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Recent Economic Developments in Sweden:  
Annual Review

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Recent Economic Developments in Sweden: Annual Review

In 1966 the pace of Swedish economic expansion slowed further in response to generally weaker demand conditions, in Sweden as well as in some other countries.<sup>1/</sup> The year-to-year growth in consumption and investment moderated, labor shortages became somewhat less marked and Sweden's external position improved, as import growth stabilized while export expansion continued despite depressed demand conditions for some staple Swedish products. (See Table 1.) However, the attainment of somewhat better over-all balance in the economy was clouded by persistently strong upward price and cost pressures, currently of great concern to the Swedish authorities. The pressures stem in part from large retroactive wage increases paid out at the end of 1966. In order to moderate consumption demand and exercise better control over emerging inflationary tendencies, the budget for the fiscal year which begins on July 1 provides for higher sales and excise taxes, some of which have already gone into effect. Other fiscal measures, still being debated, are designed to encourage business investment and housing finance. At the same time, the restrictive monetary policy which had been in effect since mid-1963 has been reversed, and the Bank of Sweden has cut the discount rate twice this year--on February 3 and March 10--in line with declining interest rate trends in other countries.

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<sup>1/</sup> For the previous review of Swedish developments see "Recent Economic Developments in Sweden: November 1965-June 1966," dated June 10, 1966.

Table 1. Sweden: Selected Economic Indicators, 1965-66

Item	1965				1966				Annual Change (per cent)	
	I	II	III	IV	I	II	III	IV	1965	1966
<u>General economic activity</u>										
Industrial production (1960=100)	142	143	147	146	147	148	151	150 a/	+7.5	+2.4 b/
Consumer expenditure c/	101	106	92	104	100	101	102	n.a.	+4.4	+1.0 d/
Gross fixed investment c/	100	104	96	104	96	109	96	n.a.	+4.2	+2.8 d/
New orders, metals (1960=100)	105	106	97	118	98	106	97	n.a.	± 0	-2.3 d/
Housing starts (thousands)	11.3	14.3	14.2	26.0	9.7	11.0	15.1	21.2 a/	-3.5	-1.9 b/
New car sales (thousands)	50.8	85.7	65.1	73.4	40.0	57.6	51.1	59.2	+6.7	-24.4
<u>Labor market trends</u>										
Unemployed (thousands)	20.2	18.9	17.9	21.8	29.6	23.4	21.9	27.9	-5.7	+33.5
Vacancies (thousands)	60.7	61.9	62.6	60.4	59.7	55.0	50.8	43.6	+12.4	-14.6
Unemployment ratio e/	1.2	1.2	1.2	1.2	1.7	1.5	1.5	1.6	--	--
<u>Prices and wages (1960=100)</u>										
Consumer prices, total	117	118	121	122	126	127	128	129	+5.3	+6.7
Wholesale prices, mfrs.	114	115	114	116	118	119	118	119	+2.7	+4.4
Import prices	106	107	106	107	110	110	108	106	+0.9	+1.9
Export prices	105	106	106	105	105	105	105	105	+3.9	-1.0
Hourly earnings, industry	145	149	148	153	154	158	163	167	+10.4	+8.1
<u>Domestic finance (bill. kr.)</u>										
Money supply	14.9	17.4	15.3	18.0	15.7	17.9	16.5	16.9 a/	+6.5	+9.7 b/
Bank credit	22.3	23.3	23.5	24.0	25.4	26.0	26.2	25.8	+12.7	+7.5
<u>Foreign trade, reserves (mill. \$)</u>										
Imports, c.i.f.	359	363	376	364	388	380	378	380 a/	+13.5	+4.5
Exports, f.o.b.	338	320	333	341	351	362	353	345 a/	+8.0	+7.6
Trade balance	-22	-43	-43	-23	-36	-18	-25	-35	--	--
Total reserves, end of period	1,106	1,114	1,124	1,086	1,121	1,123	1,146	1,154	+22 f/	+68 f/

a/ October-November. b/ January-November. c/ Calculated as indices of quarterly changes from value data in constant (1959) prices. d/ First three quarters. e/ Data for February, May, August and November. f/ In millions of dollars.

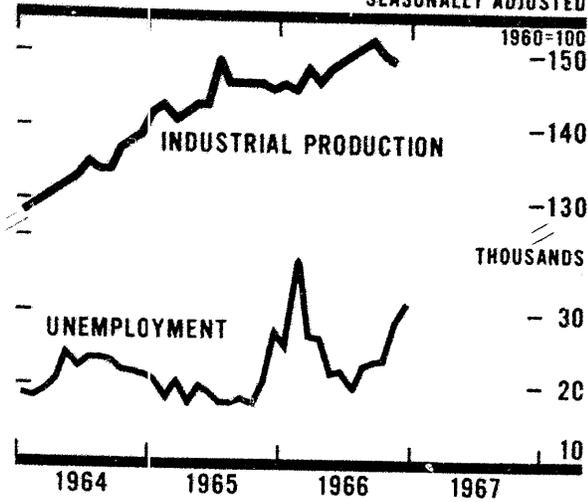
Sources: OECD, Main Economic Indicators; IMF, International Financial Statistics; Monthly Digest of Swedish Statistics; Bank of Sweden, Ur tidningarna; Preliminär Nationalbudget 1967; Affärsvärlden-Finanstidningen.

Aggregate growth trends

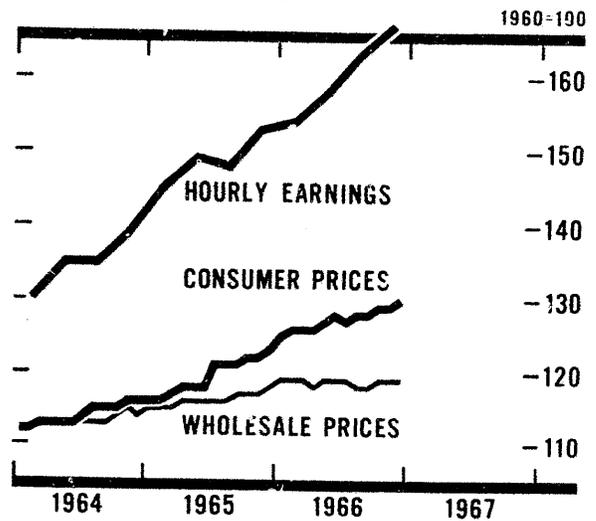
According to preliminary statistics, Sweden's real GNP rose by 3.1 per cent last year, compared to annual increases of 3.7 per cent in 1965 and just over 7 per cent in 1964. The most marked change was in the inventory position, which shifted from a sizable build-up in 1965 to a reduction, of roughly the same magnitude, in 1966. This inventory change--equivalent to about one-half of the yearly change in aggregate demand--accounted for a very large part of the balance of payments deterioration in 1965, and for some of the correction that took place last year. In real terms, business fixed investment rose by 5-1/2 per cent in 1966, confirming the revival which had been expected following a three-year period of relative stagnation, but the actual increase was below expectations because weaker demand tendencies exerted progressively moderating effects during the year. Total real fixed investment registered a moderate decline because of a drop in residential construction, which was affected by tight credit conditions and, in the early months of 1966, by the almost unprecedented cold winter. In constant prices, private consumption rose by a moderate 2.3 per cent in 1966, compared to 4.4 per cent the year before. Consumption grew more slowly in part because the effects of a wave of anticipatory buying in advance of the increase from 6 to 9.1 per cent in the general sales tax in July 1965 were still working themselves out. In addition, the delay in paying out retroactive wage settlements until the end of 1966 undoubtedly held back consumer buying.

# SWEDEN: MAIN ECONOMIC INDICATORS

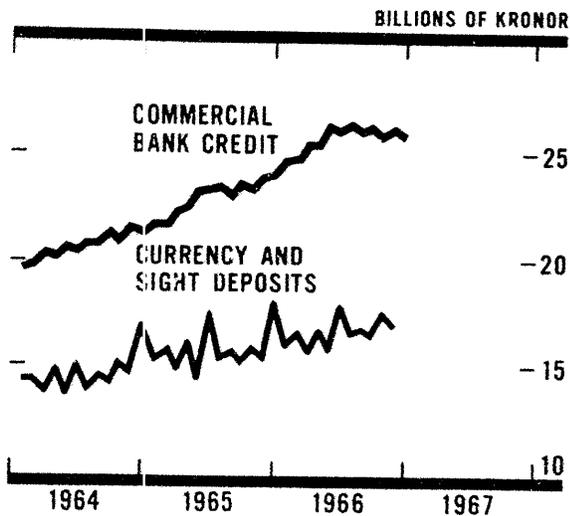
**INDUSTRIAL PROD. AND UNEMPLOYMENT**  
SEASONALLY ADJUSTED



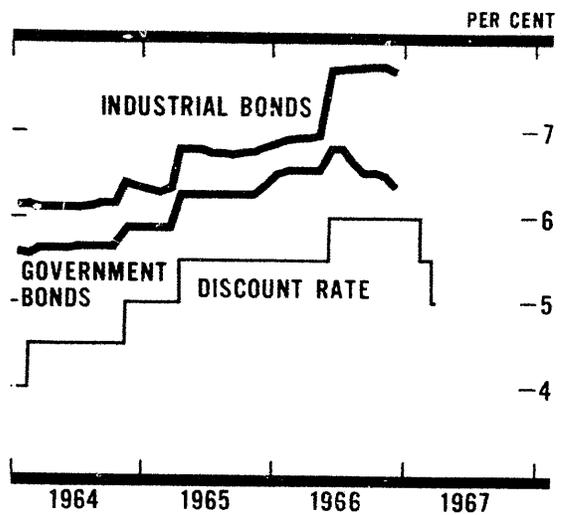
**PRICES AND WAGES**



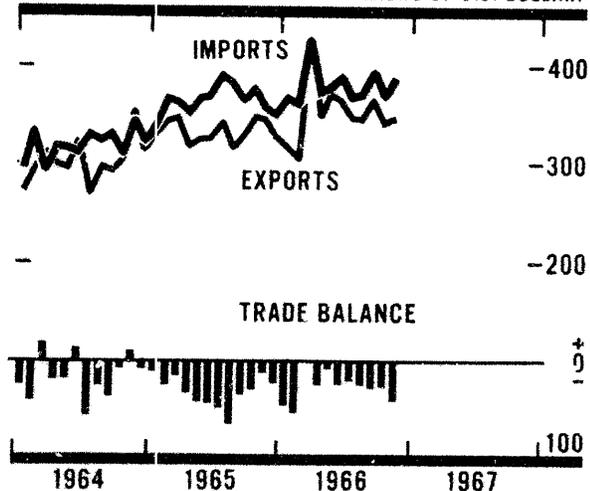
**MONEY AND CREDIT**



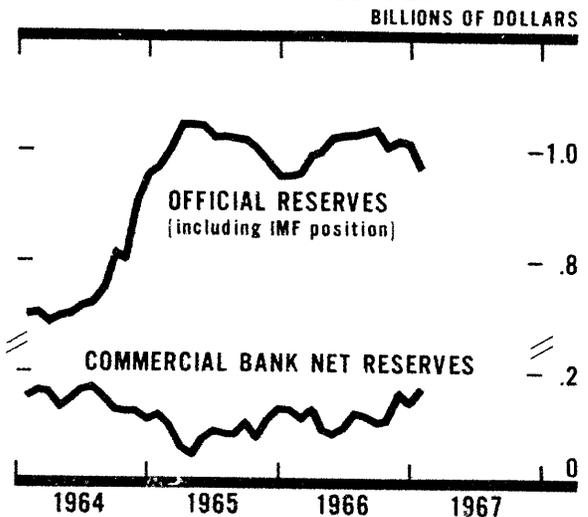
**INTEREST RATES**



**FOREIGN TRADE**  
SEASONALLY ADJUSTED MILLIONS OF U.S. DOLLARS



**FOREIGN EXCHANGE RESERVES**



The generally weaker demand conditions that prevailed during 1966 were reflected in some improvement in the external position, which deteriorated badly in 1965. In value terms, Sweden's imports rose by 4.5 per cent in 1966, significantly less than the 13.5 per cent increase registered in 1965, while exports increased by 7.6 per cent, only slightly less than the 8 per cent gain the year before. Had it not been for a worsening in Sweden's terms of trade (see Table 1), greater improvement would have been registered, but Sweden's trade deficit was nevertheless reduced from SKr. 2,100 million (\$406 million) to SKr. 1,560 million (about \$300 million) between 1965 and 1966.

For 1967, the Swedish authorities expect a moderate revival in domestic demand, sufficient to raise the rate of increase in real GNP to about 4 per cent, from the combination of an increase of 4 per cent in private consumption, an increase in housing construction (partly from a speed-up in starts in the last quarter of 1966) and a smaller reduction in inventory investment. Business fixed investment growth is expected to moderate somewhat, to an annual gain of about 4 per cent. On the external side, imports are expected to increase by about 7 per cent this year while the export forecast is for some deceleration in growth, possibly 6 per cent rather than the 8 per cent gain registered in 1966. Consequently, the authorities expect a trade deficit in 1967 roughly matching that of 1966, a prospect which should be viewed in the context of Sweden's relatively comfortable reserve position. Total gold and

foreign exchange holdings of the Bank of Sweden (including the IMF position) and the commercial banks totaled \$1,154 million at the end of 1966, a little over twice the level at the end of 1960.

Domestic economic activity

The further moderation in the growth of Swedish industrial output in 1966--a trend that seems to have set in during the second half of 1965--reflected a change to a situation in which weaker demand factors predominated over output constraints on the supply side, which was earlier the case. Industrial production rose by about 4 per cent in 1966, according to preliminary estimates, contrasting with gains of 6 and 10 per cent in the previous two years. But production registered almost no growth in the final quarter of 1966 while for the year as a whole some branches--iron ore mining, forestry products, textiles, clothing and shoes--registered declines in output as a result of weaker demand, foreign and domestic.

The state of weaker demand was reflected primarily in a reduction in inventories and in a slower growth in private consumption, which affected domestic levels of domestic output and activity and, of course, Sweden's foreign trade accounts. For example, a very large part of the slower pace of consumption demand was concentrated in lower levels of sales of consumer durables, and especially of passenger cars. One of the principal indicators of consumer buying levels, new car sales, dropped by almost 25 per cent in 1966, marking the first decline in the domestic market in many years. (See Table 1.) Imports of

cars dropped even more as dealers reduced inventories. The slump in car sales continued through the first two months of 1967, but, for last year at any rate, the loss in domestic sales of passenger cars was more than offset by a remarkable expansion in exports of Swedish cars, especially to the U.S. market.

Within Swedish industry, lower levels of foreign demand for some traditional exports resulted in declines in domestic output of iron ore, some types of pulp, and of saw mill products, while declines in domestic demand adversely affected production of textiles and clothing. Other branches, like base metals production, showed only moderate gains while the important engineering industry, which accounts for about 35 per cent of the total production covered by the index, performed reasonably well, although some sectors experienced a reduction in orders as the year wore on. One exceptionally bright spot was the chemical industry, which has experienced very rapid growth so far in the 1960's, reflecting the considerable build-up of new capacity in the petro-chemical and petroleum refining branches.

The weakening of demand last year was also reflected in better balance in Swedish labor markets. Labor shortages became much less pronounced under conditions of declining rates of output growth in many industrial branches. From about the middle of 1965, vacancies tended to decline at the same time as numbers out of work increased, although the cyclical development in unemployment levels was probably obscured in the first quarter of 1966 by the severe effects of the winter weather. (See Table 1 and Chart.) At the end of 1966, the

number of vacancies had sunk back to the level at the end of 1962, during the slowdown preceding the 1963-65 boom. The current rather higher levels of unemployment partly reflect lay-offs resulting from a rising number of industrial mergers within the past two years, representing a trend toward structural rationalization which is prompted by the desire of many Swedish firms to enhance their competitive position in international markets.

The moderating trends also showed up in wage movements although, here too, the severe winter of 1965-66 tended to cloud the significance of underlying developments. Thus, the first quarter of 1966 witnessed Sweden's most difficult postwar wage bargaining experience--as both sides were influenced by earlier boom conditions--and the three-year central wage agreement concluded in early April of last year implied prospective wage increases considerably in excess of margins then considered permissible by the authorities. It now appears that, while contractual wages continued to increase in 1966, the change in labor market conditions was reflected in a slowdown in the upward wage "drift" that has become so prominent a feature of the postwar Swedish labor scene. In 1966 wage drift in industry amounted to about 4-1/2 per cent, compared to almost 6 per cent in 1965, according to figures cited in the preliminary National Budget. The decline in upward wage drift was even more pronounced in the building industry, where the non-contractual wage gain declined from 7 to 2-1/2 per cent in the two years, reflecting the drop in housing starts and lower levels of housing construction throughout most of 1966.

These moderating tendencies were unfortunately not duplicated in the development of prices, which continued to rise somewhat faster in 1966 than in 1965. (See Table 1 and Chart.) In 1965, when the general sales tax was raised from 6 to 9.1 per cent consumer prices rose by 5.3 per cent; but in 1966, when no such tax change occurred, consumer prices increased by 6.7 per cent. The Swedish authorities have attributed the development last year to a tendency for cost increases in sectors like agriculture and housing to be transmitted to prices to a greater extent than in earlier years. In 1966, the index of wholesale prices of manufactured goods also rose more rapidly than in 1965. In addition, Sweden's terms of trade worsened as import prices rose by 1.9 per cent while export prices, which had increased by almost 4 per cent in 1965, declined by 1 per cent last year. (See Table 1.)

#### Financial developments

In 1966, the principal financial development was a change from a situation marked by tight credit policies and strained liquidity positions in the first half of the year to somewhat easier conditions, associated primarily with a shift in the government budget from relative balance to a sizable deficit. The movement toward easier monetary conditions has continued into 1967, culminating in two discount rate reductions in fairly rapid succession--on February 3 and March 10--and ending a three-year period of monetary restriction. While monetary

policy appears to be easing, however, the new budget for the fiscal year beginning on July 1 of this year is partly an "austerity" program which provides for higher sales and excise taxes designed to moderate consumption demand and restrain emerging inflationary pressures.

In the first half of 1966 Swedish monetary policy was still oriented in a restrictive direction. In June, the Bank of Sweden raised discount rate, for the fifth time since mid-1963, to the historically high level of 6 per cent, previously not experienced except for a brief time in 1932; and the penalty discount rate, in effect from February 1964, went up to 12 per cent. Subsequently, however, the Bank of Sweden moved to adopt a somewhat less restrictive policy stance, partly under the influence of signs of some weakening in the economy. In August, rules governing the application of the penalty rate were relaxed by eliminating any borrowing ceiling for those commercial banks that observed the recommended liquidity quotas. In addition, the central bank engaged in open market purchases on a fairly substantial scale over the summer months in order to ease tight liquidity positions. Subsequently liquidity positions continued to improve somewhat, and in the second half of the year there was a marked reduction in the average outstanding level of commercial bank borrowing at the Bank of Sweden.

Despite the somewhat easier tone of official policy, credit conditions continued to be generally tight and interest rates remained quite high. In 1966 there was a notable increase in new security issues, which are under the control of the Bank of Sweden. Issue activity was

especially vigorous following the discount rate increase in June and for the year as a whole, new issues totaled SKr. 7.2 billion, an increase of 85 per cent over 1965 when issue activity--at SKr. 3.9 billion--was drastically curtailed from the previous year's level. The increase in 1966 reflected in part the increase in government borrowing over 1965, when it was on a decidedly modest scale; official issues totaled SKr. 1,475 million last year, compared to SKr. 446 in 1965. However, the principal increase was in housing bond issues, which totaled SKr. 4.2 billion in 1966, roughly double the total of SKr. 2.1 billion in 1965. Mortgage bonds accounted for about 60 per cent of all new issues last year.

In 1966, the administration of issue control by the Bank of Sweden was supplemented by the operation of agreements worked out between the central bank and insurance companies in December 1965, governing the proportions of new funds to be invested in housing bonds. Similar arrangements providing for the conversion of building credits extended by commercial banks into long-term mortgages were continued in effect in 1966, and in the course of the year, there was a significant reduction in the outstanding level of "frozen" commercial bank construction credits, which had risen markedly in the previous year. In addition, the continued large increase in the National Pension Fund, partly reflecting the effects of scheduled annual increases in employers' contributions, facilitated a significant increase in 1966 in the Fund's investments in housing mortgage bonds.

Over the past five years, the Swedish central government budget has shifted between generally small annual surpluses or deficits. From May 1966 onward, a sizable budget deficit emerged, primarily as a result of the drop in revenues associated with lower levels of economic activity, although some technical factors--for example, a change in accounting rules resulting in an increase in central government transfers to the provincial authorities--also acted to increase the deficit last year. For calendar 1966, the deficit on the combined current and capital budgets of the central government amounted to SKr. 1.3 billion (about \$250 million) compared to virtual balance in 1965. (See Table 2.)

The budget for the fiscal year beginning on July 1 is an austerity program designed, basically, to restrain consumption in favor of increased industrial investment and housing finance. The budget proposals for the combined current and capital accounts project revenue to rise by 10.2 per cent (as a result of both higher tax rates and a speed-up in the growth of incomes) while total expenditures, inclusive of transfer payments, are to increase by only 6.7 per cent, resulting in total financial savings of SKr. 1,395 million, compared to SKr. 588 million in fiscal 1967. Government borrowing will rise somewhat (from SKr. 2,059 to SKr. 2,490 million) but there will nonetheless be some reduction in the over-all deficit, from SKr. 1,471 to SKr. 1,095 million. On a calendar year basis, the deficit will be reduced by a somewhat smaller margin because economic activity is not expected to revive until the later part of 1967. (See Table 2.)

Table 2. Sweden: Central Government Budget, 1965-67  
(in millions of Swedish kronor)

<u>Item</u>	<u>Fiscal Years</u>			<u>Calendar Years</u>		
	<u>1965-66<sup>a/</sup></u>	<u>1966-67<sup>b/</sup></u>	<u>1967-68<sup>c/</sup></u>	<u>1965</u>	<u>1966<sup>b/</sup></u>	<u>1967<sup>b/</sup></u>
<u>Revenue</u>						
Direct taxes	12,399	13,206	14,381	12,201	12,610	13,640
Indirect taxes	13,404	14,971	16,758	12,227	14,150	16,200
Other income	2,212	2,416	2,563	2,162	2,240	2,460
Total revenue	<u>28,015</u>	<u>30,593</u>	<u>33,702</u>	<u>26,590</u>	<u>29,000</u>	<u>32,300</u>
<u>Expenditure</u>						
Gross investments	4,952	4,950	5,451	4,773	4,950	5,150
Consumption	7,144	8,275	8,660	6,887	7,820	8,400
Sub-total	12,096	13,225	14,111	11,660	12,770	13,550
Transfers	14,562	16,780	18,196	13,534	15,430	17,650
Total expenditure	<u>26,658</u>	<u>30,005</u>	<u>32,307</u>	<u>25,194</u>	<u>28,200</u>	<u>31,200</u>
Financial savings	+1,357	+ 588	+1,395	+1,396	+ 800	+1,100
Borrowing	1,711	2,059	2,490	1,377	2,050	2,200
<u>Over-all balance</u>	<u>- 354</u>	<u>-1,471</u>	<u>-1,095</u>	<u>+ 19</u>	<u>-1,250</u>	<u>-1,100</u>

a/ Actual.

b/ Estimates.

c/ Proposed.

Source: Preliminär Nationalbudget 1967, page 115. The Swedish fiscal year is from July 1 to June 30.

The "austerity" features of the fiscal 1968 budget are primarily higher sales and excise taxes. First, the general sales tax was raised from 9.1 to 10 per cent on March 1, 1967, when higher excise taxes on tobacco also went into effect, while a 50 per cent increase in the motor vehicle tax will go into effect at the beginning of 1968. Secondly, the government has imposed a temporary 25 per cent tax on costs of non-priority construction, defined to include many types

of buildings serving consumer needs and leisure activities (retail outlets, gas stations, movie theaters, summer homes), as well as some construction by local authorities, such as municipal buildings and even schools. In order to help the balance of payments position and to divert resources into the priority housing sector, the budget includes a proposal to set aside \$100 million (about one-third of the expected increase in total revenues in the draft fiscal 1968 budget) to create a special "fund for industrial development," to be used as basic share capital for a State-owned credit institution. The institution will raise funds by issuing bonds and will engage primarily in long-term financing of industrial enterprises. The proposed development fund and credit institution are reportedly highly controversial issues whose outcome is as yet unpredictable.

#### Balance of payments and reserves

The moderate improvement in 1966 in Sweden's foreign trade accounts mirrored the effects of lower levels of domestic activity, which reduced import demand and probably freed some resources for export. However, while total export values registered about the same increase in 1966 as in 1965, sales abroad would undoubtedly have been higher under more favorable demand conditions for some staple Swedish products. In addition, of course, a worsening in terms of trade limited the reduction in the trade deficit which--at \$300 million--remained considerably higher than the \$200 million level registered in more "normal" recent years.

Mainly because of the larger trade deficit in 1965, the deterioration in Sweden's current account deficit was quite serious, for Sweden incurred rather modest deficits on current account, averaging SKr. 122 million (\$24 million), in the previous two years. However, the improvement in 1966 was rather slight. The steady increase in Sweden's net expenditures on tourism and other services continued in 1966 and, though the surplus on shipping account rose somewhat, the current account deficit for the year worked out at SKr. 1,159 million (\$224 million), compared to SKr. 1,511 million (\$292 million) in 1965. (See Table 3.)

Table 3. Sweden: Balance of Payments, 1964-66  
(in millions of Swedish kronor)

	<u>1964</u>	<u>1965</u>	<u>1966</u>
Imports, c.i.f.	-19,946	-22,644	-23,662
Exports, f.o.b.	19,014	20,541	22,103
Trade balance	<u>- 984</u>	<u>- 2,103</u>	<u>- 1,559</u>
Shipping, net	1,540	1,590	1,700
Tourism, net	- 416	- 587	- 731
Other current payments	- 274	- 411	- 569
Current account balance	<u>- 82</u>	<u>- 1,511</u>	<u>- 1,159</u>
Capital transactions <sup>a/</sup>	+ 284	+ 481	+ 435
Errors and omissions	+ 742	+ 1,081	+ 1,209
Reserve movements:			
Bank of Sweden	+ 857	- 269	+ 173
Commercial banks	- 19	+ 102	+ 55
IMF position	+ 181	+ 284	+ 118
Total reserves	<u>+ 1,019</u>	<u>+ 117</u>	<u>+ 346</u>

a/ Excluding transactions with IMF.

Source: Affärsvärlden-Finanstidningen, February 8, 1967, page 174.

As in earlier years, tight credit conditions in Sweden encouraged capital inflow and, once again in 1966, Sweden's reserves registered an increase. Much of the capital inflow into Sweden is unrecorded, being reflected in the increase in the errors and omissions entry in the Swedish balance of payments. According to the Swedish authorities, there is a presumption that unrecorded flows are not direct commercial bank operations--although the transactions may well be facilitated by commercial banks acting for their customers--but in large part reflect borrowing abroad by Swedish business concerns.

Total Swedish reserves, including the position in the International Monetary Fund, amounted to \$1,154 million at the end of 1966, up \$68 million in the course of the year. Reserves declined by \$5 million in the first two months of this year, and totaled \$1,149 million at the end of February 1967.