



SWEDEN

December 2015

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; INFORMATIONAL ANNEX; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SWEDEN

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 2015 Article IV consultation with Sweden, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 30, 2015 consideration of the staff report that concluded the Article IV consultation with Sweden.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 30, 2015 following discussions that ended on September 29, 2015, 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 November 13, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Sweden.

The documents listed below have been or will be separately released.

Selected Issues

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December 2, 2015

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IMF Executive Board Concludes 2015 Article IV Consultation with Sweden

On November 30, 2015 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Sweden.

Sweden's economy is performing well, with real GDP growth of 3.4 percent per year in the first three quarters of 2015, up from 2.3 percent in 2014. Job creation was robust in the first three quarters of 2015, helping bring the unemployment rate down to 7.2 percent in the third quarter. Solid growth of about 3 percent is expected to continue into 2016.

Core inflation (HICP basis) rose to 1.4 percent per year on average in recent months, but remains below the 2 percent target. Since early 2015 the Riksbank has implemented negative interest rates, cutting the repo rate in three steps to -0.35 percent. It is also purchasing 135 billion Swedish Kronor in government bonds in 2015, some 20 percent of the outstanding stock, and further purchases are planned in the first half of 2016.

Migration inflows to Sweden have surged to over 1.5 percent of the population in 2015, with the majority being asylum seekers, and these inflows could remain high. Historical experience is that the employment rates of migrants rise toward the high level of Swedes, but this integration process is lengthy. Unemployment rates among the foreign born, as with the low skilled, are notably higher than the overall unemployment rate.

Housing price inflation has accelerated to 18 percent per year, partly reflecting urban population growth outpacing new housing construction. Mortgage credit growth rose to 8 percent per year in September, lifting household debt to a new high of 176 percent of disposable income, with about 22.5 percent of households with a mortgage having a debt-to-income (DTI) ratio over 500 percent.

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.

Executive Board Assessment²

Executive Directors welcomed Sweden's solid economic growth, which reflects supportive macroeconomic policies and strong domestic demand. Directors noted, however, that Sweden faces major challenges including a sharp rise in migrant inflows, rapidly rising housing prices and elevated household debt, and inflation that remains below target. Directors called for policies to work together to address these intertwined challenges so as to contain medium-term risks to growth.

Directors commended Sweden's humanitarian migration policy and well-developed introduction program for refugees. Yet unemployment rates for the low-skilled and foreign-born are considerably higher than average. Directors therefore stressed the importance of reforms to broaden job creation and facilitate integration. They suggested that entry-level wages and employment protection should not be a barrier to hiring groups with high unemployment, and recommended that the authorities better align training with employer's needs and improve the effectiveness of public job matching services.

Directors endorsed the stimulatory stance of monetary policy to address weak inflation expectations and protect the effectiveness of the inflation target in promoting macroeconomic stability. They supported the Riksbank's readiness to do more, if needed, until core inflation is durably close to target, but considered that the authorities should refrain from foreign exchange intervention except as a last resort given Sweden's strong external position.

Directors agreed that the broadly neutral fiscal stance is appropriate. They considered that additional migration-related expenses should be accommodated in the near term, noting that investments in helping migrants integrate will reduce costs in the medium term and support their contribution to growth. Such expenses should be funded over time as part of achieving the medium-term fiscal target. Directors considered that balancing the central government budget on average over the cycle would be sufficient to safeguard Sweden's fiscal buffers.

Directors highlighted the need for broad-based efforts to rebalance the housing market to protect stability and help sustain growth. To increase housing supply they called for reforms to enable greater competition in residential construction, together with a general

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>.

phasing out of rent controls, with vulnerable households protected by the housing allowance. Directors also urged phasing out mortgage interest deductibility, raising the limit on capital gains tax deferrals, and expanding subsidies for building affordable rental apartments in areas with jobs to support a soft landing of housing prices, while also aiding labor mobility and migrant integration.

Directors emphasized that the legal framework for macroprudential policies needs to be strengthened to give the FSA access to a range of tools to address risks in a timely and efficient way. They supported the planned adoption of a regulation on the amortization of high loan-to-value mortgages. Directors recommended that Sweden also limit the share of mortgages with high debt-to-income ratios to reduce vulnerabilities associated with further housing price increases.

Sweden: Selected Economic Indicators, 2012–18

	2012	2013	2014	Projections			
				2015	2016	2017	2018
Real economy (in percent change)							
Real GDP	-0.3	1.2	2.3	2.9	3.0	2.7	2.4
Domestic demand	-0.6	1.6	3.4	2.5	3.3	2.7	2.5
Private consumption	0.8	1.9	2.2	2.2	2.8	2.7	2.4
Public consumption	1.1	1.3	1.6	1.9	2.4	0.9	0.7
Gross fixed investment	-0.2	0.6	7.6	4.9	5.1	4.9	4.5
Net exports (contribution to growth)	0.2	-0.3	-0.9	0.6	-0.1	0.1	0.0
HICP inflation (e.o.p)	1.0	0.4	0.3	0.9	1.9	2.0	2.3
Unemployment rate (in percent)	8.0	8.0	7.9	7.5	7.4	7.3	7.2
Gross national saving (percent of GDP)	29.2	29.2	30.0	31.6	32.2	32.6	32.8
Gross domestic investment (percent of GDP)	22.6	22.5	23.8	24.7	25.4	25.9	26.3
Output gap (as a percent of potential)	-1.9	-2.3	-1.8	-0.9	-0.1	0.5	0.8
Public finance (in percent of GDP)							
Total revenues	50.6	50.9	50.0	48.7	48.9	49.2	49.4
Total expenditures	51.5	52.2	51.7	49.6	49.9	49.7	49.5
Net lending	-0.9	-1.3	-1.7	-0.9	-0.9	-0.5	0.0
Structural balance (as a percent of potential GDP)	-0.3	-0.8	-1.1	-0.6	-0.7	-0.4	0.0
General government gross debt	37.2	39.8	44.9	43.6	42.3	41.2	39.5
Money and credit (year-on-year, percent change, eop) ^{1/}							
M3	3.1	3.1	4.2	7.4	...	...	...
Bank lending to households	4.3	4.9	5.8	7.2	...	...	...
Interest rates (end of period)							
Repo rate ^{1/}	1.0	0.8	0.0	-0.4	...	...	...
Ten-year government bond yield ^{1/}	1.5	2.4	1.0	0.7	...	...	...
Mortgage lending rate ^{2/}	3.0	2.5	1.9	1.6	...	...	...
Balance of payments (in percent of GDP)							
Current account	6.6	6.7	6.2	6.9	6.8	6.7	6.4
Foreign direct investment (net)	2.3	4.4	0.6	2.3	2.6	2.7	2.6
International reserves, changes (in billions of US dollars) ^{3/}	0.5	14.6	0.2	0.3	...	...	...
Reserve cover (months of imports of goods and services)	2.8	3.5	3.4	3.7	...	...	...
Net international investment position	-14.7	-18.0	-0.3	2.6	4.1	5.5	7.4
Exchange rate (period average, unless otherwise stated)							
SEK per euro ^{1/}	8.7	8.7	9.1	9.4	...	...	...
SEK per U.S. dollar ^{1/}	6.8	6.5	6.9	8.4	...	...	...
Nominal effective rate (2010=100) ^{4/}	105.5	108.6	103.8	96.2	...	...	...
Real effective rate (2010=100) ^{4/ 5/}	92.3	94.2	89.7	82.6	...	...	...
Fund Position (July 31, 2015)							
Quota (in millions of SDRs)				2395.5			
Reserve tranche position (in percent of quota)				13.0			
Holdings of SDRs (in percent of allocation)				97.2			

Other Indicators
GDP per capita (2014, USD): 58,538; **Population** (2014, million): 9.7; **Main products and exports**: Machinery, motor vehicles, paper products, pulp and wood; **Key export markets**: Germany, Norway, United Kingdom

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

1/ Data for 2015 is as of September 2015.

2/ Mortgage rates for new contracts, data for 2015 is as of September 2015.

3/ Data for 2015 is as of 2015Q2.

4/ Data for 2015 is as of August 2015

5/ Based on relative unit labor costs in manufacturing.



SWEDEN

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

November 13, 2015

KEY ISSUES

Sweden is expected to enjoy solid economic growth of about 3 percent y/y in 2015 and 2016, yet it faces intertwined challenges:

- Large migration inflows with effects on the labor market and on the budget;
- Rapid housing price increases associated with rising household indebtedness; and
- Low inflation and weakened inflation expectations.

Macroeconomic policies should support a rise in inflation and contain upside risks to unemployment. The firmly stimulatory stance of monetary policy is needed to avoid prolonged low inflation that would prevent monetary policy from regaining space to cushion shocks. Such a stance should continue until core inflation is durably close to target. The broadly neutral fiscal stance appropriately avoids impeding these efforts to raise inflation. Likely additional expenses related to migration should be accommodated in the near term. Looking to the medium term, maintaining central government balance on average over the cycle would be sufficient to safeguard Sweden's fiscal buffers.

It is critical that policies work together to address housing market imbalances that pose risks to stability and growth:

- Housing supply should be enhanced through land sale and planning reforms, which will also facilitate more competition in residential construction. Rent controls should be eliminated on new rental apartments and phased out more broadly.
- Mortgage interest deductibility should be phased out to moderate housing demand over time and limits on capital gains tax deferrals raised to release pent up supply.
- A debt-to-income limit should be adopted to contain rises in the already sizable share of highly indebted households, which adds to macroeconomic vulnerabilities.

Historically high migration inflows reinforce the importance of labor market reforms to broaden employment gains. Sweden has a well developed introduction program for refugees although the process of integration into employment is lengthy. Addressing high unemployment of lower skilled workers—by reducing high entry-level wages and easing strict employment protection, together with more effective training and job-matching services—would aid more rapid integration.

Approved By
Mahmood Pradhan
(EUR) and Peter Allum
(SPR)

Discussions for the 2015 Article IV consultation were held in Stockholm during September 17–29. The mission comprised Msrs. Beaumont (head) and Chen, and Mses. ElGanainy and Turk, and was assisted by Mr. Dowling and Ms. Rojas (all EUR). The mission met with Ms. Andersson, Minister of Finance; Mr. Bolund, Minister of Financial Markets and Consumer Affairs; Ms. Ekholm, State Secretary of the Finance Ministry; Mr. Ingves, Governor of the Sveriges Riksbank; the Parliamentary finance committee; the Parliamentary committee reviewing the target for general government net lending; and senior officials from the Financial Supervisory Authority, Swedish Debt Office, Competition Authority, Public Employment Service, and Migration Board. It also met with representatives of the banking sector, labor unions, enterprises, Fiscal Policy Council, National Institute of Economic Research and academics. Mr. Östros (OED) joined the discussions and Mr. Pradhan (EUR) attended some of the discussions.

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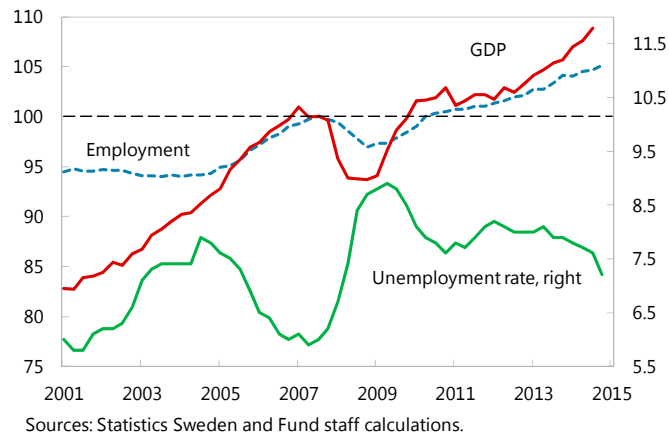
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SOLID GROWTH YET INTERTWINED CHALLENGES

1. Sweden's economy is performing well overall. GDP rose by 3 percent y/y in 2015 H1, picking up from 2.3 percent growth in 2014. The sources of H1 growth were balanced, with domestic demand up by 2.8 percent reflecting solid private consumption and rising residential investment, while services-led exports rose by 4 percent y/y. Continued robust job growth, at 1.3 percent y/y in the first three quarters, helped bring the unemployment rate down to 7¼ percent in Q3, from around 8 percent in recent years.

Key Economic Indicators, 2001-2015

(Index: 2008Q2=100, left; Percent, right)



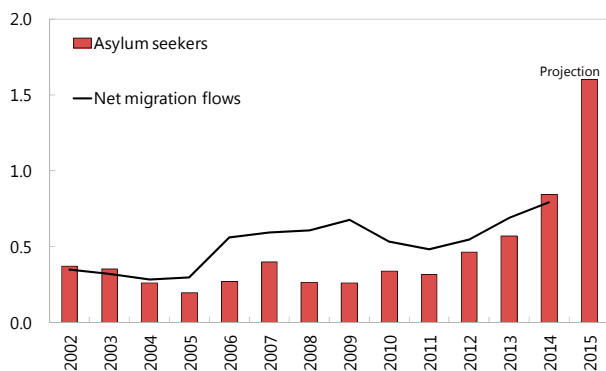
2. Yet Sweden faces a number of intertwined economic challenges:

- Large migration inflows with effects on the labor market and on the budget;
- Rapid housing price increases associated with rising household indebtedness; and
- Low inflation and weakened inflation expectations.

3. Migration inflows have risen sharply. At over 1½ percent of the population—with most being asylum seekers—estimates for migrant inflows in 2015 greatly exceed historical experience. Prospective inflows are highly uncertain, with current projections for 2016 at about 1¼ percent of the population, and inflows could remain high in later years. Government spending on refugees (introduction program and transfers to municipalities) is budgeted to rise from 0.3 percent of GDP in 2014 to about 0.7 percent by 2017, but supplementary spending of ¼ percent of GDP was recently proposed for 2015 and larger additions are expected in 2016 and thereafter. Sweden's framework for integrating refugees into the labor market is well developed (Box 1), but the process is often lengthy. This challenge overlaps with the issue of high unemployment of the low skilled.

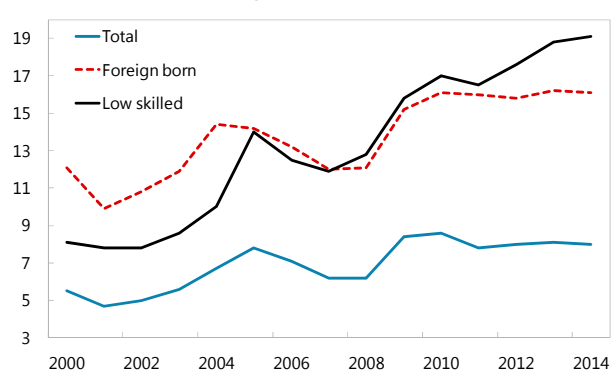
Net Migration and Asylum Seekers

(Percent of total population)



Unemployment Rates of Vulnerable Groups

(Percent of respective cohort, age 15-74)

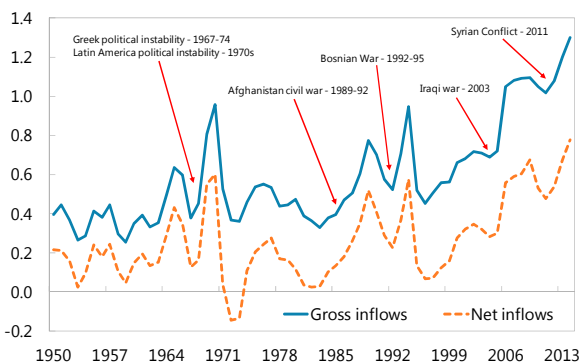


Box 1. Migration Flows and the Integration Framework for Asylum Seekers

Migration to Sweden has led to an increasingly diverse population. Net immigration to Sweden dates back to the 1930s and gross inflows have been rising over the years, reaching 1.3 percent of the population in 2014, up from $\frac{3}{4}$ percent in the early 2000s. Over that period, the share of foreign-born persons has risen from $11\frac{3}{4}$ to $16\frac{1}{2}$ percent of the population. Swedish migration policy has a strong humanitarian dimension, with peaks in migration inflows coinciding with wars and unrest elsewhere. Relative to its population, Sweden receives more asylum seekers than any other EU country.

Migration Flows

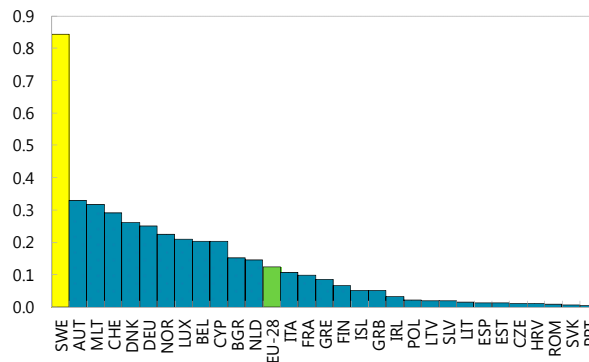
(Percent of population)



Sources: Statistics Sweden and Fund staff calculations.

Asylum Seekers, 2014

(Percent of population)



Sources: Eurostat and Fund staff calculations.

The composition of migrants to Sweden is changing. The share of those seeking asylum (and family reunification) is rising; in 2014, asylum seekers comprised about two-thirds of total migrant inflows, up from about one-third in 2010. The majority of asylum seekers in recent years come from Eritrea, Somalia, Afghanistan, Iraq, Iran, Kosovo, Albania, and Serbia, with Syria the largest source since 2012. In 2015, unaccompanied minors—primarily from Afghanistan—are more than 20 percent of total asylum seekers, up from about 8 percent over recent years.

Sweden has a well-developed framework for integrating refugees—the introduction program. Eligibility is restricted to asylum seekers who have received a residence permit as refugees, quota refugees, or other persons in need of protection, aged 20–64 years (or 18–19 years without parents living in Sweden) and their relatives. An introduction interview by the Public Employment Service (PES) assesses their experience, education, and ambitions in order to develop an “introduction plan” which can last up to 24 months. The plan has three main activities that should occupy participants full-time: (i) Swedish language training; (ii) employment preparation, such as the validation of education and professional experience; and (iii) social studies to provide a basic knowledge of Swedish society. Participation in the program is voluntary, but an introduction benefit is conditional on participation. Participants who find work are able to continue to claim the introduction benefit alongside their wages for six months, after which the benefit is reduced in proportion to the time spent working. The PES can assist refugees with an introduction plan in finding accommodation at a location where it considers the chances of obtaining work or education are good.

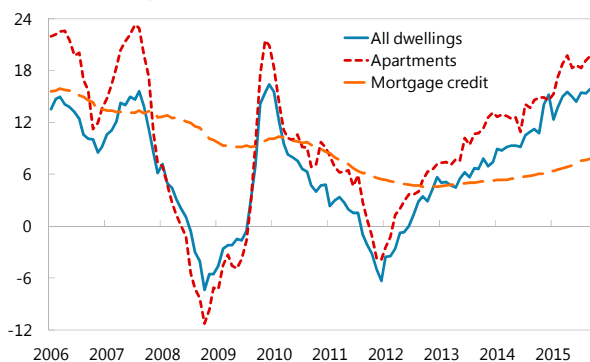
Nonetheless, rising asylum seeker inflows are stretching administrative capacity and leading to policy adjustments. Recent reports are for average daily inflows over 1,500 persons with the number of asylum seekers reaching about 160,000 in 2015 on updated estimates, up from 83,300 in the earlier official forecast. The average processing time for residency permits has doubled from an average of 108 days in 2012 to 220 days during Q1–Q3 2015. The authorities have announced that they would issue temporary residence permits for limited period, allowing for a later review of residency—with exceptions including unaccompanied minors and families with children who would continue to receive permanent residence permits. More recently border controls were established—migrants seeking asylum can enter Sweden only if they register on entry.

4. The housing market shows imbalances, with double-digit price gains as the urban population outpaces construction, pushing up household debt from already high levels.

Dwelling price rises accelerated to 16 percent y/y in September, led by apartment price increases exceeding 20 percent in Stockholm and Gothenburg. Housing supply is constrained by construction impediments and rent controls while demand is bolstered by population growth and urbanization, rising income and financial savings, and historically low interest rates. Households need to borrow more at higher house prices, with mortgage credit growth of 8 percent y/y in September lifting household debt to 176 percent of disposable income (195 percent including housing associations).

House Price and Mortgage Credit Growth

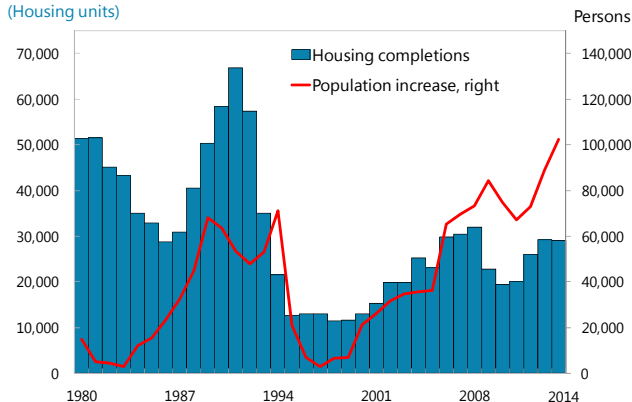
(Y/Y percent change)



Sources: Statistics Sweden, Valueguard, and Fund staff calculations.

Housing Completions and Change in Population

(Housing units)



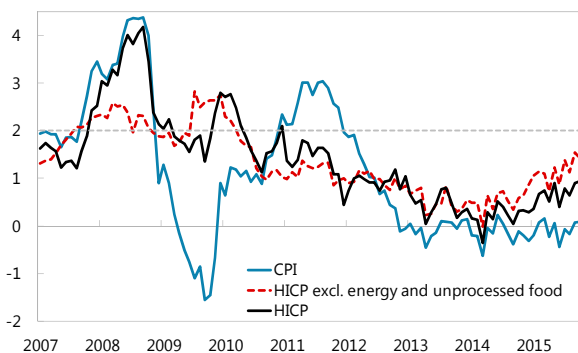
Sources: Statistics Sweden and Fund staff calculations.

5. Inflation has been below the 2 percent target for some years, dragging on expectations and potentially impacting wage negotiations.

Core inflation (HICP excluding energy and unprocessed food) averaged 1.2 percent y/y in the first ten months of 2015, up from only ½ percent in 2013–14. Declining resource utilization during 2011 to mid-2013 was a key driver of low inflation, exacerbated by [external factors](#) including commodity price falls, low euro area inflation, and past krona appreciation. Low inflation fed into inflation expectations, with 2-year expectations hitting their lowest level since 2000 in January, at 1.2 percent. Wage indicators have also slowed and employers have questioned using the inflation target as a basis for the coming negotiations on two-thirds of collective bargaining agreements, normally in force for three years.

Inflation

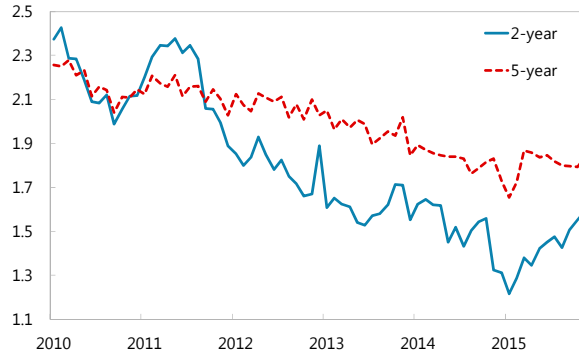
(Y/Y percent change)



Sources: Eurostat, Statistics Sweden and Fund staff calculations.

Inflation Expectations

(Percent)

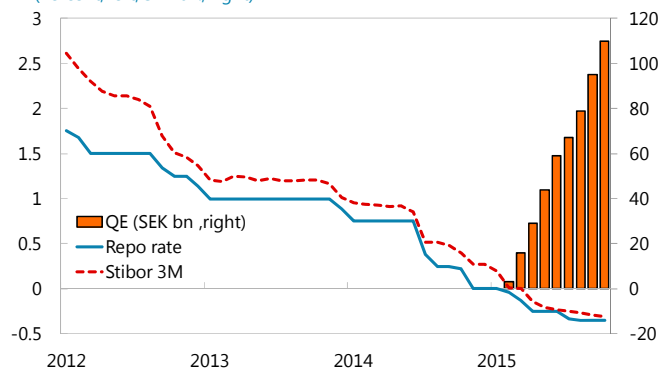


Sources: TNS Prospera and Fund staff calculations.

6. Signaling its commitment to the inflation target, the Riksbank introduced negative rates and a QE program in February 2015. After reaching 0 in October 2014, the repo rate was cut in three steps in 2015 to -0.35 percent in July. Purchases of government bonds total SEK 135 billion in 2015, some 20 percent of the outstanding stock or 4 percent of GDP. Noting an upward trend in inflation figures, yet a modestly lower outlook for growth and inflation in 2016 compared with its earlier projections, the [Riksbank](#) kept rates on hold in October, while extending bond purchases until mid-2016 by a further SEK 65 billion. It emphasized its readiness to do more if inflation prospects deteriorate, potentially including foreign exchange intervention if problematic market developments threaten the upturn in inflation.

Monetary Instruments ^{1/}

(Percent, left; SEK bil., right)



Sources: Sveriges Riksbank and Fund staff calculations.

1/ Orange bars represent the cumulative amount of government bonds that the Riksbank has already purchased by October 2015.

7. These challenges are arising in a difficult political context. The minority government in power since October 2014 failed to pass its first budget proposal. New elections were avoided by reaching the “December agreement” with opposition parties excluding an anti-immigration party and one other party. However, this agreement recently collapsed when a small party decided to exit. At this stage it appears that the government’s budget for 2016 will be passed but political uncertainties have risen.

STABILITY RISKS CLOUD BRIGHT PROSPECTS

8. Solid growth appears likely in the near term with inflation rising over the medium term. Growth in domestic demand is expected to be supported by easy monetary conditions, reinforced by additional migration-related government spending. Exports are also strengthening, especially of services, aided by a pickup in external demand. Overall, growth of about 3 percent y/y is projected in 2015 and 2016, easing to 2½ percent in the medium term. A range of indicators show declining slack in the economy, with solid growth expected to broadly close the output gap in 2016. A positive gap in later years is reflected in core HICP inflation rising to about 2 percent in 2017.

Macroeconomic Indicators

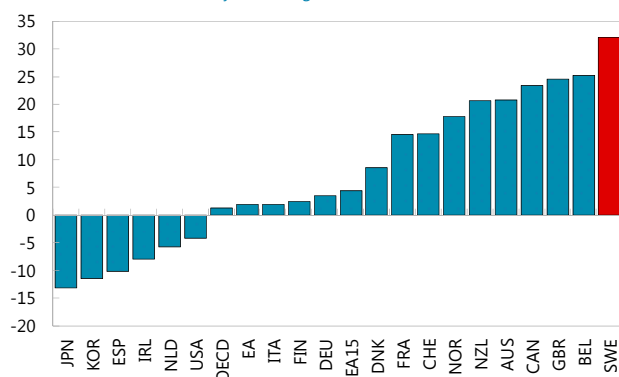
(Y/Y percent change, unless noted)	2013	2014	2015	2016	2017	2018
GDP	1.2	2.3	2.9	3.0	2.7	2.4
Domestic demand	1.6	3.4	2.5	3.3	2.7	2.5
Exports	-0.8	3.5	3.6	4.9	5.2	4.8
Trading partner GDP	1.2	1.9	1.8	2.1	2.3	2.3
Unemployment rate (percent)	8.0	7.9	7.5	7.4	7.3	7.2
Output gap (percent of potential GDP)	-2.3	-1.8	-0.9	-0.1	0.5	0.8
Core HICP inflation (e.o.p, percent)	0.4	0.7	1.4	1.5	1.9	2.4

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

9. However, house prices could continue rising from already high levels. Sweden’s house price-to-income ratio is 32 percent over its 20-year average, which is high relative to other OECD countries. Yet estimated models of house prices find that much of this deviation is accounted for by rising net financial wealth, migration, and low interest rates (Box 2), with housing prices estimated to be about 5½ percent above their long-term equilibrium, or 12 percent assuming real interest rates at more normal levels. Despite these signs of varying degrees of overvaluation, house price gains could well continue to exceed income growth given the rise in urban population relative to housing completions—the net share of households expecting house prices to rise is at record highs and low mortgage interest rates (averaging 1.6 percent recently) make larger mortgages more affordable.

House Price to Disposable Income Per Capita

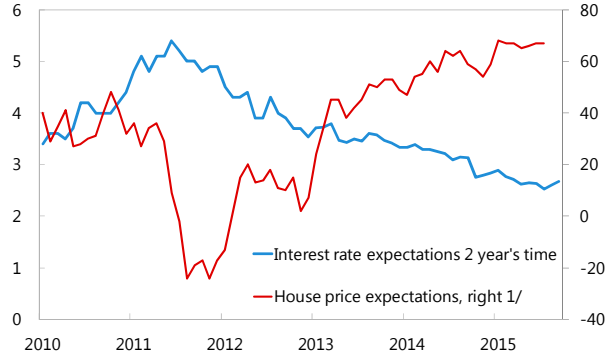
(Percent deviation from 20 year average)



Sources: OECD and Fund staff calculations.

Household Interest Rate and House Price Expectations

(Percent, left; Share of households balance, right)

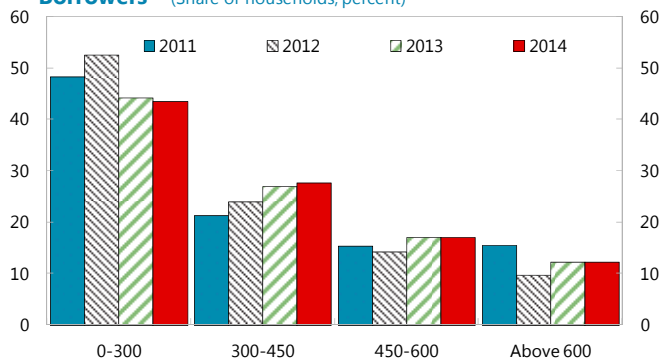


Sources: SEB, Sveriges Riksbank, and Fund staff calculations.
1/ Net share of households expecting house prices to rise.

10. Macroeconomic vulnerabilities would build as a larger share of households become highly indebted against expensive housing.

The share of new mortgages with debt-to-income (DTI) ratios of 300–450 percent has risen in recent years, and the share with DTI over 450 percent is high at 29 percent. Continued house price gains would likely raise these shares as house purchasers take on larger debts relative to income while still meeting the 85 percent loan-to-value (LTV) ceiling.¹ The further house prices and household debt rise relative to income, the greater is Sweden’s vulnerability to a prolonged recession after a shock owing to [wealth effects](#) and debt deleveraging. The [experiences](#) of [Denmark](#) and the [Netherlands](#) after the global financial crisis are indicative, although household debts and house price deviations appear to have been greater in these countries in 2008 than yet seen in Sweden.

Distribution of Debt-to-Income Ratios for New Mortgage Borrowers ^{1/} (Share of households, percent)



Sources: Finansinspektionen and Fund staff calculations.
Note: The figure shows debt-to-income ratios based on households’ total debt.
1/ Ratio based on disposable income, i.e., after tax.

¹ Such a rise was evident ahead of the Irish crisis; while over 90 percent of Irish mortgages were previously below 350 percent of income, by 2006-07 more than half were above that threshold (see Figure 4 in [Consultation Paper 87](#)).

Box 2. Housing Valuation and Policy Impacts

Broad trends in Swedish housing prices are largely accounted for by fundamental factors and the value of housing is a key determinant of household debt. A

forthcoming IMF staff working paper (Turk, 2015) finds the main drivers of real housing prices are disposable income, financial assets net of debt, real mortgage rates after tax deductions, and net migration. In parallel, household debt is driven by the value of the housing stock as well as real after-tax mortgage rates.

Real housing prices and household debt are estimated to be moderately above

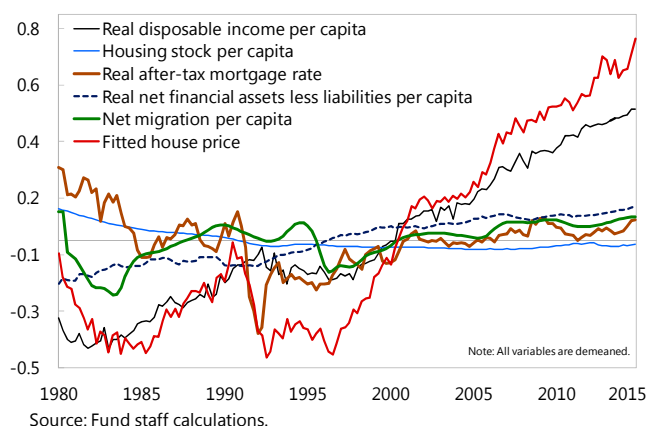
equilibrium. Estimation of a three-equation model (for housing prices, household debt, and residential investment) suggests that housing prices and household debt are above their long run equilibrium level by about 5½ and 6¼ percent respectively. Yet, real mortgage interest rates are some 1½ percentage points below their average since 2000 and could potentially rise in the medium term. Under this scenario, the combined effect of the valuation gap and interest rate reversal is a decrease in housing prices and household debt by 12 and 11 percent respectively. The analysis also finds that past house price gains fuel borrowing that in turn bolsters house prices, with a potentially disruptive eventual return to equilibrium.

Model simulations indicate that the impact of phasing out tax deductibility of mortgage interest is manageable. A gradual elimination of mortgage

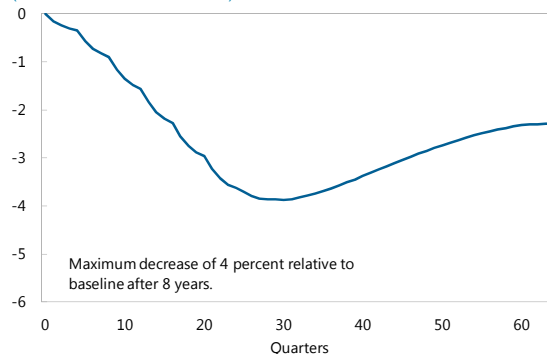
interest deductibility—cutting the 30 percent deduction by 5 percentage points per annum—is expected to lower housing prices by about 4 percent over 8 years, with household debt declining 5½ percent over 11 years. These modest estimated impacts partly reflect the current low level of interest rates, making this a good time to phase-out deductibility. Even at somewhat higher interest rates, the macroeconomic impact of phasing out mortgage interest deductibility would be manageable in the context of housing price trends due to rising income and net financial assets.

Expanding the supply of housing would have a small and gradual impact on prices. The government plans to bolster construction, to bring the cumulative increase in the housing stock to 250,000 dwellings over the medium term. Reaching this target is estimated to require 60,000 additional dwellings than in the baseline, a 1.3 percent addition to the housing stock, which is estimated to reduce real housing prices by only 1.4 percent by 2020.

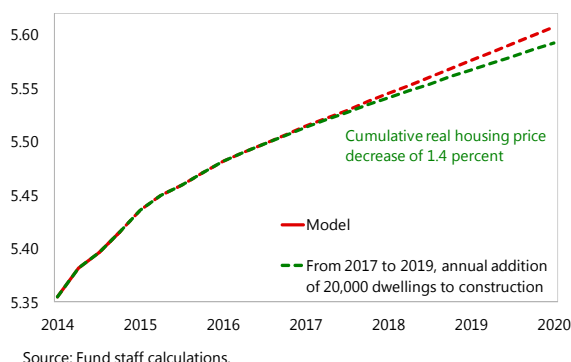
Contribution of Fundamentals to Housing Prices
(All variables demeaned)



Impact of Phasing Out Tax Deductibility on Real Housing Prices
(Percent deviation from baseline)



Impact of Increasing Housing Supply on Real Housing Prices
(Logs)

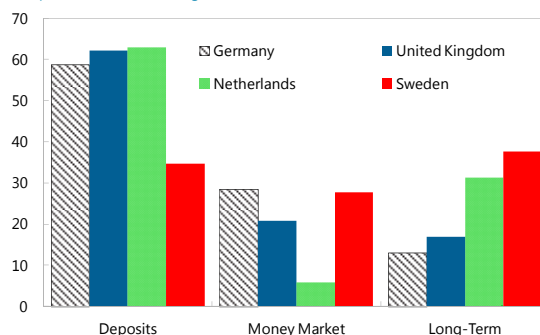


11. Such a rise in vulnerabilities would exacerbate downside risks to Sweden's outlook in the medium term from a range of potential shocks (see also the Risk Assessment Matrix):

- **External activity risks.** Weakness in euro area or emerging market activity, potentially associated with commodity price falls, would weigh on Swedish exports and growth. Krona appreciation, perhaps due to expanded QE in the euro area, would reinforce this impact. Domestic vulnerabilities could amplify the impact of such shocks, especially if continued low inflation left monetary policy with little space.
- **International financial risks.** More volatile global financial markets could raise credit spreads on Swedish bank funding. Such costs would over time be passed into lending rates, dragging on demand and perhaps impacting the housing market.
- **Domestic risks.** Although risks of a housing price correction seem modest for now, they would escalate if double-digit house price rises continue. There are also risks to the outlook for unemployment from the wide range of possible migration inflows, and the extent to which such unemployment would be structural is unclear, increasing inflation uncertainties.

Bank Funding Structure, 2014

(In percent of total funding)



Sources: Bankscope and Fund staff calculations.

12. Authorities' views. *The Swedish authorities shared broadly similar macroeconomic projections. They also had rising concerns around the high rate of housing price increases but had varying views about the scale of the associated macroeconomic vulnerabilities, with the Riksbank most concerned on this front. The authorities also saw a similar range of external and domestic risks.*

POLICIES NEED TO WORK TOGETHER

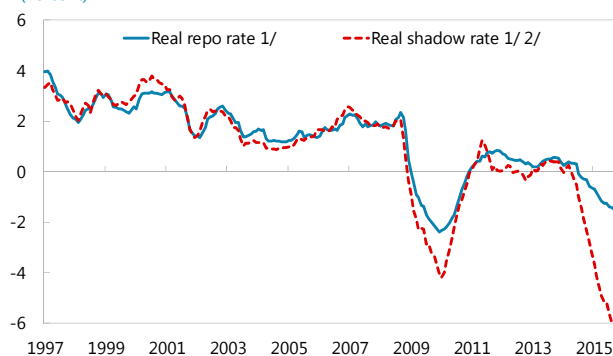
13. Economic policies should support a rise in inflation and limit the upside risks to unemployment while protecting macrofinancial stability over the medium term. A firmly stimulatory monetary stance is appropriate to avoid prolonged low inflation that would prevent monetary policy from regaining space to cushion shocks. Addressing house price and household debt vulnerabilities in a durable manner requires structural reforms and fiscal measures to rebalance housing supply and demand. Yet the benefits of such reforms would come over time. Hence, well targeted prudential measures are also needed, calibrated to protect household financial resilience while avoiding significant drag on domestic demand that would counteract monetary stimulus. Sweden's fiscal position provides room for a broadly neutral stance in the near term and allows potential migration costs to be met over the medium term, while undertaking reforms to help address the housing and unemployment challenges.

A. Monetary and Exchange Rate Policy

14. The Riksbank's shift to unconventional measures from February has generated a firmly stimulatory monetary stance. The negative repo rate is about 3 percentage points below its historical average in real terms. Lending and deposit rates for households and firms have declined broadly in line with the repo rate, but have remained positive aside from deposits of large corporations.² Swedish QE has further lowered the yield curve, with negative yields on government bonds out to about 5 years, and yields on banks' covered bonds have moved down roughly in parallel. The "shadow rate" illustrates the lower repo rate consistent with the impact of QE on the yield curve. As of October, the krona has depreciated by 4 percent in nominal effective terms from its 2014 average, further contributing to easy monetary conditions.

Monetary Policy Stance

(Percent)



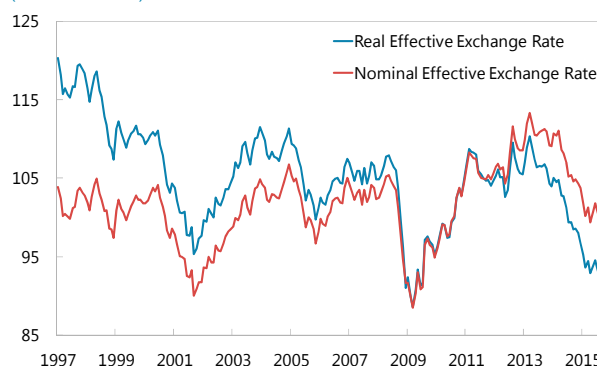
Sources: Sveriges Riksbank and Fund staff calculations.

1/ Based on a 6-month moving average of core HICP inflation.

2/ The shadow rate is calculated following Wu and Xia (2015).

Exchange Rates

(Index: 2010=100)



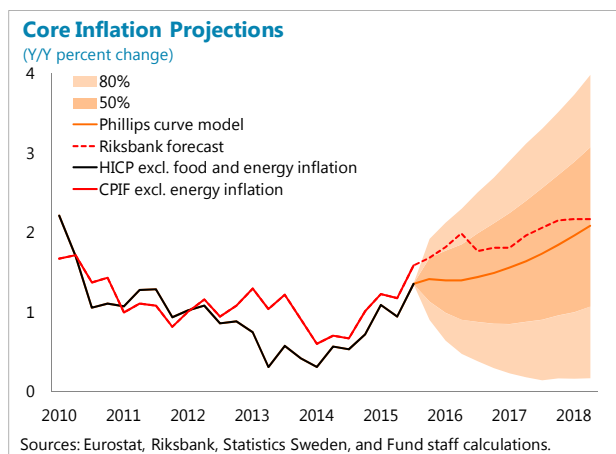
Sources: IMF Information Notice System, Riksbank, and Fund staff calculations.

15. This stimulatory stance is appropriate as the urgency of returning inflation to the 2 percent target has increased. As noted, inflation expectations fell significantly in the three months to January 2015, with 2-year ahead inflation expectations down to only 1.2 percent. Allowing low inflation to persist would pose increasing risk to the credibility of the inflation target, damaging its effectiveness in promoting macroeconomic stability including through steady functioning of the wage formation process. This consideration has become particularly important as a collective bargaining round beginning at end 2015 will set floors on nominal wage increases, usually in force for a three year period. Hence, even as concerns around housing price and household debt vulnerabilities rose, it was appropriate for monetary policy to not "[lean against the wind](#)". Although monetary stimulus adds to pressures on housing prices and household debt, low interest rates are estimated to account for a small part of the rises in recent years, whereas allowing low inflation to persist could also undermine stability, including by likely requiring a more extended period of low interest rates.

² The net interest margin of major banks in the first nine months of 2015 was higher than the same period last year, even as the major banks report some impact from not fully passing on negative interest rates to depositors.

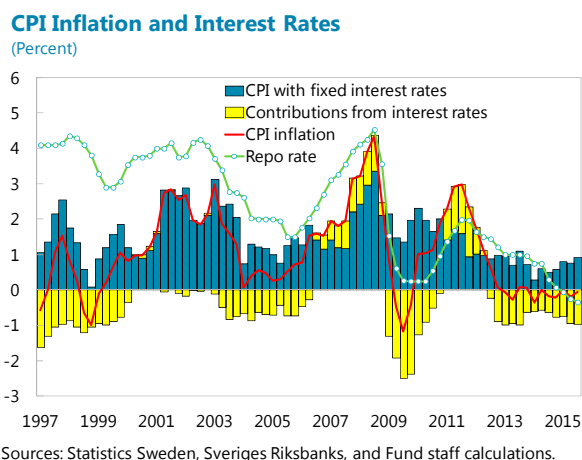
16. Such a stance should continue until core inflation is durably close to target.

From an average of ½ percent y/y in 2014, core HICP inflation has risen to 1.4 percent y/y in recent months, partly due to krona depreciation. Resource utilization has been rising since mid-2013 and will further increase in view of solid growth prospects, underpinning a pick up in domestic inflation, with staff projecting core HICP inflation at about 2 percent by end 2017. This inflation outlook suggests no major change in monetary instruments is needed at this stage. The recent extension of QE into 2016 was appropriate to maintain the current expansionary stance.



17. The Riksbank should remain ready to do more. Although recent inflation out-turns are positive, some downsides to the inflation outlook remain. Appropriately, the Riksbank is prepared to make monetary policy more expansionary if needed, where it has a number of options. The repo rate can be cut further, as indicated by Danish and Swiss policy rates at -0.75 percent, although the impact on lending rates may weaken as banks are reluctant to charge depositors. Even as it extended government bond purchases, the Riksbank indicated that it can purchase more securities; making covered bonds eligible for purchases would greatly expand the pool of assets, though there may be signaling issues given concerns about appearing to fuel housing prices. The option to launch a lending program via the banks for companies also remains. Foreign exchange intervention should be a last resort after other instruments are exhausted considering Sweden's strong external position and the undervaluation of the krona (Box 3).

18. A revision of the inflation measure targeted would have significant advantages. The target adopted by the Riksbank is in terms of Sweden's CPI, which includes mortgage interest costs. Repo rate cuts therefore result in a notable immediate fall in headline CPI inflation. Absent declines in interest rates, headline CPI inflation would have averaged about 0.9 percent y/y rather than 0 in recent years. Recognizing these issues, in practice the Riksbank focuses on a CPI measure with fixed interest rates when setting monetary policy. But having a target in terms of the internationally comparable HICP would reduce communication issues and enhance credibility.



19. Authorities' views. The authorities shared the same perspective on the monetary policy stance. The Riksbank noted that it had called for macroprudential measures to address vulnerabilities. Any change in the inflation measure targeted was best considered once inflation was back at target.

Box 3. External Assessment

The External Balance Assessment (EBA) methodology suggests that in 2015 the krona is substantially undervalued. Since the beginning of 2015, the Riksbank shifted to negative rates and a QE program to combat low inflation. This led to an 8 percent depreciation of the real effective exchange rate (REER) as of August 2015 compared with the average for 2014—which has partly reversed with recent appreciation. As a result, the REER gap has widened from 2014, when the krona was assessed to be moderately undervalued.

External Balance Assessment (EBA) Methodologies, 2015 ^{1/}

Methodology	CA gap (percent of GDP)	REER gap (percent)
EBA CA Analysis	8.5	-
EBA REER (index) Analysis	-	-22.8
EBA REER (level) Analysis	-	-24.1
Staff Assessment	0 to 5	-11 to -1

Source: IMF World Economic Outlook and Fund staff calculations.
1/ CA and REER gaps: Minus indicates undervaluation. The 2015 year average REER is calculated using actual REER through August 2015, and holding the August 2015 REER fixed through December 2015.

A number of factors are important when evaluating Sweden's external position:

- The krona is *freely floating* and there are no policy distortions impacting the current account.
- *Demographic and institutional factors* tend to influence the current account in Sweden but can be difficult to capture fully in a cross-country approach such as the EBA. Sweden's high saving rate, which is not unusual for an aging society, is reinforced by pension and welfare reforms since the mid-1990s including a shift to a defined contributions pension scheme and a decline in transfers.
- *Other structural factors* shaping Sweden's current account are not reflected in the EBA-estimated gap. Sweden operates as a regional financial center for the Nordic region (with banking assets over 400 percent of GDP, of which about 170 percent of GDP in assets are outside Sweden) and the country plays a significant role in merchanting trade. Both characteristics have been shown to lead to persistently larger current account balances, with merchanting trade in particular having accounted for a substantial share current account dynamics in the past decade.
- *Statistical issues raise some doubts about the current account position.* The Swedish net IIP is near balance at -0.3 percent of GDP in 2014, with gross external liabilities at 294 percent of GDP. But the increase over time in the net IIP is generally smaller than the cumulative current account balances, although this is in part explained by negative valuation effects.

Taking these factors into consideration, staff assesses the krona to be undervalued by about 10 percent, as a significant part of the Swedish current account surplus is structural. Staff assesses Sweden's adjusted current account norm to be around 2½–6½ percent of GDP, implying a current account gap in the range of 0 to 5 percent of GDP in 2015. As a result, the REER gap is assessed to be in the lower end of the -11 to -1 percent range in 2015, considering the EBA REER analysis.

This undervaluation is expected to be temporary, with the krona likely to appreciate once the monetary easing cycle ends. Staff assesses that the monetary policy stance is consistent with Sweden's inflation targeting framework, and expects monetary conditions to begin to normalize once core inflation is close to the target. The timing for the krona appreciating toward its fundamental value is uncertain, but it could happen as early as 2016 under the Riksbank's forecasts. Reflecting, in part, the temporary nature of the krona weakness, staff projects only a modest rise in the current account in 2015 followed by a slow decline over the medium term.

The current level of foreign currency reserve holdings appears broadly appropriate. Reserves stood at US\$50.5 billion in September 2015, equivalent to about 40 percent of Swedish banks' short term foreign currency liabilities. In view of the high dependence of Swedish banks on wholesale funding in foreign currency, and the disruptions in such funding that have occurred at times of international financial distress, maintaining adequate foreign currency liquidity buffers is prudent.

B. Fiscal Policy

20. The Budget Bill for 2016 targets a deficit just under 1 percent of GDP. New initiatives in the budget of 0.6 percent of GDP include spending on housing construction subsidies, welfare, education, and migrant integration. These new initiatives are funded by reduced tax deductibility for dwelling repairs and improvements, higher energy taxes, and a gradual tapering of the amount of the earned income tax credit as income rises. Rises in sickness leave benefits and migration-related spending are about $\frac{1}{4}$ percent of GDP in 2016 and capital gains revenues are projected to decline from high levels in 2015. Nonetheless, consolidation in other areas means the budget targets a deficit of 0.9 percent of GDP in 2016, the same level as projected for 2015.

21. The fiscal stance is appropriate and additional expenses related to migration should be accommodated in the near term. The structural balance in 2016 is projected to be little changed from 2015, at about -0.7 percent of GDP. This broadly neutral fiscal stance is appropriate given the need to avoid impeding monetary policy efforts to raise inflation. A rise in expenses owing to migration inflows exceeding budget assumptions—perhaps around $\frac{1}{2}$ percent of GDP in 2016—should be accommodated in the near term and funded over time as part of achieving medium-term fiscal targets. Investments in helping migrants gain jobs will reduce costs in the medium term and maximize their contributions to growth in the long run. Discretionary fiscal stimulus is not warranted given solid growth prospects, but full operation of the automatic stabilizers should be allowed.

22. Maintaining balance over the cycle is sufficient to safeguard Sweden's fiscal buffers, entailing a need to raise the fiscal balance over the medium term. The long standing fiscal target of a 1 percent of GDP surplus over the cycle has enabled a reduction in public debt to a relatively modest level, at 44 percent in 2015. The government has proposed to lower the target to balance over the cycle, which would allow growth to erode the debt ratio over time. This fiscal target should be reviewed periodically to keep it consistent with a prudent level of public debt or net worth. Its coverage could be narrowed to exclude the defined contribution pension system so that the central government balance need not be adjusted to offset variations in the pension balance.

23. Fiscal policy should support a rebalancing of the housing market. Sweden's tax system strongly favors debt-financed home ownership, benefitting higher income households disproportionately. Raising property tax would be preferred, but given the political difficulties a package of other measures should be adopted in a broadly fiscally neutral manner:

- **Phasing out mortgage interest deductibility would ease demand gradually.** Deductibility from income tax liabilities of 30 percent of interest costs (21 percent above SEK 100,000) currently costs about $\frac{1}{2}$ percent of GDP. A number of European countries have eliminated tax deductibility in recent years or are in the process of phasing it out. This is an ideal time to start phasing out deductibility in Sweden given low interest rates and the robust housing market. A gradual reduction, such as by 5 percentage points annually, would have little drag on growth, as the estimated impact on house prices is modest, at about 4 percent over eight years, while debt declines about $5\frac{1}{2}$ percent over 11 years (Box 2).

Examples of Phasing Out Tax Deductibility of Mortgage Interest

	Denmark		Reduction Finland		Netherlands		Elimination Ireland		Spain	
	From	To	From	To	From	To	From	To	From	To
Rate of deductibility (in percent)	33	25	65	25	52	38	30	0	20	0
Timing	2012	2019	2016	2019	2014	2041	2012	2017	2013	2013

Sources: Selected issues papers for Denmark and Netherlands, country authorities for Finland, and IMF Country Report No. 15/1.

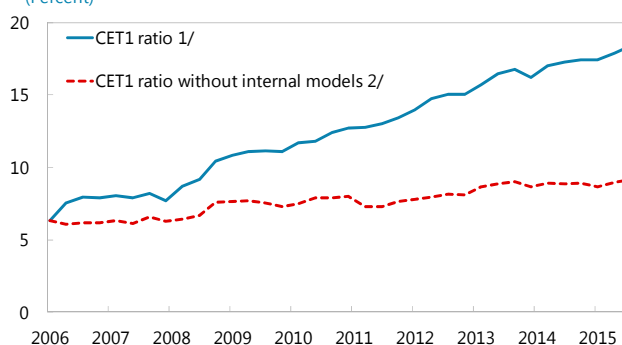
- **Adjusting capital gains taxes would enhance effective supply.** Households have accumulated significant gains on their primary residences that discourage turnover as their housing needs change. Raising the threshold for deferring capital gains taxes on primary dwellings would facilitate more efficient use of existing dwellings.
- **Supporting construction of affordable rental property in locations with jobs.** The 2016 budget allocates 0.1 percent of GDP annually to subsidizing such construction, where this additional supply is expected to have small price impacts (Box 2). Indeed, this support likely needs to be expanded and combined with reducing housing supply impediments (section E).

24. Authorities' views. *The authorities agreed that a broadly neutral fiscal stance is appropriate and noted their intention to accommodate additional migration-related costs in the near term. The budget for 2016 sets out a gradual rise in the fiscal balance in the medium term and they welcomed the support for targeting balance over the cycle. The Government has so far not favored reducing mortgage interest deductibility, partly to avoid risks of a "hard landing" in the housing market.*

C. Prudential Policy

25. Swedish banks appear healthy, but risk weights on some assets should be reviewed. Capital adequacy and profitability ratios are solid and funding structures close to Basel III requirements, although Swedish banks have a relatively high share of debt securities due in less than 1 year. However, strong regulatory capital ratios benefit from declining risk weights as internal ratings based models are partly driven by low default rates in recent years. It is therefore welcome that the Financial Supervisory Authority (FSA) is reviewing risk weights on corporate loans.

Capital Ratios of Major Banks
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

1/ With banks' reported risk weights.

2/ Excluding risk-weight reduction driven by the transition to internal models.

26. Macroprudential policies have been strengthened in recent years, but macroeconomic vulnerabilities can increase as house prices rise. In 2010 the FSA established a Loan-to-Value (LTV) ceiling of 85 percent, with new mortgages having an average LTV of 70 percent in 2014. But

households can take on more debt relative to income as house prices rise, even if prices rise above sustainable levels. There is a framework in place to contain risks of mortgage default.³ Yet macroeconomic vulnerabilities increase with the share of households with high debt to income (DTI) ratios, as their disposable income is more sensitive to interest rate fluctuations. Moreover, if house prices decline, such households would face a larger fall in their net wealth relative to income and a higher risk of debt overhangs relative to their assets.

Macprudential Instrument Status

Instrument	Percent
Countercyclical capital buffer *	1
Capital conservation buffer	2.5
Systemic risk buffer	3
Additional buffer for systemically important inst.	2
Mortgage risk weight floor	25
Liquidity coverage ratio (all currency, usd, euro)	100
Loan-to-value	85

Sources: FSA, Riksbank, and Fund staff calculations.

*To be raised to 1.5 percent in June 2016.

27. A Debt-to-Income (DTI) limit would safeguard financial resilience while containing the drag on growth, but it cannot substitute for housing market reforms. Rather than rationing credit that is still growing at a single digit pace, such limits would aim to avoid a further rise in the share of high DTI loans, which is already sizable.⁴ The DTI limits set for the [UK](#) (450 percent) and [Ireland](#) (350 percent) allow a portion of new mortgages (15 and 20 percent respectively) to exceed these thresholds.⁵ Following a similar approach in Sweden would allow the limit to be calibrated such that few households would face an additional constraint on the amount of their borrowing at the outset.⁶ To the extent that house price gains continue to outpace income, the limit would affect more borrowers over time, protecting their resilience in part by reducing their LTV ratio. Such effects would be focused on the main centers, especially Stockholm, where house prices are highest.

28. The much delayed amortization requirements should also be implemented.

Discussions in recent years around mortgage amortization appear to have contributed to a change in culture, with 68 percent of new mortgage loans being amortized in 2014, up from 42 percent in 2011. The FSA proposed a regulation in November 2014—for minimum amortization of 2 percent of the original loan when LTV is over 70 percent and 1 percent when LTV is over 50 percent—but this was later withdrawn after a court questioned the FSA’s mandate. In September the authorities proposed legislation authorizing the FSA to adopt an amortization requirement for consultation, with the specific FSA regulation subject to government approval, completing these steps by around mid-2016. As most mortgages with a higher LTV are already amortizing, the impact on demand is expected to be small, and effects on debt will be gradual as only new mortgages would be covered.

³ Banks stress test each mortgage borrower and are being conservative by using interest rates of 7-8 percent despite mortgage rates below 2 percent. FSA stress tests ([The Swedish Mortgage Market 2015](#)) find households to be resilient to a range of shocks. During the banking crisis in the early 1990s the rise in mortgage arrears was small, where the [Swedish Enforcement Authority](#) contributes to the robustness of household debt service.

⁴ A recent [paper](#) finds 38.7 percent of mortgages have DTI over 400 percent of disposable income and 22.4 percent have DTI over 500 percent. These ratios are not directly comparable to those for the U.K. and Ireland, which are based on gross income.

⁵ A limit covering all mortgage originators in Sweden would help limit leakages. The comprehensive coverage of the private credit bureau could enable all household debt to be covered, containing substitution into unsecured debts.

⁶ One of the banks indicated that it was applying its own DTI limit of about 500 percent on new mortgages.

It is nonetheless important to cement recent progress on amortization by putting the regulation in place. The adequacy of debt amortization should be kept under review.

29. It is essential that the framework for macroprudential policies be strengthened to enable timely action with suitable checks and balances. The FSA was assigned responsibility for macroprudential policy in 2013. But, as became evident in the case of amortization requirements, its legal mandate for financial stability and consumer protection does not ensure it can take certain measures principally aimed at protecting macroeconomic stability. The resulting stop and go process of adopting amortization requirements has generated market uncertainties. Especially in the current circumstances, there is an urgent need to strengthen the FSA's legal mandate to deploy a range of macroprudential tools to address risks in a timely and efficient way.⁷ If targeted macroprudential tools are delayed, banks' capital buffers may need to be further increased.

30. Regional cooperation on financial stability issues, especially for large cross-border banks, should be enhanced. Nordea, a major bank in the region, plans to change to a branch structure. With Nordea's assets outside Sweden amounting to over 100 percent of the country's GDP, it will be essential to establish robust cross-border cooperation and information sharing between the Swedish, regional, and European authorities, with respect to supervision, depositor protection, and resolution arrangements.

31. Authorities' views. *The authorities are monitoring housing market and household debt developments situation closely. At this juncture, they favor assessing the impact of amortization requirements before taking further steps given uncertainty around the impacts of macroprudential measures. A DTI limit is among a number of tools that could be considered. The FSA noted that they presently have several macroprudential tools at their disposal which can be used if the financial stability is threatened or for consumer protection purposes. Also the legal mandate for the FSA to implement an amortization requirement is being strengthened. There is an ongoing discussion on the need to further strengthen the FSA legal mandate to implement macroprudential tools. The Riksbank believes that further measures and tools are urgently needed and that housing market reforms are key. The authorities are monitoring Nordea's plans to change to a branch structure carefully and they agreed on the importance of continuing the well-functioning close supervisory and resolution cooperation both within the region and Europe.*

D. Labor Market Policy

32. The Swedish labor market has become increasingly polarized and the rise in migration inflows could initially raise unemployment. Sweden has enjoyed a rise in the labor force participation in recent years, in part reflecting rising female participation (Box 4), and also higher participation among young, older, and foreign born workers. However, job creation since 2007 has been largely focused on higher skilled workers, leaving those with low skills with an unemployment rate of 19 percent. Although employment of the foreign-born has risen substantially, their

⁷ A forthcoming IMF staff paper (Chen and Columba, 2015) finds welfare benefits from using a combination of tools.

unemployment rate is also high, at 16 percent. These gaps relative to total unemployment of 7¼ percent are relatively wide in Sweden, in part reflecting high entry-level wages (75–80 percent of average wages) and strict employment protection for regular contracts.⁸ Historically, the [employment rates of migrants](#) have risen toward the high level of Swedes, but the integration process is lengthy, taking about 10 years to reach an employment rate of 60 percent. Hence the large migration inflows could result in a significant rise in unemployment unless the pace of integration can be improved (see Chapter I of the selected issues paper).

33. Job creation should be facilitated by reforms that better adapt the labor market to the evolving composition of the labor force. The social partners should ensure that entry-level wages are not a barrier for groups with high unemployment to enter the labor market. Options include enhancing wage flexibility at the firm level or special wage scales for those needing on-the-job training. Social supports and tax credits would cushion disposable incomes. Strict employment protection for regular contracts results in high implicit minimum educational and skill requirements that form non-wage barriers to regular contracts which may have greater impacts on foreign-born workers. Employment protection law should be reviewed to ensure that such exit costs do not deter firms from hiring new entrants with sufficient skills. Providing training more aligned with employer needs would better enable vulnerable groups to gain jobs and early active labor market support should be targeted to cases of high long-term unemployment risk. The effectiveness of public job matching services needs improvement, including by expanding contacts with employers, especially as combining wage subsidies with better matching would enhance their employment benefits.

34. Faster integration of refugees into the labor market would maximize their contributions to the Swedish economy. As discussed in Box 1, Sweden has a well-developed introduction program for refugees. The authorities are seeking improvements, such as the “fast tracks” initiative for migrants with skills in occupations where there is a shortage, and they are changing the reception system to designate municipalities to receive refugees based mostly on job opportunities. Further efforts to expedite the residency permit, educational assessment, and skill validation processes, are needed in view of rising numbers. Expanding employment programs for youth that combine work and training, such as the [vocational introduction employment](#) program, to also cover newly arrived refugees could help them gain their first job quickly and build needed skills.

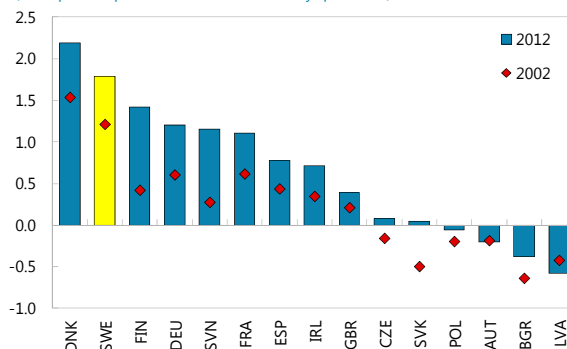
35. Authorities’ views. *The authorities agreed on the importance of enhancing training and job matching. However, they noted that the relatively low take up of some wage subsidies raises doubts as to whether wage floors are the only barriers to hinder the employment of vulnerable groups. They noted that the impact of employment protection was mitigated by temporary contracts with low protection. Social partners had differing views. Labor unions stressed the importance of protecting minimum wages—at least 75 percent of average wages—as a key pillar of Sweden’s social model and considered that use of employment subsidies should be expanded, including to higher skill jobs. Employers noted the relatively small share of low skill jobs available in Sweden, pointing to the need to ease wage compression both within and across sectors, to help the low skilled and migrants gain jobs.*

⁸ See Giang Ho and Kazuko Shirono, “The Nordic Labor Market and Migration,” forthcoming IMF staff working paper.

Box 4. Female Labor Participation and Senior Management Representation

Policy efforts in Sweden have achieved high female employment. Policies such as parental leave, subsidized child care, and scope for shorter working hours for parents with young children have made it easier for women to enter the workforce and return following childbirth. Similar to other Nordic countries, attitudes toward women working in Sweden are also markedly more positive than in other European countries. In 2014, female labor force participation among the 25 to 54 year olds stood at 88 percent in Sweden, well above the European Union average of 81 percent. And the gender gap in wages of 13 percentage points is lower than the EU average of 16 percent. Unlike other advanced European countries such as Germany, the Netherlands, and the United Kingdom, women in Sweden are much less likely to participate in the labor force on a part time basis.

Attitude Towards Women Working
(Principal component of answers to survey questions)



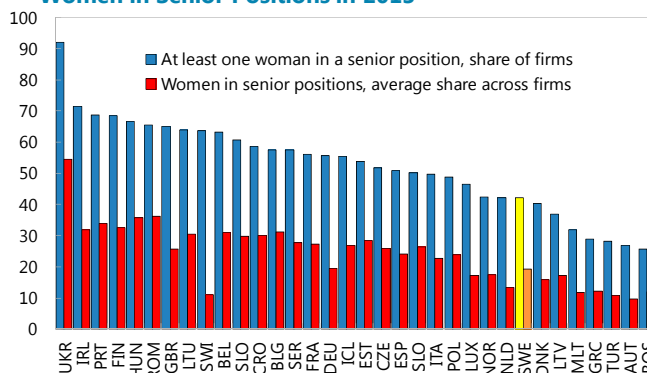
Sources: International Social Survey Programme and Fund staff calculations.

Gender equity in participation rates and hours worked could lift Sweden’s potential output by 6 percent. Based on a simple analysis in a forthcoming paper, the room for output gains from gender equity is smaller in Sweden than in most countries given the already high female employment rate. Yet, shifting from part-time to full-time work could still raise potential output notably over time.

Female representation in managerial roles falls short despite relatively high participation in corporate boards. Female representation in management (27 percent) is below the EU-27 average (33 percent), despite a higher share of women on supervisory boards (26 versus 16 percent for the EU-27).¹ Moreover, segregation by gender across sectors and occupations is more pronounced in Sweden than in other countries (European Commission, 2013).

Higher female employment in senior managerial positions could yield significant additional economic benefits by improving firm productivity. Firm-level analysis in a forthcoming staff discussion note finds that higher female participation in senior management is associated with better firm financial performance on average. The positive correlation between firm profitability and the share of women on corporate boards/management is particularly pronounced in sectors with a higher prevalence of women in the labor force, such as the services sector. Sweden has scope for improvement. Among firms with at least two members in senior management, only 42 percent have at least one woman in a senior position. In addition, the average share of females in total senior management and board members is also less than 20 percent across all firms.

Women in Senior Positions in 2013

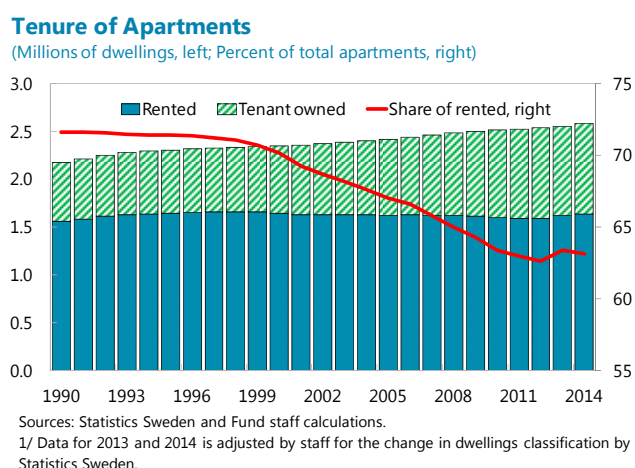
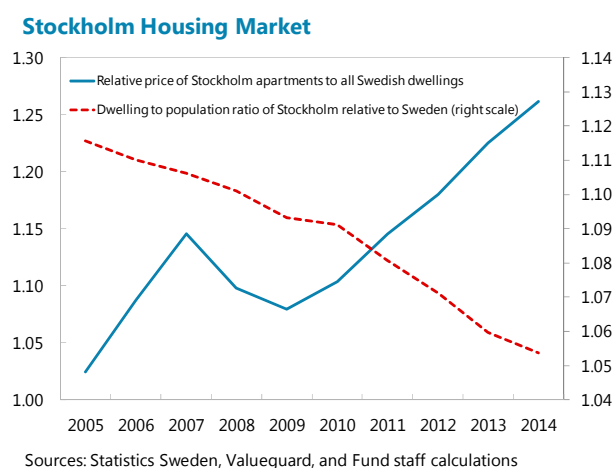


Sources: Orbis and IMF staff estimates. Averages based on firms reporting that members of senior management and board total are at least two, and without missing information on total assets, earnings before interest and taxes, or the gender of members of senior management and board.

¹ To comply with the European Commission’s proposed 40 percent objective of females in board positions of listed companies, Denmark, Finland, Netherlands, Norway, and Spain have adopted a legal quota for female board members., but such a quota has not been adopted in Sweden.

E. Housing Policy

36. Housing supply is falling behind needs owing to impediments to competition and rent controls. Rising residential property prices in part reflect ongoing urbanization and migration trends (Box 2) together with a limited supply response in urban centers (see Chapter II of the selected issues paper). Despite rising profitability in the construction sector, the construction response is inadequate, with low [competition](#) in the sector partly reflecting municipal land acquisition and planning systems that are complex and time consuming, favoring larger companies and those with local knowledge. Moreover, rent controls reduce the supply of rental apartments by driving conversion into tenant ownership and deterring new construction. Controls also have “lock in” effects where rents are low, hindering the efficient utilization of the remaining rental supply. With long waiting lists for rental homes, many young households have to buy rather than rent.



37. Reforms to enhance housing supply are needed, to both contain stability risks and support employment. Building affordable rental housing in or near the main centers where job prospects are best is the highest priority to promote labor mobility and support migrant integration. As noted in Box 2, enhancing housing supply has gradual impacts on prices as—even at higher levels—new construction remains modest relative to the dwelling stock. Key steps would include:

- **Enhancing land acquisition and planning procedures.** These procedures are a municipal responsibility, but the central government could incentivize municipalities to make these processes more transparent, standardized, and timely. This would facilitate activity by a wider range of construction companies. Municipalities could grant “use it or lose it” permits and the central government could charge taxes on undeveloped land to ensure the companies undertake projects in a timely manner.
- **Phasing out rent controls.** Newly constructed rental apartments are exempt from controls for a period, but uncertainties should be removed by permanently exempting all new construction. Existing controls—which have the most impact in Stockholm—should be phased out, with vulnerable households protected through the housing allowance.

38. Authorities' views. *The authorities are concerned about rising house prices and the budget provides subsidies specifically targeted at boosting construction of smaller and affordable rental apartments. They noted that municipalities were legally responsible for key aspects of housing supply, such that the central government needed their cooperation to address these issues. The criticism of the rent setting system and the consequences of how it has been implemented are long standing but it is politically difficult to address this issue given strong support for the present system and as market rents are associated with high rents and lack of security of tenure for tenants.*

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39. Growth is set to remain strong in the near term, but policies need to work together to combat significant risks to growth and unemployment over the medium term. Stimulatory macroeconomic policies have bolstered growth to about 3 percent, yet inflation remains below the target. Unemployment rates for the low-skilled and foreign-born are considerably higher than average and high migration inflows imply upward pressure on unemployment and have upfront fiscal costs. Housing prices are rising rapidly from elevated levels, resulting in households taking on higher debt and making the economy more vulnerable to shocks.

40. Monetary policy should remain firmly stimulatory until core inflation is durably close to target. The room for monetary policy to take into account financial stability considerations has fallen as prolonged low inflation led to a sharp decline in inflation expectations, threatening to undermine the role of the inflation target in promoting macroeconomic stability. Monetary policy has shifted to a firmly stimulatory stance, which should be maintained until core inflation is durably close to target, with the Riksbank appropriately ready to do more if needed. But, in view of Sweden's strong external position, intervention in the foreign exchange market should be a last resort.

41. The broadly neutral fiscal stance is appropriate and migration expenses should be accommodated in the near term, but fiscal policy must help the housing market rebalance. Mortgage interest deductibility should be phased out, which can be done over time with little risk of a hard landing in the housing market. Housing supply should be enhanced through further subsidies for construction of affordable rental apartments in areas where job prospects are good and also by increasing the limit for deferrals of capital gain taxes. Such a package would support sustained growth while cooling housing prices gradually, and can be implemented in a fiscally neutral manner. Moving over the medium term to maintaining a balanced central government budget over the cycle would be sufficient to safeguard Sweden's fiscal buffers.

42. It is critical to remove structural impediments to housing supply to protect stability and help sustain growth. Inadequate supply is a key contributor to rapidly rising housing prices. Improved transparency and timeliness in municipal land acquisition and planning procedures are needed to increase competition in residential construction. Rent controls should be eliminated for newly constructed apartments and phased out more broadly, with vulnerable households protected by the housing allowance. Expanding the availability of rental dwellings would also support growth and help contain unemployment by facilitating labor mobility and migrant integration.

43. The legal framework for macroprudential policies needs to be strengthened to enable timely action and a DTI limit should be adopted. The long process of adopting amortization regulations should be completed to cement the changes in amortization culture. But the FSA's legal mandate clearly needs to be strengthened to give it access to a range of macroprudential tools to address risks in a timely and efficient way. Although such measures cannot substitute for housing supply reforms, they can usefully moderate vulnerabilities from potential further rapid house price increases. A limit on DTI would help avoid a rise in the already sizable share of high DTI mortgages. Following recent international practice, a small portion of loans could exceed the threshold adopted, which should be calibrated to affect few borrowers at the outset to contain the drag on growth.

44. Migration inflows reinforce the importance of reforms to broaden job creation and facilitate integration thereby ensuring Sweden gains the full benefits for long-term growth. Sweden's humanitarian migration policy has allowed a significant rise in migrant inflows in 2015 and inflows appear likely to remain relatively high for some years. Improvements being made in the well-developed introduction program for refugees are welcome and further efforts to expedite these processes are needed. The social partners should ensure that entry-level wages are not a barrier for groups with high unemployment to gain jobs. Strict employment protection for regular contracts should be reviewed to ensure that exit costs do not deter firms from hiring new entrants with sufficient skills. Training should be better aligned with employer needs and the effectiveness of public job matching services improved. Expanding certain youth employment and training programs to newly arrived refugees would help them gain their first job and build skills.

45. It is recommended to hold the next Article IV consultation with Sweden on the standard 12-month cycle.

Box 5. Sweden: Risk Assessment Matrix^{1/}
(Scale—high, medium, or low)

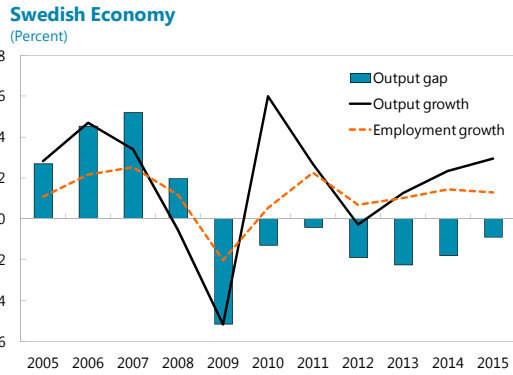
Source of Risks	Overall Level of Concern	
	Relative Likelihood ^{2/}	Impact if Realized
1. Euro area bond market contagion leads to more volatile global financial market conditions	<p>Medium</p> <ul style="list-style-type: none"> Swedish banks are reliant on wholesale funding and are directly and indirectly exposed to international financial markets. 	<p>Medium</p> <ul style="list-style-type: none"> Higher bank funding costs translate into higher lending interest rates and curtailed lending, weighing on 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 borrowed reserves and possible swap arrangements.	
2. Protracted weak growth in key advanced economies and emerging economies, including the Euro area and China.	<p>Medium-High</p> <ul style="list-style-type: none"> Sweden's economy is small and highly open with strong links to European markets. Sensitivity to shocks could be increased by high household debt and more limited space for additional monetary easing. 	<p>Medium</p> <ul style="list-style-type: none"> As exports and income decline, investment will slow as well, further reducing growth. Inflation will decline with falling growth, lower import prices, and possibly with an appreciation of the krona.
Policy response:	Provide additional monetary support, let automatic fiscal stabilizers operate fully, consider slower structural fiscal adjustment.	
3. Significant house price decline in Sweden.	<p>Medium</p> <ul style="list-style-type: none"> High house prices largely reflect demographic, balance sheet, and interest rate factors driving up demand faster than supply. But prices are rising fast and valuation risks could build over time given low rates. 	<p>High</p> <ul style="list-style-type: none"> Large impact on consumption and employment lowers growth. Loan quality impacted, primarily of firms serving domestic market. Lending could be curtailed if doubts about the quality of covered bonds rise, elevating bank funding costs.
Policy response:	Preventively, reduce vulnerabilities in the housing market through macroprudential measures, phasing out tax incentives, and enhancing housing supply. In the event, provide monetary stimulus and funding support to banks.	
4. Significant decline in inflation expectations leading inflation to persist below target in coming years.	<p>Medium</p> <ul style="list-style-type: none"> Expectations have been anchored by inflation targets, but they weakened notably in late 2014. Wage negotiations starting in late 2015 heighten the potential for a lasting impact. 	<p>Medium-High</p> <ul style="list-style-type: none"> Slower growth in nominal incomes drags on demand via higher real debt burdens. Low inflation increases risk of deflation and impedes relative price adjustment. With interest rates already negative, the potential to cushion shocks is reduced.
Policy response:	Stronger monetary actions if core inflation does not rise as expected. Allow fiscal stabilizers to operate and consider stimulus if unemployment rises significantly.	

^{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 the IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding this baseline. The RAM reflects staff's views on the source of risks and overall level of concern as of the time of discussions with the authorities.

^{2/} In case the baseline does not materialize.

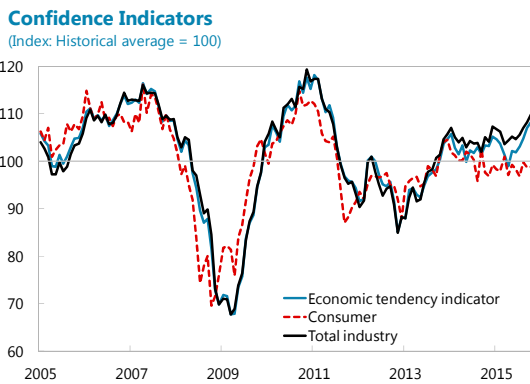
Figure 1. Sweden: Macroeconomic Indicators

Output is recovering, supporting employment growth and narrowing the output gap.



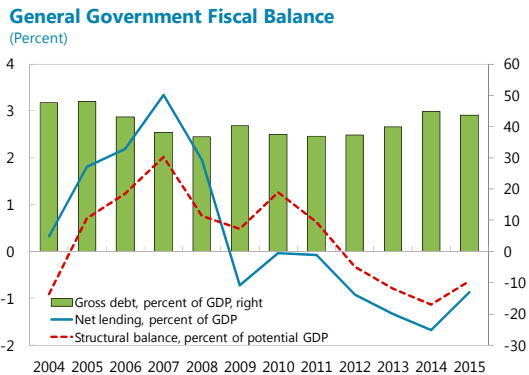
Sources: IMF World Economic Outlook, Statistics Sweden, and Fund staff calculations.

Economic sentiment has improved, although household confidence has weakened slightly.



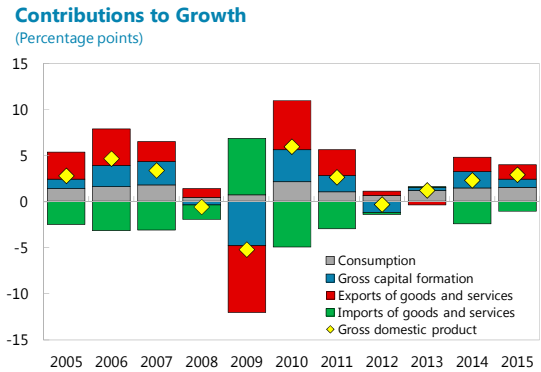
Sources: NIER and Fund staff calculations.

Headline and structural deficits are expected to narrow in 2015, and debt to decline after rising for a few years.



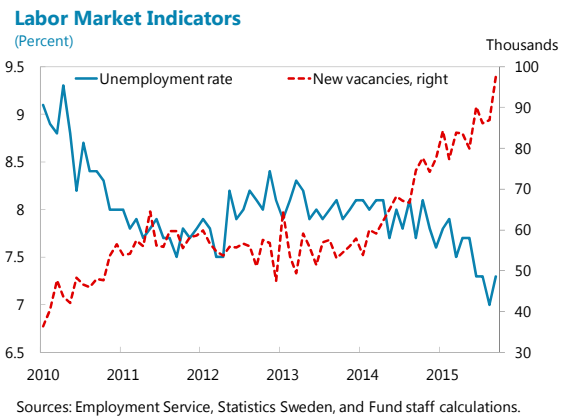
Sources: IMF World Economic Outlook, Sweden Ministry of Finance, and Fund staff calculations.

Private consumption and residential investment are key growth drivers, and exports also began to rise from 2014.



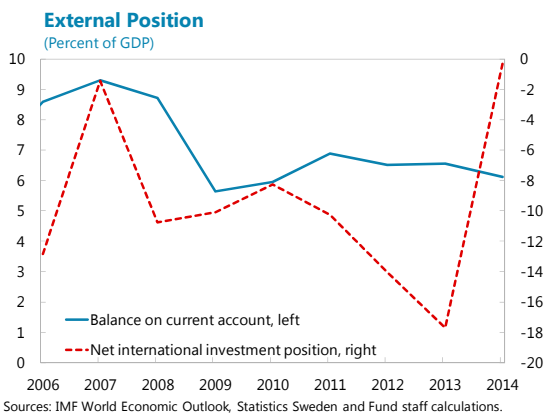
Sources: IMF World Economic Outlook and Fund staff calculations.

A rapid increase in new vacancies has helped drive unemployment down.



Sources: Employment Service, Statistics Sweden, and Fund staff calculations.

The current account surplus has stabilized at a high level, and the net IIP has improved recently.



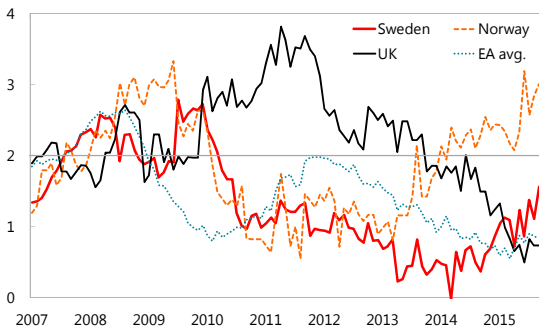
Sources: IMF World Economic Outlook, Statistics Sweden and Fund staff calculations.

Figure 2. Sweden: Inflation and Monetary Policy

Sweden's inflation has picked up but remains below the Riksbank's target.

Core HICP Inflation

(Percent)

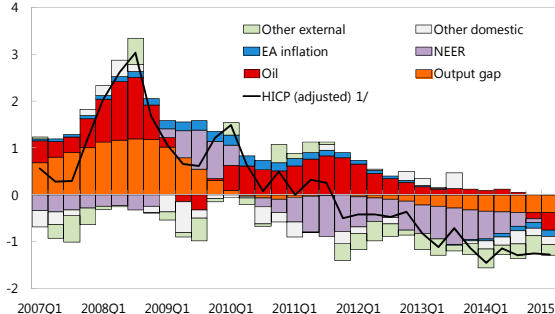


Sources: Eurostat and Fund staff calculations.

This reflects slack in the domestic economy exacerbated by falling oil prices, low euro area inflation, and past SEK appreciation.

Inflation Decomposition

(Percent)

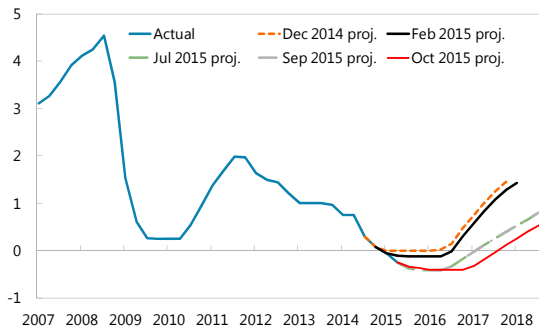


Sources: Arnold, Chen, and Christiansen (2015) and Fund staff calculations. 1/ Adjusted for the constants in the regression and any insignificant factors.

The Riksbank has cut the repo rate to -0.35 percent, and extended the period for which low rates are projected ...

Riksbank Repo Rate Forecasts

(Percent)

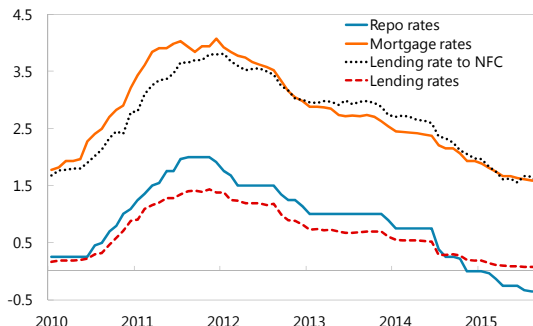


Sources: Sveriges Riksbank and Fund staff calculations.

... resulting in lower lending and deposit rates.

Interest Rates

(Percent)

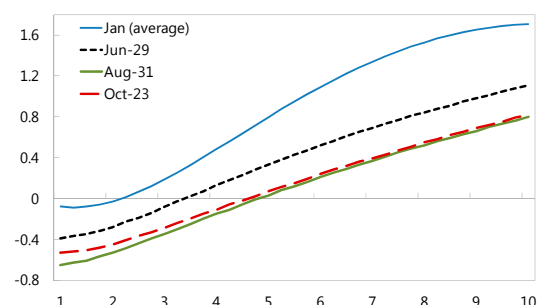


Sources: Statistics Sweden and Fund staff calculations.

In addition, the Riksbank has introduced a QE program that has shifted the yield curve down ...

Yield Curves 1/

(Percent)

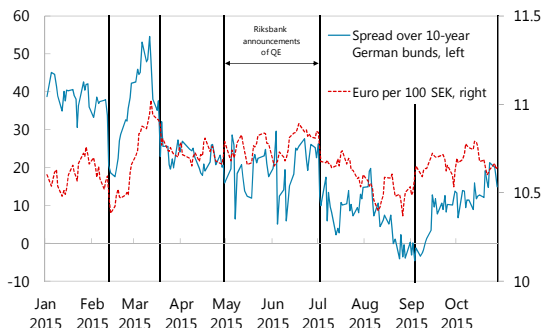


Sources: Sveriges Riksbank and Fund staff calculations. 1/ Horizontal axis shows maturities in years. The yield curve is interpolated zero coupon yields.

... implying a narrower spread over German bund yields, associated with a weaker krona.

Government Bond Spreads and Exchange Rate

(Basis points, left; EUR/100 SEK, right)

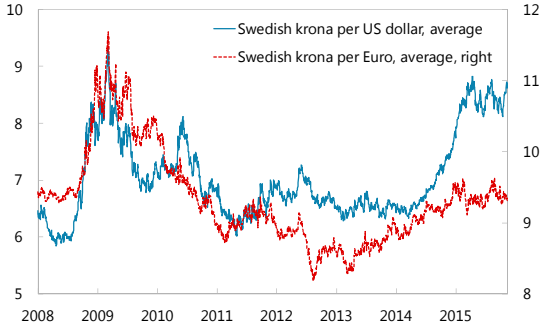


Sources: Sveriges Riksbank and Fund staff calculations.

Figure 3. Sweden: Selected Financial Market Indicators

In recent years, the krona has depreciated significantly against the USD, and more slowly against the euro.

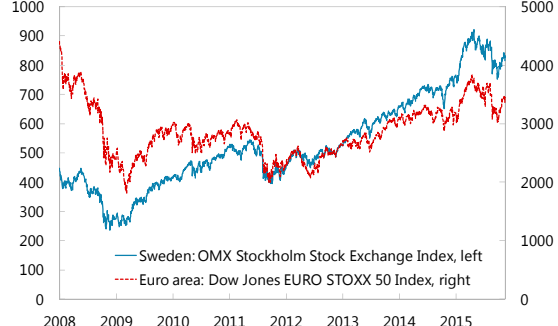
Exchange Rates
(SEK/currency)



Sources: Bloomberg and Fund staff calculations.

Swedish equities have trended up to substantially exceed pre-crisis levels.

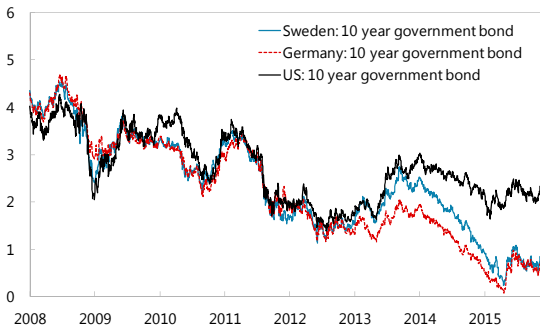
Stock Indices
(Index)



Sources: Bloomberg and Fund staff calculations.

Swedish sovereign bond yields have in recent years been tracking German rates more closely, especially in 2015...

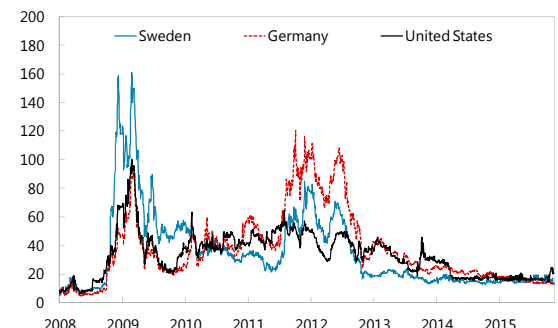
10 Year Government Bond Yields
(Percent)



Sources: Bloomberg and Fund staff calculations.

... and sovereign CDS spreads remain very close to other AAA economies.

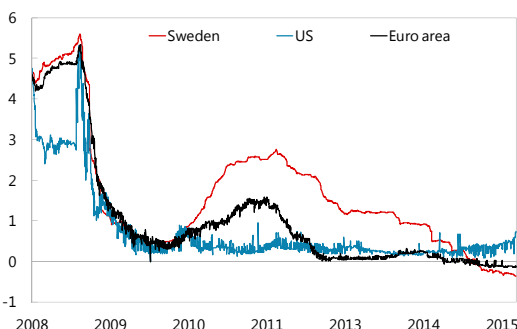
5 Year CDS Spreads
(Basis points)



Sources: Datastream and Fund staff calculations.

Interbank rates fell further and are below zero ...

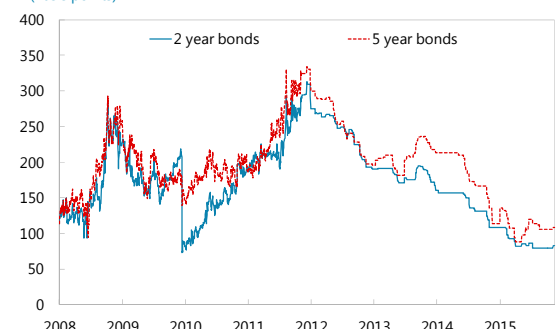
3-Month Interbank Rates
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

... and banks' covered bond yields continued to decline to very low levels, benefitting from the Riksbank's QE.

Spread of Covered Bonds over Government Bond Yields
(Basis points)

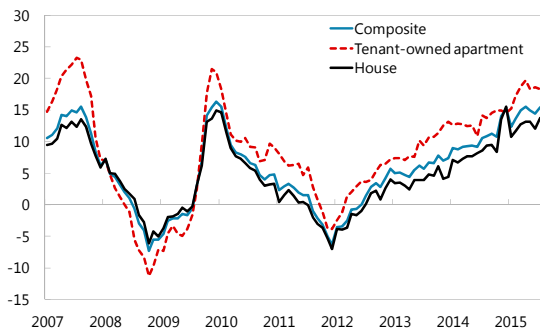


Sources: Datastream and Fund staff calculations.

Figure 4. Sweden: House Prices and Household Debt

Housing price gains have accelerated to a double-digit pace, especially for tenant owned apartments.

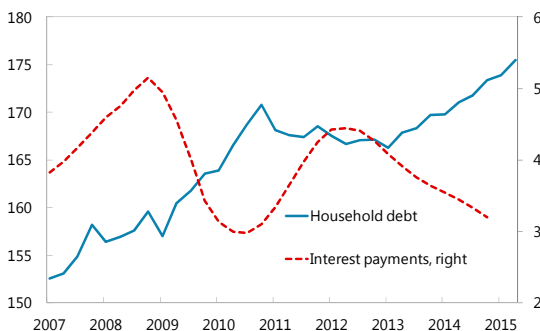
House Prices
(Y/Y percent change)



Sources: Valueguard and Fund staff calculations.

Household debt has risen to new highs relative to income, yet low rates are reducing interest payment burdens.

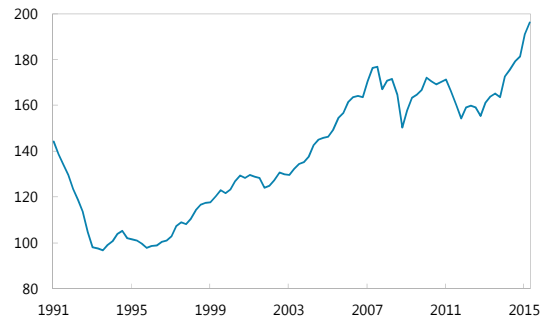
Household Debt and Interest Payments
(Percent of disposable income)



Sources: Sveriges Riksbank and Fund staff calculations.

House prices have risen to relative to income, especially for tenant-owned apartments mostly in urban centers.

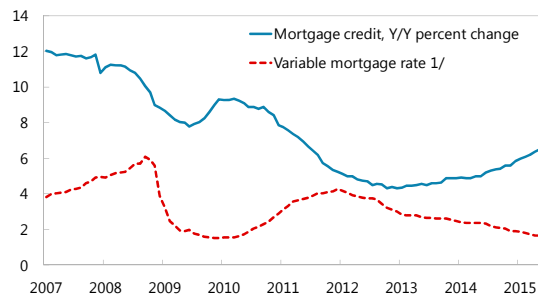
House Price to Disposable Income Per Capita
(Index, 1995=100)



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

Household borrowing has picked up and borrowers increasingly opt for variable rate mortgages owing to very low interest rates.

Mortgage Credit and Interest Rates
(Percent)

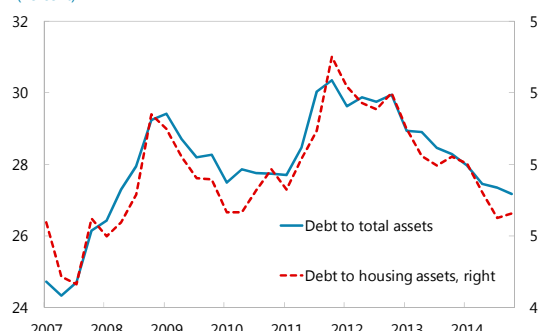


Sources: Statistics Sweden and Fund staff calculations.

1/ Variable rate refers to mortgages with initial interest rate fixation periods less or equal to 3 months.

But debt levels relative to the value of housing and total assets are declining, creating more room to borrow.

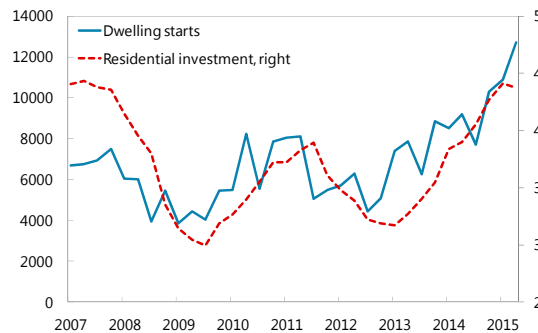
Debt Ratios
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

Rising housing prices have led to a rise in investment, but further investment is needed to meet housing shortfalls.

Dwelling Starts and Residential Investment
(Number of dwellings, left; bil. 2014 SEK, right)



Sources: Statistics Sweden and Fund staff calculations.

Table 1. Sweden: Selected Economic Indicators, 2012–18

	2012	2013	2014	Projections			
				2015	2016	2017	2018
Real economy (in percent change)							
Real GDP	-0.3	1.2	2.3	2.9	3.0	2.7	2.4
Domestic demand	-0.6	1.6	3.4	2.5	3.3	2.7	2.5
Private consumption	0.8	1.9	2.2	2.2	2.8	2.7	2.4
Public consumption	1.1	1.3	1.6	1.9	2.4	0.9	0.7
Gross fixed investment	-0.2	0.6	7.6	4.9	5.1	4.9	4.5
Net exports (contribution to growth)	0.2	-0.3	-0.9	0.6	-0.1	0.1	0.0
HICP inflation (e.o.p)	1.0	0.4	0.3	0.9	1.9	2.0	2.3
Unemployment rate (in percent)	8.0	8.0	7.9	7.5	7.4	7.3	7.2
Gross national saving (percent of GDP)	29.2	29.2	30.0	31.6	32.2	32.6	32.8
Gross domestic investment (percent of GDP)	22.6	22.5	23.8	24.7	25.4	25.9	26.3
Output gap (as a percent of potential)	-1.9	-2.3	-1.8	-0.9	-0.1	0.5	0.8
Public finance (in percent of GDP)							
Total revenues	50.6	50.9	50.0	48.7	48.9	49.2	49.4
Total expenditures	51.5	52.2	51.7	49.6	49.9	49.7	49.5
Net lending	-0.9	-1.3	-1.7	-0.9	-0.9	-0.5	0.0
Structural balance (as a percent of potential GDP)	-0.3	-0.8	-1.1	-0.6	-0.7	-0.4	0.0
General government gross debt	37.2	39.8	44.9	43.6	42.3	41.2	39.5
Money and credit (year-on-year, percent change, eop) 1/							
M3	3.1	3.1	4.2	7.4	...	...	...
Bank lending to households	4.3	4.9	5.8	7.2	...	...	...
Interest rates (end of period)							
Repo rate 1/	1.0	0.8	0.0	-0.4	...	...	...
Ten-year government bond yield 1/	1.5	2.4	1.0	0.7	...	...	...
Mortgage lending rate 2/	3.0	2.5	1.9	1.6	...	...	...
Balance of payments (in percent of GDP)							
Current account	6.6	6.7	6.2	6.9	6.8	6.7	6.4
Foreign direct investment (net)	2.3	4.4	0.6	2.3	2.6	2.7	2.6
International reserves, changes (in billions of US dollars) 3/	0.5	14.6	0.2	0.3	...	...	...
Reserve cover (months of imports of goods and services)	2.8	3.5	3.4	3.7	...	...	...
Net international investment position	-14.7	-18.0	-0.3	2.6	4.1	5.5	7.4
Exchange rate (period average, unless otherwise stated)							
SEK per euro 1/	8.7	8.7	9.1	9.4	...	...	...
SEK per U.S. dollar 1/	6.8	6.5	6.9	8.4	...	...	...
Nominal effective rate (2010=100) 4/	105.5	108.6	103.8	96.2	...	...	...
Real effective rate (2010=100) 4/ 5/	92.3	94.2	89.7	82.6	...	...	...
Fund Position (July 31, 2015)							
Quota (in millions of SDRs)				2395.5			
Reserve tranche position (in percent of quota)				13.0			
Holdings of SDRs (in percent of allocation)				97.2			

Other Indicators

GDP per capita (2014, USD): 58,538; **Population** (2014, million): 9.7; **Main products and exports**: Machinery, motor vehicles, paper products, pulp and wood; **Key export markets**: Germany, Norway, United Kingdom

Sources: IMF Institute, Sveriges Riksbank, Sweden Ministry of Finance, Statistics Sweden, and Fund staff calculations.

1/ Data for 2015 is as of September 2015.

2/ Mortgage rates for new contracts, data for 2015 is as of September 2015.

3/ Data for 2015 is as of 2015Q2.

4/ Data for 2015 is as of August 2015

5/ Based on relative unit labor costs in manufacturing.

Table 2. Sweden: General Government Statement of Operations, 2012–18

	2012	2013	2014	Projections			
				2015	2016	2017	2018
Billions of SEK							
Revenue	1,864	1,919	1,960	2,005	2,114	2,223	2,337
Tax revenue	1,459	1,507	1,486	1,572	1,669	1,761	1,850
Taxes on income, profits, and capital gains	634	661	690	734	776	827	875
Payable by individuals	539	560	587	629	667	711	751
Payable by corporations	95	101	104	105	109	115	124
General taxes on goods and services	461	471	486	503	521	539	559
Other Taxes	364	375	309	335	373	395	417
Social Contributions	172	177	183	191	199	209	219
Grants	3	3	3	3	3	3	3
Other revenue	229	232	289	239	243	251	265
Interest income	31	27	28	29	31	32	34
Expenditure	1,898	1,970	2,026	2,040	2,155	2,247	2,339
Compensation of employees	461	476	495	513	537	563	586
Intermediate consumption	272	282	293	306	320	333	346
Interest payments	31	29	28	26	27	28	31
Social benefits	640	671	679	703	738	762	787
Expense not elsewhere classified	453	471	446	406	437	460	485
Net acquisition of nonfinancial assets	40	41	86	87	97	102	105
Gross operating balance	6	-10	20	51	56	78	103
Net lending / borrowing	-34	-50	-66	-36	-41	-24	-2
Percent of GDP							
Revenue	50.6	50.9	50.0	48.7	48.9	49.2	49.4
Tax revenue	39.6	40.0	37.9	38.2	38.6	39.0	39.1
Taxes on income, profits, and capital gains	17.2	17.5	17.6	17.8	18.0	18.3	18.5
Payable by individuals	14.6	14.9	15.0	15.3	15.4	15.7	15.9
Payable by corporations	2.6	2.7	2.6	2.6	2.5	2.6	2.6
General taxes on goods and services	12.5	12.5	12.4	12.2	12.0	11.9	11.8
Other Taxes	9.9	9.9	7.9	8.1	8.6	8.8	8.8
Social Contributions	4.7	4.7	4.7	4.6	4.6	4.6	4.6
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	6.2	6.2	7.4	5.8	5.6	5.6	5.6
Interest income	0.8	0.7	0.7	0.7	0.7	0.7	0.7
Expenditure	51.5	52.2	51.7	49.6	49.9	49.7	49.5
Compensation of employees	12.5	12.6	12.6	12.5	12.4	12.5	12.4
Intermediate consumption	7.4	7.5	7.5	7.4	7.4	7.4	7.3
Interest payments	0.9	0.8	0.7	0.6	0.6	0.6	0.7
Social benefits	17.4	17.8	17.3	17.1	17.1	16.9	16.6
Expense not elsewhere classified	12.3	12.5	11.4	9.9	10.1	10.2	10.2
Net acquisition of nonfinancial assets	1.1	1.1	2.2	2.1	2.2	2.3	2.2
Gross operating balance	0.2	-0.3	0.5	1.2	1.3	1.7	2.2
Net lending / borrowing	-0.9	-1.3	-1.7	-0.9	-0.9	-0.5	0.0
Structural Balance (percent of potential GDP) 1/	-0.3	-0.8	-1.1	-0.6	-0.7	-0.4	0.0
Fiscal Impulse (expansionary +)	0.9	0.5	0.4	-0.5	0.1	-0.3	-0.4
<i>Memorandum items:</i>							
Compliance with fiscal rule							
Overall balance 10-year average	0.6	0.5	0.3	0.1	...	...	...
Overall balance 7-year rolling average (±3 years)	0.7	0.2	-0.4	-0.7	...	...	...
Gross Public Debt (percent of GDP)	37.2	39.8	44.9	43.6	42.3	41.2	39.5
Output gap (percent of potential GDP)	-1.9	-2.3	-1.8	-0.9	-0.1	0.5	0.8
Nominal GDP (in billions of SEK)	3685	3770	3918	4117	4320	4517	4729

Sources: 2012-2015 Fiscal Policy Bills and Fund staff calculations.

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

Table 3. Sweden: Public Sector Balance Sheet, 2004–12

	2004	2005	2006	2007	2008	2009	2010	2011	2012
<i>Billions of SEK</i>									
Assets	3,097	3,333	3,575	3,681	3,503	3,743	3,867	3,875	3,990
Financial assets	1,674	1,909	2,150	2,256	2,077	2,315	2,438	2,446	2,560
Currency and deposits	48	52	76	73	119	79	65	90	75
Securities other than shares	232	262	317	349	362	366	399	397	425
Loans	329	355	376	383	406	499	504	533	548
Shares and other equity	790	931	1,074	1,116	921	1,088	1,150	1,128	1,203
Other financial assets	275	310	308	335	269	282	320	298	309
Capital stock net of depreciation	1,422	1,423	1,424	1,425	1,426	1,427	1,428	1,429	1,430
Liabilities	1,608	1,696	1,600	1,555	1,601	1,621	1,645	1,730	1,732
Financial liabilities	1,608	1,696	1,600	1,555	1,601	1,621	1,645	1,730	1,732
Currency and deposits	47	51	29	37	58	50	53	64	70
Securities and other equity	1,262	1,327	1,214	1,106	1,112	1,077	1,109	1,131	1,123
Loans	143	149	168	209	213	271	230	287	270
Other liabilities	156	170	189	203	218	223	253	247	269
Net worth	1,489	1,636	1,975	2,126	1,903	2,122	2,222	2,146	2,258
Financial net worth	67	213	551	701	476	694	793	716	828
<i>Percent of GDP</i>									
Assets	110.4	114.6	115.4	111.7	103.4	113.8	109.9	106.0	108.3
Financial assets	59.7	65.7	69.4	68.4	61.3	70.4	69.3	66.9	69.5
Currency and deposits	1.7	1.8	2.5	2.2	3.5	2.4	1.9	2.5	2.0
Securities other than shares	8.3	9.0	10.2	10.6	10.7	11.1	11.3	10.9	11.5
Loans	11.7	12.2	12.1	11.6	12.0	15.2	14.3	14.6	14.9
Shares and other equity	28.2	32.0	34.6	33.8	27.2	33.1	32.7	30.8	32.6
Other financial assets	9.8	10.7	9.9	10.2	7.9	8.6	9.1	8.2	8.4
Capital stock net of depreciation	50.7	49.0	46.0	43.2	42.1	43.4	40.6	39.1	38.8
Liabilities	57.3	58.3	51.6	47.2	47.2	49.3	46.7	47.3	47.0
Financial liabilities	57.3	58.3	51.6	47.2	47.2	49.3	46.7	47.3	47.0
Currency and deposits	1.7	1.7	0.9	1.1	1.7	1.5	1.5	1.7	1.9
Securities and other equity	45.0	45.6	39.2	33.5	32.8	32.7	31.5	30.9	30.5
Loans	5.1	5.1	5.4	6.3	6.3	8.2	6.5	7.9	7.3
Other liabilities	5.5	5.8	6.1	6.2	6.4	6.8	7.2	6.8	7.3
Net worth	53.1	56.3	63.7	64.5	56.2	64.5	63.1	58.7	61.3
Financial net worth	2.4	7.3	17.8	21.3	14.1	21.1	22.5	19.6	22.5
<i>Memorandum items:</i>									
GDP (SEK billions)	2,805	2,907	3,099	3,297	3,388	3,289	3,520	3,657	3,685

Sources: Eurostat and Fund staff calculations.

Table 4. Sweden: Balance of Payments Accounts, 2012–18

	2012	2013	2014	Projections			
				2015	2016	2017	2018
Billions of SEK							
Current Account Balance	244	253	243	284	293	303	303
Trade Balance	203	217	186	204	209	228	244
Exports of G&S	1690	1656	1740	1792	1885	1998	2113
Imports of G&S	1487	1438	1554	1588	1676	1770	1870
Factor income, net	41	35	57	80	84	75	59
Financial Account Balance	71	129	100	280	288	298	298
Investment Abroad 1/	-394	-146	-343	10	13	28	19
Investment in Sweden 1/	-461	-180	-442	-270	-276	-270	-279
Reserves, change	4	95	1	0	0	0	0
Percent of GDP							
Current Account Balance	6.6	6.7	6.2	6.9	6.8	6.7	6.4
Trade Balance	5.5	5.8	4.7	5.0	4.8	5.0	5.2
Exports of G&S	45.9	43.9	44.4	43.5	43.6	44.2	44.7
Imports of G&S	40.3	38.1	39.7	38.6	38.8	39.2	39.5
Factor income, net	1.1	0.9	1.5	2.0	2.0	1.7	1.3
Financial Account Balance	1.9	3.4	2.6	6.8	6.7	6.6	6.3
Investment Abroad 1/	-10.7	-3.9	-8.7	0.2	0.3	0.6	0.4
Direct Investment	5.3	5.0	2.5	5.6	5.8	5.9	5.8
Portfolio Investment	6.0	4.5	5.2	5.3	5.0	5.2	5.3
Other Investment	2.1	5.2	0.5	4.2	4.6	4.8	4.9
Reserves	0.1	2.5	0.0	0.0	0.0	0.0	0.0
Investment in Sweden 1/	-12.5	-4.8	-11.3	-6.6	-6.4	-6.0	-5.9
Direct Investment	3.0	0.6	1.9	3.3	3.2	3.1	3.2
Portfolio Investment	8.6	12.7	1.6	4.7	4.9	5.5	5.9
Other Investment	-1.1	-1.2	1.6	2.0	2.0	1.9	1.7
Errors and Omissions	-0.7	-0.5	-0.5	0.0	0.0	0.0	0.0
Percent change							
Exports of G&S 2/							
Value	-0.8	-2.1	5.1	3.0	5.2	6.0	5.8
Volume	0.2	0.5	3.0	3.7	5.2	5.5	5.0
Deflator	-1.0	-2.5	2.0	-0.7	0.0	0.5	0.7
Imports of G&S 2/							
Value	-1.2	-3.3	8.0	2.2	5.6	5.6	5.6
Volume	-0.1	-0.5	6.3	2.7	5.6	5.3	5.2
Deflator	-1.1	-2.8	1.7	-0.5	0.0	0.3	0.5
<i>Memorandum</i>							
Net International Investment Position (Percent of GDP)	-14.7	-18.0	-0.3	2.6	4.1	5.5	7.4
Nominal GDP (SEK billion)	3685	3770	3918	4117	4320	4517	4729

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.

Table 5. Sweden: Financial Soundness Indicators: Banks, 2008–14*(End of period, in percent)*

	2008	2009	2010	2011	2012	2013	2014
<i>(End of period, percent)</i>							
Capital Adequacy							
Regulatory capital to risk-weighted assets 1/ <i>of which: Four major banks 2/</i>	10.7	13.0	12.6	12.2	12.5	12.7	15.4
Regulatory Tier I capital to risk-weighted assets 1/ <i>of which: Four major banks 2/</i>	8.1	10.9	11.0	11.3	11.7	12.0	13.4
Capital as percent of assets (leverage ratio) <i>of which: Four major banks 2/</i>	4.6	5.0	4.8	4.1	4.4	4.5	5.0
	4.7	5.0	4.7	4.0	4.2	4.4	4.9
Asset quality and exposure							
Nonperforming loans to total gross loans <i>of which: Four major banks 2/</i>	1.1	2.0	1.9	1.6	1.5	1.3	
Nonperforming loans net of loan-loss provisions to capital <i>of which: Four major banks 2/</i>	7.4	10.7	9.9	9.5	9.3	8.2	
Loan-loss provisions to nonperforming loans <i>of which: Four major banks 2/</i>	49.1	55.4	44.3	41.3	39.8	38.8	
	47.1	53.7	43.8	40.7	38.7	38.1	
Distribution of MFI credit (percent) 4/							
Sweden	79.1	80.1	81.3	80.9	80.1	79.3	77.8
Financial corporation	1.1	1.1	2.0	1.7	1.8	1.5	1.9
Non financial corporations	33.9	31.4	31.0	31.1	30.3	29.5	28.1
Public sector	3.1	3.8	2.6	2.9	2.8	2.6	3.5
Households	41.0	43.8	45.7	45.2	45.2	45.7	44.3
Outside Sweden	20.9	19.9	18.7	19.1	19.9	20.7	22.2
Other EUs	11.0	9.4	9.5	9.5	10.0	10.5	12.0
Rest of the world	9.9	10.5	9.3	9.6	10.0	10.2	10.2
Large exposures as percent of tier 1 capital 3/ <i>of which: Four major banks 3/</i>	34.1	12.3	40.1	37.2	29.5	20.0	8.5
	30.9	8.1	36.8	31.4	22.0	10.7	8.8
Earnings and profitability							
Return on assets (net income as percent of average total assets) <i>of which: Four major banks 2/</i>	0.5	0.3	0.4	0.5	0.5	0.6	0.5
Return on equity (Net income as percent of average equity capital) <i>of which: Four major banks 2/</i>	12.7	13.0	9.8	10.6	11.4	11.4	10.2
Net interest income as percent of gross income <i>of which: Four major banks 2/</i>	55.2	56.8	52.7	54.4	55.4	55.3	50.3
Noninterest expenses as percent of gross income <i>of which: Four major banks 2/</i>	57.0	57.7	55.3	57.3	58.3	58.6	55.2
Noninterest income as percent of total income <i>of which: Four major banks 2/</i>	54.2	55.4	65.1	65.7	61.0	60.7	55.8
Trading income and foreign exchange gains (losses) to gross income <i>of which: Four major banks 2/</i>	44.8	43.2	55.1	52.9	51.7	53.7	
	43.1	42.3	53.5	51.0	49.7	50.5	
Personnel expenses as percent of noninterest expenses <i>of which: Four major banks 2/</i>	8.6	11.7	11.6	9.4	10.7	8.4	9.3
	9.8	13.6	12.6	10.0	11.2	9.6	8.3
	55.0	53.2	52.6	53.6	52.2	53.9	57.4
	59.2	57.1	57.4	57.8	59.4	60.5	68.5
Liquidity							
Liquid assets as percent of total assets <i>of which: Four major banks 2/</i>	4.0	6.3	4.8	6.2	8.5	8.9	
Liquid assets as percent of short-term liabilities <i>of which: Four major banks 2/</i>	4.3	6.7	5.2	6.7	9.1	9.7	
Customer deposits as a percent of total (non-interbank) loans <i>of which: Four major banks 2/</i>	23.6	43.6	44.4	66.7	97.2	95.0	
	30.5	54.7	58.9	87.9	121.6	123.7	
Noninterbank loans to noninterbank deposits <i>of which: Four major banks 2/</i>	46.1	47.1	47.8	49.8	52.9	53.8	56.5
	45.5	45.3	46.6	48.5	50.9	52.7	54.5
	139.6	144.8	155.0	153.8	148.8	145.9	140.7
	149.7	156.1	165.9	163.5	158.0	153.7	149.5
Foreign exchange risk							
Foreign currency loans as percent of total loans	39.0	37.8	36.5	37.4	34.9	36.8	39.4
Foreign currency assets as percent of total assets	33.0	31.2	31.4	34.5	33.1	33.8	35.6
Foreign currency-denominated liabilities as percent of total liabilities	35.4	29.8	31.4	35.1	31.1	28.7	32.9
Exposure to derivatives							
Gross asset position in derivatives as percent of Tier 1 capital	336.8	210.8	222.3	351.2	243.9		
Gross liability position in derivatives as percent of Tier 1 capital	320.7	198.9	217.9	335.2	232.8		

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 6. Sweden: Financial Soundness Indicators: Non-Banks, 2008–14*(End of period, in percent)*

	2008	2009	2010	2011	2012	2013	2014
Insurance sector							
Solvency ratio (margin/required margin)							
Life insurance companies	8.4	7.8	14.2	8.0	9.9	13.8	13.0
Non-life insurance companies	6.8	7.7	10.6	10.6	10.8	11.4	12.6
Return on equity							
Life insurance companies	-86.3	45.3	20.3	-30.1	32.5	28.7	8.7
Non-life insurance companies	-21.4	29.7	35.4	3.5	40.0	11.7	23.1
Households							
Household debt as percent of GDP	71.3	77.3	76.0	79.2	81.1	81.4	82.1
Household debt as percent of disposable income	162.5	163.0	169.5	171.4	168.7	171.0	174.8
Household interest expense as percent of disposable income	5.2	3.4	3.1	4.3	4.3	3.6	3.2
Corporate sector							
Debt stock as percent of GDP 1/	34.3	35.9	33.9	33.3	33.5	34.8	33.8
Total debt stock as percent of GDP	46.8	49.6	46.5	47.3	46.7	48.1	46.9
Equity risk							
OM Stockholm Stock Exchange Index (annual percent change)	-42.0	46.7	23.1	-16.7	12.0	23.2	11.9
Market capitalization in percent of GDP	128.9	179.2	201.4	159.4	176.1	219.1	238.6
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	6.9
Greater Stockholm region	-0.6	9.2	2.9	-2.5	1.4	4.8	8.4
Buildings for seasonal and secondary use	4.3	17.5	8.4	-0.3	3.4	13.3	8.9
Memorandum items							
GDP (year on year percent change, constant prices)	-0.6	-5.2	6.0	2.7	-0.3	1.2	2.3
GDP bn SEK, current prices	3,388	3,289	3,520	3,657	3,685	3,770	3,918

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

1/ Non-financial sector borrowing from financial sector

Table 7. Sweden: Financial System Structure, 2011–14

	2011				2012				2013				2014			
	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	6,382,811	33.3	174.6	1	5,813,615	30.4	157.8	1	5,585,078	27.3	148.1	1	5,843,003	26.5	149.1
Handelsbanken	1	2,454,366	12.8	67.1	1	2,387,858	12.5	64.8	1	2,489,806	12.2	66.0	1	2,721,579	12.4	69.5
S.E.B	1	2,362,653	12.3	64.6	1	2,453,456	12.8	66.6	1	2,484,834	12.1	65.9	1	2,249,862	10.2	57.4
Swedbank	1	1,857,065	9.7	50.8	1	1,846,941	9.7	50.1	1	1,820,807	8.9	48.3	1	1,979,048	9.0	50.5
<i>Total Top Four Banks</i>	4	13,056,895	68.1	357.1	4	12,501,870	65.3	339.3	4	12,380,525	60.5	328.4	4	12,793,492	58.1	326.5
<i>Four major banking groups 1/</i>																
Banks	4	6,016,174	31.4	164.5	4	6,076,915	31.8	164.9	4	6,261,408	30.6	166.1	4	7,140,464	32.4	182.2
Insurance companies	8	500,273	2.6	13.7	8	554,856	2.9	15.1	9	616,742	3.0	16.4	10	722,970	3.3	18.5
Mortgage credit institutions	3	2,098,457	11.0	57.4	3	2,209,594	11.5	60.0	3	2,309,254	11.3	61.3	3	2,457,837	11.2	62.7
Securities firms	3	14,112	0.1	0.4	2	14,910	0.1	0.4	2	3,804	0.0	0.1	2	3,190	0.0	0.1
Other credit market companies	8	170,213	0.9	4.7	7	167,150	0.9	4.5	7	166,422	0.8	4.4	3	111,454	0.5	2.8
<i>Top four banks in Sweden</i>	26	8,799,229	45.9	240.6	24	9,023,425	47.2	244.9	25	9,357,630	45.7	248.2	22	10,435,915	47.4	266.3
Other Banks in Sweden																
<i>Of which:</i>																
Banks	29	578,692	3.0	15.8	29	656,814	3.4	17.8	28	709,534	3.5	18.8	28	747,834	3.4	19.1
Savings banks	50	157,045	0.8	4.3	49	171,406	0.9	4.7	49	181,634	0.9	4.8	48	171,085	0.8	4.4
Mortgage credit institutions	3	361,378	1.9	9.9	3	361,305	1.9	9.8	3	365,487	1.8	9.7	2	376,692	1.7	9.6
Member bank	2	1,757	0.0	0.0	2	1,909	0.0	0.1	2	2,080	0.0	0.1	2	2,213	0.0	0.1
Other credit market companies	39	772,237	4.0	21.1	35	818,635	4.3	22.2	32	816,881	4.0	21.7	27	802,202	3.6	20.5
<i>Total other banks in Sweden</i>	123	1,871,109	9.8	51.2	118	2,010,069	10.5	54.6	114	2,075,616	10.1	55.1	107	2,100,026	9.5	53.6
Nonbank credit institutions																
Insurance companies	217	2,555,220	13.3	69.9	208	2,717,606	14.2	73.8	201	3,675,409	18.0	97.5	194	4,163,547	18.9	106.3
Life insurance	40	1,987,109	10.4	54.3	39	2,143,215	11.2	58.2	40	2,962,745	14.5	78.6	40	3,389,875	15.4	86.5
Nonlife insurance 2/	177	568,111	3.0	15.5	169	574,392	3.0	15.6	150	565,733	2.8	15.0	143	608,148	2.8	15.5
Pension funds	11	123,277	0.6	3.4	11	135,266	0.7	3.7	11	146,931	0.7	3.9	11	165,524	0.8	4.2
Mutual funds 3/	911	1,534,817	8.0	42.0	866	1,737,564	9.1	47.2	863	2,158,227	10.5	57.2	860	2,770,250	12.6	70.7
<i>Other nonbank credit institutions</i>																
Asset management firms	0	0	0.0	0.0	75	7,731	0.0	0.2	73	9,592	0.0	0.3	78	11,393	0.1	0.3
Securities firms	129	22,467	0.1	0.6	125	22,615	0.1	0.6	123	12,206	0.1	0.3	112	11,600	0.1	0.3
Total financial system	1395	19,163,785	100.0	524.1	1407	19,132,721	100.0	519.2	1389	20,458,506	100.0	542.7	1366	22,015,832	100.0	561.9
<i>of which: Total banking sector 4/</i>		14,928,004	77.9	408.3		14,511,939	75.8	393.8		14,456,141	70.7	383.5		14,893,518	67.6	380.1
Memorandum item:																
Foreign bank branches in Sweden	27	789,061	4.1	21.6	27	832,627	4.4	22.6	28	865,580	4.2	23.0	27	1,022,938	4.6	26.1
Swedish bank branches abroad	61	2,063,291	10.8	56.4	61	1,993,116	10.4	54.1	64	1,972,162	9.6	52.3	69	2,455,543	11.2	62.7
Nominal GDP (in millions of SEK)				3,656,577				3,684,800				3,769,909				3,918,129

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

1/ Includes all major nonbank financial institutions of the banking groups and 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

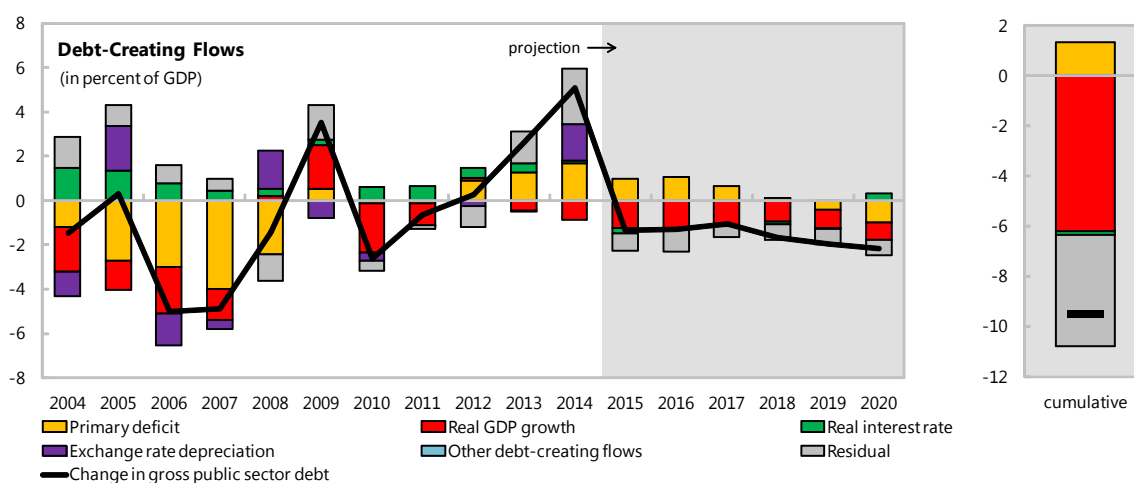
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of October 15, 2015		
	2004-2012 ^{2/}	2013	2014	2015	2016	2017	2018	2019	2020	Sovereign Spreads		
Nominal gross public debt	40.6	39.8	44.9	43.6	42.3	41.2	39.5	37.6	35.4	10		
Public gross financing needs	11.3	13.4	12.2	10.7	9.0	9.1	8.1	6.4	6.7	5Y CDS (bp) 36		
Real GDP growth (in percent)	2.0	1.2	2.3	2.9	3.0	2.7	2.4	2.3	2.1	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	1.7	1.1	1.6	2.1	1.9	1.8	2.2	2.1	2.0	Moody's	Aaa	Aaa
Nominal GDP growth (in percent)	3.7	2.3	3.9	5.1	4.9	4.5	4.7	4.4	4.2	S&P's	AAA	AAA
Effective interest rate (in percent) ^{4/}	3.3	2.1	1.9	1.5	1.9	1.7	1.9	2.1	2.9	Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020		
Change in gross public sector debt	-1.3	2.6	5.1	-1.3	-1.3	-1.0	-1.7	-2.0	-2.2	-9.5	
Identified debt-creating flows	-1.6	1.1	2.5	-0.6	-0.2	-0.5	-1.0	-1.3	-1.5	-5.1	
Primary deficit	-1.4	1.3	1.7	1.0	1.0	0.6	0.1	-0.4	-1.0	1.3	-0.5
Primary (noninterest) revenue and grants	50.8	50.2	49.3	48.0	48.2	48.5	48.7	48.8	48.8	291.0	
Primary (noninterest) expenditure	49.4	51.5	51.0	48.9	49.3	49.1	48.8	48.4	47.8	292.3	
Automatic debt dynamics ^{5/}	-0.2	-0.1	0.9	-1.5	-1.3	-1.2	-1.1	-0.9	-0.5	-6.4	
Interest rate/growth differential ^{6/}	-0.2	-0.1	-0.8	-1.5	-1.3	-1.2	-1.1	-0.9	-0.5	-6.4	
Of which: real interest rate	0.7	0.4	0.1	-0.3	0.0	0.0	-0.1	0.0	0.3	-0.2	
Of which: real GDP growth	-0.9	-0.5	-0.9	-1.3	-1.2	-1.1	-1.0	-0.9	-0.8	-6.2	
Exchange rate depreciation ^{7/}	-0.1	-0.1	1.7	...	...	...	...	...	...	...
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	
Please specify (1) (e.g., drawdown of)	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	
Lending to the Riksbank	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/}	0.3	1.5	2.5	-0.8	-1.1	-0.5	-0.7	-0.7	-0.7	-4.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r))/(1+g+\pi+gm)]$ times previous period debt ratio, with r = interest rate; π = 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 numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

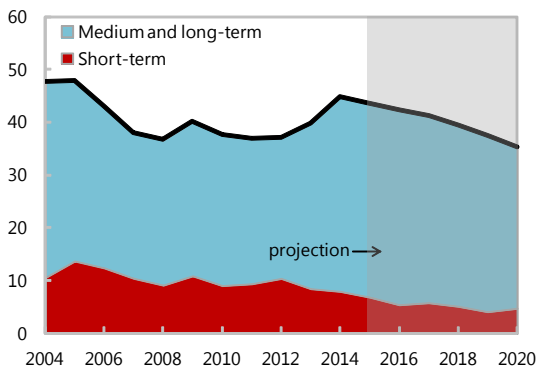
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Sweden Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

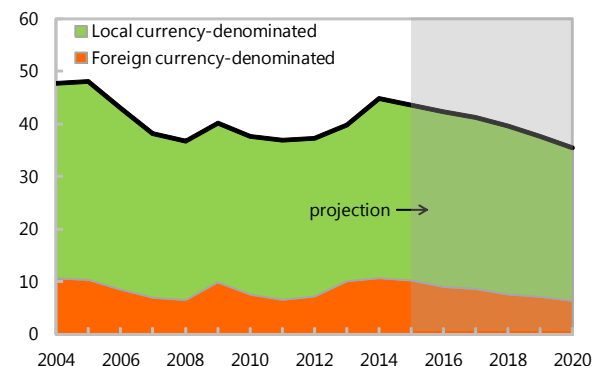
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

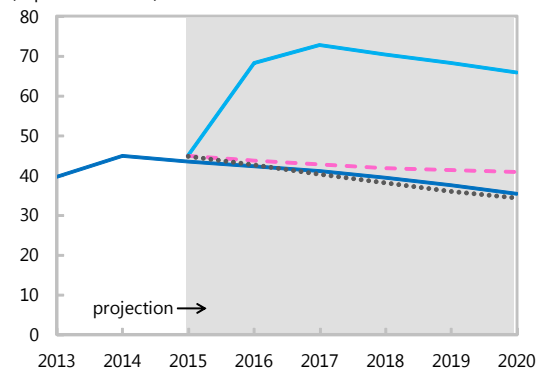
— Baseline
— Contingent Liability Shock

..... Historical

--- Constant Primary Balance

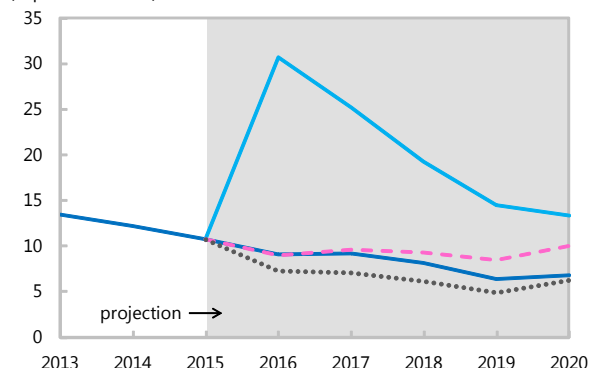
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario

	2015	2016	2017	2018	2019	2020
Real GDP growth	2.9	3.0	2.7	2.4	2.3	2.1
Inflation	2.1	1.9	1.8	2.2	2.1	2.0
Primary Balance	-1.0	-1.0	-0.6	-0.1	0.4	1.0
Effective interest rate	1.5	1.9	1.7	1.9	2.1	2.9

Constant Primary Balance Scenario

Real GDP growth	2.9	3.0	2.7	2.4	2.3	2.1
Inflation	2.1	1.9	1.8	2.2	2.1	2.0
Primary Balance	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Effective interest rate	1.5	1.8	1.6	1.8	2.0	2.7

Historical Scenario

	2015	2016	2017	2018	2019	2020
Real GDP growth	2.9	1.7	1.7	1.7	1.7	1.7
Inflation	2.1	1.9	1.8	2.2	2.1	2.0
Primary Balance	-1.0	0.8	0.8	0.8	0.8	0.8
Effective interest rate	1.5	1.8	1.8	2.2	2.4	3.3

Contingent Liability Shock

Real GDP growth	2.9	-3.3	-3.6	2.4	2.3	2.1
Inflation	2.1	0.3	0.2	2.2	2.1	2.0
Primary Balance	-1.0	-21.9	-0.6	-0.1	0.4	1.0
Effective interest rate	1.5	2.0	3.0	2.5	2.7	3.3

Source: IMF staff.



SWEDEN

November 13, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

The European Department
(In Consultation with Other Departments)

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FUND RELATIONS

(As of September 30, 2015)

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)	2,116.93	88.37
Reserve Tranche Position	278.57	11.63
Lending to the Fund		
<i>New Arrangements to Borrow</i>	436.48	

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	2,248.96	100.00
Holdings	2,186.73	97.23

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				
	2015	2016	2017	2018	2019
Principal					
Charges/Interest	0.01	0.07	0.07	0.07	0.07
Total	0.01	0.07	0.07	0.07	0.07

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

Article IV Consultation:

Sweden is on the 12-month consultation cycle.

FSAP Participation:

Sweden has been identified as one of the 29 jurisdictions which are subject to mandatory financial stability assessments under the Financial Sector Assessment Program (FSAP) every five years.

Sweden will have an assessment under the FSAP in 2016.

STATISTICAL ISSUES

(As of October 29, 2015)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate for surveillance. The country has a full range of statistical publications. The quality and timeliness of the economic database are generally very good.	
National Accounts: Sweden publishes national accounts according to the <i>European System of Accounts (ESA) 2010</i> since September 2014 and regularly reports data for <i>International Financial Statistics (IFS)</i> .	
Prices and Labor Statistics: Statistics Sweden publishes consumer, producers, and export/import price indexes following the latest international standards. In addition, data on labor force, employment, and unemployment are disseminated and reported regularly for IFS.	
Government Finance Statistics: Government finance statistics have been published based on <i>ESA 2010</i> methodology since September 2014.	
Monetary and Financial Statistics: Monetary data reported for <i>International Financial Statistics</i> are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data.	
Financial Sector Surveillance: Sweden has published Financial Soundness Indicators based on the Financial Soundness Indicators Compilation Guide (2006) since 2012.	
External Sector Statistics: Sweden publishes external sector statistics based on the sixth edition of the <i>Balance of Payments and International Investment Position Manual (BPM6)</i> methodology since December 2014. Sweden participates in the coordinated direct investment survey (CDIS) and in the coordinated portfolio investment survey (CPIS).	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 31, 1996. Uses an SDDS flexibility option for timeliness on the production index data category. The authorities completed the requirements for adherence to SDDS plus in 2015.	A data ROSC was published in September 2001, followed by an update in November 2002.

Sweden: Table of Common Indicators Required for Surveillance
(As of October 29, 2015)

	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	Data Quality – Accuracy and reliability ¹⁰
Exchange Rates	Current	Current	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	2015/09	2015/10	M	M	M		
Reserve/Base Money	2015/09	2015/10	M	M	M		
Broad Money	2015/09	2015/10	M	M	M		
Central Bank Balance Sheet	2015/09	2015/10	M	M	M		
Consolidated Balance Sheet of the Banking System	2015/09	2015/10	M	M	M		
Interest Rates ²	Current	Current	D	D	D		
Consumer Price Index	2015/09	2015/10	M	M	M		
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	2015/Q1	2015/07	Q	Q	Q		
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	2013	2015/10	A	A	A		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	2013	2015/10	A	A	A		
External Current Account Balance	2015 Q2	2015/10	Q	Q	Q		
Exports and Imports of Goods and Services	2015/09	2015/10	M	M	M		
GDP	2015 Q2	2015/10	Q	Q	Q		
Gross External Debt							
International Investment Position ⁶	2015 Q2	2015/10	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); annually (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 7, 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.

**Statement by Mr. Thomas Ostros, Alternate Executive Director for Sweden and
Mr. Paavo Miettinen, Advisor to the Executive Director
November 30, 2015**

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 macroeconomic development and outlook

The authorities broadly share staff's assessment of the current economic development and challenges. The Swedish economy is performing well. Solid private consumption and rising residential investment contribute to above average growth. In addition, a pick-up in service-led exports will help push up annual GDP growth to around 3 percent. Employment has kept a steady growth rate over 1 percent for some time, while the unemployment rate just recently started to decline and reached 7¼ percent in Q3. Inflation has been low for some time but has started to rise following the previous depreciation of the krona and supported by a highly expansionary monetary stance.

That being said, Sweden faces major challenges, foremost in light of the current sharp rise in migration inflows. Population growth is now projected to reach 1¼ percent in 2015 and to remain high in the coming years. In the short term, introduction programs and transfers to municipalities will mean a boost to public spending. Moreover, challenges in integrating immigrants overlap with current high unemployment of low-skilled workers.

The drastic uptick in the number of asylum seekers in Sweden during 2015 poses great challenges for government authorities, regional actors, and local municipalities. Among the most pressing challenges are reception and timely registration of asylum seekers, housing, immediate medical needs, and providing for the very high number of unaccompanied minors. Potentially the entire public sectors could be affected. Conditions are becoming more challenging on a daily basis, and hence frequent reassessments have to be made.

Financial stability and macroprudential policy

The authorities share the IMF's concern over rapid housing price increases associated with rising household indebtedness. Measures such as a loan-to-value limit and a risk-weight floor for mortgages have already been introduced. Moreover, work is currently ongoing to introduce an amortization requirement. Further, the authorities believe that the IMF's recommendation to consider a debt-to-income limit is one among a number of tools that could be considered. It is also important to implement reforms which increase the supply of housing.

If there is a continued increase of house prices and household debt the need increases for other policy actions aimed at reducing risks related to this. The introduction of other macroprudential tools, or further tightening of macroprudential tools already in place, can be effective means to address imbalances in the residential mortgage market. There is an

ongoing discussion on the need to further strengthen the FSA's legal mandate to deploy a range of macroprudential tools to address risks in a timely and efficient way. The Riksbank believes that implementation of further tools are urgently needed.

During recent years the Swedish banks have improved their resilience to credit- and liquidity risks, but additional measures could be warranted. The FSA considers the Swedish banks to be resilient towards credit losses. As noted in the report, work is currently being undertaken by the FSA to review risk weights on corporate loans in order to strengthen the robustness of risk-based capital requirements. The Riksbank believes that capital buffers should be further increased.

In view of Nordea's plans of changing to a branch structure, regional and European cooperation will need to continue to be enhanced in terms of resolution arrangements.

Monetary policy

The Swedish economy has coped relatively well during recent years, in particular compared to other European countries, and the favorable macroeconomic developments are in part linked to the way that monetary policy has been conducted. Inflation has, however, been low for some time, and the Riksbank shares staff's view on the importance of returning inflation to target. Inflation has started to rise, supported by the highly expansionary monetary policy and the weaker exchange rate. The krona is expected to slowly strengthen in the coming years, and thus the positive contribution of the exchange rate to inflation is expected to diminish. Nevertheless, the upturn in inflation is expected to continue, as the monetary stance contributes towards more favorable real economic conditions. There is, however, considerable uncertainty regarding global developments and the future development of the exchange rate.

Over the past year, the Executive Board of the Riksbank has clearly communicated its determination to return inflation to target. The expansionary measures undertaken so far – the negative repo rate and purchases of government bonds – have had an effect on households' and companies' financial conditions and on the exchange rate. In addition, in the most recent monetary policy meeting in October, a decision was made to extend the government bond purchase program through mid-2016 and defer an initial increase of the repo rate until the first half of 2017. There is still a high level of preparedness to quickly make monetary policy even more expansionary if inflation prospects deteriorate, underlining the Riksbank's aim to return inflation to target and protect the credibility of the inflation target.

The highly expansionary monetary policy is necessary to ensure that inflation continues to rise, but a prolonged period of low interest rates also poses risks. The Riksbank is continuously monitoring the effects of the low interest rates on the vulnerability of the financial system, especially since the repo rate entered negative territory. The assessment is that the negative interest rates have, so far, not impaired the functionality of the financial system. However, there are risks related to increased risk-taking on the financial markets and potential overvaluation of assets. The Riksbank has emphasized the high indebtedness of Swedish households as a particular risk. However, monetary policy has no room to address

this risk.

The effects of the recent migration inflows on the Swedish economy remain yet to be seen, and inflation may be affected both in the short and the longer term. The Riksbank has communicated limited tolerance for low inflation, but a higher willingness to allow inflation to temporarily exceed its forecast without necessarily tightening monetary policy. In 2016, the next large-scale round of collective bargaining will take place. Ensuring that long-term inflation expectations remain anchored around the inflation target, and thereby a steady functioning of the wage formation process, continues to be the primary concern for monetary policy ahead.

Fiscal policy

The Ministry of Finance agrees with staff's fiscal assessment that a broadly neutral fiscal stance is appropriate in the near term. Net lending remains below the target level and therefore the public finances need to be strengthened. However, resource utilization has been low for a long time and the outlook for continued recovery is uncertain. Fiscal policy therefore needs to support economic recovery and contribute to pushing down unemployment rates. The reforms proposed in the Budget Bill for 2016 should be fully funded. This position of fiscal policy will help strengthen net lending, while safeguarding the ongoing recovery.

The Government has presented to the parliament a draft addendum to the budget because of the refugee situation. In the addendum to the budget, the Government proposes a temporary support to local governments and civil society. The proposals will be financed by an increase in government borrowing. The vast number of refugees involves unforeseen, and in the short term, more or less inevitable expenditures. Increased government borrowing is a common way to manage unforeseen costs during the current budget year.

Government offices are currently reviewing how different spending increases that may occur over the coming years could be financed. Depending on how the public finances and migration flows evolve, spending increases may be financed through decreased expenditures on other items in future budgets, measures to curb cost increases, borrowing, or a combination of these measures.

Structural issues

Labor market policy

As for the Swedish labor market, it should be noted that it is strong in an international comparison. Swedish labor force participation and employment rates are the highest in the EU. At the same time, unemployment is high. The objective of the Government's employment policy is to reduce unemployment so that it is the lowest in the EU by 2020.

Accordingly, in the Budget Bill for 2016, the Government is investing in better job matching and skills development through measures to promote an active labor market policy for people who are long-term unemployed or have impairments that entail reduced working capacity.

The Government is also significantly increasing the compensation paid to municipalities for their reception of refugees, and undertaking more effective measures to introduce newly arrived immigrants to the labor market.

Staff assesses that a rise in migration inflows could initially raise unemployment. However, in the very short run, immigration is expected to have a positive effect on public expenditures as consumption related to schooling and housing etc. will rise. This will stimulate labor demand in the short run. In addition, it will take time before newly arrived immigrants get access to the labor market and become part of the labor supply. Taken together, immigration is therefore likely to result in a downward pressure on unemployment in the near future. Over time, however, unemployment could be expected to rise as newly arrived immigrants enter the labor force. Effective integration policies are key to speed up the process.

Staff recommends that the employment protection law should be reviewed to ensure that exit costs do not deter firms from hiring new entrants with sufficient skills. Temporary contracts can be an effective stepping stone into the labor market for groups whose productivity is uncertain. Moreover, there are a number of subsidies available for groups facing low demand in the labor market. This being said, it is important that employees do not get stuck in fixed term employment for longer periods of time. Open ended contracts should be the main rule. The Swedish government is currently working on a bill, intended to further reduce the possibility of using repeated fixed-term contracts and improve the situation of workers who risk becoming stuck in fixed-term employment for an extended period.

Taxation

The design of the tax system is one of many factors that can influence levels of household debt. Any potential measures in this area must however be seen in a long term perspective and must be handled with great care, due to the potential negative effects on growth that a change in measures such as tax deductibility on mortgage interest payments may have. With current economic growth being highly sensitive to changes in private consumption, it is essential that new regulation is implemented carefully in order to keep house prices from falling rapidly.

Regarding the deferral of capital gains tax when selling a house, it should be noted that one of the principles for the Swedish tax system is to tax as close to the time of the taxable income as possible. A more generous threshold for deferring capital gains tax would go in the other direction.

Housing supply

In general, the observations and recommendations by staff are in line with the analysis and policy objectives pursued by the Swedish government, i.e. housing supply must increase, competition be strengthened, and the planning and appeal processes streamlined. It should be noted that changes within these areas take time and they will consequently be subject to reforms for an extended period of time.

In the Budget Bill for 2016, the Government has proposed measures to increase investment in the housing sector, for example investment aid to rental housing and student housing. The Government has also proposed simplification of rules designed to streamline the planning and construction process as well as improved noise regulations. Furthermore, means will be allocated to municipalities in order to provide incentives to contribute to increased housing construction. Two commissions of inquiry are reviewing the competition in the construction sector as well as investigating how tenants' position could be strengthened so that the lease will be considered attractive and secure housing in the future.

As to the rent-setting process, it was, in conjunction with the re-regulation of the Municipal Housing Companies, subject to reform taking effect from January 1, 2011. Changes have also been made in the special rules applying to new rental housing extending the time period during which an exemption from the ordinary rent setting rules from 10 to 15 years as late as from February 1, 2013. There is strong support for the present rent setting system which provides a framework for ensuring “fair rents” and thereby ensures security of tenure for tenants while market rents are perceived as associated with high rents and lack of security of tenure for tenants.

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. Moreover, a special committee has been set up to enable rapid construction of high speed railways between major cities and related infrastructure.