into effect in mid-1963. In less than two years the discount rate has been raised by two full percentage points

and the entire interest rate structure has been lifted to levels that are historically very high for Sweden. The intensification of the prevailing policy of credit restraint this spring was motivated by continued signs of overheating, as reflected in continued expansion of the public sector and of housing construction. At the same time, the Bank of Sweden moved to perfect control over domestic liquidity by regulating private capital inflow. When the discount rate was raised on April 9, the Bank of Sweden warned commercial banks that it would require them to hold non interest-bearing deposits in the central bank if they acted to circumvent the domestic credit squeeze by borrowing abroad.

The latest discount rate action also served to further highlight the contrast between the central bank's tight monetary and credit policies and the generally expansionary fiscal programs to which the authorities appear committed. For more than a year at least, monetary policy has carried the major burden of any stabilization effort, but since the latest discount rate increase, the authorities have been making some effort to restrain excessive public sector demands. In early May the central government authorities decreed a 10 per cent reduction of all building activity, and in mid-month succeeded in obtaining agreement on a comparable reduction in building projects by local authorities. In the past, however, such voluntary agreements to curtail public sector project spending have not been notably successful.

On the external side, the Swedish economy performed with exceptional strength. Imports increased by 13.6 per cent in value and exports by 14.7 per cent, and the trade deficit was reduced slightly from SKr. 984 million (\$190 million) to SKr. 937 million (\$181 million).

The current account deficit remained virtually unchanged, at roughly \$30 million, but there was a rather large increase in the "errors and omissions" entry which may have concealed substantial short-term capital inflow. Sweden's net holdings of gold and foreign exchange increased by \$162 million last year.

In the first quarter, imports into Sweden were just moderately higher than in the fourth quarter--by 2.6 per cent--but fully 16 per cent over January-March of 1964. Swedish exports are always depressed in the first quarter and this year they fell by roughly the same margin (12-13 per cent) as in the same period last year, but exports in January-March were 16.4 per cent above the first three months of 1964. The build-up in Sweden's reserves continued in the first quarter, when net holdings rose by \$41 million, but they dropped by about \$19 million in April for the first decline in a six-month period.

#### Swedish economy enjoys major boom

In 1964 the Swedish economy operated under the stimuli of resource demands characteristic of a boom of major proportions and the economy registered gains which continually exceeded even the most optimistic forecasts as the year progressed. In 1964, gross national product increased by 6-1/2 per cent in real terms, according to calculations published toward the end of May by the Central Bureau of Statistics. This recent figure--a revision upward of the 5-1/2 per cent increase in real gross national product contained in preliminary estimates published in January--marks the largest annual increase over the entire period 1950-64, when real GNP rose by 3.7 per cent on the average.

Interestingly, the Swedish authorities consider that about 1 percentage point of the difference between the increase in real GNP in 1963 and 1964 is attributable to the effects of weather conditions, which were unusually favorable for Swedish production last year. In any event, the increase in 1964 was also high enough to keep Sweden well ahead of the general OECD target of a 50 per cent expansion of the economy during the 1960's; and last year's increase also raised the average annual increase since 1960 to 4.4 per cent, likewise ahead of the 4 per cent annual growth rate predicated by the Swedish Long-term Planning Commission.

General economic expansion in 1964 was stimulated primarily by very vigorous export demand, and also by continued high levels of construction activity and domestic consumer spending. Public sector demands for both consumption and investment continued their upward trend and only private business investment stagnated, for the third year in succession.

The economy was continually under strain, with labor market conditions especially tight, yet its capacity to absorb these strains proved remarkable. In 1964 industrial production increased by 9 per cent, with an increase of less than 1 per cent in employment in manufacturing branches, suggesting that Swedish industry registered substantial productivity gains which permitted maintenance of the country's competitive position in export markets despite rapidly rising wages. To some extent, too, demand appears to have been more balanced in 1964--with vigorous export demand particularly favoring the investment goods sectors of Swedish industry--so that some additions to productive capacity dating from the previous investment boom of 1958-61 could be more fully utilized than was the case in 1963.

The unexpectedly favorable export performance last year, when Swedish exports increased by over 11 per cent in volume--and continued good demand conditions domestically--now seem to have created a climate conducive to a revival of industrial investment.

For 1965, the authorities expect some moderation of the high growth rate achieved last year. (See Table 1.) However, prospects for the year as a whole are considered favorable, and achievement of the projected increase of 4-1/2 per cent in real GNP in 1965 will mean the maintenance of a very respectable rate of growth. The forecast also anticipates some slow-down in the rate of growth of foreign trade, but in past years these estimates have usually been the least reliable of all components of the estimated balance of resources. Imports may continue to rise slightly more than Swedish sales abroad but the Swedish external position is basically very strong and no marked deterioration is anticipated.

Table 1. Sweden: Estimated Balance of Resources, 1964-65  
(in millions of Swedish kronor)

<u>Item</u>	<u>1964 Revised</u>	<u>Percentage Change</u>	<u>1965 Forecast a/</u>	<u>Percentage Change</u>
<u>Supply</u>				
Gross national product	97,100	+6.5	101,400	+4.5
Imports, c.i.f.	19,900	+10.0	21,400	+7.5
Total supply	117,000	+7.0	122,800	+5.0
<u>Demand</u>				
Private consumption	51,600	+5.0	53,100	+3.0
Public consumption	13,600	+4.5	14,550	+7.0
Private investment <u>b/</u>	12,900	+2.5	13,800	+7.0
Central gov't. investment <u>b/</u>	6,600	+2.0	6,800	+3.5
Local gov't. investment <u>b/</u>	5,200	+11.5	5,800	+11.0
Housing investment <u>b/</u>	6,600	+10.5	6,750	+2.0
Inventory change	+700	--	+200	--
Exports and net services	19,800	+11.0	21,100	+6.5
Total demand	117,000	+7.0	122,800	+5.0

a/ In constant (1964) prices.

b/ Gross investment.

Source: Bank of Sweden, Ur tidningarna.

Among major components of domestic demand, the forecasts for the current year reflect the expectation that private consumption will grow less rapidly but that consumption in the public sector will continue to rise. The changes on which most attention is likely to be focussed, however, are the anticipated revival of private gross investment and the very moderate projected increase in housing investment, which has been the principal beneficiary of the highly restricted supply of loanable funds during the past year. These two components of aggregate demand are closely related. If industrial investment is to revive, it may be necessary to ease financing conditions, which are exceedingly strained at present. On the other hand, the anticipated very moderate growth of housing in 1965, as compared with the substantial increase last year, would seem to leave some greater latitude for financing a larger volume of industrial investment. However, the housing program is a key element in Swedish political programs, and housing finance has continued to enjoy a favored position in the total credit picture. In 1964, for example, the preliminary national budget projected a modest increase in housing investment--on the order of 2 or 3 per cent, or about the same as is now predicted for 1965--but housing investment in fact increased by more than 10 per cent last year.

Industrial growth exceeds expectations.

The combined stimulus of vigorous export demand, buoyant consumer spending and very high levels of building activity pushed industrial production to a postwar record in 1964. In the first quarter of 1965 the rate of growth in industrial production tapered off moderately from exceedingly high end-of-year levels.

According to calculations of the National Institute of Economic Research, industrial production increased by 9 per cent last year, which is 2.4 per cent higher than the increase shown by the Central Statistical Bureau's index of industrial production. The difference is attributable in large part to the fact that the official index of production measures output in the important engineering branches in terms of employment, which in recent years has expanded very little in this highly competitive and export-oriented sector. Allowing for this major difference, the two indices are largely comparable and the understatement in the official series is widely recognized and accepted.

The official index shows that mining and manufacturing rose by 6.6 per cent--well in excess of the annual increases registered in the preceding two years, and marking a postwar record. (See Table 2.)

Table 2. Sweden: Production Trends, 1963-65

	Index of Industrial Production <u>a/</u>	Total	Indices of Change <u>b/</u> Investment Goods	Consumer Goods
1963 I	303	103.8	98.4	101.6
II	313	105.4	100.8	104.4
III	314	104.7	101.0	102.4
IV	321	104.9	102.4	105.1
1964 I	328	108.3	106.2	108.9
II	330	105.4	105.3	102.3
III	337	107.3	106.4	105.2
IV	339 <u>r/</u>	105.6	106.2	104.1
1965 I	341 <u>p/</u>	103.9	105.8	101.1
Annual Averages:				
1962	309	101.3	101.1	100.4
1963	316	102.3	100.8	103.8
1964	337	106.1	105.9	105.3

r/ Revised data  
p/ Preliminary data  
a/ Mining and manufacturing, seasonally adjusted, 1935 = 100.  
b/ Corresponding period of preceding year = 100. Components of total index are not seasonally adjusted.

Source: Monthly Digest of Swedish Statistics; National Central Bureau of Statistics, Statistiska Meddelanden (mimeographed series)

The development of production last year, by contrast with 1963, showed a steady expansion in output of investment goods, which rose by 6 per cent, as compared with an increase of less than 1 per cent the year before. Consumer goods production continued to rise--increasing by 5.3 per cent last year, compared to about 4 per cent in 1963--but the rate of expansion in this component of industrial output moderated as the year wore on. These general trends continued through the first three months of this year, when investment goods output rose by almost 6 per cent and consumer goods production by only 1 per cent.

Production trends last year mirrored the general impact of a revival of vigorous export demand. In 1963, the increase in industrial output was very largely based on expanding private and public sector consumption and investment demand, resulting from a steady rise in personal disposable incomes and the effects of counter-cyclical fiscal programs adopted in 1962. However, as export demand revived and expanded after mid-1963 and throughout 1964, output trends in those major branches of Swedish industry which had been hardest hit by the 1961-62 recession and which were rather weak at the beginning of 1963--iron ore mining, iron and steel and pulp and paper--turned increasingly expansive. The influx of new orders in the engineering industry registered increases of 14 per cent in the third and fourth quarters of 1964--compared with the same periods in 1963--and the total stock of orders at the end of September and December was 10 and 12 per cent higher, respectively, than on the same dates a year earlier. Consequently, output and exports of a number of major Swedish production items registered records in 1964. The production

of electric power, an important indicator of levels of activity increased by 11.8 per cent in 1964 (power output registered a moderate decline in 1963), while the consumption of power by mining and manufacturing branches, which also dropped slightly in 1963, rose by 14.2 per cent in 1964.

Despite continued strains, especially in the labor market, the short-term production outlook is highly favorable. For one thing, output trends last year appear to have created a climate conducive to a long-awaited revival of industrial investment. Industrial output is expected to increase by about 6 per cent this year--on the basis of National Institute of Economic Research calculations--and this forecast of a decline from the growth of 9 per cent registered last year reflects the general view that levels of productive activity are currently very close to capacity limits. At the end of April Professor Kragh, head of the National Institute of Economic Research (Konjunkturinstitutet), predicted that 1965 would turn out to be a good year even if resources would not permit so rapid a rise as in 1964. But Professor Kragh suggested that the possibility of a cyclical dampening later on--in 1966--could not be excluded. He noted that some reduction in demand was already apparent for forest products and iron ore, and that the iron and steel branches might feel these trends at a somewhat later time.

Resources strained by construction activity, public and private spending

In 1964 construction activity continued at exceptionally high levels, adding to the strain on resources imposed by accelerated export demand. Last year the total value of project starts, at SKr. 9,348 million, exceeded the level registered in 1963 by 20 per cent, as compared with a decline of 6.4 per cent in 1963. (See Table 3.)

Table 3. Sweden: Building Activity 1963-65  
(in millions of Swedish kronor)

<u>Year and Quarter</u>	<u>Total</u>	<u>Value of Project Starts</u>		
		<u>Industry</u>	<u>Flats</u>	<u>Other</u>
1963 I	1,214	145	258	811
II	1,787	169	724	894
III	2,134	201	1,041	892
IV	2,658	247	1,201	1,210
Year	7,793	762	3,224	3,807
1964 I	1,589	213	349	1,027
II	2,708	178	1,386	1,144
III	2,969	288	1,379	1,302
IV	2,082	279	613	1,190
Year	9,348	958	3,727	4,663
1965 I	2,405	500	668	1,237

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

The results last year naturally reflect the effects of rapidly mounting costs; but nonetheless 1964 witnessed a marked increase in building starts, especially for apartments, that was not forecast in the preliminary 1964 national budget and was underestimated in the revised calculations presented in April of last year. For the year as a whole, residential construction increased by about 10 per cent. The number of completed dwelling units, both in small houses and in blocks of apartments (which is the major portion of the total) rose by 7.1 per cent, somewhat less than the 8.4 per cent increase in 1963, but considerably in excess of the rather modest target set originally set for 1964.

The momentum of construction activity continued into the first quarter of 1965. If allowance is made for the fact that the data on total starts and industrial projects shown in Table 3 for January-March of this year are swollen by the inclusion of a single large project--costing SKr. 300 million--begun in Gothenburg, the value of new starts was roughly equal in the final quarter of 1964 and the first three months of this year.

The large and relatively steady record of "other" project starts since late 1963 gives a general notion of the importance of public sector construction, especially for local authorities throughout the country. From time to time in the past the central government authorities have attempted to perfect control over public sector building activity so that project starts might be more evenly spaced and non-essential construction deferred. In the spring of 1963, for example, the authorities obtained agreement on the voluntary curtailment for one year of some provincial and municipal building projects; in March and April of last year, agreement was reached to place more restrictive conditions for authorization to begin new housing starts in certain areas of the country. But these voluntary efforts have not been noticeably effective, because they contribute to a bunching of deferred projects until some later--possibly even less desirable-- juncture, while in a period of general strain local authorities are naturally less and less willing to defer projects when costs continue to spiral upward.

Once again this year, in the wake of the further tightening of monetary policy at the beginning of April--when the discount rate was raised from 5 to 5-1/2 per cent--the authorities are making efforts to restrain public sector demands. A decision to reduce central government building activity by 10 per cent over the summer months was adopted in early May. In mid-May, agreement was reached on a comparable reduction in building projects by local authorities.

In 1964, as was the case the year before, consumer demand was quite buoyant and annual increases in spending levels from quarter to quarter--as reflected in indices of retail sales--registered healthy rates of growth. (See Table 4.) Last year, also, total sales of new

passenger cars--now a bellwether of Swedish affluence--chalked up another record although the rate of growth, at 11.6 per cent, fell short of the remarkable increase of 17.4 per cent in 1963. It would appear that the demand for consumer goods will moderate this year. According to a survey of consumer intentions conducted at the beginning of the year, smaller percentages of households responding indicated plans to purchase a range of consumer durables, such as television sets, radios, washing machines and refrigerators. It is likely that the second quarter will see a spurt of consumer goods purchases before the new sales tax increase (from 6.4 to 9.9 per cent) becomes effective on July 1, and that purchases will fall off by significant margins in the second half of this year.

Table 4. Sweden: Indices of Retail Sales, 1963  
(Second quarter 1955 = 100)

<u>Year and quarter</u>	<u>Private Retail Trade</u>	<u>Index of Change a/</u>	<u>Consumer Coop Trade</u>	<u>Index of Change a/</u>
1963 I	124	109.7	148	111.3
II	146	106.6	170	106.9
III	139	106.1	163	106.5
IV	174	108.8	194	106.6
1964 I	134	108.1	159	107.4
II	155	106.2	181	106.5
III	151	108.6	179	109.8
IV	187	107.5	211	108.7
Annual: 1963	146	108.1	169	107.6
1964	157	107.5	183	108.3

a/ Corresponding period of preceding year = 100.

Source: National Central Bureau of Statistics, Statistiska Meddelanden.

Labor markets strained, wages continue rising

Partly because weather conditions were so favorable over the winter months (October-March) in 1963-64, unemployment was reduced to minimal levels. After May of last year, however, unemployment ratios were slightly higher than the preceding year in every month; the increase in unemployment relates mostly to forestry and to construction, whereas unemployment among workers in mining and manufacturing did not register increases over 1963, even in the somewhat depressed areas of Northern Sweden. Even so, the rapid pace of economic expansion last year placed greater demands on available supplies of labor which could not be fully satisfied. In 1964, for example, total vacancies listed were 5 per cent over 1963; and in mining and manufacturing the increase over the year before was very much greater, amounting to 14.4 per cent. Moreover, in 1964 the percentage of vacancies filled was lower than the year before and, in fact, below the average for the preceding three years, attesting to the increasing difficulty of matching labor to jobs.

Under these tight labor market conditions, which have now persisted for almost two years, it is not surprising that wages should continue to move upward. From mid-1963 to early 1964, the increase in average hourly earnings in industry appeared to moderate, but with continued rapid expansion the rate of increase in earnings picked up once more. (See Table 5.) Despite the relatively moderate central wage settlement reached in April 1964, which provided for an average increase of 1.3 per cent in industrial wages, the chronic labor shortage has pushed up noncontractual wages. According to an official survey published in early November, the estimated upward "wage drift" of between 4-1/2 and 5 per cent in 1964 would be the largest in 12 years.

Table 5. Sweden: Labor Market Indicators 1963-65

<u>Year and Month</u>	<u>Unemployment Ratios a/</u>			<u>Vacancies (ooo)</u>	<u>Average Hourly Earnings b/</u>	
	<u>Total</u>	<u>Ind.</u>	<u>Constr.</u>		<u>Male</u>	<u>Female</u>
1963 Jan.	3.6	1.5	17.2	107.8	--	--
Feb.	2.5	1.3	9.8	103.5	110.1	114.8
Mar.	1.9	1.1	6.8	118.6	--	--
Oct.	0.9	0.7	1.7	127.3	--	--
Nov.	1.1	0.8	2.4	120.6	107.1	108.8
Dec.	1.2	0.8	3.9	107.8	--	--
1964 Jan.	1.7	0.9	5.6	117.1	--	--
Feb.	1.6	0.9	5.5	112.4	104.6	106.0
Mar.	1.5	0.8	5.3	117.4	--	--
Oct.	0.9	0.7	2.1	128.2	--	--
Nov.	1.2	0.8	2.9	124.4	106.4	109.3
Dec.	1.3	0.8	4.0	113.8	--	--
1965 Jan.	1.8	0.9	6.8	118.0	--	--
Feb.	1.5	0.8	5.7	119.6	110.9	114.4
Mar.	1.5	n. a.	5.9	n. a.	--	--

a/ Percentages of insured workers.

b/ Percentage increases over corresponding month of preceding year.

Sources: Monthly Digest of Swedish Statistics; National Central Bureau of Statistics, Statistiska Meddelanden.

Prices push upward, further increases ahead

The rise in price indices, which became more pronounced in the third quarter of 1964, continued through the end of the year, but appeared to moderate in the first three months of 1965. (See Table 6.) However, price rises this year are expected to exceed those of 1964, partly because of another increase in the general sales tax which goes into effect on July 1.

By last September, the consumer price index had risen by 2.8 per cent since the beginning of the year and had already exceeded the forecast, in the revised national budget for 1964, of an annual rise of 2.7 per cent. In fact, the consumer price index increased by 3.4 per cent

last year, roughly matching the increase of 3.5 per cent in 1963, while wholesale prices have risen by 5.5 per cent as compared with an increase of 4.5 per cent the year before. Import prices rose somewhat more (up 4.6 per cent) than export prices (an increase of 3.4 per cent), resulting in a slight deterioration of Sweden's terms of trade.

Table 6. Sweden: Price Movements 1964-65  
(1949 = 100)

<u>Item</u>	1963 <u>Dec.</u>	1964			1965 <u>Mar.</u>	<u>Percentage Changes</u> 1964		
		<u>June</u>	<u>Sept.</u>	<u>Dec.</u>		<u>Jan. - June</u>	<u>Jul. Dec.</u>	<u>Sept. 64 Mar. 65</u>
Cost of living	178	180	183	184	186	+1.1	+2.2	+1.6
Wholesale prices	163	165	168	172	172	+1.0	+4.2	+2.4
Export prices	147	149	150	152	154	+1.4	+2.0	+2.7
Import prices	131	135	136	137	136	+3.1	+1.5	0
Terms of trade <u>a/</u>	112	110	110	111	113	--	--	--

a/ Ratio of export prices to import prices.

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

On March 31 the Swedish Parliament passed a tax law which provided for (1) an increase in the retail turnover tax from 6.4 to 9.9 per cent, (2) elimination of certain commodity excise taxes, (3) reduced income taxes for some categories of taxpayers, as well as a lower personal assets tax. The tax measure represented a further shift from direct to indirect taxation, first evidenced when the retail turnover tax was adopted in 1960, although the latest tax law stopped short of the more radical proposal of the Tax Reform Commission for adoption of a value-added tax in place of the general sales tax.

The increase in the retail sales tax will add between 2 and 3 per cent to consumer prices, which are now expected to increase by 5.8 per cent in 1965. This development is likely to complicate bargaining when wage contracts come up for renegotiation this winter; and it is partly for this reason that the authorities have recently worked out and adopted a new price series, the "index of net prices." The new index, which will be calculated on a quarterly basis, is intended to measure movements in consumer prices "cleansed" of all indirect taxes. Indirect taxes accounted for significant shares of increases in the consumer prices index in 1960--when the sales tax was first adopted--and again at the beginning of 1962, when the tax rate was raised from 4.2 per cent to its present level of 6.4 per cent. (See Table 7.)

Table 7. Sweden: Consumer Prices and "Net" Prices  
(1959 = 100)

<u>Year</u>	<u>Index of Consumer Prices</u>	<u>Index of "Net" Prices</u>
1960	104.1	101.3
1961	106.4	103.8
1962	111.5	107.0
1963	114.6	109.8
1964	118.5	114.0

Source: Bank of Sweden, Ur tidningarna.

Expansionary budget impact continues

In calendar 1964 the government's budget operations exerted a moderately expansionary impact, as they did in 1963, although on a fiscal year basis last year witnessed a shift from a net surplus to a net deficit position on the combined working and capital budget. 1/ The net

1/ See "Economic Developments in Sweden: June-December 1964," dated December 16, 1964, pp. 9-10. The remarks in this paper relating to budget estimates for the current (1964/65) and coming fiscal year (1965/66) are based on press summaries, as complete documents have not yet been received.

expansionary impact continued in the twelve-month period ending in April 1965 but the net influence of budget operations was only moderately more expansionary than in the comparable period ending in April 1964. (See Table 8.) Partly this reflects the fact that, despite an increase in the

Table 8. Sweden: Budget Position, 1963-65  
(in millions of Swedish kronor)

<u>Item</u>	<u>Calendar Year</u>		<u>Year ending April</u>	
	<u>1963</u>	<u>1964</u>	<u>1964</u>	<u>1965</u>
<u>Budget operations</u>				
Current budget	+476	+676	+433	+675
Capital budget	-677	-946	-645	-931
Balance	-201	-260	-212	-256
<u>Financing</u>				
National debt	+193	+251	+159	+260
Cash position <u>a/</u>	+8	+9	+53	-4
Total	+201	+260	+212	+256

a/ Deposits of government departments and National Debt Office, plus short-term loans; minus sign indicates increase.

Source: Bank of Sweden, Ur tidningarna.

deficit on the capital budget, the revenue outcome--and consequently the surplus on the working budget--has been consistently larger than estimated. Thus, when the budget for the fiscal year ending June 30, 1966 was presented in mid-January the deficit on the combined working and capital budgets was estimated at SKr. 950 million (\$184 million); in the revised accounts submitted in mid-May, when revenue estimates could presumably be more accurately estimated, the combined deficit was reduced to SKr. 700 million (\$135 million)--although this amount was still larger than the estimated deficit of about SKr. 500 million (\$97 million) for fiscal 1965.

Monetary policy further tightened

The period under review witnessed a further tightening of monetary policy when the Bank of Sweden raised the discount rate from 5 to 5-1/2 per cent on April 9 and warned the commercial banks that any tendency to circumvent tight lending curbs by resorting to short-term borrowing abroad would be met by a requirement that the banks hold non-interest-bearing deposits in the central bank. The central bank's penalty rate, applicable to commercial bank borrowing in excess of one-fourth of an individual bank's capital and reserves, was increased from 10 to 11 per cent. On the day following the discount rate action--the fourth increase in less than two years--all credit institutions raised loan and deposit rates, in most cases by the full amount of the discount rate increase. As a result the entire structure of interest rates has been lifted by two full percentage points since tight credit policies were adopted toward mid-1963, and are now at levels which are, historically speaking, very high for Sweden. (See Table 9.)

Table 9. Sweden: Interest Rates, 1963-65  
(in per cent per annum)

Item	1963			1964		1965
	Jan.	June	Dec.	June	Dec.	Apr.
<u>Discount rate</u>	3.50	4.00	4.00	4.50	5.00	5.50
Penalty rate	--	--	--	9.00	10.00	11.00
<u>Security yields</u>						
Treasury bills <u>a/</u>	2.01	4.84	3.53	4.95	4.85	5.57 <u>b/</u>
Gov't. bond <u>c/</u>	4.75	4.96	5.22	5.64	5.87	5.87 <u>b/</u>
Industrial loan	5.31	5.97	5.77	6.13	6.37	6.33 <u>b/</u>
<u>Posted loan rates</u>						
Commercial banks	5.25	5.75	5.75	6.25	7.00	7.50
Savings banks	4.75	5.25	5.25	5.75	6.50	7.50
<u>Deposit rate d/</u>	3.25	3.75	3.75	4.25	4.75	5.25

a/ Issue rate, end of period.

b/ March.

c/ Issues with 15 years to maturity.

d/ Long-term deposits in commercial and savings banks.

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

The intensification of the prevailing restrictive credit policy was said to be motivated by continued signs of overheating in the economy, particularly in the building sector. But, in fact, the latest central bank action served to further highlight the fact that the Swedish authorities are relying too heavily on monetary policy, and too little on fiscal policy, in their current counter-inflationary efforts. For more than a year the demand for capital from all sources has been intense; the restrictive credit policy has worked successfully to restrain the growth in bank lending to trade and industry so as to permit the continued financing of the government-sponsored housing effort. By far the largest share of commercial bank lending last year was accounted for by building credits, in addition to which the banks purchased large amounts of mortgage bonds. However, the burgeoning demand for long-term capital has put pressure on long-term interest rates, and, at various times--in the fall of 1963 and intermittently in the periods prior to the last two discount rate increases--the Bank of Sweden has engaged in open market purchases of bank-held government bonds in order to moderate tendencies for long-term rates to rise. These tactics made it more difficult for mortgage institutions to sell bonds and in effect, complicated the conversion of short-term building credits into long-term bonds. Consequently, both discount rate increases last year (in January and November) as well as the increase this April were partly in the nature of technical adjustments to prevailing market conditions. However, the question of the proper "mix" of monetary and fiscal policies has perhaps been made clearer by indications that economic expansion last year may have created a climate conducive to a revival of industrial investment. Given the continuation of competing

demands for resources, the obstacle to the realization of larger private investment needs may well be a shortage of capital rather than lagging expectations.

Swedish external position displays marked strength

Last year the combination of vigorous domestic and foreign demand pushed foreign trade to record levels and export performance in particular exceeded all expectations, despite a somewhat indifferent third quarter. For the year as a whole, exports increased by 14.7 per cent in value and imports by 13.6 per cent and Sweden's trade deficit--at SKr. 937 million (\$181 million)--was a shade below the deficit of SKr. 984 million (\$190 million) recorded in 1963. (See Table 10.)

Table 10. Sweden: Foreign Trade, 1963-65  
(monthly averages, 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	1,657	1,610	-47
1964 I	1,622	1,396	-226
II	1,655	1,629	-26
III	1,544	1,463	-81
IV	1,835	1,843	+8
1965 I	1,882	1,625	-257
Annual Totals:			
1963	17,552	16,568	-984
1964	19,943	19,006	-937

Source: Monthly Digest of Swedish Statistics

In 1965 it is expected that the growth in both imports and exports will slow down; imports are expected to increase by 7 per cent and sales abroad by about 6.5 per cent but this forecast hardly amounts to a deterioration in Sweden's position. In any event, estimates of foreign trade have in the past proven the least reliable of all projections of demand components. In the first three months of this year foreign trade performance was on the whole favorable. Imports rose slightly over fourth quarter levels and exceeded imports in the corresponding quarter of 1964 by 16 per cent. Exports are customarily depressed in the early months of the year, and this year Swedish sales abroad dropped by about 12 per cent (as they did in January-March of 1964) but were still at a level 16.4 per cent over the first quarter last year.

Swedish reserves continue steady rise

Although Sweden had a foreign trade deficit in 1964 which was hardly changed from the year before--the current account deficit remained roughly constant, at about \$30 million--Swedish reserves continued a fairly steady rise throughout 1964. For the year as a whole combined net holdings of gold and foreign exchange increased by \$162 million, partly because the very tight domestic credit situation prompted a certain amount of short-term borrowing abroad. Sweden's reserves continued to rise in the first quarter of this year. The increase in January alone amounted to \$28.6 million, but additions tapered off sharply in the next two months and the decline of about \$19 million in April marked the first drop in reserves in a six-month period. (See Table 11.)

Table 11. Sweden: Net Reserve Position  
(in millions of Swedish kronor)

<u>End of Period</u>	<u>Bank of Sweden</u>	<u>Comm. Banks</u>	<u>Total</u>	<u>Changes</u>	
				<u>(mill. kr.)</u>	<u>(mill. \$)</u>
1962 December	3,869	492	4,361	--	--
1963 December	3,619	595	4,214	-147	-28.4
1964 June	3,812	788	4,600	+386	+74.6
December	4,476	576	5,052	+452	+87.4
1965 January	4,574	626	5,200	+148	+28.6
February	4,723	521	5,244	+44	+8.5
March	4,966	299	5,265	+21	+4.1
April	4,934	234	5,168	-97	-18.8

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

The Swedish reserve position is obviously sufficiently strong to support the burden of some decline, which may well develop this year, partly because the trade position may deteriorate slightly.

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