



Highlights and Key Issues

- Sweden crept out of recession in Q2, with revised data showing GDP up 0.2% from Q1. Net exports made a significant positive contribution, consumer spending stabilised and the rate of decline of investment slowed sharply.
- In Q3, industrial output rose 1.5%, supported by the turn in the global stock cycle, which suggests another quarter of growth. Going forward, activity should also be supported by improving world demand and the lagged impact of monetary stimulus.
- The upturn is nevertheless likely to be sluggish due to the slow growth of domestic demand in Europe and the US, the lack of incentives to invest and the headwinds facing consumers. We forecast a 4.4% fall in GDP this year, followed by 1.6% growth in 2010.
- After growing in Q1 and Q2, retail sales disappointed in Q3, with a fall of 0.1%. Consumer demand remains depressed by high unemployment, which rose to 8.3% in September, and weak property prices – although there are tentative signs of stabilisation in housing in recent months.
- Headline CPI inflation remained negative in November. In the face of this and the deep recession, the Riksbank has held the repo rate at just 0.3% and has also looked to non-standard measures to add extra monetary stimulus.

Forecast for Sweden

(Annual percentage changes unless specified)

	2008	2009	2010	2011	2012	2013
Domestic Demand	0.1	-4.4	2.1	2.2	2.7	2.3
Private Consumption	-0.4	-1.0	1.6	2.0	2.4	2.4
Fixed Investment	2.4	-15.8	2.9	1.9	2.4	2.3
Stockbuilding (% of GDP)	-0.3	-1.1	-0.9	-0.6	0.0	0.1
Government Consumption	1.1	1.8	1.7	1.4	1.4	1.4
Exports of Goods and Services	1.6	-13.5	1.1	4.6	5.2	5.1
Imports of Goods and Services	3.1	-15.4	2.0	5.2	5.2	5.1
GDP	-0.4	-4.4	1.6	2.2	2.9	2.5
Industrial Production	-2.9	-17.4	0.9	6.1	5.3	3.2
Consumer Prices	3.5	-0.3	1.1	1.6	1.8	1.8
Current Balance (% of GDP)	6.2	7.3	6.8	6.7	6.5	6.2
Government Budget (% of GDP)	0.8	-2.1	-3.9	-2.0	-1.4	-0.6
Short-Term Interest Rates (%)	4.75	0.90	0.55	2.08	4.23	4.50
Long-Term Interest Rates (%)	3.90	3.26	3.86	4.63	4.75	4.75
Exchange Rate (Per US\$)	6.59	7.65	6.48	6.36	6.58	6.81
Exchange Rate (Per Euro)	9.62	10.63	9.65	9.06	8.94	8.89

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Overview

Escape from recession in Q2...

- Sweden crept out of recession in Q2, with revised data showing GDP up 0.2% from Q1 compared with the slight decline in output originally estimated. But GDP was still 6.1% lower than a year before.
- Net exports were a significant positive contributor, with imports falling 5.6% in the quarter compared with a more modest 3.5% quarterly drop in exports. Meanwhile, consumer spending stabilised, rising marginally on the quarter, and the rate of decline of fixed investment slowed sharply.

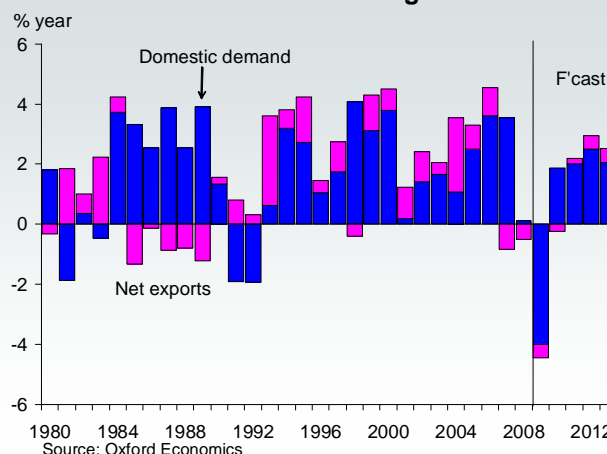
...and growth continued in Q3...

- Industrial output rose 1.5% in Q3, supported by the turn in the global stock cycle. The recovery in industry has lagged that in many other European countries and, although output has now risen in three of the last four months, it remains modest.
- Survey data suggest the improvement in industry seen in Q3 continued into the early part of Q4, with the October PMI reaching a two-year high boosted by markedly stronger export orders. Going forward, activity should continue to be supported by improving world demand and the lagged impact of monetary stimulus.

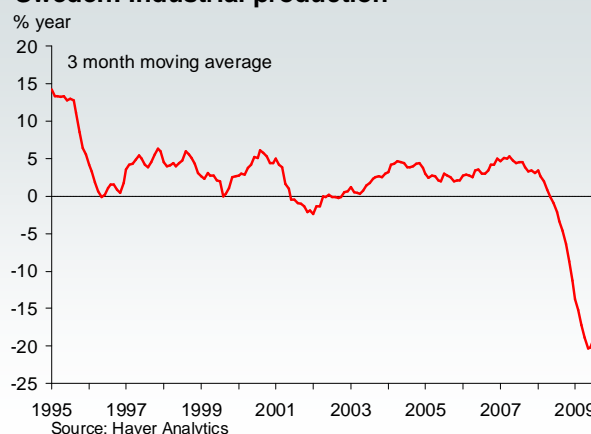
...but set to prove sluggish

- The upturn is nevertheless likely to be sluggish due to slow growth of domestic demand in Europe and the US, the lack of incentives to invest and the headwinds still facing consumers. We forecast a 4.4% contraction in GDP this year, followed by 1.6% growth in 2010.
- Although the rise in Q3 industrial output suggests another quarter of positive GDP growth, other indicators point to the pace of expansion remaining very subdued. The 'activity index', which tracks GDP closely, rose just 0.1% in Q3 – dragged down by a 0.5% fall in September.
- Export dynamics also remain weak according to official trade data. The value of exports fell 1.3% in Q3, the sixth straight quarter of decline. And although export orders showed a notable bounce in Q3, they were still 18% lower than in the same period a year earlier.

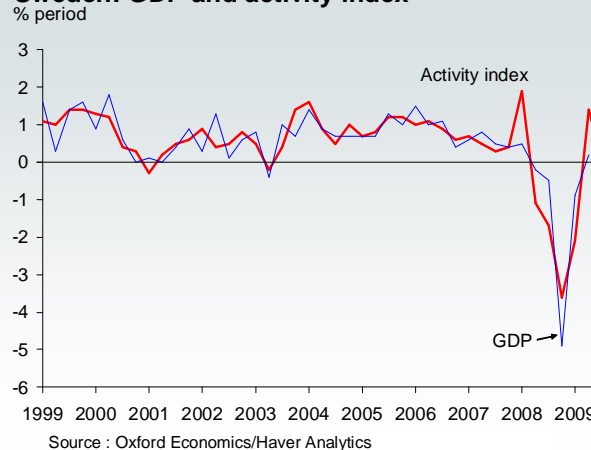
Sweden: Contributions to GDP growth



Sweden: Industrial production



Sweden: GDP and activity index



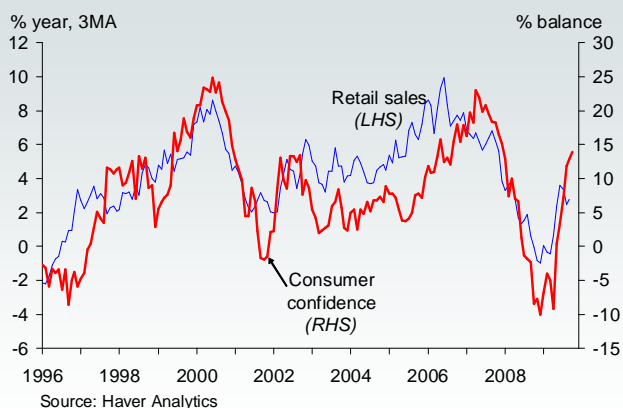
Consumers still constrained...

- After growing in Q1 and Q2, retail sales disappointed in Q3 with a fall of 0.1%. This was despite a big improvement in consumer confidence during the quarter, with the main confidence index rising to its highest since December 2007.
- Consumer demand remains depressed by high unemployment and weak property prices, and is likely to remain so for several quarters.
- Unemployment was 8.1% in October, 2.4% points higher than a year earlier. With total employment down around 3% on the year, labour cutbacks have been comparatively large but have lagged the fall in GDP, implying the need for further job losses in the months ahead.
- Survey data such as the manufacturing PMI also point to firms continuing to shed workers; we forecast unemployment will peak around 10% at the beginning of 2011.
- House prices fell 0.4% year-on-year in Q3, a shallower rate of decline than the 1.8% fall in Q2. Although this suggests a tentative stabilisation in housing market conditions, the overall picture in the sector remains bleak – housing completions were almost 60% down on the year in Q3 and housing starts 30% lower.

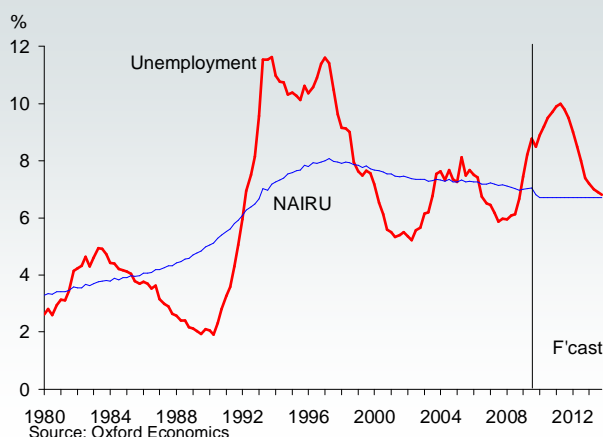
...though Riksbank policy supportive

- Headline CPI inflation remained negative in November for the seventh straight month, at -1.5% year-on-year. In the face of this, and the deep recession, the Riksbank has kept the repo rate at a record low of 0.3% since July and looks likely to hold rates at this level well into next year.
- Monetary stimulus has also been significant via non-standard channels, with the Riksbank having increased the monetary base by a factor of four since last September. In a novel move, interest rates on banks' deposits at the Riksbank have been made negative, in an attempt to prevent banks 'hoarding' the extra liquidity. The authorities also extended their scheme to guarantee bank borrowings for a further six months in October. Use of this scheme has been falling in recent months, indicating a thaw in financial market conditions, but outstanding guarantees remained at SEK308bn at the end of September.

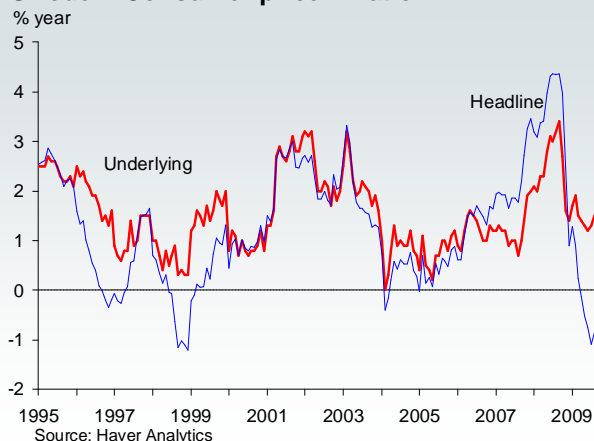
Sweden: Retail sales and consumer confidence



Sweden: Unemployment and the NAIUR



Sweden: Consumer price inflation



Key Indicators: Sweden

Percentage changes on a year earlier unless otherwise stated

	Industrial production	Unemploy- ment %	CPI (UND1X)	Hourly earn- ings, manuf.	New car sales	Industrial new orders	Trade balance SKr Bn.	Retail sales
Oct	-8.4	5.7	2.7	3.1	-23.8	-14.2	9.0	-1.1
Nov	-11.8	6.2	1.6	3.6	-38.4	-19.5	4.7	0.0
Dec	-13.5	6.4	1.4	3.1	-43.1	-31.4	8.9	-1.7
2009								
Jan	-15.7	7.3	1.7	3.4	-36.0	-26.4	7.2	1.9
Feb	-16.3	8.0	1.9	3.2	-32.3	-25.9	9.2	-1.2
Mar	-19.6	8.3	1.5	1.3	-23.0	-28.4	8.6	-2.0
Apr	-20.7	8.3	1.4	2.6	-33.8	-22.2	8.7	5.3
May	-20.6	9.0	1.3	3.0	-32.2	-23.6	9.3	3.9
Jun	-19.2	9.8	1.2	1.8	-7.3	-28.0	17.4	1.6
Jul	-17.1	7.9	1.3	2.3	-17.1	-21.3	9.1	4.6
Aug	-17.0	8.0	1.5	2.1	-15.8	-19.4	5.4	1.2
Sep	-14.5	8.3	1.0	-	-15.6	-13.7	5.5	2.6
Oct	-	8.1	1.5	-	-4.4	-	-	-

Financial Indicators: Sweden

Percentage changes on a year earlier unless otherwise stated

	Short rate %	Long rate %	Money Supply M3	Exchange rate Kroner/€	Exchange rate Kroner/\$	Exchange rate index 1995=100	Share price	Reserves \$bn
Oct	5.3	3.6	8.1	9.85	7.43	96.9	209.4	25.0
Nov	4.5	3.3	9.0	10.13	7.97	93.8	199.8	27.8
Dec	2.8	2.6	11.8	10.76	8.00	90.3	201.4	25.1
2009								
Jan	2.2	2.8	11.2	10.73	8.08	90.3	199.3	23.6
Feb	1.5	2.9	10.3	10.91	8.54	87.8	200.8	22.7
Mar	1.2	2.9	10.5	11.18	8.55	86.7	198.6	23.0
Apr	1.0	3.2	8.0	10.88	8.23	88.7	227.4	23.1
May	1.0	3.6	8.1	10.58	7.73	91.5	243.2	24.3
Jun	1.0	3.6	8.2	10.87	7.76	89.2	243.1	35.4
Jul	0.7	3.4	6.8	10.83	7.68	89.6	253.1	36.1
Aug	0.6	3.4	6.8	10.22	7.15	95.0	274.0	37.5
Sep	0.6	3.4	7.4	10.20	7.00	-	281.9	38.7
Oct	0.5	3.3	-	10.31	6.95	-	285.4	-

SWEDEN											
TABLE 1 SUMMARY ITEMS											
Annual Percentage Changes, Unless Otherwise Specified											
	CONSUMERS EXPENDITURE	REAL PERS. DISPOSABLE INCOME	SAVING RATIO (%)	REAL GDP	INDUSTRIAL PRODUCTION	UNEMPLOY- MENT RATE (%)	AVERAGE EARNINGS	WHOLE ECONOMY PRODUCT- IVITY (GDP/ET)	COMPETIT- IVENESS (2000=100)	PRODUCER PRICES	CONSUMER PRICES
	(C)	(PEDY)	(PESR)	(GDP)	(IP)	(UP)	(ER)	(GDP/ET)	(WCR)	(PPI)	(CPI)
YEARS BEGINNING Q1											
2008	-0.4	-0.1	9.3	-0.4	-2.9	6.2	1.7	-1.5	100.0	3.0	3.5
2009	-1.0	1.8	11.9	-4.4	-17.4	8.2	6.4	-2.3	138.0	1.4	-0.3
2010	1.6	1.9	12.2	1.6	0.9	9.3	3.0	2.7	152.9	0.1	1.1
2011	2.0	2.1	12.3	2.2	6.1	9.8	3.0	1.9	159.4	0.6	1.6
2012	2.4	2.0	12.0	2.9	5.3	8.2	3.0	2.4	156.2	1.8	1.8
2013	2.4	2.1	11.7	2.5	3.2	7.0	3.0	2.0	152.7	2.1	1.8
2008											
I	1.8	0.3	8.5	2.2	1.4	5.9	1.5	0.3	101.4	3.4	3.2
II	0.4	0.2	8.7	1.2	-0.2	6.1	2.2	-0.6	103.3	2.1	3.9
III	-1.1	0.2	9.3	0.2	-1.2	6.1	2.3	-0.6	101.6	2.9	4.4
IV	-2.6	-1.2	10.8	-5.1	-11.8	6.7	0.7	-5.2	93.7	3.7	2.4
2009											
I	-2.4	1.9	12.4	-6.5	-19.6	7.4	5.9	-5.3	134.3	3.2	0.8
II	-1.7	1.7	11.8	-6.1	-21.0	8.2	6.1	-4.0	136.0	2.2	-0.5
III	-0.7	1.9	11.7	-5.2	-18.1	8.8	6.5	-2.5	140.2	0.6	-1.2
IV	0.7	1.7	11.6	0.3	-10.2	8.5	7.1	3.2	141.4	-0.6	-0.5
2010											
I	1.4	1.1	12.1	1.7	-1.5	8.9	3.0	4.0	145.5	-0.5	1.0
II	1.7	2.3	12.3	1.7	1.8	9.2	3.0	3.2	152.2	-0.1	1.1
III	1.6	2.2	12.2	1.6	1.1	9.5	3.0	2.2	156.3	0.5	1.2
IV	1.5	2.1	12.2	1.5	2.3	9.7	2.8	1.6	157.8	0.6	1.1
2011											
I	1.6	2.4	12.8	1.6	3.7	9.9	3.0	1.5	159.3	0.1	1.1
II	1.8	2.0	12.4	2.1	5.4	10.0	3.0	1.8	160.2	0.4	1.7
III	2.2	2.0	12.0	2.2	7.1	9.8	3.0	1.8	159.8	0.8	1.7
IV	2.4	2.1	11.9	2.8	8.0	9.5	3.1	2.3	158.4	1.2	1.8
2012											
I	2.5	2.0	12.5	2.9	7.4	9.0	3.0	2.4	157.5	1.5	1.8
II	2.4	2.0	12.1	3.0	6.2	8.5	3.0	2.5	157.0	1.8	1.8
III	2.4	2.1	11.7	3.0	4.4	8.0	3.0	2.4	155.9	1.9	1.8
IV	2.3	2.0	11.6	2.9	3.3	7.4	3.0	2.4	154.2	2.1	1.8
2013											
I	2.4	2.1	12.2	2.7	3.1	7.2	3.0	2.2	153.6	2.1	1.8
II	2.4	2.1	11.8	2.6	3.0	7.0	3.0	2.1	153.1	2.1	1.8
III	2.4	2.1	11.4	2.5	3.2	6.9	3.0	2.0	152.6	2.1	1.8
IV	2.4	2.1	11.3	2.4	3.5	6.8	3.0	1.9	151.5	2.0	1.8

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SWEDEN											
TABLE 2 SUMMARY ITEMS											
	TRADE BALANCE (KR BN)	CURRENT ACCOUNT (KR BN)	CURRENT ACCOUNT (% OF GDP)	GOVERNMENT FINANCIAL BALANCE (KR BN)	GOVERNMENT FINANCIAL BALANCE (% OF GDP)	SHORT-TERM INTEREST RATE	LONG-TERM INTEREST RATE	REAL SHORT-TERM INTEREST RATE	REAL LONG-TERM INTEREST RATE	EXCHANGE RATE PER US DOLLAR	EXCHANGE RATE PER EURO
	(BVI/000)	(BCU/1000)	(BCU*100/GDP)	(GB/1000)	(GB*100/GDP)	(RSH)	(RLG)	(Note 1)	(Note 1)	(RXD)	(RXEURO)
YEARS BEGINNING Q1											
2008	105.9	196.5	6.2	25.9	0.8	4.75	3.90	1.27	0.42	6.59	9.62
2009	94.3	225.2	7.3	-63.5	-2.1	0.90	3.26	1.24	0.60	7.65	10.63
2010	46.3	215.0	6.8	-122.4	-3.9	0.55	3.86	-0.53	2.79	6.49	9.65
2011	35.3	219.0	6.7	-66.7	-2.0	2.08	4.63	0.48	3.03	6.36	9.06
2012	33.4	221.6	6.5	-47.7	-1.4	4.23	4.75	2.41	2.94	6.58	8.94
2013	31.2	219.5	6.2	-19.9	-0.6	4.50	4.75	2.70	2.95	6.82	8.89
2008											
I	32.7	60.4	7.7	12.6	1.6	4.66	4.02	1.44	0.80	6.27	9.40
II	23.1	42.9	5.4	12.9	1.6	4.95	4.25	1.05	0.35	5.99	9.35
III	27.9	52.6	6.6	4.7	0.6	5.18	4.14	0.82	-0.22	6.32	9.47
IV	22.1	40.6	5.2	-4.3	-0.6	4.19	3.19	1.74	0.74	7.80	10.24
2009											
I	22.7	50.2	6.6	-8.8	-1.2	1.63	2.88	0.82	2.08	8.41	10.94
II	30.4	76.0	9.9	-12.0	-1.6	0.97	3.46	1.44	3.93	7.92	10.78
III	28.0	49.0	6.4	-19.0	-2.5	0.61	3.40	1.78	4.56	7.29	10.42
IV	13.2	50.0	6.5	-23.7	-3.1	0.40	3.30	0.90	3.80	6.96	10.40
2010											
I	12.9	52.1	6.7	-30.4	-3.9	0.40	3.40	-0.55	2.45	6.73	10.14
II	12.0	53.5	6.8	-33.6	-4.3	0.40	3.70	-0.68	2.62	6.50	9.73
III	11.1	54.6	6.9	-31.1	-3.9	0.60	4.06	-0.59	2.87	6.37	9.43
IV	10.4	54.8	6.9	-27.3	-3.4	0.80	4.30	-0.29	3.21	6.34	9.29
2011											
I	9.8	54.9	6.8	-18.4	-2.3	1.20	4.47	0.11	3.38	6.33	9.16
II	8.9	54.6	6.8	-17.5	-2.2	1.60	4.60	-0.13	2.87	6.33	9.07
III	7.7	53.9	6.6	-16.0	-1.9	2.50	4.69	0.77	2.96	6.37	9.03
IV	9.0	55.5	6.7	-14.8	-1.8	3.00	4.75	1.18	2.93	6.42	9.00
2012											
I	9.2	56.1	6.7	-14.0	-1.7	3.80	4.75	1.98	2.93	6.48	8.97
II	8.4	55.4	6.6	-13.0	-1.5	4.10	4.75	2.29	2.94	6.54	8.94
III	7.2	54.2	6.4	-11.0	-1.3	4.50	4.75	2.69	2.94	6.61	8.93
IV	8.7	55.8	6.5	-9.8	-1.1	4.50	4.75	2.69	2.94	6.68	8.92
2013											
I	8.7	55.9	6.4	-10.2	-1.2	4.50	4.75	2.69	2.94	6.74	8.91
II	7.8	54.8	6.3	-6.7	-0.8	4.50	4.75	2.70	2.95	6.80	8.90
III	6.5	53.4	6.0	-2.6	-0.3	4.50	4.75	2.70	2.95	6.85	8.89
IV	8.2	55.4	6.2	-0.4	0.0	4.50	4.75	2.70	2.95	6.87	8.88

Note 1: REAL INTEREST RATES = Nominal interest rate (RSH or RLG) - % change in CPI

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Background

- Sweden is a small open economy with a substantial export-oriented high-tech manufacturing sector. Privately owned firms account for about 90% of industrial output, of that the engineering sector accounts for 50% of output and exports. Agriculture accounts for only 2% of GDP and employment. Natural resources such as timber, hydropower, and iron ore are abundant. The country is characterised by the 'Swedish model' of generous welfare provision. In this system trade unions have a strong influence on wage bargaining and there is a high degree of co-operation with government. The state in turn delivers a high level of welfare benefits – funded by high taxation – and targets unemployment through active labour market policies.
- The September 2006 election substantially changed the political landscape in Sweden. The Moderate Alliance's election victory put an end to years of Social Democrat rule - it was the first time in 25 years that a centre-right coalition gained a majority and the best performance by the Moderate Party since 1928. With the Moderate's Fredrik Reinfeldt as prime minister, the Alliance pledged to cut taxes and reform the culture of Sweden's 'cradle-to-grave' welfare system to make it more 'work friendly'. But the government will continue to play a sizeable role. In addition, there are plans to liberalise and deregulate many areas of the economy currently under state control.
- The Alliance government comprises four political parties: the Moderates (26.1% of the vote in the 2006 election, 97 seats) the Liberal Party (7.5%, 28), the Centre Party (7.9%, 29) and the Christian Democrats (6.6%, 24). Overall, the Alliance won 48.1% of the vote compared to 46.2% for Göran Persson and his allies. With a total of 178 seats in parliament, the new government has a slim majority of just seven seats. Ousted premier Persson resigned from leadership of the Social Democrats and was replaced by Mona Sahlin.
- Unemployment was fiercely debated during the election campaign and it remains a key issue. Work incentives are distorted by inefficiencies in the wage bargaining system, the generous social benefit system, and the very high fiscal burden. The 'Swedish model' delivered decades of full employment up until the early-1990s, but labour market performance since has been less impressive. While the official unemployment rate is better than many of its European neighbours, special factors such as government work schemes distort such comparisons. Meanwhile, sickness rates in Sweden are very high - in part due to generous welfare provisions and lax eligibility criteria - and some estimates suggest the 'true' unemployment rate may be higher than 15%.
- Following the 2001 recession, productivity growth improved (a consequence of reforms begun in the early 1990s), but the flipside of that was subdued employment growth, particularly in the private sector. Generally, participation rates are high, particularly so for women, but not among younger people where unemployment rates are very high. Average hours worked are also low, and that hampers potential labour supply. Raising working hours is vital to enhance the economy's long-term growth potential, broaden the tax base and ease pressure on the public finances, especially as the population ages.
- The Alliance inherited a strong economy with sound public finances, leaving ample room for manoeuvre in terms of implementing economic policy. Reforms are likely to be less painful and more likely to be pushed through when the economy is doing well. Unemployment benefits will be trimmed and it has pledged to cut taxes.
- In January 1993, Sweden became the fourth country in the world to adopt an inflation-targeting regime, after New Zealand, Canada and the UK. Monetary policy is conducted by the central bank (the Riksbank), which sets interest rates to maintain price stability defined in terms of keeping consumer price inflation around 2% per annum. There is a tolerance range of +/-1 percentage point around this target. The bank also gives special status to an underlying inflation measure known as UND1X, which strips out the direct effects of changes in indirect taxes, subsidies, and mortgage interest payments. Despite an intense publicity campaign supporting entry by Persson's Social Democrats, business and the media, voters rejected EMU membership by a wide margin in 2003. The 'no' vote at the time was widely interpreted as a vote of 'no confidence in Europe' and reflected voters' concerns about the impact on democracy and sovereignty. There are currently no plans for another referendum on the issue.

Key Facts

Politics

Head of state: King CARL XVI GUSTAF
 Head of government: Prime Minister Frederik REINFELDT
 Political system: Constitutional monarchy
 Date of next legislative election: Autumn 2010
 Currency: Swedish krona (SEK)

Long-term economic & social development

	1975	1985	1995	2007*
GDP per capita (US\$)	9315	12630	28382	49822
Inflation (%)	9.8	7.4	2.5	2.2
Population (mn)	8.19	8.35	8.82	9.11
Urban population (% of total)	83.0	83.0	84.0	84.0
Life expectancy (years)	75.0	77.0	79.0	81.0

Source : Oxford Economics & World Bank

Structure of GDP by output

	2006
Agriculture	1.0%
Industry	29.0%
Services	70.0%

Source : World Bank

* 2007 or latest available year

Long-term sovereign credit ratings & outlook

	Foreign currency	Local currency
Fitch	AAA (Stable)	AAA (Stable)
Moody's	Aaa (Stable)	Aaa (Stable)
S&P	AAA (Stable)	AAA (Stable)

Structural economic indicators

	1990	1995	2000	2007*
Current account (US\$ billion)	-6.6	8.4	10.2	38.1
Trade balance (US\$ billion)	2.7	15.0	14.4	16.3
FDI (US\$ billion)	-12.6	3.5	-17.8	-15.3
Govt budget (% of GDP)	4.2	-7.4	3.7	3.8
Govt debt (% of GDP)	42.3	72.2	53.6	40.5
Long-term interest rate	13.1	10.3	5.4	4.2
Oil production (000 bpd)	0	0	0	0
Oil consumption (000 bpd)	336	388	362	349

Source : Oxford Economics / World Bank / EIA

Destination of goods' exports (2007)

European Union (27)	60.9%
Norway	9.4%
United States	7.6%
Russian Federation	2.0%
China	1.9%

Source : WTO



Source : CIA Factbook

Location : Northern Europe, bordering the Baltic Sea, Gulf of Bothnia, Kattegat, and Skagerrak, between Finland and Norway (CIA Factbook)

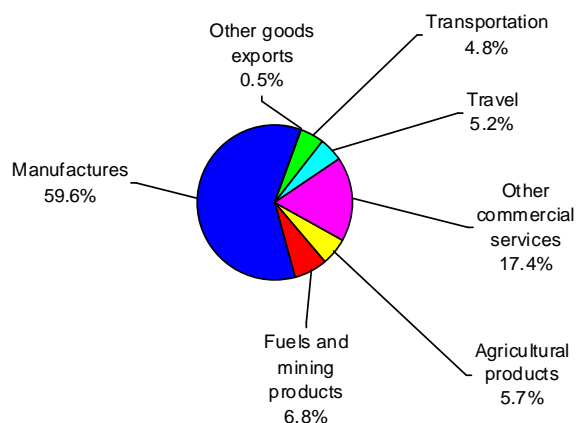
Corruption perceptions index 2009

	Score
Developed economies (average)	7.69
Emerging economies (average)	3.44
Sweden	9.20

Source: Transparency International

Scoring system 10 = highly clean, 0 = highly corrupt

Composition of goods & services exports, 2007



Source : WTO