

**LAPSE OF
TIME**

SM/21/24

March 4, 2021

To: Members of the Executive Board

From: The Secretary

Subject: **Sweden—Staff Report for the 2021 Article IV Consultation**

Board Action:	Executive Directors' consideration on a lapse of time basis as management has determined it meets the established criteria as set out in Board Decision No. 15207 (12/74); (i) there are no acute or significant risks, or general policy issues requiring a Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact in the near term; and (iii) the use of Fund resources is not under discussion or anticipated.
Deadline to Request Board meeting:	Tuesday, March 16, 2021 12:00 (noon)
Proposed Decision Deemed Approved:	Thursday, March 18, 2021
Provisional Board Meeting Date: (if requested)	Friday, March 19, 2021
Proposed Decision:	Page 23
Publication:	Yes* Press Release will be based on the staff appraisal if there is no request for a Board discussion, as attached.
Questions:	Mr. Sakr, EUR (ext. 38525) Ms. Bricco, EUR (ext. 34206) Mr. Misch, EUR (ext. 39851) Ms. Solovyeva, EUR (ext. 35858) Ms. Vtyurina, EUR (ext. 38940)

***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**

Document Transmittal
in the Absence of
an Objection and in
accordance with
Board policy:

Friday, March 5, 2021—European Central Bank, European Commission
After Board Consideration—Food and Agriculture Organization,
Organisation for Economic Cooperation and Development, World
Trade Organization



SWEDEN

STAFF REPORT FOR THE 2021 ARTICLE IV CONSULTATION

March 3, 2021

KEY ISSUES

Sweden entered the pandemic with substantial buffers and suffered a relatively shallow recession in 2020. The decline in output was moderated by substantial income and liquidity support as well as structural features of the economy. Sweden's initial less stringent containment strategy seems to have altered the timing of the economic fallout, which intensified towards the middle of the year. This fallout has particularly impacted the youth and foreign-born. Economic recovery is projected over the next two years, but uncertainty has increased due to the new strains of the virus and slow vaccination.

Fiscal space remains substantial and a premature withdrawal of support should be avoided. The fiscal stance in 2021 is adequate, but additional fiscal support should be deployed if the recovery is delayed. Support measures could also be recalibrated to assist structural transformation and minimize scarring. Over the medium term, there is scope for slowing the pace of returning to budget surpluses by increasing green and growth-enhancing expenditure.

Monetary policy should remain accommodative and stand ready to complement the fiscal stimulus if the recovery or inflation expectations falter. The Riksbank provided ample liquidity, and its asset purchase program contributed importantly to stabilizing the corporate and mortgage bond markets. Inevitably, such operations can contribute to a buildup in vulnerabilities due to reduced risk pricing, creating a need for enhanced data collection of households balance sheets and commercial real estate (CRE) revenue streams. As the recovery takes hold, withdrawal of support measures will need to be gradual, and macroprudential buffers should be rebuilt and tailored to better address banks' exposure to CRE.

Advancing structural reform is needed to boost inclusive growth. While Sweden ranks high in climate mitigation, digitalization, and creating a business-friendly environment, more effort is needed to address longstanding structural issues in the labor and housing markets and to enhance the bankruptcy framework. Furthermore, achieving Sweden's own ambitious climate targets will require additional effort.

Approved By
M. Pradhan (EUR) and
M. Kaufman (SPR)

The Article IV Consultation discussions took place in a virtual format during January 19–29, 2021. The staff team comprised K. Sakr (mission chief), J. Bricco, F. Misch, A. Solovyeva and S. Vtyurina (all EUR). A. Khan and R. Wytenburg (both MCM) participated in some meetings. A. Ekelund (OED) joined the mission. C. Jin and H. Jung (both EUR) provided administrative and editorial assistance. The mission met with Minister of Finance M. Andersson; Minister of Financial Markets and Housing P. Bolund; Riksbank Governor S. Ingves; other senior officials from the Ministry of Finance, the Riksbank, the Financial Supervisory Authority, National Debt Office, the Fiscal Council, Public Employment Service, Ministry of Justice, Climate Council, and Public Health Agency; as well as representatives of the Parliamentary Finance Committee, banking sector, labor unions, real estate sector, National Institute of Economic Research, and academics.

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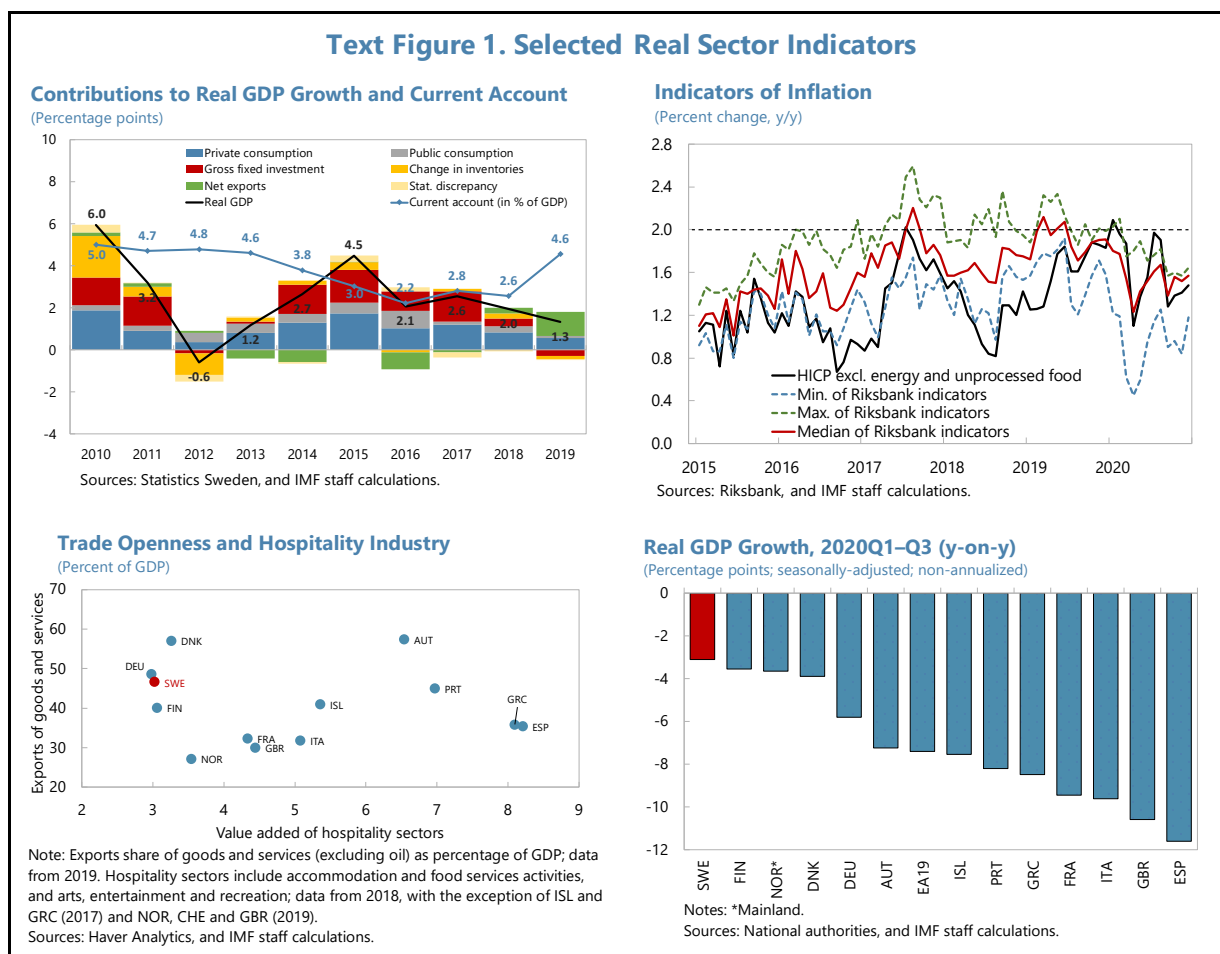
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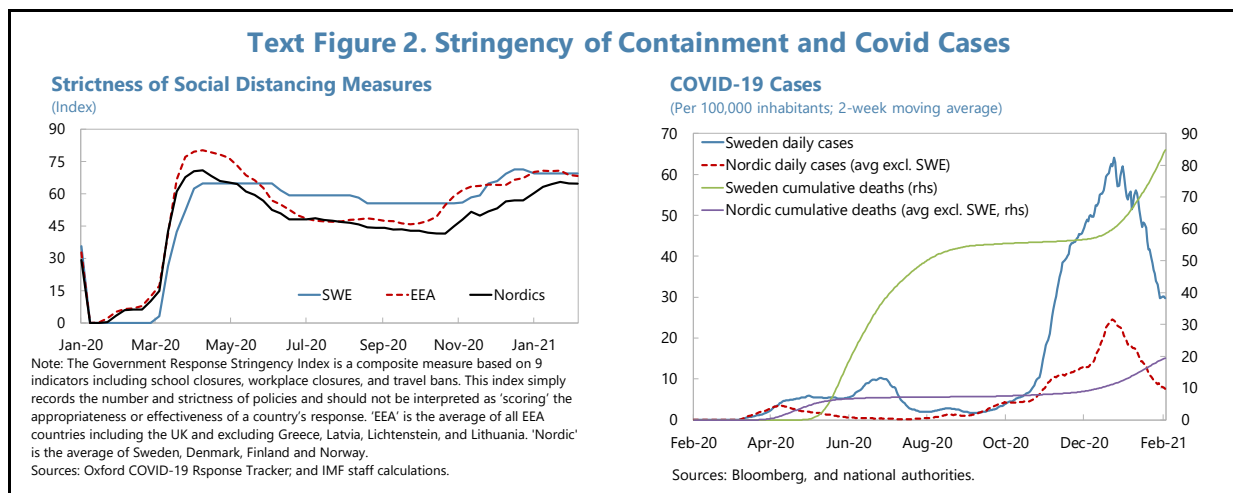
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CONTEXT AND RECENT ECONOMIC DEVELOPMENTS

1. Sweden entered the crisis with substantial buffers despite subdued growth and some lingering vulnerabilities. In 2019, growth decelerated to 1.3 percent, while the current account (CA) surplus increased to 4.6 percent of GDP as exports remained strong while import growth was constrained by weak investment and consumption. Unemployment edged up to 6.8 percent, and inflation was slightly below the 2 percent target. However, prudent fiscal policy kept public debt on a downward trend (35 percent of GDP (Annex I)). This, together with the earlier tightening of macroprudential policies and a well-capitalized financial sector positioned the economy well to deal with the Covid-induced economic crisis despite some financial vulnerabilities related to relatively high household debt and exposure to commercial real estate (CRE).

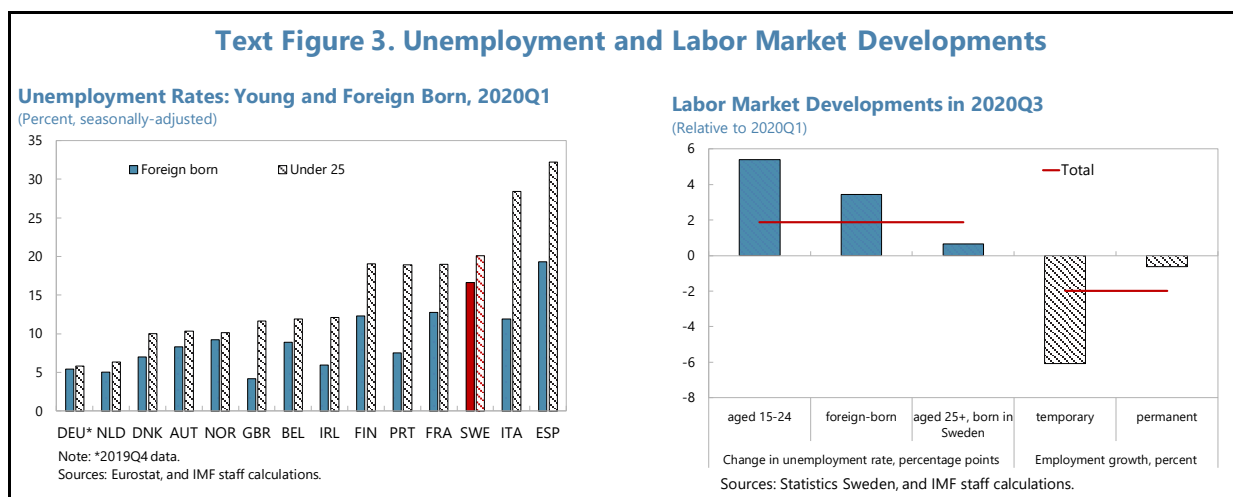


2. Economic growth contracted significantly in 2020, but the fallout was smaller than in peers. This was in part a result of a large and swift macroeconomic policy response (Annex II), but also structural features, including a high share of jobs that can be performed from home, a small hospitality sector, and buoyant pharmaceutical and machinery exports. As a result, the estimated fall in 2020 output of about 3 percent is significantly less than the EU’s average. Sweden’s initial less stringent containment strategy seems to have altered the timing of the economic fallout, which was intensified towards the middle of the year.



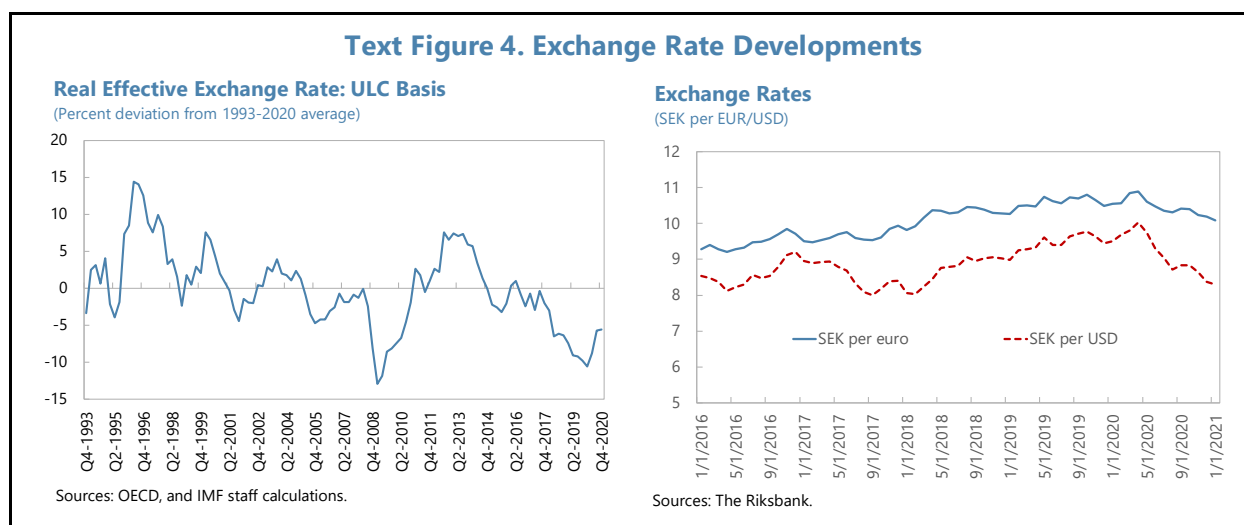
3. Sweden’s infection and mortality rates have been somewhat above the EU average, but much higher than in its Nordic peers. Initially Sweden relied more on recommendations rather than legally binding social distancing and other containment measures, such as broad lockdowns with compulsory stay-at-home orders. The strategy was based on the country’s tradition of social responsibility and a relatively high share of single-person households (Bricco, Misch, and Solovyeva, 2020).¹ More recently, in response to increasing infections in the second wave, the containment strategy has been tightened in line with, or even more stringently than in, Nordic peers. The vaccination rollout has so far been slower than expected, but in line with its pace in the EU.

4. The crisis highlighted long-standing inequities in the labor market. The increase in Sweden’s unemployment was larger than in peers suffering from a deeper recession. This was partly driven by the relatively smaller decrease in Sweden’s high participation rate. There was, however, a sharp decline in temporary employment, which is more common in the hospitality sector. The rising unemployment among the youth and foreign-born, who are more likely to have temporary contracts, compounded their already high level of unemployment prior to the crisis.



¹ J. Bricco, F. Misch and A. Solovyeva, 2020, “What are the Economic Effects of Pandemic Containment Policies? Evidence from Sweden,” IMF Working Paper No. 191 (Washington: International Monetary Fund).

5. Sweden’s external position remained stronger than what would be implied by medium-term fundamentals and desirable policies (Annex II). Although the krona appreciated by almost 5 percent in real effective terms in 2020, it remains undervalued by about 5.5 percent against the unit labor cost-based exchange rate estimate. The current account surplus is estimated to have widened further in 2020, albeit slightly. This was mainly driven by lower imports of goods and services and relatively resilient pharmaceutical and manufacturing exports. Reserves remain adequate and broadly stable. The exchange rate continues to float freely.²



OUTLOOK AND RISKS

6. While the short-term outlook is subject to risks, Sweden has substantial fiscal space for additional support if needed. Current projections suggest that it will take until early 2022 to reach the pre-pandemic output level. This baseline assumes wide vaccination by the end of the summer of 2021. Inflation will remain subdued, in part because of [the industry wage agreement](#), which sets the benchmark for annual wage growth over 2020–22 at 1.8 percent. The recovery could be impeded in the near term if the vaccination rollout remains slow or mutations of the virus turn out more difficult to control (Annex III). While averting a financial crisis, expansionary policies could be contributing to a buildup in real estate and other vulnerabilities, especially in the context of upcoming structural shifts. Furthermore, the extent of corporate vulnerabilities will become clearer as the support measures are eventually withdrawn. Over the medium-term, the outlook will depend on success in facilitating structural transformation and addressing sector-specific impediments to inclusive growth such as the dysfunctional housing market and high unemployment among the youth and foreign-born. Progress on structural reforms has been limited thus far, not least due to the complex process of building political consensus in the context of a coalition government (Annex IV).

² The Riksbank recently announced that it will gradually replace reserves that are borrowed through the National Debt Office with direct purchases. As the purchases are part of one pre-announced program, subject to low monthly limits, and will be spread over about two years in order to not have an impact on the FX market or exchange rate, they will not affect Sweden’s exchange rate classification.

Authorities' Views

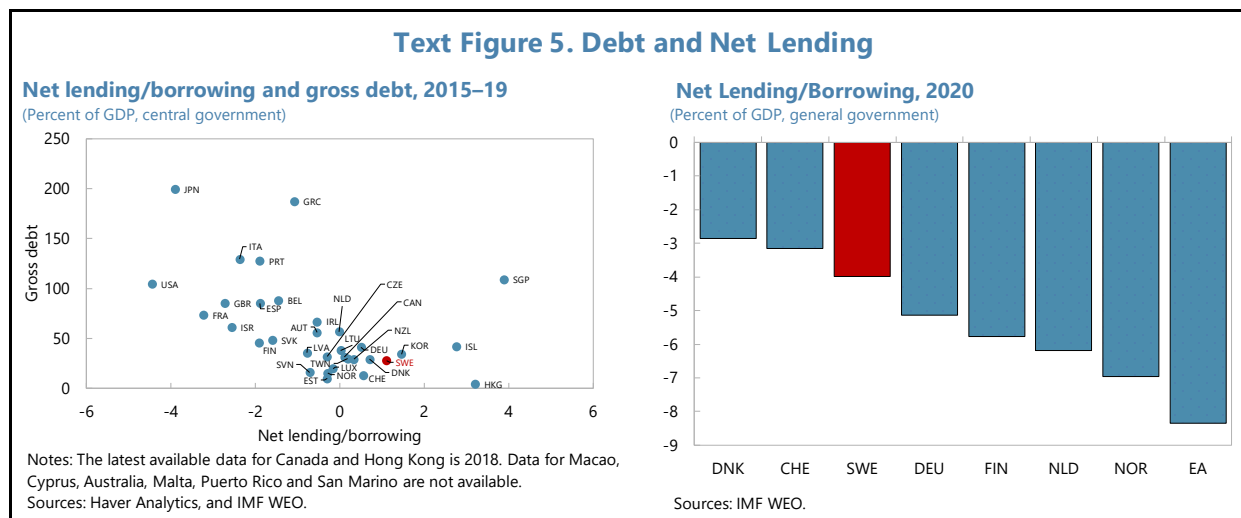
7. The authorities have broadly similar views on risks to the outlook. Some, however, put lesser weight than staff on the downside risks as they believe that the vaccination rollout will accelerate. The health authorities' goal is to have offered vaccine to the entire adult population and risk groups by end-June. They concur that an increase in bankruptcies is a risk as measures are withdrawn, and that the outlook for CRE is uncertain with some downside risks. They believe that the extension of the support measures would help mitigate short-term pressures.

POLICY DISCUSSIONS

As the crisis unfolded, Sweden provided timely and broad support to individuals and firms, thereby mitigating income and liquidity shortfalls (Annex V). The eventual withdrawal of assistance should be gradual, coordinated, and well-communicated to strike a balance between short-term considerations and minimizing medium-term economic scarring by facilitating transformation and avoiding prolonged support of non-viable businesses. In view of the substantial fiscal space, the policy mix should focus on fiscal support, but the Riksbank should stand ready to complement the fiscal measures as needed. The 2021 fiscal stance is adequate. However, there is scope for additional support if the recovery or inflation expectations falter, and for recalibration of the support measures to further facilitate structural transformation. Avoiding a premature return to the surplus target, combined with identifying additional growth-enhancing expenditure and implementing structural reforms over the medium term, would help boost green and inclusive growth.

A. Fiscal Policy

8. Sweden entered the crisis with a very strong fiscal position and continues to have substantial fiscal space to support the recovery. In response to the pandemic, the overall balance was appropriately allowed to swiftly shift from a small surplus in 2019 to a projected deficit of about 4 percent of GDP in 2020. Abstracting from automatic stabilizers, discretionary and below-the-line measures to support the health system, households, and businesses each amounted to around 4 percent of GDP, broadly in line with peers. The 2021 deficit is projected to decline slightly. Staff assesses this stance as appropriate given the emerging recovery but advised the authorities to err on the side of caution and be ready to promptly deploy additional measures should growth falter. Public debt is very low compared to other advanced economies. It is projected to peak at about 40 percent of GDP in 2021 before converging back to around 35 percent over the medium term (Annex I).



Text Table 1. Fiscal Measures in 2020

Measures (percent of GDP)	Budget	Estimate
Short-term layoffs	1.9	0.9
Reduced employers' social security contributions	0.7	0.7
General government grants	0.4	0.4
Sick pay responsibility	0.3	0.4
Reorientation support	0.8	0.3
Security and transition support	0.3	0.3
Health related	0.4	0.8
Other	0.4	0.5
Total	5.2	4.2
Below the line		
Tax deferrals (max amount)	6.8	0.9
Guarantees for SME loans	2.0	0.0
Export guarantees	2.5	2.3
Other guarantees	0.5	0.3
Capital reinforcement	0.2	0.2
Total (below the line)	12.1	3.7

Sources: Ministry of Finance, and IMF Staff calculations.

Sources: Ministry of Finance, and IMF staff calculations.

Text Table 2. Budget Bill 2021

Original	SEK bn	% GDP
Tax cuts	30	0.6
o/w to households	14	0.3
Aid to local governments	28	0.5
o/w health related	14	0.3
Unemployment & labor market	12	0.2
Green Investments	9	0.2
Public Investments	5	0.1
Other	21	0.4
Amendments (estimates)		
Short-term layoffs	18	0.4
Turnover/revenue support	16	0.3
Additional health care resources	13	0.3
Other	1	0.0
Total	155	3.0
Sources: Ministry of Finance, and IMF staff calculations.		

9. The crisis measures have been effective, but there is room for improving their design.

The short-term work scheme, which is the largest above-the-line measure, was introduced promptly and benefitted a large number of workers. Staff welcomed its extension, along with other crisis support measures, through June 2021. However, staff also noted that this scheme is less flexible than in peers as working hours cannot be reduced to zero and labor costs have to be cut to qualify for support, thereby incentivizing dismissal of temporary employees, making it less effective in avoiding a large fall in temporary employment. Staff recommended a recalibration of the underlying criteria to avoid unintended side-effects. Staff also called for considering introducing a labor retraining requirement to qualify for this measure and to redesign the “reorientation support” measure, which covers companies fixed cost but does not incentivize companies to adapt to changes in the new environment. Sweden has a strong track record of transparency in public financial management. The authorities follow a stringent budget process and several entities monitor fiscal policy and its execution.

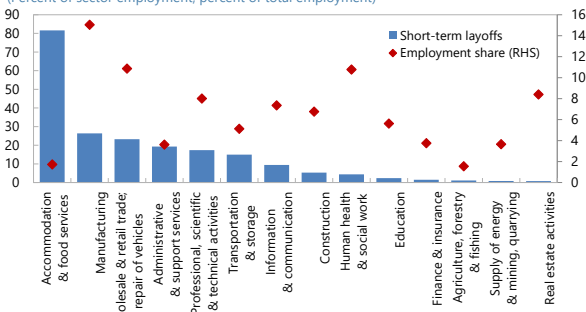
10. A premature return to the fiscal surplus target should be avoided. Sweden’s recently revamped fiscal framework sets an average surplus of 0.33 percent over the cycle and anchors debt at 35 percent of GDP, while allowing for deviations in exceptional times and requiring a review every eight years. Staff welcomed the authorities resolve to exercise this flexibility in response to the crisis. Going forward, staff recommended (i) a return to the surplus target be considered only over the medium term in order to support the recovery and minimize scarring; and (ii) identification of additional growth-enhancing expenditure, in particular public investment, to meet the health (on a municipal level), demographic, and vocational training challenges. The target of 0.33 percent of GDP is ½ a percentage point higher than the debt-stabilizing fiscal balance and, therefore, implies a continuous reduction in the debt ratio. This further highlights that there is fiscal space that can be used without compromising sustainability. Reaching Sweden’s ambitious climate goals also requires additional investments in biofuel production, hydrogen power plants, and the electric vehicle grid,

which are part of the authorities' green recovery (Box 1). On the revenue side, further reducing the still high labor tax wedge would help increase employment, including among the less skilled. As the recovery takes hold, a gradual increase in property taxes from their extremely low level would help finance part of the above spending and make the housing market more dynamic (paragraph 24).

Figure 1. Selected Indicators

Sweden: Short-term Layoffs and Employment Share by Sector

(Percent of sector employment; percent of total employment)



Notes: Layoffs data as of July 15, 2020. This chart only includes the largest 14 sectors by 2019 employment.

Sources: Swedish Agency for Economic, and Regional Growth and Eurostat.

Compensation under Short-term Work Schemes

(Percent of original full-time salary; maximum reduction of working hours)

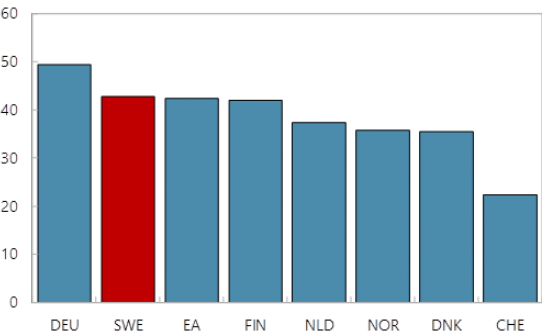


Notes: In Sweden, the maximum reduction is 80 percent contrary to peers where employers can reduce the hours worked by 100 percent.

Sources: ECB Economic Bulletin (Issue 4/2020), and IMF staff compilation.

Tax Wedge, 2019

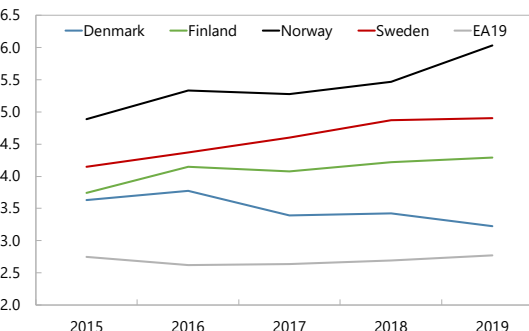
(Percent of labor cost)



Sources: OECD.

Public Investment, 2015 - 2019

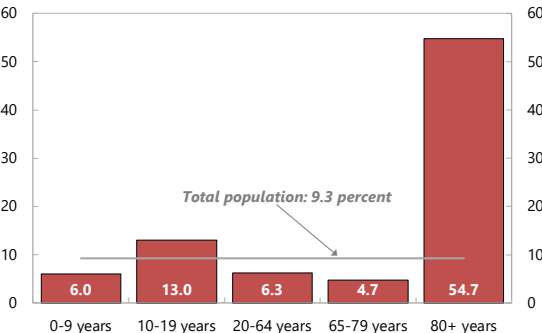
(Percent of GDP)



Source: OECD.

Population Growth from 2018 to 2030, by Age Cohort

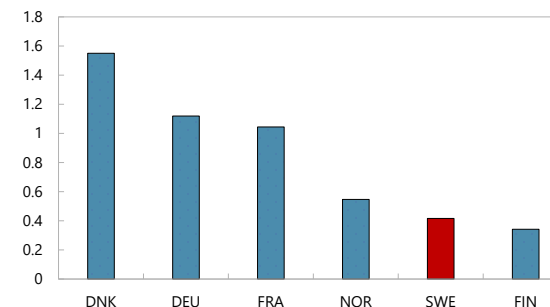
(Percent)



Sources: Statistics Sweden; and Ministry of Finance.

Short- and Medium Term Green Spending Announcements as of 2020

(announced in 2020, excl. public transportation, in percent of 2020 GDP)



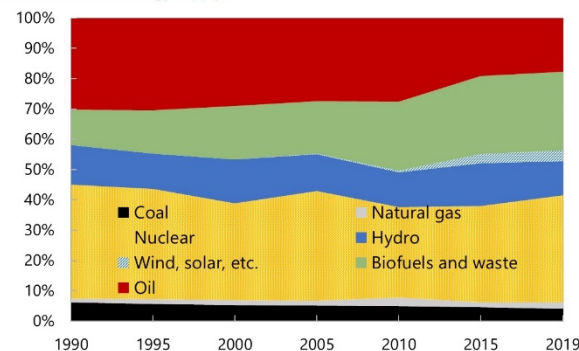
Note: The period over which the announced spending will be allocated varies across countries: DNK 2020-26; DEU 2020-21; FRA 2020-23; NOR 2020-31; SWE 2021-23; FIN 2021.

Sources: National authorities, CarbonBrief, Swedbank; and IMF staff calculations.

Box 1. Progress on Climate Change and Need for Investments

In many respects Sweden is leading the way to a low-carbon economy with some of the most ambitious climate targets. Sweden aims to reduce transport emissions by 70 percent from 2010 to 2030, generate electricity consisting of 100 percent renewables by 2040, and become a net-zero carbon economy by 2045. It was one of the first countries to implement a carbon tax in 1991 and currently imposes it at about USD 140 per ton, which is the highest in the world. As a result, Sweden has one of the lowest CO₂ emissions per capita and a low share of fossil fuels in its energy supply. Electricity use per capita is one of the highest in the world and its generation is practically decarbonized due to large access to hydro, nuclear, and, in recent years, wind power.¹

Sweden: Total Energy Supply by Source, 1990-2019
(Percent of total energy supply)



Sources: IEA World Energy Balances 2020.

Sweden is on track to meet its EU greenhouse gas (GHG) emission reduction target. It is expected to meet the EU GHG reduction target of 50 percent by 2030. It also tops the [Climate Change Performance Index](#) which “evaluates and compares the climate protection performance of 57 countries and the EU” across four categories: GHG Emission, Renewable Energy, Energy Use, and Climate Policy. Sweden ranks high across all categories except energy use, as energy-intensity remains high.

However, additional efforts are necessary to achieve Sweden’s own ambitious objectives. According to the [Swedish Climate Policy Council](#), the annual rate of reductions is below what is required to meet its own targets. The Council recommends a new road traffic tax, stronger incentives for electrifications, reduction of emissions from agriculture, and incentivizing the purchase of zero-emission goods and services. The reduction in emissions in the transport sector by 2030 will also require additional investments in biofuel production, hydrogen power plants, and the electric vehicle grid. The IEA sees that a switch to 100 percent renewable electricity generation requires additional support and suggest analyzing generation adequacy, system resilience, and cost-effectiveness of electricity supply. Infrastructure investments for climate change adaptation could also be larger than expected. Recent [staff analysis](#)² suggests that investment needs for climate adaptation are large relative to peers, including in coastal protection as well as in upgrading and retrofitting exposed assets.

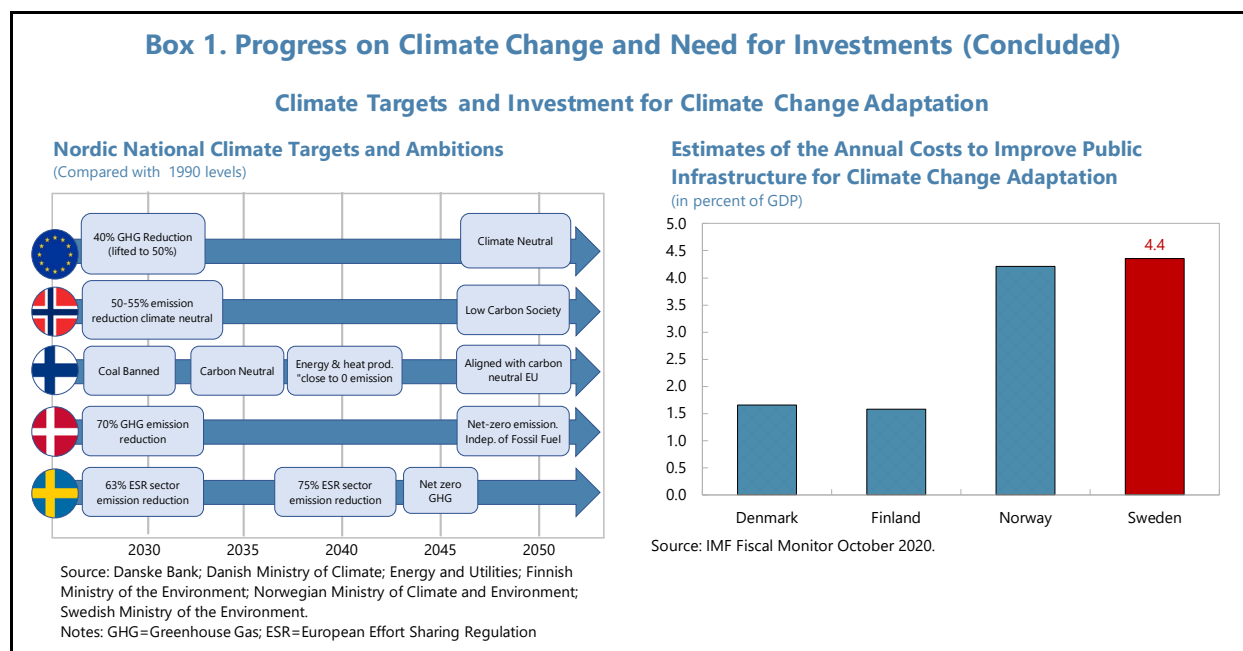
The government is supporting a green recovery, both directly and indirectly, by incentivizing investments by the private sector. The 2021 budget sets aside investments in energy efficiency, the transportation sector, natural area protection, and climate emission reduction of about 0.2 percent of GDP.³ This is in addition to public investments in this area that were announced in previous budgets. The government also believes that the private sector is well-positioned to spearhead climate investments and emission reductions. To support this, the authorities have implemented two initiatives for climate investments: The Climate Leap (2015) and the Industry Leap (2018). Both initiatives are co-funding programs that encourage investments and innovation in emission reductions. The former has been extended to 2026 and is important for the local transport sector helping fund investments in electric vehicles infrastructure and biogas. The latter is expected to run till 2040 and supports the development of technology and energy-efficient processes in the industry sector and research institutions.⁴

¹ International Energy Agency (IEA): [Energy Policies of IEA Countries: Sweden 2019 Review](#).

² IMF Fiscal Monitor: Policies for the Recovery, 2020.

³ [The Budget Bill for 2021](#).

⁴ [Sweden’s long-term strategy for reducing greenhouse gas emissions \(2020\)](#).



Authorities' Views

11. The authorities are determined to balance the support for the recovery and their commitment to fiscal prudence. Given the fiscal space, they stand ready to continue to support the recovery as needed. While Sweden has already high levels of public investment, there is room to meet higher ambitions but only through well-vetted projects. The authorities also highlighted the recent *green investment grants* to support qualifying private investment (Box 1). With respect to crisis support measures, they noted that their initial design was motivated by incentivizing cost-reduction and focusing on preserving matches of firm-specific human capital. The newly unemployed were supported through social benefits and unemployment insurance, which was increased. The authorities noted that the economic fallout was less than expected and bank lending held up, which reduced the take-up of various measures, including the credit guarantee scheme, well below their budgeted envelop.

B. Monetary Policy

12. The Riksbank's swift monetary policy measures have helped stabilize markets. In particular, the Riksbank (i) reduced the overnight lending rate by 65 basis points; (ii) provided liquidity, including through a funding-for-lending facility and weekly market operations at longer maturities at the repo rate; (iii) steadily increased its asset purchases; (iv) offered USD loans to counterparties as a backstop; and (v) expanded swap agreements with key central banks.

13. Further monetary policy easing may be increasingly less effective than fiscal stimulus in lifting aggregate demand and inflation. Liquidity shortages seem to have been alleviated and weak demand and solvency issues are now becoming more important. Government bonds are scarce and private sector securities represent a much larger share in the Riksbank's asset purchases compared to peers. While the large purchases of private sector bonds helped stabilize markets during the crisis, over time they could increase financial vulnerabilities by reducing risk premia and encouraging risk

taking. Furthermore, their growing size could increase balance sheet risks for the central bank. Forward guidance suggests that the repo rate will likely remain at the same level over the medium term (following its increase to zero in January 2020). Although long-term inflation expectations remain slightly below the 2 percent target, the Riksbank has not ruled out a return to a negative repo rate. Staff welcomed the above measures and the Riksbank's readiness to take further action in case the fiscal stimulus turns out insufficient to support demand and inflation expectations. Staff, however, emphasized that fiscal policy should be in the lead in supporting the fledgling recovery given the substantial fiscal space and the size of the current account surplus.

14. Any amendments to the Riksbank Act should preserve its operational independence. The proposed changes to the Act could introduce legal uncertainties that would potentially limit the Riksbank's ability to quickly deploy a broad range of instruments to support the economy and the financial sector in future crises as it did in response to the Covid crisis; and to lend in foreign currencies, which is essential to support the banking sector's foreign currency exposure in times of crisis.³ Staff emphasized that any changes to the Act should be in line with international best practices.

15. The Riksbank is at the forefront of exploring central bank digital currency. Currently, it is testing a conceptual architecture in the context of an "e-krona pilot," based on decentralized ledger technology. The network in the e-krona pilot is private and fully controlled by the Riksbank. The pilot project will help design an e-krona proposal that maximizes the benefits while minimizing risks, including for financial intermediation and cybercrime (Box 2).

Authorities' Views

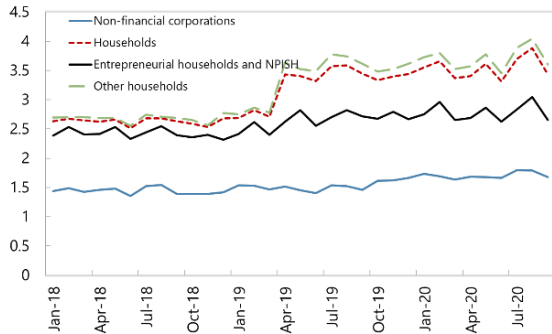
16. The authorities shared staff's views on the limitations of monetary policy and on the associated risks. The Riksbank highlighted that its early and decisive actions were essential to avert a financial crisis and moderate the recession. However, loosening of financial conditions and expanding asset purchases can inherently contribute to a buildup of financial vulnerabilities. It continues to monitor and manage such vulnerabilities, but the risks and vulnerabilities that the support measures can build up in the longer term are subordinate to the need to combat the immediate economic consequences of the pandemic. The Riksbank, therefore, stands ready to take further action as needed to support the recovery and inflation expectations. The timing for phasing out the support measures, and how quickly this occurs, must be chosen with considerable care. The Riksbank also emphasized that any changes to its Act should not impede its operational independence and ability to conduct a full range of monetary policy operations to meet its mandate and enable it to intervene promptly and effectively in future crises.

³ For more details see: ["Sweden: IMF Technical Assistance Report-Proposed Amendments to the Riksbank Act", 2020.](#)

Figure 2. Selected Monetary Policy Indicators

MFI Lending Rates

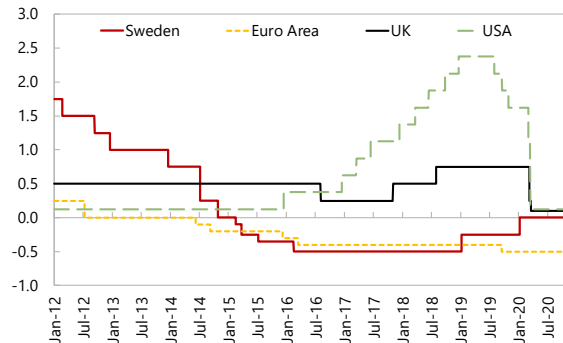
(Percent)



Sources: Statistics Sweden.

Policy Rates

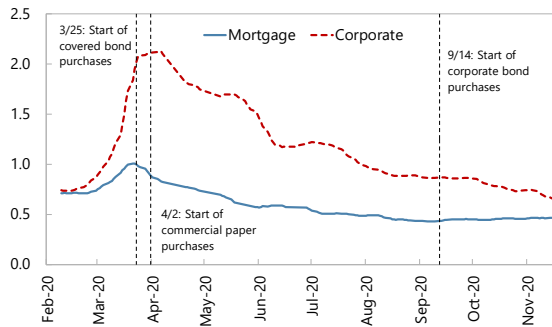
(Percent)



Sources: National authorities.

Bond Yield Spreads

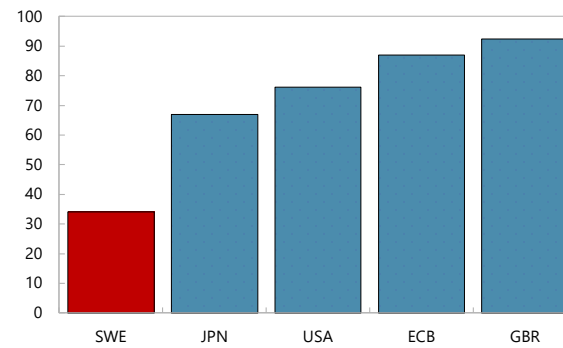
(Percentage points; relative to 5-year government bond)



Notes: 7-day rolling averages
Sources: Haver, Riksbank, and IMF staff calculations.

Purchases of Public Sector Bonds

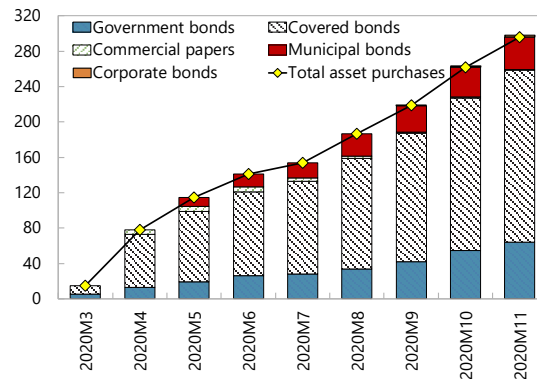
(Percent of total net cumulative asset purchases since February 2020)



Notes: As of November 2020 or latest data available.
Sources: ECB, national central banks, IMF staff calculations and estimates.

Asset Purchases since Covid

(Billions of SEK)



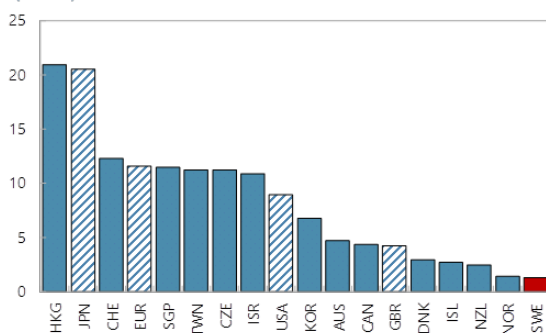
Sources: Riksbank, and IMF staff estimates.

Box 2. Sweden's E-krona Project

The Riksbank has embarked on the e-krona project in 2017 amid a further rapid decline in cash usage. From already low levels in percent of GDP, cash circulating in Sweden has almost halved over the last five years, diverging from trends in some comparator economies. The underlying reasons include the rise of Swish, a popular mobile payment system, refusal to accept cash by some businesses, and implicit incentives for the private sector to phase out cash usage.

Cash-to-GDP Ratio, 2020Q3

(Percent)

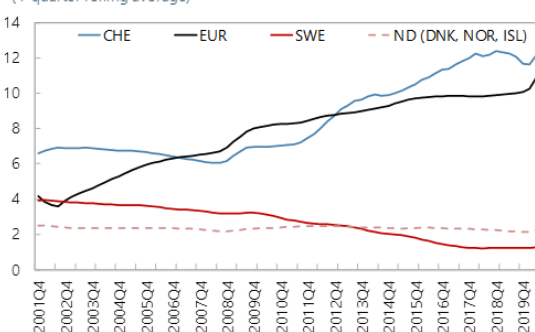


Sources: Haver and Central Banks.

Notes: Currencies used for JPN, EUR, USA and GBR are reserve currencies.

Cash-to-GDP Ratio

(4-quarter rolling average)



Sources: Haver and Central Banks.

Notes: Currencies used for EUR are reserve currencies.

With a proof-of-concept currently underway, the Riksbank remains at the forefront of exploring central bank digital currency. The e-krona pilot aims to test a possible conceptual architecture, but issuance of e-krona would likely occur after a few years.

The Riksbank sees merit in the e-krona for several reasons. These include (i) enhanced crisis preparedness and resilience in a scenario where cash is not used and privately-owned payment systems are disrupted; (ii) promotion of competition and innovation in payments markets which are prone to monopolistic behavior; and (iii) safeguarding against substitution of the krona by global stablecoins.

The Riksbank has committed to three broad and important principles that will guide the design of the e-krona (BIS, 2020). These include that the e-krona will: (i) not compromise monetary or financial stability; (ii) coexist with, and complement, existing forms of money; and (iii) promote innovation and efficiency.

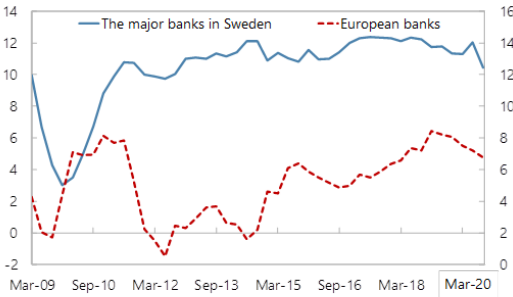
The exact design of the e-krona has not been determined yet. However, the above principles will help define its technical, legal, and economic aspects. In particular, remuneration and caps on holdings are being considered as means to help prevent bank disintermediation.

C. Financial Sector and Macprudential Policies

17. Sweden's financial sector has weathered the crisis well, not least due to the strong support measures. Banks entered the crisis with higher profitability than in European peers and strong capital and liquidity positions that exceed regulatory minima. These positions have worsened only slightly since the beginning of the crisis. After some turbulence at the onset, corporate bond markets stabilized, not least as a result of timely support measures.

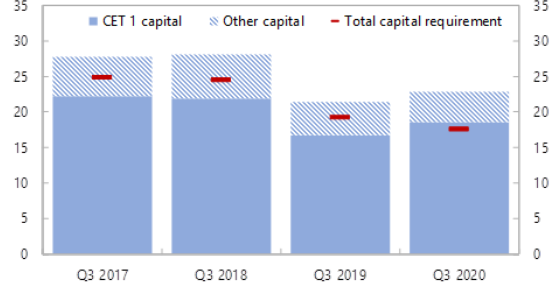
Text Figure 6. Selected Banking Indicators

Return on Equity 1/
(Rolling four quarters, percent)



1/ Calculated over a sample of European banks. Adjusted for nonrecurring items. Source: Riksbank.

Regulatory Capital 1/
(Percent of risk-weighted assets)

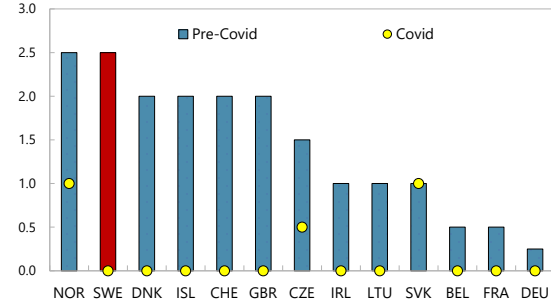


1/ Simple average for SEB, Swedbank, and Handelsbanken. Sources: Finansinspektionen, and Fund staff calculations.

Figure 3. Selected Banking and Corporate Sector Indicators

Cuts in Countercyclical Capital Buffer Rates in 2020

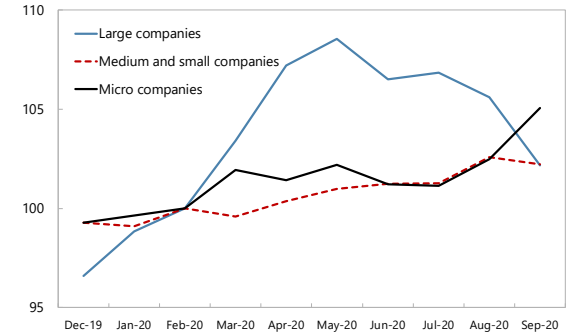
(Percentage points)



Note: The data include cancellation of previously-announced increases in the buffer. For Switzerland, change in the sectoral CCyB targeted at mortgage loans financing residential property is shown. Sources: European Systemic Risk Board, and IMF Staff calculations.

Bank Lending to Swedish Companies

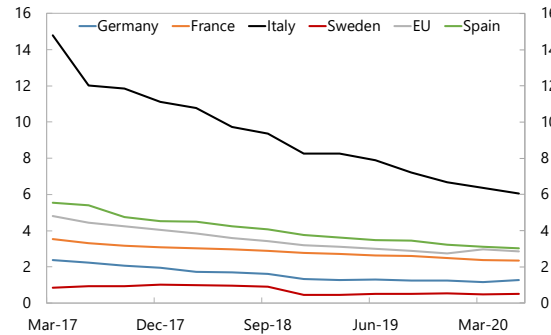
(Outstanding bank loans, Index February 2020=100)



Sources: Riksbank, and Statistics Sweden.

Non-Performing Loans

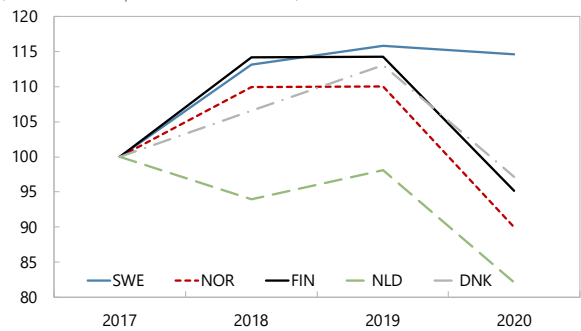
(Percent of total lending)



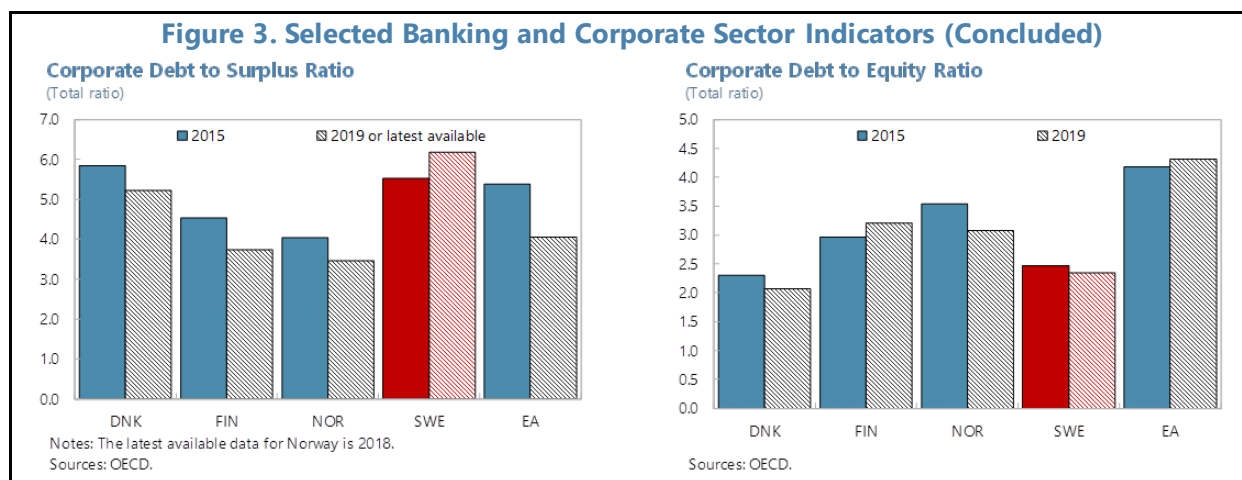
Source: EBA.

Total Bankruptcies, 2020

(Number of enterprises; Index 2017 = 100)

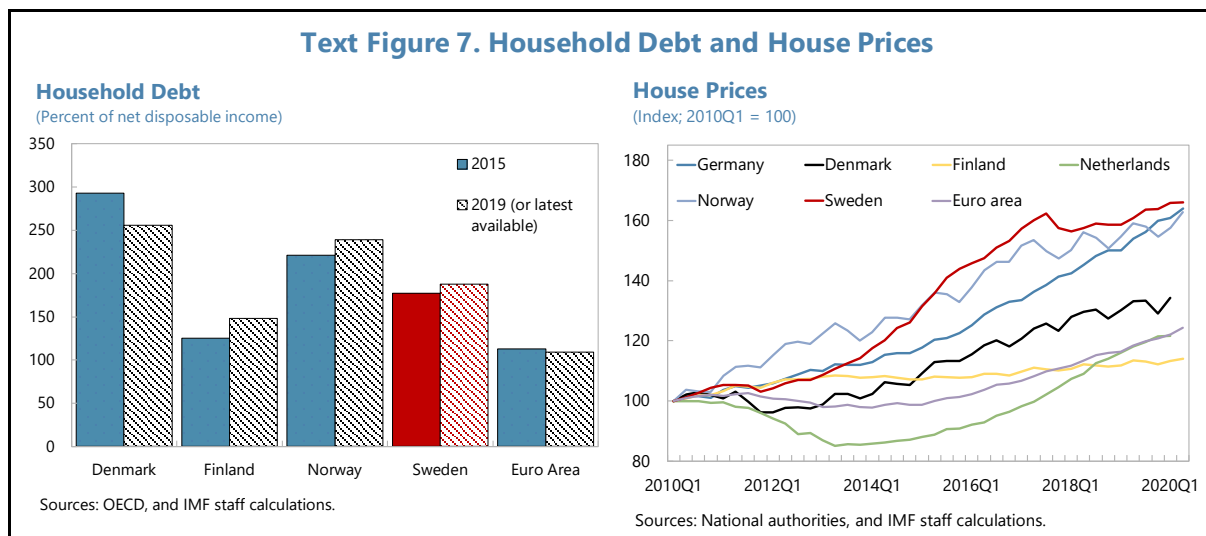


Note: Enterprises include corporates and sole proprietorships. Sources: National authorities, and IMF staff calculations.

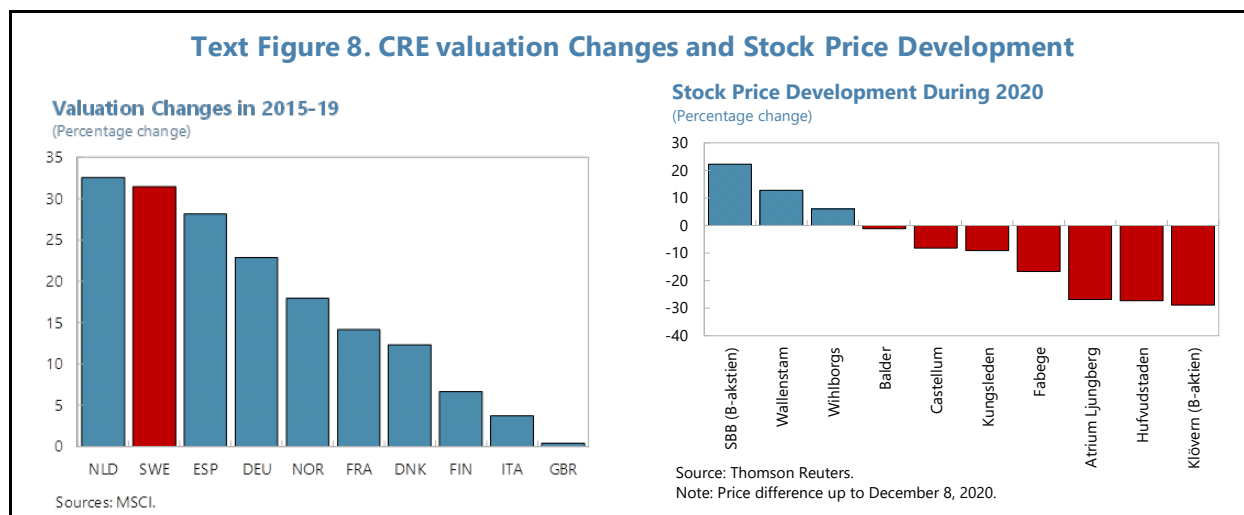


18. Timely regulatory policy measures by Finansinspektionen (FI) have helped lending to recover since the onset of the crisis. These included a full release of the counter-cyclical capital buffer, authorization of temporary breaches of the liquidity coverage ratios, and recommendation that banks postpone dividend payments. The economy appears to be no longer constrained by insufficient liquidity. Bank lending to larger companies has declined, reflecting higher bond issuance. While lending to smaller and medium-sized firms has been more restrained, it has been increasing and the possibility of tax deferrals may have helped provide liquidity to these firms as well. The temporary suspension of the amortization requirements has helped provide liquidity to households, although its widespread use could imply insufficient targeting. NPLs remain low, in part reflecting lags, the large share of mortgages in the banks' loan portfolios, and only slightly-above-average bankruptcies, mostly among relatively small firms. Loan provisioning by major banks has increased. This signals that bankruptcies could increase if support is withdrawn prematurely and highlights the need for close monitoring of corporate vulnerabilities. Staff stress tests suggest that banks can withstand most shocks, including those propagated by the regional interconnectedness of the financial sector.

19. As in many countries, residential housing prices continued to strengthen, potentially raising some risks. Easing of macroprudential regulation and monetary policy, coupled with fiscal support and likely changes in housing preferences, have contributed to rising demand. Although the 2020 price increase was higher than in most countries, it was relatively mild compared to the experience over the past decade. Recent stress tests suggest that most households have sufficient buffers to service their debt in case of income loss or mortgage rate increases, and the loan-to-value ratio is quite low (at below 70 percent). However, with continued price increases, a slow recovery, and the recent acceleration of consumer credit, the number of highly indebted borrowers could increase. Staff advised that more comprehensive data collection on households' balance sheets would help improve monitoring these risks and welcomed the recently launched government inquiry on household balance sheet statistics.



20. Monitoring risks in the CRE sector should also be enhanced. Banks’ exposure to the sector and the sector’s overall debt level are high.⁴ Stock performance of listed CRE companies has been weak. While the share of CRE companies’ non-bank debt has increased, thereby diversifying risks, [stress tests](#) show that this elevates refinancing risks. So far, vulnerabilities have been mitigated by the sector’s healthy pre-crisis balance sheets, pre-crisis [regulatory measures](#), and the crisis response measures. However, the crisis-induced recession, as well as accelerated shifts to e-commerce, teleworking, and less travel, could result in dwindling revenue streams. Staff therefore recommended to further enhance the comprehensiveness and periodicity of CRE data (e.g. on rents, vacancies, and transaction prices) and to integrate multisource data into a single database.



21. The amendments of the AML/CFT framework, its enforcement, and related regional cooperation are all welcome. In 2020, FI levied record fines against two banks with inadequate controls. It should continue to refine its implementation of risk-based supervision. The Riksbank

⁴ Seven major banks’ exposure to CRE firms constituted approximately 44 per cent of their total exposures to non-financial firms in 2019. The sector’s debt is about 26 percent of GDP.

coordinated a request to the Fund to conduct analysis of cross-border AML/CFT issues in the Nordic-Baltic region, beginning in 2021.

Authorities' Views

22. The authorities broadly concurred with staff's assessment. Work is ongoing on strengthening the resilience of the corporate bond market, including through improving transparency of price and volume of transactions. The recent industry agreement on new reporting standards, facilitated by the supervisory authority, will go beyond the scope of existing EU rules. On balance, CRE and household risks have somewhat decreased since the beginning of the pandemic as the recovery ensued. However, the authorities agreed that withdrawing the temporary measures should be gradual. The upcoming expiration of the exemptions from the amortization requirement will bring some tightening. While banks' balance sheets are fairly strong, the FI will endorse full flexibility on dividend payments only after the economic situation stabilizes. The authorities acknowledged that yearly and somewhat partial data are not ideal for assessing immediate pressures in CRE markets, while at the same time recognizing the limitations to the availability of higher frequency and relevant data in times of crisis. They are working towards improving the assessments, including through the FI's annual survey, and also by endeavoring to account for all (non-bank) debt exposures of CRE corporations in stress scenarios. With time, more frequent (monthly and quarterly) data are expected to become available on loans and collateral. If risks do not subside, the FI could take further measures to strengthen banks' resilience to risks related to exposure to CRE. For households there is only partial data on balance sheets with data on loans and assets within the same bank, but no available data collection on individual asset holdings, which inhibits a complete risk analysis of household balance sheet risk profiles. There is an ongoing government inquiry on whether such data should be produced and in what format.

D. Structural Policies

23. Efforts should continue to improve employment prospects for the youth and foreign-born. It is encouraging that the 2021 Budget Bill included higher spending on employment training schemes. This may help address labor shortages in specific occupations. Furthermore, when reviewing employment protection arrangements, social partners should seek to facilitate fair labor market entry by, and retention of, the low-skilled and foreign-born, for example by revisiting the requirement that downsizing should start with retrenching those who have a shorter tenure. While the restructuring of the Public Employment Service is underway, it would be important to ensure timely provision of well-designed active labor market programs to prevent short-term unemployment becoming entrenched. It would also be important that the new job matching system, which is being contracted out to the private sector, ensures that vulnerable groups are not left behind. An *intensive year* training program for new asylum seekers is planned to start in 2021, and the "[entry agreement](#)" is expected to help enhance employment prospects of the newly arrived foreign-born. These initiatives also aim at preserving the gender balance, in which Sweden is a global leader (Box 3).

24. Reforms are imperative to address market distortions and shortages of affordable housing.

Housing shortages hinder labor mobility and contribute to inequities. There has not been much progress in implementing the housing market objectives set in the 2019 January Coalition Agreement and [past staff recommendations](#)⁵ (Annex IV). Rent controls and extremely low real estate taxes impede an efficient allocation of the existing housing stock by reducing the cost to households of retaining prime or large real estate beyond their needs. Complex and divergent building codes contribute to high construction costs, and thus reduce the supply of affordable housing. Staff advised to phase out the above impediments to market operation, while providing social protection in a more efficient way, including through expanding the housing allowance. In this regard, the ongoing public inquiries aimed at presenting proposals to improve the functioning of the rental market are welcome.

25. Enhancing the bankruptcy framework would help facilitate structural transformation.

The number of bankruptcies increased in 2020 but have moderated recently. However, insolvencies could be lagging due to support measures and the relatively lengthy and costly process. In this context, the bankruptcy framework could be made more efficient by following the recommendations by the [OECD](#), including streamlining procedures, reducing barriers to restructuring, and lowering costs. Further progress in transposing of the EU Directive on [Preventive Restructuring Frameworks](#) would also be helpful.

Box 3. Female Participation and Gender Equality in Sweden

Often considered a gender equality role model, Sweden has made even further progress since 1994 when it put in place an important strategy for reaching gender equality.

- At 73.6 percent (2020:Q3), Sweden has achieved one of the highest female employment rates in the OECD. However, 17.3 percent of women work part-time vs. 10.5 percent of men (2019).
- Registry data show that the unemployment rate for females is lower than for males, but that more progress is needed to reduce the unemployment of foreign-born women.
- Sweden scores the full 100 points on the Women, Business and the Law index 2020, indicating that women have equal economic rights as men.
- Women play an important role in policy making. The number of women in the national government is close to 60 percent of total, and 12 of the 22 cabinet ministers are women.
- Nearly half of the 349-member parliament are women.

Stakeholders' Views**26. The authorities and other stakeholders agreed with the identified long-standing structural challenges of the Swedish economy.**

Efforts to better integrate the marginalized groups into the labor market were recognized by labor union representatives, who also called for more spending on ALMP and better targeting of training. Some stakeholders expressed a view that political constraints make a comprehensive housing sector reform, including of rent regulation, unlikely over the near term. With regard to the bankruptcy framework, the authorities are mindful of a potential wave of bankruptcies and the needed changes to improve the resolution framework. They plan to

⁵ Sweden: 2019 Article IV Consultation Staff Report.

complete the transposition of the EU directive in the summer. Finally, the government expects to meet the 2030 carbon reduction target despite large biofuel needs. The authorities believe they can import the necessary quantities and alluded to potential investment in a domestic biofuel refinery. Many investments for climate adaptation are carried out and paid for by the municipalities to a large extent.

STAFF APPRAISAL

27. Sweden's economy fared the crisis better than many of its European neighbors, not least due to substantial buffers and generally strong fundamentals. The authorities' large support package was timely and adequate. The package provided ample support to households and businesses, helped avert a financial crisis, and stabilize markets. As a result, the 2020 fall in output is projected at around 3 percent, which is less than the EU average. However, the increase in unemployment, especially of the young and foreign-born, was larger than in countries that suffered a deeper recession. While the recovery is expected to start this year, uncertainties have recently increased regarding the new strains of the virus and the rollout of vaccination. It is therefore appropriate that most of the crisis measures were extended to June 2021.

28. Fiscal policy should continue to support the economy and lead the recovery. It is important to not prematurely return to the surplus target. As the recovery takes hold, the eventual withdrawal of the support measures should be cautiously gradual in order to minimize scarring. Furthermore, there is room for increasing public expenditure, including on green outlays, over the medium term to enhance growth and achieve Sweden's ambitious climate and inclusion objectives. At the same time, it is desirable to review the design of the support measures, not least to facilitate structural transformation. In particular, the short-term work scheme could be redesigned to be more flexible and more supportive for temporary workers.

29. Monetary policy should stand ready to further assist the recovery if needed, but its effectiveness may be diminishing. The monetary policy stance has been appropriate and the expansion of the Riksbank's asset purchase program contributed importantly to supporting the economy and stabilizing key markets. Inevitably such necessary operations can contribute to a buildup in vulnerabilities due to reduced risk pricing. As liquidity constraints seem to have been alleviated, the policy mix should focus on fiscal support, while the Riksbank should stand ready to complement fiscal measures as needed. Any amendments to the Riksbank law should preserve its operational independence and ability to quickly deploy a broad range of instruments in future crises. The e-krona pilot project will help design a central bank currency proposal in a way that maximizes the benefits while minimizing risks, including for financial intermediation and cybercrime. The amendments to the anti-money laundering framework and its enforcement are also welcome.

30. Financial vulnerabilities require continued vigilance and enhanced data collection. Banks' exposures to the CRE sector and high household debt call for better data collection to enhance monitoring and guide possible further strengthening of prudential regulations, especially for CRE. A prolonged recession, as well as accelerated shifts to e-commerce, teleworking, and less travel, could result in dwindling revenue streams of CRE companies with high exposure to sectors affected

by the crisis. Close monitoring of corporate vulnerabilities and bond markets is also necessary to preserve financial stability.

31. It is imperative to address Sweden’s long-term structural challenges and market distortions, including to tackle the limited employment prospects for the foreign-born and youth, shortages in affordable housing, and demographic shifts. It is encouraging that the 2021 Budget Bill contained higher spending on training and education, lower social security contributions for the youth, as well as initiatives geared towards the foreign-born, especially women. A further reduction of the high labor tax wedge is also desirable. The overly regulated rental market, with its long queues, favors existing tenants. Introducing a simpler market-based system, that is complemented with adequate housing allowances, would be more transparent and effective in meeting both the economic and social objectives. In addition, streamlining the complex local regulations would help increase supply and competition in the construction sector, thus driving down costs. Comprehensive reforms, including gradually increasing property taxes from their extremely low level, would make the housing market more dynamic. Such reforms would help improve efficiency and equity, and facilitate labor mobility.

32. It is proposed that the next Article IV consultation with Sweden take place on the standard 12-month cycle.

Proposed Decision

The Executive Board endorses the thrust of the staff appraisal in the report for the 2021 Article IV consultation with Sweden (SM/21/24, 03/04/21).

It is expected that the next Article IV consultation with Sweden will take place on the standard 12-month cycle.

Table 1. Sweden: Selected Economic Indicators, 2018–26

	2018	2019	Est. 2020	Projections					
				2021	2022	2023	2024	2025	2026
Real economy (percent change)									
Real GDP	2.0	1.3	-3.0	3.3	2.9	2.4	2.1	2.0	2.0
Domestic demand	1.7	0.2	-3.2	3.0	2.9	2.8	2.3	2.1	2.1
Private consumption	1.8	1.3	-4.8	3.2	3.3	2.3	2.2	2.0	2.0
Public consumption	0.8	0.3	0.2	2.7	1.5	1.3	1.3	1.0	1.0
Gross fixed investment	1.4	-1.2	-1.4	3.0	3.5	3.2	3.2	3.1	3.1
Net exports (contribution to growth)	0.3	1.1	0.1	0.4	0.1	-0.3	-0.2	0.0	0.0
Exports of G&S	4.2	3.6	-5.6	5.4	4.1	3.0	2.9	2.7	2.7
Imports of G&S	3.8	1.2	-6.2	4.9	4.2	3.8	3.4	2.9	2.9
HICP inflation (e.o.p)	2.2	1.7	0.4	0.7	1.2	1.6	1.8	1.9	1.9
HICP core inflation (e.o.p)	1.3	1.8	1.3	1.3	1.3	1.4	1.6	1.7	1.9
Unemployment rate (percent)	6.3	6.8	8.3	8.7	8.4	7.7	7.2	7.2	7.2
Gross national saving (percent of GDP)	28.6	29.7	30.4	29.7	30.0	30.4	30.5	30.7	30.8
Gross domestic investment (percent of GDP)	26.0	25.1	25.4	25.2	25.7	26.5	27.1	27.4	27.8
Output gap (percent of potential)	2.5	2.2	-1.4	-0.8	-0.6	-0.4	-0.2	0.0	0.0
Public finance (percent of GDP)									
Total revenues	49.6	48.8	49.1	48.4	48.8	49.2	49.3	49.4	49.4
Total expenditures	48.8	48.3	53.1	52.2	50.6	49.3	49.2	49.0	49.1
Net acquisition of nonfinancial assets	1.6	1.7	1.8	2.0	1.9	1.8	1.5	1.5	1.4
Net lending	0.8	0.5	-4.0	-3.9	-1.8	-0.2	0.1	0.3	0.3
Structural balance (as a percent of potential GDP)	0.0	-0.4	-3.4	-3.5	-1.5	0.0	0.2	0.3	0.3
General government gross debt, official statistics	38.9	35.1	38.6	40.7	40.7	39.3	37.8	36.1	34.4
Money and credit (year-on-year, percent change, eop)									
M3	5.9	7.9	17.8	...	...	...	...	...	...
Bank lending to households	5.3	5.0	5.5	...	...	...	...	...	...
Interest rates (percent, end of period)									
Repo rate	-0.5	-0.25	0.0	...	...	...	...	...	...
Ten-year government bond yield	0.5	0.1	0.0	...	...	...	...	...	...
Mortgage lending rate	1.5	1.5	1.4	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account	2.6	4.6	5.0	4.5	4.3	3.9	3.4	3.2	3.0
Foreign direct investment, net	2.5	0.7	1.4	1.7	1.7	1.7	1.3	1.1	1.0
International reserves, changes (in billions of US dollars)	-0.3	-6.6	3.0	...	...	...	...	...	...
Reserves coverage (months of imports of goods and services)	3.0	2.8	3.3	...	...	...	...	...	...
Net international investment position	8.6	18.4	23.3	27.7	32.0	35.8	39.2	42.4	45.4
Exchange rate (period average, unless otherwise stated)									
SEK per euro	10.3	10.5	10.2	...	...	...	...	...	...
SEK per U.S. dollar	8.7	9.5	8.4	...	...	...	...	...	...
Nominal effective rate (2010=100)	92.8	89.2	90.8	...	...	...	...	...	...
Real effective rate (2010=100) 1/	93.4	88.7	93.5	...	...	...	...	...	...

Other Indicators

GDP per capita (2019, USD): 51,434; Population (2019, million): 10.3.

Key export markets: Germany, Norway, United Kingdom.

Sources: IMF WEO, Riksbank, Swedish Ministry of Finance, Statistics Sweden, and IMF Staff calculations.

1/ Based on relative unit labor costs in manufacturing.

Table 2. Sweden: General Government Statement of Operations, 2018–26

	2018	2019	Est.	Projections					
			2020	2021	2022	2023	2024	2025	2026
Billions of SEK									
Revenue	2,395	2,451	2,422	2,492	2,624	2,750	2,864	2,983	3,105
Tax revenue	1,974	2,012	1,942	1,987	2,079	2,164	2,240	2,317	2,397
Taxes on income, profits, and capital gains	878	886	882	888	944	997	1,044	1,094	1,146
Payable by individuals	733	736	750	753	799	843	882	924	966
Payable by corporations	145	150	131	135	145	154	162	171	180
General taxes on goods and services	610	627	623	638	656	672	686	700	714
Other Taxes	485	499	437	462	479	495	509	523	538
Social Contributions	165	172	172	176	184	191	198	205	212
Grants	6	6	6	6	6	6	6	6	6
Other revenue	249	261	303	323	355	389	421	455	490
Interest income	24	24	24	25	26	27	28	29	30
Expenditure	2,355	2,426	2,619	2,691	2,719	2,760	2,859	2,962	3,084
Compensation of employees	614	635	647	672	693	704	733	760	792
Intermediate consumption	331	341	343	361	387	393	410	425	443
Interest payments	25	19	18	16	31	32	33	34	36
Social benefits	781	797	826	847	919	934	973	1,009	1,051
Expense not elsewhere classified	526	548	695	690	586	596	620	644	671
Net acquisition of nonfinancial assets	79	85	90	105	102	102	90	90	90
Gross operating balance	119	111	-107	-94	8	92	95	111	112
Net lending / borrowing	40	26	-197	-199	-94	-9	5	21	22
Percent of GDP									
Revenue	49.6	48.8	49.1	48.4	48.8	49.2	49.3	49.4	49.4
Tax revenue	40.9	40.1	39.3	38.6	38.7	38.7	38.5	38.3	38.2
Taxes on income, profits, and capital gains	18.2	17.6	17.9	17.2	17.6	17.8	18.0	18.1	18.2
Payable by individuals	15.2	14.6	15.2	14.6	14.9	15.1	15.2	15.3	15.4
Payable by corporations	3.0	3.0	2.7	2.6	2.7	2.7	2.8	2.8	2.9
General taxes on goods and services	12.6	12.5	12.6	12.4	12.2	12.0	11.8	11.6	11.4
Other Taxes	10.1	9.9	8.9	9.0	8.9	8.9	8.8	8.7	8.6
Social Contributions	3.4	3.4	3.5	3.4	3.4	3.4	3.4	3.4	3.4
Grants	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other revenue	5.2	5.2	6.1	6.3	6.6	7.0	7.2	7.5	7.8
Interest income	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Expenditure	48.8	48.3	53.1	52.2	50.6	49.3	49.2	49.0	49.1
Compensation of employees	12.7	12.6	13.1	13.0	12.9	12.6	12.6	12.6	12.6
Intermediate consumption	6.9	6.8	6.9	7.0	7.2	7.0	7.1	7.0	7.1
Interest payments	0.5	0.4	0.4	0.3	0.6	0.6	0.6	0.6	0.6
Social benefits	16.2	15.9	16.7	16.4	17.1	16.7	16.7	16.7	16.7
Expense not elsewhere classified	10.9	10.9	14.1	13.4	10.9	10.6	10.7	10.6	10.7
Net acquisition of nonfinancial assets	1.6	1.7	1.8	2.0	1.9	1.8	1.5	1.5	1.4
Gross operating balance	2.5	2.2	-2.2	-1.8	0.1	1.7	1.6	1.8	1.8
Net lending / borrowing	0.8	0.5	-4.0	-3.9	-1.8	-0.2	0.1	0.3	0.3
Structural Balance (percent of potential GDP) 1/	0.0	-0.4	-3.4	-3.5	-1.5	0.0	0.2	0.3	0.3
Fiscal Impulse (expansionary +)	0.8	0.3	3.0	0.1	-2.0	-1.5	-0.2	-0.2	0.0
<i>Memorandum items:</i>									
Gross public debt (percent of GDP)	38.9	35.1	38.6	40.7	40.7	39.3	37.8	36.1	34.4
Net public debt (percent of GDP)	6.0	3.5	6.5	9.9	11.2	10.9	10.4	9.8	9.1
Real GDP growth (percent change)	2.0	1.3	-3.0	3.3	2.9	2.4	2.1	2.0	2.0
Output gap (percent of potential GDP)	2.5	2.2	-1.4	-0.8	-0.6	-0.4	-0.2	0.0	0.0
Nominal GDP (in billions of SEK)	4,828	5,024	4,936	5,151	5,372	5,593	5,812	6,043	6,283

Sources: The 2021 Budget Bill, and IMF Staff calculations.

1/ Structural balance takes into account output gaps.

Table 3. Sweden: Public Sector Balance Sheet, 2010–19

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
<i>Billions of SEK</i>										
Assets	5,691	5,970	6,146	6,472	6,943	7,101	7,596	8,038	8,411	8,910
Financial assets	2,509	2,674	2,795	2,953	3,325	3,409	3,672	3,906	4,030	4,240
Currency and deposits	67	101	98	92	174	159	168	189	178	166
Debt securities	330	333	343	343	442	451	491	597	555	553
Loans	486	515	541	664	727	779	814	811	859	826
Shares and other equity	1,245	1,375	1,445	1,485	1,600	1,565	1,727	1,829	1,869	2,111
Other financial assets	382	349	368	369	382	456	472	480	568	583
Capital stock net of depreciation	3,182	3,297	3,351	3,519	3,618	3,692	3,925	4,132	4,381	4,671
Liabilities	1,921	2,024	2,071	2,229	2,612	2,679	2,754	2,794	2,861	2,814
Financial liabilities	1,921	2,024	2,071	2,229	2,612	2,679	2,754	2,794	2,861	2,814
Currency and deposits	58	69	75	56	59	51	73	69	74	69
Debt securities	1,096	1,114	1,116	1,216	1,430	1,492	1,450	1,373	1,334	1,201
Loans	272	327	315	342	446	437	480	554	563	593
Other liabilities	495	515	564	614	677	700	752	798	889	952
Net worth	3,770	3,946	4,075	4,244	4,332	4,422	4,842	5,245	5,550	6,096
Financial net worth	588	650	724	724	714	730	917	1,112	1,169	1,425
<i>Percent of GDP</i>										
Assets	159.3	160.2	164.2	169.3	173.9	166.7	172.1	173.8	174.2	177.3
Financial assets	70.2	71.7	74.7	77.2	83.3	80.0	83.2	84.5	83.5	84.4
Currency and deposits	1.9	2.7	2.6	2.4	4.4	3.7	3.8	4.1	3.7	3.3
Debt securities	9.2	8.9	9.2	9.0	11.1	10.6	11.1	12.9	11.5	11.0
Loans	13.6	13.8	14.5	17.4	18.2	18.3	18.4	17.5	17.8	16.4
Shares and other equity	34.8	36.9	38.6	38.9	40.1	36.7	39.1	39.6	38.7	42.0
Other financial assets	10.7	9.4	9.8	9.6	9.6	10.7	10.7	10.4	11.8	11.6
Capital stock net of depreciation	89.1	88.4	89.5	92.1	90.6	86.7	88.9	89.3	90.7	93.0
Liabilities	53.8	54.3	55.3	58.3	65.4	62.9	62.4	60.4	59.2	56.0
Financial liabilities	53.8	54.3	55.3	58.3	65.4	62.9	62.4	60.4	59.2	56.0
Currency and deposits	1.6	1.8	2.0	1.5	1.5	1.2	1.7	1.5	1.5	1.4
Debt securities	30.7	29.9	29.8	31.8	35.8	35.0	32.8	29.7	27.6	23.9
Loans	7.6	8.8	8.4	9.0	11.2	10.3	10.9	12.0	11.7	11.8
Other liabilities	13.9	13.8	15.1	16.1	17.0	16.4	17.0	17.3	18.4	19.0
Net worth	105.5	105.9	108.9	111.0	108.5	103.8	109.7	113.4	115.0	121.3
Financial net worth	16.4	17.4	19.3	18.9	17.9	17.1	20.8	24.0	24.2	28.4
<i>Memorandum items:</i>										
GDP (SEK billions)	3,574	3,728	3,743	3,823	3,993	4,260	4,415	4,625	4,828	5,024

Sources: Eurostat, Statistics Sweden, and IMF Staff calculations.

Table 4. Sweden: Balance of Payments Accounts, 2018–26

	2018	2019	Est. 2020	Projections					
				2021	2022	2023	2024	2025	2026
Billions of SEK									
Current Account Balance	127	229	245	231	231	216	198	195	191
Trade Balance	111	178	181	218	217	202	183	179	175
Exports of G&S	2,210	2,380	2,251	2,352	2,463	2,545	2,619	2,690	2,761
Imports of G&S	2,099	2,202	2,070	2,134	2,245	2,343	2,436	2,510	2,586
Factor income, net	17	51	64	13	14	14	15	15	16
Financial Account Balance	68	195	246	232	232	217	199	196	193
Investment Abroad 1/	-1,346	-868	-495	-660	-809	-909	-944	-1,016	-1,090
Investment in Sweden	1,417	1,125	741	892	1,041	1,125	1,143	1,212	1,283
Reserves, change	-3	-62	25	0	0	0	0	0	0
Percent of GDP									
Current Account Balance	2.6	4.6	5.0	4.5	4.3	3.9	3.4	3.2	3.0
Trade Balance	2.3	3.6	3.7	4.2	4.0	3.6	3.2	3.0	2.8
Exports of G&S	45.8	47.4	45.6	45.7	45.8	45.5	45.1	44.5	43.9
Imports of G&S	43.5	43.8	41.9	41.4	41.8	41.9	41.9	41.5	41.2
Factor income, net	0.3	1.0	1.3	0.3	0.3	0.3	0.3	0.3	0.3
Financial Account Balance	1.4	3.9	5.0	4.5	4.3	3.9	3.4	3.2	3.1
Investment Abroad 1/	-27.9	-17.3	-10.0	-12.8	-15.1	-16.2	-16.2	-16.8	-17.3
Direct Investment	3.2	2.9	4.3	4.3	4.1	3.8	3.5	3.5	3.3
Portfolio Investment	-1.0	1.7	3.4	3.1	2.7	2.6	2.4	2.3	2.4
Other Investment	2.4	-2.2	3.3	1.6	1.0	0.9	1.6	1.3	0.6
Reserves, change	-0.1	-1.2	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Investment in Sweden	29.4	22.4	15.0	17.3	19.4	20.1	19.7	20.1	20.4
Direct Investment	0.8	2.2	2.9	2.6	2.4	2.1	2.2	2.4	2.4
Portfolio Investment	0.8	-0.4	1.4	1.2	0.8	1.2	0.0	-0.6	-1.1
Other Investment	2.5	-3.8	0.8	0.2	-0.3	-1.0	-0.2	-0.1	-0.2
Errors and Omissions	-1.3	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
<i>Memorandum</i>									
Exports of G&S Value 2/	7.2	-1.0	-2.9	17.6	5.8	4.5	4.0	3.7	3.7
Imports of G&S Value 2/	8.6	-3.6	-3.4	16.0	6.4	5.5	5.0	4.1	4.1
Net International Investment Position (Percent of GDP)	8.6	18.4	23.3	27.7	32.0	35.8	39.2	42.4	45.4
Nominal GDP (SEK billion)	4,828	5,024	4,936	5,151	5,372	5,593	5,812	6,043	6,283

Sources: Statistics Sweden, and IMF 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. Financial Soundness Indicators, 2015–20

	2015	2016	2017	2018	2019	2020Q3
Capital Adequacy						
Regulatory Capital to Risk-Weighted Assets	24.2	26.9	26.4	21.6	22.8	22.8
Regulatory Tier 1 Capital to Risk-Weighted Assets	21.2	23.2	23.4	18.8	20.4	20.4
Total Capital to Total Assets	5.6	6.1	6.1	6.1	5.6	5.7
Asset quality and exposure						
Non-performing Loans to Total Gross Loans 1/	1.2	1.1	1.1	0.5	0.6	0.5
Non-performing Loans Net of Provisions to Capital	7.0	8.7	10.1	4.0	4.5	3.6
Earnings and profitability						
Return on Assets	0.8	0.9	0.9	1.0	0.9	0.5
Return on Equity	14.9	17.6	16.1	18.9	16.3	9.0
Non-interest Expenses to Gross Income, percent	49.1	47.5	53.3	49.4	51.5	56.6
Personnel Expenses as Percent of Noninterest Expenses	...	50.6	50.8	49.3	47.9	46.8
Liquidity						
Liquid Assets to Total Assets (Liquid Asset Ratio)	9.8	16.8	17.2	16.9	17.3	23.7
Liquid Assets to Short Term Liabilities	140.3	29.6	28.2	26.4	26.2	34.4
Customer Deposits as Percent of Total (non-interbank) Loans	...	44.0	44.0	41.2	42.5	44.6
Memorandum items						
Change in Housing Price Index (in percent, year average)	10.8	8.5	8.2	0.3	2.2	1.6
Total Household Debt (in percent of GDP)	84.5	85.7	87.4	87.9	88.6	93.2
Total Household Debt (in percent of disposable income)	177.6	183.0	188.1	189.2	188.0	194.6
Household Interest Expenses (in percent of disposable income)	4.1	3.8	3.7	3.7	3.7	4.1
Gross Debt of Non-financial Corporations (in percent of GDP)	176.8	168.9	170.7	180.6	191.0	...
Sources: ECB, IMF Financial Soundness Indicators, Statistics Sweden and OECD.						

Annex I. Debt Sustainability Analysis

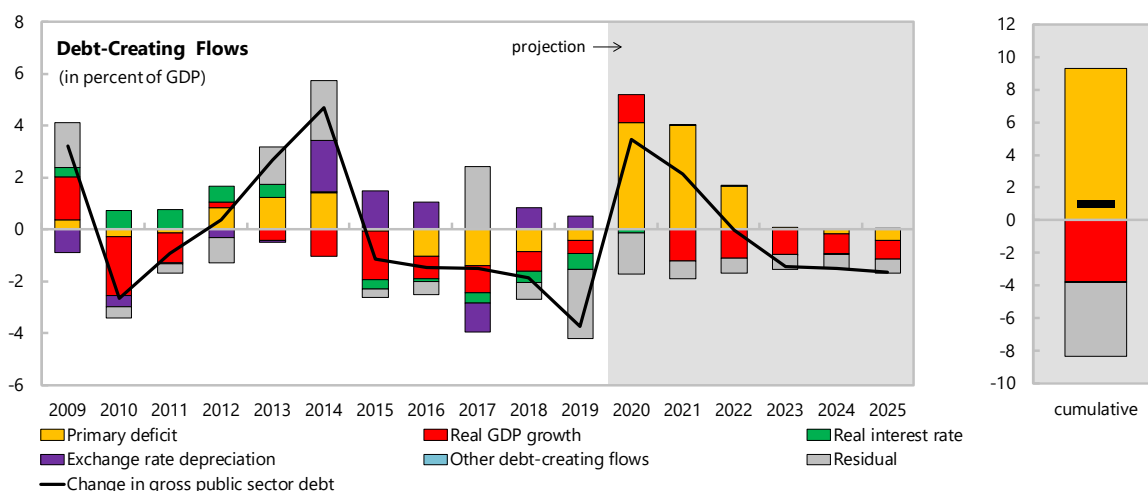
Sweden: Public Sector Debt Sustainability Assessment (DSA)—Baseline Scenario (In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of December 02, 2020		
	2009-2017 ^{2/}	2018	2019	2020	2021	2022	2023	2024	2025			
Nominal gross public debt	40.6	38.9	35.1	38.6	40.7	40.7	39.3	37.8	36.1	Sovereign Spreads		
Public gross financing needs	9.6	5.7	8.0	12.6	12.8	9.6	7.1	6.2	8.6	SEK bond (bps) ^{3/} 59		
Real GDP growth (in percent)	1.9	2.0	1.3	-3.0	3.3	2.9	2.4	2.1	2.0	5Y CDS (bps) 12		
Inflation (GDP deflator, in percent)	1.5	2.4	2.7	1.3	1.0	1.4	1.6	1.8	1.9	Ratings	Foreign	Local
Nominal GDP growth (in percent)	3.5	4.4	4.1	-1.8	4.4	4.3	4.1	3.9	4.0	Moody's	Aaa	Aaa
Effective interest rate (in percent) ^{4/}	2.2	1.3	1.0	0.8	1.1	1.4	1.6	1.8	2.1	S&Ps	AAA	AAA
										Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing primary balance ^{9/}
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025		
Change in gross public sector debt	0.4	-1.9	-3.7	3.5	2.1	0.0	-1.4	-1.5	-1.7	1.0	
Identified debt-creating flows	-0.2	-1.2	-1.0	5.0	2.8	0.5	-0.9	-1.0	-1.1	5.4	
Primary deficit	0.1	-0.8	-0.4	4.1	4.0	1.7	0.1	-0.2	-0.4	9.3	
Primary (noninterest) revenue and grants	48.4	49.1	48.3	48.6	47.9	48.4	48.7	48.8	48.9	291.2	
Primary (noninterest) expenditure	48.5	48.3	47.9	52.7	51.9	50.0	48.8	48.6	48.4	300.5	
Automatic debt dynamics ^{5/}	-0.3	-0.4	-0.6	0.9	-1.2	-1.1	-1.0	-0.8	-0.7	-3.8	
Interest rate/growth differential ^{6/}	-0.5	-1.2	-1.1	0.9	-1.2	-1.1	-1.0	-0.8	-0.7	-3.8	
Of which: real interest rate	0.2	-0.4	-0.6	-0.1	0.0	0.0	0.0	0.0	0.0	-0.1	
Of which: real GDP growth	-0.8	-0.8	-0.5	1.1	-1.2	-1.1	-1.0	-0.8	-0.7	-3.7	
Exchange rate depreciation ^{7/}	0.2	0.8	0.5	...	...	...	...	...	...	...
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	
Residual, including asset changes ^{8/}	0.6	-0.6	-2.7	-1.6	-0.7	-0.6	-0.6	-0.5	-0.5	-4.5	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)] / (1+g+\pi+g\pi)$ 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.

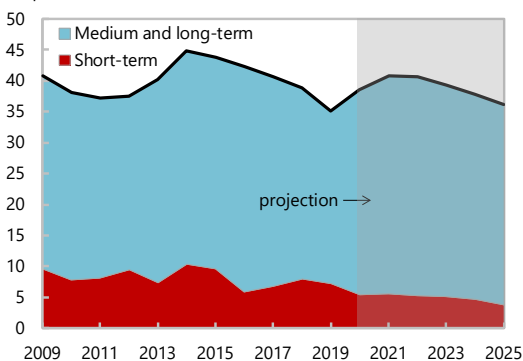
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Sweden: Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

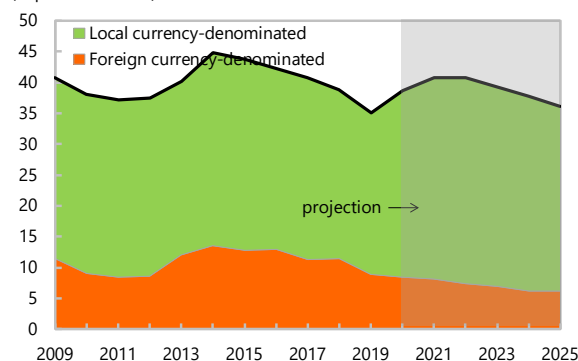
By Maturity

(in percent of GDP)

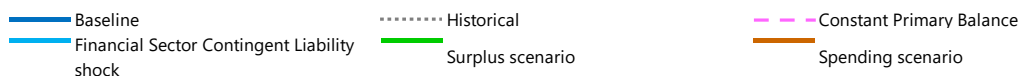


By Currency

(in percent of GDP)

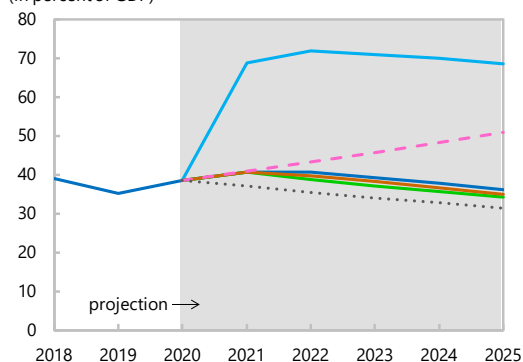


Alternative Scenarios



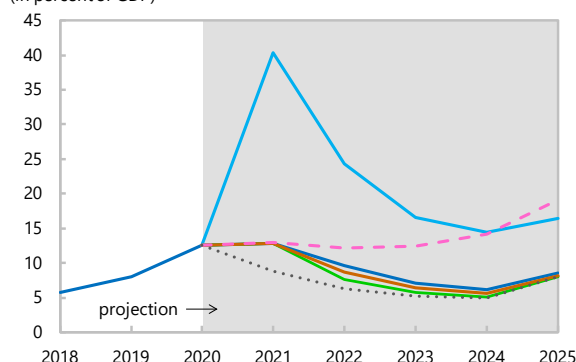
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.0	3.3	2.9	2.4	2.1	2.0
Inflation	1.3	1.0	1.4	1.6	1.8	1.9
Primary Balance	-4.1	-4.0	-1.7	-0.1	0.2	0.4
Effective interest rate	0.8	1.1	1.4	1.6	1.8	2.1
Constant Primary Balance Scenario						
Real GDP growth	-3.0	3.3	2.9	2.4	2.1	2.0
Inflation	1.3	1.0	1.4	1.6	1.8	1.9
Primary Balance	-4.1	-4.1	-4.1	-4.1	-4.1	-4.1
Effective interest rate	0.8	1.1	1.4	1.6	1.7	1.8
Surplus scenario						
Real GDP growth	-3.0	3.3	2.9	2.4	2.1	2.0
Inflation	1.3	1.0	1.4	1.6	1.8	1.9
Primary Balance	-4.1	-4.0	0.3	0.3	0.3	0.3
Effective interest rate	0.8	1.1	1.5	1.8	2.1	2.4

Historical Scenario	2020	2021	2022	2023	2024	2025
Real GDP growth	-3.0	2.5	2.5	2.5	2.5	2.5
Inflation	1.3	1.0	1.4	1.6	1.8	1.9
Primary Balance	-4.1	0.1	0.1	0.1	0.1	0.1
Effective interest rate	0.8	1.1	1.6	1.9	2.1	2.4
Financial Sector Contingent Liability Shock 1/						
Real GDP growth	-3.0	1.5	1.1	2.4	2.1	2.0
Inflation	1.3	0.6	0.9	1.6	1.8	1.9
Primary Balance	-4.1	-31.3	-1.7	-0.1	0.2	0.4
Effective interest rate	0.8	1.3	5.0	3.4	3.5	3.6
Spending scenario						
Real GDP growth	-3.0	3.3	3.1	2.5	2.0	1.9
Inflation	1.3	1.0	1.4	1.6	1.8	1.9
Primary Balance	-4.1	-4.0	-0.8	0.1	0.3	0.6
Effective interest rate	0.8	1.1	1.5	1.8	2.0	2.3

1/ Assumes fiscal costs equivalent to 10 percent of banking sector assets in a single year.

Source: IMF staff.

Annex II. External Sector Assessment

<p>Overall Assessment: <i>On a preliminary basis, and adjusting for transitory factors, recent developments suggest that the external position in 2020 was stronger than the level implied by medium-term fundamentals and desirable policies. However, this assessment is preliminary pending full-year data for 2020. A complete analysis will be provided in the 2021 External Sector Report.</i></p> <p>Potential Policy Responses: Given the large fiscal buffers, Sweden is in a good position to provide further support to companies and households, if the crisis is protracted. Over the medium term, there is scope for greener and growth-enhancing expenditure to facilitate structural transformation and support domestic demand. The Riksbank has ensured ample liquidity, but further ability to increase aggregate demand may be limited. As the recovery resumes, past imbalances and policy distortions will need to be addressed through reforms that raise potential output and productive investment, decrease unemployment, and reduce household debt levels.</p>							
Foreign Asset and Liability Position and Trajectory	<p>Background. The Swedish net IIP is projected to reach 23.3 percent of GDP in 2020, an increase of 4.9 percentage points in 2020 in line with the positive current account balance. It is expected to rise further in the medium term, reflecting the outlook for continued CA surpluses. However, these projections are subject to uncertainty as Swedish IIP data includes large errors and omissions, which have averaged -2.1 percent of GDP in the past five year.</p> <p>Assessment. Gross liabilities are projected to increase to 273 percent of GDP in 2020, with about a half being gross external debt (137 percent of GDP). Other financial institutions (87 percent of GDP) hold the bulk of net foreign assets followed by Social Security Funds (26 percent of GDP), households (20 percent of GDP), and the Riksbank (12 percent of GDP), while non-financial corporations (60 percent of GDP), monetary financial institution's (51 percent of GDP) and the central government (11 percent of GDP) are net external debtors. Although rollovers of external debt (which include banks' covered bonds) pose some vulnerability, risks are moderated by the banks' ample liquidity and large capital buffers.</p>						
	2020 (% GDP)	NIIP: 23.3	Gross Assets: 295.9	Debt Assets: 95.9	Gross Liab.: 272.6	Debt Liab.: 136.7	
Current Account	<p>Background. Despite the global Covid-19 crisis, the CA has increased to 5.0 percent of GDP in 2020 when compared to 2019 (4.6 percent of GDP) supported by exports of goods (machinery and chemicals) in Q1 and doubling of primary income from investments in Q2. Sweden is a net oil importer with a negative oil balance. Lower domestic demand for external goods and tourism services due to decreased economic activity and mobility have reduced imports in 2020 substantially compared to 2019. In addition, low oil prices have decreased the value of oil imports. The impact from the lower-than-usual imports of oil and tourism services is estimated to have improved the current account surplus by about 1.1 percentage points (see COVID-19 adjustor). The cyclically adjusted fiscal stance, which was not as expansionary as in the rest of the world, may have contributed to the mild increase in the CA as well. Over the medium-term, the current account is projected to return to its long-run average of 3 percent of GDP.</p> <p>Assessment. The cyclically adjusted current account is estimated at 5.6 percent of GDP in 2020, 4.2 percentage points above the cyclically adjusted EBA norm of 1.4 percent of GDP. However, the estimated EBA norm for Sweden has been below the actual CA balance for the past two decades, suggesting that factors not captured by the model, such as Sweden's mandatory contributions to fully-funded pension schemes, demographic dynamics and an older labor force, may also be driving Sweden's savings-investment balances. Overall, taking into account adjustments for oil and tourism imports, which were affected by the Covid crisis, staff assesses Sweden's CA gap at 3.1 percent of GDP in 2020, within a range of \pm 1.5 percent of GDP, reflecting uncertainty around the EBA estimated norm.</p>						
	2020 (% GDP)	Est. CA: 5.0	Cycl. Adj. CA: 5.6	EBA Norm: 1.4	EBA Gap: 4.2	COVID-19 Adj.: -1.1	Other Adj.:	Staff Gap: 3.1
Real Exchange Rate	<p>Background. The Swedish krona appreciated by 5.3 percent in real effective terms (ULC based) in 2020 relative to its average level in 2019, partly reflecting the change in the repo rate from negative to zero effective since the beginning of 2020, financial inflows, and a milder recession than in peers.</p> <p>Assessment. The staff CA gap implies a REER gap of -8.8 percent in 2020 (applying an estimated elasticity of 0.35), with a range between -5.1 to -13.7 percent.¹ The REER index and level models suggests a gap of -18.2 percent and -16.9 percent respectively. The ULC based REER index was 5.5 percent below its 28-year average (since the krona was floated in 1993) in 2020. Because this indicator has fluctuated around a broadly stable level since the currency was floated, it provides a useful indication of valuation that staff prefers. Overall, staff assesses the <i>krona</i> to be undervalued by 3 to 13 percent, with a midpoint of 8 percent as guided by the ULC based REER index. This REER gap may continue to decline once the situation, including monetary policy, normalizes.</p>						
	<p>Capital and Financial Accounts: Flows and Policy Measures</p> <p>Background. Other investments (such as the provision of loans, insurance, pension, trade credits etc.) of about 2.5 percent of GDP constituted half of the financial account in 2020, with portfolio investment outflows (2.0 percent), direct investments (1.4 percent), and derivatives (-1 percent) being the remainder.</p> <p>Assessment. Given their size, interconnectedness, and funding model, Sweden's large banks are vulnerable to liquidity risks stemming from global wholesale markets. However, banks have improved their structural liquidity positions in recent years. Also, the authorities have strengthened regulation by introducing liquidity coverage ratio (LCR) requirements in foreign and domestic currency in addition to the overall LCR. This created substantial buffers before the Covid-19 crisis and, together with the swift and strong policy response, eased liquidity, and funding pressures for banks in 2020.</p>						
FX Intervention and Reserves Level	<p>Background. The exchange rate is freely floating. Foreign currency reserves increased by USD 3 billion to stand at USD 59 billion in December 2020, which is equivalent to 22 percent of the short-term external debt of monetary and financial institutions (primarily banks), about 10 percent of GDP and 3.3 months of imports. There have been no foreign exchange interventions in 2020.</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, Sweden should maintain adequate foreign reserves. A USD 60 billion swap facility was agreed with the Fed to address risks on dollar funding related to the Covid-19 crisis. Although it wasn't utilized, it provided an important backstop function.</p>						
	<p>¹ The range is used to reflect uncertainty around the EBA estimated norm.</p>						

Annex III. Risk Assessment Matrix ¹

Risks	Likelihood of Risk	Impact of Risk	Policy Response
<p>Unexpected shifts in the Covid-19 pandemic.</p> <ul style="list-style-type: none"> • Downside. The disease proves harder to eradicate (e.g., due to new virus strains, short effectiveness of vaccines, or widespread unwillingness to take them), requiring costly containment efforts and prompting persistent behavioral changes rendering many activities unviable. For countries with policy space, prolonged support—while needed to cushion the economy—exacerbates stretched asset valuations, fueling financial vulnerabilities. For those with limited space, especially EMs, policy support is insufficient. • Upside. Pandemic is contained faster than expected due to the rapid production and distribution of vaccines, boosting confidence and economic activity. 	<p>M</p> <p>M</p>	<p>Medium: Demand in contact intensive services remains low for longer. Financial markets reassess real economy risks leading to a repricing of risk assets. CRE and corporate vulnerabilities worsen, affecting banks.</p> <p>High: Strong confidence impact in the near term; activity recovers faster than expected over the medium term and limits scarring.</p>	<p>Keep provide adequate support to the health system . Fully use available fiscal space to support households and businesses overcome liquidity needs while encouraging necessary reallocation of resources.</p>
<p>Sharp rise in global risk premia exposes financial vulnerabilities. A reassessment of market fundamentals (e.g., in response to adverse Covid-19 developments) triggers a widespread risk-off event. Risk asset prices fall sharply and volatility spikes, leading to significant losses in major non-bank financial institutions. Higher risk premia generate financing difficulties for leveraged firms (including those operating in unviable activities) and households, and a wave of bankruptcies erode banks' capital buffers.</p>	<p>M</p>	<p>Low: Further pressure on bank capital adequacy triggering credit tightening. Adverse spillover to other (viable) sectors through lower incomes and intermediate input demand. Higher unemployment due to bankruptcies and pressures on the social security system.</p>	<p>Stand ready to implement further policy support. Maintain flow of credit by making sure financial policies are adequately targeted and effectively deployed.</p>
<p>Accelerating de-globalization. Despite renewed efforts to reach multilateral solutions to existing tensions, geopolitical competition leads to further fragmentation. Reshoring and less trade reduce potential growth.</p>	<p>M</p>	<p>High: Higher barriers to trade—particularly those on Sweden's vehicles and machinery exports—would dampen exports and investment and weaken growth. A negative shock following Brexit would hit exports.</p>	<p>Provide monetary and fiscal support, implement labor market reforms and enhance bankruptcy regime to facilitate sectoral reallocation of labor and capital.</p>
<p>Significant property price decline in Sweden due structural changes. Price declines could possibly affect commercial property markets and/or residential property.</p>	<p>L</p>	<p>Medium: Investment and collateral values for lending could be undermined by sizable falls in commercial property prices. 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.</p>	<p>Monitor recent developments through better data collections and supervise banks commercial real estate lending closely. In the event, provide monetary stimulus and funding support to banks.</p>

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent).

Annex IV. Authorities' Response to Past IMF Policy Recommendations

IMF 2019 Article IV Recommendations	Authorities' Response
Fiscal Policy	
Sweden should maintain its practice of allowing full operation of automatic fiscal stabilizers given the downside risks to growth. A temporary cut in the surplus target could help address higher public investment needs from demographic shifts or other sources.	Sweden has fully allowed automatic stabilizers operate during the crisis. The medium-term surplus objective has been reduced, and Sweden has expanded spending to some extent.
Structural Reforms	
<p><i>Labor:</i> Further reforms, including of employment protection and public employment services, should support employment of the low-skilled and migrants, aided by enhanced education and training.</p> <p><i>Wage setting:</i> The social partners should consider updating wage formation to reflect structural changes in the Swedish economy, including the rise of other sectors such as services. Scope for wage variation across sectors should also be increased.</p> <p><i>Housing:</i> Making the rental market work; Taxing property to rebalance the housing market; Producing housing that is affordable; Protecting households in the transition.</p>	<p>Reforms are ongoing.</p> <p>Limited traction.</p> <p>Reforms have been piecemeal due to housing being a politically contentious issue, in general, and during the Covid-19 crisis, in particular.</p>
Macro-Financial Issues	
<p>Data collection: Household level data collection need to be enhanced to help evaluate supervisory effectiveness. Close review the adequacy of banks' risk management along with the financial health of commercial property borrowers.</p> <p><i>AML/CFT:</i> need for strong anti-money laundering and combating the financing of terrorism (AML/CFT) frameworks and for close regional cooperation.</p> <p><i>e-krona:</i> The authorities should also explore regulatory options to ensure reliable and efficient private payments, such as standards for business continuity and regulation of fees.</p>	<p>Efforts are ongoing, but many shortcomings persist.</p> <p>The Nordic-Baltic constituency has requested regional TA from the Fund.</p> <p>The e-krona pilot is being launched for testing purposes which is part of a more general evaluation of the merits of CBDC in Sweden. Efforts ongoing.</p>

Annex V. Key Policy Response Measures in 2020

Fiscal	<p>Additional spending in the health sector (SEK 38 bn): funding of extraordinary cost for municipalities and regions, elderly care boost, training of health and social care workers, expansion of the National Board of Health and Welfare's credit framework for purchases of personal protective equipment and intensive care equipment.</p> <p>Additional spending and foregone revenue in areas other than health (SEK 169 bn): wage subsidies for short-term leave, sick leave, rent subsidies, more generous unemployment benefits, temporary grants to businesses based on their loss of turnover to cover fixed costs, infrastructure investment, extra support to public transport, general grants to municipalities and regions, temporary reduction in employers' social security contributions.</p> <p>Tax deferrals (SEK 335 bn): deferral of a maximum of three-month worth of payments of companies' social contributions, VAT and payroll taxes for a period of up to 12 months, annual VAT for 2019, and SME taxes.</p> <p>Capital reinforcement (SEK 12 bn): capital injection to the Scandinavian carrier SAS, the state-owned airport operator Swedavia, Lernia (state-owned education and matching firm) and ALMI (the Swedish SME and Entrepreneur Agency).</p> <p>Credit guarantees (SEK 250 bn): guarantees for Swedish airlines, expansion of the Swedish Export Credit Agency's credit guarantee framework and the programs under the Export Credit Corporation, central government guarantees for loans to companies.</p>
Monetary	<p>Reduction of the lending rate for overnight loans by 55 basis points to 0.2 percent and subsequently to 0.1 percent (while leaving the repo rate unchanged at 0 percent).</p> <p>Lending of up to SEK 500 billion to companies via banks (funding for lending).</p> <p>Introduction of a new lending facility whereby monetary policy counterparties can borrow unlimited amounts (given adequate collateral) with a maturity of 3 and 6 months at an interest rate corresponding to the Riksbank's repo rate.</p> <p>Increase of purchases of securities of up to SEK 700 billion this year and next (where securities may include government and municipal bonds, covered bonds and securities issued by non-financial corporations).</p> <p>The establishment of a swap facility of USD 60 billion between the Riksbank and the US Federal Reserve (mutual currency arrangement).</p> <p>The possibility for banks to borrow in US dollars against collateral of up to USD 60 billion (until March 31, 2021).</p> <p>All credit institutions under the supervision of the Swedish FSA can apply to become temporary monetary policy counterparties so that they can access the new funding for lending facility.</p>
Financial	<p>Easing of countercyclical capital buffer from 2.5 to 0 percent.</p> <p>The possibility for banks to temporarily breach the liquidity coverage ratio (LCR) for individual currencies and for their total currencies.</p> <p>Banks may grant all new and existing mortgagors an exemption from the amortization requirement until 31 August 2021.</p> <p>Recommendation for banks and credit market companies to temporarily stop dividend payments.</p>
Sources: Ministry of Finance, Riksbank, and Finansinspektionen.	



Appendix I. Draft Press Release

IMF Executive Board Concludes 2021 Article IV Consultation with Sweden

FOR IMMEDIATE RELEASE

Washington, DC—[March 19, 2021]: The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation¹ with Sweden and endorsed the staff appraisal without a meeting.

The economy has been hit hard by historical standards, but the fallout has been smaller than in peers. The 2020 output is estimated to have fallen by about 3 percent. While inflation hovered around 1 percent, its medium-term projection is slightly below the 2 percent target. Unemployment increased sharply, with temporary workers, the youth, and foreign-born suffering disproportionately. The external current account surplus widened on the back of compressed imports and buoyant exports. The fiscal response was strong with the small surplus of the past years shifting to a deficit of about 4 percent of GDP. Sweden's Covid-19 infection and mortality rates have been somewhat above the EU average but much higher than in its Nordic peers.

Sweden is projected to grow at about 2 percent in 2021 but uncertainties have increase recently regarding the new strains for the virus and the rollout of vaccination. Higher growth implies that the budget deficit will decline, and public debt remain fairly low, at around 40 percent. Monetary policy has been accommodative, with ample liquidity provision, large asset purchase program and a reduction of the Riksbank overnight lending rate. Forward guidance suggests that the policy (repo) rate will likely remain at the same level over the medium term (following its increase to zero effective January 2020). Regulatory policy has also been temporarily eased and the banking sector remains strong. Structural reforms are still lagging, especially in the dysfunctional housing market.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Executive Board Assessment²

In concluding the Article IV consultation with Sweden, Executive Directors endorsed the staff's appraisal as follows:

Sweden's economy fared the crisis better than many of its European neighbors, not least due to substantial buffers and generally strong fundamentals. The authorities' large support package was timely and adequate. The package provided ample support to households and businesses, helped avert a financial crisis, and stabilize markets. As a result, the 2020 fall in output is projected at around 3 percent, which is less than the EU average. However, the increase in unemployment, especially of the young and foreign-born, was larger than in countries that suffered a deeper recession. While the recovery is expected to start this year, uncertainties have recently increased regarding the new strains of the virus and the rollout of vaccination. It is therefore appropriate that most of the crisis measures were extended to June 2021.

Fiscal policy should continue to support the economy and lead the recovery. It is important to not prematurely return to the surplus target. As the recovery takes hold, the eventual withdrawal of the support measures should be cautiously gradual in order to minimize scarring. Furthermore, there is room for increasing public expenditure over the medium term to enhance growth and achieve Sweden's ambitious green and inclusion objectives. At the same time, it is desirable to review the design of the support measures, not least to facilitate structural transformation. In particular, the short-term work scheme could be redesigned to make it more flexible and more supportive for temporary workers and to incentivize retraining and hiring.

Monetary policy should stand ready to further assist the recovery if needed, but its effectiveness may be diminishing. The monetary policy stance has been appropriate and the expansion of the Riksbank's asset purchase program contributed importantly to supporting the economy and stabilizing key markets. Inevitably such necessary operations can contribute to a buildup in vulnerabilities due to reduced risk pricing. As liquidity constraints seem to have been alleviated, the policy mix should focus on fiscal support, while the Riksbank should stand ready to complement fiscal measures as needed. Any amendments to the Riksbank law should preserve its operational independence and ability to quickly deploy a broad range of instruments in future crises. The e-krona pilot project will help design a central bank currency proposal in a way that maximizes the benefits while minimizing risks, including for

² The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

financial intermediation and cybercrime. The amendments to the anti-money laundering framework and its enforcement are also welcome.

Financial vulnerabilities require continued vigilance and enhanced data collection. Banks' exposures to the CRE sector and high household debt call for better data collection to enhance monitoring and guide possible further strengthening of prudential regulations, especially for CRE. A prolonged recession, as well as accelerated shifts to e-commerce, teleworking, and less travel could result in dwindling revenue streams of CRE companies with high exposure to sectors affected by the crisis. Close monitoring of corporate vulnerabilities and bond markets is also necessary to preserve financial stability.

It is imperative to address Sweden's long-term structural challenges and market distortions, including to tackle the limited employment prospects for the foreign-born and youth, shortages in affordable housing, and demographic shifts. It is encouraging that the 2021 Budget Bill contained higher spending on training and education, lower social security contributions for the youth, as well as initiatives geared towards the foreign-born, especially women. A further reduction of the high labor tax wedge is also desirable. The overly regulated rental market, with its long queues, favors existing tenants. Introducing a simpler market-based system that is complemented with adequate housing allowances would be more transparent and effective in meeting both the economic and social objectives. In addition, streamlining the complex local regulations would help increase supply and competition in the construction sector, thus driving down costs. Comprehensive reforms, including gradually increasing property taxes from their extremely low level, would make the housing market more dynamic. Such reforms would help improve efficiency and equity, and facilitate labor mobility.

Sweden: Selected Economic Indicators, 2018–26

	2018	2019	Est. 2020	Projections					
				2021	2022	2023	2024	2025	2026
Real economy (percent change)									
Real GDP	2.0	1.3	-3.0	3.3	2.9	2.4	2.1	2.0	2.0
Domestic demand	1.7	0.2	-3.2	3.0	2.9	2.8	2.3	2.1	2.1
Private consumption	1.8	1.3	-4.8	3.2	3.3	2.3	2.2	2.0	2.0
Public consumption	0.8	0.3	0.2	2.7	1.5	1.3	1.3	1.0	1.0
Gross fixed investment	1.4	-1.2	-1.4	3.0	3.5	3.2	3.2	3.1	3.1
Net exports (contribution to growth)	0.3	1.1	0.1	0.4	0.1	-0.3	-0.2	0.0	0.0
Exports of G&S	4.2	3.6	-5.6	5.4	4.1	3.0	2.9	2.7	2.7
Imports of G&S	3.8	1.2	-6.2	4.9	4.2	3.8	3.4	2.9	2.9
HICP inflation (e.o.p)	2.2	1.7	0.4	0.7	1.2	1.6	1.8	1.9	1.9
HICP core inflation (e.o.p)	1.3	1.8	1.3	1.3	1.3	1.4	1.6	1.7	1.9
Unemployment rate (percent)	6.3	6.8	8.3	8.7	8.4	7.7	7.2	7.2	7.2
Gross national saving (percent of GDP)	28.6	29.7	30.4	29.7	30.0	30.4	30.5	30.7	30.8
Gross domestic investment (percent of GDP)	26.0	25.1	25.4	25.2	25.7	26.5	27.1	27.4	27.8
Output gap (percent of potential)	2.5	2.2	-1.4	-0.8	-0.6	-0.4	-0.2	0.0	0.0
Public finance (percent of GDP)									
Total revenues	49.6	48.8	49.1	48.4	48.8	49.2	49.3	49.4	49.4
Total expenditures	48.8	48.3	53.1	52.2	50.6	49.3	49.2	49.0	49.1
Net acquisition of nonfinancial assets	1.6	1.7	1.8	2.0	1.9	1.8	1.5	1.5	1.4
Net lending	0.8	0.5	-4.0	-3.9	-1.8	-0.2	0.1	0.3	0.3
Structural balance (as a percent of potential GDP)	0.0	-0.4	-3.4	-3.5	-1.5	0.0	0.2	0.3	0.3
General government gross debt, official statistics	38.9	35.1	38.6	40.7	40.7	39.3	37.8	36.1	34.4
Money and credit (year-on-year, percent change, eop)									
M3	5.9	7.9	17.8	...	...	...	...	...	...
Bank lending to households	5.3	5.0	5.5	...	...	...	...	...	...
Interest rates (percent, end of period)									
Repo rate	-0.5	-0.25	0.0	...	...	...	...	...	...
Ten-year government bond yield	0.5	0.1	0.0	...	...	...	...	...	...
Mortgage lending rate	1.5	1.5	1.4	...	...	...	...	...	...
Balance of payments (percent of GDP)									
Current account	2.6	4.6	5.0	4.5	4.3	3.9	3.4	3.2	3.0
Foreign direct investment, net	2.5	0.7	1.4	1.7	1.7	1.7	1.3	1.1	1.0
International reserves, changes (in billions of US dollars)	-0.3	-6.6	3.0	...	...	...	...	...	...
Reserves coverage (months of imports of goods and services)	3.0	2.8	3.3	...	...	...	...	...	...
Net international investment position	8.6	18.4	23.3	27.7	32.0	35.8	39.2	42.4	45.4
Exchange rate (period average, unless otherwise stated)									
SEK per euro	10.3	10.5	10.2	...	...	...	...	...	...
SEK per U.S. dollar	8.7	9.5	8.4	...	...	...	...	...	...
Nominal effective rate (2010=100)	92.8	89.2	90.8	...	...	...	...	...	...
Real effective rate (2010=100) 1/	93.4	88.7	93.5	...	...	...	...	...	...

Other Indicators

GDP per capita (2019, USD): 51,434; **Population** (2019, million): 10.3.

Key export markets: Germany, Norway, United Kingdom.

Sources: IMF WEO, Riksbank, Swedish Ministry of Finance, Statistics Sweden, and IMF Staff calculations.

1/ Based on relative unit labor costs in manufacturing.