INTERNATIONAL MONETARY FUND

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SWEDEN

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SWEDEN

August 2014

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2014 Article IV consultation with Sweden, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on August 28, 2014, following discussions that ended on June 13, 2014, with the officials of Sweden on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 30, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its August 28, 2014 consideration of the staff report that concluded the Article IV consultation with Sweden.
- A **Statement by the Executive Director** for Sweden.

The following document has been or will be separately released.

Selected Issues Paper

The publication policy for staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SWEDEN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

July 30, 2014

KEY ISSUES

Sweden's economy has re-gained speed, following supportive macroeconomic policies and strong household demand. Employment has been rising, but the labor force expanded even more, resulting in higher unemployment mostly among vulnerable groups. Inflation remains very low, driven by external and domestic factors. At the same time, financial stability risks are an increasing concern, reflecting high and rising household debt, accelerating house prices, and Sweden's very large banking system.

Addressing financial risks is the key policy priority. Policies are underway to further strengthen banks' capital, but directly containing mortgage demand is urgent now. Longer term, this should include phasing-out tax incentives that delay mortgage amortization and addressing housing supply constraints.

Monetary policy is balancing financial stability risks and concerns about low inflation. Absent decisive action to reduce financial vulnerabilities, monetary policy may have to "lean against the wind" and follow a less supportive policy course than warranted by short-term macroeconomic conditions alone. The large policy rate cut in July should help address low inflation, but adds to the urgency of quickly implementing effective macroprudential measures.

Structural measures would help achieve more inclusive labor market outcomes and reduce financial stability risks.

- *Additional labor market reforms* can help accelerate and sustain the transition of vulnerable groups into employment. Social partners should explore ways to both increase wage flexibility at the firm level and, with the government, provide training opportunities to help the vulnerable gain better-paid, higher-productivity jobs.
- *Alleviating housing constraints* would address an important underlying factor behind the rise in residential property prices especially in urban areas. This will require a continued and strong effort to significantly expand the stock of affordable housing, including additional reforms to zoning, permitting, and the rent-setting process.

It is time for fiscal consolidation. Given the strong growth outlook, fiscal consolidation will preserve the prudent borrowing capacity adequate for a small open economy with an aging population and significant contingent liabilities from a large financial sector.

Approved By
Mahmood Pradhan (EUR) and Ranil Salgado (SPR)

Discussions took place in Stockholm during June 2–13, 2014. The staff comprised of Messrs. Berger (head), Schindler, Arnold, and Chen (all EUR). Ms. Meyersson, Alternate Executive Director (OED), attended for the duration of the mission. Mr. Dowling and Ms. Colon (EUR) provided support from headquarters.

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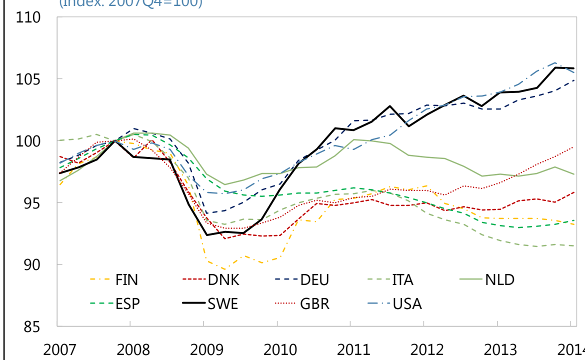
RECENT ECONOMIC DEVELOPMENTS AND OUTLOOK

A. Recent Economic Developments

1. Sweden's economy has re-gained speed. Following a moderate slowdown in 2011–12, GDP growth reached 1.6 percent in 2013, driven by accelerating private consumption in the second half of the year. This lifted real GDP at end-2013 to nearly 15 percent above its 2009 trough, compared to the EU average of less than 4 percent. Consistent with this robust performance, various methodologies point to a narrowing output gap, estimated to average about -¾ percent of potential GDP in 2013.

Recent GDP Developments

(Index: 2007Q4=100)

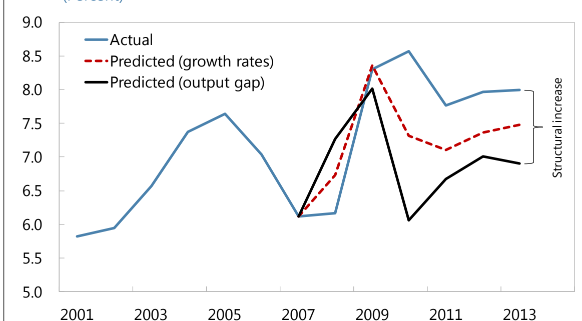


Sources: Haver Analytics and Fund staff calculations.

2. Unemployment has remained high, reflecting largely structural factors. Despite solid employment growth of around 1 percent in 2013, driven mostly by strong employment growth in the services sector, an even stronger expansion of the labor force resulted in the unemployment rate remaining flat at around 8 percent, well above its pre-crisis level of around 6½ percent. The increase in the labor force reflected both past reforms and Sweden's growing immigrant population. The increase in unemployment has been borne disproportionately by the young, the low-skilled, and the foreign-born. Combined with a reduced responsiveness of unemployment with respect to growth (i.e., Okun's law), this suggests that much of the increase in unemployment is structural.

Cyclical vs. Structural Unemployment

(Percent)



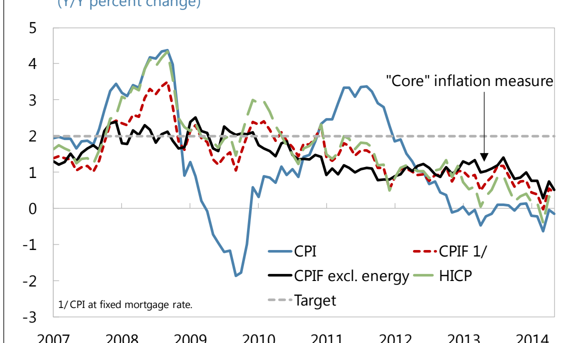
Sources: IMF World Economic Outlook and Fund staff calculations.

Note: Based on a regression of the change in (level of) unemployment on GDP growth (output gap) during 1998-2013.

3. Despite accelerating domestic demand, inflation has continued to decline. Headline consumer price index (CPI) inflation averaged 0 percent in 2013 and declined slightly to -0.2 percent in the first half of 2014.[1] Core inflation, measured as CPI with constant mortgage

Inflation

(Y/Y percent change)



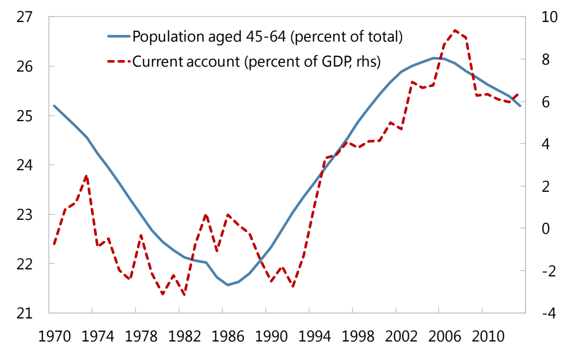
Sources: Eurostat, Haver Analytics, Statistics Sweden and Fund staff calculations.

[1] Headline CPI includes mortgage interest costs in its consumption basket. The Riksbank's preferred measure of inflation is CPI at a fixed mortgage rate (CPIF), which averaged 0.9 percent in 2013 and 0.4 percent in 2014:H1.

rates and excluding energy, averaged 1.1 percent in 2013 and 0.6 percent in the first half of 2014. In part, low inflation reflected imported global price trends and the continuing strength of the *krona*, a moderate depreciation during the second half of 2013 notwithstanding (see Box 1). Service sector inflation in particular has slowed since early 2013, partly due to second-round effects of declining fuel prices on transportation costs. Favorable unit labor cost (ULC) developments in services, with productivity improvements roughly compensating for nominal wage growth of around 2 percent in 2013, also reduced pressure on prices (see Figure 2). While inflation expectations have drifted downward, they remain relatively well-anchored at the policy horizon.

4. The large and positive external balance largely reflects structural factors. The current account surplus reached 6.4 percent of GDP in 2013, a moderate increase from 6 percent in 2012. Among the structural factors are the very large financial sector and pension and household savings patterns, which are consistent with Sweden's population aging dynamics. These trends have been reinforced by social protection reforms since the mid-1990s. In addition, Swedish investment income rose in 2013, on account of high returns from equity assets and low interest payments on debt liabilities, as did net trade in services, driven by an increase in merchanting trade. The moderate depreciation of the *krona* exchange rate helped as well. Overall, staff estimates the *krona* to be broadly in equilibrium, with Sweden's strong external position reflecting mostly structural factors (see Box 1).

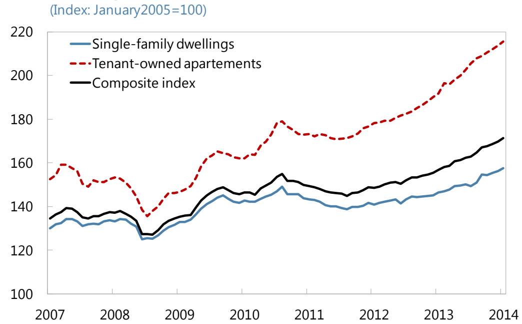
Current Account and Demographics
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

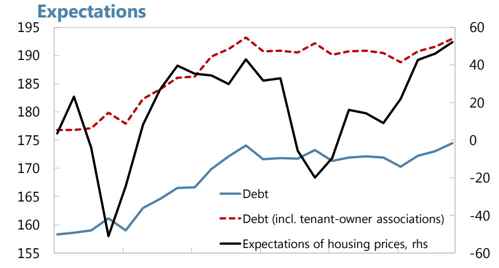
5. Housing prices and household indebtedness have increased from already high levels. Reflecting strong demand fueled by low interest rates, as well as structural factors such as ongoing urbanization and insufficient housing supply, house price increases have picked up again, at about 7½ percent annual growth for single-family homes and nearly 13 percent for tenant-owned apartments in the first half of 2014. Household credit growth remained equally strong, pushing household indebtedness to almost 175 percent of disposable income in 2013, and over 190 percent

Housing Prices
(Index: January2005=100)



Sources: Sveriges Riksbank and Fund staff calculations.

Swedish Household Indebtedness and Housing Price Expectations

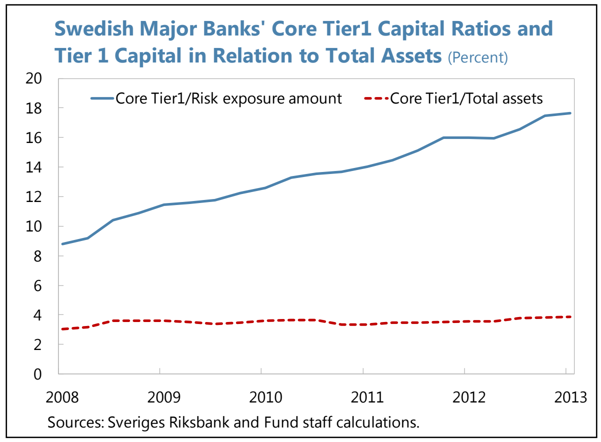


Sources: SEB, Sveriges Riksbank and Fund staff calculations.
Note: The debt ratios are expressed as shares of household disposable income. House price expectations are defined as the share of households believing housing prices will rise less the share of households believing they will fall.

if debt from tenant-owned housing associations is included. Amortization rates are very low, with about 40 percent of households having increased or failed to reduce their debt stock in 2013. Recent data indicate that debt ratios are particularly high for indebted lower-income households who are especially vulnerable to income, interest rate, and house price shocks.

6. Economic policies have supported the recovery and strengthened the resilience of the large banking sector. In particular:

- *Financial sector reforms continued.* The authorities have rolled out Basel III measures ahead of schedule, including implementing systemic risk buffers and plans to impose counter-cyclical buffer and strengthen liquidity coverage ratios (LCRs), in addition to increasing mortgage risk weights. However, with assets close to four times GDP, the Swedish banking sector is large and leverage ratios are low, having improved little in recent years.



- *Monetary policy has been supportive while stressing financial stability risks.* The Riksbank reduced the repo rate by 25 basis points in December 2013 and a further 50 basis points in July 2014, setting it at 0.25 percent, but highlighted the growing tension between addressing low inflation and further fueling household borrowing.

- *Fiscal policy remains expansionary for now.* Net lending is projected to increase to -1.9 percent of GDP in 2014, up from -1.3 percent in 2013, primarily on account of lower revenues. Given strengthening growth, this implies—at least in hindsight—a procyclical structural expansion of about ½ percent of potential GDP.

B. Outlook and Risks

7. The outlook is for accelerating growth. Real GDP growth is projected to strengthen further, to about 2.6 percent in 2014 and about 2.8 percent in 2015. Exports are expected to pick up along with euro area growth and global trade, but private consumption and investment should provide most of the dynamics, while fiscal policy is set to consolidate. With the output gap fully closing, staff expects inflation to gradually rise to around 1½ percent in 2015, as disinflationary pressures from falling imported prices dissipate and wage growth picks up.

8. Financial instability is a key downside risk. Household debt ratios have continued to rise and remain particularly high among indebted lower-income households, and the share of new mortgages with a variable rate has increased from over one half in 2012 to more than two thirds in 2013. While many households show large net asset positions, a significant share of assets is illiquid. As a consequence, adverse shocks to interest rates, house prices, or income could quickly translate into lower consumption, employment, and growth, and ultimately impact the banking system, especially if these shocks occurred at a time of high global funding stress.[2] Sweden's large and regionally connected banks are also vulnerable to a sudden increase in financial tensions in the wider Nordic region or to surges in global financial market volatility. Conversely, financial instability in Sweden would quickly spread to other Nordic and Baltic countries.[3] (See also the Risk Assessment Matrix, Box 3.)

9. Low inflation and moderating global trade also pose risks. An extended period of very low inflation could cause longer-run inflation expectations to fall significantly below the inflation target. This, in turn, could act as a drag on growth if households and firms defer expenditures in anticipation of lower prices in the future. At the same time, rising oil prices or a depreciation of the *krona* could help lift Swedish inflation above the baseline. Geopolitical tensions could lead to lower external demand.

The Authorities' Views

10. The authorities broadly agreed with staff on the outlook and the risks. They saw a recovery driven by private domestic demand and a gradual increase of inflation to the Riksbank's target of 2 percent, with risks stemming from lower external demand and financial instability related to high household debt. The authorities, however, also noted upside risks from stronger than currently anticipated global growth.

POLICY AGENDA

11. Sweden's main challenge is to reduce financial risks, while additional structural reforms will help lower unemployment.

- *Progress on the financial stability agenda is urgent.* This will take measures targeted directly at household credit demand and further strengthening banking resilience. More fundamentally, tax reforms and improving housing supply will help arrest the rise in house prices and credit growth in the medium to long term.

- *The Riksbank still has to balance financial stability and low-inflation concerns.* Effective macroprudential policy should be the first line of defense and would allow the Riksbank to pursue its inflation target with less concern about financial risks.

- *Lowering unemployment requires structural reforms.* With vulnerable groups experiencing substantially higher unemployment rates than others, there is scope for improvement.
- *The time has come for fiscal consolidation.* Fiscal policy has supported the recovery, but with

[2] See Chapter III of the 2013 Selected Issues for Sweden for a discussion of funding risks.

[3] See the 2013 Nordic Regional Report for a discussion of regional spillovers.

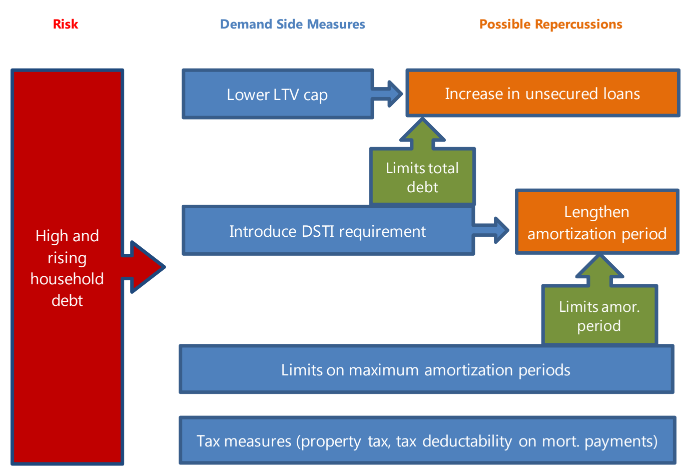
robust growth ahead, a steady consolidation path will help preserve fiscal buffers.

A. Financial Policies: Addressing Stability Risks

12. A number of financial reforms are on the way. The authorities have announced plans to further improve banks' capital buffers, including raising minimum mortgage risk weights to 25 percent at the end of 2014 and introducing Basel III measures such as systemic risk and countercyclical capital buffers. This should help to further improve the balance sheets of Swedish banks. However, reflecting very low borrowing costs and strong expectations that house prices will continue to increase, household credit has picked up again recently and, under current policies, is projected by the Riksbank to continue rising in 2014 and 2015.

13. Macroprudential policies focused more directly on mortgage demand stand a better chance of curbing credit growth. Further measures on the credit supply side are likely to have limited additional impact, not least given banks' favorable funding conditions and the low mortgage rates they allow.[4] On the demand side, following an agreement with the Financial Supervisory Authority (FSA), banks are committed to encourage new customers to agree to voluntary amortization plans. However, with no sign of credit slowing down, real progress might require the gradual introduction of mandatory amortization requirements. Such regulation has been enforced, for example, in Singapore in 2012, where new mortgages have to be amortized within 35 years.

Illustration of Demand Side Measures



Source: Fund staff calculations.

14. A gradual introduction of a debt service-to-income (DSTI) limit, combined with a lower binding loan-to-value (LTV) cap, would further help contain mortgage demand. The LTV cap of 85 percent is relatively generous compared with that in many other advanced economies. Nevertheless, in 2013, about 10 percent of households have taken on supplementary unsecured loans that were in part used to help finance house purchases. In addition, given rising housing values, even a more binding LTV cap might not keep debt-to-income ratios from rising. This suggests that adding a DSTI limit to the Swedish macroprudential toolbox could help keep debt at sustainable levels. It would tie households' debt to their income level, independent of house values,

[4] See the Selected Issues paper *Macroprudential Policies in Sweden: An Overview* for details.

and could work as an automatic stabilizer that helps contain excessive increases in credit (and asset prices) relative to income, further reducing household vulnerabilities.

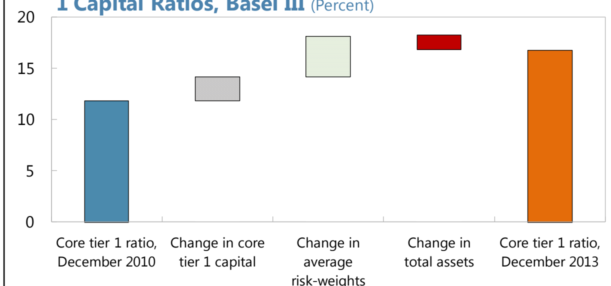
15. Mortgage interest tax deductibility contributes to high household debt by providing an incentive to accumulate debt and keep it at high levels.[5] As a result, many Swedish households are more leveraged and vulnerable to economic or financial shocks than they would otherwise be. A gradual reduction in mortgage interest deductibility—as is, for example, being done in Finland—would reduce this distortion.

16. A longer-term solution to rising house prices and mortgage levels will require alleviating housing supply constraints. Insufficient housing supply growth is a fundamental factor behind the rise in residential property prices, especially in metropolitan areas, where ongoing urbanization and immigration trends boost demand. This has resulted in higher housing prices, driving up the size of mortgages. While some steps have been taken, containing house price pressures will require a continuing effort to expand the stock of affordable housing and further reforms to zoning, permitting, and the rent-setting process. Public infrastructure investments, coordinated with municipalities, would also make private housing investments more attractive.

17. Recent progress notwithstanding, there is scope for additional measures to increase the resilience of Sweden's banking system. This includes:

- *Capital*. While the average core Tier I risk-weighted capital ratio rose from 11.8 to 16.8 percent between end-2010 and end-2013, most of the improvement reflected changes in average risk weights, in part driven by the introduction of new risk models. The average leverage ratio (measured by core Tier 1 capital as share of total assets) has increased only slightly from 3.6 percent to 3.9 percent, which remains low in comparison to other large banking systems. A higher leverage ratio requirement, such as the 5 percent minimum leverage ratio requirement proposed by the U.S. Federal Reserve, would ensure a more substantial increase in shock-absorbers. Introducing the countercyclical capital buffer at or close to 2½ percent—the maximum value subject to international reciprocity—would also help.

Development of Major Swedish Banks' Core Tier 1 Capital Ratios, Basel III (Percent)



Sources: Sveriges Riksbank and Fund staff calculations.
Note: The intermediate columns show how different factors have contributed to the change in weighted average of Swedish major banks' core Tier 1 capital ratios between December 2010 and December 2013. Lower average risk weights contributed largest part of the increase, which was partly driven by the implementation of advanced internal ratings-based models.

- *Liquidity*. Over half of Swedish bank funding comes from wholesale sources, consisting mostly of relatively short-maturity covered bonds and certificates. According to the Riksbank's measure of

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[5] Currently, mortgage interest costs up to 100,000 *krona* (in excess of capital income) can be deducted at a 30 percent income tax rate, with amounts over that deducted at a 21 percent rate.

structural liquidity, the resulting maturity mismatch has improved only marginally in recent years and remains low compared to other European banks. Rapid progress towards fulfilling the Basel III Net Stable Funding Ratio (NSFR) requirement at 100 percent would help in this regard; and introducing a minimum LCR requirement in Swedish *krona* could add to banks' ability to withstand a short-term *krona* liquidity squeeze.

18. The size and regional orientation of Sweden's banks makes cross border cooperation essential. The coordinated Nordic approach to raising mortgage lending standards in Norway—with the Swedish and Danish authorities ensuring the compliance of local bank branches—marks important progress towards the necessary macroprudential cooperation in the highly integrated regional banking market. The implementation of the EU Bank Recovery and Resolution Directive (BRRD) should allow the completion of the work of the Nordea Crisis Management Group (CMG) and facilitate a binding ex-ante burden sharing agreement. Retaining the option of Sweden joining the Banking Union would keep the door open to further improving the level of regulatory and macroprudential cooperation and coordination across the Nordic-Baltic region.

The Authorities' Views

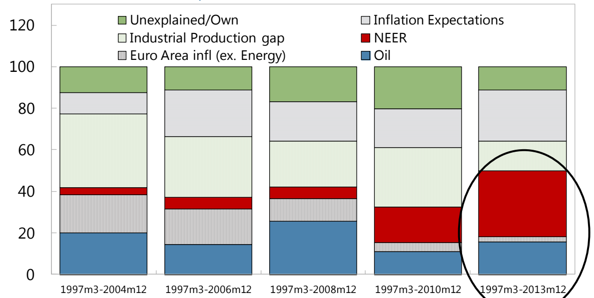
19. The authorities broadly concurred with staff's assessment of financial vulnerabilities and stressed that measures were under way to address them. They saw household indebtedness as high both from a historical and international perspective. However, they also noted that the ongoing push for higher capital and liquidity standards—often well in advance of the Basel III timetable—should help contain emerging risks. There was also support for the call for demand-side measures, with the Riksbank and the Ministry of Finance emphasizing the need to make further progress on improving the amortization culture. The FSA argued that to assess whether further policy action would be warranted, the effects of the already implemented measures, such as increased risk weights and voluntary amortization plans, needed to be evaluated first.

B. Monetary Policy: Balancing Price and Financial Stability

20. Inflation has been persistently below target, driven by a combination of external and domestic factors. "Flight to safety" dynamics in financial markets, together with relatively higher interest rates in Sweden, contributed to a strong appreciation of the *krona* and lowered import prices. In 2013, even as *krona* appreciation eased, declines in global oil and food prices created additional disinflationary pressures.[6] Domestic inflation also slowed, in part reflecting the indirect impact of lower energy prices on transportation services inflation. Moderate nominal wage growth along with slightly stronger productivity growth, helped bring aggregate ULC growth down from 2.7 percent in 2012 to 1.4 percent in 2013, reducing cost-push pressures on inflation (see Figure 2).

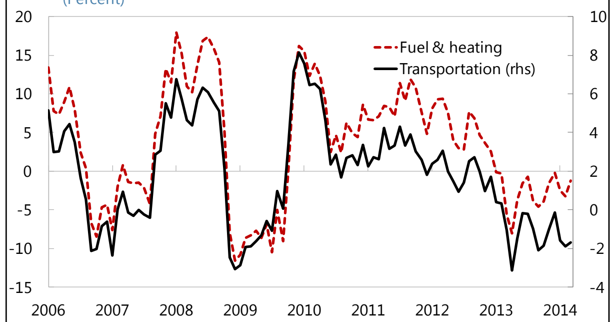
[6] See the Selected Issues paper *Low Inflation in Sweden: What's Driving It?* for details.

Swedish Inflation: VAR Variance Decomposition
(Share of variance in percent)



Sources: Eurostat, Haver Analystics, Statistics Sweden, and Fund staff calculations.
Note: This illustrates the variance decomposition of a VAR estimated over sample periods of increasing length, with sample periods ending in 2004m12, 2006m12, 2008m12, 2010m12, and 2013m12, respectively (all start in 1997m3). As the sample length increases the share of the variance explained by different variables changes, providing an indication of what factors are driving recent inflation changes.

Transportation and Fuel Price Inflation
(Percent)

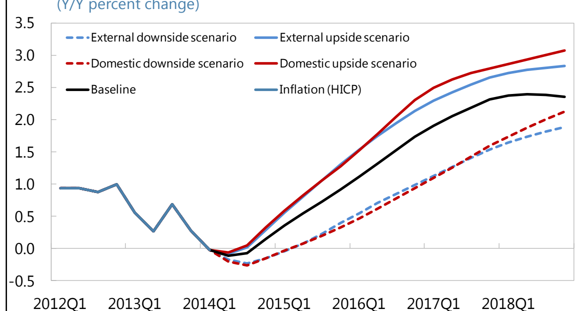


Sources: NIER, Statistics Sweden, and Fund staff calculations.
Notes: Transportation inflation is on RHS scale to better illustrate the comovement with fuel price inflation, though the latter is more volatile.

21. **Staff analysis suggests that inflation will converge back to the two-percent target, but there is uncertainty around the baseline.** A Philips curve model confirms that the forces to lift inflation from its current low level are in place, including dissipating external disinflationary pressures and a pick-up in growth supported by very low interest rates (see Box 2). However, the speed of convergence back to the target depends on the pace of domestic growth and external developments, including in particular oil price and exchange rate dynamics.

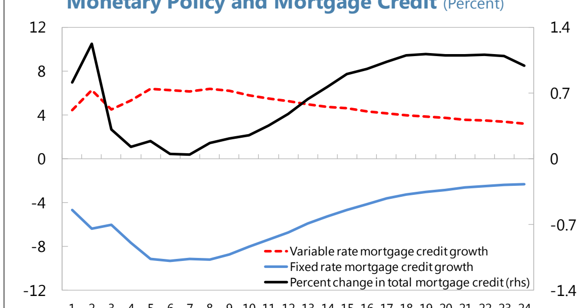
22. **As long as inflation remains low, the presence of increasing financial stability risks forces monetary policy into a difficult balancing act.** A reduction in interest rates tends to depreciate the *krona* and raise domestic demand, which should increase inflation. At the same time, lower policy rates are associated with a reduction in mortgage rates, higher overall mortgage credit growth, and a shift from fixed to variable interest rate mortgages. For example, a simple VAR exercise suggests that, over a two-year period, a 50 basis point decrease in the policy rate increases the ratio of debt to disposable income by about 2 percentage points and the share of variable rate mortgages in the total mortgage stock by about 5 percentage points. This increases financial stability risks, particularly in an environment where buoyant expectations in the housing market invite speculative price dynamics.

Simulated Inflation Paths under Different Scenarios
(Y/Y percent change)



Source: Fund staff calculations.
Note: Figure plots the stimulated inflation paths using the median model from the ones forming the baseline range.

Monetary Policy and Mortgage Credit (Percent)



Sources: Fund staff calculations.
Note: This chart depicts the impulse response functions following an exogenous 60 bp negative shock in the Stibor rate, which is equivalent to a 50bp decrease in the repo rate. Total mortgage credit growth is calculated based on the March 2014 variable and fixed rate mortgage stocks as starting points, and applying the credit growth rates separately to the corresponding stock of mortgages.

23. **The balance between price and financial stability can change.** The policy rate

cuts in December 2013 and July 2014 have reaffirmed the Riksbank's commitment to achieving its inflation objective. However, while effective macroprudential policies must be the first line of defense, a substantial rise in financial stability risks—such as a further acceleration in house price increases and mortgage credit growth—might mean interest rates will have to rise sooner than otherwise to help contain financial vulnerabilities.

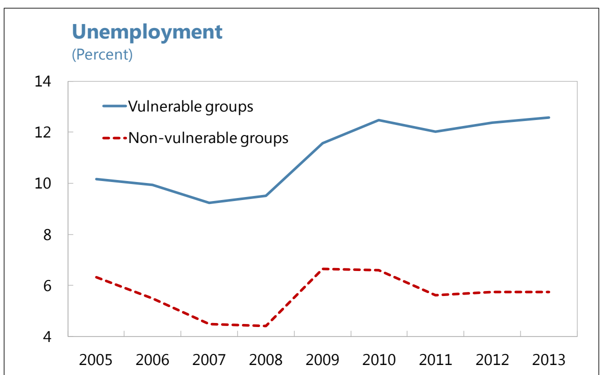
24. This only adds to the urgency of implementing a comprehensive set macroprudential policy measures to contain rising household credit. While monetary policy can "lean against the wind" to help subdue mortgage growth, higher interest rates than warranted by macroeconomic conditions alone are an economically costly instrument, as the cost of credit would increase for all borrowers, including firms. Instead, successfully addressing financial stability risks with macroprudential measures would allow monetary policy to more freely pursue its inflation target.

The Authorities' Views

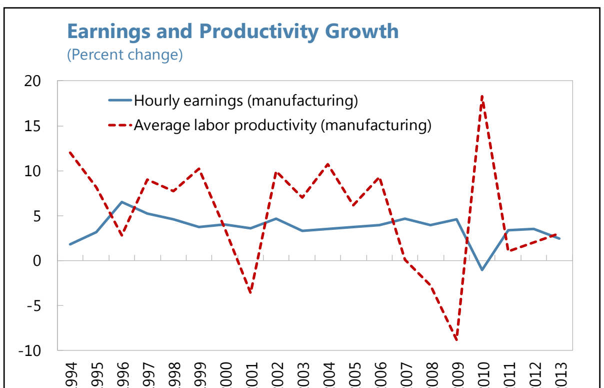
25. The authorities agreed that low inflation and rising financial stability concerns are pulling monetary policy in different directions. They welcomed further inquiries into the external and domestic sources of low inflation, including the role played by monetary policy. At the same time, they shared the view that the repo rate was not the first-best policy instrument to address financial sector risks and that, to ensure financial stability, macroprudential and fiscal policies required continued attention—especially given the recent reduction in policy rates.

C. Structural Reforms: Reducing Unemployment

26. Recent reforms and relatively strong GDP growth have fostered employment—but unemployment remains high especially among vulnerable groups. The introduction of an Earned-Income Tax Credit (EITC), reforms to disability insurance, and enhanced Active Labor Market Programs (ALMPs) have resulted in a substantial expansion of the labor force. Increased immigration inflows have added to these dynamics. Despite solid employment growth overall, unemployment rates have risen markedly among the low-skilled, especially youths, foreign-born, and older workers while they have remained low among others, suggesting that much of the rise in unemployment is structural.



Sources: Statistics Sweden and Fund staff calculations.
Notes: Vulnerable groups are individuals born outside of Europe, over the age of 55, or with low educational attainment.

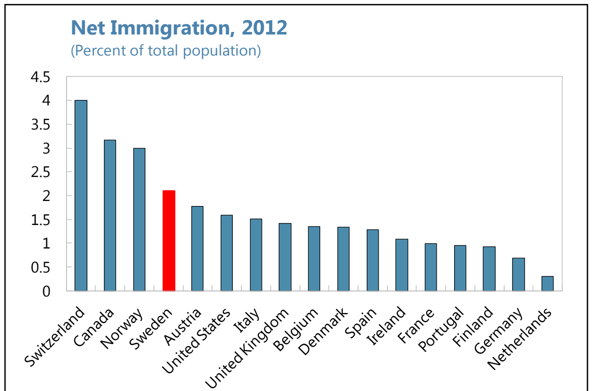


Sources: Haver Analytics, National Institute of Economic Research and Fund staff calculations.

27. Further reforms can help accelerate and sustain the transition of vulnerable groups into employment. The Swedish wage formation process has contributed to creating one of the most compressed wage distributions among OECD economies. While Sweden's collective bargaining institutions have, on average, delivered wage growth in line with productivity, a narrow wage range can limit employment opportunities at the lower end where unemployment is most pronounced. Here, social partners have an important role to play—for example, by exploring ways to increase wage flexibility at the firm level. They, and the government, can also help the young and the low-skilled add to their human capital. For example, developing vocational training programs that are aligned with employers' needs would allow these groups to gain better-paying, higher-productivity jobs. An expansion of training-based ALMPs can also help in this context.[7]

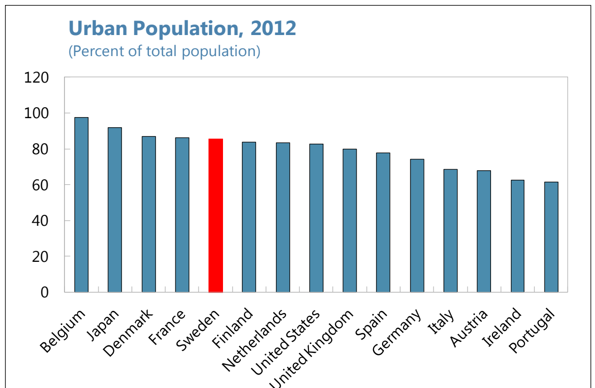
28. Addressing structural housing market constraints will facilitate labor mobility and improve financial stability. High urbanization rates and immigration flows have added to high and rising demand for housing and boosted residential property prices.

- Meeting this demand will require *expanding the supply of affordable housing*, including by tackling well-known problems with zoning regulations and adjusting the rent setting mechanism, which can prevent the efficient allocation of the existing stock of properties and, by keeping the average rent below market levels, limits incentives for the construction of rental properties.[8] Exempting new construction from rental regulations for longer than is currently the case would help.



Sources: World Development Indicators and Fund staff calculations.

- *Tax reforms* also have a role to play. The capital gains tax acts as a deterrent to moving and complicates the efficient allocation of the existing stock of housing. A reform in this area could be complemented by an increase in the property tax on private residences. Property taxation, reduced in 2008 to a municipal property fee capped at 0.75 percent, is below the values in many other advanced countries, such as up to 4 percent in the U.S. and up to 3 percent in Denmark.



Sources: World Development Indicators and Fund staff calculations.

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[7] See the Selected Issues paper *The Swedish Labor Market—Responding to Global Challenges* for details.

[8] See Boverket Market Report (Fall 2013).

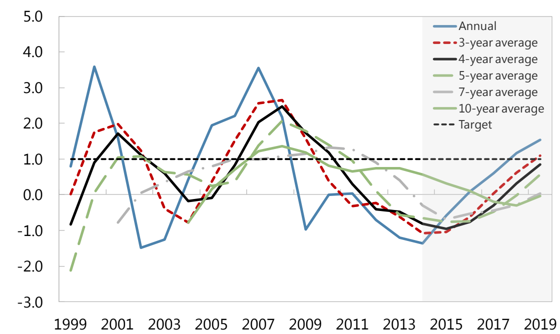
The Authorities' Views

29. The authorities shared staff's concern over high unemployment and housing market rigidities. They were concerned over the high level of unemployment and how vulnerable groups are affected. The authorities noted that the persistent recession, combined with an expansion of the labor force, has contributed to the relatively high unemployment rate. However, there were differing views among the authorities on whether the high level of unemployment is mainly cyclical or structural. On housing, the authorities agreed with the need to address supply constraints and noted several measures they had already taken and that over time are expected to increase housing supply. However, in this context, they saw little scope for substantial tax reforms in the near term.

D. Fiscal Consolidation: Moving To Protect Buffers

30. Fiscal policy is rightly turning toward consolidation. Underpinned by the "*krona*-for-*krona*" strategy, which requires any reforms to be (at least) counterfinanced, the government has suggested a structural consolidation path with annual adjustments of about ½ percent of potential GDP starting in 2015. On staff's numbers, this would help achieve a headline fiscal surplus of above 1 percent of GDP by 2018 and reduce the public debt-to-GDP ratio to around 30 percent of GDP, from nearly 42 percent currently (see the DSA in the Appendix). The Swedish fiscal framework requires a 1 percent surplus "over the cycle," a target chosen to build up sizable fiscal buffers. While the length of a "cycle" is open to interpretation, under most definitions the target will not be met until later.

General Government Net Lending
(Percent of GDP)



Sources: Sweden Ministry of Finance and Fund staff calculations.

31. The current fiscal framework serves Sweden well. While public debt is not high, prudent policy requires maintaining a borrowing capacity at or below this level—in line with the potentially large contingent government liabilities arising in a small open economy with an aging population and a large financial sector.[9] This means making clear progress towards the current net lending target and keeping it in place for some time. In this context, there are synergies between fiscal consolidation needs and efforts to rein in financial stability risks, including gradual reforms of mortgage interest deductibility and the property tax to contain mortgage credit growth.

[9] The 2013 Staff Report estimated the contingent liabilities from financial sector risks alone to be in the range of 17 to 90 percent of GDP, depending on the severity of the underlying event and the resolution approach.

The Authorities' Views

32. **The authorities were in broad agreement with the staff's fiscal assessment.** They agreed on the importance of adhering to the ambitious consolidation plan to retain the credibility of the fiscal framework. They also saw the need to further strengthen fiscal buffers given the size of Sweden's banking sector and the associated risks, and to ensure the possibility for fiscal policy to weather serious economic downturns without incurring large deficits. The authorities saw no substantial need for modifications of the framework in the near future. The Ministry of Finance also noted that it saw higher spare capacity than estimated by staff.

STAFF APPRAISAL

33. **Sweden's economy is doing well.** Growth is gaining speed ahead of many European peers, helped by buoyant household consumption and supportive macroeconomic policies. Employment has been rising, but the labor force expanded even more. The resulting increase in unemployment is largely structural, borne disproportionately by the young, the low-skilled, and the foreign-born. Inflation is low, reflecting global commodity price trends and a still strong *krona*. Domestically, lower imported energy prices and moderate nominal wage growth along with strong productivity gains have reduced cost pressures. While Sweden's external position is moderately stronger than the level consistent with medium-term fundamentals and desirable policies, structural factors, including demographics and the large banking sector, explain much of Sweden's high and persistent current account surplus. This suggests that the *krona* is moderately undervalued or close to its equilibrium level.

34. **However, financial stability risks are high and increasing.** Sweden's banking system is large and wholesale-dependent, and household debt has grown to 190 percent of disposable income on some measures while house prices are increasing rapidly. Behind this are very low interest rates and structural factors, such as housing supply constraints and tax incentives that keep amortization rates low. With indebtedness particularly high among lower-income households, their vulnerability to income, interest rate, and house price shocks is high as well.

35. **Containing mortgage demand is urgent.** Policies to further strengthen banks need to continue, including higher mortgage risk weights and the introduction of many Basel III measures ahead of schedule. However, there is little evidence that mortgage credit or house price growth is slowing in the current low-interest rate environment. This will require macroprudential measures directly targeting credit demand, including the gradual introduction of statutory amortization rates if voluntary measures remain ineffective, lower LTV caps, and the introduction of DSTI limits to improve households' resilience to shocks. More fundamentally, gradually phasing-out the tax deductibility of mortgage interest rates would reduce incentives to accumulate debt.

36. **Longer term, housing supply rigidities need to be addressed.** A fundamental factor behind the growth in Swedish housing prices and mortgage lending is insufficient housing supply growth in the face of strong urbanization trends. A number of policies are available to expand the

stock of affordable housing, including continuing reforms to zoning, permitting, and the rent-setting process, and through public infrastructure investments. In addition, it will be important to improve the allocation of the existing housing stock—for example through a tax reform that reduces capital gains taxation while raising very low property tax rates.

37. Monetary policy still has to balance price and financial stability risks. The outlook is for a gradual increase in inflation, as external disinflationary forces dissipate and the output gap is set to close on the back of strong GDP growth. However, while the policy rate cut to 0.25 percent in July 2014 will help in this regard, very low interest rates are also likely to fuel household borrowing. In the absence of effective macroprudential measures, a further acceleration in housing prices and mortgage credit growth could mean that interest rates will have to rise sooner than otherwise to help reduce the resulting financial stability risks. This will require careful consideration of the trade-off between the possible impact on the recovery and the ultimate cost of rising financial vulnerabilities. It also adds to the urgency of implementing a comprehensive set macroprudential policy measures to contain household credit demand.

38. Structural unemployment requires structural reforms. High unemployment is concentrated among vulnerable groups where the gap between entry-level sectoral wages and productivity can be large. Social partners have an important role to play, both by exploring ways to increase wage flexibility at the firm level and, together with the government, to develop vocational training programs that are aligned with employers' needs. This would help the vulnerable add to their human capital, which would allow them to gain better-paying, higher-productivity jobs.

39. It is time for fiscal consolidation. Given the strong growth outlook, 2015 is the right time to embark on a consolidation path towards the one-percent net lending surplus target over the cycle. Doing so would help preserve the prudent borrowing capacity adequate for a small open economy preparing for an aging population and facing potentially significant contingent liabilities from a large financial sector.

40. It is recommended that Sweden remains on the standard 12-month Article IV consultation cycle.

Box 1. Current Account, External Assessment and the Equilibrium Real Exchange Rate

Since its trough in early 2009, the *krona* has appreciated nearly 20 percent against the euro and in real effective terms, partly driven by safe-haven flows reflecting Sweden's relatively strong growth and solid fiscal position.[1] Despite this, the IMF's External Balance Assessment (EBA) methodology, using data up to June 2014, suggests that the *krona* remains substantially undervalued relative to the value consistent with medium-term fundamentals and desirable policies. Similarly, the EBA approach estimates Sweden's current account to have exceeded the level implied by fundamentals and policies in 2013 by about 8½ percent. These results are reflective of Sweden's relatively large and persistent current account surplus, which reached 6.4 percent of GDP in 2013.

External Balance Assessment (EBA) Methodologies, 2013 1/

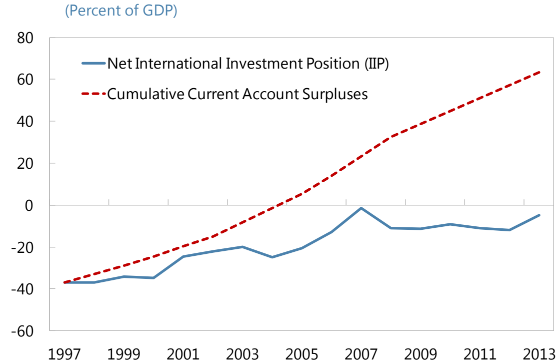
Methodology	CA gap *(percent of GDP)*	REER gap *(percent)*
EBA CA Analysis	8.4	-28
EBA REER Analysis	-	-6
Staff Assessment	-½ to +3½	-10 to +2

Source: Fund staff calculations.

1/ CA gaps: minus indicates overvaluation. REER gaps: minus indicates undervaluation. EBA estimates are based on data available as of June 2014.

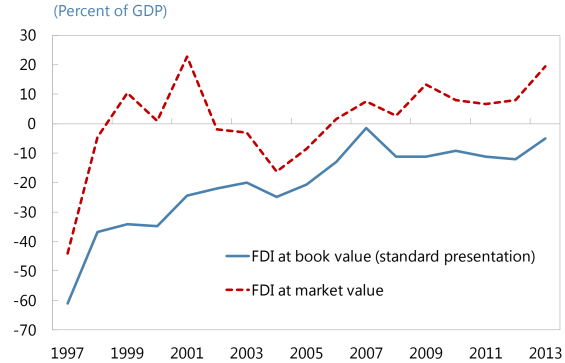
In 2013, gross external assets reached 298.5 percent of GDP and gross external liabilities at 304.0 percent of GDP, including sizable external liquid liabilities from Sweden's large banking sector. The resulting Swedish net international investment position (IIP) of -5.6 percent of GDP in 2013 is a substantial improvement from -12.7 percent in 2012, but the discrepancy between the recorded net IIP and the balance implied by cumulative past current account balances has widened over time. Valuation effects account for much of the difference. For example, if FDI was valued at market prices, instead of the standard book value, the Swedish net IIP would be nearly 25 percentage points higher in 2013.

Net IIP vs. Cumulative Current Account
(Percent of GDP)



Sources: Sveriges Riksbank and Fund staff calculations.

Net IIP: Valuation Effects
(Percent of GDP)



Sources: Sveriges Riksbank and Fund staff calculations.

A number of factors are important when evaluating the Swedish external position:

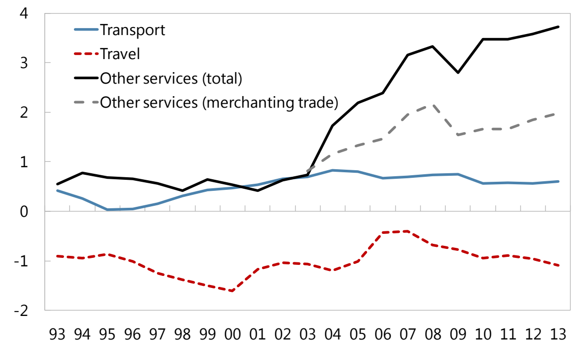
- The *krona* is *freely floating* and there are no significant policy gaps that would impact the current account.
- *Demographic factors* tend to influence the current account but these can be difficult to capture fully in a cross-country approach such as the EBA. Sweden's high saving rate is not unusual for an aging society, and has been reinforced by pension and other social protection reforms since the mid 1990s, notably a phased shift to a defined contributions pension scheme and a progressive shrinkage in transfers. High private savings tend to be associated with high capital exports and current account surpluses (see also the text figure in ¶4).
- In addition, the EBA-estimated gap does not reflect important other *structural factors* shaping the current account. Sweden operates as regional financial center for the Nordic region (with total assets about four times GDP, Sweden's banks are among the largest in Europe) and plays a significant role in merchanting trade[2]. Both characteristics have been shown to lead to persistently larger current

Box 1. Current Account, External Assessment and the Equilibrium Real Exchange Rate (concluded)

account balances, with merchanting trade in particular having accounted for a substantial share of the past decade's current account dynamics.

In staff's view, this suggests that a significant part of the Swedish current account surplus is structural in nature and likely to persist into the medium term. Staff assesses Sweden's adjusted current account norm to be around 2–6 percent of GDP and the current account gap to be in the range of -½ to +3½ percent of GDP in 2013. In line with this, the REER gap is assessed to be in the range of -10 to +2.

Net Trade in Services
(Percent of GDP)



Sources: Sveriges Riksbank and Fund staff calculations.

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[1] A moderate nominal depreciation against the euro and the dollar since December 2013, in part reflecting reductions in the repo rate, still leaves the *krona* in a position of relative strength.

[2] Merchanting trade refers to transactions in which a resident purchases a good from a non-resident and subsequently resells the good to another non-resident without the good entering the resident merchant's economy. The difference between the value of goods when acquired and when sold represents the value of merchanting services provided.

Box 2. Inflation Simulations Based on a Philips Curve Model

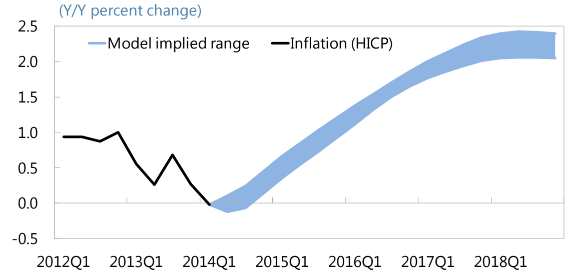
Swedish inflation is projected to reach the 2-percent target towards the end of 2016. However, with a number of external and domestic factors at play, there is uncertainty in both directions. To allow for a more structured discussion, a simple, small open economy Philips curve is estimated based on the following equation:

$$\pi_t = \alpha_1 + \alpha_2 \pi_{t-1} + \alpha_3 y_t + \alpha_4 \pi_t^{EA} + \alpha_5 oil_t + \alpha_5 NEER_t + \varepsilon_t$$

where π is HICP inflation in Sweden and y is the output gap estimated based on the Hodrick-Prescott filter (with λ = 1,600). Euro area core inflation (π_t^{EA}) is used to capture imported inflation from Sweden's main trading partners, in addition to oil prices (oil_t) and the nominal effective exchange rate ($NEER_t$).[1] The disturbance term ε_t can be seen as representing supply (cost-push) shocks, and the lagged inflation term represents adaptive inflation expectations. The model is estimated by two-stage least-squares (2SLS) using quarterly data during 1994Q1–2013Q4. Alternative estimation approaches, including GMM and system estimation, yield similar results.

Simulated Inflation Paths with Different Models

(Y/Y percent change)



Source: Fund staff calculations.

Note: The model implied range refers to the simulated inflation paths (not the WEO projections) generated using the same baseline assumptions but with the three different models as explained in the box. This exercise focuses on HICP which tends to be below Swedish CPI during periods of increasing interest rates, as in the assumed baseline.

The estimated model allows the simulation of alternative scenarios of inflation going forward. While not an inflation forecast, the exercise sheds light on some of the factors entering staffs' projections. In a baseline scenario, the output gap is assumed to close by early 2015, while the euro area recovery drives up euro area core inflation, and the oil price continues to decline. In this scenario, simulations suggest that HICP inflation will exceed 1½ percent in mid-2016 and converge to the 2-percent mark sometime between end-2016 and mid-2017 (see the text chart above).[2]

Alternative assumptions about domestic growth, the euro area recovery, and energy price dynamics alter the simulated inflation path. To illustrate possible deviations from the baseline simulation, four scenarios are considered:

Scenario 1: *External Downside Scenario*. Euro area inflation reaches currently predicted levels only with a two-year delay; imported oil prices fall by 20 percent by end of 2018; and the *krona* strengthens by 1 percentage point a year over the simulation horizon.

Scenario 2: *External Upside Scenario*. Euro area inflation reaches 2 percent by end of 2016, two years earlier than in the baseline projection; and the NEER depreciates moderately as safe haven flows dissipate.

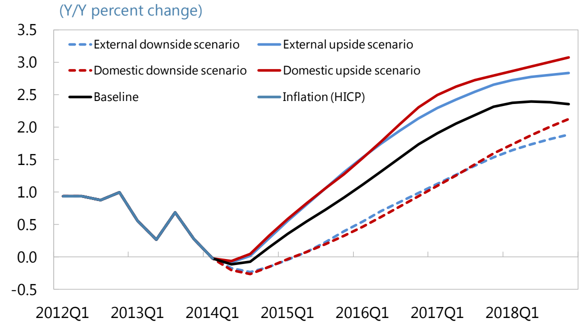
Scenario 3: *Domestic Downside Scenario*. The Swedish output gap closes by around end-2016, two years later than in the baseline scenario.

Scenario 4: *Domestic Upside Scenario*. The Swedish output gap closes by end of 2014, and the Swedish economy will be running a slightly larger (positive) output gap than in the baseline during 2016-2018.

Box 2. Inflation Simulations Based on a Philips Curve Model (concluded)

The simulation results show that under the downside scenarios, the expected pick-up in inflation would be delayed until mid-2018, converging to the target of 2 percent with a 6-8 quarter delay relative to the baseline. Conversely, under the upside scenarios, inflation would reach 2 percent already 2-4 quarters earlier, in early 2016.

Simulated Inflation Paths under Different Scenarios
(Y/Y percent change)



Source: Fund staff calculations.
Note: Figure plots the stimulated inflation paths using the median model from the ones forming the baseline range.

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[1] Euro area core inflation is used instead of the headline CPI to avoid potential endogeneity as oil is separately included as an explanatory variable in the Philips curve model.

[2] In the Riksbank's July 2014 forecast, CPIF inflation (which is very similar to the HICP) reaches 2 percent in 2016, while CPI inflation is projected to rise to around 3 percent reflecting the impact of forecast repo rate hikes.

Box 3. Sweden: Risk Assessment Matrix[1/]

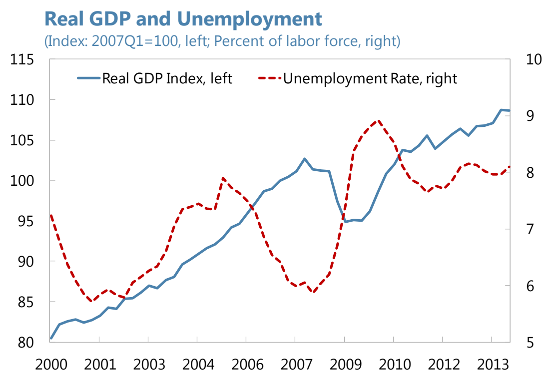
Potential Deviations from Baseline

Source of Risks	Overall Level of Concern	
	Relative Likelihood	**Impact if Realized**
1. Surges in global financial market volatility.	**High** • Triggered, e.g., by geopolitical tensions or revised market expectations on UMP exit. • Swedish banks are reliant on wholesale funding and directly and indirectly exposed to international financial markets.	**Medium** • Bank losses and funding stress could translate into curtailed lending, with negative effects for investment, consumption, and growth. • Adverse impact could be partially mitigated by safe-haven flows.
Policy response:	Preventively, reduce vulnerabilities of the financial sector and preserve fiscal buffers. In the event, provide liquidity support, including in foreign currency using Sweden's large borrowed reserves and possible swap arrangements.	
2. Protracted period of slow European growth.	**High** • Exacerbated, e.g., by geopolitical tensions. • Sweden's exports are tightly linked to European markets.	**Medium** • As exports and income decline, domestic demand will slow as well, further reducing growth.
Policy response:	Provide monetary support, let automatic fiscal stabilizers operate, consider slowing structural fiscal adjustment.	
3. Significant house price decline in Sweden (or an interconnected neighboring Nordic country).	**Medium** • Household debt is high due to easy access to credit, low interest rates, and housing tax incentives. • Property prices remain elevated. • Swedish banks are active throughout the Nordic region.	**High** • The flow-on effect to consumption and employment will lower growth. • Rising non-performing loans (NPLs) and bank funding costs, e.g., during times of high global financial stress, could translate into curtailed lending, with negative effects on investment.
Policy response:	Preventively, reduce vulnerabilities in the housing market through macroprudential measures. Failing to do so will add to the risk. In the event, lower the policy rate and provide liquidity support to banks.	
4. Significant and lasting decline in inflation expectations leading to lower growth.	**Low** • Following a strong negative shock to inflation (e.g., linked to much weaker euro area growth or dropping global energy prices), inflation and inflation expectations drop persistently to very low or negative levels. • Wage growth could fall to very low or negative levels along with inflation.	**Medium** • This could drag down growth if households and firms deferred expenditure in anticipation of lower prices in the future. • Falling nominal income could trigger debt sustainability issues for households.
Policy response:	Lower the policy rate and keep low for longer; reconsider fiscal consolidation.	

[1/] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

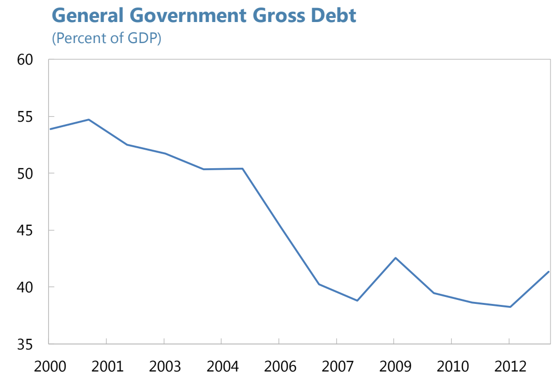
Figure 1. Sweden: Macroeconomic Indicators

Output is recovering strongly, but unemployment persists at high levels.



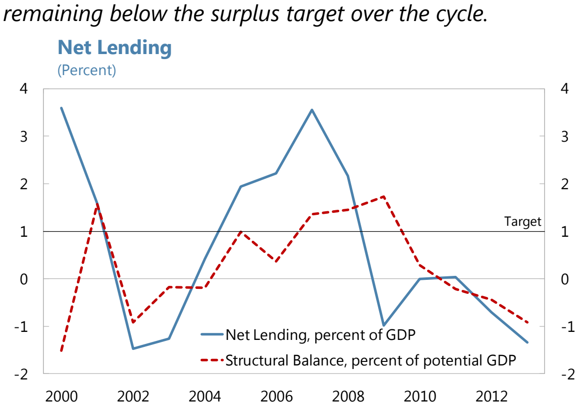
Sources: Statistics Sweden and Fund staff calculations.

Public debt is low but recently has increased slightly...



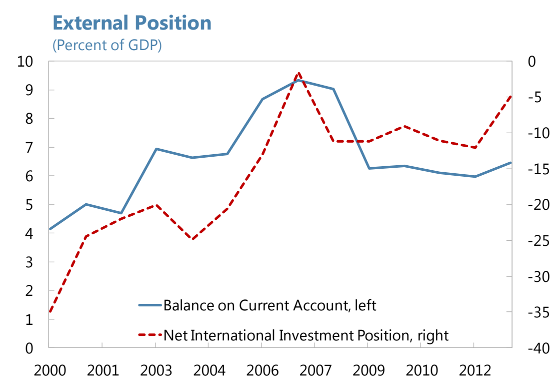
Sources: IMF World Economic Outlook and Fund staff calculations.

...as fiscal policy has been supportive, with net lending remaining below the surplus target over the cycle.



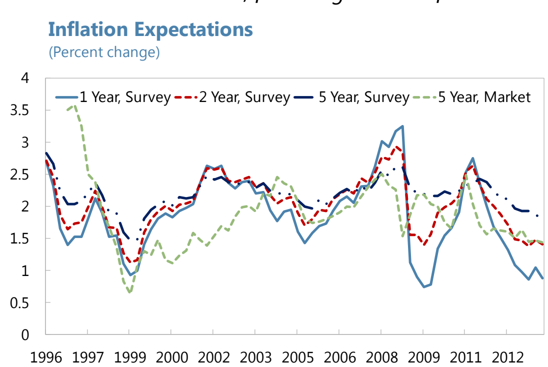
Sources: IMF World Economic Outlook, Sweden Ministry of Finance and Fund staff calculations.

The current account has stabilized at a high level.



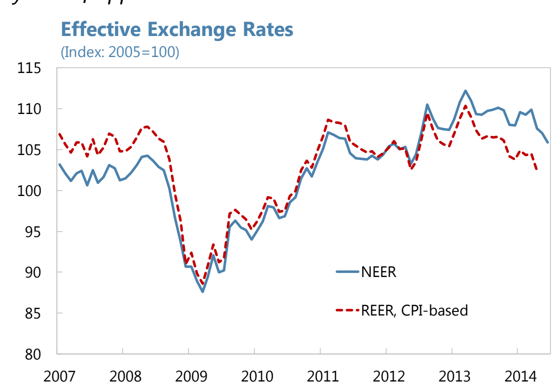
Sources: IMF World Economic Outlook, Statistics Sweden and Fund staff calculations.

Inflation expectations have edged downwards, in particular at the short end, following actual inflation...



Sources: Sveriges Riksbank, TNS Prospera and Fund staff calculations.

...even though the krona recently stabilized after almost 4 years of appreciation.

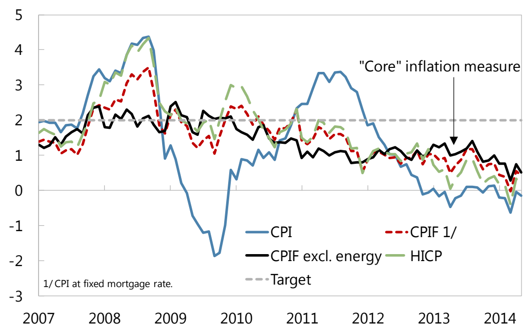


Sources: IMF International Financial Statistics, Sveriges Riksbank and Fund staff calculations.

Figure 2. Sweden: Inflation and Monetary Policy

Inflation has trended down since 2010…

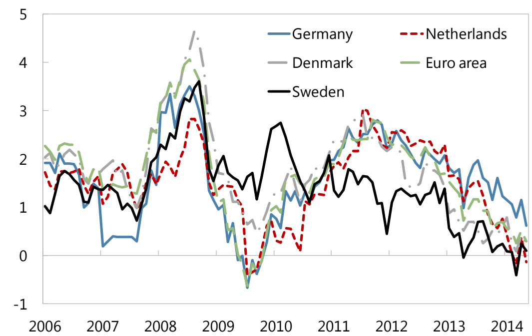
Inflation
(Y/Y percent change)



Sources: Eurostat, Haver Analytics, Statistics Sweden and Fund staff calculations.

…though this is hardly unique to Sweden.

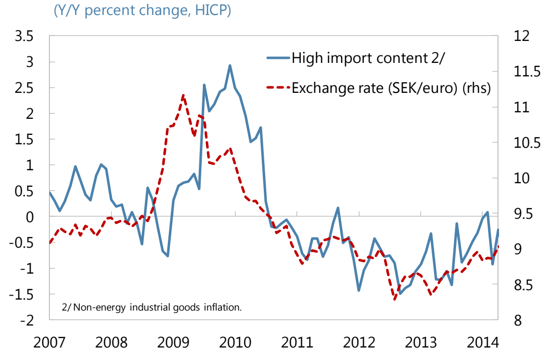
Inflation in Sweden and Select Trade Partners
(Y/Y percent change, HICP at constant tax rates)



Sources: Eurostat and Fund staff calculations.

Imported disinflation, linked in part to a stronger krona, played a role, while more recently…

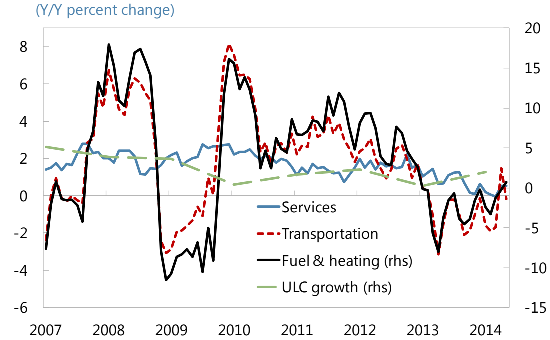
Imported Inflation and the Exchange Rate
(Y/Y percent change, HICP)



Sources: Eurostat, Haver Analytics, Statistics Sweden and Fund staff calculations.

…lower fuel prices and slower ULC growth have pulled down services inflation, especially for transportation.

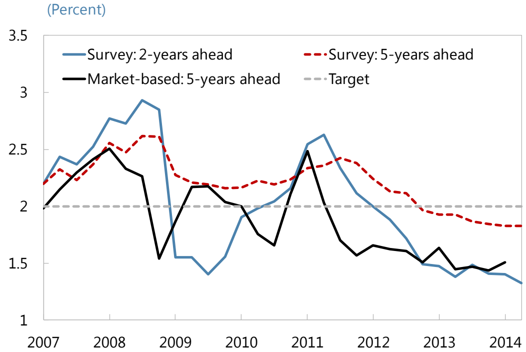
Services Inflation, Unit Labor Costs and Fuel Prices
(Y/Y percent change)



Sources: Eurostat, Haver Analytics, NIER, Statistics Sweden and Fund staff calculations.

Long-term inflation expectations remain close to the 2 percent target, but shorter-term expectations are lower…

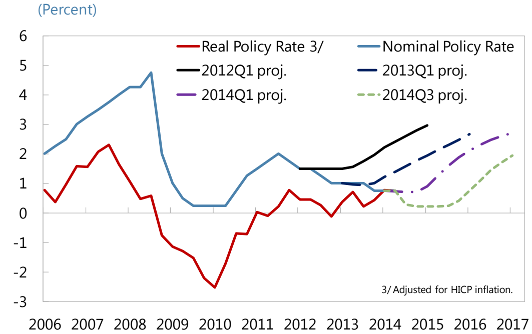
Inflation Expectations
(Percent)



Sources: Sveriges Riksbank, TNS Prospera and Fund staff calculations.

…and the Riksbank has recently lowered policy rates as well as its policy rate forecast.

Real Policy Rate, Nominal Policy Rate and Forecasts
(Percent)

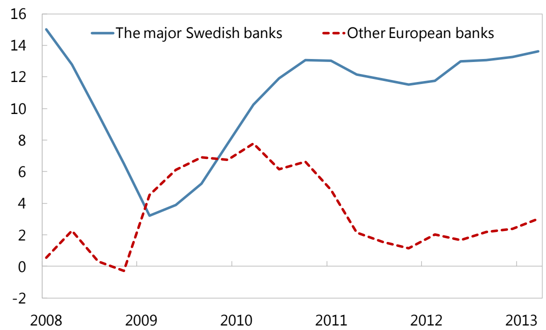


Sources: Haver Analytics, Statistics Sweden, Sveriges Riksbank and Fund staff calculations.

Figure 3. Sweden: Performance of the Banking System

Swedish banks are more profitable than many European peers...

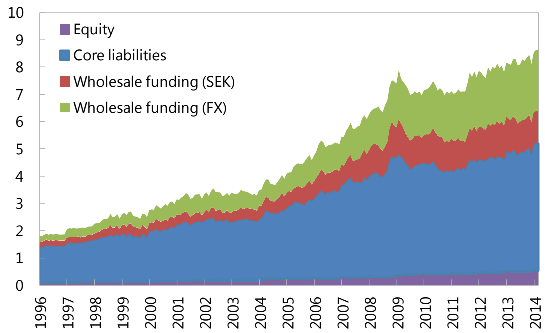
Swedish Banks' Return on Equity
(Percent, rolling 4 quarters)



Sources: Sveriges Riksbank and Fund staff calculations.

...driven, in part, by an increasing share of low-cost foreign-currency-denominated wholesale funding.

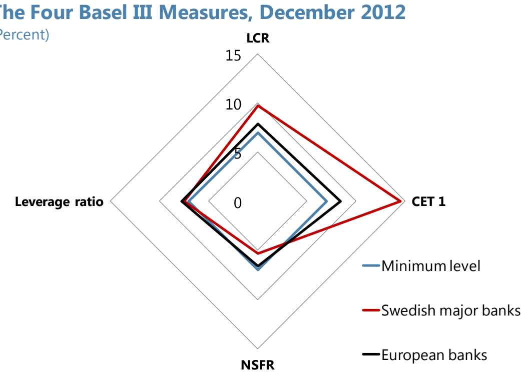
Swedish Banks' Funding Structure
(Trillions of SEK)



Sources: Statistics Sweden, Sveriges Riksbank and Fund staff calculations.

Banks' CET1 ratio is above the European average, but their leverage ratio is underperforming...

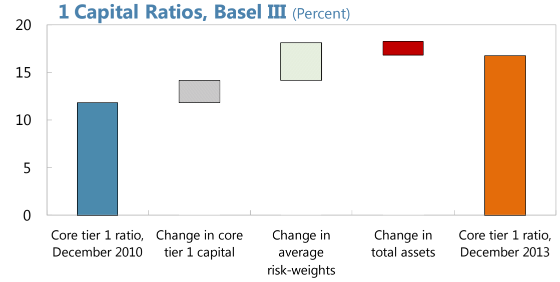
The Four Basel III Measures, December 2012
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

...as improvements in CET1 ratios were driven by changes in risk weights.

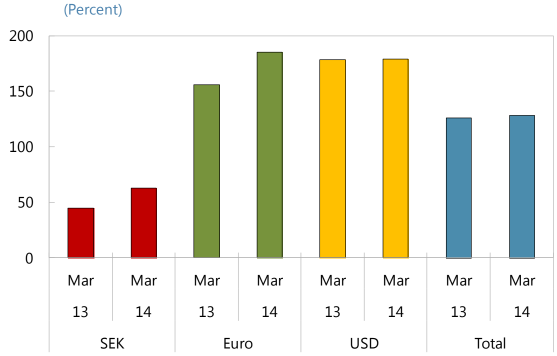
Development of Major Swedish Banks' Core Tier 1 Capital Ratios, Basel III (Percent)



Sources: Sveriges Riksbank and Fund staff calculations.
Note: The intermediate columns show how different factors have contributed to the change in weighted average of Swedish major banks' core Tier 1 capital ratios between December 2010 and December 2013. Lower average risk weights contributed largest part of the increase, which was partly driven by the implementation of advanced internal ratings-based models.

Banks have further strengthened their liquidity positions...

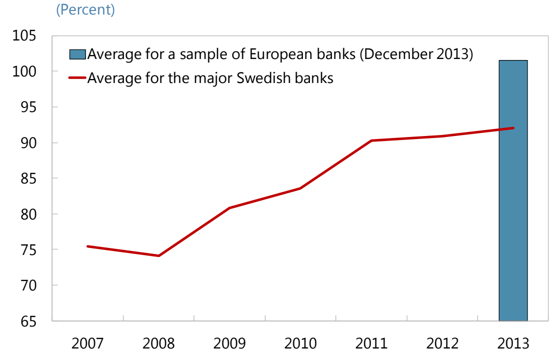
The Major Swedish Banks LCR
(Percent)



Sources: Finansinspektionen, Sveriges Riksbank and Fund staff calculations.

...but improvements in structural liquidity have slowed and its level remains below the European average.

Riksbank's Structural Liquidity Measure
(Percent)

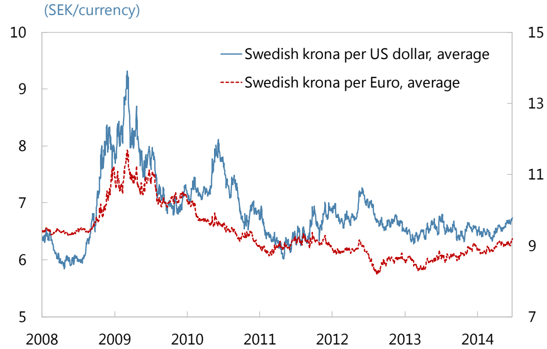


Sources: Sveriges Riksbank and Fund staff calculations.

Figure 4. Sweden: Selected Financial Market Indicators

Since the global financial crisis, the krona has remained appreciated against key currencies...

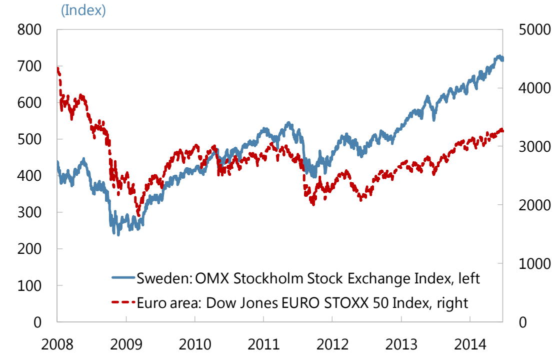
Exchange Rates
(SEK/currency)



Sources: Bloomberg and Fund staff calculations.

...while Swedish equities exceed their pre-crisis values.

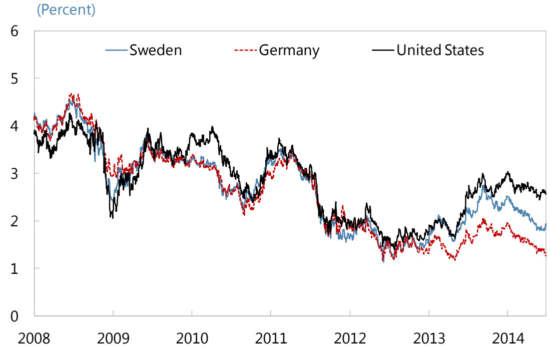
Stock Indices
(Index)



Sources: Bloomberg and Fund staff calculations.

Swedish sovereign bond yields are very low, but have recently picked up along with U.S. rates...

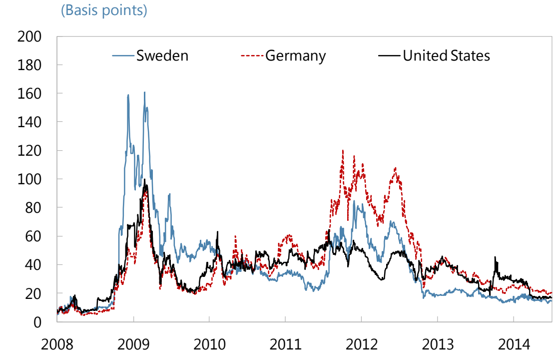
10 Year Government Bond Yields
(Percent)



Sources: Bloomberg and Fund staff calculations.

...while sovereign CDS spreads remain close to or below key AAA economies.

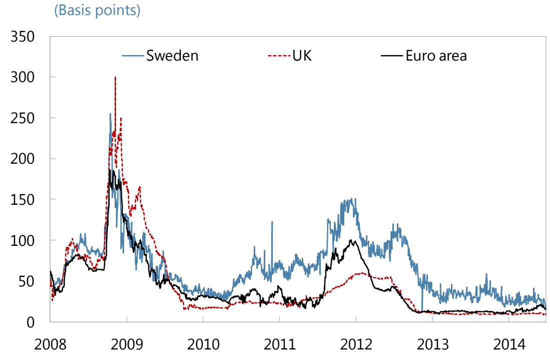
5 Year CDS Spreads
(Basis points)



Sources: Datastream and Fund staff calculations.

Interbank rates fell further and are below pre-crisis levels...

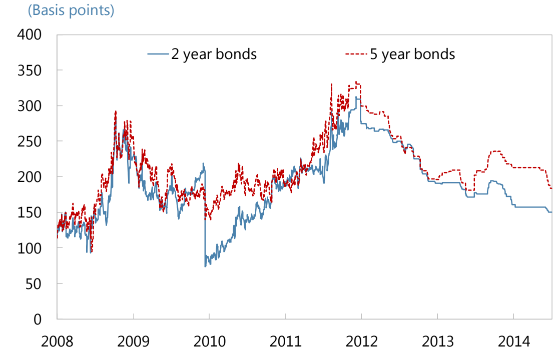
Spread of 3 Month Interbank Rates
(Basis points)



Sources: Bloomberg, Datastream and Fund staff calculations.

...and mortgage bond yields have declined since 2011.

Spread Between Mortgage and Government Bond Yields
(Basis points)

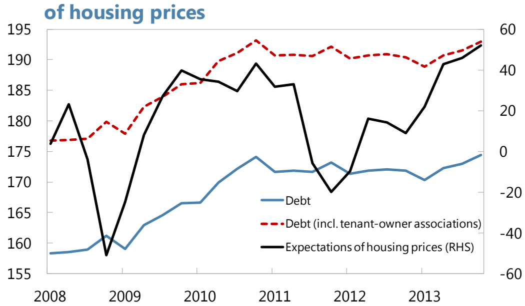


Sources: Datastream and Fund staff calculations.

Figure 5. Household Balance Sheets and Consumption

Swedish households' debt is high and rising…

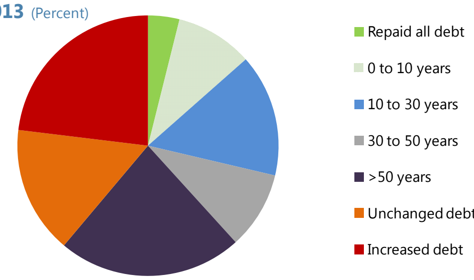
The Swedish Households' Debt and Expectation of housing prices



Sources: The Riksbank and SEB
Note: The debt ratios are expressed as a share of household's disposable income. The expectation of housing prices is defined as the difference between the percentage of households who believe bousing prices will fall.

…and households have little incentive to pay down their existing debt.

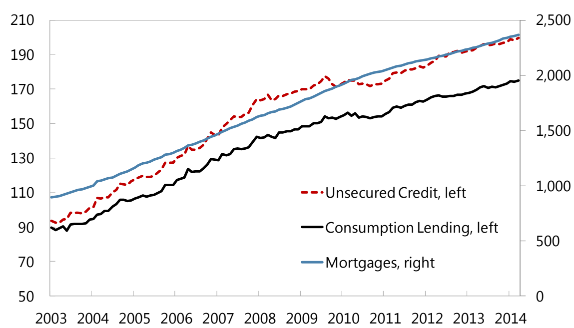
Proportion of Mortgage Borrowers That Have Increased, Decreased, or Kept Their Debt Unchanged Between 2012 and 2013 (Percent)



Sources: Sveriges Riksbank and Fund staff calculations.
Note: The chart shows how deficit balance of mortgage holders changed between 2012 and 2013 and the average repayment period if those who reduce their debts do so at the same rate as during the period.

Household debt consists mostly of mortgage loans, but unsecured borrowing has also increased…

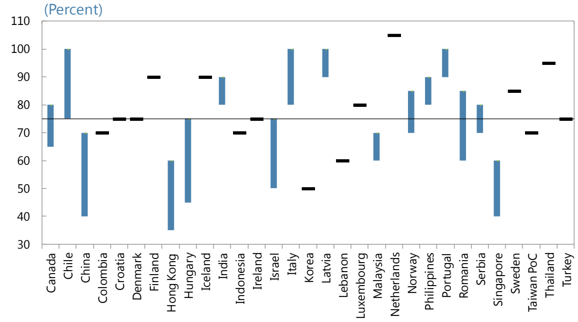
MFIs' Unsecured and Consumption Lending to Households
(Billions of SEK)



Sources: Statistics Sweden, Sveriges Riksbank and Fund staff calculations.

…while the recently introduced LTV cap is less restrictive than in many other countries.

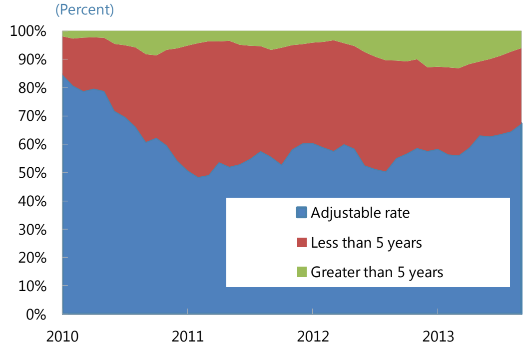
Limits on LTV Ratios
(Percent)



Sources: National authorities and Fund staff calculations.
Note: When calculating the sample average LTV, the mid-point of LTV ranges was used.

At the same time, the share of new variable-rate mortgages is increasing, driven by low interest rates…

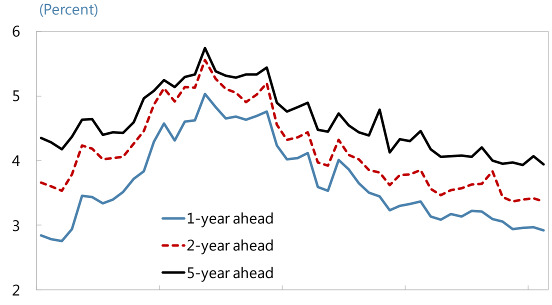
Fixed-rate Periods in Sweden for New Mortgages
(Percent)



Sources: Statistics Sweden and Fund staff calculations.

…and by households' expectations of continued low (or lower) interest rates.

Households' Mortgage Rate Expectations
(Percent)

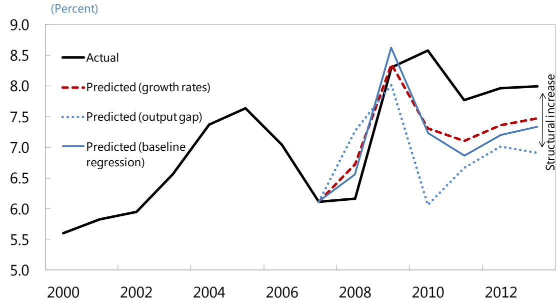


Sources: NIER and Fund staff calculations.
Note: The households' mortgage-rate expectations refer to expectations regarding the variable mortgage rate.

Figure 6. Sweden: Labor Market Indicators

Much of the post-crisis increase in unemployment has been structural...

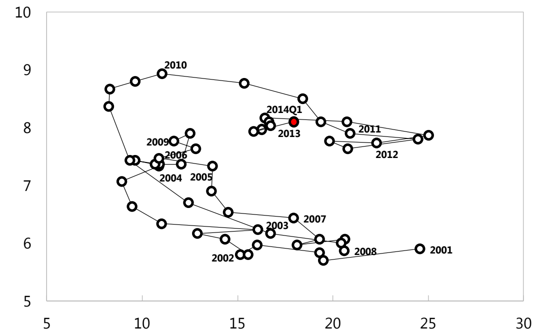
Okun's Law
(Percent)



Sources: IMF World Economic Outlook and Fund staff calculations.
Note: Based on a regression of the change in (level of) unemployment on GDP growth (output gap) during 1998-2013. The third series is based on the baseline regression (column 1) in Table 1 and includes both inflation and the output gap during 1960-2013.

...reflecting, in part, a decline in labor market matching efficiency.

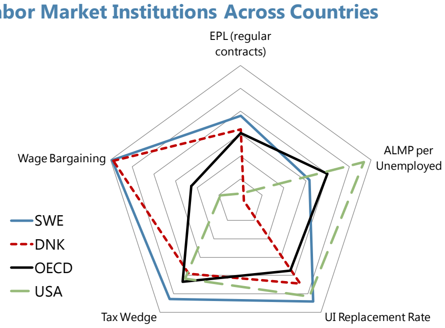
Beveridge Curve
(X-axis: thousands; Y-axis: percent of labor force)



Sources: Statistics Sweden and Fund staff calculations.

Swedish labor market institutions are unique, with strong collective bargaining and high replacement rates...

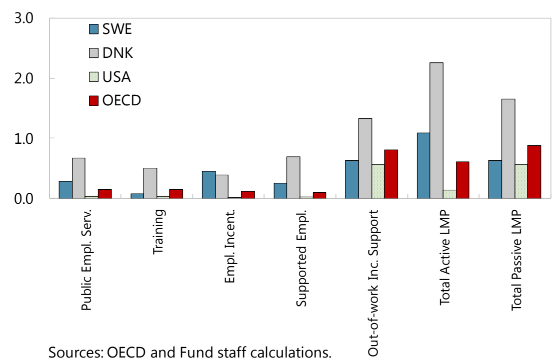
Labor Market Institutions Across Countries



Sources: European Commission, OECD and Fund staff calculations.
Notes: Larger distances from the center are associated with higher unemployment rates. The upper limit is scaled by the maximum values observed in the OECD in 2011 (inverted scale for ALMP per unemployed).

...while training-related ALMP expenditures are not as high as elsewhere.

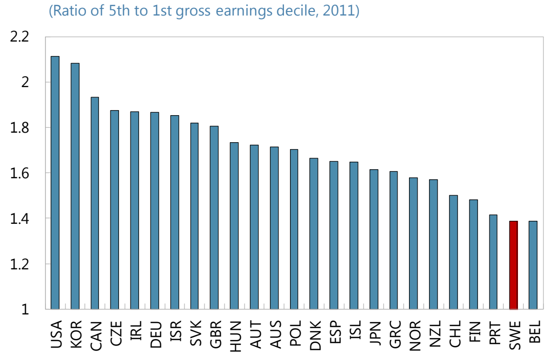
Labor Market Program Expenditures
(Percent of GDP)



Sources: OECD and Fund staff calculations.

Wages are highly compressed, including at the lower end...

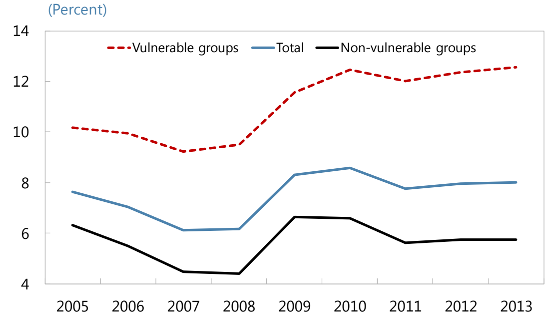
Wage Dispersion
(Ratio of 5th to 1st gross earnings decile, 2011)



Sources: OECD and Fund staff calculations.

...contributing to particularly high unemployment rates among vulnerable groups.

Unemployment Rates Among Subgroups
(Percent)



Sources: Statistics Sweden and Fund staff calculations.
Notes: Vulnerable groups are individuals born outside of Europe, over the age of 55, or with low educational attainment.

Table 1. Sweden: Selected Economic Indicators, 2011–19

				Projections					
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
Real economy (in percent change)									
Real GDP	2.9	0.9	1.6	2.6	2.8	2.7	2.6	2.5	2.4
Domestic Demand	3.2	0.3	1.6	2.8	2.4	2.6	2.7	2.7	2.6
CPI inflation	3.0	0.9	0.0	0.1	1.4	1.9	2.1	2.1	2.0
Unemployment rate (in percent)	7.8	8.0	8.0	8.1	7.7	7.5	7.4	7.3	7.1
Gross national saving (percent of GDP)	26.0	24.9	24.6	25.6	25.9	26.3	26.6	26.9	27.2
Gross domestic investment (percent of GDP)	19.5	18.8	18.4	19.1	19.3	19.7	20.1	20.6	21.1
Output Gap (as a percent of potential)	0.5	-0.5	-0.8	-0.5	0.3	0.7	1.0	0.9	0.8
Public finance (in percent of GDP)									
Total Revenues	51.5	51.4	51.7	50.3	50.9	51.2	51.2	51.2	51.2
Total Expenditures	51.5	52.1	53.0	52.2	51.4	51.1	50.6	49.9	49.5
Net lending	0.0	-0.7	-1.3	-1.9	-0.6	0.1	0.6	1.3	1.7
Structural balance (as a percent of potential GDP)	-0.2	-0.4	-0.9	-1.6	-0.7	-0.2	0.2	0.8	1.3
General government gross debt, official statistics	38.6	38.3	40.5	41.8	40.7	38.5	35.9	32.6	29.1
Money and credit (year-on-year, percent change, eop)									
M1	0.9	5.9	9.0	...	...	...	...	...	...
M3	6.9	3.1	3.1	...	...	...	...	...	...
Bank lending to households	6.0	11.7	3.8	...	...	...	...	...	...
Interest rates (year average)									
Repo rate (end of period)	1.8	1.0	0.8	...	...	...	...	...	...
Three-month deposit rate	1.7	1.3	0.9	...	...	...	...	...	...
Ten-year government bond yield	2.6	1.6	2.1	...	...	...	...	...	...
Balance of payments (in percent of GDP) 2/									
Current account	6.1	6.0	6.4	6.0	6.1	6.1	5.9	5.8	5.6
Trade balance	5.3	5.3	5.3	4.9	5.0	5.0	4.9	4.7	4.6
Foreign Direct Investment, net	-3.2	-2.4	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
International reserves, changes (in billions of US dollars)	-0.7	-0.5	-14.6	...	...	...	...	...	...
Reserve cover (months of imports of goods and services)	2.8	2.7	3.5	3.4	3.2	3.1	2.9	2.7	2.6
Exchange rate (period average, unless otherwise stated)									
Exchange rate regime					Free floating exchange rate				
SEK per U.S. dollar (as of July 24, 2014)					6.8				
Nominal effective rate (2010=100)	105.7	107.0	110.1	...	...	...	...	...	...
Real effective rate (2010=100) 1/	97.0	98.3	100.4	...	...	...	...	...	...
Fund Position (May 31, 2014)									
Holdings of currency (in percent of quota)					78.5				
Holdings of SDRs (in percent of allocation)					92.6				
Quota (in millions of SDRs)					2395.5				

Other Indicators

GDP per capita (2013, USD): 58.014; **Population** (2013, million): 9.6; **Main products and exports**: Machinery, motor vehicles, paper products, pulp and wood; **Key export markets**: Germany, Norway, United Kingdom

Sources: Haver Analytics, IMF Institute, Sveriges Riksbank, Sweden Ministry of Finance and Fund staff calculations.
1/ Based on relative unit labor costs in manufacturing.
2/ Based on Balance of Payments Manual 5.

Table 2. Sweden: General Government Statement of Operations, 2012–19

	2012	2013	2014	2015	2016	2017	2018	2019
			Projections					
					Billions of SEK			
Revenue	1,825	1,882	1,893	1,996	2,102	2,204	2,305	2,408
Tax revenue	1,309	1,362	1,359	1,442	1,524	1,601	1,675	1,750
Taxes on income, profits, and capital gains	636	664	682	713	755	800	844	882
Payable by individuals	540	568	579	605	639	677	710	742
Payable by corporations	95	96	102	108	116	123	134	140
General taxes on goods and services	448	459	467	483	501	520	539	563
Other Taxes	225	238	210	246	269	281	293	306
Social Contributions	275	273	279	288	299	312	325	340
Grants	3	3	3	3	3	3	3	3
Other revenue	238	244	252	263	275	289	302	316
Interest income	33	33	34	36	38	39	41	43
Expenditure	1,850	1,930	1,962	2,018	2,098	2,177	2,248	2,328
Compensation of employees	504	522	540	554	569	589	610	637
Intermediate consumption	323	350	362	377	395	414	433	452
Interest payments	33	31	35	37	38	38	38	38
Social benefits	645	673	660	676	708	735	751	766
Expense not elsewhere classified	306	316	329	338	349	362	377	393
Net acquisition of nonfinancial assets	38	38	37	35	38	40	40	41
Gross operating balance	13	-11	-33	13	42	68	97	122
Net lending / borrowing	-25	-49	-70	-22	4	28	57	80
Net financial worth, transactions	-12							
Net acquisition of financial assets	-25							
Net incurrence of liabilities	-11							
					Percent of GDP			
Revenue	51.4	51.7	50.3	50.9	51.2	51.2	51.2	51.2
Tax revenue	36.9	37.4	36.1	36.8	37.1	37.2	37.2	37.2
Taxes on income, profits, and capital gains	17.9	18.2	18.1	18.2	18.4	18.6	18.7	18.7
Payable by individuals	15.2	15.6	15.4	15.4	15.6	15.7	15.8	15.8
Payable by corporations	2.7	2.6	2.7	2.7	2.8	2.9	3.0	3.0
General taxes on goods and services	12.6	12.6	12.4	12.3	12.2	12.1	12.0	12.0
Other Taxes	6.3	6.5	5.6	6.3	6.5	6.5	6.5	6.5
Social Contributions	7.7	7.5	7.4	7.3	7.3	7.3	7.2	7.2
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Interest income	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Expenditure	52.1	53.0	52.2	51.4	51.1	50.6	49.9	49.5
Compensation of employees	14.2	14.3	14.4	14.1	13.9	13.7	13.5	13.5
Intermediate consumption	9.1	9.6	9.6	9.6	9.6	9.6	9.6	9.6
Interest payments	0.9	0.9	0.9	1.0	0.9	0.9	0.8	0.8
Social benefits	18.2	18.5	17.5	17.2	17.3	17.1	16.7	16.3
Expense not elsewhere classified	8.6	8.7	8.7	8.6	8.5	8.4	8.4	8.4
Net acquisition of nonfinancial assets	1.1	1.0	1.0	0.9	0.9	0.9	0.9	0.9
Gross operating balance	0.4	-0.3	-0.9	0.3	1.0	1.6	2.1	2.6
Net lending / borrowing	-0.7	-1.3	-1.9	-0.6	0.1	0.6	1.3	1.7
Net financial worth, transactions	-0.3							
Net acquisition of financial assets	-0.7							
Net incurrence of liabilities	-0.3							
Structural Balance (percent of potential GDP) 1/	-0.4	-0.9	-1.6	-0.7	-0.2	0.2	0.8	1.3
Fiscal Impulse (expansionary +)	0.2	0.5	0.7	-0.9	-0.4	-0.4	-0.7	-0.6
Memorandum items:								
Compliance with fiscal rule								
Overall balance 10-year average	0.6	0.6	0.3	0.1	0.0	-0.2	-0.2	0.0
Overall balance 7-year rolling average (±3 years)	0.8	0.3	-0.4	…	…	…	…	…
Structural balance (percent of potential GDP) 2/	-0.4	-0.9	-1.6	-0.7	-0.3	0.1	0.8	1.3
Gross Public Debt (percent of GDP)	38.3	40.5	41.8	40.7	38.5	35.9	32.6	29.1
Real GDP growth (percent change)	0.9	1.6	2.6	2.8	2.7	2.6	2.5	2.4
Output gap (percent of potential GDP)	-0.5	-0.8	-0.5	0.3	0.7	1.0	0.9	0.8
Nominal GDP (in billions of SEK)	3550	3641	3762	3922	4106	4302	4503	4705

Sources: 2008-2013 Fiscal Policy Bills and Fund staff calculations.

1/ Structural balance takes into account output and employment gaps.

2/ Overall balance adjusted for the output gap, based on authorities' measure.

Table 3. Sweden: Public Sector Balance Sheet

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
					(In billions of SEK)					
Assets	**2,981**	**3,097**	**3,333**	**3,575**	**3,681**	**3,503**	**3,743**	**3,867**	**3,875**	**3,990**
Financial assets	1,559	1,674	1,909	2,150	2,256	2,077	2,315	2,438	2,446	2,560
Currency and deposits	50	48	52	76	73	119	79	65	90	75
Securities other than shares	211	232	262	317	349	362	366	399	397	425
Loans	318	329	355	376	383	406	499	504	533	548
Shares and other equity	725	790	931	1,074	1,116	921	1,088	1,150	1,128	1,203
Other financial assets	256	275	310	308	335	269	282	320	298	309
Capital stock net of depreciation	1,421	1,422	1,423	1,424	1,425	1,426	1,427	1,428	1,429	1,430
Liabilities	**1,560**	**1,608**	**1,696**	**1,600**	**1,555**	**1,601**	**1,621**	**1,645**	**1,730**	**1,732**
Financial liabilities	1,560	1,608	1,696	1,600	1,555	1,601	1,621	1,645	1,730	1,732
Currency and deposits	46	47	51	29	37	58	50	53	64	70
Securities and other equity	1,224	1,262	1,327	1,214	1,106	1,112	1,077	1,109	1,131	1,123
Loans	137	143	149	168	209	213	271	230	287	270
Other liabilities	152	156	170	189	203	218	223	253	247	269
Net worth	**1,421**	**1,489**	**1,636**	**1,975**	**2,126**	**1,903**	**2,122**	**2,222**	**2,146**	**2,258**
Financial net worth	**0**	**67**	**213**	**551**	**701**	**476**	**694**	**793**	**716**	**828**
					(In percent of GDP)					
Assets	**117.1**	**116.4**	**120.3**	**121.4**	**117.8**	**109.3**	**120.5**	**115.9**	**111.3**	**112.4**
Financial assets	61.3	62.9	68.9	73.0	72.2	64.8	74.5	73.1	70.3	72.1
Currency and deposits	2.0	1.8	1.9	2.6	2.3	3.7	2.6	2.0	2.6	2.1
Securities other than shares	8.3	8.7	9.5	10.8	11.2	11.3	11.8	12.0	11.4	12.0
Loans	12.5	12.4	12.8	12.8	12.3	12.7	16.1	15.1	15.3	15.4
Shares and other equity	28.5	29.7	33.6	36.5	35.7	28.7	35.0	34.5	32.4	33.9
Other financial assets	10.0	10.3	11.2	10.5	10.7	8.4	9.1	9.6	8.6	8.7
Capital stock net of depreciation	55.9	53.5	51.4	48.4	45.6	44.5	46.0	42.8	41.1	40.3
Liabilities	**61.3**	**60.4**	**61.2**	**54.3**	**49.8**	**50.0**	**52.2**	**49.3**	**49.7**	**48.8**
Financial liabilities	61.3	60.4	61.2	54.3	49.8	50.0	52.2	49.3	49.7	48.8
Currency and deposits	1.8	1.7	1.8	1.0	1.2	1.8	1.6	1.6	1.8	2.0
Securities and other equity	48.1	47.4	47.9	41.2	35.4	34.7	34.7	33.2	32.5	31.6
Loans	5.4	5.4	5.4	5.7	6.7	6.6	8.7	6.9	8.3	7.6
Other liabilities	6.0	5.8	6.1	6.4	6.5	6.8	7.2	7.6	7.1	7.6
Net worth	**55.8**	**56.0**	**59.1**	**67.1**	**68.0**	**59.4**	**68.3**	**66.6**	**61.6**	**63.6**
Financial net worth	**0.0**	**2.5**	**7.7**	**18.7**	**22.4**	**14.9**	**22.4**	**23.8**	**20.6**	**23.3**
Memorandum items:										
GDP (SEK billions)	2,545	2,661	2,769	2,944	3,126	3,204	3,106	3,338	3,481	3,550

Sources: Eurostat and Fund staff calculations.

Table 4. Sweden: Balance of Payments Accounts, 2012–19

	2012	2013	2014	2015	2016	2017	2018	2019
			Projections					
				Billions of SEK				
Current Account Balance	212	235	225	239	249	255	260	265
Trade Balance	189	194	183	196	205	210	214	218
Exports of G&S	1678	1626	1677	1757	1850	1952	2062	2179
Imports of G&S	-1490	-1432	-1494	-1561	-1645	-1742	-1848	-1961
Factor income, net	88	102	105	107	110	113	116	118
Current Transfers, net	-65	-61	-63	-64	-66	-68	-69	-71
Financial Account Balance	-77	-124	-209	-217	-226	-228	-239	-249
Investment Abroad [1]	388	72	-27	-52	-71	-109	-136	-166
Investment in Sweden [2]	-461	-101	-181	-165	-157	-121	-104	-86
Reserves, change	-4	-95	0	0	0	0	0	0
				Percent of GDP				
Current Account Balance	6.0	6.4	6.0	6.1	6.1	5.9	5.8	5.6
Trade Balance	5.3	5.3	4.9	5.0	5.0	4.9	4.7	4.6
Exports of G&S	47.3	44.7	44.6	44.8	45.1	45.4	45.8	46.3
Imports of G&S	-42.0	-39.3	-39.7	-39.8	-40.1	-40.5	-41.0	-41.7
Factor income, net	2.5	2.8	2.8	2.7	2.7	2.6	2.6	2.5
Current Transfers, net	-1.8	-1.7	-1.7	-1.6	-1.6	-1.6	-1.5	-1.5
Financial Account Balance	-2.2	-3.4	-5.5	-5.5	-5.5	-5.3	-5.3	-5.3
Investment Abroad 1/	10.9	2.0	-0.7	-1.3	-1.7	-2.5	-3.0	-3.5
Direct Investment	-5.5	-6.2	-6.2	-6.2	-6.2	-6.2	-6.2	-6.2
Portfolio Investment	18.8	13.9	11.4	10.8	10.4	9.3	8.8	8.3
Financial Derivatives	25.0	19.3	17.8	17.2	16.8	15.8	15.3	14.8
Other Investment	-2.3	-5.7	-5.9	-5.9	-5.9	-5.7	-5.7	-5.7
Reserves	-0.1	-2.6	0.0	0.0	0.0	0.0	0.0	0.0
Investment in Sweden 1/	-13.0	-2.8	-4.8	-4.2	-3.8	-2.8	-2.3	-1.8
Direct Investment	3.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Portfolio Investment	-15.0	-4.2	-6.4	-5.8	-5.4	-4.4	-3.9	-3.4
Financial Derivatives	-23.9	-17.5	-17.8	-17.2	-16.8	-15.8	-15.3	-14.8
Other Investment	-1.1	-0.6	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Errors and Omissions	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
				Percent change				
Exports of G&S 2/								
Value	-4.8	0.8	1.8	5.3	6.4	7.5	8.2	8.2
Volume	-3.4	3.6	3.5	6.1	6.4	7.0	7.5	7.3
Deflator	-1.4	-2.8	-1.6	-0.7	0.0	0.5	0.7	0.8
Imports of G&S 2/								
Value	-5.1	0.0	2.9	5.0	6.6	8.0	8.7	8.6
Volume	-4.1	2.9	4.3	5.6	6.6	7.7	8.2	8.1
Deflator	-1.0	-2.8	-1.4	-0.5	0.0	0.3	0.5	0.5
Memorandum								
Nominal GDP (SEK billion)	3550	3641	3762	3922	4106	4302	4503	4705

Sources: Statistics Sweden and Fund staff calculations.

1/ Positive number indicates an accumulation of foreign assets.

2/ Percent changes of exports of G&S and imports of G&S are calculated using numbers in USD terms.

Note: Based on Balance of Payments Manual 5.

Table 5. Sweden: Net International Investment Position, 2006–13

(Percent of GDP)

	2006	2007	2008	2009	2010	2011	2012	2013
ASSETS	238.0	265.6	274.2	293.4	281.3	280.1	280.3	298.5
Direct investment	81.1	92.8	106.7	110.7	102.0	100.1	97.2	98.6
Equity & investment fund shares	56.9	64.1	74.7	78.9	73.3	70.9	69.0	71.8
Debt instruments	24.2	28.7	32.0	31.9	28.8	29.1	28.2	26.8
Portfolio investment	92.5	99.1	78.8	98.7	99.1	87.0	92.6	107.2
Equity & investment fund shares	60.5	63.9	45.0	64.1	67.1	58.5	65.1	77.3
Debt securities	32.0	35.2	33.8	34.6	32.0	28.4	27.5	29.9
Fin. deriv. (other than reserves)	5.9	7.1	16.8	11.6	10.6	14.2	13.7	9.3
Other investment	51.9	60.1	64.6	61.5	59.8	69.0	67.1	71.9
Reserve assets	6.6	6.4	7.3	10.9	9.7	10.0	9.6	11.5
LIABILITIES	251.1	267.1	285.5	305.5	291.1	291.9	293.0	304.0
Direct investment	72.9	85.1	96.0	105.9	96.8	94.4	91.6	88.4
Equity & investment fund shares	35.9	41.2	42.7	49.5	47.6	46.9	49.5	50.1
Debt instruments	37.0	43.9	53.2	56.3	49.2	47.5	42.1	38.3
Portfolio investment	111.4	108.8	92.9	121.3	126.2	126.1	133.4	152.6
Equity & investment fund shares	48.7	41.9	21.2	32.1	40.7	33.7	40.9	49.1
Debt securities	62.6	66.9	71.7	89.3	85.4	92.4	92.5	103.5
Other investment	60.6	65.9	81.4	68.7	59.9	60.7	57.2	55.3
NET INVESTMENT POSITION	-13.1	-1.6	-11.2	-12.0	-9.8	-11.8	-12.7	-5.6
Direct Investment	8.2	7.7	10.8	4.9	5.2	5.6	5.6	10.2
Portfolio Investment	-18.9	-9.7	-14.1	-22.6	-27.1	-39.2	-40.8	-45.4
Other Investment	-8.7	-5.8	-16.7	-7.2	-0.1	8.2	9.9	16.6

Sources: International Financial Statistics and Fund staff calculations.

Note: Based on Balance of Payments Manual 5.

Table 6. Sweden: Financial Soundness Indicators, 2008–13

Percent unless stated otherwise

	2008	2009	2010	2011	2012	2013
Regulatory Capital to Risk-Weighted Assets	10.2	12.7	12.0	11.5	11.7	12.0
Regulatory Tier 1 Capital to Risk-Weighted Assets	7.7	10.6	10.5	10.8	11.3	11.2
Non-performing Loans Net of Provisions to Capital	8.1	12.5	11.2	9.7	9.4	8.8
Non-performing Loans to Total Gross Loans	0.5	0.8	0.8	0.7	0.7	0.6
Sectoral Distribution of Total Loans: Residents	43.0	45.4	47.1	45.3	48.3	48.0
Sectoral Distribution of Total Loans: Deposit-takers	1.5	1.3	1.7	1.3	0.9	1.0
Sectoral Distribution of Total Loans: Central Bank	1.4	1.7	0.1	0.2	-	0.1
Sectoral Distribution of Total Loans: Other Financial Corporations	0.5	0.5	0.5	0.5	0.6	0.2
Sectoral Distribution of Total Loans: General Government	1.0	1.8	0.9	0.9	0.9	0.7
Sectoral Distribution of Total Loans: Nonfinancial Corporations	17.5	16.6	17.5	16.6	17.9	17.5
Sectoral Distribution of Total Loans: Other Domestic Sectors	21.1	23.5	26.4	25.8	28.0	28.5
Sectoral Distribution of Total Loans: Nonresidents	57.0	54.6	52.9	54.7	51.7	52.0
Return on Assets	0.6	0.4	0.6	0.6	0.7	0.7
Return on Equity	16.9	8.0	14.1	14.9	15.3	16.7
Interest Margin to Gross Income	59.9	59.7	57.1	59.3	60.1	60.1
Non-interest Expenses to Gross Income	54.2	55.4	56.4	57.4	53.1	51.6
Liquid Assets to Total Assets (Liquid Asset Ratio)	19.0	21.6	20.9	22.5	21.4	9.7
Liquid Assets to Short Term Liabilities	45.0	49.1	55.3	55.9	50.7	123.7
Net Open Position in Foreign Exchange to Capital	5.4	6.7	8.5	5.4	5.4	4.7
Household Debt to GDP	70.4	81.4	87.0	81.8	83.6	85.4
Household Debt Service and Principal Payments to Income	6.3	4.8	4.3	6.1	5.9	5.2
Residential Real Estate Prices	2.9	2.0	7.0	1.0	-1.0	4.1

Source: Financial Soundness Indicators (FSI)

(-) Indicates that a figure is zero

(...) Indicates a lack of statistical data that can be reported or calculated from

Table 7. Sweden: Financial Soundness Indicators: Banks, 2008–13

(End of period, in percent)

	2008	2009	2010	2011	2012	2013
(End of period, percent)						
Capital Adequacy						
Regulatory capital to risk-weighted assets 1/	10.7	13.0	12.6	12.2	12.5	12.7
of which: Four major banks 2/	10.2	12.7	12.0	11.5	11.7	12.0
Regulatory Tier I capital to risk-weighted assets 1/	8.1	10.9	11.0	11.3	11.7	12.0
of which: Four major banks 2/	7.6	10.5	10.4	10.7	11.1	11.2
Capital as percent of assets (leverage ratio)	4.6	5.0	4.8	4.1	4.4	4.5
of which: Four major banks 2/	4.7	5.0	4.7	4.0	4.2	4.4
Asset quality and exposure						
Nonperforming loans to total gross loans	1.1	2.0	1.9	1.6	1.5	1.3
of which: Four major banks 2/	1.0	2.0	1.9	1.5	1.4	1.2
Nonperforming loans net of loan-loss provisions to capital	7.4	10.7	9.9	9.5	9.3	8.2
of which: Four major banks 2/	6.5	11.0	10.6	9.9	10.0	8.8
Loan-loss provisions to nonperforming loans	49.1	55.4	44.3	41.3	39.8	38.8
of which: Four major banks 2/	47.1	53.7	43.8	40.7	38.7	38.1
Distribution of MFI credit (percent) 4/						
Sweden	75.7	75.7	79.1	78.2	78.1	78.2
Financial corporation	1.1	1.1	2.0	1.7	1.8	1.7
Non financial corporations	33.9	31.4	31.0	31.1	30.3	31.1
Public sector	3.1	3.1	3.7	2.4	2.8	2.4
Households	37.6	40.1	42.4	43.0	43.3	43.0
Outside Sweden	16.6	20.5	19.2	17.6	18.2	17.6
Other EUs	7.8	10.7	9.1	8.9	9.1	8.9
Rest of the world	8.8	9.7	10.1	8.7	9.2	8.7
Large exposures as percent of tier 1 capital 3/	34.1	12.3	40.1	37.2	29.5	20.0
of which: Four major banks 3/	30.9	8.1	36.8	31.4	22.0	10.7
Earnings and profitability						
Return on assets (net income as percent of average total assets)	0.5	0.3	0.4	0.5	0.5	0.6
of which: Four major banks 2/	0.6	0.2	0.4	0.5	0.5	0.6
Return on equity (Net income as percent of average equity capital)	12.7	13.0	9.8	10.6	11.4	11.4
of which: Four major banks 2/	14.3	5.4	10.1	11.1	12.0	11.4
Net interest income as percent of gross income	55.2	56.8	52.7	54.4	55.4	55.3
of which: Four major banks 2/	56.9	57.7	55.3	57.3	58.3	58.6
Noninterest expenses as percent of gross income	57.0	56.9	66.2	66.1	63.2	63.9
of which: Four major banks	54.2	55.4	65.1	65.7	61.0	60.7
Noninterest income as percent of total income	44.8	43.2	55.1	52.9	51.7	53.7
of which: Four major banks	43.1	42.3	53.5	51.0	49.7	50.5
Trading income and foreign exchange gains (losses) to gross income	8.6	11.7	11.6	9.4	10.7	8.4
of which: Four major banks 2/	9.8	13.6	12.6	10.0	11.2	9.6
Personnel expenses as percent of noninterest expenses	55.0	53.2	52.6	53.6	52.2	53.9
of which: Four major banks 2/	59.2	57.1	57.4	57.8	59.4	60.5
Liquidity						
Liquid assets as percent of total assets	4.0	6.3	4.8	6.2	8.5	8.9
of which: Four major banks 2/	4.3	6.7	5.2	6.7	9.1	9.7
Liquid assets as percent of short-term liabilities	23.6	43.6	44.4	66.7	97.2	95.0
of which: Four major banks 2/	30.5	54.7	58.9	87.9	121.6	123.7
Customer deposits as a percent of total (non-interbank) loans	46.1	47.1	47.8	49.8	52.9	53.8
of which: Four major banks 2/	45.5	45.3	46.6	48.5	50.9	52.7
Noninterbank loans to noninterbank deposits	139.6	144.8	155.0	153.8	148.8	145.9
of which: Four major banks 2/	149.7	156.1	165.9	163.5	158.0	153.7
Foreign exchange risk						
Foreign currency loans as percent of total loans	39.0	37.8	36.5	37.4	34.9	39.9
Foreign currency assets as percent of total assets	33.0	31.2	31.4	34.5	33.1	33.8
Foreign currency-denominated liabilities as percent of total liabilities	35.4	29.8	31.4	35.1	31.1	28.7
Exposure to derivatives						
Gross asset position in derivatives as percent of Tier 1 capital	336.8	210.8	222.3	351.2	243.9	153.1
Gross liability position in derivatives as percent of Tier 1 capital	320.7	198.9	217.9	335.2	232.8	141.7

Sources: Financial Supervisory Authority, Riksbank, and Fund staff calculations.

1/ The calculations follow rules under Basel II, including transition rules as reported by the Riksbank. Without transition rules, the capital ratios would currently be higher due to lower risk-weighted assets (the result of banks' implementation of the IRB approach).
2/ On consolidated basis.
3/ From 2010 onward, exposures to credit institutions are included.
4/ Non consolidated bases, and parent banks only. Monetary financial institutions include banks and housing credit institutions.

Table 8. Sweden: Financial Soundness Indicators: Non-Banks, 2008–13

(End of period, in percent)

	2008	2009	2010	2011	2012	2013
(End of period, percent)						
Insurance sector						
Solvency ratio (margin/required margin)						
Life insurance companies	8.4	7.8	14.2	8.0	9.9	13.8
Non-life insurance companies	6.8	7.7	10.6	10.6	10.8	11.4
Return on equity						
Life insurance companies	-86.3	45.3	20.3	-30.1	32.5	28.7
Non-life insurance companies	-21.4	29.7	35.4	3.5	40.0	11.7
Households						
Household debt as percent of GDP	75.6	81.8	80.4	83.2	84.8	85.3
Household debt as percent of disposable income	164.6	166.5	172.6	175.8	172.6	175.1
Household interest expense as percent of disposable income	5.2	3.5	3.2	4.4	4.4	3.7
Corporate sector						
Debt stock as percent of GDP (non-financial sector borrowing from financial sector)	36.2	38.0	35.8	35.0	34.8	36.0
Total debt stock as percent of GDP	49.5	52.5	49.1	49.7	48.5	49.8
Equity risk						
OM Stockholm Stock Exchange Index (annual percent change)	-42.0	46.7	23.1	-16.7	12.0	23.2
Market capitalization in percent of GDP	136.2	189.8	212.4	167.5	182.8	226.9
Real estate markets (prices; year on year percent change)						
One- or two dwelling buildings	-0.8	8.6	3.2	-3.1	2.7	3.9
Greater Stockholm region	-0.6	9.2	2.9	-2.5	1.4	4.8
Buildings for seasonal and secondary use	4.3	17.5	8.4	-0.3	3.4	13.3
Memorandum items						
GDP (year on year percent change, constant prices)	-0.6	-5.0	6.6	2.9	0.9	1.6
GDP bn SEK, current prices	3,204	3,106	3,338	3,481	3,550	3,641

Sources: Financial Supervisory Authority, Riksbank, and Fund staff calculations.

Table 9. Sweden: Financial System Structure, 2009–13

	2009				2010				2011				2012				2013			
	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP
Four Major Banks, consolidated																				
Nordea	1	5,212,530	30.3	167.8	1	5,207,511	30.0	156.0	1	6,382,811	33.3	183.4	1	5,813,615	30.4	163.8	1	5,585,078	27.3	153.4
Handelsbanken	1	2,122,843	12.3	68.4	1	2,153,530	12.4	64.5	1	2,454,366	12.8	70.5	1	2,387,858	12.5	67.3	1	2,489,806	12.2	68.4
S.E.B	1	2,308,227	13.4	74.3	1	2,179,821	12.6	65.3	1	2,362,653	12.3	67.9	1	2,453,456	12.8	69.1	1	2,484,834	12.1	68.2
Swedbank	1	1,794,687	10.4	57.8	1	1,715,681	9.9	51.4	1	1,857,065	9.7	53.4	1	1,846,941	9.7	52.0	1	1,820,807	8.9	50.0
Total Top Four Banks	4	11,438,287	66.5	368.3	4	11,256,543	64.9	337.3	4	13,056,895	68.1	375.1	4	12,501,870	65.3	352.2	4	12,380,525	60.5	340.0
Four major banks in Sweden 1/																				
Banks	4	7,040,183	40.9	226.7	4	5,464,340	31.5	163.7	4	6,016,174	31.4	172.9	4	6,076,915	31.8	171.2	4	6,261,408	30.6	172.0
Insurance companies	8	509,691	3.0	16.4	8	544,463	3.1	16.3	8	500,273	2.6	14.4	8	554,856	2.9	15.6	9	616,742	3.0	16.9
Mortgage credit institutions	3	1,899,919	11.0	61.2	3	1,971,472	11.4	59.1	3	2,098,457	11.0	60.3	3	2,209,594	11.5	62.2	3	2,309,254	11.3	63.4
Securities firms	3	30,242	0.2	1.0	3	14,109	0.1	0.4	3	14,112	0.1	0.4	2	14,910	0.1	0.4	2	3,804	0.0	0.1
Other credit market companies	8	235,297	1.4	7.6	8	167,768	1.0	5.0	8	170,213	0.9	4.9	7	167,150	0.9	4.7	7	166,422	0.8	4.6
Top four banks in Sweden	26	9,715,332	56.5	312.8	26	8,162,152	47.1	244.6	26	8,799,229	45.9	252.8	24	9,023,425	47.2	254.2	25	9,357,630	45.7	257.0
Other Banks in Sweden																				
Of which:																				
Banks	30	481,797	2.8	15.5	29	546,619	3.2	16.4	29	578,692	3.0	16.6	29	656,814	3.4	18.5	28	709,534	3.5	19.5
Savings banks	53	164,177	1.0	5.3	49	147,512	0.9	4.4	50	157,045	0.8	4.5	49	171,406	0.9	4.8	49	181,634	0.9	5.0
Mortgage credit institutions	4	436,302	2.5	14.0	3	338,789	2.0	10.2	3	361,378	1.9	10.4	3	361,305	1.9	10.2	3	365,487	1.8	10.0
Member bank	2	1,521	0.0	0.0	2	1,621	0.0	0.0	2	1,757	0.0	0.1	2	1,909	0.0	0.1	2	2,080	0.0	0.1
Other credit market companies	43	790,385	4.6	25.4	40	722,164	4.2	21.6	39	772,237	4.0	22.2	35	818,635	4.3	23.1	32	816,881	4.0	22.4
Total other banks in Sweden	132	1,874,182	10.9	60.3	123	1,756,705	10.1	52.6	123	1,871,109	9.8	53.8	118	2,010,069	10.5	56.6	114	2,075,616	10.1	57.0
Nonbank credit institutions																				
Insurance companies	253	2,351,945	13.7	75.7	254	2,536,287	14.6	76.0	217	2,555,220	13.3	73.4	208	2,717,606	14.2	76.6	201	3,675,409	18.0	100.9
Life insurance	43	1,782,371	10.4	57.4	44	1,965,284	11.3	58.9	40	1,987,109	10.4	57.1	39	2,143,215	11.2	60.4	40	2,962,745	14.5	81.4
Nonlife insurance 2/	210	569,574	3.3	18.3	210	571,003	3.3	17.1	177	568,111	3.0	16.3	169	574,392	3.0	16.2	150	565,733	2.8	15.5
Pension funds	14	105,567	0.6	3.4	13	117,511	0.7	3.5	11	123,277	0.6	3.5	11	135,266	0.7	3.8	11	146,931	0.7	4.0
Mutual funds 3/	849	1,393,337	8.1	44.9	896	1,635,074	9.4	49.0	911	1,534,817	8.0	44.1	866	1,737,564	9.1	48.9	863	2,158,227	10.5	59.3
Other nonbank credit institutions																				
Asset management firms	82	7,346	0.0	0.2	80	7,662	0.0	0.2	0	0	0.0	0.0	75	7,731	0.0	0.2	73	9,592	0.0	0.3
Securities firms	132	28,895	0.2	0.9	132	23,817	0.1	0.7	129	22,467	0.1	0.6	125	22,615	0.1	0.6	123	12,206	0.1	0.3
Total financial system	1466	17,199,559	100.0	553.8	1502	17,333,599	100.0	519.4	1395	19,163,785	100.0	550.6	1407	19,132,721	100.0	539.0	1389	20,458,506	100.0	561.9
of which: Total banking sector 4/		13,312,469	77.4	428.6		13,013,248	75.1	389.9		14,928,004	77.9	428.9		14,511,939	75.8	408.8		14,456,141	70.7	397.0
Memorandum item:																				
Foreign bank branches in Sweden	24	686,265	4.0	22.1	26	760,045	4.4	22.8	27	789,061	4.1	22.7	27	832,627	4.4	23.5	28	865,580	4.2	23.8
Swedish bank branches abroad	55	1,411,402	8.2	45.4	61	1,456,017	8.4	43.6	61	2,063,291	10.8	59.3	61	1,993,116	10.4	56.1	64	1,972,162	9.6	54.2
Nominal GDP (in millions of SEK)				3,105,790				3,337,531				3,480,543				3,549,709				3,640,976

Sources: Financial Supervisory Authority, Riksbank, and Fund staff calculations.

1/ Including branches in abroad.
2/ Not including minor local companies
3/ Market value of funds
4/ Number of institutions is computed on unconsolidated basis.

Appendix I. Debt Sustainability Analysis

Sweden – Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percentage of GDP unless otherwise indicated)

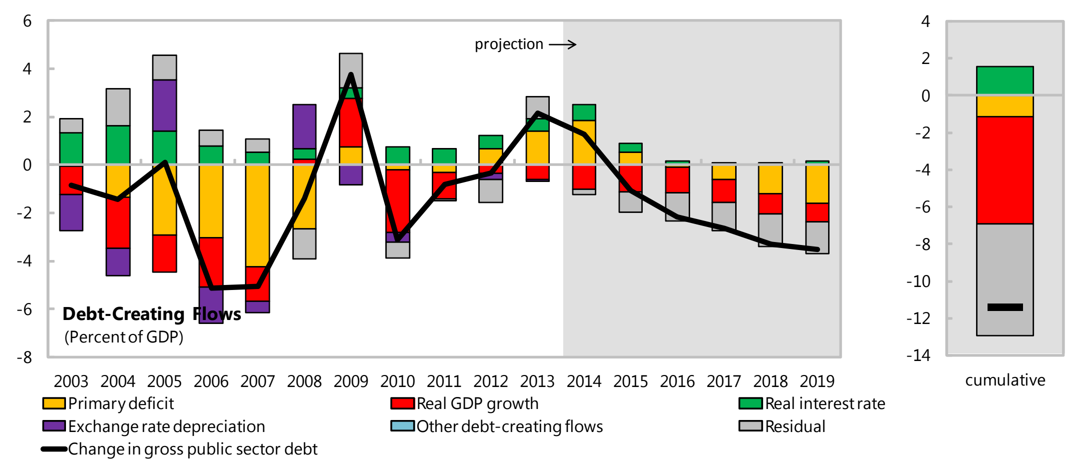
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	44.1	38.3	40.5	41.8	40.7	38.5	35.9	32.6	29.1
Public gross financing needs	8.4	9.4	10.0	12.5	13.2	11.7	10.8	9.2	8.2
Real GDP growth (in percent)	2.4	0.9	1.6	2.6	2.8	2.7	2.6	2.5	2.4
Inflation (GDP deflator, in percent)	1.7	1.0	0.9	0.7	1.4	1.9	2.1	2.1	2.0
Nominal GDP growth (in percent)	4.0	2.0	2.6	3.3	4.3	4.7	4.8	4.7	4.5
Effective interest rate (in percent) [4/]	3.7	2.5	2.3	2.4	2.4	2.4	2.4	2.4	2.6

As of July 11, 2014		
Sovereign Spreads		
Spread (bp) 3/		-29
CDS (bp)		19
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AAA	AAA
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-1.5	-0.33	2.17	1.3	-1.1	-2.2	-2.6	-3.3	-3.5	-11.4	
Identified debt-creating flows	-2.0	0.61	1.23	1.6	-0.4	-1.1	-1.7	-2.2	-2.5	-6.3	
Primary deficit	-1.6	0.7	1.4	1.8	0.5	-0.1	-0.6	-1.2	-1.6	-1.1	-0.9
Primary (noninterest) revenue and gra	53.0	50.5	50.8	49.4	50.0	50.3	50.3	50.3	50.3	300.5	
Primary (noninterest) expenditure	51.5	51.2	52.2	51.2	50.5	50.2	49.7	49.1	48.7	299.4	
Automatic debt dynamics [5/]	-0.4	-0.1	-0.2	-0.2	-0.9	-1.0	-1.1	-1.0	-0.9	-5.2	
Interest rate/growth differential [6/]	-0.2	0.2	-0.1	-0.4	-0.8	-0.9	-0.9	-0.8	-0.6	-4.3	
Of which: real interest rate	0.9	0.5	0.5	0.7	0.4	0.2	0.1	0.1	0.2	1.5	
Of which: real GDP growth	-1.1	-0.4	-0.6	-1.0	-1.1	-1.1	-1.0	-0.9	-0.8	-5.8	
Exchange rate depreciation [7/]	-0.2	-0.3	-0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other debt-creating flows (specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.4	-0.9	0.9	-0.2	-0.8	-1.2	-1.2	-1.3	-1.3	-6.0	



Source: Fund staff calculations. 1/ Public sector is defined as general government. 2/ Based on available data. 3/ Bond Spread over U.S. Bonds.

4/ Defined as interest payments divided by debt stock at the end of previous year. Its relatively stable path reflects long debt maturities (> 5 years on average) and a gradual projected increase in interest rates.

5/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the denominator in footnote 4 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

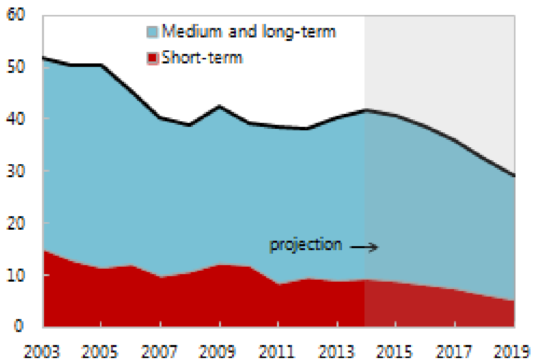
8/ For projections, this line includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

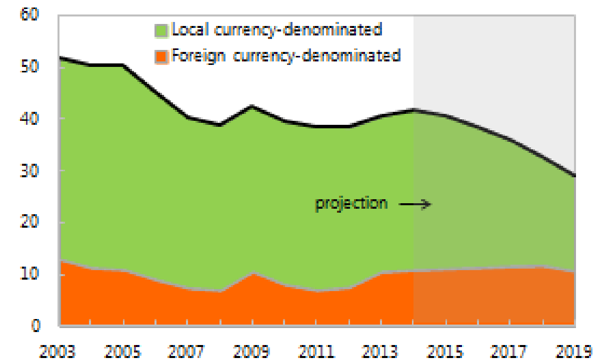
Sweden Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



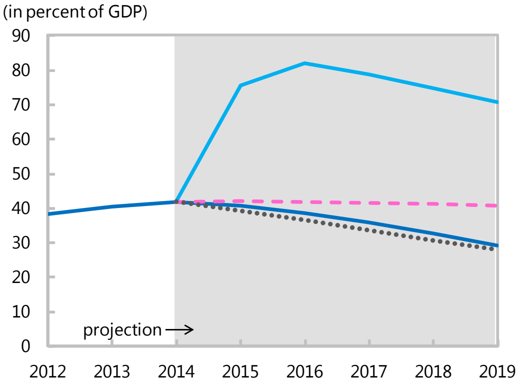
By Currency
(in percent of GDP)



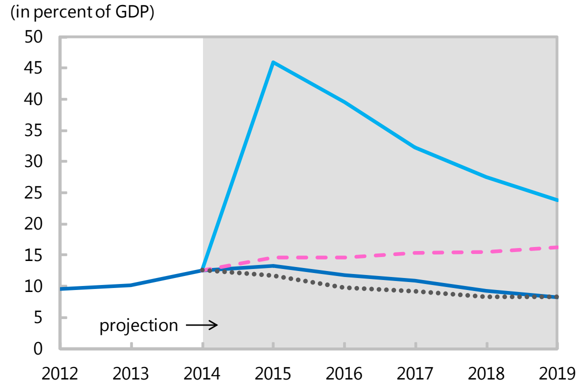
Alternative Scenarios 1/

Baseline
Contingent Liability Shock
Historical
Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.6	2.8	2.7	2.6	2.5	2.4
Inflation	0.7	1.4	1.9	2.1	2.1	2.0
Primary Balance	-1.8	-0.5	0.1	0.6	1.2	1.6
Effective interest rate	2.4	2.4	2.4	2.4	2.4	2.6
Constant Primary Balance Scenario						
Real GDP growth	2.6	2.8	2.7	2.6	2.5	2.4
Inflation	0.7	1.4	1.9	2.1	2.1	2.0
Primary Balance	-1.8	-1.8	-1.8	-1.8	-1.8	-1.8
Effective interest rate	2.4	2.4	2.4	2.5	2.6	2.8

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.6	2.1	2.1	2.1	2.1	2.1
Inflation	0.7	1.4	1.9	2.1	2.1	2.0
Primary Balance	-1.8	1.2	1.2	1.2	1.2	1.2
Effective interest rate	2.4	2.4	2.9	3.0	3.2	3.4
Contingent Liability Shock						
Real GDP growth	2.6	-3.6	-3.7	2.6	2.5	2.4
Inflation	0.7	-0.2	0.3	2.1	2.1	2.0
Primary Balance	-1.8	-32.0	0.1	0.6	1.2	1.6
Effective interest rate	2.4	2.7	6.7	3.7	3.7	3.8

Source: Eurostat, Ministry of Finance, Statistics Sweden, Swedish National Debt Office, and Fund staff calculations.
1/ The Baseline is constructed from historical data on debt maturity, currency denomination of debt, and other characteristics of outstanding government debt. Projections are based on financing needs and other related variables from reports of the Swedish National Debt Office and the Ministry of Finance. In the Historical scenario, real GDP growth, the real interest rate, and the primary balance are set to historical averages. In the Constant Primary Balance scenario, the primary balance projection is kept constant at the 2013 Baseline proejction level. The Contingent Liability Shock scenario considers a one-time increase in non-interest expenditures equivalent to 10 percent of banking sector assets. In turn, this results in adverse effects on real GDP growth, which is reduced by 2 standard deviations for 2 consecutive years. The revenue-to-GDP ratio remains unchanged relative to the baseline; the deterioration in the primary balance leads to an increase in the interst rate; and the decline in growth results in lower inflation.

SWEDEN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 30, 2014

Prepared By

European Department
(In Consultation with Other Departments)

CONTENTS

FUND RELATIONS

(As of June 13, 2014)

Mission: June 2–13, 2014 in Stockholm. The concluding statement of the mission is available at http://www.imf.org/external/np/ms/2014/061314.htm. The staff report will be published.

Staff team: Mr. H. Berger (Head), Messrs. M. Schindler, N. Arnold, and J. Chen (all EUR). Ms. P. Meyersson, Alternate Executive Director (OEDNO), attended for the duration of the mission. Mr. T. Dowling and Ms. J. Colon provided support from headquarters.

Outreach: The team met with the Parliamentary Finance Committee, representatives of the private sector, several large banks, the Swedish Trade Union Confederation, which represents blue-collar workers, the National Institute of Economic Research, academics, and the Fiscal Policy Council. The mission held a press conference at the Riksbank after the concluding meeting.

Fund relations: Discussions for the 2013 Article IV consultation were held in Stockholm during May 20–31, 2013 and the staff report was discussed by the Executive Board on August 30, 2013. The Executive Board's assessment and staff report (IMF Country Report No. 13/276, September 2013) are available at http://www.imf.org/external/pubs/cat/longres.aspx?sk=40921.0. The Article IV discussions with Sweden are on the 12-month consultation cycle.

Membership Status: Joined: August 31, 1951; Article VIII.

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	2,395.50	100.00
Fund holdings of currency (Exchange Rate)	1,872.97	78.19
Reserve Tranche Position	522.53	21.81
Lending to the Fund		
New Arrangements to Borrow	610.09	

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	2,248.96	100.00
Holdings	2,083.09	92.62

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund:

(SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/Interest	0.07	0.15	0.15	0.15	0.15
Total	0.07	0.15	0.15	0.15	0.15

Exchange Rate Arrangements:

The Krona has been floating freely since November 19, 1992. Sweden has accepted the obligations of Article VIII (sections 2(a), 3 and 4) and maintains an exchange system free of restrictions on payments and transfers for current international transactions, apart from those notified to the Fund pursuant to Decision No. 144-(52/51).

Resident Representative: None

STATISTICAL ISSUES

(As of July 21, 2014)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance. The country has a full range of statistical publications, many of which are on the internet. The quality and timeliness of the economic database are generally very good.
National Accounts: Sweden will publish the national accounts according to the European System of Accounts (ESA) 2010 in September 2014. As part of implementing the new ESA 2010 regulations and standards, data sources will be reviewed. Explanations of the impact of the new regulations and review of the data sources will be released with the data in September 2014. The following data will be released on September 18, 2014: (i) annual national accounts for the period 1993-2012; and (ii) quarterly national accounts for the period Q1 1993 – Q2 2014. It has not yet been determined when data for the period 1980-1992 will be revised to reflect ESA 2010.
Price Statistics: Sweden publishes consumer price index (CPI), producer and import price index, and service producer price index regularly. Some changes were introduced to the calculation of CPI and related measures from January 2014 publication in order to make index calculations more efficient. Further, a new index called CPI-CT (CPI at constant taxes) is introduced and this index could replace the current use of net price index in some cases. For the specific requirements of Riksbank, Statistics Sweden also started compiling another CPI called CPIF-CT (CPI with fixed interest rate and at constant taxes). The calculation of the CPI-CT and CPIF-CT follows the methodology used in previous calculations of the constant tax index with some differences.
Government Finance Statistics: Starting from September 2014, government finance statistics data will be based on ESA 2010 methodology which is likely to include revisions of the general government deficit and debt levels from 1995 onwards. Revised data series will be published in October 2014.
Monetary and Financial Statistics: Monetary data reported for *International Financial Statistics* are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data.
External Sector Statistics: Sweden plans to publish external sector statistics in the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* format by December 2014.

II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 31, 1996. Has expressed interest in adhering to the SDDS Plus	A data ROSC (update) was disseminated in November 2002.

Sweden: Table of Common Indicators Required for Surveillance
(As of July 14, 2014)

	Date of latest observation (For all dates in table, please use format dd/mm/yy)	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items:[8] Data Quality–Methodological soundness[9]	Memo Items:[8] Data Quality – Accuracy and reliability[10]
Exchange Rates	2014/06	2014/07	M	M	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	2014/06	2014/07	M	M	M		
Reserve/Base Money	2014/04	2014/06	M	M	M		
Broad Money	2014/04	2014/06	M	M	M		
Central Bank Balance Sheet	2014/04	2014/06	M	M	M		
Consolidated Balance Sheet of the Banking System	2014/04	2014/06	M	M	M		
Interest Rates[2]	2014/06	2014/07	M	M	M		
Consumer Price Index	2014/06	2014/07	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2013 04	2014/04	Q	Q	Q		
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	2012	2012/12	A	A	A		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2011	2012/12	A	A	A		
External Current Account Balance	2014 Q1	2014/07	Q	Q	Q		
Exports and Imports of Goods and Services	2014/01	2014/07	M	M	M		
GDP/GNP	2013 Q4	2014/06	Q	Q	Q		
Gross External Debt							
International Investment Position[6]	2014 Q1	2014/07	Q	Q	Q		

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition. 6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7/ Daily (D), weekly (W), monthly (M), quarterly (Q), annual (A), irregular (I); and not available (NA).
8//These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.
9/ This reflects the assessment provided in the data ROSC or the Substantive Update (published on ..., and based on the findings of the mission that took place during...) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
10/ Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Press Release No. 14/407
FOR IMMEDIATE RELEASE
August 29, 2014

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2014 Article IV Consultation with Sweden

On August 28, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Sweden.[1]

Sweden's economy is gaining speed. Following a moderate slowdown in 2011–12, GDP growth reached 1.6 percent in 2013 and is set to accelerate further, driven by robust household consumption and strengthening private investment. The output gap is narrowing and employment is growing solidly. However, with the labor force expanding even more strongly—reflecting both past reforms and Sweden's growing immigrant population—unemployment has remained high and has been borne disproportionately by the young, low-skilled and foreign-born. This suggests that much of the increase in unemployment is structural. At the same time, inflation has remained very low, driven by external and domestic factors. Financial stability is an increasing concern, against a background of high and rising household debt and fast house price growth.

Financial instability is the key downside risk, especially in the context of Sweden's large banking system. Household debt has reached 190 percent of disposable income on some measures, more than two thirds of new mortgages have variable rates, and a significant share of household net-assets is illiquid. Against this background, adverse shocks to interest rates, house prices, or income could quickly translate into lower consumption, higher unemployment, and reduced growth, and ultimately impact the banking system, especially if these shocks occurred at a time of high global funding stress. Sweden's large and regionally connected banks are also vulnerable to financial tensions in other Nordic

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[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

countries and the Baltics. Conversely, financial instability in Sweden would affect the rest of the region.

An extended period of very low inflation or a drop in global trade triggered by rising geopolitical tensions also pose risks. Lasting low inflation could cause longer-run inflation expectations to fall significantly below the inflation target. This, in turn, could act as a drag on growth if households and firms defer expenditures in anticipation of lower prices in the future.

The policy framework is supporting the recovery and strengthening bank balance sheets. Fiscal policy will remain expansionary through 2014, and the Riksbank has lowered its policy rate to near zero. Minimum mortgage risk weights are set to rise to 25 percent at the end of 2014, and the Basel III toolkit is being deployed mostly ahead of time. But even though first steps have been taken to strengthen mortgage amortization and address housing supply shortages, these measures are unlikely to stop household credit growth against a background of record-low borrowing costs and strong expectations that house prices will continue to increase.

Executive Board Assessment[2]

Executive Directors welcomed the Swedish economy's strong economic performance, which reflects supportive macroeconomic policies and strong household demand. However, Directors noted that high and rising household debt and house prices pose financial stability risks and complicate the conduct of monetary policy in the context of very low inflation and high unemployment. They encouraged the authorities to persevere with their prudent macroeconomic management while addressing emerging vulnerabilities.

Directors generally supported the authorities' intention to embark on fiscal consolidation soon, in light of the favorable growth outlook. They emphasized, however, the need to calibrate the pace of adjustment so as not to hamper the economic recovery. Directors also agreed that achieving the authorities' medium-term surplus goal would help preserve the policy room necessary to tackle rising demographic pressures.

Directors recognized that monetary policymakers face the challenge of balancing macroeconomic concerns against financial stability risks. While the recent policy rate cut should help keep inflation expectations well anchored, very low interest rates could further fuel household borrowing, calling for an earlier policy reversal than warranted by price stability concerns to contain financial stability risks. Accordingly, Directors considered that additional steps will be needed to manage the associated tradeoffs through additional

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

macroprudential measures.

Directors welcomed the authorities' ongoing initiatives to strengthen bank balance sheets, but saw scope to further improve capital buffers and liquidity positions. Directors also recommended introducing gradually macroprudential measures that target credit demand directly, including statutory amortization rates, lower loan-to-value caps, and limits to debt service-to-income ratios. Phasing-out the tax deductibility of mortgage interest payments would further reduce incentives to accumulate debt. Given the size and orientation of Sweden's banks, Directors also highlighted the importance of strong cross-border cooperation among supervisors, and a number of Directors encouraged the authorities to consider the potential benefits of joining the European banking union.

Directors agreed that housing supply rigidities need to be addressed to contain house price pressures. In this context, they also saw scope for measures to improve the allocation of the existing housing stock, for example, through tax reform and changes to the rent-setting process.

Directors commended the authorities for the broad labor market reforms undertaken in recent years. Nonetheless, they saw a need for further efforts to address more effectively the high unemployment, particularly among vulnerable groups. They recommended exploring ways to increase wage flexibility and developing vocational training programs aligned with employers' needs.

Directors took note of the staff's assessment that the value of the krona is broadly in line with medium-term fundamentals. They also took note of the staff's assessment that Sweden's strong external position reflects mostly structural factors.

Sweden: Selected Economic Indicators, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
						Projections			
Real economy (in percent change)									
Real GDP	2.9	0.9	1.6	2.6	2.8	2.7	2.6	2.5	2.4
Domestic Demand	3.2	0.3	1.6	2.8	2.4	2.6	2.7	2.7	2.6
CPI inflation	3.0	0.9	0.0	0.1	1.4	1.9	2.1	2.1	2.0
Unemployment rate (in percent)	7.8	8.0	8.0	8.1	7.7	7.5	7.4	7.3	7.1
Gross national saving (percent of GDP)	26.0	24.9	24.6	25.6	25.9	26.3	26.6	26.9	27.2
Gross domestic investment (percent of GDP)	19.5	18.8	18.4	19.1	19.3	19.7	20.1	20.6	21.1
Output Gap (as a percent of potential)	0.5	-0.5	-0.8	-0.5	0.3	0.7	1.0	0.9	0.8
Public finance (in percent of GDP)									
Total Revenues	51.5	51.4	51.7	50.3	50.9	51.2	51.2	51.2	51.2
Total Expenditures	51.5	52.1	53.0	52.2	51.4	51.1	50.6	49.9	49.5
Net lending	0.0	-0.7	-1.3	-1.9	-0.6	0.1	0.6	1.3	1.7
Structural balance (as a percent of potential GDP)	-0.2	-0.4	-0.9	-1.6	-0.7	-0.2	0.2	0.8	1.3
General government gross debt, official statistics	38.6	38.3	40.5	41.8	40.7	38.5	35.9	32.6	29.1
Money and credit (year-on-year, percent change, eop)									
M1	0.9	5.9	9.0	...	...	...	...	...	...
M3	6.9	3.1	3.1	...	...	...	...	...	...
Bank lending to households	6.0	11.7	3.8	...	...	...	...	...	...
Interest rates (year average)									
Repo rate (end of period)	1.8	1.0	0.8	...	...	...	...	...	...
Three-month deposit rate	1.7	1.3	0.9	...	...	...	...	...	...
Ten-year government bond yield	2.6	1.6	2.1	...	...	...	...	...	...
Balance of payments (in percent of GDP) 2/									
Current account	6.1	6.0	6.4	6.0	6.1	6.1	5.9	5.8	5.6
Trade balance	5.3	5.3	5.3	4.9	5.0	5.0	4.9	4.7	4.6
Foreign Direct Investment, net	-3.2	-2.4	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2	-4.2
International reserves, changes (in billions of US dollars)	-0.7	-0.5	-14.6	...	...	...	...	...	...
Reserve cover (months of imports of goods and services)	2.8	2.7	3.5	3.4	3.2	3.1	2.9	2.7	2.6
Exchange rate (period average, unless otherwise stated)									
Exchange rate regime				Free floating exchange rate					
SEK per U.S. dollar (as of July 24, 2014)					6.8				
Nominal effective rate (2010=100)	105.7	107.0	110.1	...	...	...	...	...	...
Real effective rate (2010=100) 1/	97.0	98.3	100.4	...	...	...	...	...	...
Fund Position (May 31, 2014)									
Holdings of currency (in percent of quota)					78.5				
Holdings of SDRs (in percent of allocation)					92.6				
Quota (in millions of SDRs)					2395.5				

Other Indicators

GDP per capita (2013, USD): 58.014; **Population** (2013, million): 9.6; **Main products and exports**: Machinery, motor vehicles, paper products, pulp and wood; **Key export markets**: Germany, Norway, United Kingdom

Sources: Haver Analytics, IMF Institute, Sveriges Riksbank, Sweden Ministry of Finance and IMF staff calculations.

1/ Based on relative unit labor costs in manufacturing.

2/ Based on Balance of Payments Manual 5.

Statement by Pernilla Meyersson, Alternate Executive Director for Sweden
August 28, 2014

The Swedish authorities would like to thank the mission team for the report as well as for the open and constructive policy discussions during the Article IV consultation with Sweden. The authorities broadly agree with the conclusions and recommendations of the staff report.

Recent economic developments and outlook

Macroeconomic developments in Sweden have been relatively favorable in recent years, given the situation in the world economy. The Swedish economy has recovered after the financial crisis at a pace similar to that in the US and much faster than in the UK or the euro area. Sweden is one of the few countries where GDP per capita is higher now than it was prior to the crisis. Employment has been growing steadily by about 1 percent per year since2010. Labor force participation is the highest in the EU. However, the unemployment rate is still high due to increased labor supply and participation rates. Monetary and fiscal policies have responded forcefully to the crisis. The need to support the economy by economic policy measures will gradually decline as growth picks up and inflation increases.

The authorities broadly share staff's assessment of the economic developments and risks in Sweden and internationally. According to recent data, however, GDP growth for the second quarter was lower than expected and annual growth for 2014 will most likely be lower than projected at the time the Article IV report was written. The recovery in the Euro area is moving more slowly than anticipated. Nevertheless, the main scenario is that growth in the Euro area increases in 2015 and that the international economic recovery takes hold. This, together with a continued expansionary monetary policy, should lead to a higher growth in the Swedish economy in 2015.

The growth in consumption and housing investment in the Swedish economy is relatively strong and is expected to continue increasing at a good pace. As demand from abroad strengthens, growth in the more export-dependent business sector will pick up. The labor market has shown resilience and the outlook is stable. The labor force is expected to grow at a slower pace going forward. And, as growth picks up, employment will rise faster and unemployment will fall.

Due to the low inflation over the past years, a further cut in the repo rate was made in July. The repo rate was cut by 0.5 basis points to 0.25 percent and the path indicates a slow increase of the repo rate towards the end of 2015.

Financial stability, macroprudential policy and financial reforms

The authorities share the view that addressing financial risks is a key policy priority and that it is important to make further progress on the financial stability agenda. The authorities see household debt as a key downside risk to the economic development. Besides decreasing growth and increasing unemployment, shocks to the economy in the high-debt environment can affect financial stability in Sweden and the entire Nordic region given the high interconnectedness in the Nordic (and Baltic) financial systems.

The authorities agree that measures are needed to address increases in house prices and household debt. Several measures, such as a mortgage cap, increased capital requirements, and higher risk weights for mortgages have already been implemented. Since many of the implemented measures have focused on credit supply, further measures should focus on credit demand. The government's efforts to strengthen financial stability have led to banks voluntarily promoting stricter amortization regarding mortgages. However, the authorities agree with staff that actions in order to further improve amortization are necessary and should be a priority. Measures must be taken in a gradual manner to avoid jeopardizing the economic recovery.

The authorities agree that further progress is needed to increase the resilience of the banking system. The Riksbank shares staff's view that imposing a leverage ratio requirement and a countercyclical buffer of 2.5 percent, would be a desirable way to increase the shock absorbing capacity of the banking system. The Riksbank has a recommendation to activate the countercyclical buffer at 2.5 percent in its latest FSR. During the fall, the Financial Stability Council will discuss further on non-risk-weighted capital (i.e. leverage ratio) measures.

The Riksbank agrees with staff that further steps to reduce liquidity risks, through the banks rapidly approaching a Basel III NSFR measure of 100 percent, and introducing an LCR requirement in Swedish krona, would strengthen the banking system. The Riksbank also has recommendations regarding these measures in its latest FSR.

Monetary policy

Staff points out that persistently low inflation in an environment of rapidly-increasing housing prices and a related high growth in credit to households, implies a difficult balancing act for monetary policy. This is a dilemma that Swedish monetary policy has struggled with for some time. Since mid-2011, CPIF inflation has gradually been drifting below 2 percent, which suggests that monetary policy could have been even more expansionary. On the other hand, rapid increases in household debt and house prices create the risk of serious macroeconomic consequences of the kind some other countries have experienced. The Executive Board of the Riksbank therefore has seen a need to, to some extent, take such longer-term risks into account when making the repo-rate decisions.

In this balancing act, the particularly low inflation outcomes since last autumn have successively increased the need for monetary policy to put greater weight on the short-term development of inflation. In doing so, there is less risk that long-term inflation expectations will become de-anchored from the target. This will increase the likelihood of achieving the inflation target within a reasonable time span. At the same time, the more expansionary monetary policy now is associated with higher risks linked to household indebtedness and the housing market. Several members of the Executive Board have therefore stressed the importance of other authorities taking relevant actions.

The Riksbank would like to emphasize that, when it comes to monetary policy considerations, the main concern has been the risks regarding financial imbalances and their macroeconomic consequences - with depressed growth, higher unemployment and possibly difficulties in achieving the inflation target - rather than risks to the stability of the financial system. That being said, in a very negative scenario, financial imbalances may not only lead to unfavorable macroeconomic outcomes, they can also pose risks to financial stability.

It is noteworthy that the Swedish economy has coped relatively well during the years since the financial crisis. Sweden is one of the few countries where GDP per capita is higher now than it was prior to the crisis and the share of the working-age population in employment has also held up well. This reflects the fact that Sweden was not in the epicenter of the financial crisis. Unlike many other countries, Sweden has not experienced a fall in housing prices and difficult deleveraging processes in various parts of the economy. The different economic situation in Sweden compared to the US and many European countries has called for a different emphasis in monetary policy deliberations.

Fiscal stance

The Ministry of Finance broadly agrees with staff's fiscal assessment even though the Ministry's assessment of the output gap and the structural balance in the near term is higher than staff assesses. The Ministry agrees with staff that the need to support the economy through fiscal policy measures is gradually declining as the growth outlook improves and resource utilization picks up.

The Ministry of Finance agrees with staff that returning to surplus is vital in order to protect jobs and welfare in a small, open economy like Sweden. Sustainable public finances will provide scope for the automatic stabilizers to operate effectively and for active fiscal policy in the next recession, if necessary. Since many other countries, due to problems in their public finances, will have less capacity to tackle the next recession with fiscal policy, there are strong arguments in favor of Sweden building up surpluses again and maintaining a low level of debt.

In addition, as pointed out by staff, Sweden has a large financial sector and the latest crisis in particular has shown that this is a potential risk for the economy and public finances. However, earmarking fiscal surplus and buffers for the financial sector may lead to moral hazard. The Ministry of Finance therefore emphasizes that strong financial market policy measures are the first-best option to protect against such fiscal risks.

Output gap

Staff presents a more pessimistic picture of the potential of the Swedish economy than is assessed by the Ministry of Finance (as well as the OECD and the European commission). The differences between staff and the Ministry in assessing the size of the output gap are to a large extent related to different assessments of the extent to which structural reforms have lowered the equilibrium unemployment. The Ministry of Finance believes that the low wage growth and the low inflation indicate a large output gap compared to staff's assessment. In addition, indicators on e.g. labor shortages are below average levels, which is in line with the assessment that there is a low level of resource utilization on the labor market.

Structural balance

The staff forecast for the public sector net lending in Sweden is broadly in line with the authorities' forecasts for 2014–2016. However, staff makes a considerably more pessimistic assessment of the structural balance than the Ministry of Finance, especially for the years 2014 and 2015. The different views on the structural balance are mainly explained by staff's assessment that resource utilization is more strained.

Staff assesses the government's fiscal policy to be pro-cyclical in 2014. According to the Ministry of Finance's assessment a small deterioration of the structural balance in 2014 is, however, appropriate considering the low resource utilization in the economy.

Structural issues

Labor market

The Swedish labor market is strong in an international comparison. Swedish labor force participation is the highest in the EU and Sweden has managed to maintain high labor force participation throughout the crisis. Partly as a consequence of Sweden's generous policy towards asylum-seeking refugees, Sweden has had a growing immigrant population. At the same time, numerous reforms have been implemented to increase labor force participation. Higher labor force participation implies less exclusion, but also that more vulnerable groups enter the labor force. Higher labor force participation *initially* leads to higher unemployment. *In the long run*, however, employment growth is determined by labor supply as most people who enter the labor market eventually find jobs. Staff assesses that unemployment has remained high much due to structural factors. According to the Ministry of Finance's assessment, however, today's elevated unemployment level is due to a sharp rise in labor force participation combined with lower demand for labor following the financial crisis.

As staff points out, the increase in unemployment from the pre-crisis level has been disproportionally borne by vulnerable groups and, despite solid employment growth in 2013, the unemployment rate remains flat. With regard to unemployment among young people, it is worth mentioning that a large share of this group is studying full time.

Important steps have been taken to increase labor demand and improve education/training opportunities to help individuals find a job, in particular those in vulnerable groups. Such measures include improvements in the teaching of Swedish to immigrants, the introduction of an entry recruitment incentive, increased resources to subsidize employment, and increased income tax credit for people over 65. Nevertheless, further steps are necessary to increase employment and reduce structural unemployment. One step in this direction is the initiative by the government to engage in talks with the social partners about how to obtain a more inclusive and flexible labor market. Within this framework, vocational introduction agreements have already been signed between social partners in important sectors and negotiations are ongoing in several other sectors. This will help young people establish themselves in the labor market.

Taxation

Staff mentions the possible need for tax reforms. The government would like to emphasize that as taxation-related measures overall may have a large economic impact, such measures require broad, long-term political agreement, which does not exist at present.

Regarding property taxation, there are no plans to increase recurrent property taxes on privately owned properties. The former property tax was criticized as being unfair and lacked popular support and legitimacy.

The issue of mortgage deductibility is difficult. A too rapid phase-out of deductions for interest payments can have negative effects on household consumption and the economic recovery. A reduction in mortgage deductions would also disproportionately affect households that are highly leveraged, e.g. younger households who just entered the market. Any changes to the level of mortgage deductibility must be made on a long-term basis and with broad political consensus, to reduce uncertainties.

Housing supply

In general, the observations and recommendations by staff are in line with the analysis and policy objectives pursued by the Swedish government. Having said this, changes within these areas take time and they will consequently be subject to reforms for an extended period of time.

As to the need to reform regulations concerning zoning and permits, the government focused its second term (2010-2014) especially on easing administrative and legal rules that slow down and complicate the planning and building process. Among other things, an inquiry was tasked by the government to review opportunities to streamline a judicial review of municipal decisions that have been appealed against under the prevalent Planning and Building Act. Work on improving how regulations concerning planning and building can be made more efficient and conducive to housing production will continue.

As to the rent-setting process, it was, in conjunction with the regulation of the Municipal Housing Companies, subject to reform in 2010 (the new rules being valid from January 1, 2011). Changes have been made in the special rules applying to new rental housing. For example, the time period during which an exemption from the ordinary rent setting rules is valid was prolonged from 10 to 15 years as late as from February 1, 2013.

As to public infrastructure investments as an available policy measure, the government agrees with staff that such measures should be implemented. Accordingly, the government recently presented a program that contains substantial long-term investments in housing, public transport, and railways.