September 03, 2020

Economics Group

Special Commentary

Michael Pugliese, Economist
michael.d.pugliese@wellsfargo.com • (212) 214-5058
Jen Licis, Economic Analyst
jennifer.licis@wellsfargo.com • (704) 410-1309

How Have More Relaxed Domestic Restrictions Impacted the Swedish Economy?

Executive Summary

When COVID-19 struck, the Swedish government elected not to pursue some of the most stringent lockdown measures adopted in many other Western nations. While there were some restrictions on activity, such as bans on large public gatherings, full-scale lockdowns that closed schools, businesses and severely limited mobility were generally avoided. Did this more relaxed approach lead the Swedish economy to significantly outperform relative to its peers? Although there is some evidence of modest outperformance on a relative basis, it is far from overwhelming, and on an absolute basis the Swedish economy still had a terrible first half of 2020. Real GDP growth in Sweden was "only" down 7.7% year-over-year in Q2-2020, and even with substantial policy stimulus we still expect the economy to contract 4.5% in 2020. And while new cases and deaths from COVID-19 are relatively low in Sweden at present, the cumulative, population-adjusted death toll from COVID-19 is much higher in Sweden than it is in other Nordic countries, such as Denmark or Norway.

Sweden's Economy Still Weak Despite Less Stringent Limitations

The Swedish public health and economic experience with COVID-19 has been somewhat different than that of many of its Western peers. As COVID-19 cases climbed in March and April, Swedish officials eschewed the more draconian lockdown measures adopted in much of Europe. While there were some restrictions on activity in Sweden, full-scale lockdowns that closed schools, businesses and severely limited mobility were generally avoided. New daily cases per million in Sweden leveled off in April and May and then rose further in June (Figure 1), in contrast to the steady declines seen across Europe through late spring and early summer.

The Swedish economy has modestly outperformed on a relative basis, with real GDP "only" down 7.7% year-over-year in Q2-2020.

Figure 1

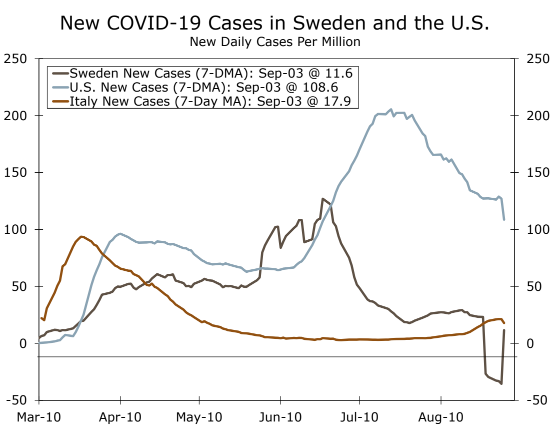
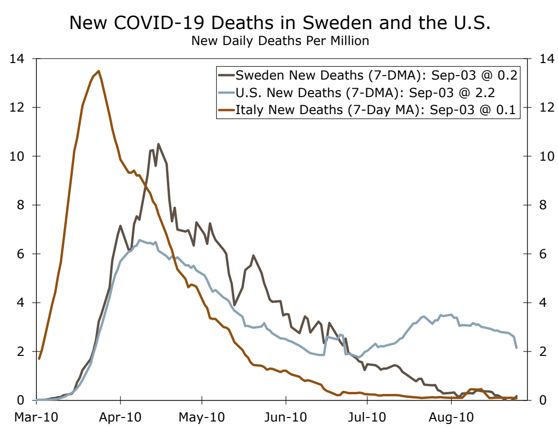


Figure 2



Source: Bloomberg LP and Wells Fargo Securities

Together we'll go far

Despite the increase in cases that occurred in June, new deaths have been on a steady downward descent from their peak, and at present deaths are in the single digits on a daily basis (Figure 2). Still, the cumulative death toll from COVID-19 has been much higher in Sweden (574 deaths per million residents) than in other Nordic countries such as Norway (48 deaths per million) or Denmark (108 deaths per million) and more in line with hard-hit countries like Italy (587 deaths per million) or the United States (565 deaths per million).

Interestingly, the trend in new cases and deaths in Sweden looked pretty similar to the United States from April-June (refer back to Figures 1 & 2). Since June, however, the two countries have seen much different outcomes, with cases and deaths remaining elevated in the United States but declining further in Sweden. The reason for this improved public health outcome in Sweden is unclear, but it is worth noting that Swedish limitations on activity became, if anything, even less stringent in June. Researchers at the University of Oxford have created a [Government Stringency Index] that attempts to measure how much a country's policymakers are limiting mobility and activity through lockdown measures. Figure 3 shows that Sweden was far more relaxed than many other Western countries at the peak of lockdowns in March and April, and the country has generally remained more relaxed in its measures in the months since.

Figure 3

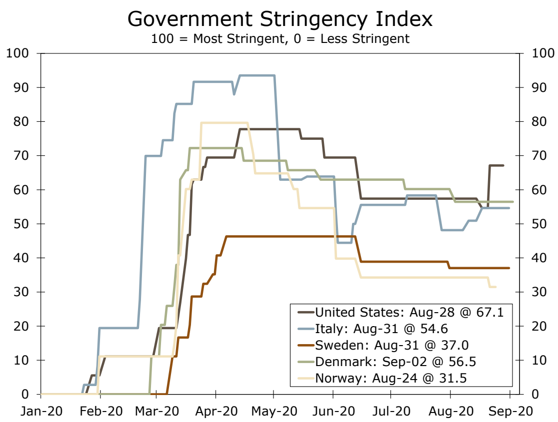
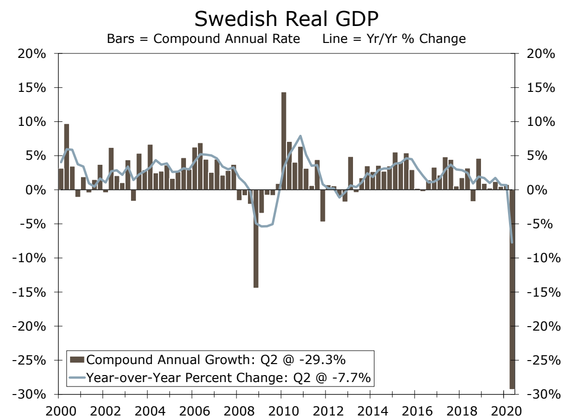


Figure 4



Source: University of Oxford, IHS Markit and Wells Fargo Securities

Has this more relaxed approach to lockdown measures been a boon to the Swedish economy? The evidence on this front is mixed, in our view. On relative basis, there are some signs of Swedish outperformance. Real GDP actually expanded slightly in Q1 in Sweden (Figure 4), in contrast to contractions in the United States, Denmark, Norway, and many other Western economies. But in the second quarter, the Swedish economy contracted at a devastating 29.3% annualized rate, and on a year-over-year basis Swedish GDP was down 7.7% in Q2. On the one hand, this is noticeably better than some of the hard hit countries in Europe that resorted to strict lockdowns, such as the United Kingdom, Italy and Spain (Figure 5). On the other hand, Swedish GDP still declined at a historic rate, signaling that government-imposed lockdowns are not the only thing constraining economic activity. Furthermore, year-over-year Swedish real GDP growth in Q2 was only slightly stronger than Denmark and actually weaker than Norway. This occurred despite generally stricter lockdown measures in those two countries as compared to Sweden.

Swedish GDP still declined at a historic rate in the second quarter.

Of course, not all economies are built the same, and one might argue that Sweden's heavy reliance on exports is causing the weak headline GDP reading. Presumably output that is tied to foreign external demand will be less impacted by domestic lockdowns than other types of output, such as personal consumption. And if other countries are imposing strict lockdown measures that dampen demand for foreign products, an export-oriented economy like Sweden may see material weakness in its economy regardless of what lockdown measures it maintains. Exports accounted for roughly 47% of GDP in Sweden at the end of 2019 (the comparable number in the United States was about 11%), and those exports were down 15.4% year-over-year in the second quarter. In contrast, personal consumption in Sweden was "only" down 9.0% year-over-year in Q2, one of the best performances among developed economies (Figure 6). Notably, personal consumption contracted by less in Sweden than in Norway, despite Norway's outperformance when viewed through the lens of total real GDP growth. This can be explained in part by compositional differences between the two economies, notably Norway's important petroleum sector, which helped ease the contraction in their economy in H1-2020.

Figure 5

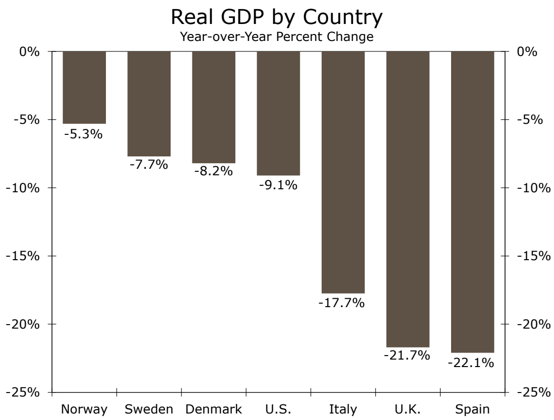
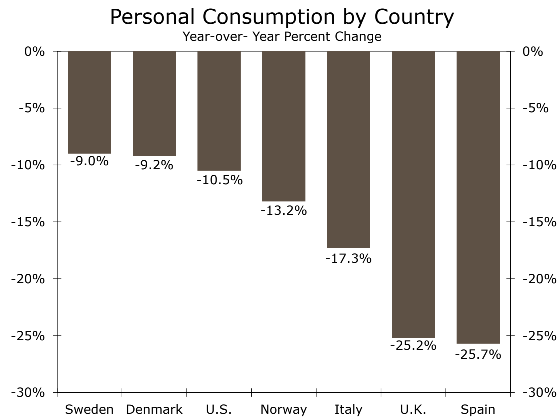


Figure 6



Source: Bloomberg LP and Wells Fargo Securities

Of course, a 9% year-over-year decline in personal consumption is still the biggest decline in at least 40 years. So it would be unfair to characterize the weakness in the Swedish economy as purely a function of collapsing external demand, in our view. In short, it does appear that the less stringent limitations on activity in Sweden may have led to some modest economic outperformance on a relative basis. And if the Swedish economy were more reliant on consumption and less reliant on exports, this outperformance likely would have been even larger. That said, the relative outperformance was fairly modest: it is not as if the Swedish economy has clearly outperformed all of its peers by wide margins. Furthermore, this outperformance should not be mistaken for what was, in an absolute sense, an abysmal first half for economic growth in Sweden. The human toll taken by COVID-19 in Sweden has been much larger than that of other Nordic countries, although spread of COVID-19 in Sweden does appear to be under control at present.

The less stringent limitations on activity in Sweden may have led to some modest economic outperformance on a relative basis.

What Is the Outlook for Sweden Moving Forward?

Since March, the Swedish Riksbank has adopted several measures aimed at supporting the supply of credit and countering the economic effects of COVID-19. Perhaps the biggest move has been the expansion of its quantitative easing program—comprised of government bonds, municipal bonds, mortgage bonds, commercial paper and most recently corporate bonds—to SEK500B (~10% of GDP) through June 2021. In addition, the central bank further cut interest rates and extended maturities for loans made to private banks.

At its most recent monetary policy meeting on July 1, the Riksbank kept its repo rate unchanged at zero, but nevertheless held the door open to further easing. In the accompanying statement, policymakers indicated that the central bank is prepared to continue to use or expand all of the tools at its disposal to provide support to the Swedish economy, including the potential for a return to a negative policy rate. After several years of negative interest rates, the Riksbank hiked its repo rate 25 bps to 0% in December 2019, becoming the first major central bank to exit negative interest rates. Based on the central bank's recent commentary, we expect that it will leave rates on hold for the foreseeable future. First Deputy Governor Skingsley was among the latest policymakers to comment on the possibility of returning to negative rates, but she indicated that she was not supportive of returning the repo rate to negative territory at this time.

On the fiscal front, the Swedish government has introduced extensive measures to support the economy. To aid the business sector, the Swedish government proposed several crisis packages to support businesses and reduce the number of jobs lost. These measures include a short-term furlough scheme that runs until year-end, a temporary reduction of employers' social security contributions, subsidizing paid sick leave, loans to small- and medium-sized businesses and several temporary changes to unemployment insurance to make it easier to qualify for the benefits and to ensure the insurance provides greater financial security for those unemployed. The government also introduced other measures including rent support, additional funding to municipalities and regions hit hard by the outbreak, more funding to the media, cultural and sports sectors, expansion of education and credit guarantees for Swedish airlines and regional airports, among others. The International Monetary Fund estimates that the overall package of fiscal measures is between SEK544billion and SEK832billion, or 11%-17% of 2019 GDP.

We still look for the Swedish economy to contract 4.5% for full-year 2020.

Despite the substantial stimulus measures, we still look for the Swedish economy to contract 4.5% for full-year 2020. However, going forward we expect data to continue to improve and look for the economy to recover over the second half of this year and into 2021. For the Swedish currency, earlier in the year the krona sold off sharply against the greenback and euro, in part because the Swedish economy is more exposed than most to disruptions in global trade. More recently, as sentiment and global equity markets improved, the krona rallied substantially off of its lows and is now the best performing G10 currency year to date, gaining over 8% versus the greenback. The spread of COVID-19 appears to be under control in Sweden, and investor sentiment is likely to continue improving, which should be a positive influence on the currency in medium- to longer-term. Additionally, as the local and global economies begin to recover and global equity markets strengthen we believe the Swedish krona could gain further support.

Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	International Economist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

WELLS FARGO SECURITIES