Economic outlook 25 November 2014

Summary

International economy: No turnaround in Europe

More than six years have passed since the acute financial crash in autumn 2008. The international economy is still coloured by the repercussions of the crisis. Central banks have put in place major monetary policy stimulation measures. In the euro area an ill-designed austerity policy has been implemented that has held back economic recovery and counteracted the more active monetary policy.

Table 1:1.

Balance of resources and key ratios				
Percentage change				
	2013	2014	2015	2016
Private consumption	2.1	2.8	2.3	2.2
General government consumption	1.6	1,2	1,1	1.1
Investment	-0,1	4,3	3,4	3.9
Changes in stocks<1>	0.0	0.1	0.0	0.0
Exports of goods and services	-0.5	2.4	4.0	4.5
Imports of goods and services	-0.8	4.2	4.4	4.8
GDP <2>	1.5	2.1	2.1	2.3
Key indicators:				
Employment	1.0	1.6	1.4	1.0
Unemployment, ILO, 15-74 <3>	8.0	7.9	7.7	7.6
Employment rate, 20-64 <4>	79.8	80.4	80.9	81.1
Hourly wages	2.4	2.6	2.7	3.3
Productivity in the business sector	1.7	1.2	1.3	2.0
CPI	0.0	-0.2	0.4	1.5
CPIF	0.9	0.4	0.9	1.4
Real disposable income	2.1	2.6	2.6	2.6
Balance in current payments <5>	6,5	5.8	6.1	6.1
Repo räte <6>	0.75	0.00	0.00	0.75
USD/SEK <6>	6.51	6.81	7.24	7.24
EUR/SEK <6>	8.65	9.07	9.17	9.17

<1> Change as a percentage of previous year's GDP
<2> Calendar adjusted values 2015 and 2016
<3> Percentage of labour force
<4> Percentage of population aged 20-64
<5> Percentage of GDP
<6> At close of year, per cent

Source: Statistics Sweden, the Riksbank and own calculations

Sweden, as an export-oriented country, is highly dependent on events in the rest of the world. Several of Swedenôs export markets are expected to show weak growth. The economy in the euro area will continue to show weak growth in the coming year. The forecast for economic growth in Germany has worsened in recent months. Parts of the Nordic countries also have relatively weak growth; above all Finland, where negative growth is expected in 2014. In light of the major problems in many of the European economies the general hope is that the USA will act as a locomotive in the world economy.

Swedish economy: Weak GDP growth and continued high unemployment

The Swedish economy is not lifting. Growth in the rest of the world is expected to continue to be sluggish, monetary policy has reached the end of the road and fiscal policy is slightly contractionary.

In the next few years GDP growth is expected to be just over 2 per cent per year. To bring about stronger growth the international economy must pick up speed and support exports. This is not regarded as very probable.

Another possibility is that household consumption will be a stronger driver of growth. This assumes that households will reduce their saving considerably. The high savings level at the outset indicates this. But there are several counteracting factors. Uncertainty about world developments, particularly in Europe, is great. This is probably one reason that the National Institute of Economic Research confidence indicator for households is below its historical average. In addition there is the proposed amortisation requirement for new mortgages. It has not been thought probable that households will reduce their saving.

Demand is too weak to challenge high unemployment. A stable increase in employment is expected to continue in 2015 and 2016, but at a somewhat slower rate compared with this year. The number of newly reported vacancies is quite close to the high level of 2007 and the number of redundancy notices is low. Employment is expected to increase by just over 70,000 people this year and altogether by 114,000 people in 2015-2016.

Firms are expected over time to become more restrained in their recruiting and nevertheless be able to meet the moderate increase in demand that is forecast. The pattern of recent years of weak productivity growth will only be broken in 2016 when productivity will increase by 2 per cent, which is somewhat higher than our assessment of underlying productivity growth, but far below historical averages.

Labour supply is still growing fast and the increase going forward is expected to be so strong that the growth in employment will not be enough to reduce unemployment more than to 7.6 per cent in 2016.

There was very high productivity growth in the period 2001-2006 while employment was by and large static. After the financial crisis the situation has been the opposite. A partial explanation of recent developments may be both ñhoardingò and a policy aimed at job creation in businesses with low productivity.

Inflation measured as CPIF is expected to stay at 1.5 per cent in 2016. This year and next year unit labour costs are expected to increase relatively fast. At the same time import prices are increasing more than before. But continued weak demand, increased competition and low inflation expectations nevertheless indicate low inflation going forward. The scope for price increases is limited. Moderate increases in housing costs and energy prices, as well as falling fuel prices as a result of a lower oil price, also indicate that inflation will not accelerate.

Economic policy: can we afford to invest?

Better economic development than we can foresee now will depend on fiscal policy. This is true of both Europe and Sweden. In earlier editions of Economic Outlook the LO economists have argued that circumstances are particularly favourable for stabilising the economy through fiscal policy. Since the economic situation has not materially improved these arguments still stand. Put plainly, right now it is cheap to ñbuyò demand in Sweden and other countries whose public finances allow it. Fiscal policy stimulation coordinated at EU level would have been by far the most effective. However, as yet this is not politically possible, even if there are signs that the policy of austerity enforced by Germany is starting to be abandoned.

With the last interest rate decision a majority of the Executive Board set a new course and started to focus again on its main task: the inflation target: Reality, in the form of low inflation and falling inflationary expectations, finally caught up with the majority of the Executive Board that set the interest rate. The failures of Swedish monetary policy have been so great that they have attracted attention internationally. Future evaluations will show exactly what went wrong. A combination of poor inflation forecasts, consistent overestimation of resource utilisation and misguided attempts to influence household indebtedness are reasonable explanations.

The policy rate will not be raised until ñinflation has clearly picked up againò. But the fact remains: monetary policy has had major negative effects on output and employment. This must have consequences for the institutional and legal framework around the Riksbank. Neither the General Council of the Riksbank nor the Riksdag Committee on Finance, the democratic bodies that appoint new members of the Executive Board and evaluate monetary policy, can be said to have discharged their duties adequately.

In a more normal economic situation monetary policy should, if conducted correctly, take care of stabilisation policy. With the zero interest decision the more conventional monetary policy tools have been exhausted.

We see before us a relatively long period with a weak international economy, in particular in Europe, which is our most important export market. Consequently, we will not be able to export ourselves out of the downturn, as in the 1990s. It would have been particularly welcome if lower real interest rates had got business investments moving. This does not seem to be the case, however, in Sweden or other parts of Europe. Household consumption will not develop as positively as the Government expects. Active fiscal policy is therefore necessary to ensure better growth in demand and employment.

All conditions for active fiscal policy to be effective are in place and have been so for a long time. It is probable that at no time in the post-war period has Sweden ever had greater reason to implement substantial fiscal policy stimulation. The LO economists propose initiatives equivalent to SEK 70 billion, SEK 55 billion of which constitutes permanent weakening of public finances. In our opinion the stimulus package will lead to an increase in employment of just over 100,000 people and a fall in unemployment of about 2 percentage points.