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December 2, 1965

Economic Developments in Sweden:
June-November 1965

10 pages

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Summary

The Swedish economy was characterized by continued high levels of activity through the third quarter although, as expected, the pace of expansion has moderated slightly.[1/] The major factors acting to stimulate the economy continued to be export demand, high levels of building activity, and sustained domestic spending levels. Recent surveys also indicate that industrial investment demand, which has been virtually stagnant since 1961, will revive somewhat this year.

Despite some moderation in overall rates of industrial expansion there has not been much let-up in tight labor markets. Labor supplies are especially strained in the building sector, in which the volume of completions has been running at very high rates, although the authorities have succeeded in reducing the numbers of approved projects and new starts. Under these conditions wages in the building sector, and in industry generally, have continued to rise. At this writing, the customary biennial wage negotiations in Swedish industry are about to begin and wage prospects even for the near future are quite uncertain.

1/ See "Economic Developments in Sweden: November 1964-May 1965," dated June 4, 1965.

The period under review has not witnessed any modification of the tighter monetary and credit policy initiated with the Bank of Sweden's discount rate increase to 5-1/2 per cent on April 9, the fourth increase since mid-1963. Commercial bank liquidity was almost continually under pressure, occasionally severe, in both the second and third quarters. In the latter period, indeed, some banks were forced to resort to borrowing from the central bank at the penalty discount rate--currently 11 per cent. Although increasing concern is being voiced over the imbalance in Sweden's overall financial policy "mix"--an expansionary fiscal regime that relies almost exclusively on monetary and credit policy for its stabilization efforts--there appears to be little likelihood of any change in the near future. However, the January-September period showed some strengthening in the budgetary position, which exerted a slightly contractionary effect compared to the deficit in this same period in 1964, and it is possible that the basis for some easing in credit policy early next year is now being laid.

Since the first quarter Sweden's foreign trading position has worsened markedly. Export performance has continued to be satisfactory, with Swedish sales abroad rising by just under 10 per cent in the first nine months, but as a result of the unexpectedly large increase in imports--up by 15 per cent over the same period--Sweden's trade deficit almost doubled, jumping from $188 to $356 million in the January-September periods in 1964 and 1965. The large rise in imports is attributable in part to a wave of anticipatory buying, mostly in the second quarter, in advance of the retail turnover tax increase that went into effect on July 1. In addition, continued high levels of consumer demand evidently encouraged some extra buying for wholesale inventory stocking, because imports continued to rise at about the same pace in the third quarter of this year.

In addition to the larger trade deficit this year, Sweden's customary surplus on non-trade items in the current account of the balance of payments continued to decline, reflecting the continued steady trend of rising net tourist expenditures. Nevertheless, because tight domestic credit conditions in Sweden encouraged a sizeable inflow of capital--most of it in unrecorded forms--the deterioration in Sweden's external position in the period under review was not reflected in any marked drain on reserves. Total holdings have been rising steadily since the spring of 1964 and although there have been some declines in recent months the movement has been moderate. At the end of October, total reserves of the Bank of Sweden and the commercial banks were, in fact, only about $37 million lower than at the end of last year, while Sweden's IMF reserve position increased from $88 to $143 million over the same period; and at roughly 5 billion Swedish Kronor--about 1 billion dollars--the Swedish reserve position can undoubtedly bear the strain of some temporary reduction.

Output trends moderate slightly

The slight moderation in the pace of industrial expansion that was evident in the opening months of the year continued, as expected, through August, the latest month for which production indices are available. According to the Institute of Economic Research, the somewhat lower rate of output expansion reflected in part the strains of capacity operating levels--both in terms of plant and of labor supply--in some industrial sectors, and in part some weakening of demand affecting other branches of industry. As a result, the Institute reported in mid-October that these tendencies were reflected in a lower rate of industrial expansion in the third quarter than in the two preceding ones.

Table 1. Sweden: Production Trends, 1964-1965

Period	Index of Industrial Production a/	Indices of Change b/ Total	Investment Goods	Consumer Goods
1964 III	337	107.3	106.4	105.2
IIV	339	105.6	106.2	104.1
1965 I	341	103.9	105.8	101.1
II	346	104.7	104.9	103.6
III	c/330	c/ 98.4	n.a.	n.a.

a/ Mining and manufacturing, seasonally adjusted, 1935=100.
b/ Corresponding period of preceding year = 100. Components of total indexes are not seasonally adjusted.
c/ July-August and change over July-August 1964.
Sources: Monthly Digest of Swedish Statistics; Statistiska Meddelanden (mimeographed series).

This slowing down is also suggested by movements in the production index this year. Between January-August, the seasonally-adjusted index of industrial production rose by just under 4 per cent, compared with an increase of more than 7 per cent in the same period last year. (See Table 1.) However, the comparison is affected by the introduction this year of longer (4-week) paid vacations, which fall almost entirely in July. Consequently, the actual increase in production this year is greater than the index suggests, both for the unadjusted series and, to a lesser extent, for the seasonally adjusted index as well.

The slowing down in output this year has been more pronounced for consumer goods than for capital goods. (See Table 2.) High levels of domestic and export demand have been responsible for the maintenance of near-capacity operating levels in iron ore mining and in the metals branches. New domestic and foreign orders for ores increased at the end of the third quarter but slowed down somewhat for steel mills, where continued high rates of activity have resulted in some shortening of delivery periods over the summer months. Generally speaking, order book positions are reportedly satisfactory in the machinery and engineering industry; in shipbuilding a recent gratifying increase in new export orders ensures satisfactory employment levels for some period ahead. Finally, levels of activity have also been favorable in the paper industry and in sawmilling and woodworking branches but activity has definitely levelled off in the important pulp industry, in which relatively large producers' inventories overhang the market.

Table 2. Sweden: Output Trends in Industry

Industrial Sector	Indexes a/ January-July 1964	1965	Increase (+) or Decrease (-) (per cent)
Iron ore mines	340	382	+11.6
Base metals	365	397	+8.7
Wood pulp	243	254	+4.4
Paper and paperboard	350	386	+10.0
Wood industry	246	264	+5.6
Food processing	236	234	-2.6
Textiles and clothing	202	197	-2.5
Leather and shoes	109	101	-7.2
Total index a/	327	338	+3.4

a/ Base, 1935=100. Not adjusted for seasonal variations.
Source: Central Bureau of Statistics, Statistiska Meddelanden.

High levels of building activity continue to strain resources.

The strain on resources resulting from continued economic expansion in Sweden is most clearly evident in the building sector. This is the general area exhibiting the most severe shortage of labor and where costs are rising more rapidly. The authorities are focusing on construction activity their attempts to moderate tendencies toward overheating in the Swedish economy.

Current Swedish statistics on construction--building starts, completed housing and units under construction--provide a very imperfect picture of current activity at any time. Data on completed dwelling apartment units are available only through July. They show that completions were 4.3 per cent higher than in the first seven months of 1964. However, building activity in July this year was affected very greatly by the longer summer vacations; the January-June data, for example, show that completions of apartments were 11 per cent over the corresponding six-month period last year. These continued high levels of construction activity have been reflected in a persistently high demand for labor and in shortages of manpower. In each month since the first quarter, the unemployment ratio in construction has been below the corresponding month in 1964.

High levels of activity and insufficient labor resources have been reflected in a steady increase in building costs, which also appear to have accelerated slightly. The index of total building costs for apartments, which accounts for the major portion of total residental construction, increased by 4 per cent between January and July this year, compared with about 3.1 to 3.2 per cent in the same period in 1964 and 1965. By comparison with the preceding six-month period, the cost increase has been somewhat greater for materials than for total building costs which, of course, includes labor, even though wages have been rising more rapidly in the building trades than in other sectors of the economy.

For some time, the central authorities have tried to meet the problem of over-strain in the building sector by administrative means. They have direct control over their own projects and have made a variety of attempts to enlist the voluntary cooperation of provincial and local government bodies. Arrangements of this sort, providing for the voluntary curtailment of some provincial and municipal projects, were worked out in the spring of 1963, in March and April 1964, and again in May 1965. Each time the agreements have been made more restrictive and have applied building control or permit regulations to wider areas and to more numerous types of construction projects.

These efforts have had some success, to judge by changes so far this year in project starts. In the first three quarters, the total value of project starts was about 10 per cent less than a year earlier. (See Table 3.) Only industrial starts show an increase and this is heavily weighted by a single very large project, (costing about Skr. 300 million or $58 million), in the first quarter. The decline shown for "other" building starts, (schools, hospitals, roads and highways and similar public works activities) reflects the effects of the government's efforts to restrain this overheated sector.

Table 3. Sweden: Building Activity, 1964-65
(in millions of Swedish kronor)

Period		Value of Project Starts			
		Total	Industry	Flats	Other
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
1965	I	2,463	511	672	1,280
	II p/	2,190	393	898	899
	III p/	1,833	339	864	630
1964	I-III	7,266	679	3,114	3,473
1965	I-III	6,486	1,243	2,434	2,809

p/ P=preliminary. Some earlier data are subject to later revision not yet shown in published sources.

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

Despite the apparent success of these efforts they are not felt to be wholly effective partly because the authorities lack any means of pressing for the deferral of some types of projects. The current regulations, which expire at the end of this year, permit the government to require prior authority for certain types of building in case labor shortages would prevent other socially more desirable construction. Under these regulations, building permits for projects costing about Skr. 800 million were postponed between July 1964 and the end of September 1965. Of this amount, rejections this year amounted to Skr. 625 million, of which almost two-thirds was for business premises. The authorities have recently proposed legislation which would permit control over construction projects in cases of shortages of materials as well as of labor. Details on the proposed legislation are not yet available but it is known that the draft law will propose that the new regulations be valid for a two-year period, or until the end of 1967.

Indicators of consumer spending are not yet available for the period under review. According to unofficial reports, however, for the first ten months new passenger car registrations exceeded January-October 1964 totals by 13 per cent, continuing the earlier uptrend. In addition, a survey of trade outlets at the beginning of October reported larger than anticipated third quarter increases in domestic retail and wholesale trade volume--in the wake of the retail tax increase--and reported that even larger increases are anticipated for the final three months of the year.

Labor market tightness unabated, wages trend upward.

There was no visible let-up in the prevailing tight conditions in Swedish labor markets in the period under review, despite the slight moderation in the pace of industrial expansion. Except for the winter months, when the seasonal effects of weather variations sometimes play havoc with labor force statistics, unemployment ratios have been lower than in corresponding months in 1964 and, in fact, at their lowest levels in a decade. (See Table 4.) Despite some increase, also, in foreign labor in Sweden--amounting to 155,000 at the beginning of October, somewhat less than one-half of them from Finland--listed vacancies have generally been higher, and the percentage of vacancies filled lower, than at this period last year.

The previous upward trend in wages has also persisted, although data on average hourly earnings, reported on a quarterly basis, are not available for any period later than May. (See Table 4.) Press reports suggest, however, that the increase in wages this year will probably be in the range of 10 per cent, or about the same as in 1964. This also appears to be the popular prognosis for the eventual results of the biennial wage negotiations but, as these have not yet begun in earnest, it is still too early to tell.

Price rises continue.

The upward price movements in 1965 are particularly difficult to interpret because of the increase from 6.4 to 9.9 per cent in the

Table 4. Sweden: Labor Market Data, 1964-65

Year and Month		Unemployment Ratios a/ Total	Ind.	Constr.	Vacancies (000)	Average Hourly Earnings b/ Male	Female
1964	Feb.	1.6	0.9	5.5	112.4	104.6	106.0
	May	1.2	0.7	3.4	156.1	105.2	106.3
	Aug.	0.8	0.6	1.9	137.6	105.6	108.2
	Nov.	1.2	0.8	2.9	124.4	106.2	108.8
1965	Feb.	1.5	0.8	5.7	119.6	110.1	113.5
	May	1.0	0.6	2.6	168.6	109.4	112.9
	Aug.	0.6	0.4	1.5	c/136.7	n.a.	n.a.
	Oct.	0.7	0.6	1.7	n.a.	n.a.	n.a.

a/ Percentages of insured workers.
b/ Corresponding month of preceding year = 100.
c/ July

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

retail turnover tax that became effective on July 1. The cost-of-living index increased by 2.1 per cent in the first half of this year, roughly the same rate as in the preceding six-month period; but the further and roughly equivalent rise by 2.1 per cent in the third quarter is entirely the reflection of the tax change, since the index was stable in August and September after the initial jump in July. Both wholesale and import prices have had a stable declining tendency so far this year, probably reflecting the stabilizing effects of the large expansion in imports. Export prices rose by 1.3 per cent in January-June but were unchanged, on balance, in the third quarter, and Sweden's terms of trade have therefore improved very slightly this year. (See Table 5.)

Table 5. Sweden: Price Trends, 1964-65
(1949=100)

Item	Index Numbers 1963 Dec.	1964 Dec.	1965 June	1965 Sept.	Percentage Changes 1964 Jan-June	1964 July-Dec.	1965 Jan-June	1965 July-Sept.
Cost of living	178	184	188	a/193	+1.1	+2.2	+2.1	a/+2.1
Wholesale prices	163	172	173	172	+1.0	+4.2	±0.0	-0.6
Export prices	147	152	154	154	+1.4	+2.0	+1.3	±0.0
Import prices	131	137	137	136	+3.1	+1.5	±0.0	-0.7
Terms of trade b/	112	111	112	113	----	----	----	----

a/ Reflects increase in retail turnover tax from 6.4 to 9.9 per cent, effective July 1, 1965.
b/ Ratio of export to import prices.

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

Restrictive monetary policies maintained unchanged

The generally tighter credit policy instituted in April when the Bank of Sweden raised discount rate (for the fourth time since mid-1963) to the historically very high level of 5-1/2 per cent was not modified in the period under review. Almost continually throughout the second and third quarters, the Swedish commercial banks were under heavy liquidity pressure. In the April-June period, in addition to normal seasonal demands at tax payment dates, the banks were subjected to exceptionally severe strain because the expansion in retail turnover in advance of the July 1 sales tax increase heightened the public's demand for cash. In the third quarter the heavier tax collections after the turnover tax increase went into effect added to liquidity strains, as did some decline in foreign exchange reserves. At times during the quarter, the Swedish commercial banks were forced to the discount window, with some banks reportedly paying the penalty rate of 11 per cent (double the discount rate) applicable to that portion of a commercial bank's borrowing that exceeds one-half of its capital and reserves. According to press accounts, the shortage of interbank funds had pushed the day-to-day loan rate to 7 - 7-1/4 per cent at the end of the quarter. There has been no change in deposit rates of interest--currently 5-1/4 per cent for 3-months deposits and 6-1/4 per cent for long-term accounts requiring 12 months' notice of termination--or in posted loan rates.

Swedish budget position shifts to exert contractionary effect.

The recent period has aroused considerable concern over the evident "imbalance" in Sweden's over-all financial policies. It is recognized that Swedish welfare aims, and existing commitments to expand such facilities as the health service, the schools and the pension system involve a high and rising level of public expenditures financed by taxes which are very high by international standards; but these aims also require, in the aggregate, a very substantial preemption of economic resources to government needs. The counterpart of expansionary fiscal policies has been a highly restrictive monetary and credit regime, which has been criticized because of its effects on business financing and especially on a revival of industrial investment so necessary for the export-oriented Swedish economy.

Recent fiscal developments suggest that some change in the Swedish fiscal-monetary policy "mix" may be in the offing. The earlier deficit position has been replaced by a moderate surplus, in part because of the increase in the turnover tax rate but also because of moderation in spending. For the period, January-September, the combined working and capital budgets showed a deficit of Skr. 308 million in 1964 and a surplus of Skr. 151 million in 1965. (See Table 6.) During this year, there was some increase in government debt which was more than offset by additions to government cash accounts.

Table 6. Sweden: Budget Position, 1964-65
(in millions of Swedish kronor)

Items	Year ending September 1964	1965
Budget operations		
Current budget	+601	+1,028
Capital budget	-909	- 877
Balance	-308	+ 151
Financing		
National debt	+227	+ 193
Cash position a/	+ 81	- 344
Total	+308	- 151

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

Source: Bank of Sweden, Ur Tidningarna.

The tighter budgetary position raises hopes that some monetary relaxation might materialize during 1966, which could be significant in easing financing requirements of the long-awaited revival of industrial investment demand.

Trade deficit worsens sharply.

The development of Sweden's foreign trade in the early months of this year was quite vigorous by past standards, but it did not arouse undue notice. In the first quarter, for example, imports and exports were both roughly 16 per cent above January-March levels in 1964, exceeding by considerable margins the forecasts of annual increases of about 9 per cent in Sweden's purchases and sales abroad, contained in the revised national budget.

Sweden's first quarter trade deficit this year was only moderately higher than in the same three-month period in 1964. But thereafter, the growth in imports steadily outpaced the expansion in Swedish sales abroad. Swedish imports continued to rise rapidly in the second quarter, in part on anticipatory buying in advance of the July retail turnover tax increase: they were fully 12 per cent higher than the year earlier level. The growth of exports slowed down markedly, up only about 3 per cent on a year-to-year basis. The trade deficit for the first six months rose from Skr. 728 million ($141 million) in 1964 to Skr. 1,292 million ($250 million) in 1965.

This deterioration continued into the third quarter. Although export growth revived, there was some acceleration in the expansion of Swedish imports. For the first nine months of the year, imports had risen by 15 per cent and exports by not quite 10 per cent. Sweden's trade deficit--at Skr. 1,843 million ($356 million)--was almost double the deficit of Skr. 970 million ($188 million) registered in 1964. (See Table 7.)

Table 7. Sweden: Foreign Trade, 1964-65
(monthly averages, millions of Swedish kronor)

Year and Quarter		Imports	Exports	Trade Surplus (+) or Deficit (-)
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
	II	1,851	1,679	-172
	III	1,801	1,616	-185
Totals:				
1964	Jan-Sept.	14,436	16,603	-970
1965	Jan-Sept.	13,466	14,760	-1,843

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

The increase in imports this past spring was quite unforeseen; however, the export performance has not been unfavorable. The year-to-year gain in Swedish exports amounted to about 9 per cent for both the January-June and the January-September periods. This happens to match the annual forecast of the National Institute of Economic Research, given in the revised national budget for 1965.

The considerably more rapid growth in Swedish imports largely reflected the effects of the July sales tax increase--which should have been temporary--and, no doubt, a somewhat higher level of purchases for inventory than earlier forecasts had presumed. Nevertheless, the third quarter results (which included exceptionally large trade deficits in July and August) suggest that, unless there is a fundamental reversal of the import trend, the deficit for this year will substantially exceed the annual deficits of just under 1 billion Swedish kronor (not quite $200 million) registered in 1963 and 1964.

Current account position deteriorates.

For the first half of the year, the customary surplus on non-trade items in the current account has been less of an offset to the larger trade deficit. The usual surplus on shipping account was a bit lower in the first half of this year than in January-June 1964--which could reflect some seasonal factors--and the deficit on other non-trade payments was up from Skr. 375 million ($72 million) to Skr. 488 million ($94 million) this year, mostly because of the steadily rising trend of tourist expenditures. Whereas the surplus on non-trade items made the current account deficit about one-half the trade deficit in the first half of 1964, this year the half-yearly trade deficit was cut by a much smaller amount. (See Table 8.)

Tight credit conditions encourage capital inflow.

There was a continuation of the tendency, which was accentuated in the last six months of 1964, for a considerable volume of short-term borrowing abroad induced by the tight credit conditions in Sweden. Much of this borrowing is unrecorded. Private loans rose by Skr. 219 million this year, compared with Skr. 395 million in 1964. By contrast, however, there was a very large increase in the positive

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

Item	Annual Totals 1963	Annual Totals 1964	First half year 1964	First half year 1965
A. Current payments				
Exports, f. o. b.	16,568	19,006	9,077	9,909
Imports, c. i. f.	-17,552	-19,943	-9,802	-11,201
Trade balance	- 984	- 938	- 725	- 1,292
Freight earnings, net	1,465	1,540	755	725
Other current payments	- 640	- 730	- 375	- 488
Goods & services, balance	- 159	- 128	- 345	- 1,055
B. Capital transactions				
Official operations	73	123	45	- 1
Security transactions	- 117	- 40	- 11	- 19
Private loans	- 245	473	78	219
Direct investment	125	- 288	- 72	- 84
Other private transactions	- 8	5	24	54
Capital account, balance	- 172	273	64	169
C. Residual item	230	832	691	965
D. Banks' foreign exchange position				
Bank of Sweden	- 251	857	193	222
IMF position, net	26	181	78	155
Commercial banks' exchange	104	- 19	193	- 120
Commercial banks' forward position	20	- 42	- 54	- 178
Total change in foreign exchange	- 101	977	410	79

Source: Bank of Sweden, Ur Tidningarna.

residual (errors and omissions) item, which amounted to almost 1 billion kronor in the first six months of this year. (See Table 8.)

Worsened payments position not reflected in reserve changes.

Because of the large increase in recorded and unrecorded capital inflow so far this year, the deterioration in Sweden's external position has been reflected in only a very moderate loss of reserves. Where the combined holdings of gold and foreign exchange of the Bank of Sweden and the Swedish commercial banks rose by Skr. 714 million ($138 million) in the first nine months of 1964, they declined by Skr. 192 million ($37.1 million) this year.

Table 9. Sweden: Net Reserve Position
(in millions of Swedish kronor)

End of Period		Bank of Sweden	Comm. Banks	Total	Changes (mill kr.)	Changes (mill $)
1963	Dec.	3,619	595	4,214	-147	- 28.4
1964	Dec.	4,476	576	5,052	+838	+162.0
1965	Mar.	4,966	299	5,265	+213	+ 41.2
	June	4,698	456	5,154	-111	- 21.5
	Sept.	4,539	544	5,083	- 71	- 13.7
	Oct.	4,466	394	4,860	-223	- 43.1

Source: Bank of Sweden, Ur Tidningarna.

Swedish sources have recently suggested that the country's foreign exchange reserves may have reached a peak, and that a period of decline may well set in. These prospects are probably realistic enough, but they must be judged against the background of the steady and fairly uninterrupted rise in reserves that has continued generally since mid-1963. Swedish reserves are slightly in excess of Skr. 5 billion--almost $1.0 billion, a level ample enough to support the strain of a temporary deterioration in the trading position, even if the deterioration is somewhat more severe than had been anticipated earlier.