

## Sweden in 2018: So far, not great

The Swedish economy looks to be slowing down and the currency has weakened substantially in 2018. The Riksbank will respond as it always does: with extreme caution



Source: Shutterstock

It's fair to say that 2018 hasn't been a vintage year for the Swedish economy. Growth is slowing down, inflation has disappointed, and the housing market still looks wobbly. Meanwhile, the US administration's aggressive trade policy creates a major risk for Sweden's export-dependent economy. The Swedish Krona has been the worst performer among the G10 currencies so far in 2018.

### Solid growth, but momentum is slowing down

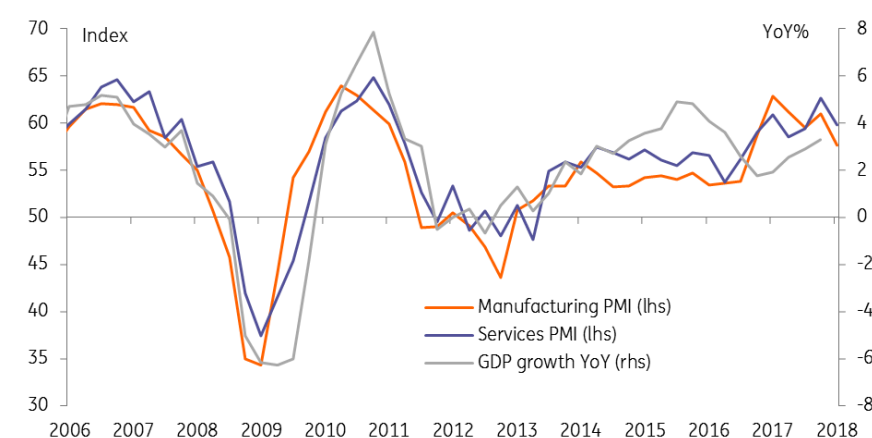
Sweden headed into 2018 on a bit of a winning streak, with four straight years of strong growth averaging more than 3% per year. And with the global economy picking up in the second half of 2017, things ought to be looking up for the export-heavy Swedish economy.

But instead the economy looks to be slowing down, with PMI surveys and other near-term indicators suggesting that 4Q17 could prove the top of the recent growth cycle. While 1Q growth is still likely to come in at a solid pace, around 2.5% YoY, the direction from here looks to be downward.

A key reason for this slowdown is the housing sector. After several years of rapidly rising house prices and increasing construction of new homes, the Swedish housing market hit a wall in the second half of 2017. Prices have dropped rapidly, down 6% nationally and 10% in Stockholm.

Construction also seems to be slowing down, with permits for new construction falling by nearly half in the second half of the year. Developers are struggling to sell all the expensive new flats they have built and planned, and new affordability restrictions on mortgages brought into force at the start of March will not make things any easier. Many developers, especially new companies set up during the boom years are facing an increasingly difficult financial situation.

## Swedish PMI surveys point to slower growth



Source: Macrobond

## Inflation has softened and the currency depreciated

Inflation has disappointed expectations in January and February, falling back below 2%. While we expect a pick-up in March, that is largely down to higher energy prices and an earlier Easter this year. The underlying core inflation measure is likely to remain well short of 2%: we expect 1.6% in March, up from 1.5% in the previous two months.

Partly as a result of the weaker economic outlook and negative data surprises, the Swedish currency has struggled. After a solid performance in January (as the year-end headwind from low STIBOR rates unwound), SEK has become the weakest performer in the G10.

A key trigger for SEK weakness was the market turmoil at the start of February, followed by President Trump's increasingly strident approach to trade policy. As a very open, export-oriented economy, Sweden is particularly vulnerable to rising protectionism. As the trade war rhetoric has ratcheted up, investors have started pricing in a risk premium for the krona.

## What does this mean for the Riksbank?

The weaker outlook for inflation and SEK sell-off has caught the Riksbank by surprise. The central

bank revised down its inflation forecast at the February policy meeting, only to see January inflation undershoot the new forecast a week later. February also came in below their forecast. Though we think March will be in line with, or even a touch above the Riksbank's expectation, their forecast further out looks too ambitious.

At the same time, the trade-weighted KIX index is now around 6% weaker than the Riksbank had factored into its last forecast. That should offset some of the weakness in domestic price pressure. Still, we think another slight downward revision to inflation is likely at the next Riksbank meeting in April.

That probably means the Riksbank will also push back its interest rate forecast to indicate the first hike will come only at the end of this year. The minutes from the February meeting indicated the committee was already leaning in that direction, and events since then – in particular the increasing trade tensions – will only have added to their concerns. Caution has long been the Riksbank's preferred stance, and in turbulent times they will most likely stick to that approach.