



SWEDEN

November 2016

2016 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; 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 2016 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 14, 2016 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 14, 2016, following discussions that ended on September 29, 2016, 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 October 21, 2016.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Supplement** of November 1, 2016 updating information on recent developments.
- 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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IMF Executive Board Concludes 2016 Article IV Consultation with Sweden

On November 14, 2016 the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Sweden.

Sweden is enjoying strong economic performance, with real GDP growth heading for about 3.4 percent in 2016 on the heels of an expansion of just over 4 percent in 2015. Employment has increased by 1.5 percent so far in 2016, pushing unemployment down to about 7 percent. Growth is expected to moderate to a still solid 2.4 percent in 2017. Core inflation (HICP basis) has risen significantly to an average of 1.2 percent in 2016 and inflation expectations have moved closer to Riksbank's target. After a further easing in early 2016, the central bank has kept the repo rate at -0.5 percent and it has continued bond purchases.

House price rises slowed to about 5 percent annualized in the last ten months from around 15 percent for most of 2015. This slowing may reflect the high level that prices reached in the Fall of 2015 along with some anticipation of the introduction of an amortization requirement on new mortgages in June 2016. Nonetheless, housing prices stand at some 40 percent above their 20-year average relative to income, and expensive housing has resulted in a growing share of new borrowers taking on high debts relative to their income.

The fiscal deficit is expected to be small in 2016 even as migration-related government spending has almost doubled to about 1.4 percent of GDP owing to the surge in refugee inflows in 2015. The budget for 2017 provides for initiatives totaling 0.5 percent of GDP in education, active labor market policies, and child and elder care, yet still targets a small fiscal deficit. Despite current favorable labor market conditions, the integration of migrants into jobs is lengthy and unemployment is high among less educated foreign-born workers.

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.

Sweden participated in the IMF's Financial Sector Assessment Program (FSAP) in 2016, the findings of which suggest Swedish banks are largely resilient to solvency shocks, although they are very reliant on wholesale funding. The findings of the FSAP are summarized in the accompanying Financial System Stability Assessment.

Executive Board Assessment²

Executive Directors commended Sweden's macroeconomic policies, which have supported strong economic growth, a reduction in unemployment, and a rise in inflation from low levels. Directors called for balanced policies to sustain solid growth. These policies should include returning inflation to target to rebuild space for monetary policy to cushion future downturns, containing the rise in housing market and household debt vulnerabilities, ensuring the resilience of the financial sector, and accelerating the integration of refugees.

Directors welcomed the rise in inflation expectations as a clear signal of the commitment of the Riksbank to the inflation target. They recommended that monetary policy remain stimulatory for some time given the prospect for inflation to rise only gradually. Directors considered that any unwinding of stimulus should await confirmation of a durable rise in inflation, while greater stimulus would be appropriate if inflation or inflation expectations were to weaken. At the same time, Directors strongly encouraged the authorities to continue monitoring the effects of negative interest rates on the financial sector and bank profitability, even as the financial sector is considered to be in good health.

Directors called for housing market reforms and macroprudential measures to contain household debt vulnerabilities. To moderate the uptrend in housing prices they recommended reforms to maintain an adequate land supply for construction, phasing out tax deductibility of interest payments, and phasing out rent controls while protecting the vulnerable. With household debt likely to keep rising in the medium term, Directors emphasized the need to reinforce macroprudential policies through timely adoption of a debt-to-income limit.

Directors welcomed the recent agreement on expanding the financial supervision authority's (FI) ability to take macroprudential measures to address emerging risks in a timely manner. To further support FI's ability to preserve the resilience of Sweden's regionally important financial sector, Directors recommended an expansion of its resources to achieve an appropriate frequency of supervisory inspection. They supported timely adoption of a leverage ratio as a backstop and a strengthening of foreign exchange liquidity requirements on banks in view of their high reliance on wholesale funding, in line with the recommendations of the Financial System Stability Assessment.

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>.

Given Sweden's strong fiscal position, Directors recommended that fiscal policy accommodate the temporary migration-related costs, making the modestly expansionary fiscal stance planned for 2017 appropriate. They noted that the proposed revisions to the fiscal framework would continue to protect Sweden's fiscal health. Directors also supported utilizing the fiscal room available in coming years to further support migrant integration given the employment and long-term fiscal benefits within the new fiscal targets.

Directors commended the Swedish authorities' efforts to improve migrant reception and settlement. They called for further initiatives to provide affordable housing, ensure sufficient educational capacity at the municipalities, and improved coordination across agencies. To alleviate high and rising unemployment among less educated workers born outside Sweden, most Directors recommended that social partners allow temporary and targeted exceptions to high entry-level wages to enable on-the-job skill building. They also recommended that employment subsidy programs be streamlined and employer-employee matching be improved to maximize employment gains.

Sweden: Selected Economic Indicators, 2013–19

	2013	2014	2015	Projections			
				2016	2017	2018	2019
Real economy (in percent change)							
Real GDP	1.2	2.6	4.1	3.4	2.4	2.2	2.1
Domestic demand	1.6	2.9	4.0	4.3	2.7	2.4	2.2
Private consumption	1.9	2.1	2.7	2.6	2.4	2.3	2.2
Public consumption	1.3	1.5	2.5	3.6	1.9	1.2	1.0
Gross fixed investment	0.6	5.5	7.2	6.9	3.9	3.8	3.6
Net exports (contribution to growth)	-0.3	-0.1	0.3	-0.6	-0.1	-0.1	0.0
HICP inflation (e.o.p)	0.4	0.3	0.7	1.2	1.6	2.0	2.2
Unemployment rate (in percent)	8.0	7.9	7.4	6.9	6.7	6.7	6.7
Gross national saving (percent of GDP)	27.8	28.0	29.5	30.4	31.1	31.3	31.3
Gross domestic investment (percent of GDP)	22.5	23.3	24.2	25.5	26.0	26.3	26.5
Output gap (as a percent of potential)	-2.8	-2.2	-0.7	0.9	1.0	0.7	0.4
Public finance (in percent of GDP)							
Total revenues	50.9	50.1	49.1	48.9	48.9	48.9	48.7
Total expenditures	52.2	51.7	48.9	49.1	49.1	49.1	48.7
Net lending	-1.3	-1.6	0.2	-0.2	-0.3	-0.2	0.0
Structural balance (as a percent of potential GDP)	-0.5	-0.6	0.0	-0.5	-0.9	-0.5	-0.1
General government gross debt, official statistics	39.8	44.6	42.9	41.6	40.5	39.4	38.8
Money and credit (year-on-year, percent change, eop) 1/							
M3	3.1	4.1	7.6	8.5	...	...	...
Bank lending to households	4.9	6.0	7.4	7.4	...	...	...
Interest rates (end of period)							
Repo rate 2/	0.8	0.0	-0.4	-0.5	...	...	...
Ten-year government bond yield 2/	2.1	1.7	0.7	0.2	...	...	...
Mortgage lending rate 3/	2.5	1.9	1.6	1.6	...	...	...
Balance of payments (in percent of GDP)							
Current account	5.3	4.6	5.2	4.9	5.1	5.0	4.7
Foreign direct investment, net	4.4	1.0	2.7	2.6	2.8	2.6	2.6
International reserves, changes (in billions of US dollars) 4/	14.6	0.2	1.3	0.5	...	...	...
Reserve cover (months of imports of goods and services)	3.4	3.3	3.5	...	...	...	...
Net international investment position	-12.6	-0.3	4.1	6.0	8.1	10.1	12.0
Exchange rate (period average, unless otherwise stated)							
SEK per euro 2/	8.7	9.1	9.4	9.4			
SEK per U.S. dollar 2/	6.5	6.9	8.4	8.4			
Nominal effective rate (2010=100) 5/	108.5	103.7	97.5	96.7	...	...	...
Real effective rate (2010=100) 5/ 6/	103.4	98.8	94.7	95.7	...	...	...
Fund Position (August 31, 2016)							
Quota (in millions of SDRs)				4430.0			
Reserve tranche position (in percent of quota)				1.8			
Holdings of SDRs (in percent of allocation)				87.4			
Other Indicators							
GDP per capita (2015, USD): 50,591; Population (2016, million): 9.9; 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 2016 is as of August 2016.

2/ Data for 2016 is as of September 2016.

3/ Mortgage rates for new contracts, data for 2016 is as of June 2016.

4/ Data for 2016 is as of Q2 2016.

5/ Data for 2016 is as of August 2016

6/ Based on relative unit labor costs in manufacturing.



SWEDEN

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

October 21, 2016

KEY ISSUES

Sweden is enjoying robust growth aided by supportive macroeconomic policies.

Growth is heading for about 3½ percent in 2016 helping bring unemployment down to about 7 percent. Domestic demand is the key growth driver, boosted by the stimulatory monetary policy along with higher government spending related to migration in 2015–16. Growth is expected to moderate to a still solid 2½ percent in 2017.

Balanced policies are needed to sustain Sweden’s solid growth by:

- Returning inflation to target in order to rebuild space to cushion future downturns;
- Containing the build-up of vulnerabilities from household debt;
- Ensuring that Sweden’s large financial sector remains resilient; and
- Accelerating the integration of refugees into the workforce.

Macroeconomic policies should continue supporting the economy while observing medium-term targets. Monetary policy needs to remain stimulatory for some time with any unwinding of stimulus awaiting clear confirmation of a durable rise in inflation. It was appropriate for fiscal policy to accommodate the sharp rise in migration-related costs in 2016–17, including by boosting education spending. Meeting the revised fiscal targets over the medium term will continue to safeguard Sweden’s fiscal buffers.

Housing market reforms combined with macroprudential measures would best contain vulnerabilities. Moderating the trend rise in housing prices and household debt requires reforms to maintain an adequate supply of land ready for development, phase out mortgage interest deductibility, and gradually remove rent controls. A limit on debt-to-income would contain growth in the share of highly-indebted households.

The resilience of Sweden’s regionally-important financial sector should be preserved. The legal framework for macroprudential policy should be fixed to enable timely measures. Greater supervisory intensity is needed, supported by expanded resources. The interconnected Nordic-Baltic financial system also requires arrangements that ensure close coordination in supervision, liquidity support, and resolution.

Integrating the surge of refugees from 2015 into work entails complementary action by government and social partners. Additional affordable housing and educational capacity in municipalities would help refugees prepare for the Swedish labor market. Employment outcomes would be boosted by streamlining employment subsidy programs and improving job matching, and also by allowing temporary and targeted exceptions to high entry-level wages.

Approved By
Mahmood Pradhan
(EUR) and
Martin Kaufman
(SPR)

Discussions for the 2016 Article IV consultation were held in Stockholm during September 20–29. The mission comprised Mesrs. Beaumont (head) and Chen, and Mses. Ho and Turk, and was assisted by Mr. Scutaru and Ms. Tenali (all EUR). Mr. Čihák (MCM) participated in the concluding discussions. The mission met with Ms. Andersson, Minister of Finance; Mr. Bolund, Minister of Financial Markets and Consumer Affairs; Ms. Ekholm, State Secretary to Minister for Finance; Mr. Holm, State Secretary to Minister for Financial Markets and Consumer Affairs; Mr. Ingves, Governor of the Sveriges Riksbank; the Parliamentary finance committee; and senior officials from the Financial Supervisory Authority, Swedish National Debt Office, National Audit Office, 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.

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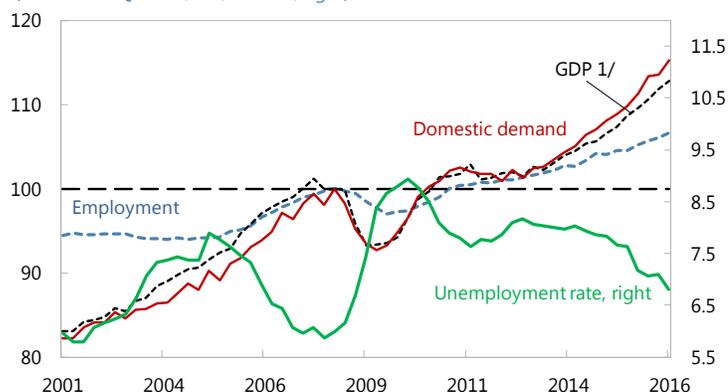
ROBUST GROWTH YET MIXED PROGRESS

1. Sweden's robust growth is reducing unemployment and raising resource utilization (Figure 1).

Excluding volatile items within services exports, GDP growth was very strong at 4 percent y/y in the first half of 2016, on the heels of 3.7 percent growth in 2015.¹ Domestic demand is the key driver, with the 4.7 percent y/y rise in 2016 H1 underpinned by high private investment growth, especially new dwelling construction, and by solid growth in private and public consumption. Export growth moderated to just over 4 percent, still performing well in relation to the modest growth of trading partners. Employment gains of 1.5 percent y/y helped bring trend unemployment down to 7 percent in August from around 8 percent in 2011–14. Survey indicators and output gap estimates point to a rise in resource utilization to just above normal levels.

Key Economic Indicators, 2001-2016.

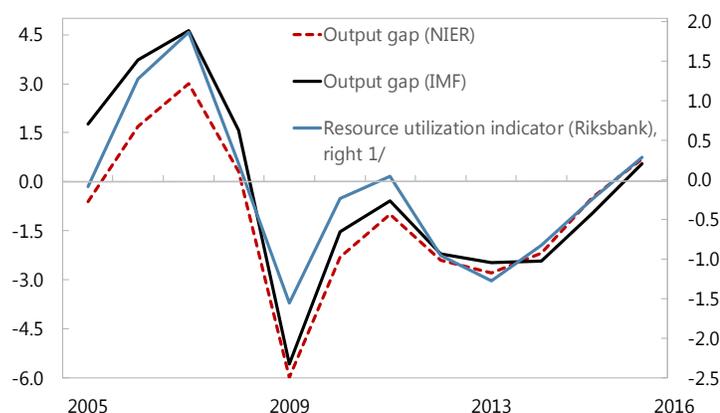
(Index: 2008Q2=100, left; Percent, right)



1/ Excludes royalties & license fees and research & development.

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

Resource Utilization



1/ Resource utilization: principal component of business survey indicators.

Sources: Riksbank, NIER and IMF staff estimates.

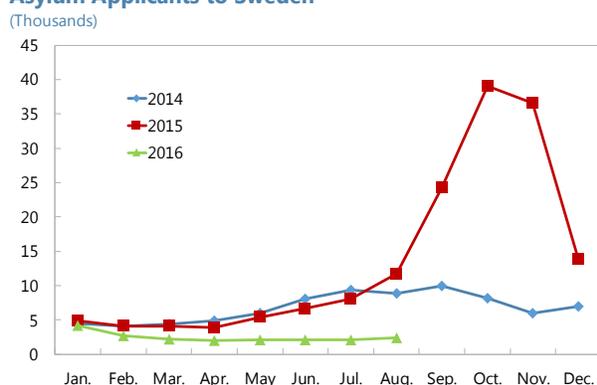
2. However, the progress in addressing Sweden's three main economic challenges is mixed, as elaborated in the remainder of this section:

- **Integration of migrants:** Refugee inflows have declined markedly in 2016, but administrative capacity is stretched, impeding their progress toward integration into the labor force.
- **House prices and household debt:** Housing price increases have slowed, yet the share of households taking on high debt relative to income continues to rise.
- **Low inflation:** Strong monetary policy efforts have helped to raise inflation expectations significantly, but core HICP inflation has stabilized at about 1.2 percent for the past year.

¹ A spike in exports of research and development and royalties and license fees in 2015:H2 contributed about 0.5 percentage points to GDP growth in 2015, even though these items were only 2 percent of GDP in 2014.

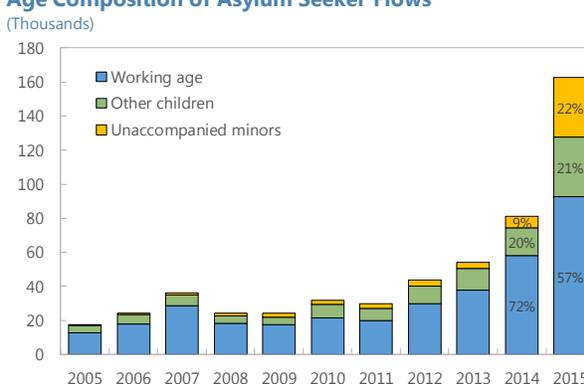
3. Migration inflows have subsided after last year’s historic surge, but there are significant hurdles to integrating the large stock of asylum seekers. Almost 163,000 people (1¾ percent of the population) sought asylum in Sweden in 2015, with just over one-fifth being unaccompanied minors, notably higher than in previous migration waves. These inflows dropped to just over 15,000 in the first half of 2016, mostly due to external developments, but Sweden has also temporarily introduced border controls and tightened rules for asylum seekers. As a result, the Swedish Migration Agency (SMA) has revised down its forecast to between 30,000 and 50,000 asylum seekers this year. Nonetheless, the large stock of asylum seekers with pending applications for residence permits is straining Sweden’s reception capacity and impediments beyond the asylum period may slow their integration into the labor market and Swedish society (Box 1).

Asylum Applicants to Sweden



Sources: Eurostat and Fund staff calculations.

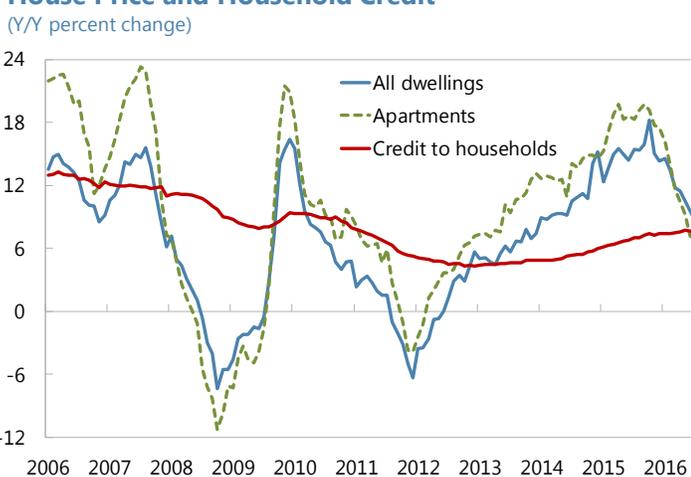
Age Composition of Asylum Seeker Flows



Sources: Swedish Migration Board and Fund staff calculations.

4. House price increases have slowed significantly but household debt is steadily rising. Housing price inflation declined to about 5 percent annualized in the last 10 months, from around 15 percent for most of 2015. Stockholm apartment prices have been broadly flat since September 2015, after jumping by 54 percent in the three preceding years. This slowing may reflect the high level housing prices reached in the Fall of 2015, renewed public discussion of reducing tax deductibility of mortgage interest payments, and some anticipation of the impact of minimum amortization requirements on new mortgages that became effective in mid-2016. Even as prices slowed, household credit growth was little changed in the past year, running at 7.5 percent y/y in August, bringing household debt to 179 percent of disposable income, rising steadily by 11 percentage points in the past three years, as new housing purchasers take on higher debts.

House Price and Household Credit

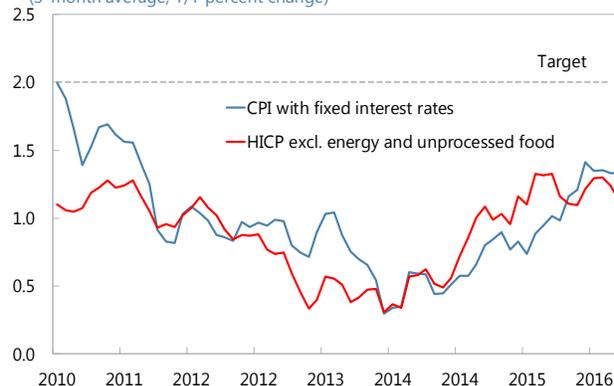


Sources: Statistics Sweden, Valueguard, and Fund staff calculations.

5. Inflation and inflation expectations have risen significantly from low levels, although core inflation has stabilized more recently. Sweden's output gap widened to 2½ percent in 2013, contributing to core HICP inflation falling to just ½ percent in 2013–14, below the 1.1 percent rate in the euro area. Core inflation rose to an average of 1.1 percent in 2015, with depreciation of the Swedish krona in 2014 playing a significant role. This progress, together with the Riksbank's strong commitment to its inflation target, underpinned a rebound in inflation expectations from their record lows in early 2015. Nonetheless, the wage round in 2016 (covering about 80 percent of private sector employees), agreed wage growth of only 2.2 percent, below the historical average despite labor market tightening. Core inflation has since picked up only marginally, to average 1.2 percent so far in 2016, which may contribute to expectations leveling out in recent months.

Inflation

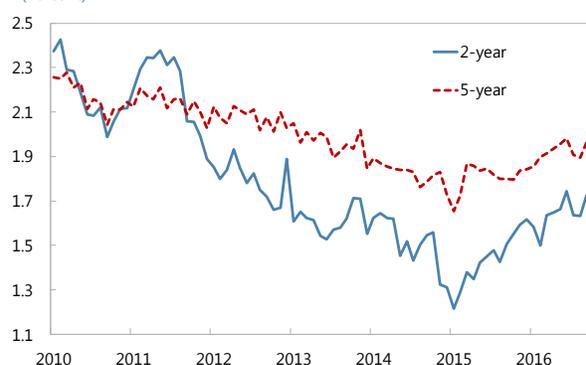
(3-month average, Y/Y percent change)



Sources: Eurostat, Statistics Sweden and Fund staff calculations.

Inflation Expectations

(Percent)



Sources: TNS Prospera and Fund staff calculations.

MACROFINANCIAL OUTLOOK AND RISKS

6. Growth is expected to moderate, with inflation rising towards the target only gradually, and residential investment remaining relatively high. Strong domestic demand growth in 2015–16 was aided by expansionary monetary policy and rising spending on migrants. Yet most of the monetary easing took place in 2015, public consumption growth is expected to be significantly lower in 2017, and very high growth in residential investment is expected to slow in the face of resource constraints, so domestic demand and GDP growth is expected to cool from 2017. Nonetheless, residential investment recently reached 5 percent of GDP compared with a 25-year average of 3 percent, and the high level of housing prices is expected to sustain a high level of construction in coming years unless land supply and other supply-side constraints become binding. Export growth is expected to remain at moderate levels consistent with prospects for trading partner growth. The output gap turns positive from 2016, feeding into a renewed inflation pick up from 2017, yet core HICP inflation takes three years to approach the target. Despite solid growth and rising employment, the unemployment rate is projected to stop declining after 2017 as newly arrived migrants start to join the labor force but take a number of years to gain jobs (Box 2).

Macroeconomic Indicators

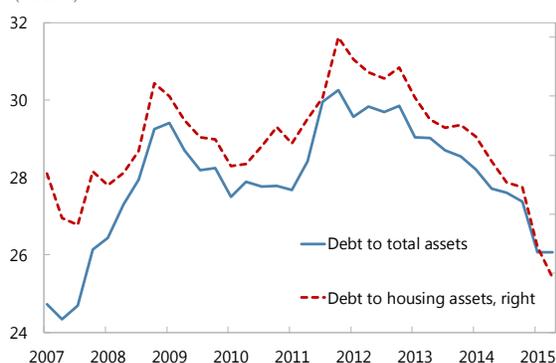
(Y/Y percent change, unless noted)	2013	2014	2015	2016	2017	2018	2019
GDP	1.2	2.6	4.1	3.4	2.4	2.2	2.1
GDP ex. volatile items 1/	1.3	2.4	3.7	4.1	...	...	...
Domestic demand	1.6	2.9	4.0	4.3	2.7	2.4	2.2
Exports ex. volatile items 1/	-0.7	4.8	4.7	3.7	3.3	2.8	2.8
Trading partner GDP	1.2	2.0	2.0	1.8	1.9	2.1	2.2
Unemployment rate (percent)	8.0	7.9	7.4	6.9	6.7	6.7	6.7
Output gap	-2.8	-2.2	-0.7	0.9	1.0	0.7	0.4
Core HICP inflation, e.o.p.	0.4	0.7	1.2	1.1	1.3	1.6	1.8
Residential Investment (percent of GDP)	3.6	4.0	4.5	4.9	5.1	5.2	5.2
Credit to households	4.9	6.0	7.4	6.8	6.1	6.0	6.0

1/ Research & development and royalties & license fees are excluded from services exports.

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

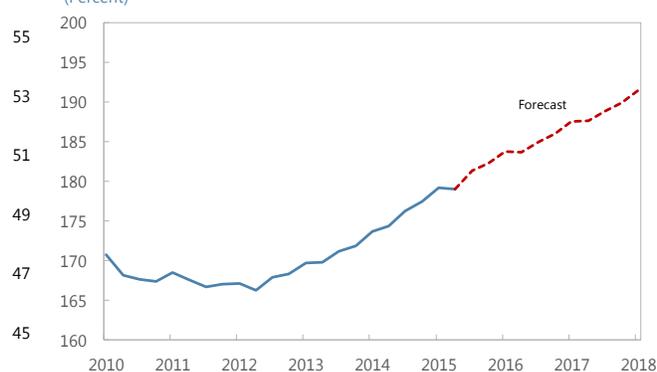
7. At the same time, household debt is expected to keep rising in the medium term as banks are well placed to meet rising household credit demand. The acceleration in housing prices that began around 2013 was principally driven by a combination of growth in incomes and financial asset holdings and lower interest rates. The impact of population growth and urbanization is evident in the rapid increase in apartment prices in the main cities.² The financial sector does not appear to be a key driver of this residential property cycle, with household credit growth lagging the acceleration in housing prices and remaining well below the pace of those gains.³ As a result, although household debt has risen relative to income, it has fallen relative to household assets. Based on past patterns of household balance sheet adjustment, households are expected to seek higher debt in coming years. Banks are well placed to supply this credit as they enjoy solid profitability despite negative interest rates and have buffers over capital requirements (Table 6).

Debt Ratios
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

Household Debt to Disposable Income
(Percent)



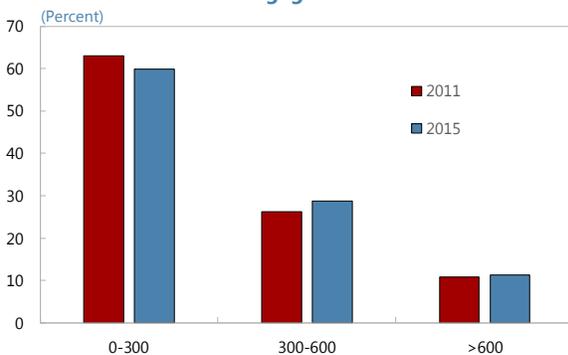
Sources: Riksbank, Monetary Policy Report, September 2016.

² See Giang Ho, 2015, "[Housing Supply Constraints in Sweden](#)," Sweden Selected Issues, IMF Country Report No. 15/330 (Washington).

³ Household debt is found to adjust over time especially to developments in the value of collateral, see Rima A. Turk, 2015, "[Housing Price and Household Debt Interactions in Sweden](#)," IMF Working Paper, WP/15/276 (Washington: International Monetary Fund).

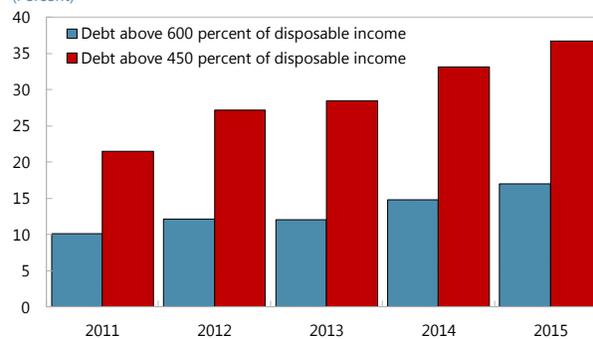
8. Macroeconomic vulnerabilities related to the distribution of household debt could build even if financial stability is maintained. The recent rise in dwelling construction is welcome to address shortages and support labor mobility and productivity.⁴ But many past episodes of debt accumulation to finance property investment warn about stability risks. The FSAP findings suggest the banks are largely resilient to potential solvency shocks, although they are very reliant on wholesale funding (Box 3). Nonetheless, a rise in the share of highly-indebted households would increase macroeconomic vulnerabilities.⁵ Although the distribution of household debt-to-disposable income (DTI) ratios has shifted out relatively modestly in recent years, the shares of new mortgage borrowers with DTI ratios above 600 percent rose by 7 percentage points from 2011 to reach 17 percent by 2015, and the share over 450 percent rose 16 percentage points to 37 percent. This suggests the share of highly indebted households could rise more rapidly going forward.

Distribution of Debt-to-Disposable Income Ratios of Households with Mortgages
(Percent)



Source: Riksbank.

Share of Highly-Indebted New Mortgage Borrowers 1/
(Percent)



Sources: Finansinspektionen and Fund staff calculations.

Note: The figure shows debt-to-income ratios based on households' total debt and net disposable income.

9. Such rising vulnerabilities would exacerbate the impact on Sweden if downside risks are realized, with potentially significant spillovers to the region (see also Box 4):

- **External risks:** Sweden is highly exposed to external shocks including through banks' high share of wholesale funding and strong trade linkages with Europe including the UK. Weak growth in major advanced and emerging economies would impact primarily via lower exports, while economic fallout from political fragmentation in Europe, including uncertainty associated with post-Brexit arrangements, could weigh on investment. The adverse impact on Sweden's growth and inflation would be greater if the nature of policy responses in these major economies resulted in a significant appreciation of the krona.

⁴ Based on detailed regional data from the National Board of Housing and Planning, a shortage of 140,000 units is estimated, equivalent to 3½ years of dwelling construction at the recent rate of completions.

⁵ Using Swedish household level data, [Flodén and others \(2016\)](#) find a large effect from interest rates on household consumption via a cash-flow channel. The estimated marginal propensity to consume is around unity or even higher in response to changes in interest expenses. So highly indebted households reduce consumption by several percentage points more in response to a one percentage point increase in the household interest rate than households with little debt.

- **Housing risks:** The market seems to be cooling off from the high price levels reached last fall. A gradual increase in housing supply is expected to moderate prospective rises in housing prices rather than resulting in a significant decline. Nonetheless, Swedish house prices are historically high, at some 40 percent over their 20-year average relative to income, implying potential for a significant fall with a likely recession-like impact on consumption and unemployment.⁶

10. Authorities' Views. *The authorities shared a similar macroeconomic outlook, although they projected lower investment growth as it was already high by historical standards, and the Riksbank considered inflation would likely rise more rapidly. While housing supply shortages reduced the likelihood of a significant fall in prices, the authorities shared concern about the implications of trends in household debt levels and composition for macroeconomic stability.*

FINDING THE RIGHT BALANCE

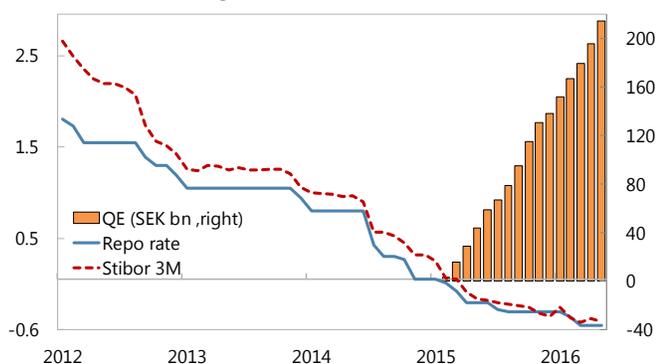
11. Sustaining solid growth while containing macrofinancial vulnerabilities requires well targeted policy efforts. The expansionary monetary stance needs to be maintained to avoid prolonged low inflation that would prevent monetary policy regaining space to cushion shocks, and, if needed, some room remains to ease monetary policy. Fiscal policy should emphasize addressing migrant integration and housing challenges while moving to the new surplus target in the medium term, and it will need to play a larger than usual role in cushioning the economy in case of adverse shocks. Further macroprudential steps are needed to contain vulnerabilities associated with a likely continued rise in household indebtedness, which adds to the urgency of fixing the legal framework to enable more timely adoption of macroprudential measures as risks evolve. Expanded education should be complemented by temporary and targeted flexibility in entry-level wages to help migrants and others gain employment and over time become contributors to Sweden's strong social model.

A. Monetary and Exchange Rate Policy

12. To raise inflation and inflation expectations the Riksbank eased further in 2016 using unconventional monetary policy (UMP) tools. The repo rate was cut by a further 15 bps in February to -50 bps. Additional bond purchases were also announced, bringing total purchases to about 37 percent of government bonds by end 2016, amounting to some 6 percent of GDP. Moreover, the pool of eligible assets for these purchases was expanded to include inflation-indexed bonds, signaling the

Monetary Instruments 1/

(Percent, left; SEK bil., right)



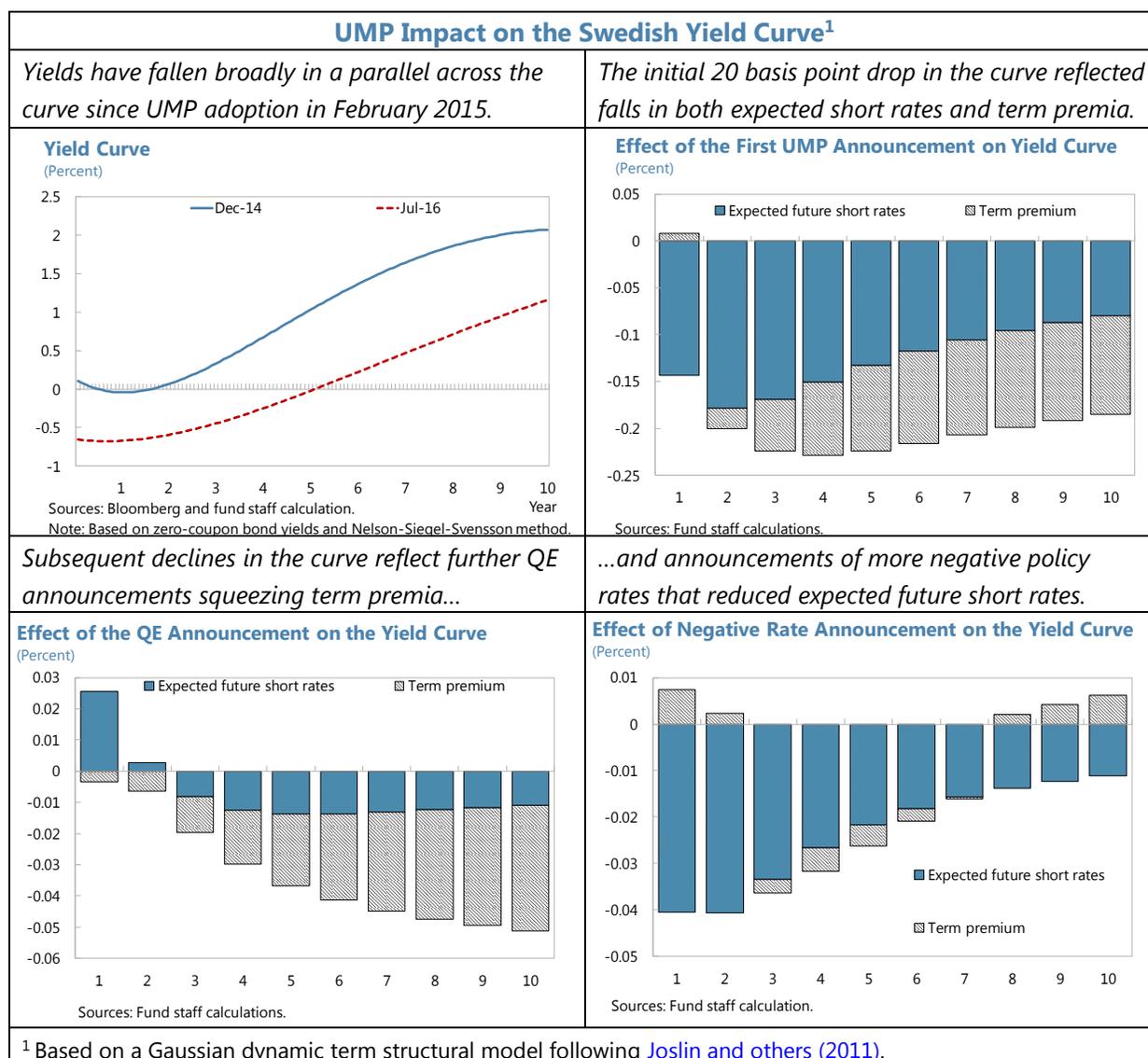
Sources: Sveriges Riksbank and Fund staff calculations.

1/ Orange bars represent the cumulative amount of government bonds that the Riksbank has already purchased by July 2016.

⁶ See analysis by [Gustafsson and others \(2015\)](#).

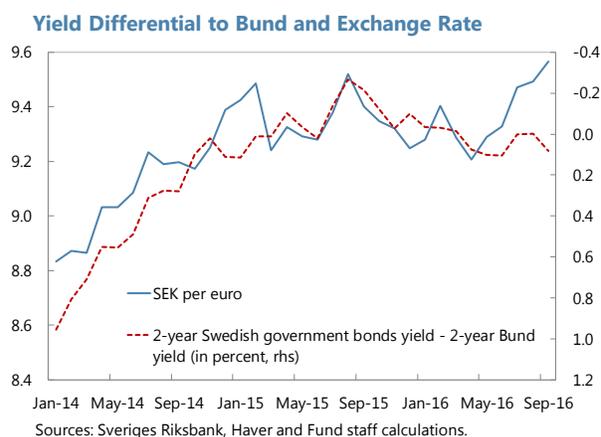
capacity for further action. Since these purchases began, nonresident holdings of Swedish government bonds have declined by almost 25 percent, equivalent to about 40 percent of total bond purchases, but more recent purchases are mainly from residents.

13. Combined use of UMP instruments has enhanced the impact on yields, with limited side effects on banks to date and mixed readings regarding the impact on bond market liquidity. Repo rate cuts and commitments to keep rates low have most effect on the short end of the yield curve while asset purchases directly compress term premia. Deploying a package of all three measures shifted yields down by at least 50 bps at all maturities since end-2014. Moreover, the strong pass-through into the cost of the wholesale funding of banks has helped mitigate adverse impacts from negative interest rates on Swedish bank profitability (Box 5), although these effects should continue to be closely monitored. Although the National Debt Office considers that the large volume of bond purchases contributes to increased use of its repo facility, the Riksbank notes that market interest in its regular auctions remains strong, suggesting scope for further purchases.

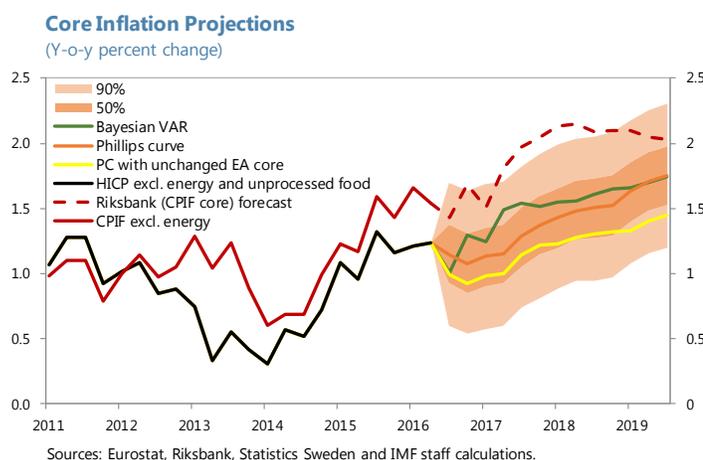


¹ Based on a Gaussian dynamic term structural model following [Joslin and others \(2011\)](#).

14. The Krona has been broadly stable despite easy monetary policy in the major currency areas. Since February 2015, the Riksbank's monetary stimulus has kept Swedish yields roughly in line with German Bunds, despite the ECB's monetary easing. Given the strong correlations between yield differentials and the exchange rate, this has supported broad stability of the Swedish krona during 2015–16. Although the Riksbank signaled its readiness to intervene at the foreign exchange (FX) market if necessary, in practice no FX purchases have been made.



15. Inflation is expected to rise, but the return toward the target will likely be gradual. A range of forecasting tools indicate inflation will gradually rise over time, although at a slower pace if euro area inflation does not rise as projected. Yet, there is uncertainty about how quickly resource pressures will feed into inflation. Wage setting is one source of this uncertainty, as wage growth remains relatively low despite rising indicators for labor shortages. A spillover from sluggish growth in euro area wages may play a role, as wage discussions in Sweden's industrial sector—which traditionally leads the national wage rounds—pay close attention to maintaining competitiveness. Contracting out work to foreign companies has also helped contain the impact of labor shortages in some areas, most prominently in the construction sector. The Riksbank's projection for inflation to rise more rapidly partly reflects a greater rise in firms' margins than staff expects.



16. The expansionary monetary stance therefore needs to be maintained for some time. An unwinding of the monetary expansion should await clear confirmation that tightening resource utilization is translating into a durable rise in inflation, and any unwinding should be at a measured pace that accepts a broadly symmetric risk of inflation being above or below the target. In case inflation prospects and expectations were to weaken, further rate cuts would be appropriate, although such an easing would need to be accompanied by heightened vigilance regarding household debt vulnerabilities and preparedness to tighten the macroprudential stance. Bond purchases could be extended while continuing to monitor debt markets.

17. Sweden's external position is moderately stronger than the level consistent with medium-term fundamentals and desirable policies so foreign exchange intervention should

remain a last resort. The current account surplus of 5 percent of GDP reflects a number of factors including measurement issues (Appendix II). Taking these factors into account, the surplus modestly exceeds staff's view of the norm for Sweden, hence the krona is assessed to be moderately undervalued. In that context, FX intervention should be a last resort after exhausting other instruments, being limited to averting a decline in inflation owing to rapid Krona appreciation.

18. A parliamentary review of the Riksbank law should be used to strengthen Sweden's monetary and financial stability arrangements. Given the communication challenges from the immediate positive impact of the policy rate on the headline CPI, the inflation target should be in terms of the internationally comparable HICP.⁷ Greater symmetry in inflation targeting would be desirable, with inflation (CPI with fixed interest rates) below the target for over 70 percent of 12-year period prior to the GFC. Even as the Finansinspektionen (FI) is the designated authority for macroprudential policies, the Riksbank's role in financial stability should be put on a firmer legal footing, including in relation to systemic financial risks and emergency liquidity provision (FSSA ¶166).

19. Authorities' Views. *The Riksbank broadly agreed with staff views on the monetary and exchange rate policy. The authorities will continue monitoring developments in the financial markets and institutions closely for potential adverse effects from UMP. The authorities endorsed the recommendation to clarify the Riksbank's financial stability mandate.*

B. Housing and Household Debt Policies

20. Minimum amortization requirements on new mortgages became effective in June, which will help cement the progress made in recent years. The FI's [Swedish Mortgage Market](#) report indicates amortization of mortgages with an LTV of 70–85 percent rose from 0.8 percent of principal in 2011 to 1.3 percent by 2015. New mortgage borrowers are required to make annual repayments of at least 1 percent of the debt principal for mortgages with LTV over 50 percent, and at least 2 percent for those with LTV above 70 percent. The direct macroeconomic impact of higher amortization is contained as only new borrowers are affected.⁸ As amortization net of refinancing is key to containing the development of household debt vulnerabilities the adequacy of these minimum amortization rates should be reviewed annually. The macroprudential stance was also tightened by raising the counter-cyclical capital buffer to 2 percent effective March 2017, even as the [credit-to-GDP gap](#) has declined substantially in recent years.

21. But the current conjuncture calls for broader efforts to lean against the evolving risks. Income and population drivers of housing demand are expected to remain strong in Sweden and interest rates may remain exceptionally low for some years. Hence, even with the recent rise in construction (less than 1 percent of the total dwelling stock annually), the potential for a renewed increase in housing prices remains. The resulting upward pressure on high-DTI borrowing would not

⁷ The CPI with fixed interest rates is subject to significant fluctuations in imputed components such as depreciation while the HICP includes only observed prices of goods and services (see [Riksbank Studies, September 2016](#)).

⁸ While nearly all mortgages with LTV above 70 percent were being amortized, average repayments were only 1.3 percent of debt, below the new 2 percent requirement. For mortgages with LTV of 50–70 percent, only 51.2 percent were being amortized, by an average of 0.9 percent of the debt.

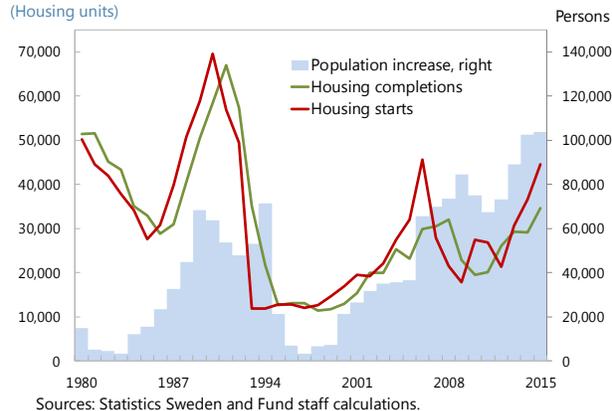
be contained by the current framework of an LTV ceiling (85 percent), minimum risk weights (25 percent) on mortgages, and minimum amortization requirements. A sustained rebalancing of housing demand and supply in order to moderate the trend rise in housing prices is therefore key to protecting the financial resilience of households over the longer term. New macroprudential tools also have a significant role to play in containing the rise in vulnerabilities over the medium term.

22. Rebalancing housing demand and supply requires deep reforms of Sweden’s poorly functioning housing market, that would have broader benefits including for labor mobility:

- **Sustaining the increase in housing supply.**

Maintaining an adequate supply of land that is ready for development is needed to sustain the recent welcome rise in construction, requiring more transparent, standardized, and timely municipal land sale and planning procedures. Expanded budgetary support for affordable rental housing—currently at 0.1 percent of GDP—would also help enhance supply while avoiding an increase in household debt.

Housing Completions, Starts, and Change in Population
(Housing units)



- **Tax reform to reduce demand and incentives for debt financing.** A first-best approach would be to raise the very low ceilings on property tax to broaden the tax base in a progressive manner. The low interest rate environment makes it ideal to also phase out the tax deductibility of interest payments. The proposal to temporarily remove the threshold for deferring capital gains tax on a primary residence would promote more efficient use of existing dwellings.
- **Phasing out rent controls is key.**⁹ Long queues for rental apartments leave new entrants little option but to buy, “lock-in” effects from rent controls hinder the efficient use of housing, and the incentive is to build tenant-owned rather than rental housing. Phasing-out rent controls while protecting vulnerable households through the housing allowance and exempting all new construction from controls would reduce housing imbalances.

23. In addition, the macroprudential toolkit should be reinforced by a DTI limit. Banks report that they are taking household DTI into account in mortgage origination, with some having internal thresholds that are resulting in a larger share of loan applications being rejected. Signs of a tightening of lending standards are seen in average LTVs on new mortgages declining to 68.3 percent in 2015, from around 70 percent in 2012–14. However, banks that are competing with each other are unlikely to fully internalize the macroeconomic risks of having a large share of highly-indebted households in their loan-by-loan origination decisions. Reflecting such concerns, a mortgage loan-to-income (LTI) threshold that only a minority of borrowers may exceed has been adopted in the UK and Ireland and a DTI is under consideration in New Zealand. A [study](#) by FI of the

⁹ Rent controls are strictest in Sweden among European countries according to a European Commission [index](#).

macroeconomic effects of the DTI limit suggests that a cap of 600 percent of disposable income, with exemption of 15 percent of mortgages, would slow the rise in household debt while having modest negative effect on growth.¹⁰

24. A limit on the share of high DTI loans should be adopted soon in order to:

- Lean against growth in the share of households with high DTI ratios while allowing some flexibility for individual household circumstances. This would contain increases in the interest sensitivity of consumption and protect households' resilience to income losses in a recession.
- Automatically reduce LTVs on high DTI loans when housing prices rise faster than incomes, providing larger buffers for a potential adjustment in house prices.
- Make lending responses to house price increases somewhat less elastic than relying solely on an LTV ceiling, helping to dampen the potential for an upward credit-price spiral.

In view of the lengthy process to adopt new tools, the FI should initiate the adoption of a DTI limit soon, but a final calibration of the DTI limit could be deferred until the tool is authorized to take into account developments including experience with the amortization requirement.

25. An approach based on risk weights and close supervision could allow more timely implementation than a regulated DTI limit. Other countries have applied higher risk weights for mortgages above certain LTV thresholds.¹¹ Following a similar approach, FI could raise the risk weight for the portion of mortgages exceeding a certain DTI threshold to be considerably above the current floor of 25 percent or it could adopt a capital surcharge on such loans. Such measures would clearly signal that banks should contain the volume of high-DTI lending. It would be important to support such a signal with regular supervisory monitoring and engagement on the scale of such lending by each bank. But if these signals and supervisory efforts are not sufficiently effective a regulatory limit on DTI would be needed.

26. Authorities' Views. *The authorities are alert to housing supply challenges, noting that recent improvements in construction permitting would streamline processes for buildings of a similar design. However, gaining consensus on raising the property tax is unlikely and political support for the present rent setting system is strong given concerns that reforms would bring high rents and reduced security of tenure. The government considers there needs to be political consensus with opposition parties to hold discussions on reducing mortgage interest deductibility. The Government and FI prefer to first assess the impact from the amortization requirement before taking further measures. The FI will continue to study a range of options regarding household DTI limits, with the Riksbank noting that implementation of such tools is urgently needed, where regulation would have a more certain impact on containing risks.*

¹⁰ Analysis by [van Santen and Ölcer \(2016\)](#) finds that household's gross income averages 40 percent more than disposable income. This suggests that 600 percent of disposable income in Sweden is equivalent to 430 percent of gross income, making the former threshold broadly comparable to that in the UK of 450 percent of gross income.

¹¹ For example, the Reserve Bank of New Zealand raises standardized mortgage risk weights from 35 to 50 percent if LTV is over 90 percent, in Luxembourg, the risk weight goes from 35 to 70 percent for amounts exceeding an LTV of 80 percent, and in Switzerland, a risk weight of 100 percent is applied for loan tranches above an 80 percent LTV.

C. Prudential Policy and Financial Safety Nets

27. The legal framework for macroprudential policies should be fixed to enable timely action, a priority that is heightened by prospects for household debt to keep rising. The recent introduction of amortization requirements on new mortgages came after long delays, revealing shortcomings in the process for the FI to adopt new macroprudential tools that it considers to be justified primarily on macroeconomic stability grounds.¹² Accordingly, the law should be amended to remove uncertainties around FI's macroprudential powers and provide FI with a toolbox that can be used to address systemic risks in a timely and effective manner (FSSA ¶138). Experience in a range of countries suggests approaches to providing effective oversight by governments and parliaments while achieving timely authorization of new tools.¹³

28. The coming review of the Financial Stability Council (FSC) should seek to structure its operations to most effectively support FI's fulfilment of its macroprudential mandate. The FSC has provided a valuable forum for sharing information. Joint work on risk analysis and on the design and impact assessment of potential measures should be expanded. To foster cooperation among the authorities involved, and to take full advantage of Riksbank expertise in the assessment of macrofinancial risks, the FSC should have the power to make recommendations, preferably with the FI having a responsibility to comply or explain (FSSA ¶139).

29. FI needs to step up supervisory intensity. FI is responsible for supervising some of the largest and systemically important banks in the Nordic region. But [analysis](#) by FI of its resources assigned to the banking sector compared with other supervisors finds a resource gap of approximately 45 percent. FI resources should be expanded to achieve an appropriate frequency of inspections (FSSA ¶148). Moreover, delays in introducing regulations while relevant legislation and ordinances are being amended should be minimized to support FI's capacity to safeguard stability.

30. A leverage ratio can provide a useful backstop to risk-based capital requirements. Reflecting the strong capital buffers of Swedish banks, stress tests suggest that their solvency is resilient under a severe scenario where a slump in global growth is associated with a sharp rise in unemployment and a large fall in housing prices. Yet, the exercise also illustrated the challenges of modeling tail risks in Sweden. It is therefore welcome that FI has proposed a new supervisory approach to risk weights on corporate exposures.¹⁴ Timely adoption of a leverage ratio as a backstop would further safeguard against model and measurement errors (FSSA ¶124).

¹² FI has previously adopted a ceiling on LTV ratios under its consumer protection mandate and a floor on mortgage risk weights under its mandate for financial stability, but it lacks a legislative mandate for macroeconomic stability.

¹³ See first chapter of Selected Issues.

¹⁴ In May 2016 the FI announced a new [supervisory method](#) on IRB models for corporate exposures. Corporate risk weights are expected to rise to over 30 percent, raising capital requirements by about 2.5 percentage points (see Sweden FSSA Technical Note on Stress Testing, 2016).

31. To address systemic liquidity issues in foreign currency, a further tightening of FX liquidity requirements should be evaluated.¹⁵ Swedish banks, excluding subsidiary banks in the region, had about 50 percent of GDP in short-term external debt at end 2015. Banks have improved their FX liquidity following the global financial crisis, with liquidity coverage ratios (LCRs) in U.S. dollars and in euro well above 100. Nonetheless, in case market funding is interrupted, banks could need sizable FX liquidity support, in part because some of banks' liquid assets are held in securities that may not be widely traded in a crisis such as covered bonds. Taking into account the time that may be required to replenish foreign reserves by borrowing or to access central bank swap lines, and the desirability to have a buffer for contingencies, it would not be appropriate to reduce Sweden's existing reserves of 11 percent of GDP. The adequacy of reserves could be further assured by monitoring an extended (three-month) LCR in U.S. dollars and euros (FSSA ¶46) and ensuring that an adequate portion of banks' high quality liquid assets can be sold on the market in a crisis.

32. Sweden plays a central role in the highly interconnected Nordic-Baltic financial system requiring close coordination in supervision, liquidity support, and resolution. Sweden hosts four of the largest publicly-listed banks in the Nordic region, with assets amounting to about 120 percent of Nordic region GDP, including Nordea which is a top-3 bank in Denmark, Finland, and Sweden. Swedish banks also account for large shares of total bank assets in Estonia, Latvia, and Lithuania. Regional cooperation on financial stability should therefore be enhanced, building on the Nordic-Baltic Macroprudential Forum established in 2011 (FSSA ¶36). Memoranda of Understanding under discussion between the regional supervisors should entail full access to supervisory information including participating in on-site inspections. In parallel, cooperative agreements among the relevant authorities are needed regarding potential liquidity support and to ensure financial stability in all countries is protected in event of resolution.

33. Authorities' Views. *Recognizing the deficiencies in the legal framework for macroprudential policies, the Finance Ministry is analyzing options to clarify FI's mandate in this regard. Although the authorities aim to make best use of the FSC, it is not possible under Sweden's constitution for the FSC to make recommendations to FI entailing a comply or explain obligation. The budget for 2017 provides additional resources to FI, and these would be reviewed once again at the next budget. While the Riksbank supports the FSAP's call for timely adoption of a leverage ratio as a backstop, FI considers that steps to make risk weights more robust better address model risk concerns. FI also notes that a leverage ratio, should it be constructed as a minimum requirement, would remove most of the current capital buffers. On banks' FX liquidity, FI noted that Swedish LCR implementation exceeds international norms, and already is focused on requirements in foreign currency. The Riksbank, however, supported consideration of a further tightening of FX liquidity regulation. The authorities agree on the need to continue strengthening regional coordination in supervision, liquidity, and resolution.*

¹⁵ See second chapter of Selected Issues.

D. Fiscal Policy

34. The budget for 2017 targets a continuation of a small deficit. Migration-related spending almost doubled to about 1.5 percent of GDP in 2016 despite lower than assumed refugee inflows. But the budget is expected to record only a small deficit owing to strong revenue performance and lower than expected spending including on healthcare. Looking to 2017, migration-related spending is expected to rise modestly as introduction program costs rise when refugees obtain residence permits and settle in municipalities. New initiatives of about 0.5 percent of GDP include education and active labor market measures together with expanded elderly and child care. These are only partly covered by a new bank tax, higher taxes on chemicals and energy, and state income tax. A reversion to a more normal revenue performance also contributes to the expected small decline in net lending to -0.3 percent of GDP in 2017.

35. A modestly expansionary fiscal stance is appropriate in the near-term given the need to accommodate temporarily high migration-related spending. In 2015 the Fund recommended that swings in migration-related expenses should be accommodated in the near term and funded over time as part of achieving medium-term fiscal targets. Over 2015–17, the decline in the structural balance is estimated to broadly match the 0.8 percent of GDP increase in migration-related

spending. As a result, the structural balance adjusted for the exceptional element of migration-related spending is about -¼ percent of GDP in 2017, little changed from 2015. Although the primary

Key Indicators for General Government (No Policy Change After 2017) 1/					
<i>(Percent of GDP unless otherwise noted)</i>	2015	2016	2017	2018	2019
Net lending 2/	0.2	-0.2	-0.3	0.0	0.8
Adjustment for one off factors 3/	0.5	-0.1	0.2	0.0	0.0
Net lending ex. one-offs	-0.3	-0.1	-0.5	0.0	0.8
Cyclical contribution	0.3	-0.4	-0.4	-0.3	-0.2
Structural balance (Percent of potential GDP)	0.0	-0.5	-0.9	-0.3	0.6
Migration-related adjustment 4/	-0.2	0.5	0.6	0.1	-0.1
Adjusted structural balance	-0.2	0.0	-0.3	-0.2	0.5
<i>Memo items</i>					
Change in structural balance	0.5	-0.5	-0.4	0.6	0.9
Output gap (percent of potential GDP)	-0.7	0.9	1.0	0.7	0.4
Migration-related spending	0.8	1.5	1.6	1.1	0.9
Gross public debt	42.9	41.5	40.3	39.0	37.7

Sources: Swedish Ministry of Finance, NIER, ESV and Fund staff calculations.

1/ After 2017, revenues grow in line with tax bases and nominal spending rises according to current rules.

2/ Projections from Budget Bill 2017.

3/ Includes EU fee discount and extraordinary elements of corporate income and capital gains taxes.

4/ Migration-related spending in excess of an assumed medium-term outlook of 1 percent of GDP.

response to needs that are partly temporary, the resulting fiscal easing supports growth and employment to a modest extent, complementing monetary policy efforts.

36. The proposed revisions to the [fiscal framework](#) will continue to safeguard Sweden's fiscal buffers. With effect from 2019, the surplus target is to be reduced from 1 percent of GDP to 0.33 percent of GDP in view of the reduction in Sweden's debt to 43 percent of GDP in 2015. A debt anchor at 35 percent of GDP is a new element, serving as a benchmark consistent with the surplus target rather than an additional operational target, with the government required to explain deviations of more than 5 percent of GDP from this anchor. Staff's debt sustainability indicates that public debt is on a downward path toward the new anchor (Appendix II). This new debt anchor is

valuable considering the importance of Sweden's strong fiscal position for cushioning potential shocks, such as potential liquidity needs of the large financial sector. In practice, these targets should be achieved over periods sufficient to avoid a procyclical fiscal stance.

37. Fiscal policy has room to cushion the economy if needed and there is also room to help address structural challenges while still adhering to the revised fiscal framework. On a no policy change basis, the structural balance is expected to reach 0.6 percent of GDP by 2019, somewhat above the new medium-term target (Text Table). Public debt is expected to be only a little above the 35 percent target. This strong fiscal position allows full operation of automatic stabilizers and for proactive stimulus in adverse scenarios, which is particularly valuable at a time when monetary policy space has decreased. This outlook also indicates that there is some room for new initiatives in coming years in migration and housing, along the lines discussed in Sections B and E, while still observing the new fiscal targets. Such investments may have significant up-front costs, but will yield longer-term benefits as more refugees become net contributors to the public finances and as improved housing supply facilitates mobility and employment. As highlighted by the [Fiscal Policy Council](#), it would be important to frame such initiatives within a credible medium-term plan.

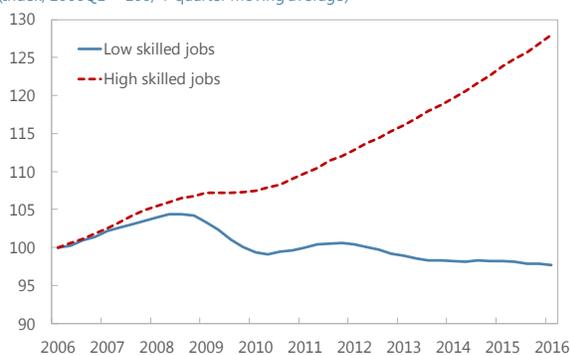
38. Authorities' Views. *The government's approach to fiscal policy is indeed to accommodate the temporary element of migration-related costs. While recognizing these costs, the Fiscal Policy Council, considered that 2017 budget should be less expansionary given Sweden's position of the business cycle. The authorities noted that there was broad political consensus on the proposed revised fiscal targets, and there was flexibility to observe them while avoiding overly rapid adjustment.*

E. Labor Market Policies

39. The Swedish labor market is performing well but skill mismatch is growing. Strong job creation in recent years has been largely concentrated in higher skilled occupations. As a result, the unemployment rate among those with lower education has risen to 20 percent, similar to that for workers born outside the EU. This trend reflects the underlying imbalance between skill demand and supply in the Swedish labor market, where employers increasingly demand labor with at least upper-secondary education, while lower skilled workers dominate the pool of job seekers.¹⁶ This

Employment in Low and High Skilled Occupations

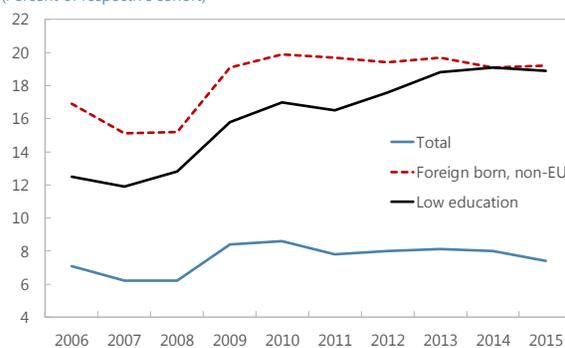
(Index, 2006Q1 = 100, 4-quarter moving average)



Sources: Eurostat and Fund staff calculations.

Unemployment Rates of Vulnerable Groups

(Percent of respective cohort)



Sources: Eurostat and Fund staff calculations.

¹⁶ See also Asmaa El-Ganainy, "[Sweden's Labor Market and Migration](#)" IMF Country Report 15/330 (Washington).

imbalance could become more severe in coming years as the recent influx of refugees, many of whom have less education, enter the workforce. At the same time, high collectively-agreed wage floors (75–80 percent of average wages), and high similarity of wages across sectors, limit scope to create jobs that would be more suitable for absorbing the skill mix of the unemployed.

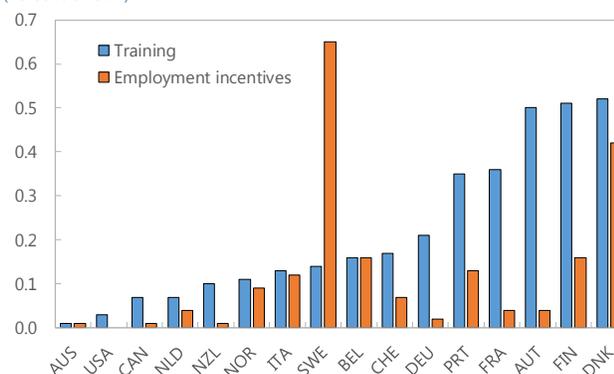
40. Reforms should focus on promoting higher employment among the vulnerable groups.

Recent education initiatives to upgrade the skills of job seekers are important, but it would also help to boost the demand for lower skills to build skills on-the-job:

- Recent initiatives to make trainee jobs and vocational introduction employment programs available for the newly arrived migrants and increase resources for basic education and vocational training are encouraging steps. Additional resources are likely needed, and given the large disparity between spending on training and employment incentives, the relative effectiveness of ALMP measures should be systematically assessed.

Spending on ALMP Measures

(Percent of GDP)



Sources: OECD and Fund staff calculations.

- To expand hiring of lower skilled workers, greater wage flexibility at the firm level or temporary and targeted exceptions to entry level wages have been used in nearby countries (e.g., “apprentice wages” in Denmark for newly arrived migrants, “mini jobs” in Germany). In this respect, the social partners have a key role to play. Carefully designed social supports and tax credits (e.g., lower payroll taxes targeted at low wage earners) would protect living standards while preserving work incentives. Employment subsidy programs (e.g., “Step In” and “New Start” jobs for new arrivals) have proven effective in helping migrants gain unsubsidized jobs subsequently. To encourage wider use of these subsidies, the PES should step up outreach to employers and streamline the numerous programs to reduce the administrative burden on employers, while also improving job matching to enhance employment gains.

41. More immediately, further improvements in refugee reception and establishment are critical for their integration into the labor market.

Sweden has a well-developed refugee integration framework and the current favorable labor market conditions are helpful. However, asylum reception capacity is under great pressure given the exceptional number of new arrivals, and various hurdles undermine the effectiveness of the introduction program (Box 1). The authorities have announced measures to reduce burdens on reception, speed up introduction such as offering early language/civic training, adult education and skills assessment during asylum period (Box 6), and to open more pathways into the labor market. In view of the scale of the challenge, further efforts are urgently needed to provide affordable housing to avoid settlement delays (Section B), ensure sufficient capacity at the municipalities for individually-tailored language training and basic education, and improve coordination among the many agencies involved in the integration process.

42. Authorities' Views. *With the majority of migrants below 35 years of age, the government sees potential from new education initiatives. Representatives of trade unions and the PES also stressed the importance of education as a sustainable long-term strategy given that a large share of the 2015 asylum seeker wave are young and have little education, and that wage subsidy programs do not generate sufficient volumes. While it does not interfere in collectively-agreed wages, the government is also providing incentives for municipalities and private employers to employ low-skilled workers in sectors with labor shortage (e.g., elderly care) which could potentially facilitate integration of migrants.*

STAFF APPRAISAL

43. Sweden's economy is performing well and balanced policies are needed to help sustain solid growth. Supportive monetary and fiscal policies have contributed to strong economic growth in recent years, helping to reduce unemployment and raise inflation from low levels. Growth is expected to moderate yet remain solid in coming years, but household indebtedness will likely continue to rise. The priorities are rebuilding space for monetary policy to cushion the economy against future downturns by returning inflation to target, containing the rise in housing market and household debt vulnerabilities, ensuring that Sweden's large financial sector remains resilient, and accelerating the integration of refugees into the work force.

44. Monetary policy needs to remain stimulatory for some time. Monetary easing in recent years has kept Swedish yields roughly in line with those on German Bunds and the krona broadly stable. The commitment demonstrated by the Riksbank has lifted inflation expectations close to the target. Nonetheless, core inflation has been around 1.2 percent for the past year and it is expected to rise relatively gradually to the target in coming years. Any unwinding of monetary stimulus should therefore await clear confirmation of a durable rise in inflation. If inflation or expectations were to weaken, greater stimulus would be appropriate, yet foreign exchange intervention should be a last resort. The parliamentary review of the Riksbank law is an opportunity to refine monetary arrangements and to clarify its role in relation to financial stability.

45. A combination of housing market reforms and macroprudential measures would best contain the rise in household debt vulnerabilities. Although housing price gains have slowed since the Fall of 2015, expensive housing is requiring a growing share of new borrowers to take on high debts relative to their income. Moderating the upward trend in housing prices entails reforms to maintain an adequate supply of suitable land to help sustain the recent rise in construction, phasing out tax deductibility of mortgage interest, and also phasing out rent controls while protecting the vulnerable. Reinforcing the existing macroprudential policies through timely adoption of a limit on DTI ratios is needed to contain growth in the share of highly-indebted households, ensure that any further rise in already high housing prices leads to lower LTVs on high-DTI loans, and dampen feedbacks between credit and housing prices.

46. The legal framework for macroprudential policy should be fixed to enable FI to take timely actions. The lengthy process to introduce mortgage amortization requirements revealed deficiencies in FI's macroprudential mandate and powers. To fulfill its macroprudential mandate,

legal amendments are needed to provide FI with the capacity to adopt new tools to address emerging risks in a timely manner. The FSC should expand joint work on risk analysis, tool design, and impact assessment, and the coming review of the FSC should seek to most effectively support FI's fulfilment of its macroprudential mandate.

47. Preserving the resilience of Sweden's regionally-important financial sector is essential.

Reflecting the strong capital buffers of Swedish banks, stress tests suggest that their solvency is resilient under a severe scenario. To support FI's capacity to safeguard financial stability, its resources should be expanded to achieve an appropriate frequency of supervisory inspection, and delays in the introduction of regulations owing to legal amendments should be minimized. The proposed new supervisory approach to corporate risk weights is welcome, yet a leverage ratio can provide a useful backstop to risk-based capital requirements. Although Swedish banks meet international liquidity requirements, strengthening regulation in this area should be considered when reviewing foreign reserves. The highly interconnected Nordic-Baltic financial system also requires arrangements that ensure close coordination in supervision, liquidity support, and resolution, with enhanced cooperation building on the Nordic-Baltic Macroprudential Forum.

48. Fiscal policy should accommodate the temporary element of migration-related costs and support measures with long-term benefits while observing the new fiscal targets.

Last year's historic surge in asylum seekers has doubled migrant-related spending by 2017 compared with 2015. Considering Sweden's strong fiscal position and the significant temporary component of such spending, it is appropriate that the 2017 budget allowed a broadly similar decline in the structural balance over that period, while adopting new initiatives in education and active labor market policies that will support the integration of refugees. Sweden's fiscal health will continue to be protected following the proposed revisions to the fiscal framework, including a surplus target of 0.33 percent of GDP and a new debt anchor of 35 percent of GDP. The medium-term fiscal projections show some room that should be used to further support migrant integration and affordable rental housing in coming years while still observing these new targets.

49. The social partners have a key role to play in facilitating the integration of migrants into the workforce to limit prolonged unemployment.

Unemployment is high and rising among less educated workers born outside Sweden, and many of the new arrivals that will be seeking work in coming years have less education. The authorities have taken a range of steps to improve migrant reception and introduction, but further efforts are needed to provide affordable housing, ensure sufficient educational capacity at the municipalities, and improve coordination across agencies. Initiatives in adult education and vocational training will help migrants prepare for work, but it is also important for the social partners to facilitate arrangements that enable skills to be built on-the-job. Temporary and targeted exceptions to high entry-level wages can be combined with expanded tax credits and strengthened benefit conditionality to protect living standards and improve work incentives. Employment subsidy programs should be streamlined to increase their take-up and employer-employee matching should be improved to boost subsequent employment outcomes.

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

Box 1. Issues with Refugee Reception and Establishment¹

Sweden has a well-developed framework for integrating refugees.² However, the exceptionally large wave of asylum seekers in late 2015 exposed several challenges in the current system of receiving and establishing the new arrivals, impeding their path to successful integration in the labor market and Swedish society. Some of these impediments are being addressed with new initiatives in the 2016 Spring and 2017 Budget Bills (Box 6).

Reception of newly arrived refugees. At the start of 2016, about 182,000 people were registered in the SMA's reception system, straining administrative capacity. The large number of unaccompanied minors compounds the challenge as more intensive support is needed in these cases. As a result:

- **Processing time for asylum applications has increased substantially, delaying residence permits that are needed to start the introduction program.** Processing time has increased from under 5 months in 2014 to between 15 months and 2 years currently. The lengthy stay in reception centers also raises the housing costs, as about 55 percent of asylum seekers choose to stay in SMA-provided accommodation.
- **There is a long wait before refugees are settled in a municipality which means the introduction program is further delayed.** Even after a residence permit is granted, refugees currently have to wait about 5 months before being assigned to a municipality—often due to lack of affordable housing.

Establishment of refugees with a residence permit. The two-year introduction program is the cornerstone of the integration framework. It helps prepare the refugees for entry to the labor market and Swedish society. An introduction plan that is tailored for each migrant covers Swedish language training, employment preparation and social studies. A range of hurdles are undermining the effectiveness of the introduction program, however, including:

- **Low participation in introduction activities means that the refugees are not receiving sufficient training designed to help them integrate.** Although many new arrivals lack upper secondary education, very few take up basic education programs. Participation in labor market training including work placement is also low. In addition, language training—a key to labor market success particularly in Sweden—is often interrupted. These facts could reflect health and/or social issues with the new arrivals, but also inadequate training capacity and difficulties in coordinating the parallel measures among different agencies.
- **Delays in education assessment and skill validation prevent refugees with sufficient qualifications from quickly entering the workforce.** For refugees with higher education, waiting and processing times for recognition of foreign qualifications remain long, especially in the health sector. Validation of vocational skills is also under-utilized.
- **Unclear division of responsibilities and sometimes lack of cooperation among different agencies involved in the integration process can further undermine the quality of introduction.** Insufficient coordination between the Public Employment Services (PES), which draws up the introduction plan for each migrant, and the municipalities, who largely implement it, can undermine the effectiveness of introduction and lead to varying quality of language and civic training. Responsibility for health/social support of the newly arrived refugees also needs to be clarified.

¹ See also Swedish National Audit Office Report 2015:17, "Establishment of Newly Arrived Immigrants—Are Central Government Initiatives Effective?" and OECD 2016, "Working Together: Skills and Labor Market Integration of Immigrants and Their Children in Sweden."

² See Box 1, [Sweden 2015 Article IV Staff Report](#), IMF Country Report 15/329 (Washington).

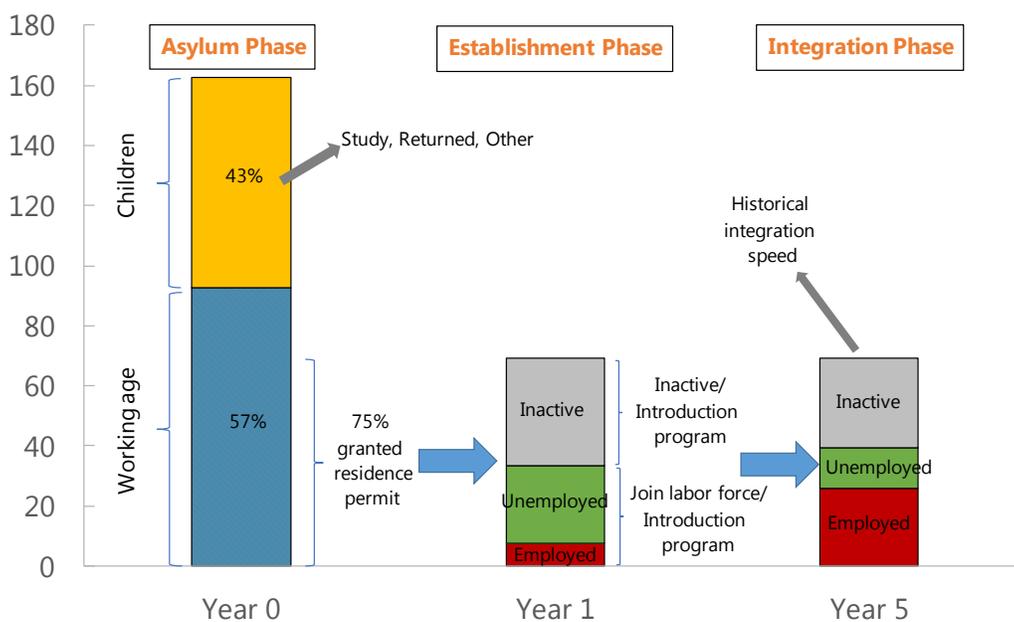
Box 2. Impact of Migration on Potential Output and Labor Market

This Box investigates the impact of last year’s migration surge on Sweden’s potential output and labor market, focusing on the supply-side effects of the labor supply expansion.

Assumptions are made regarding how quickly the refugees move from the asylum phase to the establishment and integration phases. In particular, out of the 163,000 asylum applicants last year, 57 percent are of working age. Of these, historical country-specific acceptance rates indicate that about 75 percent would be granted residence permits. It is assumed that half of the residence permits are granted in 2017 and half the following year. The refugees can then decide to join the labor force (or not) while participating in the introduction program, i.e. the establishment phase. The potential addition to aggregate employment during 2017–21 is calculated by applying the historical employment rates that prevail among the refugees during their first five years living in Sweden. An alternative scenario illustrates the impact of faster integration by applying the corresponding employment rates among refugees in Germany, whose integration performance is among the best in the EU.

Process From Asylum to Integration

(Number of refugees in thousands)

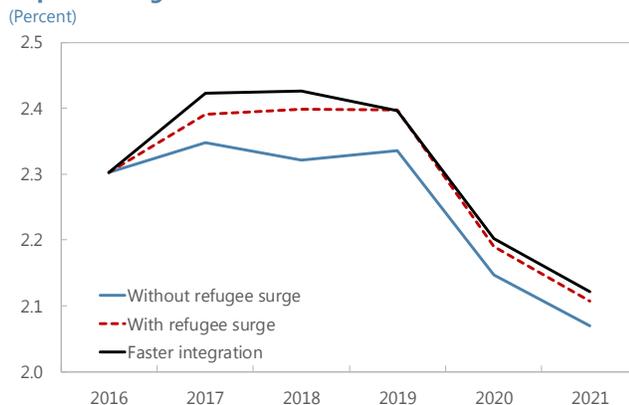


Sources: Swedish Migration Board, Eurostat, and Fund staff calculations.

Box 2. Impact of Migration on Potential Output and Labor Market (concluded)

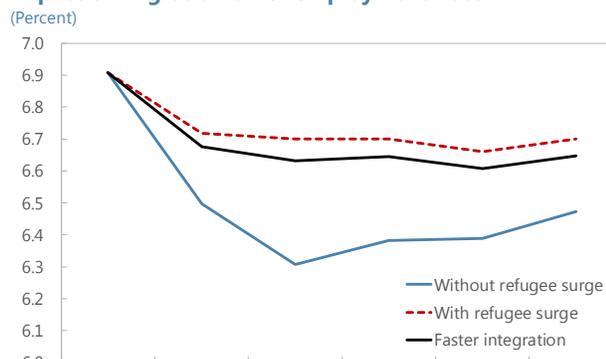
The supply-side impact of the refugee surge on Sweden’s potential output and unemployment is estimated to be small, but varies with the pace of integration. The impact on potential output growth amounts to about 0.05 percentage points in 2017 and 0.1 in 2018, for a cumulative of 0.3 percentage points over five years. The growth impact is slightly larger in the faster integration scenario—0.4 percentage points over five years. The limited near and medium-term impact is due to the low employment rates among the refugees during the first few years after arrival. Also due to this, the unemployment rate is expected to be higher by 0.2 percentage points in 2017 and 0.4 in 2018 compared to a no-surge scenario, stabilizing thereafter. Improvement in the pace of integration would mitigate the adverse impact on unemployment, even though under this scenario the refugees are joining the labor force at a faster rate.

Impact of Migration on Potential Growth

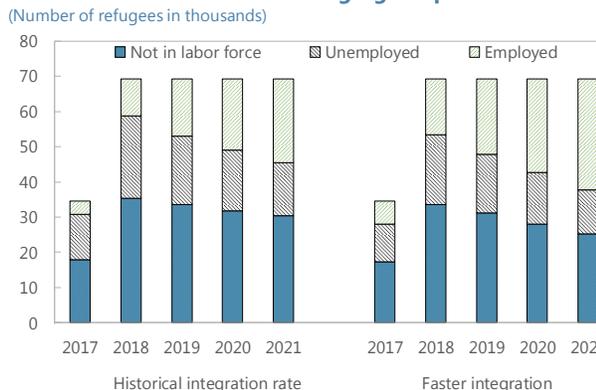


Sources: Fund staff estimates.

Impact of Migration on Unemployment Rate



Cumulative Addition to Working Age Population



Sources: Fund staff estimates.

Box 3. Main Findings of Sweden's FSAP

Bank solvency and liquidity

Stress tests suggest that bank solvency is resilient under a severe scenario. The Swedish authorities have strengthened capital requirements to exceed Basel III standards ahead of many peers. Even in a severe stress scenario, including a 6 percentage point rise in unemployment and a 30 percent fall in real housing prices, no bank would break the regulatory threshold and only one bank would fall below the supervisory threshold (which does not take into account that some bank capital buffers may be released in a crisis). Lower net interest income and higher provisions for credit losses, primarily on corporate exposures, are the main drivers. The system-wide leverage ratio would fall by 0.3 percentage points in the stressed scenario (from 4.1 percent in 2015).

Yet, doubts about the reliability of banks' and supervisors' models point to the need for the timely adoption of a leverage ratio as a backstop. Available models may suffer from overreliance on recent historical experience, and have difficulties capturing unexpected losses occurring in extreme but plausible scenarios. Recognizing the importance of preserving the risk-based approach to supervision, the leverage ratio is a valuable complement providing a simple and transparent backstop to safeguard against model and measurement errors in calculating capital ratios.

Moreover, the stability impact of a house price decline with an associated loss of confidence in housing collateral, could be amplified by Swedish banks' reliance on wholesale funding. Given the interconnectedness within the Nordic-Baltic financial systems, such a shock could have significant spillovers across the region. The Swedish Liquidity Coverage Ratio (LCR) suggests banks are resilient to liquidity shocks. However, some banks would face liquidity pressures, especially in foreign currencies, if the stress scenario intensified and lasted longer than one month. The FSAP therefore recommended to adopt an extended (three-month) LCR in euros and U.S. dollars, initially for monitoring purposes. It also recommended to closely monitor banks' cross-holdings of covered bonds, and consider measures to contain the concentration risk.

Nonbank financial sector

The nonbank financial sector appears resilient to shocks, but has pockets of vulnerability. In the stressed scenario, only two insurance companies drop slightly below a solvency ratio of 100 percent, and the total additional capital that would be needed to restore full coverage of the solvency capital requirement amounts to less than 1 percent of GDP. The solvency impact is mostly due to the equity shocks and a default of largest banking counterparty. Over the medium term, the low interest rate environment is challenging for the life insurance sector, making it difficult to find alternative assets without taking on undue credit risks, as a large share of the current fixed-income portfolio with high coupon rates will expire in the next 5 years. Investment funds have grown significantly, and the FSAP's liquidity analysis suggests that corporate bonds markets may face stress if investment funds were to face tail event redemption shocks.

Supervisory powers, resources, and cooperation

The authorities are encouraged to address key data gaps that reduce the efficacy of systemic risk oversight. Given the high household indebtedness, a crucial missing element is data on the distribution of household financial assets, available in other countries but discontinued in Sweden. For systemic risk monitoring purposes, the mission recommended introducing comprehensive anonymized surveys of household balance sheets. The mission recommended enhancements in the stress testing framework for banks, insurance companies, and investment funds. FI should improve the availability and quality of investment fund data, to enhance the authorities' ability to conduct stress testing and other analyses to assess market sensitivity to extreme redemptions from investment funds. To better understand the effects of shocks on the broader economy, it will be important to undertake periodic stress tests of corporate resilience.

Box 3. Main Findings of Sweden's FSAP (concluded)

The institutional framework for systemic risk oversight needs an upgrade. Sweden has a unique framework, in which the macroprudential mandate was given by an ordinance to the supervisory agency (FI) that reports to the Government. The FSAP called for establishing a firm legal mandate that removes uncertainties around FI's macroprudential powers and provides FI with a toolbox that can be used address systemic risks in a timely and effective manner. The FSAP also recommended providing the Financial Stability Council with a statutory basis.

On the microprudential level, FI needs to step up supervisory intensity. Achieving it requires financial and human resources that are sustainable and adequate given the size and complexity of the Swedish financial system. Current budgeting arrangements have so far failed to meet this need. Higher charges on the industry should be considered to generate more resources. FI should put new staff through extensive supervisory training program, make full use of other Nordic supervisors in support of cross border operations, and it could also bring in supervisors from foreign supervisory agencies. In the medium term, FI needs to develop an HR strategy to build and retain a larger group of experienced supervisors. This will likely require more support for senior supervision staff to reduce turnover, and improved terms and conditions of service to make FI a more attractive career option. In the area of securities supervision, enhancements to cross-border supervisory cooperation and active participation in the work of the European Securities and Markets Authority are necessary complements to FI's active domestic supervisory program.

FI also needs a broader mandate to issue binding regulations on safety and soundness issues. In instances such as the issuance of credit risk standards, introduction has been delayed by several years awaiting legal amendments to provide the specific power required. FI should have a broad ability to issue regulations related to any safety and soundness issues. If this not feasible, the government should amend the laws or ordinances promptly to address issues identified by FI.

The FSAP called for further strengthening financial safety nets. It welcomed Sweden's new resolution framework for credit institutions and investment firms. It called for ensuring agency-specific and national financial crisis preparedness, and suggested a revamp of the Nordic-Baltic Stability Group to fulfill a similar role regionally. It also recommended defining strategies for liquidity assistance to banks in resolution and ensuring that resources for recovery and resolution planning are commensurate with the size and complexity of Sweden's financial sector. The mission emphasized the need to amend the law to clarify the Riksbank's financial stability mandate, including by giving it authority to provide emergency liquidity for financial stability purposes.

Box 4. Sweden: Risk Assessment Matrix ^{1/}
(Scale—high, medium, or low)

Source of Risks	Overall Level of Concern	
	Relative Likelihood ^{2/}	Impact if Realized
1. Sharp rise in risk premia with flight to safety 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.	
2. Structurally weak growth in key advanced 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 to medium-term targets.	
3. Economic fallout from political fragmentation in Europe, including uncertainty associated with post-Brexit arrangements, renewed surge in migration flows, and rising populism and nationalism in large economies.	<p>Medium-High</p> <ul style="list-style-type: none"> The UK is an important trading partner (Sweden exports over 2 percent of its GDP to the UK). More generally, Sweden is a small open economy highly dependent on unrestricted movement of labor, goods and services. 	<p>Medium</p> <ul style="list-style-type: none"> Uncertainty during post-Brexit negotiations could weigh on confidence and investment. Renewed large scale refugee inflows would increase spending and support activity but would further strain capacity to receive and integrate migrants, raising unemployment and undermining social cohesion. Higher barriers to trade would dampen exports and investment and weaken the growth outlook.
Policy response:	Provide monetary and fiscal support, strengthen refugee integration policy and supply of low skilled work, facilitate sectoral reallocation of labor and capital.	
4. 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. Price levels remain high despite the recent moderation, but the slow reduction in supply shortfalls mitigates downside risks. 	<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.	

^{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 ("low" is meant to indicate a probability below 10%, "medium" between 10 and 30%, and "high" between 30 and 50%). 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.

Box 5. Limited Impact of Negative Interest Rates on Banks so Far

Negative policy rates in Sweden were part of a package of measures to protect the credibility of the inflation target.¹ Inflation in Sweden had been low for some years culminating in inflation expectations

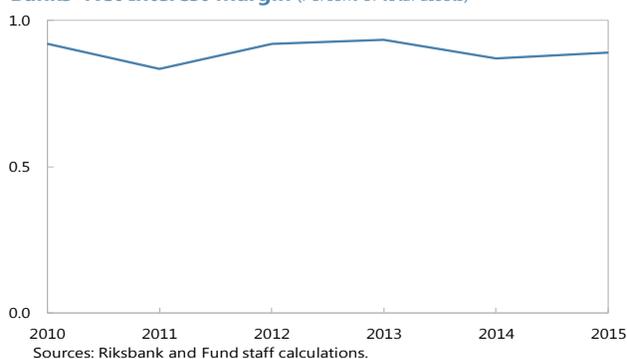
falling sharply in late 2014, with 2-year ahead expectations hitting 1.2 percent by January 2015, well below the 2 percent target. In February 2015, the Riksbank responded with the simultaneous adoption of negative rates, quantitative easing (QE), and forward guidance in order to raise inflation and reverse the fall in inflation expectations. Subsequently, it cut the repo rate in a number of steps, at times in conjunction with announcing additional bond purchases to total close to 40 percent of government bonds by end 2016. Further, it firmly stated its willingness to do more as needed to achieve its inflation target.

Unconventional Monetary Policy Actions

Date	Repo rate (basis points)	New QE (SEK bn)
Feb-15	-10	10
Mar-15	-25	30
Apr-15		40-50
Jul-15	-35	45
Oct-15		65
Feb-16	-50	
Apr-16		45

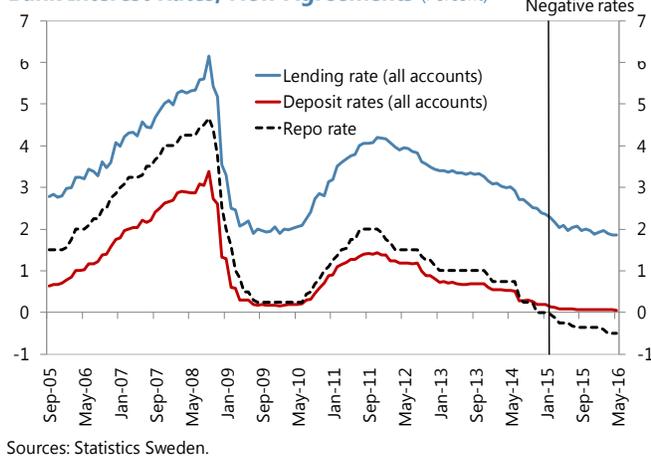
The introduction of negative policy interest rates raises concerns about their impact on bank profitability. Negative interest rates can reduce bank profitability as banks must pay for their deposits at the central bank. Even though the Riksbank does not apply tiering or other methods to moderate this impact of negative rates on bank profits, in practice it is relatively small. It would be more important if negative rates put pressure on banks' net interest margins, which would happen if lending rates fell by more than their overall funding costs.

Banks' Net Interest Margin (Percent of total assets)



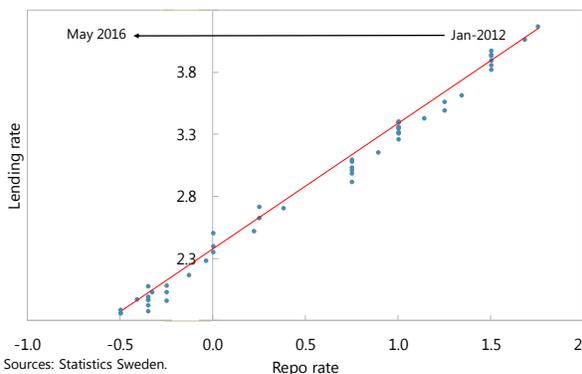
A stronger pass-through to lending rates compared to deposit rates narrowed lending-deposit margins. Lending rates continued to fall in line with the policy rate even after rates turned negative after February 2015. In contrast, the pass-through to deposit rates weakened such that they did not fall below 0, with only certain large companies and municipalities facing negative deposit rates. This decline in the pass-through to deposit rates occurred before policy rates became negative, emerging around mid-2014 when the repo rate hit about ½ percent. As a result, margins between lending and deposit rates fell to just below 2 percent since February 2015, down from a relatively high level of 2¾ percent during the period preceding negative rates.

Bank Interest Rates, New Agreements (Percent)

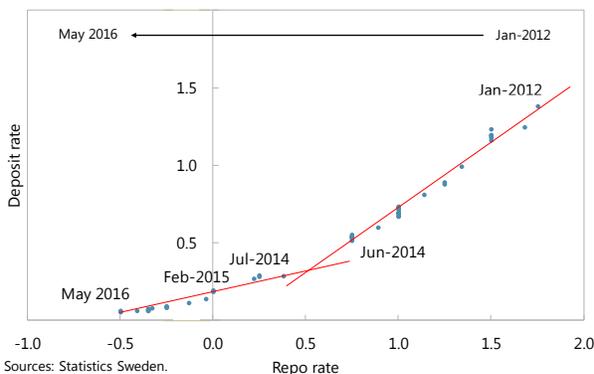


Box 5. Limited Impact of Negative Interest Rates on Banks so Far (concluded)

Lending Rate Sensitivity to Repo Rate, Jan 2012-May 2016
(Percent)

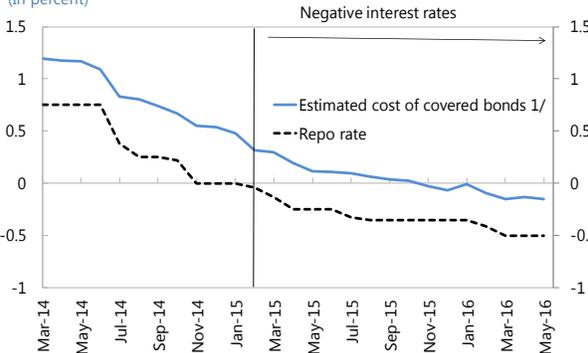


Deposit Rate Sensitivity to Repo Rate, Jan 2012-May 2016
(Percent)



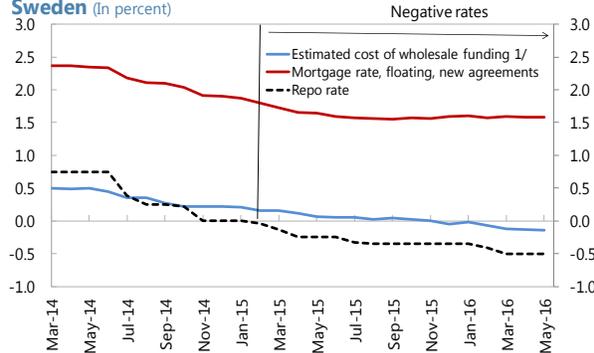
Nonetheless, reductions in wholesale funding costs since February 2015 have cushioned overall net interest margins. In contrast with the stickiness of deposit rates, the overall cost of wholesale funding—reflecting the combination of short-term funding and use of long-term covered bond funding with hedging of interest and FX risks—has decreased since negative interest rates were introduced in Sweden. With wholesale funding supporting over half of Swedish bank loans, their reduced costs helped maintain bank profits in 2015.²

Overall Estimated Funding Cost on Covered Bonds
(In percent)



Sources: Bloomberg, Haver, Statistics Sweden, and Fund staff calculations.
1/ Weighted average of estimated funding cost on covered bonds in SEK and Euros.

Estimated Wholesale Funding Cost and Mortgage Rate, Sweden (In percent)



Sources: Bloomberg, Haver, Statistics Sweden, and Fund staff calculations.
1/ Weighted average cost of funding from covered bonds and from money markets in SEK and Euros.

Nonetheless, the effects of negative rates on bank profitability should continue to be closely monitored. Despite fast asset repricing owing to the high share of variable rate loans, profitability could weaken as repo rates have been significantly lower in 2016 compared with 2015. Although an erosion of bank profitability owing to such factors would not soon threaten the financial soundness of banks, possible risks to the quantity and quality of lending if profitability was compressed for an extended period require careful oversight.

¹ Turk, R., 2016, "Negative Interest Rates: How Big a Challenge for Large Danish and Swedish Banks?" IMF Working Paper 16/198 (Washington: International Monetary Fund).

² Data from Fitch indicate that the unweighted average share of wholesale funding in total funding was 58 percent in 2015 for the largest banks in Sweden, compared with a corresponding ratio of 34 percent for major European banks.

Box 6. Recent Initiatives to Improve Refugee Integration

The government has introduced measures aimed at improving refugee integration. The measures focus on speeding up introduction of the new arrivals, improving labor market access for those with skills that are in demand, and streamlining refugee establishment efforts across different government agencies. In particular, they include:

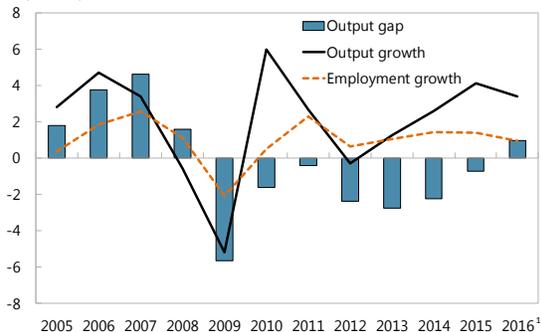
- Introducing early language and civic training and adult education for those who have been granted residence permits but are still living in reception centers (e.g., due to lack of housing delaying settlement at a municipality). This measure aims at promoting early introduction and making better use of the (currently lengthy) asylum period.
- Early skills assessment offered by the PES during the period when the refugees are still in the process of seeking asylum. This would facilitate the design of an introduction program more appropriately tailored to individual needs.
- In coordination with social partners and employers, creating “fast track” schemes to speed up labor market matching for refugees with skills in professions with labor shortages (e.g., chefs, teachers, nurses and physicians), and to facilitate entrepreneurship for migrants with start-up experience.
- Making schemes that combine work and training available to newly arrived immigrants, such as “trainee jobs” and “vocational introduction employment”.
- Increasing the standard compensation to municipalities for refugee reception while removing their autonomy over settlement decisions. The latter ensures that municipalities, especially those with housing and job availability, take sufficient responsibility for settling the refugees.
- Giving resources to the county administrative boards to (i) coordinate early measures to promote introduction during the asylum period, (ii) develop targeted measures to support the unaccompanied minors, and (iii) strengthen reception capacity in municipalities.

More broadly, the government has identified several areas in which it needs to focus its efforts to improve refugee reception and establishment. The Minister for Employment and Integration has been given the mandate to coordinate policies across different ministries, with a view to manage the refugee situation in a comprehensive manner. The identified priority areas include, among others, (i) dealing with the housing shortages, (ii) ensuring adequate capacity, including supply of teachers, in schools and language training and basic education programs, and (iii) streamlining establishment efforts and creating more pathways into the labor market. Emphasis is also placed on collaboration between different actors, including regional and county councils, municipalities, businesses and civil society organizations.

Figure 1. Sweden: Macroeconomic Indicators

Output is recovering, supporting job creation and turning the output gap positive for the first time in 8 years.

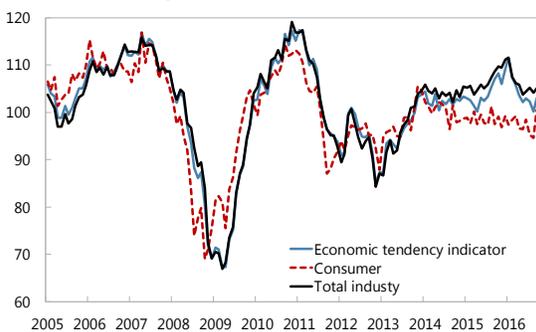
Swedish Economy
(Percent)



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

Consumer confidence has remained flat while business confidence has fallen back to the historical average.

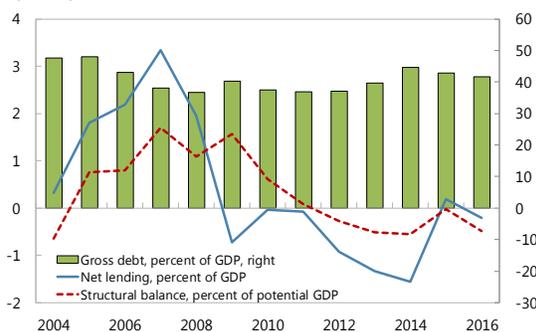
Confidence Indicators
(Index: Historical average = 100)



Sources: NIER and Fund staff calculations.

Headline and structural balances both improved in 2015, and debt declined after rising for a few years.

General Government Fiscal Balance
(Percent)

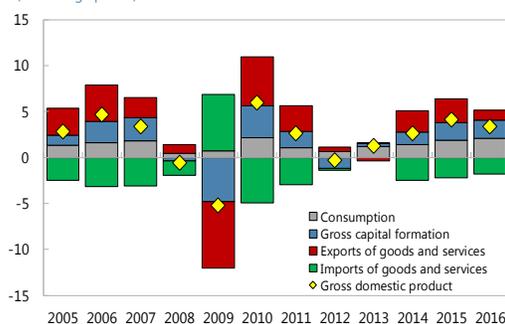


Sources: IMF World Economic Outlook, Sweden Ministry of Finance, and Fund staff calculations.

¹ IMF staff projections.

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

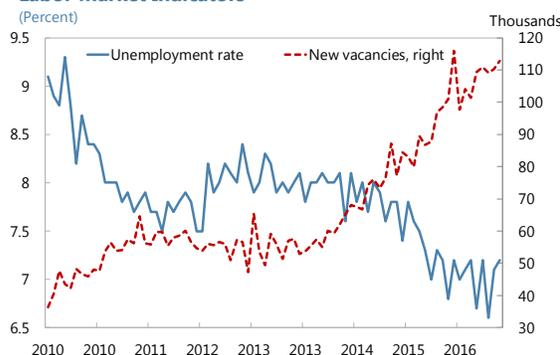
Contributions to Growth
(Percentage points)



Sources: IMF World Economic Outlook and Fund staff calculations.

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

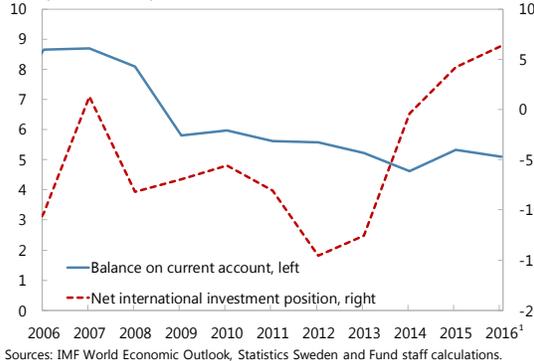
Labor Market Indicators



Sources: Public 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.

External Position
(Percent of GDP)

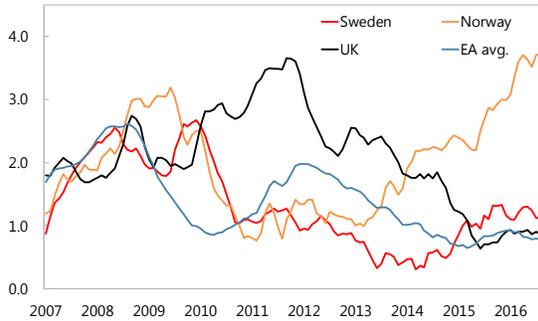


Sources: IMF World Economic Outlook, Statistics Sweden and Fund staff calculations.

Figure 2. Sweden: Inflation and Monetary Policy

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

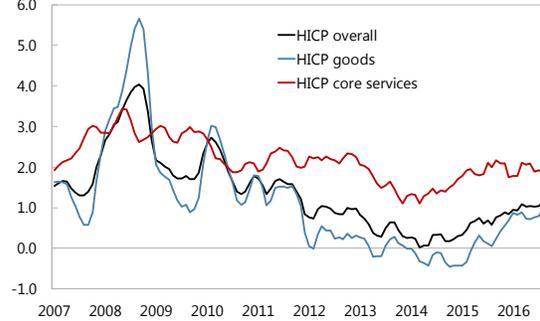
Core HICP Inflation
(Percent, y-o-y, 3-month average)



Sources: Eurostat and Fund staff calculations.

... supported by rises in both goods and services inflation.

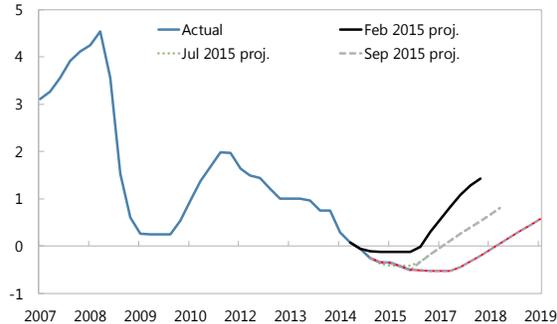
HICP Inflation
(Percent, y-o-y, 3-month average)



Sources: Haver Analytics and Fund staff calculations.

The Riksbank has cut the repo rate to -0.5 percent, and extended the period for which low rates are projected ...

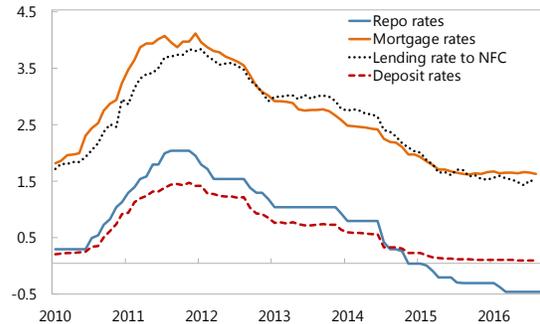
Riksbank Repo Rate Forecasts
(Percent)



Sources: Sveriges Riksbank and Fund staff calculations.

... resulting in lower lending rates while deposit rates have reached the zero lower bound before repo rates.

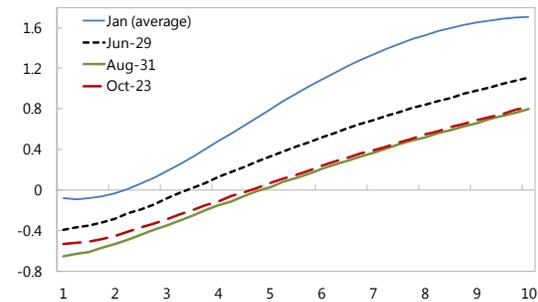
Interest Rates
(Percent)



Sources: Statistics Sweden and Fund staff calculations.

Together with the expanded QE program, the Riksbank 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.

...at the same time foreign investor's holdings of Swedish government bond have declined.

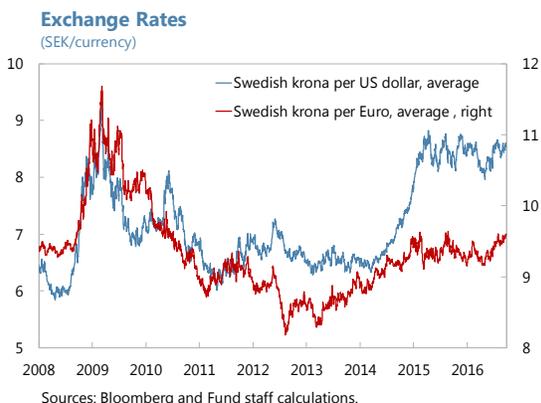
Non-resident Holdings of Swedish General Government Bonds (billion SEK, nominal value)



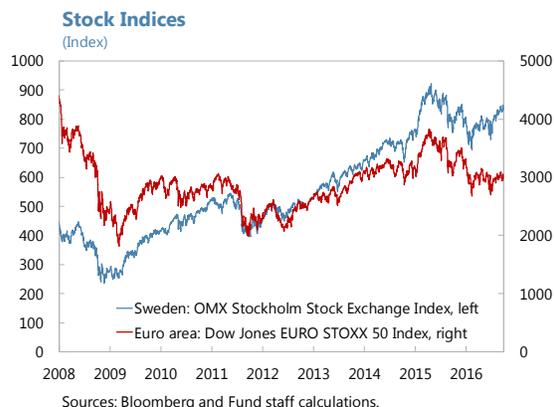
Sources: Statistics Sweden.

Figure 3. Sweden: Selected Financial Market Indicators

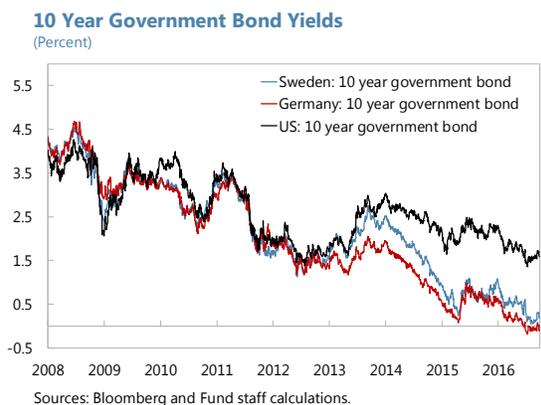
In recent years, the krona has stabilized against the USD, and the euro.



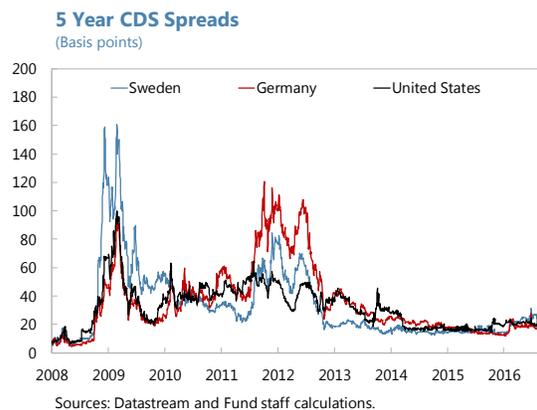
Swedish equities have trended up to substantially exceed pre-crisis levels.



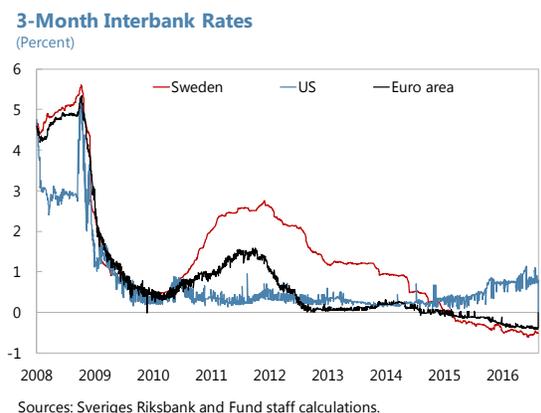
Swedish sovereign bond yields have been tracking German rates more closely, especially after 2015...



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



Interbank rates fell further and are below zero.



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

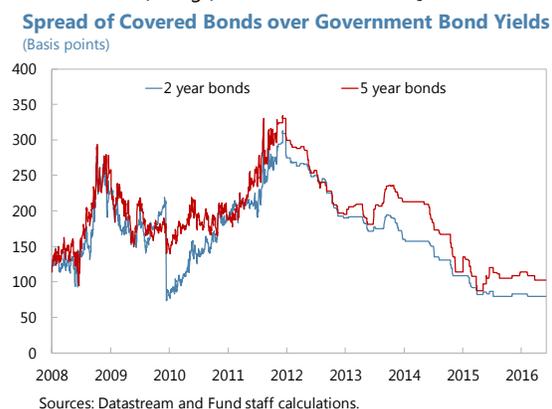
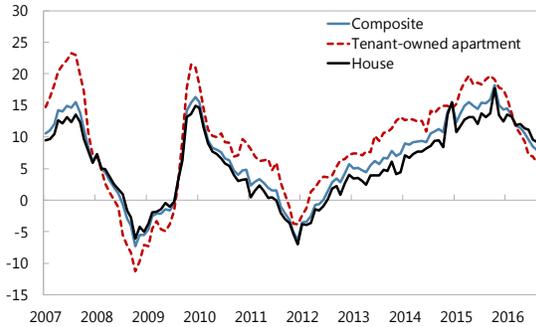


Figure 4. Sweden: House Prices and Household Debt

Housing price inflation has slowed in 2016 from high rates of increase in recent years...

House Prices

(Y/Y percent change)

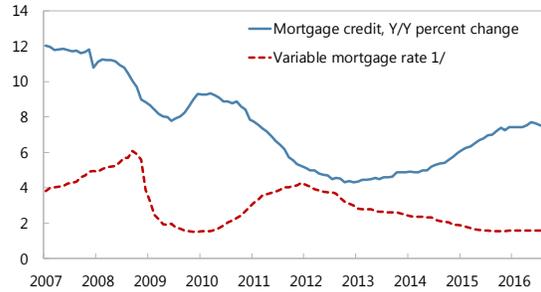


Sources: Valueguard and Fund staff calculations.

...yet growth in mortgage credit has continued at a similar single-digit pace.

Mortgage Credit and Interest Rates

(Percent)



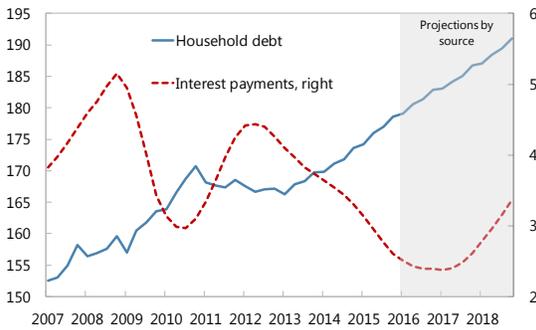
Sources: Statistics Sweden and Fund staff calculations.

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

Indeed, household debt is expected to continue rising...

Household Debt and Interest Payments

(Percent of disposable income)

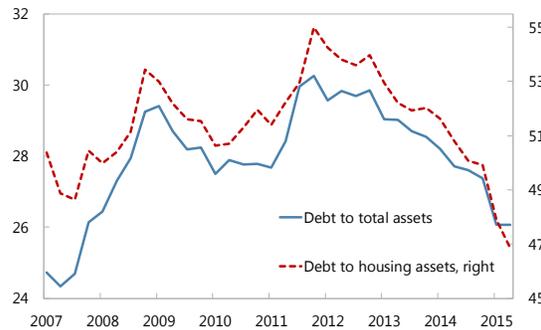


Sources: Sveriges Riksbank and Fund staff calculations.

...as households restore debt levels toward historical norms relative to their balance sheets.

Debt Ratios

(Percent)

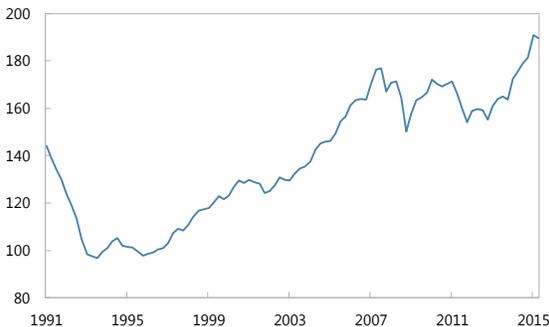


Sources: Sveriges Riksbank and Fund staff calculations.

House prices have risen to relative to income in recent years, 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.

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)

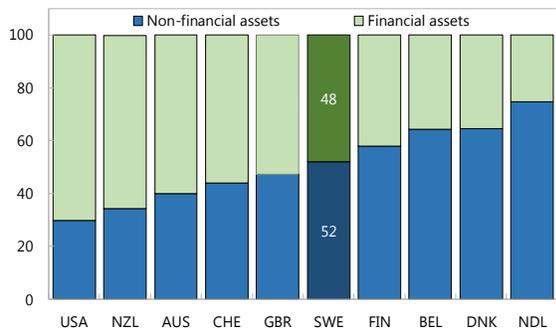


Sources: Statistics Sweden and Fund staff calculations.

Figure 5. Cross-Country: Household Balance Sheet Indicators

Swedish household assets are broadly evenly split across financial and non-financial assets...

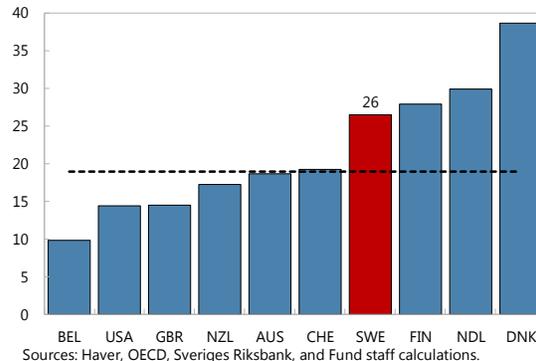
Composition of Household Assets, 2014
(In percent of total)



Sources: Haver, OECD, Sveriges Riksbank, and Fund staff calculations.

...with household debt representing about 1/4 of assets.

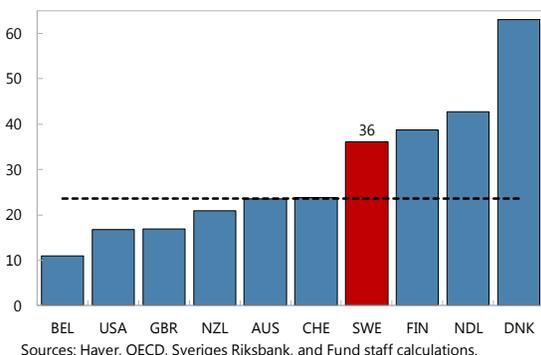
Household Liabilities to Assets, 2014
(In percent)



Sources: Haver, OECD, Sveriges Riksbank, and Fund staff calculations.

Household debt relative to net worth is higher in Sweden compared with other countries...

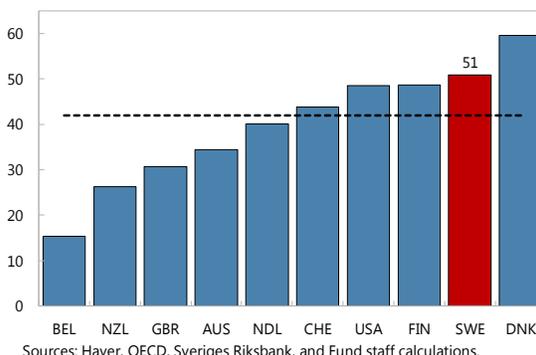
Household Liabilities to Net Worth, 2014
(In percent)



Sources: Haver, OECD, Sveriges Riksbank, and Fund staff calculations.

...and debt levels relative to the value of housing are also high in Sweden.

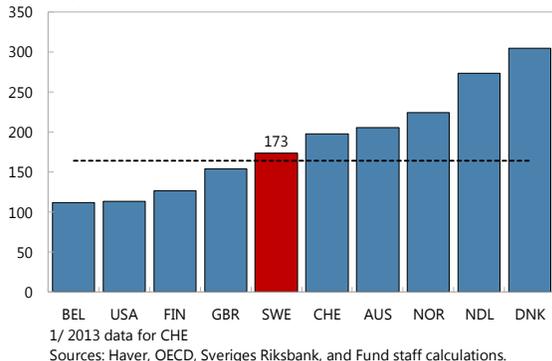
Household Liabilities to Non-Financial Assets, 2014
(In percent)



Sources: Haver, OECD, Sveriges Riksbank, and Fund staff calculations.

But debt to disposable income is close to the median across peers with high housing ownership...

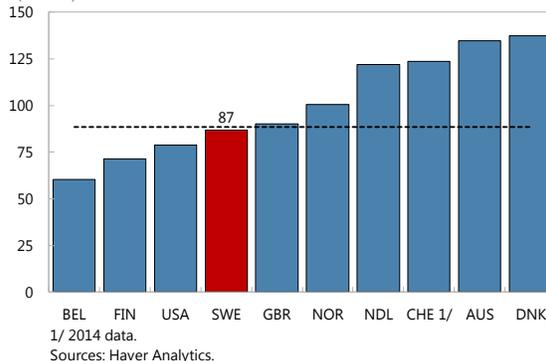
Household Debt to Net Disposable Income, 2014 1/
(Percent)



1/ 2013 data for CHE
Sources: Haver, OECD, Sveriges Riksbank, and Fund staff calculations.

... and household debt relative to GDP is at the median, between the US and UK.

Household and NPISHs Debt to GDP, 2015
(Percent)



1/ 2014 data.
Sources: Haver Analytics.

Table 1. Sweden: Selected Economic Indicators, 2013–19

	2013	2014	2015	Projections			
				2016	2017	2018	2019
Real economy (in percent change)							
Real GDP	1.2	2.6	4.1	3.4	2.4	2.2	2.1
Domestic demand	1.6	2.9	4.0	4.3	2.7	2.4	2.2
Private consumption	1.9	2.1	2.7	2.6	2.4	2.3	2.2
Public consumption	1.3	1.5	2.5	3.6	1.9	1.2	1.0
Gross fixed investment	0.6	5.5	7.2	6.9	3.9	3.8	3.6
Net exports (contribution to growth)	-0.3	-0.1	0.3	-0.6	-0.1	-0.1	0.0
HICP inflation (e.o.p)	0.4	0.3	0.7	1.2	1.6	2.0	2.2
Unemployment rate (in percent)	8.0	7.9	7.4	6.9	6.7	6.7	6.7
Gross national saving (percent of GDP)	27.8	28.0	29.5	30.4	31.1	31.3	31.3
Gross domestic investment (percent of GDP)	22.5	23.3	24.2	25.5	26.0	26.3	26.5
Output gap (as a percent of potential)	-2.8	-2.2	-0.7	0.9	1.0	0.7	0.4
Public finance (in percent of GDP)							
Total revenues	50.9	50.1	49.1	48.9	48.9	48.9	48.7
Total expenditures	52.2	51.7	48.9	49.1	49.1	49.1	48.7
Net lending	-1.3	-1.6	0.2	-0.2	-0.3	-0.2	0.0
Structural balance (as a percent of potential GDP)	-0.5	-0.6	0.0	-0.5	-0.9	-0.5	-0.1
General government gross debt, official statistics	39.8	44.6	42.9	41.6	40.5	39.4	38.8
Money and credit (year-on-year, percent change, eop) 1/							
M3	3.1	4.1	7.6	8.5	...	...	...
Bank lending to households	4.9	6.0	7.4	7.4	...	...	...
Interest rates (end of period)							
Repo rate 2/	0.8	0.0	-0.4	-0.5	...	...	...
Ten-year government bond yield 2/	2.1	1.7	0.7	0.2	...	...	...
Mortgage lending rate 3/	2.5	1.9	1.6	1.6	...	...	...
Balance of payments (in percent of GDP)							
Current account	5.3	4.6	5.2	4.9	5.1	5.0	4.7
Foreign direct investment, net	4.4	1.0	2.7	2.6	2.8	2.6	2.6
International reserves, changes (in billions of US dollars) 4/	14.6	0.2	1.3	0.5	...	...	...
Reserve cover (months of imports of goods and services)	3.4	3.3	3.5	...	...	...	...
Net international investment position	-12.6	-0.3	4.1	6.0	8.1	10.1	12.0
Exchange rate (period average, unless otherwise stated)							
SEK per euro 2/	8.7	9.1	9.4	9.4	...	...	...
SEK per U.S. dollar 2/	6.5	6.9	8.4	8.4	...	...	...
Nominal effective rate (2010=100) 5/	108.5	103.7	97.5	96.7	...	...	...
Real effective rate (2010=100) 5/ 6/	103.4	98.8	94.7	95.7	...	...	...
Fund Position (August 31, 2016)							
Quota (in millions of SDRs)				4430.0			
Reserve tranche position (in percent of quota)				1.8			
Holdings of SDRs (in percent of allocation)				87.4			

Other Indicators

GDP per capita (2015, USD): 50,591; **Population** (2016, million): 9.9; **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 2016 is as of August 2016.

2/ Data for 2016 is as of September 2016.

3/ Mortgage rates for new contracts, data for 2016 is as of June 2016.

4/ Data for 2016 is as of Q2 2016.

5/ Data for 2016 is as of August 2016

6/ Based on relative unit labor costs in manufacturing.

Table 2. Sweden: General Government Statement of Operations, 2013–19

	2013	2014	2015	Projections			
				2016	2017	2018	2019
Billions of SEK							
Revenue	1,919	1,973	2,053	2,142	2,233	2,323	2,412
Tax revenue	1,507	1,507	1,619	1,703	1,784	1,859	1,940
Taxes on income, profits, and capital gains	661	698	757	796	838	877	915
Payable by individuals	560	590	632	681	715	747	776
Payable by corporations	101	108	125	114	122	130	139
General taxes on goods and services	471	488	514	534	547	563	576
Other Taxes	375	320	347	373	400	419	448
Social Contributions	177	183	193	204	210	218	225
Grants	3	3	3	3	3	3	3
Other revenue	232	281	239	232	236	244	245
Interest income	27	28	30	31	33	34	35
Expenditure	1,970	2,034	2,045	2,151	2,244	2,333	2,414
Compensation of employees	476	494	517	548	575	597	621
Intermediate consumption	282	293	309	331	349	360	371
Interest payments	29	27	20	17	18	24	30
Social benefits	671	679	693	712	742	764	788
Expense not elsewhere classified	471	455	418	445	454	480	492
Net acquisition of nonfinancial assets	41	86	88	98	106	107	112
Gross operating balance	-10	25	95	89	95	97	110
Net lending / borrowing	-50	-61	8	-9	-11	-10	-2
Percent of GDP							
Revenue	50.9	50.1	49.1	48.9	48.9	48.9	48.7
Tax revenue	40.0	38.3	38.7	38.8	39.1	39.1	39.1
Taxes on income, profits, and capital gains	17.5	17.7	18.1	18.2	18.3	18.5	18.5
Payable by individuals	14.9	15.0	15.1	15.5	15.7	15.7	15.7
Payable by corporations	2.7	2.7	3.0	2.6	2.7	2.7	2.8
General taxes on goods and services	12.5	12.4	12.3	12.2	12.0	11.8	11.6
Other Taxes	9.9	8.1	8.3	8.5	8.8	8.8	9.0
Social Contributions	4.7	4.6	4.6	4.7	4.6	4.6	4.5
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	6.2	7.1	5.7	5.3	5.2	5.1	4.9
Interest income	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Expenditure	52.2	51.7	48.9	49.1	49.1	49.1	48.7
Compensation of employees	12.6	12.5	12.4	12.5	12.6	12.6	12.5
Intermediate consumption	7.5	7.4	7.4	7.5	7.7	7.6	7.5
Interest payments	0.8	0.7	0.5	0.4	0.4	0.5	0.6
Social benefits	17.8	17.2	16.6	16.2	16.2	16.1	15.9
Expense not elsewhere classified	12.5	11.6	10.0	10.2	9.9	10.1	9.9
Net acquisition of nonfinancial assets	1.1	2.2	2.1	2.2	2.3	2.3	2.3
Gross operating balance	-0.3	0.6	2.3	2.0	2.1	2.0	2.2
Net lending / borrowing	-1.3	-1.6	0.2	-0.2	-0.3	-0.2	0.0
Structural Balance (percent of potential GDP) 1/	-0.5	-0.6	0.0	-0.5	-0.9	-0.5	-0.1
Fiscal Impulse (expansions +)	0.2	0.0	-0.5	0.5	0.4	-0.4	-0.4
<i>Memorandum items:</i>							
Gross Public Debt (percent of GDP)	39.8	44.6	42.9	41.6	40.5	39.4	38.8
Real GDP growth (percent change)	1.2	2.6	4.1	3.4	2.4	2.2	2.1
Output gap (percent of potential GDP)	-2.8	-2.2	-0.7	0.9	1.0	0.7	0.4
Nominal GDP (in billions of SEK)	3770	3937	4181	4383	4567	4749	4956

Sources: The 2017 Budget Bill and Fund staff calculations.

1/ Structural balance takes into account output gaps.

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

Table 3. Sweden: Public Sector Balance Sheet, 2007–15

	2007	2008	2009	2010	2011	2012	2013	2014	2015
Assets	2,425	2,414	2,575	2,580	2,808	2,811	2,813	2,939	2,924
Financial assets	1,000	988	1,147	1,151	1,378	1,380	1,382	1,507	1,491
Currency and deposits	26	75	27	22	49	28	18	87	64
Securities other than shares	17	27	36	38	44	42	45	49	48
Loans	190	192	289	283	292	303	415	454	472
Shares and other equity	528	463	531	542	734	732	628	617	584
Other financial assets	238	231	264	266	260	274	277	299	323
Capital stock net of depreciation	1,425	1,426	1,427	1,428	1,429	1,430	1,431	1,432	1,433
Liabilities	1,467	1,436	1,499	1,481	1,556	1,564	1,659	1,892	1,899
Financial liabilities	1,467	1,436	1,499	1,481	1,556	1,564	1,659	1,892	1,899
Currency and deposits	42	61	53	58	69	75	55	58	51
Securities and other equity	1,116	1,047	1,068	1,114	1,114	1,108	1,207	1,378	1,396
Loans	66	64	125	54	85	54	65	128	118
Other liabilities	243	263	253	254	288	327	332	329	334
Net worth	958	978	1,076	1,099	1,252	1,247	1,154	1,047	1,025
Financial net worth	-468	-448	-352	-329	-177	-184	-278	-386	-408
Assets	73.6	71.3	78.3	73.3	76.8	76.3	74.6	74.7	70.0
Financial assets	30.3	29.2	34.9	32.7	37.7	37.5	36.6	38.3	35.7
Currency and deposits	0.8	2.2	0.8	0.6	1.3	0.8	0.5	2.2	1.5
Securities other than shares	0.5	0.8	1.1	1.1	1.2	1.1	1.2	1.3	1.1
Loans	5.8	5.7	8.8	8.1	8.0	8.2	11.0	11.5	11.3
Shares and other equity	16.0	13.7	16.1	15.4	20.1	19.9	16.7	15.7	14.0
Other financial assets	7.2	6.8	8.0	7.6	7.1	7.4	7.4	7.6	7.7
Capital stock net of depreciation	43.2	42.1	43.4	40.6	39.1	38.8	38.0	36.4	34.3
Liabilities	44.5	42.4	45.6	42.1	42.5	42.4	44.0	48.1	45.4
Financial liabilities	44.5	42.4	45.6	42.1	42.5	42.4	44.0	48.1	45.4
Currency and deposits	1.3	1.8	1.6	1.6	1.9	2.0	1.5	1.5	1.2
Securities and other equity	33.8	30.9	32.5	31.7	30.5	30.1	32.0	35.0	33.4
Loans	2.0	1.9	3.8	1.5	2.3	1.5	1.7	3.3	2.8
Other liabilities	7.4	7.8	7.7	7.2	7.9	8.9	8.8	8.3	8.0
Net worth	29.0	28.9	32.7	31.2	34.2	33.8	30.6	26.6	24.5
Financial net worth	-14.2	-13.2	-10.7	-9.4	-4.9	-5.0	-7.4	-9.8	-9.8
<i>Memorandum items:</i>									
GDP (SEK billions)	3,297	3,388	3,289	3,520	3,657	3,685	3,770	3,937	4,181

Sources: Eurostat and Fund staff calculations.

Table 4. Sweden: Balance of Payments Accounts, 2013–19

	2013	2014	2015	Projections			
				2016	2017	2018	2019
Billions of SEK							
Current Account Balance	198	182	218	216	232	237	234
Trade Balance	187	172	200	173	171	174	181
Exports of G&S	1647	1758	1888	1934	2001	2077	2159
Imports of G&S	1460	1586	1688	1761	1830	1903	1978
Factor income, net	12	10	18	43	61	63	54
Financial Account Balance	124	135	130	207	223	228	224
Investment Abroad ¹	-143	-381	-800	-90	-79	-91	-141
Investment in Sweden	-171	-514	-919	-298	-302	-319	-365
Reserves, change	95	1	11	0	0	0	0
Percent of GDP							
Current Account Balance	5.3	4.6	5.2	4.9	5.1	5.0	4.7
Trade Balance	5.0	4.4	4.8	3.9	3.7	3.7	3.6
Exports of G&S	43.7	44.7	45.2	44.1	43.8	43.7	43.6
Imports of G&S	38.7	40.3	40.4	40.2	40.1	40.1	39.9
Factor income, net	0.3	0.2	0.4	1.0	1.3	1.3	1.1
Financial Account Balance	3.3	3.4	3.1	4.7	4.9	4.8	4.5
Investment Abroad 1/	-3.8	-9.7	-19.1	-2.1	-1.7	-1.9	-2.8
Direct Investment	5.2	1.5	5.5	5.7	5.8	5.7	5.7
Portfolio Investment	4.4	5.1	-1.9	4.2	4.4	4.4	4.3
Financial Derivatives	-18.6	-16.8	-21.8	-16.1	-16.2	-16.5	-17.2
Other Investment	5.2	0.4	-0.9	4.1	4.3	4.4	4.4
Reserves	2.5	0.0	0.3	0.0	0.0	0.0	0.0
Investment in Sweden	-4.5	-13.1	-22.0	-6.8	-6.6	-6.7	-7.4
Direct Investment	0.8	0.6	2.8	3.1	3.0	3.1	3.1
Portfolio Investment	12.7	1.0	0.5	4.9	5.5	5.8	6.2
Financial Derivatives	-16.9	-16.2	-21.8	-16.4	-16.6	-16.9	-17.6
Other Investment	-1.2	1.6	-3.6	1.6	1.5	1.3	0.9
Errors and Omissions	-0.3	-0.2	-0.2	0.0	0.0	0.0	0.0
Percent change							
Exports of G&S 2/							
Value	1.5	1.3	-12.7	2.5	2.0	2.5	2.9
Volume	0.1	4.6	5.5	2.4	3.0	3.1	3.1
Deflator	1.4	-3.2	-17.2	0.1	-1.0	-0.6	-0.2
Imports of G&S 2/							
Value	1.5	3.1	-13.4	4.4	2.4	2.7	2.9
Volume	0.4	6.6	5.4	4.3	3.6	3.5	3.5
Deflator	1.1	-3.3	-17.9	0.1	-1.2	-0.8	-0.5
<i>Memorandum</i>							
Net International Investment Position (Percent of GDP)	-12.6	-0.3	4.1	6.0	8.1	10.1	12.0
Nominal GDP (SEK billion)	3770	3937	4181	4383	4567	4749	4956

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, 2010–15

	2010	2011	2012	2013	2014	2015
	<i>(End of period, in percent)</i>					
Capital Adequacy						
Regulatory capital to risk-weighted assets 1/ <i>of which: Four major banks 2/</i>	12.6	12.2	12.5	12.7	22.4	24.2
Regulatory Tier I capital to risk-weighted assets 1/ <i>of which: Four major banks 2/</i>	11.0	11.3	11.7	12.0	19.5	21.1
Capital as percent of assets (leverage ratio) <i>of which: Four major banks 2/</i>	4.8	4.1	4.4	4.5	5.0	5.5
	4.7	4.0	4.2	4.4	5.1	5.6
Asset quality and exposure						
Nonperforming loans to total gross loans 3/ <i>of which: Four major banks 2/ 3/</i>	1.9	1.6	1.5	1.3	2.1	1.9
Nonperforming loans net of loan-loss provisions to capital 3/ <i>of which: Four major banks 2/ 3/</i>	9.9	9.5	9.3	8.2	16.1	14.6
Loan-loss provisions to nonperforming loans 3/ <i>of which: Four major banks 2/ 3/</i>	44.3	41.3	39.8	38.8	19.6	20.8
Distribution of MFI credit (percent) 4/ Sweden	81.3	80.9	80.1	79.3	77.8	78.0
Financial corporation	2.0	1.7	1.8	1.5	1.9	1.1
Non financial corporations	31.0	31.1	30.3	29.5	28.0	27.8
Public sector	2.6	2.9	2.8	2.6	3.5	3.1
Households	45.7	45.2	45.2	45.7	44.4	46.0
Outside Sweden	18.7	19.1	19.9	20.7	22.2	22.0
Other EU countries	9.5	9.5	10.0	10.5	12.0	12.4
Rest of the world	9.3	9.6	10.0	10.2	10.2	9.6
Large exposures as percent of tier 1 capital 5/ <i>of which: Four major banks 5/</i>	40.1	37.2	29.5	20.0	8.5	
	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>	0.4	0.5	0.5	0.6	0.5	0.6
Return on equity (Net income as percent of average equity capital) <i>of which: Four major banks 2/</i>	9.8	10.6	11.4	11.4	10.2	11.4
Net interest income as percent of gross income <i>of which: Four major banks 2/</i>	52.7	54.4	55.4	55.3	50.3	50.6
Noninterest expenses as percent of gross income <i>of which: Four major banks</i>	66.2	66.1	63.2	63.9	32.0	59.2
Noninterest income as percent of total income 3/ <i>of which: Four major banks 3/</i>	55.1	52.9	51.7	53.7	62.3	45.5
Trading income and foreign exchange gains (losses) to gross income <i>of which: Four major banks 2/</i>	11.6	9.4	10.7	8.4	9.3	10.6
Personnel expenses as percent of noninterest expenses <i>of which: Four major banks 2/</i>	52.6	53.6	52.2	53.9	57.4	48.5
	57.4	57.8	59.4	60.5	68.5	54.0
Liquidity						
Liquid assets as percent of total assets 3/ <i>of which: Four major banks 2/ 3/</i>	4.8	6.2	8.5	8.9	7.1	9.2
Liquid assets as percent of short-term liabilities 3/ <i>of which: Four major banks 2/ 3/</i>	44.4	66.7	97.2	95.0	75.1	92.9
Customer deposits as a percent of total (non-interbank) loans <i>of which: Four major banks 2/</i>	47.8	49.8	52.9	53.8	56.5	52.6
Noninterbank loans to noninterbank deposits <i>of which: Four major banks 2/</i>	155.0	153.8	148.8	145.9	140.7	152.4
	165.9	163.5	158.0	153.7	149.5	165.4
Foreign exchange risk						
Foreign currency loans as percent of total loans	36.5	37.4	34.9	36.8	39.4	38.1
Foreign currency assets as percent of total assets	31.4	34.5	33.1	33.8	35.6	33.1
Foreign currency-denominated liabilities as percent of total liabilities	31.4	35.1	31.1	28.7	32.9	28.0
Exposure to derivatives						
Gross asset position in derivatives as percent of Tier 1 capital	222.3	351.2	243.9			
Gross liability position in derivatives as percent of Tier 1 capital	217.9	335.2	232.8			

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

1/ From 2010 to 2013 based on Basel II, including including consideration to the Basel I-floor. From 2014 based on Basel III.

2/ On consolidated basis.

3/ Reporting based on national accounting regulations until 2013 and International Financial Reporting Standards thereafter.

4/ Non consolidated basis and parent banks only. Monetary financial institutions include banks and housing credit institutions.

5/ From 2010 onward, exposures to credit institutions are included.

Table 6. Sweden: Financial Soundness Indicators: Non-Banks, 2008–15

	2010	2011	2012	2013	2014	2015
	<i>(End of period, in percent)</i>					
Insurance sector						
Solvency ratio (margin/required margin)						
Life insurance companies	14.2	8.0	9.9	13.7	12.3	13.6
Non-life insurance companies	10.6	10.6	10.8	11.4	11.8	12.2
Return on equity						
Life insurance companies	20.3	-30.1	32.5	28.7	8.7	13.8
Non-life insurance companies	35.4	3.5	40.0	11.7	22.8	4.8
Households						
Household debt as percent of GDP	76.0	79.2	81.1	81.2	81.6	81.7
Household debt as percent of disposable income	169.3	171.1	168.6	170.8	174.8	180.2
Household interest expense as percent of disposable income	3.1	4.3	4.3	3.6	3.2	2.9
Corporate sector						
Debt stock as percent of GDP (NFC borrowing from financial sector)	33.9	33.3	33.5	34.8	33.6	32.8
Total debt stock as percent of GDP	46.5	47.3	46.7	48.1	46.7	45.0
Equity risk						
OM Stockholm Stock Exchange Index (annual percent change)	23.1	-16.7	12.0	23.2	11.9	6.6
Market capitalization in percent of GDP	201.4	159.4	176.1	219.1	237.5	253.3
Real estate markets (prices; year on year percent change)						
One- or two dwelling buildings	3.2	-3.1	2.7	3.9	6.9	10.1
Greater Stockholm region	2.9	-2.5	1.4	4.8	8.4	13.4
Buildings for seasonal and secondary use	8.4	-0.3	3.4	13.3	8.9	5.7
Memorandum items						
GDP (year on year percent change, constant prices)	6.0	2.7	-0.3	1.2	2.6	4.1
GDP bn SEK, current prices	3,520	3,657	3,685	3,770	3,937	4,181

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

Table 7. Sweden: Financial System Structure, 2012–15

	2012				2013				2014				2015			
	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP	Number of institutions	Total assets (in millions of SEK)	Percent of total assets	Percent of GDP
Four Major Banks, consolidated																
Nordea	1	5,813,615	30.4	157.8	1	5,585,078	27.3	148.1	1	5,843,003	26.5	148.4	1	5,475,503	25.4	110.5
Handelsbanken	1	2,387,858	12.5	64.8	1	2,489,806	12.2	66.0	1	2,721,579	12.4	69.1	1	2,418,478	11.2	48.8
S.E.B	1	2,453,456	12.8	66.6	1	2,484,834	12.1	65.9	1	2,249,862	10.2	57.1	1	2,091,724	9.7	42.2
Swedbank	1	1,846,941	9.7	50.1	1	1,820,807	8.9	48.3	1	1,979,048	9.0	50.3	1	1,995,532	9.2	40.3
<i>Total Top Four Banks</i>	4	12,501,870	65.3	339.3	4	12,380,525	60.5	328.4	4	12,793,492	58.1	325.0	4	11,981,238	55.5	241.7
Four major banking groups 1/																
Banks	4	6,076,915	31.8	164.9	4	6,261,408	30.6	166.1	4	7,140,464	32.4	181.4	4	6,819,802	31.6	137.6
Insurance companies	8	554,856	2.9	15.1	9	616,742	3.0	16.4	10	722,970	3.3	18.4	9	753,553	3.5	15.2
Mortgage credit institutions	3	2,209,594	11.5	60.0	3	2,309,254	11.3	61.3	3	2,457,837	11.2	62.4	3	2,594,135	12.0	52.3
Securities firms	2	14,910	0.1	0.4	2	3,804	0.0	0.1	2	3,190	0.0	0.1	2	3,860	0.0	0.1
Other credit market companies	7	167,150	0.9	4.5	7	166,422	0.8	4.4	3	111,454	0.5	2.8	3	108,840	0.5	2.2
<i>Top four banks in Sweden</i>	24	9,023,425	47.2	244.9	25	9,357,630	45.7	248.2	22	10,435,915	47.4	265.1	21	10,280,190	47.6	207.4
Other Banks in Sweden																
<i>Of which:</i>																
Banks	29	656,814	3.4	17.8	28	709,534	3.5	18.8	28	747,834	3.4	19.0	28	737,354	3.4	14.9
Savings banks	49	171,406	0.9	4.7	49	181,634	0.9	4.8	48	171,085	0.8	4.3	47	186,511	0.9	3.8
Mortgage credit institutions	3	361,305	1.9	9.8	3	365,487	1.8	9.7	2	376,692	1.7	9.6	2	389,993	1.8	7.9
Member bank	2	1,909	0.0	0.1	2	2,080	0.0	0.1	2	2,213	0.0	0.1	2	2,352	0.0	0.0
Other credit market companies	35	818,635	4.3	22.2	32	816,881	4.0	21.7	27	802,202	3.6	20.4	25	796,274	3.7	16.1
<i>Total other banks in Sweden</i>	118	2,010,069	10.5	54.6	114	2,075,616	10.1	55.1	107	2,100,026	9.5	53.3	104	2,112,484	9.8	42.6
Nonbank credit institutions																
Insurance companies	208	2,717,606	14.2	73.8	201	3,675,409	18.0	97.5	194	4,163,547	18.9	105.8	187	4,262,003	19.7	86.0
Life insurance	39	2,143,215	11.2	58.2	40	2,962,745	14.5	78.6	40	3,389,875	15.4	86.1	37	3,531,579	16.4	71.3
Nonlife insurance 2/	169	574,392	3.0	15.6	150	565,733	2.8	15.0	143	608,148	2.8	15.4	139	559,953	2.6	11.3
Pension funds	11	135,266	0.7	3.7	11	146,931	0.7	3.9	11	165,524	0.8	4.2	11	170,471	0.8	3.4
Mutual funds 3/	866	1,737,564	9.1	47.2	863	2,158,227	10.5	57.2	860	2,770,250	12.6	70.4	866	3,039,509	14.1	61.3
Other nonbank credit institutions																
Asset management firms	75	7,731	0.0	0.2	73	9,592	0.0	0.3	78	11,393	0.1	0.3	83	12,012	0.1	0.2
Securities firms	125	22,615	0.1	0.6	123	12,206	0.1	0.3	112	11,600	0.1	0.3	109	12,196	0.1	0.2
Total financial system	1407	19,132,721	100.0	519.2	1389	20,458,506	100.0	542.7	1366	22,015,832	100.0	559.2	1364	21,589,913	100.0	435.6
<i>of which: Total banking sector 4/</i>		14,511,939	75.8	393.8		14,456,141	70.7	383.5		14,893,518	67.6	378.3		14,093,722	65.3	284.4
Memorandum item:																
Foreign bank branches in Sweden	27	832,627	4.4	22.6	28	865,580	4.2	23.0	27	1,022,938	4.6	26.0	28	1,038,262	4.8	20.9
Swedish bank branches abroad	61	1,993,116	10.4	54.1	64	1,972,162	9.6	52.3	69	2,455,543	11.2	62.4	74	2,005,494	9.3	40.5
Nominal GDP (in millions of SEK)			3,684,800				3,769,909				3,936,840				4,956,379	

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

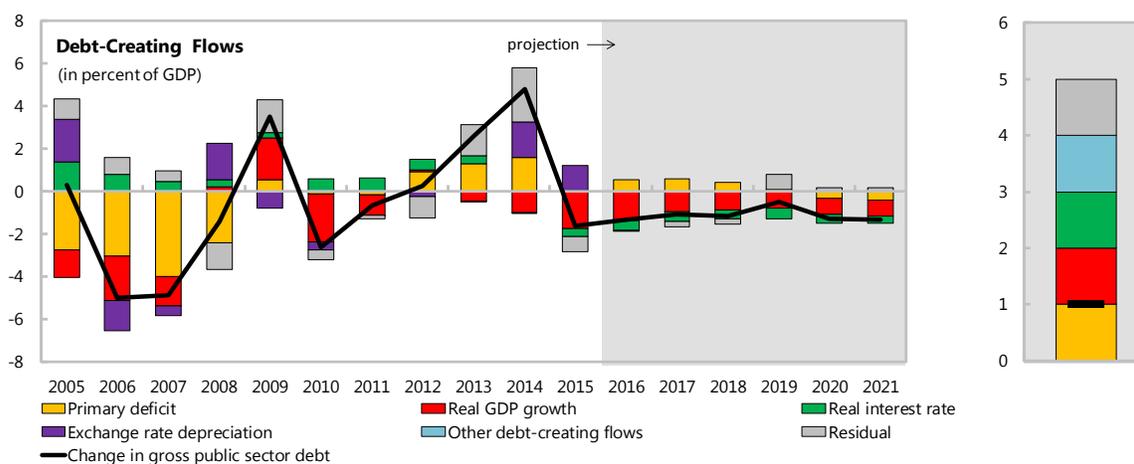
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of August 18, 2016	
	2005-2013 ^{2/}	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads	
Nominal gross public debt	39.7	44.6	42.9	41.6	40.5	39.4	38.8	37.5	36.2	15	
Public gross financing needs	11.1	13.1	9.6	8.8	10.7	11.2	10.5	9.3	7.8	5Y CDS (bp)	26
Real GDP growth (in percent)	1.6	2.6	4.1	3.4	2.4	2.2	2.1	2.0	2.0	Ratings	Foreign Local
Inflation (GDP deflator, in percent)	1.7	1.8	2.0	1.4	1.7	1.7	2.2	2.1	2.1	Moody's	Aaa Aaa
Nominal GDP growth (in percent)	3.4	4.4	6.2	4.9	4.2	4.0	4.4	4.2	4.2	S&Ps	AAA AAA
Effective interest rate (in percent) ^{4/}	3.2	1.8	1.2	0.3	0.7	0.7	0.9	1.1	1.2	Fitch	AAA AAA

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021		
Change in gross public sector debt	-0.9	4.8	-1.6	-1.3	-1.1	-1.1	-0.5	-1.3	-1.3	-6.7	
Identified debt-creating flows	-1.1	2.2	-0.9	-1.3	-0.8	-0.9	-1.2	-1.5	-1.5	-7.2	
Primary deficit	-1.1	1.6	0.0	0.5	0.6	0.4	0.1	-0.3	-0.4	0.9	
Primary (noninterest) revenue and grants	50.6	49.4	48.4	48.1	48.2	48.2	48.0	47.8	47.8	288.1	
Primary (noninterest) expenditure	49.5	51.0	48.4	48.7	48.8	48.6	48.1	47.4	47.3	288.9	
Automatic debt dynamics ^{5/}	-0.1	0.7	-0.9	-1.8	-1.4	-1.3	-1.3	-1.2	-1.1	-8.1	
Interest rate/growth differential ^{6/}	-0.1	-1.0	-2.1	-1.8	-1.4	-1.3	-1.3	-1.2	-1.1	-8.1	
Of which: real interest rate	0.6	0.0	-0.4	-0.5	-0.4	-0.4	-0.5	-0.4	-0.3	-2.5	
Of which: real GDP growth	-0.7	-1.0	-1.7	-1.4	-1.0	-0.9	-0.8	-0.8	-0.7	-5.5	
Exchange rate depreciation ^{7/}	0.0	1.7	1.2	...	...	...	...	...	...	...
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	
Other (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
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	2.6	-0.7	0.0	-0.3	-0.3	0.7	0.2	0.1	0.5	



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 $[(r - \pi(1+g) - g + ae(1+r))/(1+\pi+grt)]$ 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.

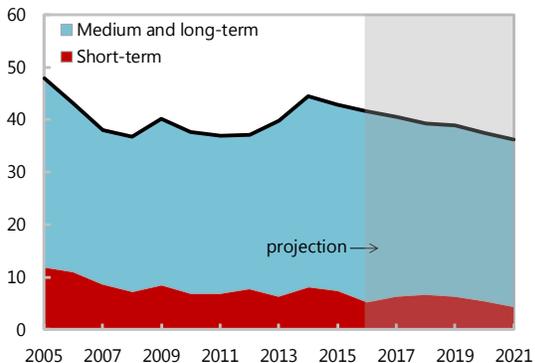
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Sweden Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

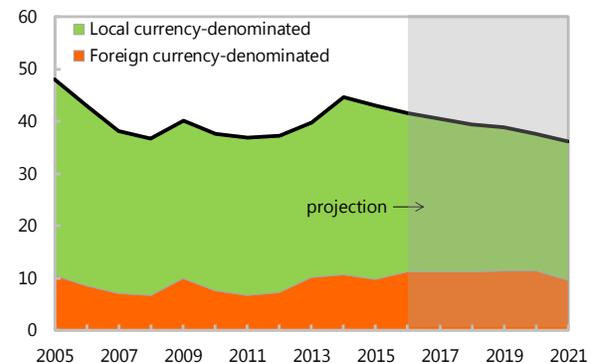
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

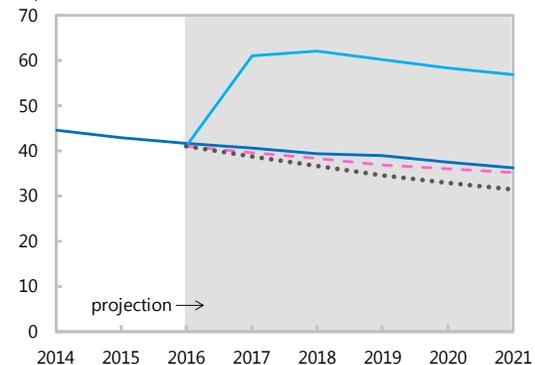


Alternative Scenarios

— Baseline — Contingent Liability Shock Historical - - - Constant Primary Balance

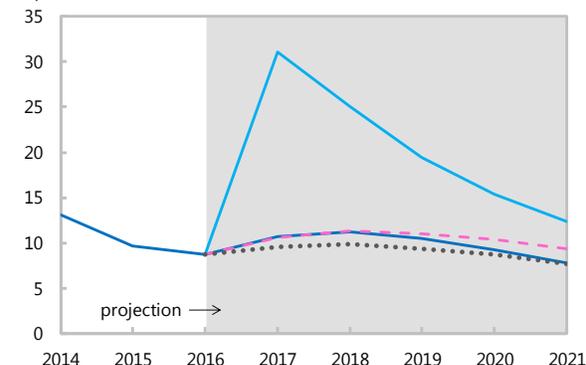
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Scenario	2016	2017	2018	2019	2020	2021
Baseline Scenario						
Real GDP growth	3.4	2.4	2.2	2.1	2.0	2.0
Inflation	1.4	1.7	1.7	2.2	2.1	2.1
Primary Balance	-0.5	-0.6	-0.4	-0.1	0.3	0.4
Effective interest rate	0.3	0.7	0.7	0.9	1.1	1.2
Constant Primary Balance Scenario						
Real GDP growth	3.4	2.4	2.2	2.1	2.0	2.0
Inflation	1.4	1.7	1.7	2.2	2.1	2.1
Primary Balance	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	0.3	0.6	0.7	0.9	1.1	1.3
Historical Scenario						
Real GDP growth	3.4	1.9	1.9	1.9	1.9	1.9
Inflation	1.4	1.7	1.7	2.2	2.1	2.1
Primary Balance	-0.5	0.5	0.5	0.5	0.5	0.5
Effective interest rate	0.3	0.6	1.1	1.5	1.9	2.4
Contingent Liability Shock						
Real GDP growth	3.4	-0.8	-1.0	2.1	2.0	2.0
Inflation	1.4	1.4	1.4	2.2	2.1	2.1
Primary Balance	-0.5	-20.6	-0.4	-0.1	0.3	0.4
Effective interest rate	0.3	0.6	2.4	1.8	2.1	2.3

Source: IMF staff.

	Sweden	Overall Assessment
Foreign asset and liability position and trajectory	<p>Background. The Swedish net IIP rose by 4.5 percentage points in 2015 to 4.1 percent of GDP. It is expected to rise further in the medium term, reflecting the outlook for continued current account surpluses. But in the last decade, the average increase in the net IIP was only about 2.2 percent of GDP annually, well below the average surplus of 6.2 percent of GDP. This gap may in part reflect negative valuation effects, but may also reflect some overstatement of the surplus as discussed below. Hence it is appropriate to project a smaller IIP rise than the cumulative surplus.</p> <p>Assessment. Gross liabilities were 266 percent of GDP in 2015, with over a third being external debt (97 percent of GDP). Although rollovers of external debt (which include banks' covered bonds) pose some vulnerability, risks are moderated by the banks' capital buffers. Sweden's strong FX reserves and low public debt help ensure capacity to manage pressures.</p>	<p>Overall Assessment:</p> <p><i>Sweden's external position in 2015 was moderately stronger than the level consistent with medium-term fundamentals and desirable policies. As of September 2016, subsequent developments do not point to a clear change in the external position.</i></p> <p>Staff assesses the Sweden's current account norm to be relatively high due to structural factors, including its status as a financial center, its role as a hub for merchanting trade, and its fully-funded pension schemes. Measurement issues may also overstate current account surpluses. There is an absence of obvious policy distortions affecting the current account or the exchange rate.</p> <p>Potential policy responses:</p> <p>Current policies are broadly appropriate. Monetary policy is highly stimulatory, supporting strong domestic demand growth which is expected to help narrow the current account surplus modestly over the medium term. Fiscal policy is accommodating spending on migrants, making the fiscal stance expansionary in the near-term. A gradual fiscal consolidation toward the medium-term target is effectively deferred to a period when output is expected to exceed potential.</p>
Current account	<p>Background. The current account balance was 5.2 percent of GDP in 2015, modestly below its average in the past decade. Over the medium term the current account is expected to gradually decline to 4.5 percent in 2021, mostly reflecting a strengthening of domestic demand and appreciation of the krona as monetary policy normalizes.</p> <p>Assessment. The cyclically-adjusted current account was 5.3 percent of GDP in 2015—in line with its average for the past decade—but 7 percentage points above the cyclically-adjusted EBA norm of -1.9 percent of GDP. However, there are no clear and substantial policy distortions impacting the current account. A number of factors may be behind the EBA estimated CA gap:</p> <ul style="list-style-type: none"> - A high saving rate, reinforced by pension and welfare reforms since the mid-1990s, including a shift to a defined contributions pension scheme and a decline in social supports. - Structural factors: (i) Sweden is identified as a systemically important 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 (ii) the country plays a significant role in merchanting trade, contributing about 1.7 percent of GDP on average to the trade balance since 2006. - The surplus may be overstated, with errors and omissions contributing about 2.6 percent of GDP on average to the reported surplus in the last decade. <p>Taking these factors into consideration, staff assesses Sweden's adjusted current account norm to be around 3 to 5 percent of GDP, implying a current account gap in the range of 0 to 2 percent of GDP in 2015.</p>	
Real exchange rate	<p>Background. The Swedish krona depreciated 7 percent in 2015 in real effective terms relative to its average level in 2014. As of June 2016, the REER had appreciated by 2 percent compared with its 2015 average. This appears to reflect expectations for ECB policy easing and perhaps Sweden's recent strong growth led markets to expect less easy Riksbank policy in future.</p> <p>Assessment. EBA estimates using the REER index and level approaches suggest a gap of -20.1 and -17 percent, respectively, for 2015. However, consistent with the assessment of the CA gap, staff assesses the <i>krona</i> to be undervalued by 0 to 12 percent. This REER gap is expected to be temporary, with the krona likely to appreciate once the monetary easing cycle ends.</p>	
Capital and financial accounts: flows and policies	<p>Background. Given their size and funding model, Sweden's large banks remain vulnerable to liquidity risks stemming from global wholesale markets even though banks have improved their structural liquidity measures in recent years.</p> <p>Assessment. A further decline in banks' short-term funding in favor of longer maturities is desirable over time. Macroprudential policies, including planned increases in capital buffers of domestic banks, raising funding stability standards, and mortgage amortization regulations on the household side, can help contain vulnerabilities and hence potential liquidity risks.</p>	
FX intervention and reserves level	<p>Background. The exchange rate is freely floating—Riksbank statements regarding their potential to intervene have not as yet been implemented. Foreign currency reserves stood at USD 52.9 bn in August 2016, which is equivalent to about 20 percent of the short-term external debt of monetary and financial institutions (primarily banks) and about 11 percent of GDP.</p> <p>Assessment. 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, it would not be appropriate to reduce Sweden's existing reserves. A further tightening of FX liquidity requirements on banks should be evaluated.</p>	



SWEDEN

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

October 21, 2016

Prepared By

European Department
(In Consultation with Other Departments)

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FUND RELATIONS

(As of September 30, 2016)

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

General Resources Account:	SDR Million	Percent of Quota
Quota	4,430.00	100.00
Fund holdings of currency (Exchange Rate)	4,348.81	98.17
Reserve Tranche Position	81.20	1.83
Lending to the Fund		
<i>New Arrangements to Borrow</i>	391.35	

SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	2,248.96	100.00
Holdings	1,964.95	87.37

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				
	2016	2017	2018	2019	2020
Principal					
Charges/Interest	0.04	0.22	0.22	0.22	0.22
Total	0.04	0.22	0.22	0.22	0.22

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:

A mandatory FSAP has been conducted in time for the 2016 Article IV consultation, in line with the five-year cycle for members or members' territories with financial sectors that are determined to be systemically important pursuant to Decision No. 15495-(13/111), adopted December 6, 2013.

STATISTICAL ISSUES

(As of October 12, 2016)

I. Assessment of Data Adequacy for Surveillance	
<p>General: Data provision is adequate for surveillance. The country has a full range of statistical publications, many of which are on the internet. The quality and timeliness of the economic database are generally very good.</p>	
II. Data Standards and Quality	
<p>Subscriber to the Fund's Special Data Dissemination Standard (SDDS) since May 31, 1996. Uses an SDDS flexibility option for timeliness on the data category production index.</p> <p>The authorities have expressed initial interest to adhere to the Special Data Dissemination Standard Plus.</p>	<p>A data ROSC was published in September 2001, followed by an update in November 2002.</p>

National Accounts: Sweden publishes the national accounts according to the *European System of Accounts (ESA) 2010* since September 2014.

Government Finance Statistics: Government finance statistics were published based on *ESA 2010* methodology in September 2014.

External Sector Statistics: Sweden publishes external sector statistics based on the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* format since December 2014.

Monetary and Financial Statistics: Monetary data reported for *International Financial Statistics* are based on the European Central Bank's (ECB) framework for collecting, compiling, and reporting monetary data.

Sweden: Table of Common Indicators Required for Surveillance

(As of October 12, 2016)

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	2016/10/07	2016/10/11	W	W	W
Reserve/Base Money	2016/10/07	2016/10/11	W	W	W
Broad Money	2016/10/07	2016/10/11	W	W	W
Central Bank Balance Sheet	2016/10/07	2016/10/11	W	W	M
Consolidated Balance Sheet of the Banking System	2016/09	2016/10	M	M	M
Interest Rates ²	Current	Current	D	D	D
Consumer Price Index	2016/09	2016/10	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ —General Government ⁴	2014	2016/10	A	A	A
Revenue, Expenditure, Balance, and Composition of Financing ³ —Central Government	2014	2016/10	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	2014	2016/10	A	A	A
External Current Account Balance	2016 Q2	2016/09	Q	Q	Q
Exports and Imports of Goods and Services	2016 Q2	2016/09	Q	Q	Q
GDP	2016 Q2	2016/09	Q	Q	Q
Gross External Debt					
International Investment Position ⁶	2016 Q2	2016/09	Q	Q	Q

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

3/ Foreign, domestic bank, and domestic nonbank financing.

4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

5/ Including currency and maturity composition.

6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

7/ Daily (D), weekly (W), monthly (M), quarterly (Q), annual (A), irregular (I); and not available (NA).

8/ These columns should only be included for countries for which Data ROSC (or a Substantive Update) has been published.

9/ This reflects the assessment provided in the data ROSC or the Substantive Update (published on ..., and based on the findings of the mission that took place during...) for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).

10/ Same as footnote 9, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.



SWEDEN

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—SUPPLEMENTARY INFORMATION

November 1, 2016

Prepared By

The European Department

This supplement updates the staff report (SM/16/297).

1. The Swedish authorities recently announced a political agreement on expanding the ability of Finansinspektionen (FI) to take macroprudential measures.

The Government, together with a number of other political parties, [agreed](#) on October 26, 2016 to expand the ability of FI to counteract financial imbalances in the credit market. In particular, the government will introduce new legislation to provide the FI with a formal mandate to propose new measures for the government's approval. A legislative proposal will be sent for public consultation by the Ministry of Finance, with the aim for it to become effective from 2018.

2. This agreement is a promising step toward enabling timely macroprudential policy action, a key recommendation of the Financial System Stability Assessment and the Article IV Staff Report. Although details are not yet available, the agreement would appear to enable the adoption of new tools without specific authorizing legislation, as was necessary recently in the case of the requirement for minimum amortization of new mortgage loans. The resulting clearer and shorter process for implementing possible new requirements on the credit market would enable FI to act more quickly should there be a sharp increase in credit market risks. Staff notes that this welcome strengthening of FI's macroprudential authority should not itself delay measures to contain vulnerabilities, such as those related to a further rise in the share of households with high debt-to-disposable income ratios.

**Statement by Mr. Thomas Ostros, Executive Director for Sweden,
and Mr. Thomas Pihl Gade, Senior Advisor to Executive Director
November 14, 2016**

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

Recent macroeconomic development and outlook

The Swedish economy is enjoying robust growth on the back of strong domestic demand. Growth is high relative to main trading partners. Household consumption, residential investment, and public consumption related to rising spending on migrants have all contributed to growth. As a result, strong job creation has led to a decrease in unemployment. Inflation has picked up as resource utilisation has increased, supported by expansionary monetary policy. Growth is expected to moderate in 2017 as the increase in housing investments will slow due to supply constraints and public consumption growth will be lower. Net exports are only expected to leave small contributions to growth due to a slow international recovery.

While there is robust growth, Sweden faces challenges. Migration inflows rose sharply in 2015, totalling 163 000 individuals, with one fifth being unaccompanied minors. Inflows have dropped substantially in 2016, due to measures taken by Sweden, such as temporary border controls, and measures in other countries including in the EU, but the reception capacity is still stretched. The newly arrived must receive education and training and then be given opportunity to start working and contributing to society. Additionally, rapidly increasing housing prices have brought household debt to high levels. While housing price increases have slowed recently, debt relative to income is high and poses macroeconomic stability risks.

Financial stability and macroprudential policy

Household indebtedness and housing prices have continued to rise since Sweden's last FSAP in 2011, giving rise to concerns from both a macroeconomic and a financial stability perspective. These risks should be seen in the context of a banking system which is large relative to the Swedish economy and dependent on short-term wholesale funding, to a large extent from abroad, adding to potential vulnerabilities. The authorities remain cognizant of the need to be vigilant in view of these risks. At the same time, staff analyses show that direct effects of potential declines in housing prices on Swedish households appear limited, with FSAP stress tests suggesting that financial institution solvency is resilient under severe scenarios.

The authorities have implemented a number of the recommendations from the FSAP in 2011, including the creation of the Financial Stability Council (FSC) and increased resources to Finansinspektionen. A new resolution framework for credit institutions and investment firms has also been adopted. All of these measures have contributed to strengthening the policy and regulatory framework. At the same time, the authorities note that more work is needed in order to further strengthen the financial stability framework and enhance resilience in the financial system.

Macroprudential and Financial Stability Framework

Steps have been taken to tackle risks emanating from rapid credit growth and increasing household indebtedness. An amortization requirement was recently introduced as a measure to mitigate increased household indebtedness. It is still too early to draw any firm conclusions of the subsequent effects of this reform. The authorities are continuously monitoring the situation to assess whether further measures are needed. Potential further action will have to be duly analysed in advance of implementation. The authorities make somewhat different judgements on the timing of further measures, as illustrated in the Authorities' Views in the Article IV report.

The authorities agree that it is important to ensure a clear legal mandate for macroprudential policy. Finansinspektionen has been designated as the macroprudential authority to apply a range of macroprudential tools. Additionally, the Government has in October, together with the centre-right parties and the Left Party, agreed to expand the ability of Finansinspektionen to take measures to counteract financial imbalances on the credit market. The agreement means that Finansinspektionen will receive a formal mandate, enabling it to draw up proposals for additional tools that will then be approved by the Government. The new framework should ensure swifter implementation of potential measures. As to the role of the Riksbank in financial stability, a future parliamentary inquiry will revert with possible proposals for clarifying the Riksbank's responsibilities.

The authorities note the recommendations with respect to the FSC. Although the authorities aim to make best use of the FSC and welcome suggestions to increase inter-agency cooperation on crisis preparedness, it is not possible under the Swedish constitution for the FSC to make recommendations to Finansinspektionen (or any other public authority) entailing a comply or explain obligation.

Prudential Supervision

The Government concurs with the need to ensure that adequate resources are allocated for prudential supervision. In this context, it can be noted that in the recent budget bill, Finansinspektionen is allocated increased resources as a result of being tasked with additional responsibilities resulting from new legislation and the need to strengthen existing activities, primarily supervision. The appropriation is continuously reviewed under the yearly budget process.

The Swedish authorities note the recognition that the supervision and oversight of Financial Market Infrastructures (FMIs) has been effective in improving risk management practices in Swedish FMIs. The Swedish authorities agree with the recommendations of the importance of crisis preparedness, meaning that further enhancements should be made and work has already been initiated, in line with the recommendations.

On recommendations regarding the introduction of a leverage ratio, the Government notes that this will be part of the upcoming negotiations on revised capital requirement rules within the EU, which should ensure a timely adoption. The Riksbank, however, prefers an early introduction of a leverage ratio as a backstop. As regards banks' foreign exchange liquidity requirements, the authorities welcome analytical considerations on the need for a further tightening. At the same time, the Government notes that Swedish liquidity coverage ratio implementation exceeds international norms and is already focused on requirements in foreign currencies.

Crisis readiness, management, and resolution

The cooperation between the relevant authorities in Sweden regarding crisis preparedness and crisis management has historically functioned well. Given the recent introduction of the Bank Recovery and Resolution Directive (BRRD) into Swedish legislation, the authorities are in agreement with the recommendation for further measures and resources to ensure operational capacity of the new framework in order to rapidly be able to deploy recovery and resolution tools. Work is already underway in this area. In addition, since the FSAP mission, a first crisis-simulation exercise was held under the auspices of the FSC, fostering stronger crisis preparedness and inter-agency cooperation.

The authorities also agree with the need to expedite work on resolution planning for systemic financial institutions and the resolution handbook. As a part of this work, analysis of the liquidity provision to a bank in resolution, including Emergency Liquidity Assistance (ELA), will be considered.

The authorities can see the merits with swap agreements between central banks and agree that such should be endeavoured. However, swap agreements cannot be a substitute for liquidity coverage in foreign currency at the level of the individual bank, a strong financial sector and an adequate level of foreign exchange reserves. Several of these aspects are currently under review by the Government. The issue of indemnification of losses related to ELA is also important in this regard. The aforementioned parliamentary inquiry will be tasked with reporting on the need for an explicit guarantee for any losses relating to ELA.

Regional cooperation

Financial integration in the Nordic-Baltic area is extensive, making it essential to have strong cross-border cooperation arrangements. The Nordic-Baltic Stability Group has recently been revamped under Swedish leadership and the authorities are planning for a

regional crisis- simulation exercise in the near future. The Nordic-Baltic Macroprudential Forum, created in 2011 between central banks and supervisory authorities, is continuing its work on financial stability risks and macroprudential policy. The authorities remain committed to continuing to deepen the already strong regional cooperation.

Monetary policy

Monetary policy has contributed to the positive development of the Swedish economy, with high GDP growth, rising inflation, and long-term inflation expectations increasing towards the inflation target. The expansionary measures have had an effect on market interest rates, households' and companies' financial conditions and on the exchange rate that is broadly in line with expectations. The negative interest rate has, so far, not impaired the functioning of the financial system, and no major adverse effects directly linked to the unconventional monetary policy have been observed. The Riksbank is continuously monitoring the effects of the low interest rates on the financial system.

In 2014/2015 inflation continued to undershoot the inflation target after having done so for several years and inflation expectations were trending downwards. At the same time, monetary policy in the euro area was entering into a new phase, with a new program of large-scale asset purchases – measures that risked putting even more downward pressure on inflation in Sweden via a stronger exchange rate. The Riksbank therefore needed to undertake further expansionary monetary policy measures, in order to ensure that inflation increased towards the target and long-term inflation expectations remained anchored around the inflation target. The repo rate has since the beginning of 2015 been lowered in four steps to -0.50%, and so far the Riksbank has announced government bond purchases of SEK 245 bn.

Swedish monetary policy also needs to relate to the low level of international interest rates. Global economic developments and the monetary policy decisions of the large central banks affect financial conditions in Sweden, and therefore the scope for a further increase in inflation. The krona exchange rate is an important channel for how monetary policy abroad affects the Swedish economy. So far this year, the exchange rate has been weaker than expected, but the Riksbank assesses that it will slowly strengthen in coming years. This gradual strengthening of the krona is assessed to be consistent with inflation increasing towards the inflation target. But a too rapid strengthening of the exchange rate can lead to slower growth in the prices of import-related goods and services, and to a lower demand for Swedish exports. Such a development would make it more difficult for the Riksbank to attain the inflation target. Since inflation has been low for a long time, it is crucial that the strengthening of the krona is slow.

Monetary policy is, thus, continuing to support the upturn in inflation. However, considerable uncertainty about the global economy, and uncertainty about how fast inflation will increase, necessitates a high level of preparedness to quickly make monetary policy even more expansionary if necessary. The Riksbank has clearly

communicated that there is still scope for further cutting the repo rate and to expand the purchases of securities. There are also additional tools, described in the Riksbank's Monetary Policy Reports, which the Riksbank can use if the upturn in inflation is threatened. The expansionary monetary policy underlines the Riksbank's aim to safeguard the role of the inflation target as a nominal anchor for price setting and wage formation.

However, the Swedish authorities share the IMF's view that even though monetary policy needs to be expansionary to get inflation back to target, there are risks associated with long periods of very low interest rates, such as increased risk-taking on the financial markets and potential overvaluation of assets. Housing prices are rising faster than income and household debt is increasing, making households and banks more vulnerable. A heavily-increased repo rate would certainly slow down the build-up of debts, but at the cost of a rapid appreciation of the krona, lower inflation, and higher unemployment. It is therefore essential to implement targeted measures within macroprudential policy, housing policy, and fiscal policy to limit the accumulation of debt by households.

Fiscal policy

The Government agrees with staff's fiscal assessment, that accommodating the sharp rise in migration-related costs is appropriate. The unprecedented increase of refugees in 2015 has put an upward pressure on expenditure in the short run. It is reasonable to allow exceptional and temporary events of this kind to be accommodated without requiring short-term contractionary budgetary measures. Public debt is low and estimated to be on a downward trend as percent of GDP. This provides fiscal space to accommodate these expenditure increases in a socially and economically responsible way, without jeopardizing the long-term sustainability of public finances.

The Government intends to pursue a prudent fiscal policy in the coming years, without jeopardizing the economy's long term growth prospects. Refugee-related expenditure is still expected to be substantial in 2016 and 2017, but will then decline in the following years. The general government fiscal position is estimated to improve with unchanged policies so as to be in near balance in 2018 and reach a surplus of 1.5 percent of GDP in 2020.

The Government agrees with staff that the parliamentary committee agreement on the surplus target is welcome. The committee agreed to recommend that the target, currently at 1 percent of GDP over the cycle, should be reduced to one third of a percent of GDP. It also agreed to recommend a debt anchor to be introduced. The fiscal policy framework has served Sweden well and the proposed changes will further strengthen the framework.

Structural issues

Labor market policy

The Swedish labor market is performing well. Unemployment is falling and the employment rate is the highest in the EU. Despite this there are too many unemployed. The objective of the Government's employment policy is to reduce unemployment so that it will be the lowest in the EU by 2020.

Although the influx of refugees has declined in 2016, staff assesses that there are significant hurdles to integrating the large stock of asylum seekers. The Government is well aware of the challenge the recent influx of refugees implies. Foreign born individuals between 16 and 74 years old represented 20 percent of the Swedish population in 2015, out of which 25 percent has only primary education. At the same time, the share of low-skilled is as high as 48 percent in the group of newly-arrived that participate in the introductory activities at the Public Employment Services. The Government offers the newly arrived several alternative paths for adult education and agrees with the IMF on the importance of recent education initiatives.

There are different ways to make workers more attractive in the labor market. The Government agrees that recent initiatives to make trainee jobs and vocational introduction employment programs available for the newly arrived migrants and increase resources for basic education and vocational training are essential. Another alternative is to offer subsidized employment during the first years in the country while the individuals learn the language and adapt to the Swedish labor market. The Government agrees with the IMF on the effectiveness of employment subsidy programs and is analyzing how to streamline the numerous programs.

Regarding the discussion on entry wages, wage formation in Sweden is the responsibility of the social partners. This arrangement has contributed to stability and wage development in line with productivity in the last two decades.

Household debt and housing

The Government shares the IMF's view that addressing the high household debt and housing prices is an economic challenge. How to curb the rising debt levels is a delicate matter as the Government does not want to trigger a rapid decline in housing prices. The Government's approach is two folded. It is important to increase the supply of housing and, if needed, take further measures directed at the mortgage market. The amortization requirement was introduced less than half a year ago, and before further steps are taken the Government wants to assess its effects on house prices and mortgage growth.

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 be seen in a long-term perspective and therefore need to be based on a broad political consensus. Changes must be handled with great care, due to the potential negative effects on growth. Taxes can also influence the number of transactions in the housing market. The Government has proposed a temporary removal of the threshold for deferring capital gains tax. This reform will give greater incentives to move in the near future for those with high capital gains, often older persons who have lived in their current house for a longer period. The reform is expected to lead to a larger number of transactions and a better allocation on the housing market.

The Government agrees that adequate supply of land is a necessary precondition to sustain the construction of new dwellings at a high level. In the budget bill for 2017 the Government has declared more thoroughly its intention to regulate the quantitative aspect of the municipalities planning for housing. In a short-term perspective the supply of qualified labour within the building and planning sector is the most notable constraint. A public inquiry is evaluating the situation and will present its recommendations later this year.