

Sweden: How long can the good times last?

The Swedish economy has held up surprisingly well in the first half of 2018. We still think a slowdown is coming though

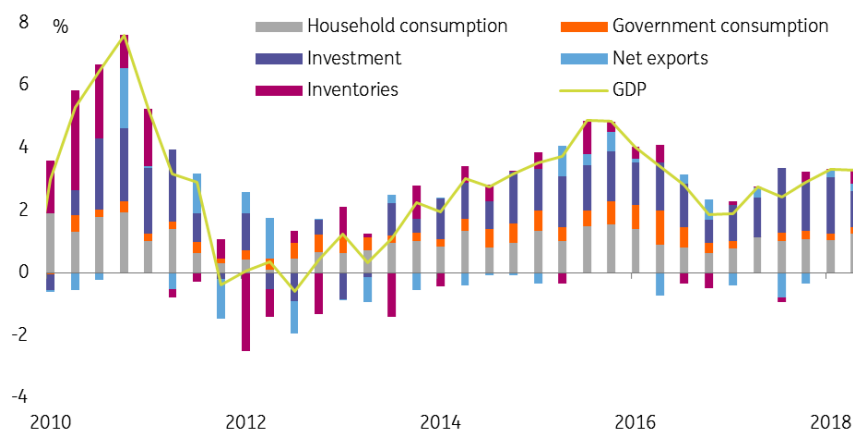


Growth has remained strong

For some time now, we and most other forecasters have been expecting the Swedish economy to slow down. After several years of strong growth, driven in large part by a booming housing market and strong consumer demand, the Swedish economy seems unlikely to sustain 3%+ annual growth in output. Long-term potential growth is more like 2% per year.

But so far this year, expectations for a slowdown have proven unfounded. GDP grew strongly in both 1Q and 2Q, with output up 3.3% compared to the middle of 2017. The housing slowdown has yet to make a major impact on growth figures. While new housing construction slowed markedly in 2Q, an increase in other investments offset this. And consumer spending, which is typically sensitive to house prices, has held up despite the sharp fall in house prices at the end of 2017.

Swedish GDP growth by component, YoY

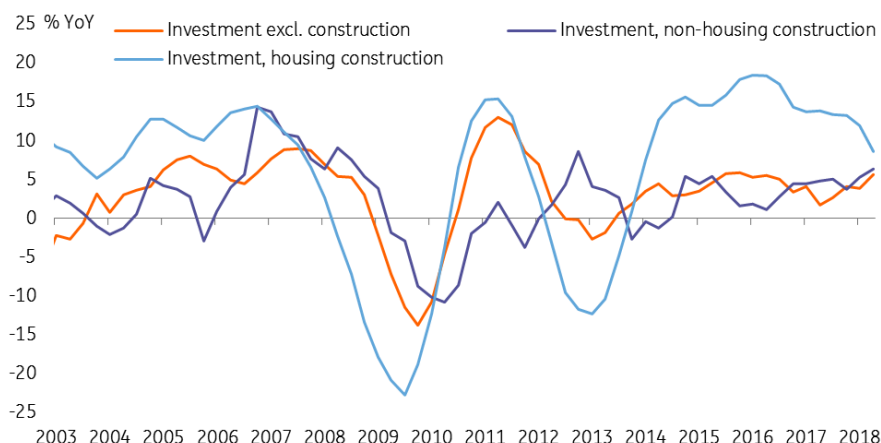


Source: Macrobond and ING calculations

Still, the second half of 2018 is likely to see softening growth momentum. First off, the 2Q growth figure was flattered by a build-up of inventories and strong net exports, which is likely to be partly reversed in 3Q. Household consumption may also have been flattered by changes to the taxation of new cars from the start of July, which created an incentive to bring purchases forward. Again, this may push down on the 3Q and 4Q growth figures.

High-frequency survey data also suggest momentum is faltering, with consumer confidence weakening, in particular. Housing construction will slow further, and it is not clear that investment in other sectors will continue to make up the shortfall. So growth in the second half of the year is unlikely to match the first half pace.

Housing investment is slowing down



Source: Macrobond and ING calculations

But the housing market is still a concern

House prices have been broadly flat in 2018, stabilising after the sharp fall last autumn. The market is down around 5% nationally and around 10% in Stockholm. So far, the spillover to the rest of the economy appears limited, with household consumption holding up well in the first half

of the year.

The key question now is how the market develops over the rest of the year. The signals are mixed. On the positive side, sentiment on housing seems to be turning more positive again. But at the same time, sales volumes have been extremely low over the summer, and there remains a large overhang of newly built properties coming on to the market in Stockholm and other major cities.

In our view, a further leg down in prices over the autumn, perhaps another 5-10%, is a plausible scenario. This would likely further depress new construction, and would likely start to dampen consumption to some extent as well.

And the global outlook also looks cloudy

While the deal between the US and EU to take auto tariffs off the table has reduced the immediate threat from the US administration's aggressive tariff policies, continued tensions between the US and China are bad news for the export-dependent Swedish economy. If the global economy slows down, Sweden will slow with it. At a time when domestic momentum is already waning, this would be a double-whammy for Swedish growth.

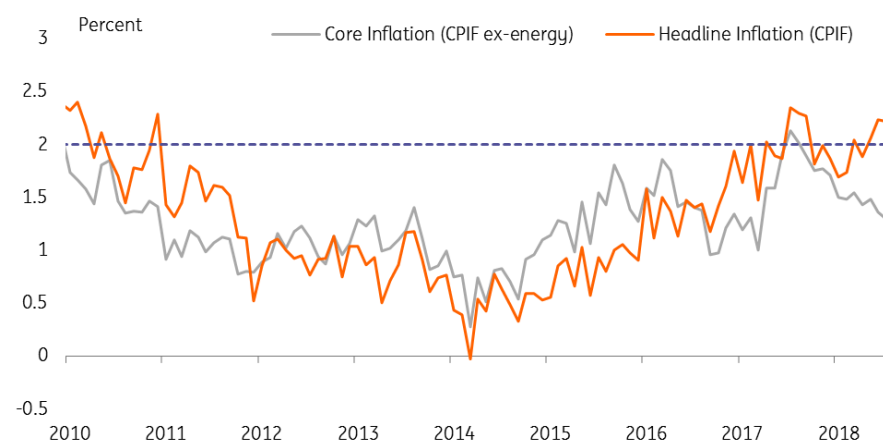
The recent turmoil in Turkey that's spread to other emerging markets, as well as the underlying tension between the EU and Italy's new government around the country's fiscal plans, also poses risks to the global outlook, and particularly the European economy.

Energy prices have risen, but underlying inflation continues to disappoint

Over the summer, the headline inflation rate has risen above 2%. But this is entirely down to high energy prices: the rise in oil prices earlier this year is feeding through to consumers, and the extremely hot summer causing electricity prices to spike (the dry weather meant Sweden's hydropower plants had to reduce output). As the energy effects start to fade, inflation is likely to fall back, unless domestic inflation starts to pick up.

But underlying, domestically-generated inflation remains weak, with core inflation at 1.3% in July and services inflation at 1.2%. And there are few signs of domestic prices picking up materially. The Riksbank's core inflation forecast has proved too optimistic six out of seven months this year, despite a 10% depreciation of the krona since last autumn (which should be pushing up in core inflation by now).

Headline inflation rises on energy prices, but core lags behind



Source: Macrobond

The Riksbank's dilemma remains the same

For the Swedish central bank, the situation is drearily familiar. Swedish growth is strong, but risks are clearly skewed to the downside both at home and abroad. Underlying inflation remains stubbornly low, with no clear upward trend. And ECB continues to keep policy setting loose – no interest rate change is likely until the autumn of 2019.

This puts the Riksbank in a tough spot. There's no doubt the committee would like to start raising rates, and a 10 basis point hike in December, consistent with the Riksbank's current interest forecast, cannot be excluded. But given how adamant policymakers (at least the majority of the MPC led by Governor Stefan Ingves) have been that inflation needs to return sustainably to target before monetary stimulus is withdrawn, the likelihood is that the continued weakness in underlying inflation will cause them to delay the first rate hike into 2019.

We expect a move in that direction at the 6 September policy meeting, though divisions on the committee make it difficult to judge how the communication will play out.

Elections in September

Sweden holds elections on 9 September. Polls suggest the likely outcome is a hung parliament, where record support for the far-right, anti-EU Sweden Democrats means neither of the traditional centre-left and centre-right blocks are even close to a majority. That means messy and potential lengthy negotiations to form a new government lie ahead, which could lead to at least a short-term political risk premium being priced into the krona.

Author

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri

thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors

maurice.van.sante@ing.com

Marcel Klok

Senior Economist, Netherlands

marcel.klok@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

james.knightley@ing.com

Tim Condon

Asia Chief Economist

+65 6232-6020

Martin van Vliet

Senior Interest Rate Strategist

+31 20 563 8801

martin.van.vliet@ing.com

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com