BUSINESS SWEDEN


# THE PANDEMIC SLASHES INVESTMENTS

## INVESTMENTS IN THE GLOBAL AND SWEDISH ECONOMY

"The pandemic's devastating impacts on the world economy cannot overshadow the fact that global trade and foreign direct investments have stagnated over recent years, for reasons that we still don't fully understand."

Lena Sellgren, Chief Economist, Business Sweden

# EXECUTIVE SUMMARY

- The coronavirus pandemic has radically weakened the prospects for foreign direct investments (FDI) over the next few years. An already sluggish trend will be followed by a drop of almost 40 per cent in 2020 and another 10 per cent fall in 2021, according to the latest UNCTAD forecast.
- Following a three-year decline in foreign direct investments, the trend was broken with an increase of 3 per cent in 2019 compared to 2018 amounting to a total of USD 1,540 billion. In Europe, FDI increased by 22 per cent to USD 473 billion following a weak development in 2018 while investment levels fell in Asia and stagnated in North America.
- Foreign direct investments in Sweden amounted to SEK 187 billion in 2019 which is a five-fold increase from 2018. This was the highest recorded level since 2008 and far above the average during the period 2000–2019. The fact that around 200 corporate deals involving foreign investors were concluded in 2019 contributed to the increase.
- Foreign direct investment assets in Sweden amounted to SEK 3,079 billion (latest available figure) in 2018. Sixty per cent of the investments were made in the services sector and 40 per cent in the manufacturing industry.
- European companies account for the largest share of foreign investments in Sweden. Investments by Asian companies are increasing sharply but still only represented 4 per cent of foreign direct investment assets in Sweden in 2018.

*Foreign direct investment* (FDI), or *outward investment* (ODI), is defined as an investment in which an investor, usually a company, directly or indirectly owns at least 10 per cent of shares or votes in an enterprise located in another country. A direct investment – as opposed to a portfolio investment – is characterised by a long-term view and ownership control. Direct investments are primarily made via company acquisitions, new business establishments as well as replacement and expansion investments.

Information on foreign direct investment in Sweden is collected by Statistics Sweden (SCB) on behalf of the Riksbank (Sweden's central bank), as part of the research base for the balance of payments and the national accounts. Given that the statistics show financial transactions – which for example may also be attributable to restructuring and group loans – the figures should be interpreted with caution. They may also be revised at a later date.

For a more detailed presentation of the statistics, please consult Business Sweden's report *When companies invest* (2018). In order to simplify the information in this report, foreign direct investments are occasionally referred to as "investments".

All figures and accounting research are presented in current prices.

# GLOBAL CROSS-BORDER DIRECT INVESTMENT

When companies take the decision to invest overseas there are typically three principle objectives: to service new customers and markets, to reduce costs and to leverage or acquire strategic assets. Investments are often motivated by several factors that carry different weight in each situation. The term strategic assets encompasses everything from skilled labour and competence to research and development, technology, brands and patents and, in some sectors, raw materials such as oil, gas, minerals and even renewable energy. The ultimate driving force behind each company's investment is to increase revenue and improve profitability.

## FROM GLOBALISATION TO REGIONALISATION

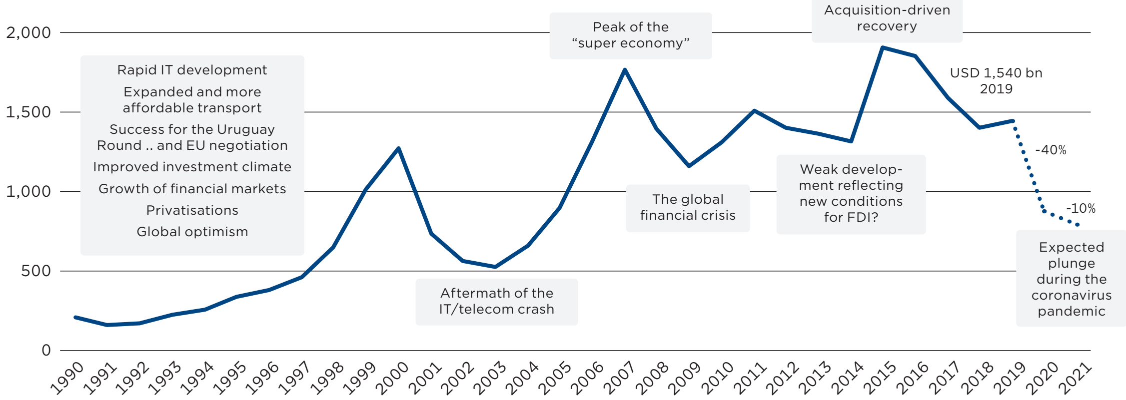
The nature of any foreign direct investment is shaped by several factors dictated by the company's internal capabilities and operations, competitive position as well as business conditions in different markets. A market-driven horizontal investment means that parts of a company's operations are replicated in one or several overseas markets. Thanks to emerging technologies, modern communications and transport, different elements of production can be split up into separate operations that are located to countries and regions offering the best conditions in terms of cost, quality and availability. These (primarily cost-driven) vertical investments divide processes into different parts of the production chain and leverage consolidation benefits as well as cost-plus pricing (wages, interest rates etc) between different countries. This development has been further spurred by incentives such as tax credits offered in many countries and other forms of establishment support in relation to foreign investments. Setting up local production is sometimes a criteria for allowing companies to sell their products.

Over the past decade, the trend of establishing manufacturing facilities in developing countries – coupled with the simultaneous rise of production in industrialised nations – has increasingly focused on the perceived advantages of having close proximity to customers and markets. At the same time, environmental aspects and concepts

Figure 1

THE RECOVERY FAILED IN 2019 AND A SHARP DECLINE IS NOW EXPECTED

Global direct investment 1990-2021, USD billion




Note: The amounts for 2020 and 2021 are UNCTAD's forecast.
Sources: UNCTAD, Business Sweden (2020)

such as sustainable manufacturing have started to have a real impact on corporate strategies. The idea of tapping into rapid growth, especially in Asia, is attracting more and more companies. In the report *Manufacturing changes course* (2019), Business Sweden highlights the trend towards increased regionalisation of production and trade. This topic is also covered in the report *A world of uncertainty* (2020) co-produced together with Kommerskollegium, the National Board of Trade Sweden.

## SHARP DOWNTURN AWAITS

The outlook for foreign direct investment in the next few years has been dramatically overclouded by the coronavirus pandemic. A forecast issued by UNCTAD points to a drop of nearly 40 per cent in 2020 followed by an additional 10 per cent decline in 2021 given the global economy's severe fall in the wake of national responses to prevent the spread of coronavirus. For example, Business Sweden's survey of coronavirus impacts on Swedish export companies (*Sweden's exports in the eye of the storm,* May 2020) shows that over 60 per cent of companies have delayed their investments due to the pandemic. In addition, investments usually only pick up momentum late in a recovery phase which further indicates a weak trend for investments going forward.

UNCTAD reports that the number of FDI projects and acquisitions fell by half in the first months of the year compared to the same period in 2019. The companies' degraded earnings will also have a negative impact on reinvestments in foreign subsidiary operations in 2020. According to UNCTAD, reinvested profits account for up to 50 per cent of global foreign direct investment each year.

Recently published statistics from UNCTAD show that global FDI increased by 3 per cent in 2019 compared to the previous year – reaching a total of USD 1,540 up from USD 1,495, see Figure 1. The investments in Europe increased by 22 per cent and reached USD 473 billion following a weak development in 2018, when US companies repatriated large profits accumulated overseas following domestic tax reform. The upswing for Europe in 2019 is largely explained by the fact that some countries with favourable corporate taxation became more attractive once again for foreign investments. For example, FDI in Ireland increased from an outflow of USD 28 billion in 2018 to an inflow of USD 78 billion in 2019.

In Asia, investments fell 8 per cent to USD 561 billion. In North America, FDI was basically unchanged at USD 330 billion. In the smaller investment regions, the trend took different trajectories: while foreign direct investment in Latin America increased by 15 per cent to USD 131 billion, investments in Africa decreased by 10 per cent to USD 45 billion.

According to the consulting firm Mergermarket, the overall global value of corporate acquisitions fell by 7 per cent in 2019 compared to the previous year. The decline was approximately 20 per cent for Europe in part due to the absence of large business deals during the year.

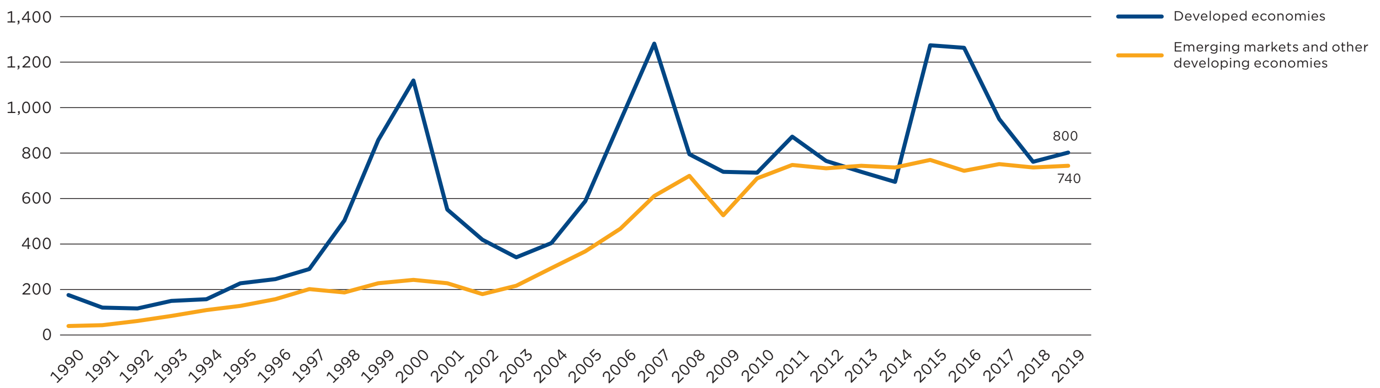
## TEMPORARY BREAK IN DOWNWARD TREND

Beyond the exceptional situation that has arisen due to the coronavirus pandemic, global direct investment – like world trade – is taking a downswing that cannot be explained by economic development. Despite healthy growth in the world economy and record levels of acquisition activity, the average annual increase in global FDI amounted to just 7 per between the global financial crisis and 2018. By contrast, global FDI increased by an average of 13 per cent per year between 1990 and 2007. There may be several reasons for this obvious slowdown.

Figure 2

INVESTMENTS IN GROWTH MARKETS ARE STAGNATING

Foreign direct investment 1990-2019, USD billion




Sources: UNCTAD, Business Sweden (2020)

A possible explanation for this development is that foreign direct investment has become more difficult to pinpoint in the statistics, partly as a result of the more complex nature of financial deals related to acquisitions and other capital movements. The internationalisation of the capital market has facilitated local financing, with loans and other transactions that are not recorded as foreign direct investment. Business collaborations and partnerships of various forms have also emerged as an attractive alternative to capital investment.

Another possible explanation is the regionalisation trend mentioned above – with companies increasingly concentrating their production and trade in industrial goods to the three regions North America, Europe and Asia. The increasingly commonplace strategy of near-market production reduces the pace of overseas relocation and fragmentation of production in different countries.

A third possible explanation is that companies are pivoting towards services at the local level which is reducing the need for large investments. UNCTAD reports that global investments in capital-intensive businesses have fallen sharply in recent years, which has primarily affected the developing economies.

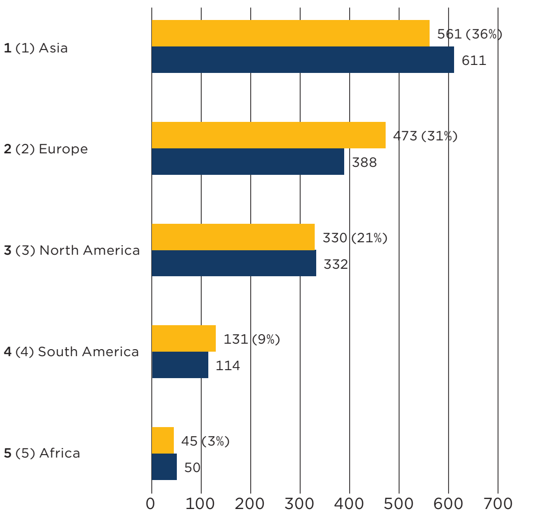
Figure 2 provides a comparative view of the foreign direct investment trend in developed countries versus emerging markets and developing economies. While investments in developing countries have primarily been aimed at establishing a presence and building new production capacity, the unmistakable peak levels in 2000, 2007 and 2015 demonstrate how an increased acquisition rate and high corporate valuations impact FDI figures in advanced economies. The stagnation of FDI is particularly evident when the developing economies are grouped together.

Figure 3 and 4 show the share of global FDI by continent as well as the most important recipient countries for FDI in 2019. Sweden achieved an 18th placement, a considerable jump from 47th place in 2018.

Figure 3

## ASIA STAYS IN THE LEAD

Recipients of foreign direct investment 2019 and 2018, USD billion and percentage share of total

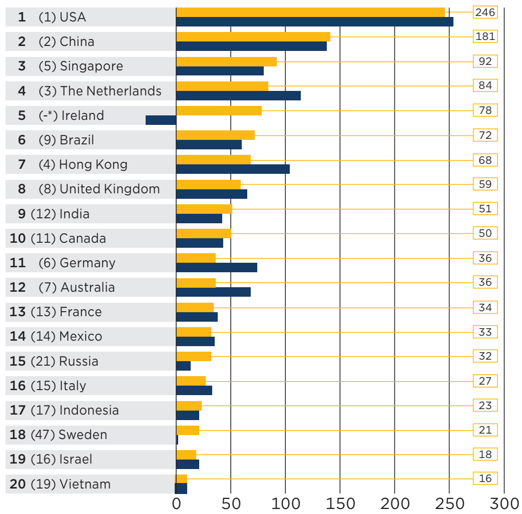



Note: 2018 rank in brackets, regional division according to UNCTAD with amendments by Business Sweden.
Sources: UNCTAD, Business Sweden (2020)

Figure 4

## TOP 20 COUNTRIES

Recipients of foreign direct investment 2019 and 2018, USD billion




Note: 2018 rank in brackets, regional division
* Ireland is not included in 2018 statistics as the country had a net outflow of FDI.
Sources: UNCTAD, Business Sweden (2020)

# FOREIGN DIRECT INVESTMENT IN SWEDEN

Sweden has been a significant host country for foreign direct investment since the mid-1990s. A number of contributing domestic and international factors have underpinned interest from overseas. Sweden's EU accession in 1995 as well as a period of extensive deregulation and privatisation of state-run companies gave foreign enterprises new incentives to exploit the potential for investments in Sweden.

## LARGE ANNUAL VARIATIONS

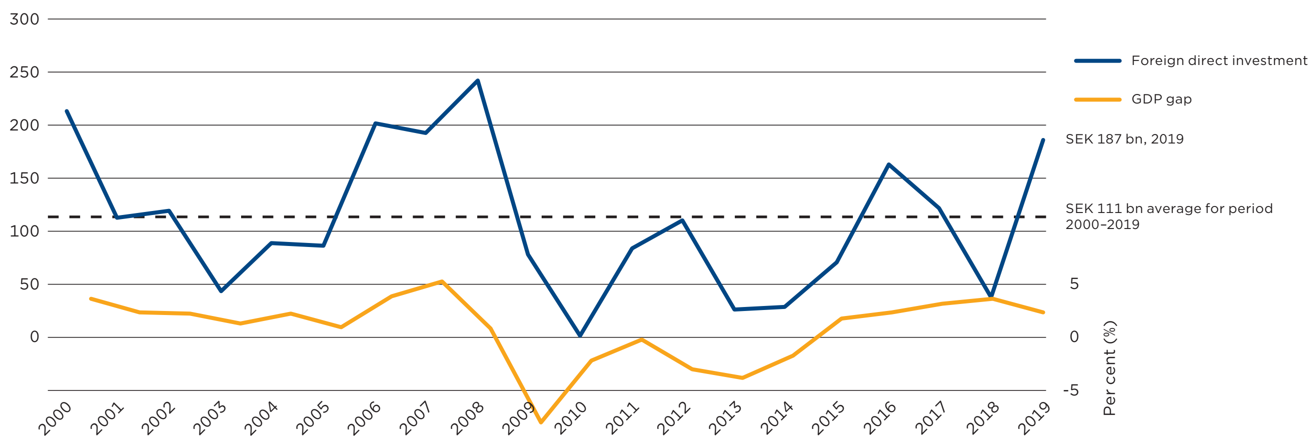
The changed structural conditions for international business coupled with Sweden's attractiveness for investors have contributed to a sharp increase in the presence of foreign enterprises over the past few decades. However, annual investments also rises and falls in line with the business cycle. The varying levels of FDI in Sweden reflect the tendency of companies to expand their operations in good times while, in periods of economic downturn, their enthusiasm for overseas expansion is markedly diminished. This somewhat erratic curve is compounded by the fact that large corporate acquisitions can leave a major footprint in statistics.

Figure 5 shows how the annual volumes of foreign direct investment in Sweden compare with the so-called GDP gap, which indicates the difference between actual and potential GDP. When the curve is above the zero mark the economy is in an expansionary phase and vice versa when it is below the zero mark. Total FDI in Sweden amounted to SEK 187 billion in 2019 (preliminary figure), which is a five-fold increase from 2018 and considerably above the average SEK 111 billion for the period 2000–2019. The increase was partly driven by the fact that around 200 corporate deals involving foreign buyers were concluded during the year.

Figure 5

SWEDEN STANDS OUT IN GLOBAL FDI TREND WITH STRONG RESULTS FOR 2019

Foreign direct investment and GDP gap in Sweden 2000–2019, SEK billion and per cent




Note: The figure for foreign direct investment 2019 is preliminary and is subject to change.
Sources: Statistics Sweden (SCB), The National Institute of Economic Research (NIER), Business Sweden (2020)

Sweden's internationalised economy helps to sustain FDI levels given that a large share of profits made through subsidiaries are reinvested in the local operations. Foreign-owned companies employ 680,000 people in Sweden. Many of the subsidiaries based in Sweden are investment-intensive and have Swedish roots including ABB, Astra Zeneca, Volvo Cars and Scania.

## NINE OUT OF TEN KRONA FROM EUROPE

As shown in Figure 6, the majority of companies with a presence in Sweden come from the Nordics and other European countries. Asian companies – above all Chinese and Indian enterprises – have increased their Swedish presence markedly over the past decade and now represent 4 per cent of total FDI in Sweden. The statistics also show that Luxembourg and the Netherlands are large investors in Sweden, but in most cases the controlling company is based elsewhere, sometimes even in Sweden.

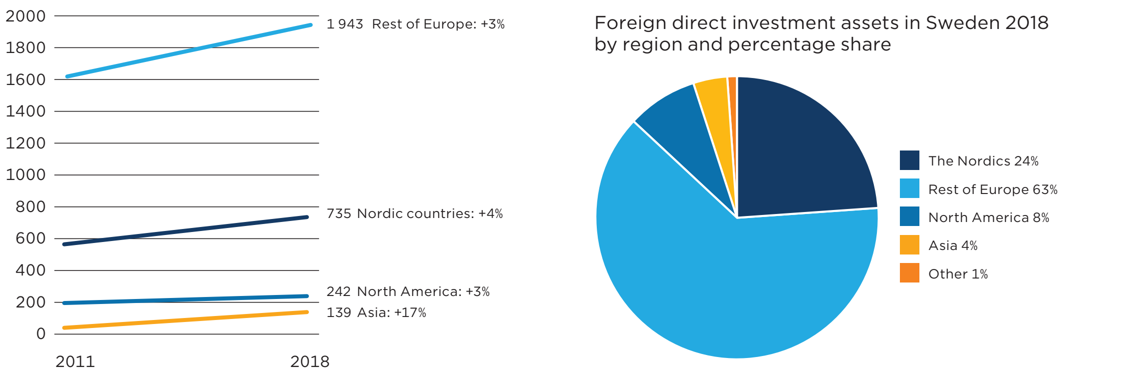
The services sector attracts 60 per cent of total foreign direct investment in Sweden and the remaining 40 per cent concerns investments in the manufacturing sector, see Figure 7. The segments attracting the most FDI in the services sector are finance and insurance (SEK 577 billion), retail and services (SEK 365 billion) and real estate (SEK 280 billion). The investments in the manufacturing sector amounted to SEK 1,188 billion in 2018. This includes segments such as chemicals and pharmaceuticals (SEK 461 billion), food (SEK 194 billion) and automotive (SEK 172 billion), see Figure 8 and 9.

Figure 8 and 9 demonstrate the share of global FDI by continent as well as the most important recipient countries for FDI in 2019. Sweden achieved an 18th placement, a considerable jump from 47th place in 2018.

Figure 6

### THE NORDICS AND EUROPE DOMINATE

Foreign direct investment stock in Sweden 2011–2018, SEK billion and average annual percentage change

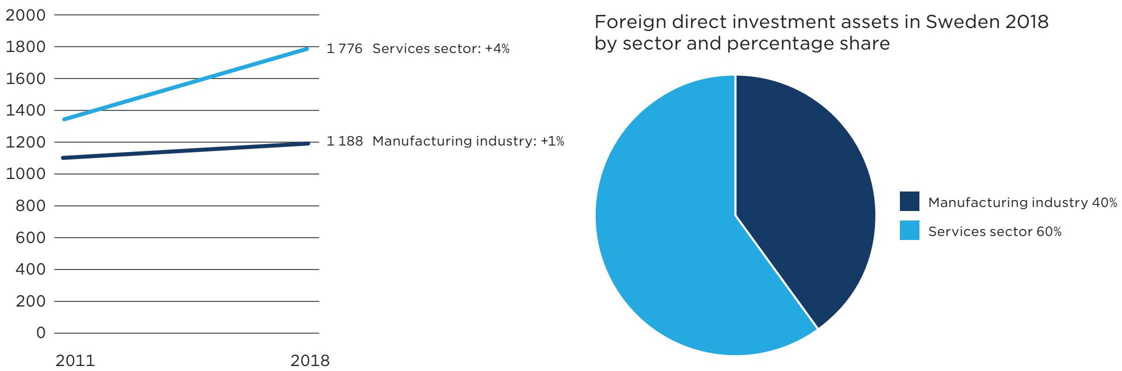



Note: Foreign direct investment assets in Sweden increased from SEK 2,463 billion in 2011 to SEK 3,079 billion in 2018.
Sources: Statistics Sweden (SCB), Business Sweden (2020)

Figure 7

### FOREIGN INVESTORS PRIMARILY FOCUSED ON SERVICES SECTOR

Foreign direct investment stock in Sweden 2011–2018, SEK billion and average annual percentage change

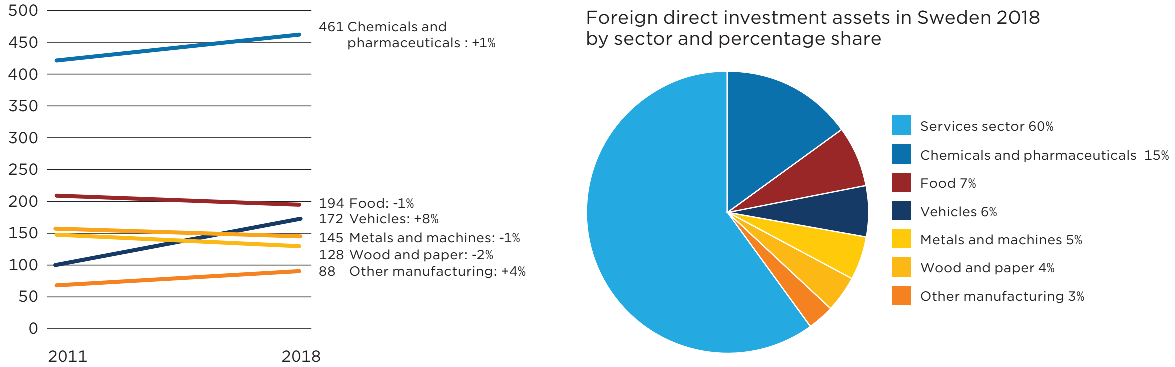



Note: The total figure of SEK 3,079 billion for 2018 does not include sector-divided assets as well as assets in the mining industry.
These assets are not reflected in the above statistics.
Sources: Statistics Sweden (SCB), Business Sweden (2020)

Figure 8

## LARGE INVESTMENTS IN CHEMICALS AND PHARMACEUTICALS…

Foreign direct investment stock in Sweden 2011–2018, SEK billion and average annual percentage change

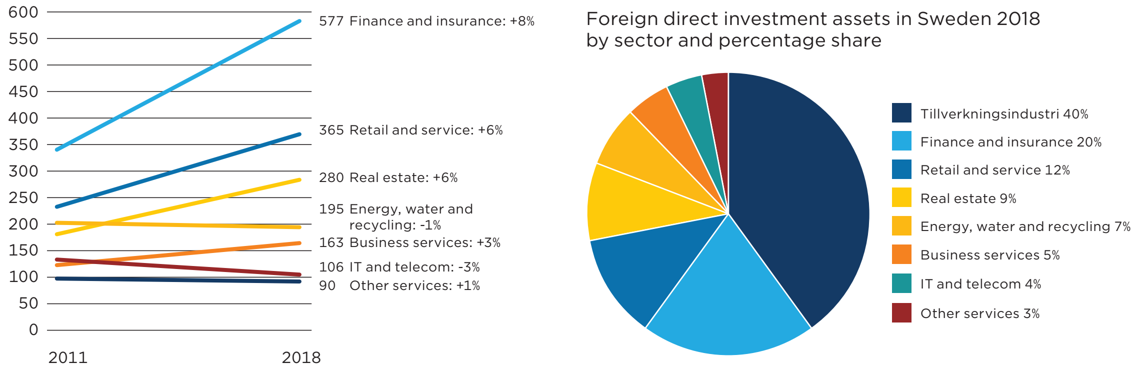



Note: The total figure of SEK 3,079 billion for 2018 does not include sector-divided assets as well as assets in the mining industry. These assets are not reflected in the above statistics.
Sources: Statistics Sweden (SCB), Business Sweden (2020)

Figure 9

## … WHILE FINANCE AND INSURANCE DOMINATE THE SERVICES SECTOR

Foreign direct investment stock in Sweden 2011–2018, SEK billion and average annual percentage change




Note: The total figure of SEK 3,079 billion for 2018 does not include sector-divided assets as well as assets in the mining industry. These assets are not reflected in the above statistics.
Sources: Statistics Sweden (SCB), Business Sweden (2020)

# THE 2025 OUTLOOK FOR INVESTMENTS

Business Sweden's trendspotting until 2025 notes the following factors that will affect global FDI levels and foreign direct investments in Sweden:

- The coronavirus pandemic has had severe negative repercussions on the global economy and the effects will be felt for many years to come. The bleak economic outlook represses the willingness of companies to invest and reduces opportunities for international expansion. Nonetheless, in relation to GDP global direct investments are at historically high levels for most countries and regions, see Figure 10.

- Beyond the horizon of the pandemic, digitalisation and the ongoing technological shift in industry will require large public and private investments. National initiatives related to the environment and sustainable manufacturing will also bring opportunities for foreign investors.

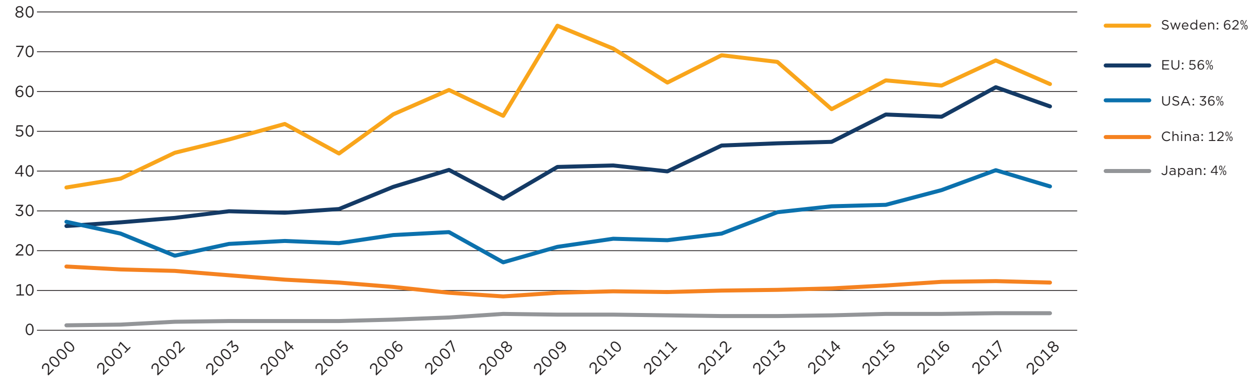
- As Business Sweden concludes in the report *The services revolution – a global opportunity for Sweden and Swedish companies* (2018) the private sector and international trade are becoming increasingly service-driven. This means that international expansions will to a far lesser degree involve large capital investments in machinery and equipment. At the same time, international acquisitions of high-valued service companies could make FDI levels surge.

- New conditions for the manufacturing industry will dampen the pace of localisation of production to low-wage countries, which has been an important driver of the sharp increase in FDI in recent decades. Increased automation, digitalisation and high customer expectations on innovation capacity and fast readjustments make it less interesting for companies to manage intermediate goods with

Figure 10

SWEDEN'S ECONOMY IS HIGHLY INTERNATIONALISED

Foreign direct investment stock 2000–2018, percentage share of GDP

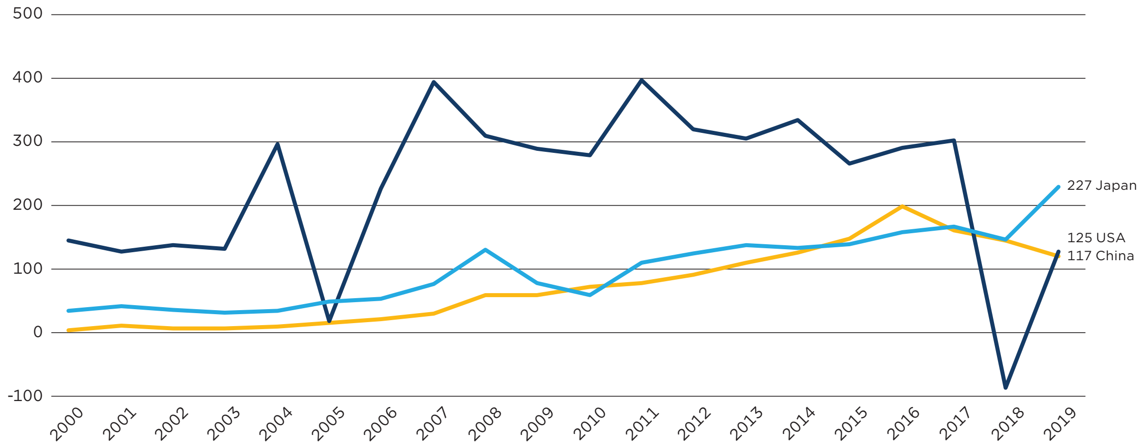



Note: The figures are stated in USD which means that the outcome is affected by exchange rate changes.
Sources: Oxford Economics, UNCTAD, amendments by Business Sweden (2020)

Figure 11

## OVERSEAS INVESTMENTS BY CHINESE COMPANIES FALL

Overseas investments by USA, Japan and China 2000-2019, USD billion




Note: the sharp decline in outward investments by US companies in 2018 can be explained by the repatriation of accumulated profits overseas, as a result of the US tax reform in 2017.
Sources: UNCTAD, Business Sweden (2020)

long delivery routes. The coronavirus pandemic could accelerate the current trend towards regionalisation of industrial production and trade, including a reorientation of supply chains pivoting towards increased local and regional supply of intermediate goods, in part to minimise vulnerability in times of crisis.

- The internationalisation of private sectors in the growth economies will continue and, in turn, drive up global FDI levels. Figure 11 illustrates the international expansion of Chinese companies since 2000. Last year, China was on par with the US but trailing Japan in a ranking of the most important countries for outward investments. Chinese overseas investments have, nonetheless, fallen in recent years.

- A hardening atmosphere in international relations and countries' increased efforts to protect companies and sectors that are considered to be critical for society and national security, have led to new regulations for scrutiny of foreign investments (investment screening). These are primarily targeted towards corporate acquisitions by foreign buyers. The expansion of Chinese companies has been the catalyst for the negative reactions from the US and Europe, linked to the lack of equal trading conditions and the perception that China is competing on different terms, with financial support from the Chinese government. Business Sweden's assessment is that that the intensified screening of some foreign investments is likely to continue for the foreseeable future, but are likely to have a limited impact on the on global FDI overall. UNCTAD has reported that approximately ten corporate acquisitions were stopped during 2019 as a result of national regulations for scrutinising foreign investments.

Sources:

The National Institute of Economic Research (NIER)
Statistics Sweden (SCB)
The Swedish Agency for Growth Policy Analysis

fD Intelligence
Mergermarket
Oxford Economics
UNCTAD

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**BUSINESS SWEDEN** Box 240, SE-101 24 Stockholm, Sweden
World Trade Center, Klarabergsviadukten 70
T +46 8 588 660 00 info@business-sweden.se www.business-sweden.se