INTERNATIONAL MONETARY FUND

IMF Country Report No. 23/111

SWEDEN

March 2023

2023 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SWEDEN

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2023 Article IV consultation with Sweden, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 13, 2023 consideration of the staff report that concluded the Article IV consultation with Sweden.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 13, 2023, following discussions that ended on January 27, 2023, with the officials of Sweden on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on February 17, 2023
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Sweden.

The documents listed below have been separately released.

Selected Issues
Financial Stability System Assessment

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

PRESS RELEASE

PR23/76

IMF Executive Board Concludes 2023 Article IV Consultation with Sweden

FOR IMMEDIATE RELEASE

Washington, DC – **March 16, 2023:** The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Sweden on March 13, 2023.

Following the pandemic, Sweden's economy experienced a strong recovery, which continued well into 2022. GDP growth is projected at around 3 percent in 2022. The labor market improved, while general labor shortages persisted. A higher budget surplus is expected for 2022. Inflationary pressures intensified in 2022 despite several monetary policy actions. Strong borrowing by households and real estate firms fueled price and value growth, with both house prices and total household debt in relation to income peaking in end-2021. House prices started to decline in the second half of 2022. Commercial real estate (CRE) companies took on more debt, with the sector becoming highly concentrated.

Risks are on the downside. A mild recession is expected in 2023 reflecting a slowdown in private consumption as households continue to grapple with high inflation and greater debt servicing costs. A mild recession is thus anticipated, while inflation continue to be stubbornly high. The 2023 budget aims at a fiscal stance that is conducive to reducing aggregate demand pressures. Developments in the real estate sector will further dampen demand and investment.

Banks have structurally higher profitability than its European peers, high regulatory capital, and liquidity positions exceeding regulatory minima. The sector is highly exposed to mortgages and CRE and could come under pressure if downside risks are amplified.

Executive Board Assessment[2]

Executive Directors noted that following a strong post-pandemic recovery, a mild recession is expected amid weaker external demand and higher inflation and interest rates. Building on Sweden's strong fundamentals, Directors encouraged the authorities to maintain a tight monetary policy stance and prudent fiscal position to stabilize prices and maintain financial stability, while advancing structural reforms to support inclusive, green growth.

Given the high uncertainty, Directors stressed that the fiscal stance should adapt to developments, including by allowing the automatic stabilizers to fully operate. Directors stressed the need for energy support to be well-targeted and phased out as energy prices decline. As inflation subsides, Directors also called on the authorities to increase social and

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

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

infrastructure investments to support a green transition and inclusive growth. Directors welcomed the pension reform that links retirement age to life-expectancy. They noted that it would also be important to reduce the labor tax wedge and rationalize unemployment benefits to further increase the labor supply. Gradually increasing the extremely low property tax would also help improve the tax structure, finance new investments, and reduce distortions in the housing market.

Directors commended the authorities' strong policy actions to stem inflation. Considering the exceptionally high level of uncertainty, they urged continuous review of the appropriate pace and magnitude of monetary tightening, including of the ongoing tapering of the asset purchase program. Directors noted the positive early indications from the constructive wage negotiations, which should reduce the risk of a wage-price spiral.

Directors welcomed the timely recommendations of the FSAP. They emphasized the need to closely monitor developments in residential and commercial real estate markets and improve the collection of household balance sheet data. Directors saw merit in expanding the macroprudential toolkit and considering higher capital buffers for banks' exposure to commercial properties. Gradually increasing the mortgage amortization requirement and abolishing the interest rate deductibility would also help attenuate risks. Directors called for continued actions to strengthen the AML/CFT and crisis management frameworks.

Directors stressed that structural reforms are essential to improve inclusive growth and social outcomes. While commending the employment gains in recent years, they noted that unemployment remains high among the youth, foreign-born, and low-skilled. This should be addressed through education enhancements and increasing the efficiency of programs and regional services. Directors agreed that reforms in the rental market would help address housing market distortions. They also noted that to achieve Sweden's ambitious climate goals, its high carbon tax should be complemented with increased investments in renewables and green technology infrastructure and enhancing the electricity grid.

Sweden: Selected Economic Indicators, 2020–28

	2020	2021	Est. 2022	Projections 2023	2024	2025	2026	2027	2028
Real Economy (percent change)									
Real GDP	-2.2	5.1	2.8	-0.3	1.4	2.3	2.3	2.3	2.3
Domestic demand	-2.3	5.7	4.2	-0.6	0.7	2.1	2.0	2.0	2.0
Private consumption	-3.2	6.0	2.8	-0.2	1.5	2.8	2.8	2.8	2.8
Public consumption	-1.8	2.8	-0.2	0.2	0.7	1.0	1.0	1.0	1.0
Gross fixed investment	1.7	6.4	5.6	-2.3	1.0	1.7	1.7	1.7	1.7
Net exports (contribution to growth)	0.0	-0.3	-1.2	0.3	0.7	0.3	0.4	0.4	0.4
Exports of G&S	-5.5	7.9	4.4	0.1	3.4	3.4	3.5	3.5	3.5
Imports of G&S	-6.0	9.6	7.8	-0.4	1.9	3.0	3.0	3.0	3.0
HICP inflation (average) 2/	0.7	2.7	8.1	6.5	3.0	2.3	2.0	2.0	2.0
HICP core inflation (average)	1.5	1.6	5.5	5.2	2.6	2.2	2.0	2.0	2.0
Unemployment rate (percent)	8.5	8.8	7.5	7.7	8.0	7.9	7.9	7.9	7.9
Gross national saving (percent of GDP)	31.0	32.2	31.7	31.5	31.9	32.0	32.1	32.1	32.2
Gross domestic investment (percent of GDP)	25.1	25.9	27.9	28.0	27.9	28.0	27.9	27.9	27.9
Output gap (percent of potential)	-2.6	0.4	1.3	-0.9	-1.1	-0.5	0.0	0.0	0.0
Public Finance (percent of GDP)									
Total revenues	48.3	48.4	47.5	46.9	47.7	48.0	48.0	48.0	48.0
Total expenditures	51.0	48.5	46.8	46.8	48.0	48.0	47.7	47.7	47.7
Net acquisition of nonfinancial assets	1.6	1.3	1.2	1.2	1.4	1.3	1.3	1.3	1.3
Net lending	-2.8	-0.1	0.7	0.0	-0.3	0.0	0.3	0.3	0.3
Structural balance (as a percent of potential GDP)	-1.7	-0.2	0.2	0.4	0.1	0.2	0.3	0.3	0.3
General government gross debt, official statistics	39.5	36.3	31.3	31.1	30.5	29.5	28.4	27.2	25.9
Money and Credit (year-on-year, percent change, eop)									
M3	17.8	9.7	2.4	...	...	...	...	...	...
Bank lending to households	5.5	6.8	3.5	...	...	...	...	...	...
Interest Rates (percent, end of period)									
Repo rate	0.0	0.0	2.5	...	...	...	...	...	...
Ten-year government bond yield	0.0	0.3	1.5	...	...	...	...	...	...
Mortgage lending rate	1.4	1.4	3.4	...	...	...	...	...	...
Balance of Payments (percent of GDP)									
Current account	6.0	6.3	3.8	3.6	4.0	4.0	4.2	4.2	4.2
Foreign direct investment, net	0.7	1.0	1.6	1.7	1.4	1.3	1.2	1.1	0.8
International reserves, changes (in billions of US dollars)	-0.3	6.0	...	...	...	...	...	...	...
Reserves coverage (months of imports of goods and	3.2	2.8	2.7	2.7	2.7	2.6	2.5	2.5	2.4
Net international investment position	8.8	22.1	25.9	29.5	33.4	37.5	41.6	45.8	50.1
Exchange Rate (period average, unless otherwise									
SEK per euro	10.2	10.3	10.9	...	...	...	...	...	...
SEK per U.S. dollar	8.4	9.1	11.1	...	...	...	...	...	...
Nominal effective rate (2010=100)	90.7	93.7	88.1	...	...	...	...	...	...
Real effective rate (ULC) (2010=100) 1/	93.8	97.2	91.1	...	...	...	...	...	...
REER ULC long run average deviation	-8.6	-5.1	-10.8	...	...	...	...	...	...
Real effective rate (CPI) (2010=100)	87.7	90.2	84.6	...	...	...	...	...	...
Fund Position (December 31, 2022)									
Quota (in millions of SDRs)	4,430								
Reserve tranche position (in percent of quota)	29.1								
Holdings of SDRs (in percent of allocation)	103.2								
Memorandum Items									
CPIF inflation (average)	0.5	2.4	7.7	...	...	...	...	...	...

Other Indicators
GDP per Capita (2021, USD): 60,029; **Population** (2021, million): 10.4.
Key Export Markets: Germany, Norway, and Netherlands.

Sources: IMF World Economic Outlook; Swedish Ministry of Finance; Statistics Sweden; and IMF staff calculations.

1/ OECD based Unit Labor Cost (ULC) real effective exchange rate indicator.

2/ The unemployment rate and inflation represent actual figures, not predictions.

INTERNATIONAL MONETARY FUND

SWEDEN

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION

February 17, 2023

KEY ISSUES

Sweden experienced a strong post-pandemic rebound in 2021–22 but is potentially heading into a recession. Global headwinds started to steadily put breaks on consumption and business confidence in the third quarter of 2022, as external demand weakened, and higher inflation and interest rates are increasing the burden on households and firms. A slightly negative GDP growth and a moderate decline in inflation are expected in 2023. The recovery will be gradual over the medium term, and inflation is expected to decelerate towards its 2 percent target, but the uncertainty surrounding this outlook is high.

The fiscal stance is slightly contractionary in 2023, which is appropriately supportive of monetary policy. This stance should, however, be regularly reviewed in line with growth and inflation developments. Automatic stabilizers should be allowed to fully operate and, if needed, discretional expenditures should be adjusted. Temporary energy support measures could be better targeted, and fuel subsidies should be phased out as energy prices normalize to meet climate goals. As inflation stabilizes, and given the ample fiscal space, the pace of returning to the fiscal surplus target of 0.33 percent of GDP could be slowed to allow for greater green and growth-enhancing expenditure. A gradual increase in property taxes from their extremely low level would help finance part of the above spending and improve the structure of revenues. The pension reform that links retirement-age to life expectancy will further improve *long-term* debt dynamics. Reductions in labor taxation are also desirable to help raise employment.

The rapid and decisive monetary policy response targeted at reigning in record high inflation is well justified. Notwithstanding the uncertain environment, given the priority to reduce inflation, the recent tightening and readiness to tighten further is welcome. To safeguard financial stability, emphasis should be placed on closely monitoring the high bank exposures to household and commercial real estate (CRE) debt and on improving the collection of relevant balance sheet data. Higher bank capital requirements for CRE should be considered and the macroprudential tool kit should be expanded to enhance resilience, in line with 2022 FSAP recommendations.

Concrete progress in structural reforms is needed. Reforms should aim at addressing long-standing shortcomings in the labor and housing markets, educational gaps, employment of the foreign-born, and the bankruptcy framework. Fulfilling Sweden’s ambitious climate agenda will also require substantial effort and funding.

Approved By
Oya Celasun (EUR) and Geremia Palomba (SPR)

The Article IV Consultation discussions took place in Stockholm during January 18–27, 2023. The staff team comprised K. Sakr (mission chief), J. Bricco, S. Dell'Erba, A. Fotiou, and S. Vtyurina (all EUR). A. Ekelund (OED) accompanied the mission. F. Jiang and H. Jung (both EUR) assisted the team. The mission worked closely with the FSAP team led by T. Mancini Griffoli. The mission met with Minister of Finance Elisabeth Svantesson and State Secretaries Johanna Lybeck Lilja and Johan Almenberg; Governor and First Deputy Governor of the Central Bank of Sweden Erik Thedéen and Anna Breman; other senior officials; parliamentarians; and representatives of labor unions, business community, banking sector, and academics.

CONTENTS

TABLES

ANNEXES

CONTEXT AND RECENT DEVELOPMENTS

1. **Sweden's economy experienced a strong recovery after the pandemic, which continued well into 2022.** GDP growth is projected at around 3 percent in 2022. It was broad-based, reflecting high, albeit declining, private consumption, investment, and exports. The labor market was tight and general shortages persisted. Labor market participation was high, and the employment rate (69.5 percent in November) and hours worked continued to increase. However, the unemployment rate remained one of the highest in the region (7.2 percent in November).

2. **Inflationary pressures remained elevated in 2022 despite the Riksbank's actions.** High electricity and food prices resulted from external price pressure, krona depreciation, and a pass-through of higher prices to consumers. Responding to pressures, the Riksbank brought forward the path of normalization, raising the policy rate from zero by 25 basis points (bps) in April 2022, and communicated a reduction path for its balance sheet. By end-2022, the policy rate stood at 2.5 percent. In 2022, the average and core HICP were at 8.1 and 5.6, respectively.

3. **After a small fiscal deficit in 2021, a surplus of 0.7 percent of GDP is projected for 2022, double the fiscal surplus target.** This overperformance was largely due to stronger energy VAT revenue and lower-than-expected social security benefits, which reflected the recovery and high employment. Small fiscal support was provided to households and firms to partially offset the sharp rise in energy bills (Box 1). The surplus and favorable interest-rate-growth differential helped push down public debt to about 32 percent of GDP, which is below its pre-pandemic level, bolstering Sweden's substantial fiscal space (Annex I).

4. **The real estate market is experiencing substantial weakening.** Mortgage and CRE borrowing grew strongly during the pandemic. Like in other advanced countries, house prices were fueled by the easing of monetary policy and macroprudential regulation, fiscal support, and a change in dwelling preferences towards larger units. Both residential real estate (RRE) prices and total household debt in relation to income peaked in Q4 2021. RRE prices started to decline in the second half of 2022, registering a 16 percent decline by end-year from their March peak. Shares of CRE firms listed in Stockholm have lost more than 40 percent of their value in 2022, and more companies face the risk of downgrades spurred by their deteriorating debt profiles as they need to rollover maturing bonds at higher interest rates.

5. **Sweden's current account (CA) surplus is projected to narrow substantially in 2022 but the external position is assessed to be stronger than what would be implied by the medium-term fundamentals and desirable policies.** This assessment is preliminary pending full-year data for 2022. The CA surplus should fall to around 3.8 from 6.3 percent of GDP on the back of lower net exports of goods and high recovery-driven imports of services. The krona depreciated by 6.5 and 12.4 percent against the euro and the US dollar (average, yoy, in December 2022), respectively. In real effective terms—against its unit labor cost-based average—it depreciated as well, resulting in an undervaluation of about 11 percent (Annex II). Reserves remained adequate.

6. Elections took place on September 11, 2022. Gang violence and immigration policies were among the main concerns for voters. The new conservative coalition government consists of the Moderate Party, the Christian Democrats, and the Liberals. The Sweden Democrats, now the second largest party in the parliament after the Social Democrats, is conditionally backing the government without being part of it. Sweden is holding the EU presidency as of January 2023.

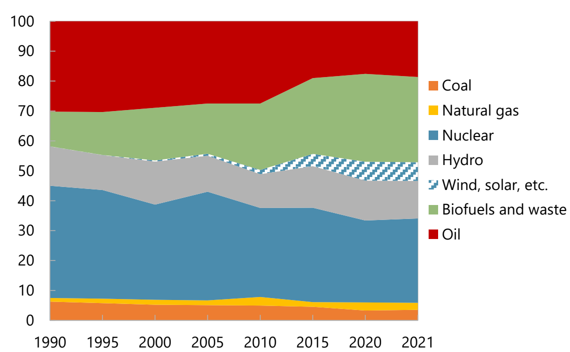
Box 1. Impact and Response to High Energy Prices

Energy dependence: Sweden's dependence on natural gas is very low. In 2019, gas made up about 2 percent of its energy mix. Sweden's net imports of crude and gas in 2021 were about 1 percent of GDP. Its main energy sources are nuclear (35 percent), biofuels and waste (26 percent), oil (18 percent), and hydro (11 percent). More than 75 percent of crude and gas is imported from Norway, about 10 percent from the UK and Russia, respectively (though imports from the later decline substantially after the war) and the rest from others. However, because of the EU wholesale market pricing, electricity prices have soared, especially in the South where the electricity grid is connected to Germany and Denmark rather than Sweden's North that has ample supply. Energy bidding zones impede efficient connectivity between the North and South of Sweden, and the energy grid needs investment.

Support to households: Energy subsidies and support measures to households totaling about 0.3 percent of GDP have been provided in 2022. Initially these were untargeted and did not encourage conservation as they were usage-based. During the summer, electricity support measures were discontinued. Recently, additional electricity subsidies of 1.1 percent of GDP were announced for 2023. They are aimed at households and companies, mainly in southern Sweden, are based on retroactive electricity consumption (during Sep 2021–Oct 2022 and Nov-Dec 2022) and are financed by congestion revenue surpluses from the state-owned power distribution enterprise (SOE) "Svenska Kraftnät". Across-the-board fuel tax reductions of 0.3 percent of GDP over three years were announced as part of the new budget.

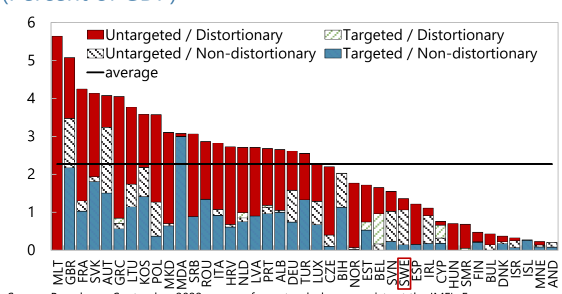
Support to companies: Due to skyrocketing prices in September, the Nordic electricity companies faced unexpectedly higher margin calls. To avert a default, the Swedish, Danish, and Finnish governments offered loan guarantees, which have stabilized the market. The 2023 budget mentions limited electricity subsidies for energy intensive businesses (listed outside the budget to the tune of 0.04 percent of GDP) to be paid by congestion revenue surpluses of the SOE "Svenska Kraftnät".

Total Energy Supply by Source, 1990–2021
(Percent of total energy supply)



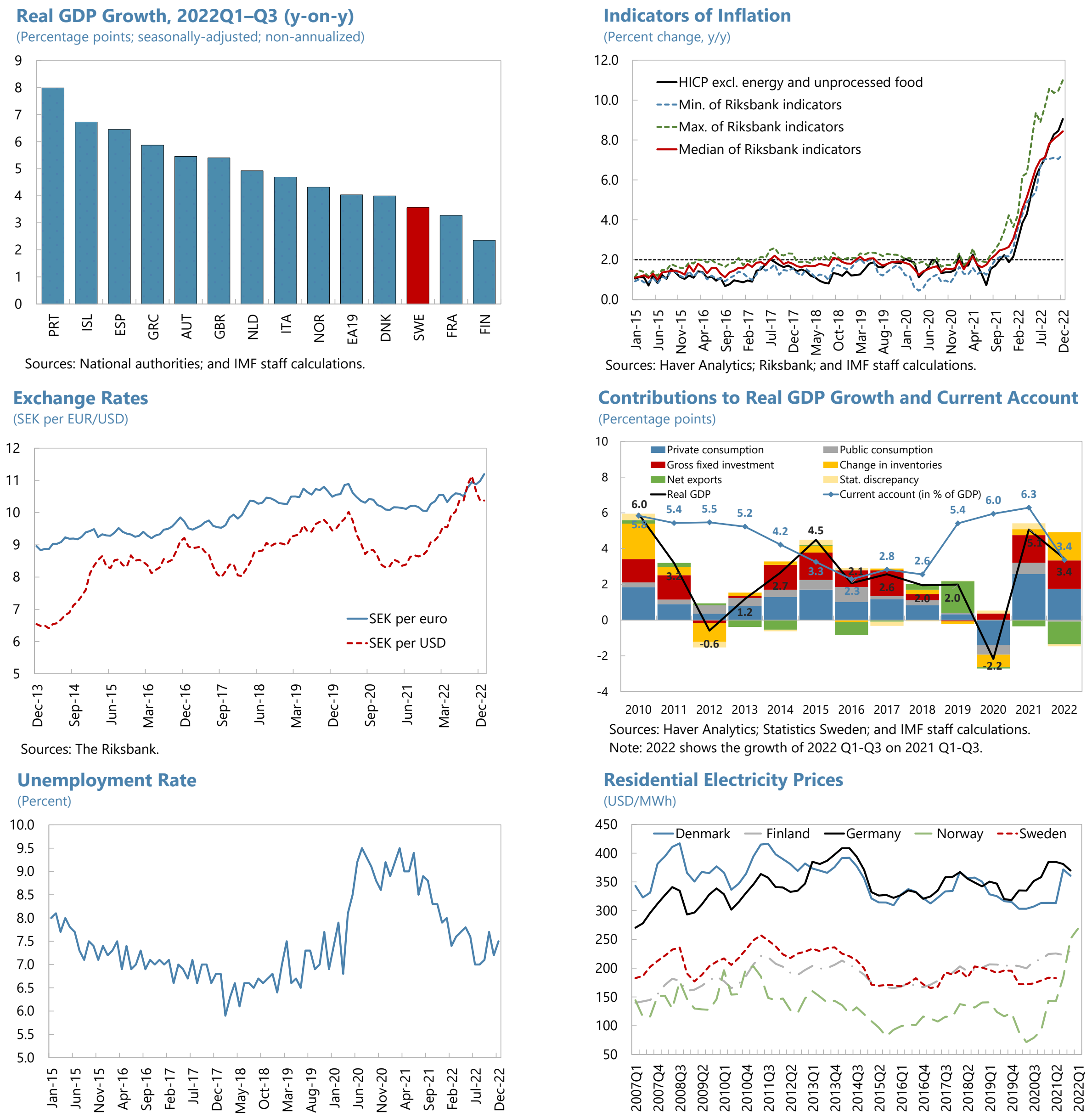
Source: IEA World Energy Balances 2022.

Fiscal Costs of Household Support Measures in 2022–23
(Percent of GDP)



Source: Based on a September 2022 survey of country desk economists at the IMF's European Department. Sweden data is updated with most recent measures.
Note: (i) Fiscal support measures specifically targeting firms and sectors were excluded. (ii) Only 24 of the 39 surveyed countries provided fiscal costs estimates for 2023. For those countries with no such estimates, the numbers shown in the table likely underestimated the total fiscal costs for 2022 and 2023.

Figure 1. Selected Real Sector Indicators



Sources: National authorities; and IMF staff calculations.

Sources: Haver Analytics; Riksbank; and IMF staff calculations.

Sources: The Riksbank.

Sources: Haver Analytics; Statistics Sweden; and IMF staff calculations.
Note: 2022 shows the growth of 2022 Q1-Q3 on 2021 Q1-Q3.

Sources: Haver Analytics; and Statistics Sweden.

Sources: International Energy Agency; and IMF staff calculations.

OUTLOOK AND RISKS

7. **The short-term outlook is subject to substantial risks due the uncertainties surrounding geopolitical and global developments** (Annex III). In addition, long-standing structural shortcomings remain. While GDP grew much above expectations in Q3 2022, consumption and investment are expected to decline in 2023 as the purchasing power and operating margins catch up with higher costs and possibly tighter financial conditions. The higher-than-expected inventories build-up in Q3 could also mean weaker growth ahead. This is coupled with a slowdown in external demand (notably, from Germany). Inflation is likely to recede somewhat because of the

reduced domestic demand and global inflation. Wage increases have been moderate thus far, and the labor market could also be losing some steam. Markets expect house prices to decline by 15–20 percent from their peak but remain at their pre-pandemic level, implying a correction from a post pandemic boom, and with the attenuating factor being an accumulation of large savings during the pandemic. Corporate bankruptcies have started to pick up, mostly in the construction sector, reflecting the housing slump and the increase in financing costs and electricity prices. Financial sector risks are balanced, as banks are entering the slowdown with large buffers. However, household debt and CRE vulnerabilities significantly weigh on the outlook. Potential funding pressures could arise, given the structural shortcomings in bond markets and high level of interconnectedness, for instance in the CRE sector. A mild recession is thus anticipated in 2023.

8. **Concrete progress on structural reform is needed to boost inclusive growth.** Reaching consensus on several important reforms will be crucial. This is particularly relevant for addressing longstanding sector-specific impediments to inclusive growth such as the dysfunctional housing market, educational gaps, and the high unemployment among the youth and foreign-born. Thus, it would be necessary to rationalize rent-control, increase property taxes, enhance active labor market policies, and reduce the labor tax wedge while monitoring the roll out of the new labor market reforms. Increasing in funding for programs and regional services would better integrate the less educated and the foreign-born. A timely upgrade of the South-North electricity connections would contribute to more stable and secure energy for households and businesses.

Authorities' Views

9. The authorities broadly shared staff's assessment. They expect a somewhat deeper recession in 2023 due to the interest rate sensitivity of households and a continuing decline in housing investment. However, they noted that there has not been a large decline in consumption yet, which makes risks more balanced. The authorities' view is that reduced inflation needs to be a priority and believe that achieving this objective will be helped by the ongoing constructive wage negotiations and their conservative monetary and fiscal policies.

POLICY DISCUSSIONS

Like elsewhere in Europe, risks are elevated. Sweden is relatively well placed to face the headwinds due to its strong fundamentals. In the short-term, the policy mix should aim at stabilizing prices while ensuring financial stability. Monetary policy should continue to forcefully attack inflation, aided by a slightly contractionary fiscal stance. Given the high uncertainty, both the monetary and fiscal stance should remain data driven and responsive to developments in growth and inflation. Over the medium term, as inflation decelerates, it would be desirable to use the substantial fiscal space to increase infrastructure and social investment to boost potential growth and make it greener and more inclusive.

A. Fiscal Policy

10. Relentless inflation and a relatively mild projected downturn suggest a need for a slightly contractionary fiscal stance in the short-term. The fiscal stance in 2023 is thus appropriate. While the nominal surplus is expected to narrow due to lower tax revenue amid the recession, the structural surplus would be widening by an estimated 0.2 percentage point of potential GDP, pointing to a mild contractionary stance, notwithstanding estimation uncertainties.[1] This would support monetary policy by containing aggregate demand. The fiscal stance should remain flexible, and automatic stabilizers should be allowed to operate fully. If the recession deepens, discretionary spending should be adjusted. However, it would be important that any such adjustments concentrate on bringing structural improvements to the budget, which promote the green transition, increase incentives to work, and support inclusiveness.

11. The budget contains several new measures and a partial reversal of previous commitments. The gross impact on the budget is around 0.6 percent of GDP (Text Table 1). This includes energy support measures, support to regions and municipalities, permanently higher unemployment support, infrastructure investments, and substantially higher police and defense funding (given the forthcoming NATO membership obligations). Most of the new measures are in line with the new government's reform ("Tidö") agreement, but the intended substantial structural reforms such as income and corporate tax cuts or reforms that tackle the dysfunctional housing market are missing. The increased support for regions and municipalities, including in the health sector is welcome, but additional support will be necessary, while ensuring the quality and efficiency of the regional fiscal expenditure, given the demographic headwinds and the experience from the pandemic (OECD, 2021). The permanently higher unemployment benefits are not conducive to increasing employment and hours worked. Means-tested transfers are a more efficient way to support the vulnerable. Furthermore, the discontinuation of the climate bonus for electric cars and lower taxes on fuels could hinder meeting Sweden's 2030 EU climate obligations (Annex IV).

12. Energy support measures could be better targeted. Compensation measures to households will total 1.1 percent of GDP during 2022–23, which is below the European average of around 2 percent. Many measures are not targeted, and some impede energy conservation (Box 1). The fuel tax cuts, which will affect budgets over the next three years, should be gradually phased out during this period as energy prices decline. Although the recently announced retroactive electricity support to households and companies in the south region is small, temporary, and preserved price signals, it is not means-tested. Moreover, Sweden should replicate some of the better practices in other European countries where support was linked to the household income level.

[1] Energy support measures to households in the South are financed by congestion revenue surpluses from the state-owned power distribution enterprise "Svenska Kraftnät" and are thus considered off budget, which complicates the accounting and assessment of the fiscal stance.

Text Table 1. 2023 Budget

Fiscal Budget 2023 Summary of Reforms	SEK bn 2023	% GDP	SEK bn 2024	SEK bn 2025
Energy Support Measures	13.6	0.2	6.9	7.0
Support Municipalities & Regions	9.0	0.1	8.6	10.1
of which health related	3.0	0.0	2.6	4.1
Defence and police spending	7.5	0.1	13.7	16.3
Permanently higher unemployment supp	5.8	0.1	6.4	6.6
Investment & CO2 Reduction	5.3	0.1	4.7	4.1
Employment and Education	2.7	0.0	3.3	3.5
Other	-3.21	-0.1	-3.35	-9.19
Total	**40.7**	**0.6**	**40.3**	**38.4**
Electricity subsidies for energy intensive business 1/	2.4	**0.04**		

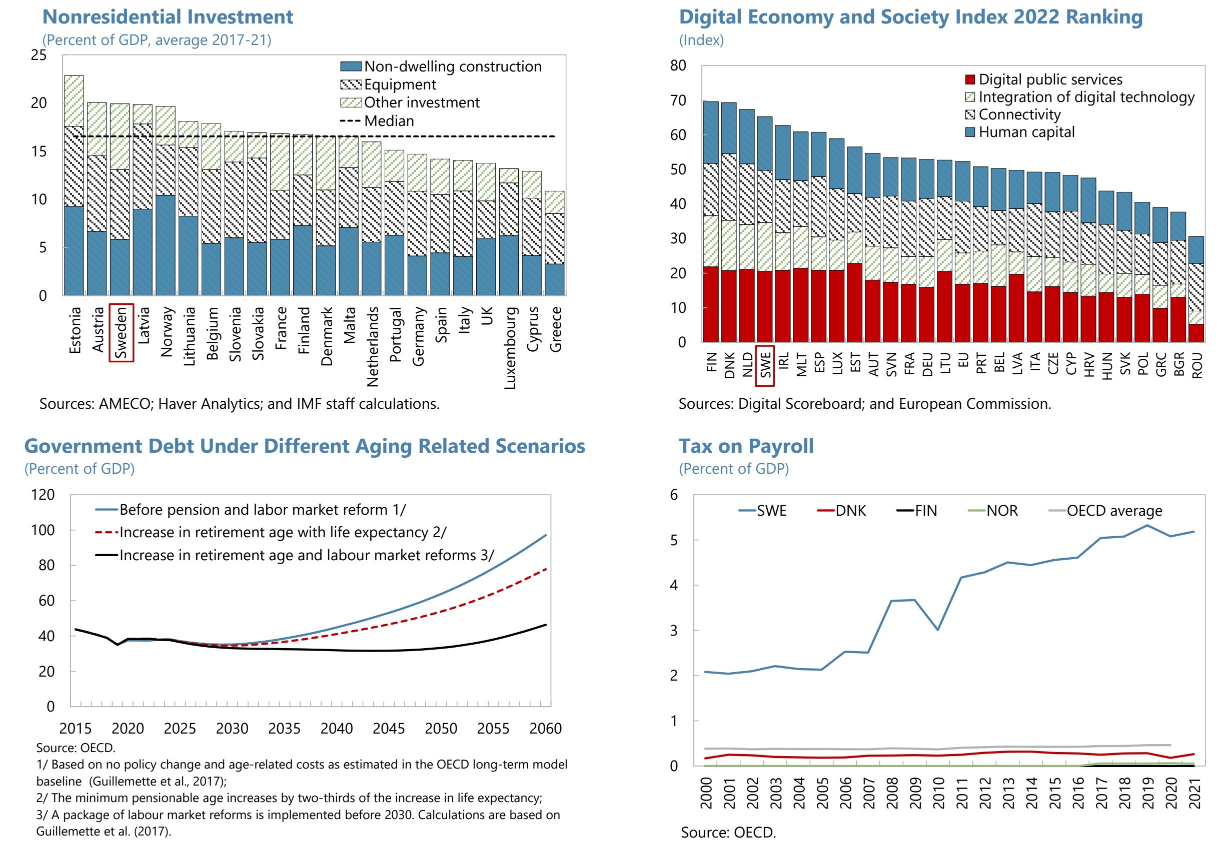
1/ Below the line because financed from congestion revenue surpluses by Svenska Kraftnät

13. Over the medium term, as inflation decelerates, Sweden should increase social investment to boost and broaden potential growth. Sweden ranks high in terms of infrastructure investment, as well as digitalization and climate change actions (Figure 2). However, more investment is needed for education, elderly health care, and its ambitious green transition agenda. Studies by the Ministry of Finance and the Swedish Association of Local Authorities and Regions point out the need for building at least 1,400 schools, 700 elderly nursing compounds, and 93 healthcare facilities. Meeting Sweden's climate goal will also require more investment in fossil-free energy generation and further developing the aging and insufficient electricity grid at an estimated cost of more than 10 percent of GDP (Annex IV). Given the substantial fiscal space and favorable debt dynamics, the next fiscal framework review—set to begin in 2024—should consider increasing growth-enhancing infrastructure and social spending. Furthermore, the authorities should gradually increase property taxes from their extremely low level and phase out mortgage interest deductibility, while reducing labor taxation in order to make the tax mix more growth friendly (OECD, 2021). The 2022 pension and labor market reform that links retirement age to life-expectancy and reduces extensive employment protection are welcome as in the long run this will substantially reduce debt and increase labor supply (Figure 2).

Authorities' Views

14. The authorities agree that fiscal policy stance should support monetary policy in reducing inflation. They note that the energy support package is relatively broadly targeted in order to reach different income groups, given the wide impact of the shock. Moreover, a swift delivery of support measures was a key priority. The government plans to consider lowering the wage tax wedge during the term of office but there is no appetite to increase property taxes.

Figure 2. Selected Indicators



B. Monetary Policy

15. To arrest inflation pressures, policy tightening started in April 2022, but further action is needed. Core inflation has been above projections, including driven by second round effects of high electricity and food prices, and *short-term* inflation expectations are somewhat elevated (Figure 3). However, long-term expectations remain anchored. Monetary policy should remain flexible, and future actions be set against a risk of inflation remaining sticky or winding down as its temporary drivers moderate. In addition, it should consider a continued tight labor market, economic slack, transmission lags, and an overarching objective of anchoring short-term inflation expectations, not least with the view of steering wage negotiations. Considering an exceptionally high level of uncertainty, continuous review of the pace and magnitude of monetary tightening is appropriate. The potential costs of under-tightening (including weakening of Riksbank's credibility) outweigh those of over-tightening (risk of recession).

16. At the time of the discussions in January, staff analysis suggested that the policy rate would need to be slightly higher to achieve the desired inflation path. The Taylor rule-implied policy rate paths were somewhat higher comparing to the Riksbank's path. Thus, the policy rate could be increased to slightly above 300 basis points in 2023–24 and then converge towards Riksbank's announced peak of 2.84 percent. This would be somewhat tighter than the ECB's projected stance. On February 9, Riksbank raised the policy rate by 0.5 percentage points to 3 percent, indicating that the rate would be raised further during the spring. This should allow for inflation to start moving towards the target in 2024. Such a decline is also contingent on a slowing down of inflation globally and the abatement of pandemic-related supply shocks. In view of high uncertainty, the monetary stance should be continually assessed. Reliance on forward guidance should be reduced, while preserving clear communication to avoiding de-anchoring of medium-term inflation expectations, which are currently well anchored (Figure 3).

17. The planned Asset Purchase Program tapering is appropriate but should be recalibrated if the need arises to safeguard corporate liquidity. The Riksbank started a purchase program of about 10 percent of GDP in March 2020. Compared with many other central banks, the Riksbank's securities holdings are smaller and have a shorter time to maturity. Most of them are covered bonds, reflective of the low level of public debt. Purchases in 2022 focused on reinvestment purchases (restricted to half of the maturing bond) and have ceased by end-2022. Holdings will now decline steadily as they fully mature over the next few years. The pace of this path should be revisited if needed as market conditions allow in response to significant developments in inflation. On February 8, Riksbank decided to reduce their asset holdings at a faster pace, by selling until further notice nominal and real government bonds with longer maturities at a nominal value of SEK 3 billion and SEK 0.5 billion respectively per month, starting in April.

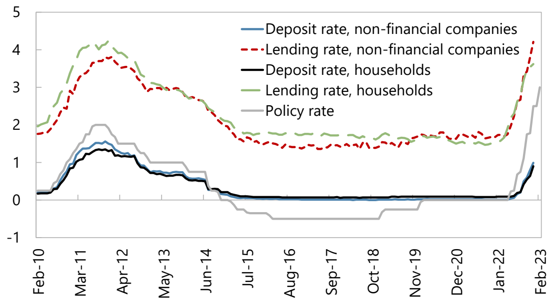
18. The Riksbank continued to carefully explore the introduction of e-krona and more in-depth studies are needed. An e-krona pilot aims to test technological design details while limiting risks, including financial disintermediation and cybersecurity concerns, as well as to consider the appropriate legal framework. In February 2021, Phase 2 of the pilot was concluded, and tests showed possible integration into existing infrastructure, as well as the possibility to have off-line e-krona transactions. The pilot is entering Phase 3, which focuses on specific parts of the technical solution (e.g., role of DLT and token-based solutions in innovations in payments) and preparing the requirements of an e-krona.

Authorities' Views

19. The authorities highlighted that the interest rate path is intended to indicate a projection for the inflation and future interest rates rather than a commitment. The current disinflation path reflects the expectation of a steady dissipation of the supply shock. They believed that risks to the real economy were tilted to the downside due to the impact of both energy prices and high interest rates on consumption, while uncertainty concerning inflation was high, with risks tilted to the upside. However, their decisions on the rate path will be data driven. They saw merit in publishing the forecast path for transparency reasons. With regards to quantitative tightening, the Riksbank plans to continue to reduce its balance sheet by not replacing maturing bonds and by selling government bonds with longer maturity, while being mindful of the impact on liquidity.

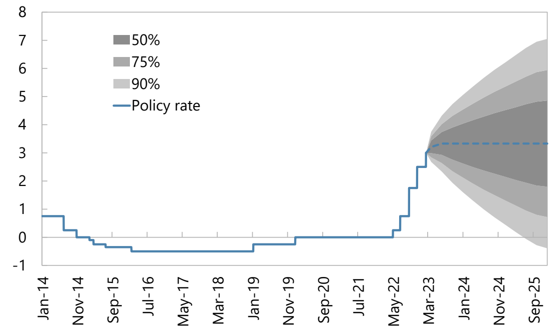
Figure 3. Selected Monetary and Financial Indicators

Policy Rate, Average Deposit and Lending Rates
(Percent, new loans)



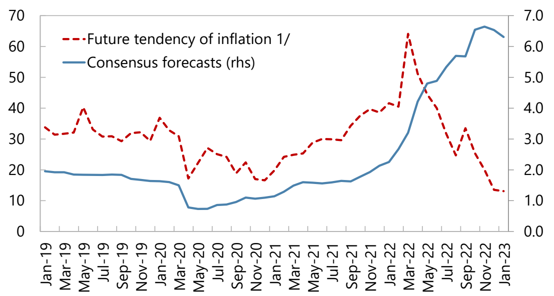
Sources: Statistics Sweden; and Riksbank.
Note: The household lending rate refers to loans for housing purposes.

Policy Rate with Uncertainty Band
(Percent)



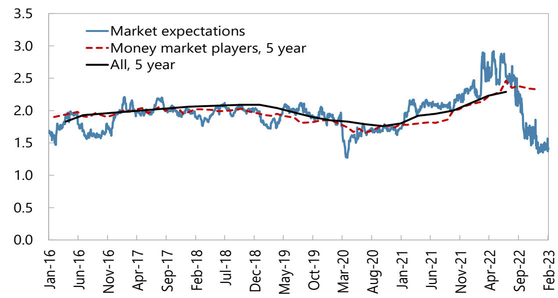
Source: The Riksbank's Monetary Policy Report, February 2023.

Inflation Expectations over the next 12 Months
(Percent)



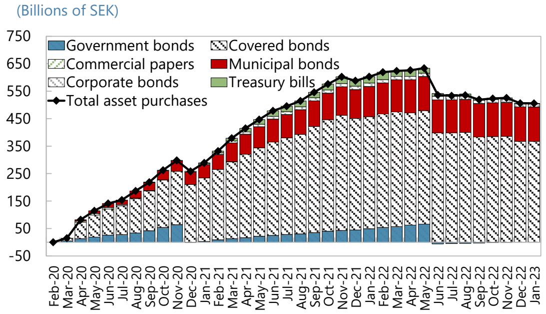
Sources: Consensus Forecast; and OECD.
1/ Net balance of the percentages of respondents giving favourable and unfavourable answers, which answer to the survey question: "By comparison with the past 12 months, how do you expect that consumer prices will develop in the next 12 months?"

Long-term Inflation Expectations
(Percent)



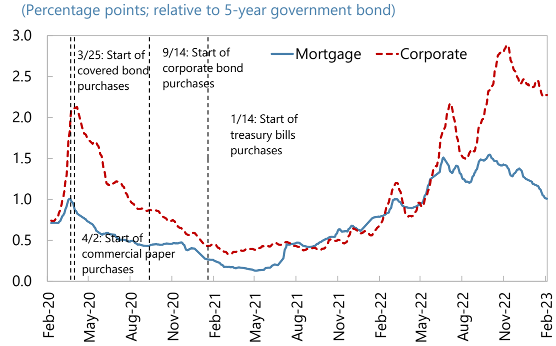
Sources: Kantar Prospera and the Riksbank.

Asset Purchases since Covid
(Billions of SEK)



Sources: Riksbank; and IMF staff calculations.
Note: The purchases represent the net amount of assets purchased, meaning the total assets minus the matured assets.

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



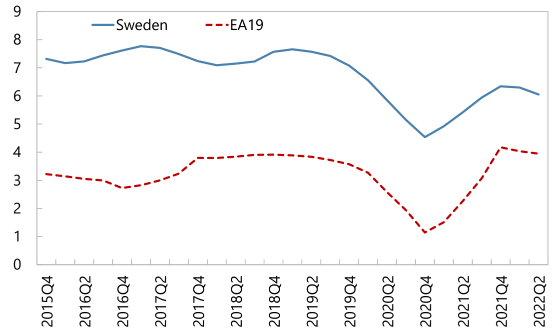
Sources: Haver Analytics; Riksbank; and IMF staff calculations.
Notes: 7-day rolling averages

C. Financial Sector and Macroprudential Policies

20. **Sweden's banking sector entered the current economic juncture with generally solid fundamentals.** Banks have structurally higher profitability than its European peers, high regulatory capital, and liquidity positions exceeding regulatory minima of 100 percent in all banks (Figure 4). The sector's assets were around 300 percent of GDP at end–2021, with the five largest banks accounting for over 75 percent of deposits and lending. Swedish banks are highly interconnected

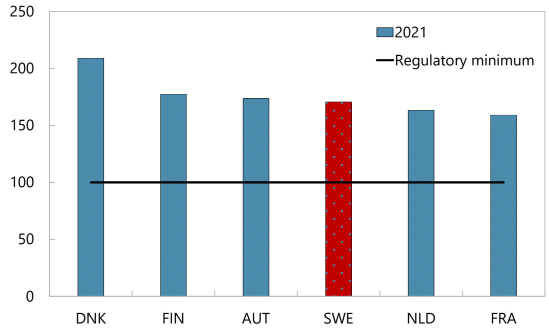
Figure 4. Selected Banking Indicators

Return on Equity, All Banks
(Rolling four quarters; percent)



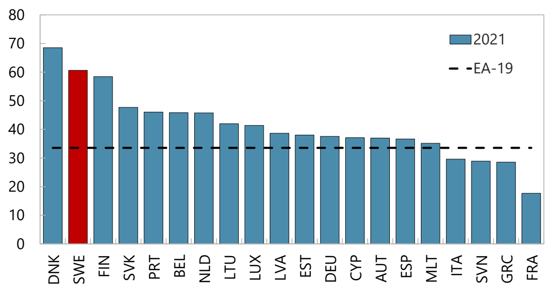
Sources: European Central Bank; and Haver Analytics.

Liquidity Coverage Ratio
(Percent)



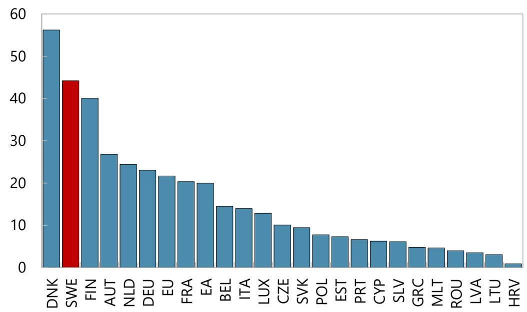
Source: European Central Bank.

Real Estate Exposure Share
(Percent; domestic banks)



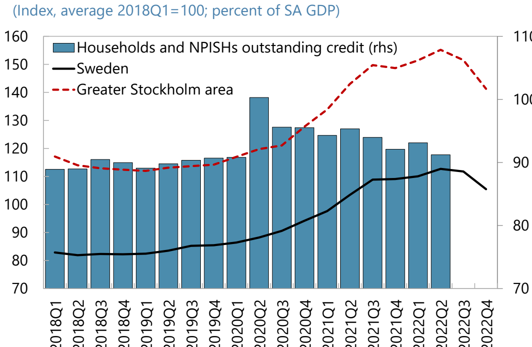
Source: European Central Bank.
Note: Mortgage loans as percent of total consolidated loans and advances of domestic banks.

Bank Funding Structures 1/
(Percent of total liabilities, 2021)



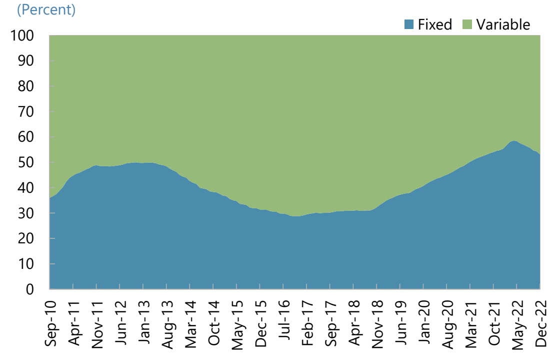
Source: European Central Bank.
1/ Ratio of credit institutions' deposits and debt securities to total liabilities.

Household Credit and House Price Index
(Index, average 2018Q1=100; percent of SA GDP)



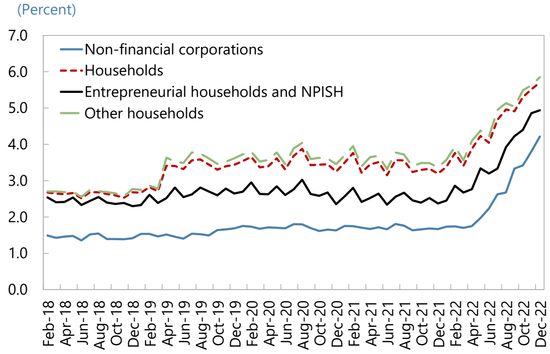
Sources: Haver Analytics; Statistics Sweden; and IMF staff calculations.

Fixed and Variable Mortgage Rates in Sweden
(Percent)



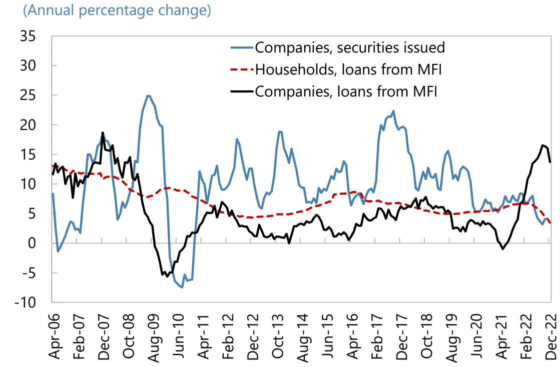
Sources: Haver Analytics; and Statistics Sweden.

MFI Lending Rates
(Percent)



Source: Statistics Sweden.

Household and Corporate Borrowing
(Annual percentage change)



Sources: Statistics Sweden; and Riksbank.

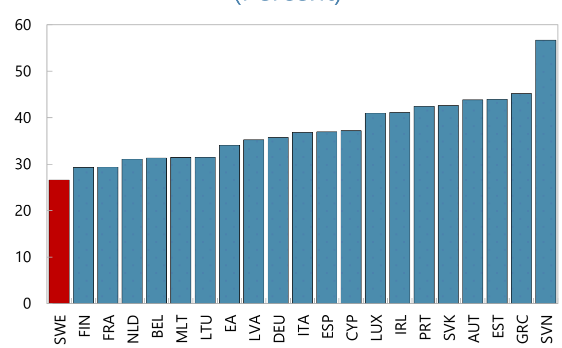
regionally, as they are active across the Nordic-Baltic region, and the UK.[2] They depend on international markets and domestic non-bank financial institutions for their mortgage funding via covered bonds. The share of wholesale funding in the three major banks remains high at around 63 percent.

21. Structural vulnerabilities highlighted in the previous FSAPs have intensified. The 2022 FSAP identified that banks have maintained high exposure to residential real estate, with the largest banks accounting for 75 percent of the total mortgage lending. The housing market has been affected by long-standing supply and demand issues, but historical defaults rates have been extremely low given the low amortization requirements, very long maturities, generous social protection in the case of a job loss (Section D). Mortgages and lending to CRE constitute about 40 and 20 percent of banks' lending portfolios, respectively. While banks have high capital ratios, low risk weights on mortgages imply that these buffers are not as high when measured in SEK. These capital cushions could be challenged in case of a very large macro-financial shock, amplified by the high sensitivity to interest rates of households and corporates owing to their high level of indebtedness and short rate fixation (Figure 4).[3] Systemic risks are now elevated but remain manageable. Risks to financial stability have increased stemming from limited liquidity in the corporate bond markets, exposing especially the investment funds sector (Annex V).

22. FSAP stress tests suggest that banks could on average withstand severe shocks, but enhancements to the already comprehensive macroprudential policy toolkit can help further attenuate cyclical and structural risks.[4]

- Countercyclical capital buffer (CCyB): By June 2023, the CCyB will be at 2 percent. Since this level reflects a standard risk environment, the authorities should recalibrate the level of capital that would be required in a more heightened risk environment. While it could be too restrictive to raise it further at present, sectoral application could be considered for CRE, if the EU legislation permits. A regulation resulting in a very low level of risk weighted assets (RWAs) in the calibration of capital buffers, given low historical defaults on mortgages, could also be reviewed (Figure 5).

Figure 5. Risk Weighted Assets
(Percent)



Sources: ECB; and Haver Analytics

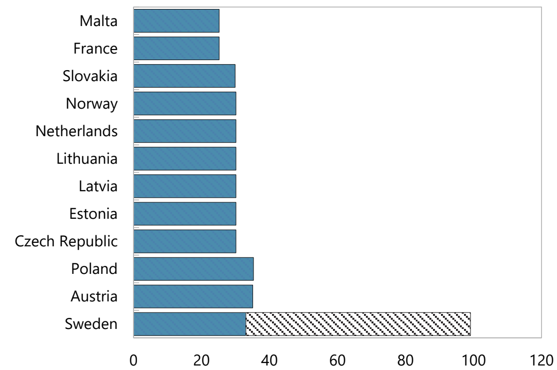
[2] Banks exited Russian and Ukrainian markets well before the start of the Russia-Ukraine war.

[3] See 2023 Financial Sector Stability Assessment (FSSA), including on banks' vulnerabilities to corporate exposures.

[4] FSAP tested banks' stability at house prices falling 38 percent in two years and interest rate at 4 percent. The FI recently conducted tests on new mortgages with rates going out to 7 percent assessing the repayment capacity of various households' based on income levels and recourse to unemployment insurance.

- Mortgages: Amortization requirements are currently 1 percent per year for loan-to-value (LTV) below 70 and 2 percent for LTV below 85 percent. These rates are low compared to international lending standards. As financial conditions stabilize, the requirement should be gradually increased to safeguard against greater borrowing and perpetual mortgages (Figure 6). Caps on the length of mortgage loans and/or debt-to-income (DTI) and debt-service-to-income (DSTI) ratios should also be introduced. Collecting better data on household assets and liabilities would help calibrate better the macroprudential policies (Box 2).

Figure 6. Maximum Implied Mortgage Length



Source: OECD.

- **CRE supervision:** Greater use of "soft powers" and joint communication by institutions comprising the Financial Stability Council could help influence firms' behavior. CRE firms could also be required to disclose their contingency funding plans in their annual reports and bond prospectuses (Annex VI, 2023 Selected Issues paper). In addition, higher capital requirements, or sectoral CCyB or Systemic Risk Buffer (SRB) for banks' exposures to CRE risks—due to notable amplification and spillover channels from CRE solvency to the macro-economy—should be considered (Annex VI).

23. **Banking and fintech supervision and crisis management framework have improved but could be strengthened further.** The frequency and intrusiveness of onsite inspections need to increase, and more efficient analytical tools and dashboards could facilitate offsite monitoring of banks. The crisis management framework would benefit from greater clarity and guidance in multiple areas (Annex V). Regulation and cross-border supervisory arrangements need to adapt. The fintech sector is growing rapidly in size and relevance and needs to be better understood. Cyber threats/attacks have become more prominent, hitting many Swedish financial institutions. Thus, a framework for comprehensive operational and cyber resilience is needed. Given a potential increase in bankruptcies, bankruptcy framework should be strengthened, including by streamlining procedures, reducing barriers to restructuring, and lowering costs.

24. **Efforts to enhance the understanding of money-laundering/terrorist financing risks and strengthen the AML/CFT framework should continue.** FATF recognized Sweden's progress to broaden the scope and content of measures for fit and proper requirements. Further developing (and increasing resources) AML/CFT supervisory risk assessment tools should be prioritized in order to deepen the understanding (for example, the collection and analysis of more granular data on transactions) of cross-border non-resident ML/TF risks and ensure that risk-based supervisory activities target the highest ML/TF risk areas. The FI should step up AML/CFT supervision targeted towards correspondent banking activities and Virtual Asset Service Providers. The ongoing regional IMF Nordic-Baltic Technical Assistance Project that focuses on analysis of cross-border ML/TF threat

and related aspects of banking sector supervision, potential financial integrity implications on financial stability, and virtual assets is due to be finalized in 2023.

Box 2. Gaps in Household Data Statistics

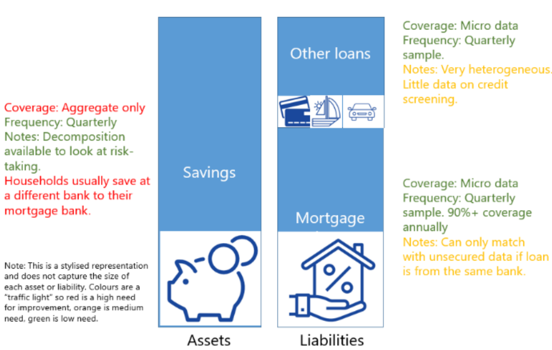
No legal entity in Sweden has a mandate to collect household-level (HH) data on finances. Statistics Sweden (STA) is responsible for this type of statistics but is not able to show HHs' assets and liabilities on a disaggregated level, partly because the individual expenditure is no longer available as the tax returns no longer contain data on wealth due to the 2007 tax reform. The STA has been publishing information since 2016 on HHs' total real and financial wealth, broken down into a few different asset and liability types. While Swedish HH, in aggregate, are net asset holders, detailed data on the distribution of wealth and debt would be more helpful in identifying pockets of vulnerabilities.

Since 2011, the Riksbank has made several proposals to start collecting data. A government inquiry into HHs' over-indebtedness during 2000s also pointed to the same need. In 2016, the FSAP recommended to act quickly to gather data on households' balance sheets. The government-commissioned 2021 inquiry investigating how individual-based statistics on households' assets and liabilities could be produced, is currently undergoing a public consultation.

Some headway has been made in collecting data, but there are limits. Since the last FSAP, the FI has been able to collect HH data to get a better picture of finances, but it is only able to do it at the *household-bank level*. With better data, the FI would be able to calibrate and target macroprudential policies leading to better cost-benefit trade-offs. It will also mean that it is easier for anyone to assess the effect of macroprudential measures and therefore improve accountability.

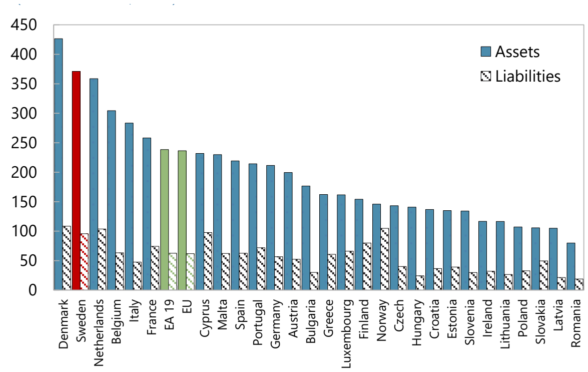
In many European countries, the HH data collection is more advanced than in Sweden. Under the European System of Central Banks' initiative, the micro-level structural data on HHs' finances and consumption is collected through the Household Finance and Consumption Network in a harmonized survey. The Austrian central bank is responsible for maintaining the dashboard presenting comparable data across participating countries (the Euro Area, Poland, Slovakia, Hungary). While the Riksbank is a member, there is no Swedish data available.

Stylized Diagram of the Authorities' Ability to Observe Household Balance Sheets



Sources: Finansinspektionen and IMF staff estimates.

Total Assets and Liabilities of Households
(Percent of GDP, 2021)



Source: Eurostat.

Authorities' Views

25. The FSA did not see a current need to revisit the CCyB level. According to the FSA, banks have already internalized the need to raise additional capital, and the interest rate hikes are generating enough deleveraging in the economy to reduce risks. The authorities agreed that RWAs are low but contended that this is related to structural issues of the Swedish banks and pointed out to the relatively high capital ratios. They noted the ongoing review of IRB models, which is expected to result in risk weights being harmonized and on an overall level more conservative. They did not see a need to increase the residential mortgages' amortization requirement as they considered the current household borrower-based measures as sufficient given ongoing adjustments in mortgage markets. They agreed on the need to address data gaps and hoped to build on the progress made in aggregating total loan portfolios of borrowers and to possibly make similar progress for savings, despite the lack of a register of household assets and debts. The Riksbank and the FSA emphasized that the lack of such statistics in Sweden imposes constraints on the analysis of important questions linked to financial stability and monetary policy. The authorities noted that even if the number of onsite inspections has been assessed as few, the supervisory outcome of the onsite inspections conducted are sufficiently intrusive, and they stressed that to increase the number of onsite inspections more personnel is required. The authorities saw merit in further strengthening the crisis management framework. They noted that resources for AML/CFT work have increased substantially in the past years and that they are continuously improving risk assessment tools.

D. Structural Policies

26. The structural reform agenda will be guided by the Recovery and Resilience Plan (RRP). Most of the commitments under the RRP are to be completed by end-2023. These include reforms and investments to increase the resilience of the economy through tackling demographic and educational challenges and addressing the disfunctions of the housing market. The "Tidö" Agreement compliments the RRP and sets out the reform agenda for the next four years. It focuses on health, climate and energy, crime, migration and integration, education, growth, households, and economy.

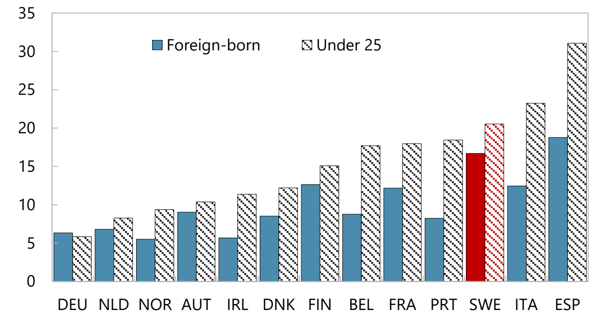
Box 3. Key Deliverables Under the Recovery and Resilience Plan for 2022–23

- Entry into force of a law abolishing the reduction of energy tax on fuel in certain sectors.
- At least 7,900 new study places created in vocational training and adult education.
- Entry into force of changes in the employment protection framework and new regulations providing greater transition possibilities.
- At least 18,400 buildings newly connected to broadband access.
- Implementation of a new bank account and safe deposit box system that can be checked directly by the competent authorities.
- Entry into force of a law setting better standards for housing construction.

27. Efforts should persist to tackle education and skills gaps, especially for the foreign-born. The unemployment rate is one of the highest in the region due to the slow progress in integrating low-skilled workers (Figure 7). Policy actions should include active labor market and retraining policies, especially for the youth and women (WEO, 2020). Both the "job-matching" program and Intensive Year program, which aim at newly arrived refugees, are commendable. At the same time, there is a needed to enhance the effectiveness of the Public Employment Service, vocational training, and science and engineering education (EC, 2022).

Figure 7. Unemployment Rates: Young and Foreign-born, 2022Q3

(Percent, seasonally adjusted)



Sources: Eurostat; Haver Analytics; and IMF staff calculations.

28. Limited reforms are taking place to address housing market distortions. Recent actions focused mainly on the supply side of the market through providing investment subsidies for rental and student housing, shortening planning processes, and simplifying permits application. These reforms should be supplemented with lowering taxes on deferred capital gains, a gradual removal of interest rate deductibility, and increasing the extremely low property taxes (Annex VII; Box 4). In lieu of the tax breaks, social protection could be provided in a more efficient way, including through expanding the housing allowance. Easing rental controls and simplifying building codes is also vital to bringing more dynamism to the market.

29. Significant investments are being made in improving digitalization which should help further improve productivity. High-speed and reliable broadband connectivity is being expanded, especially in less populated areas, which will benefit inter-regional equity. The expansion of e-government services will also help improve the provision of services.

Stakeholder's Views

30. The authorities shared staff's views on the need to improve the functionality of the housing market. They also agreed on the importance of supporting the youth and foreign born through improving the effectiveness of the education and training programs to facilitate their entry into the labor force. They were confident that the October 2022 reforms to the employment protection framework will be implemented in a way that will be beneficial for the labor market. They also conveyed that the government remains committed to Sweden's climate targets and plan to raise additional investments if necessary, including to help upgrade the energy grid. They also intend to alleviate planning and difficulties related to permits for large investment projects.

Box 4. Mortgage Tax Relief in the European Union

A market distortion is created if a tax benefit favors one investment over another. Mortgage interest tax relief contributes to the favorable tax treatment of owner-occupied housing but may not necessarily fulfill its intended goal of increasing home ownership. Therefore, EC country-specific recommendations have long included advice to gradually abolish this benefit, also considering macroeconomic stability risks.

A recent EC study analyzed the effects of removing mortgage interest tax relief on public revenue and expenditure, household disposable income and income inequality in 14 EU Member States (MSs) using the microsimulation model EUROMOD.[1] It finds that the tax relief largely benefits households at medium to high income levels. Consequently, its removal could help decrease income inequality in almost all MSs. The impact of mortgage interest tax relief on government revenues is sizable in some MSs, with exceptionally large for the Netherlands (1.8 percent of GDP), followed by Belgium and Sweden (0.4 and 0.25 percent of GDP, respectively). The tax expenditures associated with interest deductibility alone amounts to around ½ percent of GDP (EC, 2022). Alongside low amortization rates and the low rate of recurrent property taxation, mortgage interest deductibility has been an important factor driving up house price growth and household debt in Sweden.

1/ MSs, which still had mortgage interest relief in 2018 for all mortgages and for which simulations were performed, were Belgium, Czechia, Estonia, Italy, Luxembourg, the Netherlands, Finland, and Sweden.

STAFF APPRAISAL

31. Following a strong post-pandemic recovery, Sweden is faced with substantial economic uncertainty. A mild recession is expected in 2023 while inflationary pressures are proving difficult to abate despite numerous policy actions. Strong employment so far is a positive sign and should partly attenuate the burdens placed on households from higher debt servicing, inflation and house price declines. The latter, together with lower CRE yields, highlight the well-known vulnerabilities in these two sectors, such as their high exposure to variable interest rates and high leverage.

32. Fiscal policy will need to strike a fine balance between supporting the vulnerable and containing demand pressures. The slightly contractionary stance in 2023 will help support monetary policy's efforts. The fiscal stance should adapt to developments, including by allowing the automatic stabilizers to fully operate. Energy support measures were swift, and small compared to other European countries. However, they could have been more targeted to the vulnerable segments of the population. In this regard, the discontinuation of the climate bonus for electric cars and lowering taxes on fuels risks reversing progress towards reducing carbon emissions and meeting Sweden's climate goals. As inflation subsides, investments should be increased to support green transition and inclusive growth. A gradual rise in the extremely low property taxes would help finance the above expenditures and make the housing market more dynamic. While the pension reform that links retirement age to life-expectancy is welcome, additional reforms that reduce the high labor tax wedge would further increase labor supply and lower debt in the long-run. Given the available fiscal space and favorable debt dynamics, a small deviation from the surplus target over the medium-term would allow for additional growth-enhancing infrastructure and social spending.

33. Monetary policy should continue to forcefully tackle inflation if it persists. The increases in the policy interest rate have been appropriate and a more aggressive tightening path may be needed in the short run to avoid the risk of entrenched inflation. The ongoing tapering of the asset purchase program will contribute to the needed overall tightening but could be recalibrated in line with market and inflation conditions. Avoiding policy surprises is essential to help anchor inflation expectations.

34. Tighter financial conditions are testing the resilience of the banking sector. The IMF Financial Sector Assessment Program confirmed banks' strong capital position and resilience to severe macroeconomic shocks, while revealing pockets of vulnerabilities in the face of higher interest rates. Special attention needs to be given to residential and commercial real estate developments. The frequency and intrusiveness of onsite inspections should increase given the looming uncertainties. Furthermore, CCyB level and other buffers may need to be recalibrated to better reflect risks, and possibly tightened for CRE, and enhancements to the macroprudential toolkit on mortgages would help attenuate risks, such as gradually increasing the mortgage amortization requirement. Greater disclosure by CRE firms and collecting better data on household assets and liabilities would help calibrate macroprudential policy. The crisis management framework would benefit from greater clarity. In addition, while good progress has been made in anti-money laundering efforts, further developing supervisory risk assessment tools would help deepen the analysis of cross-border risks.

35. Implementation of structural reforms is essential to support growth, productivity and improve social outcomes. Tackling education and skills gaps, especially for the foreign-born, is a priority, and it is important to increase efficiency of programs and regional services. Education enhancements should particularly focus on science, engineering, and vocational training. More reforms are also needed to address housing market distortions. In this regard, it would be important to gradually ease rent controls and simplify building codes, while substituting rent-controls with more efficient social protection. There is also a need to implement reforms that raise incentives to work to further increase labor market participation. To achieve Sweden's ambitious climate goals, its high carbon tax should be complemented with increased investments in energy supply and transmission, including renewables and the electricity grid. All the above will help boost Sweden's productivity and inclusive and green growth over the medium-term.

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

Table 1. Sweden: Selected Economic Indicators, 2020–28

			Est.	Projections					
	2020	**2021**	**2022**	**2023**	**2024**	**2025**	**2026**	**2027**	**2028**
Real Economy (percent change)									
Real GDP	-2.2	5.1	2.8	-0.3	1.4	2.3	2.3	2.3	2.3
Domestic demand	-2.3	5.7	4.2	-0.6	0.7	2.1	2.0	2.0	2.0
Private consumption	-3.2	6.0	2.8	-0.2	1.5	2.8	2.8	2.8	2.8
Public consumption	-1.8	2.8	-0.2	0.2	0.7	1.0	1.0	1.0	1.0
Gross fixed investment	1.7	6.4	5.6	-2.3	1.0	1.7	1.7	1.7	1.7
Net exports (contribution to growth)	0.0	-0.3	-1.2	0.3	0.7	0.3	0.4	0.4	0.4
Exports of G&S	-5.5	7.9	4.4	0.1	3.4	3.4	3.5	3.5	3.5
Imports of G&S	-6.0	9.6	7.8	-0.4	1.9	3.0	3.0	3.0	3.0
HICP inflation (average) 2/	0.7	2.7	8.1	6.5	3.0	2.3	2.0	2.0	2.0
HICP core inflation (average)	1.5	1.6	5.5	5.2	2.6	2.2	2.0	2.0	2.0
Unemployment rate (percent)	8.5	8.8	7.5	7.7	8.0	7.9	7.9	7.9	7.9
Gross national saving (percent of GDP)	31.0	32.2	31.7	31.5	31.9	32.0	32.1	32.1	32.2
Gross domestic investment (percent of GDP)	25.1	25.9	27.9	28.0	27.9	28.0	27.9	27.9	27.9
Output gap (percent of potential)	-2.6	0.4	1.3	-0.9	-1.1	-0.5	0.0	0.0	0.0
Public Finance (percent of GDP)									
Total revenues	48.3	48.4	47.5	46.9	47.7	48.0	48.0	48.0	48.0
Total expenditures	51.0	48.5	46.8	46.8	48.0	48.0	47.7	47.7	47.7
Net acquisition of nonfinancial assets	1.6	1.3	1.2	1.2	1.4	1.3	1.3	1.3	1.3
Net lending	-2.8	-0.1	0.7	0.0	-0.3	0.0	0.3	0.3	0.3
Structural balance (as a percent of potential GDP)	-1.7	-0.2	0.2	0.4	0.1	0.2	0.3	0.3	0.3
General government gross debt, official statistics	39.5	36.3	31.3	31.1	30.5	29.5	28.4	27.2	25.9
Money and Credit (year-on-year, percent change, eop)									
M3	17.8	9.7	2.4	...	...	...	...	...	...
Bank lending to households	5.5	6.8	3.5	...	...	...	...	...	...
Interest Rates (percent, end of period)									
Repo rate	0.0	0.0	2.5	...	...	...	...	...	...
Ten-year government bond yield	0.0	0.3	1.5	...	...	...	...	...	...
Mortgage lending rate	1.4	1.4	3.4	...	...	...	...	...	...
Balance of Payments (percent of GDP)									
Current account	6.0	6.3	3.8	3.6	4.0	4.0	4.2	4.2	4.2
Foreign direct investment, net	0.7	1.0	1.6	1.7	1.4	1.3	1.2	1.1	0.8
International reserves, changes (in billions of US dollars)	-0.3	6.0	...	...	...	...	...	...	...
Reserves coverage (months of imports of goods and services)	3.2	2.8	2.7	2.7	2.7	2.6	2.5	2.5	2.4
Net international investment position	8.8	22.1	25.9	29.5	33.4	37.5	41.6	45.8	50.1
Exchange Rate (period average, unless otherwise stated)									
SEK per euro	10.2	10.3	10.9	...	...	...	...	...	...
SEK per U.S. dollar	8.4	9.1	11.1	...	...	...	...	...	...
Nominal effective rate (2010=100)	90.7	93.7	88.1	...	...	...	...	...	...
Real effective rate (ULC) (2010=100) 1/	93.8	97.2	91.1	...	...	...	...	...	...
REER ULC long run average deviation	-8.6	-5.1	-10.8	...	...	...	...	...	...
Real effective rate (CPI) (2010=100)	87.7	90.2	84.6	...	...	...	...	...	...
Fund Position (December 31, 2022)									
Quota (in millions of SDRs)	4,430								
Reserve tranche position (in percent of quota)	29.1								
Holdings of SDRs (in percent of allocation)	103.2								
Memorandum Items									
CPIF inflation (average)	0.5	2.4	7.7	...	...	...	...	...	...

Other Indicators
GDP per Capita (2021, USD): 60,029; **Population** (2021, million): 10.4
Key Export Markets: Germany, Norway, and Netherlands.

Sources: IMF World Economic Outlook; Swedish Ministry of Finance; Statistics Sweden; and IMF staff calculations.

1/ OECD based Unit Labor Cost (ULC) real effective exchange rate indicator.
2/ The unemployment rate and inflation represent actual figures, not predictions.

Table 2. Sweden: General Government Statement of Operations, 2020–28

			Est.	Projections					
	2020	2021	2022	2023	2024	2025	2026	2027	2028
				Billions of SEK					
Revenue	2,431	2,639	2,846	2,993	3,198	3,366	3,512	3,666	3,825
Tax revenue	1,994	2,177	2,266	2,399	2,578	2,691	2,802	2,923	3,047
Taxes on income, profits, and capital gains	893	982	1,018	1,070	1,184	1,244	1,294	1,350	1,411
Payable by individuals	741	798	821	868	963	1,011	1,054	1,100	1,150
Payable by corporations	152	184	197	202	221	233	240	250	261
General taxes on goods and services	624	670	738	780	840	875	914	954	999
Other Taxes	477	525	510	549	553	571	594	618	637
Social contributions	172	185	197	206	211	220	228	238	249
Grants	6	13	13	13	13	13	13	13	14
Other revenue	259	264	369	375	395	443	468	492	515
Interest income	20	18	20	21	22	23	24	25	26
Expenditure	2,571	2,644	2,805	2,991	3,217	3,364	3,491	3,641	3,800
Compensation of employees	652	680	697	740	807	847	888	931	976
Intermediate consumption	348	374	400	418	471	490	490	511	533
Interest payments	23	21	41	43	43	48	46	48	50
Social benefits	824	847	867	910	963	1,019	1,068	1,123	1,170
Expense not elsewhere classified	644	649	727	800	837	867	904	929	967
Net acquisition of nonfinancial assets	80	72	73	80	96	94	94	99	104
Gross operating balance	-60	67	113	82	77	96	115	124	129
Net lending / Borrowing	-140	-5	40	2	-19	2	21	25	25
				Percent of GDP					
Revenue	48.3	48.4	47.5	46.9	47.7	48.0	48.0	48.0	48.0
Tax revenue	39.6	39.9	37.8	37.6	38.5	38.4	38.3	38.3	38.3
Taxes on income, profits, and capital gains	17.7	18.0	17.0	16.7	17.7	17.8	17.7	17.7	17.7
Payable by individuals	14.7	14.6	13.7	13.6	14.4	14.4	14.4	14.4	14.4
Payable by corporations	3.0	3.4	3.3	3.2	3.3	3.3	3.3	3.3	3.3
General taxes on goods and services	12.4	12.3	12.3	12.2	12.5	12.5	12.5	12.5	12.5
Other Taxes	9.5	9.6	8.5	8.6	8.3	8.1	8.1	8.1	8.0
Social contributions	3.4	3.4	3.3	3.2	3.2	3.1	3.1	3.1	3.1
Grants	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other revenue	5.1	4.8	6.2	5.9	5.9	6.3	6.4	6.4	6.5
Interest income	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Expenditure	51.0	48.5	46.8	46.8	48.0	48.0	47.7	47.7	47.7
Compensation of employees	12.9	12.5	11.6	11.6	12.0	12.1	12.1	12.2	12.2
Intermediate consumption	6.9	6.9	6.7	6.5	7.0	7.0	6.7	6.7	6.7
Interest payments	0.5	0.4	0.7	0.7	0.6	0.7	0.6	0.6	0.6
Social benefits	16.4	15.5	14.5	14.3	14.4	14.5	14.6	14.7	14.7
Expense not elsewhere classified	12.8	11.9	12.1	12.5	12.5	12.4	12.4	12.2	12.1
Net acquisition of nonfinancial assets	1.6	1.3	1.2	1.2	1.4	1.3	1.3	1.3	1.3
Gross operating balance	-1.2	1.2	1.9	1.3	1.1	1.4	1.6	1.6	1.6
Net lending / Borrowing	-2.8	-0.1	0.7	0.0	-0.3	0.0	0.3	0.3	0.3
Structural Balance (percent of potential GDP) 1/	-1.7	-0.2	0.2	0.4	0.1	0.2	0.3	0.3	0.3
Fiscal impulse (expansionary +)	1.5	-1.4	-0.4	-0.2	0.2	-0.1	-0.1	0.0	0.0
Memorandum items:									
Gross public debt (percent of GDP)	39.5	36.3	31.3	31.1	30.5	29.5	28.4	27.2	25.9
Net public debt (percent of GDP)	8.1	7.1	4.8	6.1	6.7	6.8	6.6	6.4	5.9
Real GDP growth (percent change)	-2.2	5.1	2.8	-0.3	1.4	2.3	2.3	2.3	2.3
Output gap (percent of potential GDP)	-2.6	0.4	1.3	-0.9	-1.1	-0.5	0.0	0.0	0.0
Nominal GDP (in billions of SEK)	5,039	5,450	5,995	6,387	6,699	7,011	7,314	7,632	7,965

Sources: The 2023 Budget Bill; and IMF staff calculations.
1/ Structural balance takes into account output gaps.

Table 3. Sweden: Balance of Payments, 2020–28

	2020	2021	Est. 2022	Projections 2023	2024	2025	2026	2027	2028
				Billions of SEK					
Current Account Balance	300	343	228	228	265	282	305	322	338
Trade balance	226	233	120	113	144	156	173	192	211
Exports of G&S	2,219	2,495	2,586	2,588	2,679	2,769	2,866	2,967	3,071
Imports of G&S	1,993	2,261	2,466	2,475	2,535	2,613	2,693	2,775	2,860
Factor income, net	74	109	108	115	121	126	132	130	128
Net oil balance	-38	-53	-132	-115	-109	-104	-101	-98	-96
Financial Account Balance	-17	437	238	238	276	294	317	334	351
Investment abroad 1/	-1214	-1140	-1,001	-1,141	-1,171	-1,264	-1,353	-1,461	-1,622
Investment in Sweden	-1197	-1577	-1239	1,379	1,447	1,557	1,670	1,795	1,973
Reserves, change	-3	51	0	0	0	0	0	0	0
				Percent of GDP					
Current Account Balance	6.0	6.3	3.8	3.6	4.0	4.0	4.2	4.2	4.2
Trade balance	4.5	4.3	2.0	1.8	2.2	2.2	2.4	2.5	2.6
Exports of G&S	44.0	45.8	43.1	40.5	40.0	39.5	39.2	38.9	38.6
Imports of G&S	39.5	41.5	41.1	38.7	37.8	37.3	36.8	36.4	35.9
Factor income, net	1.5	2.0	1.8	1.8	1.8	1.8	1.8	1.7	1.6
Net oil balance	-0.8	-1.0	-2.2	-1.8	-1.6	-1.5	-1.4	-1.3	-1.2
Financial Account Balance	-0.3	8.0	4.0	3.7	4.1	4.2	4.3	4.4	4.4
Investment Abroad 1/	-24.1	-20.9	-16.7	-17.9	-17.5	-18.0	-18.5	-19.1	-20.4
Direct investment	4.3	4.2	4.0	3.8	3.6	3.6	3.5	3.3	3.2
Portfolio investment	5.6	6.6	3.2	3.2	3.1	3.1	3.3	3.1	3.0
Other investment	1.8	-1.0	0.7	0.6	1.3	0.9	0.3	0.1	-0.2
Reserves, change	-0.1	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Investment in Sweden	-23.8	-28.9	-20.7	21.6	21.6	22.2	22.8	23.5	24.8
Direct investment	3.6	3.2	2.4	2.1	2.2	2.3	2.2	2.2	2.3
Portfolio investment	7.0	-3.8	1.0	1.4	0.1	-0.4	-1.0	-1.6	-2.6
Other investment	-0.4	1.8	-0.3	-0.9	-0.1	0.0	-0.1	0.0	0.1
Errors and omissions	-6.3	1.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum									
Exports of G&S value 2/	-6.3	20.7	-12.1	-2.4	3.9	4.4	4.6	0.0	0.0
Imports of G&S value 2/	-7.4	21.9	-7.5	-2.1	2.8	4.1	4.2	0.0	0.0
Net international investment position (percent of GDP)	8.8	22.1	25.9	29.5	33.4	37.5	41.6	45.8	50.1
Nominal GDP (SEK billion)	5,039	5,450	5,995	6,387	6,699	7,011	7,314	7,632	7,965

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 UDS terms.

Table 4. Sweden: Financial Soundness Indicators, 2016–22

	2016	2017	2018	2019	2020	2021	2022 1/
Capital Adequacy							
Regulatory capital to risk-weighted assets	26.9	26.4	21.6	22.8	23.5	23.0	22.6
Regulatory tier 1 capital to risk-weighted assets	23.2	23.4	18.8	20.4	21.1	20.9	20.2
Total capital to total assets	6.3	6.3	3.8	6.2	6.0	6.7	7.1
Asset Quality and Exposure							
Non-performing loans to total gross loans	1.1	1.1	0.5	0.6	0.5	0.4	0.3
Non-performing loans net of provisions to capital	7.5	8.9	3.5	4.0	2.6	1.4	1.0
Earnings and Profitability							
Return on assets	0.8	0.8	0.5	0.9	0.7	1.1	1.0
Return on equity	10.0	9.5	7.2	13.0	10.0	12.8	11.7
Non-interest expenses to gross income, percent	54.3	56.6	53.1	51.5	55.0	48.6	50.9
Personnel expenses as percent of noninterest expenses	50.6	50.8	49.3	47.9	47.7	49.5	44.5
Liquidity							
Liquid assets to total assets (liquid asset ratio)	18.2	18.2	17.1	17.6	21.0	24.8	32.6
Liquid assets to short term liabilities	30.1	28.7	26.7	26.6	30.5	23.6	29.5
Customer deposits as percent of total (non-interbank) loans	44.9	44.8	41.8	43.1	47.6	60.6	60.3
Memorandum Items							
Change in housing price index (in percent, year average)	8.2	6.6	-0.9	2.5	4.2	10.1	4.9
Total household debt (in percent of GDP)	83.5	85.3	86.3	86.8	91.0	87.3	88.4
Total household debt (in percent of disposable income)	182.5	187.4	188.9	189.5	200.0	203.0	198.0
Household interest expenses (in percent of disposable income)	3.8	3.7	3.7	3.8	4.0	3.7	4.8
Gross debt of non-financial corporations (in percent of GDP)	169.0	170.8	174.6	185.8	200.7	197.5	N.A.

Sources: ECB; IMF Financial Soundness Indicators; Statistics Sweden; and OECD.
1/ 2022 shows 2022Q3.

Annex I. Summary of the Sovereign Risk and Debt Sustainability Assessment

Annex I. Figure 1. Public DSA—Composition of Public Debt and Alternative Scenarios

(In percent of GDP unless otherwise indicated)

Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	…	Low	The overall risk of sovereign stress is low, reflecting a relatively low level of vulnerability in the near- and medium-term and low levels of vulnerability over the long-term horizon.
Near term 1/			
Medium term	Low	Low	Medium-term risks are assessed as low against a mechanical signal of low. Sweden's low debt levels and historical debt performance suggest that medium-term risk are low as debt is very likely to continue to decline over the medium term.
Fanchart	Low	Low	
GFN	Low	Low	
Stress test	...	…	
Long term	Low	Low	Long-term risk are low. Only under the pension and health scenario would Sweden's debt increase substantially but even then it would remain below the EU Maastricht debt threshold of 60 percent. Also, the new pension reform, which links retirement age to 2/3 of life-expectancy, is going to ensure long-term sustainability of Sweden's fiscal position.
Sustainability assessment 2/	Not required for surveillance countries	Not required for surveillance countries	
Debt stabilization in the baseline			Yes

DSA Summary Assessment

Commentary: Sweden is at a low overall risk of sovereign stress and debt is sustainable. Strong growth, fiscal surpluses, and favorable interest rate/inflation dynamics have pushed debt even lower than before the pandemic and debt is projected to continue to decline. Medium-term liquidity risks as analyzed by the GFN Financeability Module and Fanchart are low as well. Over the longer run, Sweden debt is also at low risk of stress and only under very conservative assumptions, as in the pension and health scenario, it is expected to increase substantially. However, even then debt is comfortably below the EU Maastricht debt of 60 percent of GDP.

Source: IMF staff calculations.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex I. Figure 2. Debt Coverage and Disclosures

(In percent of GDP unless otherwise indicated)

Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	
2. Subsectors included in the chosen coverage in (1) above:						

		Subsectors captured in the baseline	Inclusion	Comments
CPS / NFPS / GG: expected / CG	1	Budgetary central government	Yes	
CPS / NFPS / GG: expected / CG	2	Extra budgetary funds (EBFs)	No	Not applicable
CPS / NFPS / GG: expected	3	Social security funds (SSFs)	Yes	
CPS / NFPS / GG: expected	4	State governments	No	Not applicable
CPS / NFPS / GG: expected	5	Local governments	Yes	Municipalities and Regions
CPS / NFPS	6	Public nonfinancial corporations	No	
CPS	7	Central bank	No	
CPS	8	Other public financial corporations	No	

3. Instrument coverage: Currency & deposits | Loans | Debt securities | Oth acct. payable 2/ | **IPSGSs 3/**

4. Accounting principles:

Basis of recording		Valuation of debt stock		
Non-cash basis 4/	Cash basis	Nominal value 5/	Face value 6/	Market value 7/

5. Debt consolidation across sectors: Consolidated | Non-consolidated

Color code: chosen coverage; Missing from recommended coverage; Not applicable

Reporting on Intra-government Debt Holdings

	Issuer \ Holder	Budget. central govt	Extra-budget. funds	Social security funds	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt			60.2		70.4		356.5	43.1	530.2
2	Extra-budget. funds									0
3	Social security funds	0.3								0.3
4	State govt.									0
5	Local govt.	2.2		1.7				9.8	217.5	231.2
6	Nonfin pub. corp.								245.3	245.3
7	Central bank	210.2		0		0.3				210.5
8	Oth. pub. fin. corp							109.9		109.9
	Total	212.7	0	61.9	0	70.7	n.a.	476.2	505.9	1327.4

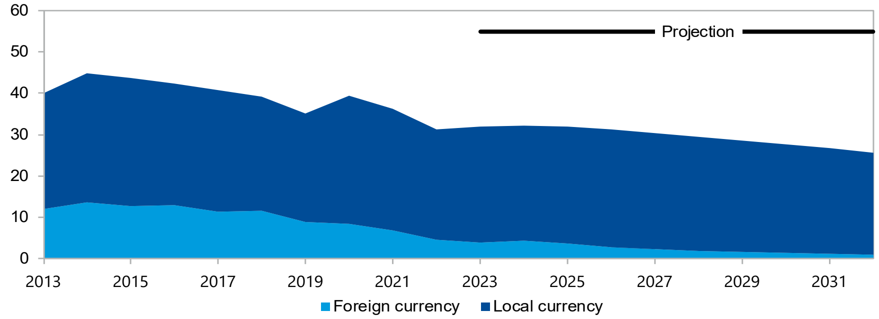
(Rows 1–5: GG: expected, NFPS, CPS; rows 1–2: CG; row 6: NFPS, CPS; rows 7–8: CPS.)

Commentary: In Sweden, the general government consist of the central government, the local government (which includes the regions and municipalities) and the social security funds.

Sources: IMF staff calculations; Swedish Authorities: OEDC; and Bloomberg
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

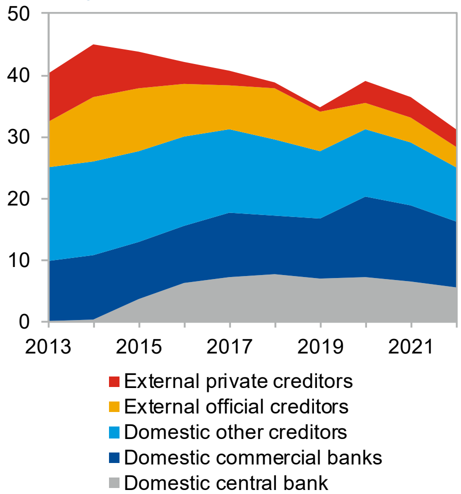
Annex I. Figure 3. Public Debt Structure Indicators

Debt by Currency (Percent of GDP)



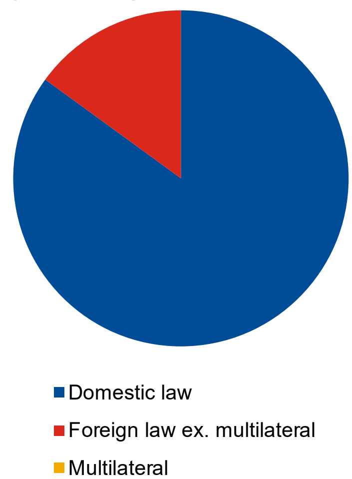
Note: The perimeter shown is general government.

Public Debt by Holder (percent of GDP)



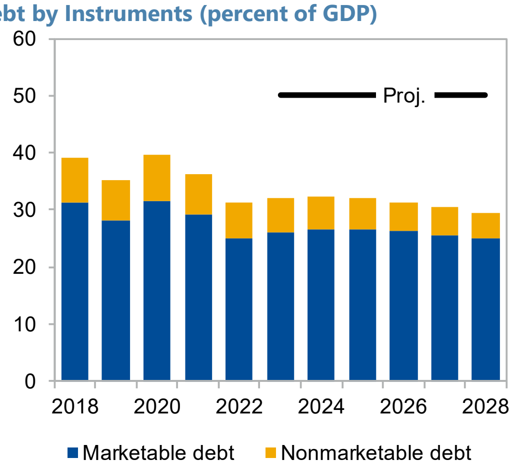
Note: The perimeter shown is general government.

Public Debt by Governing Law, 2022 (percent)



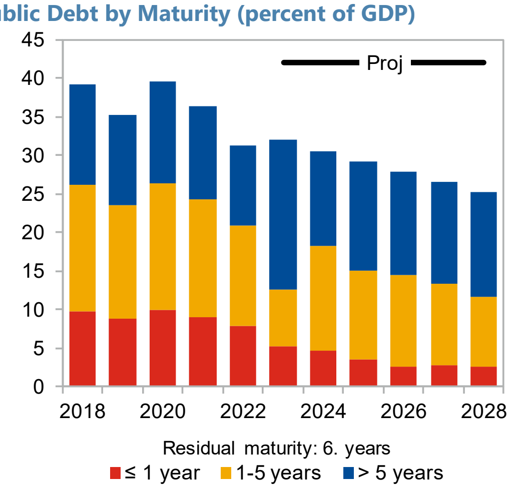
Note: The perimeter shown is general government.

Debt by Instruments (percent of GDP)



Note: The perimeter shown is general government.

Public Debt by Maturity (percent of GDP)



Note: The perimeter shown is general government.

Commentary: The share of FX debt in overall debt will steadily decline. This is due to the change how the Riksbank is financing its foreign reserves. Starting in 2021, the Riksbank is gradually replacing reserves that are borrowed through the National Debt Office (which is in charge of central government debt issuances and planning) with direct purchases. With this change, the government announced to reduces its FX debt gradually to zero as debt matures. This will also change the maturity profile of pubic debt. This is also one of the reasons debt declined more than usual in 2021 as Riksbank took over the responsibility for FX reserves management.

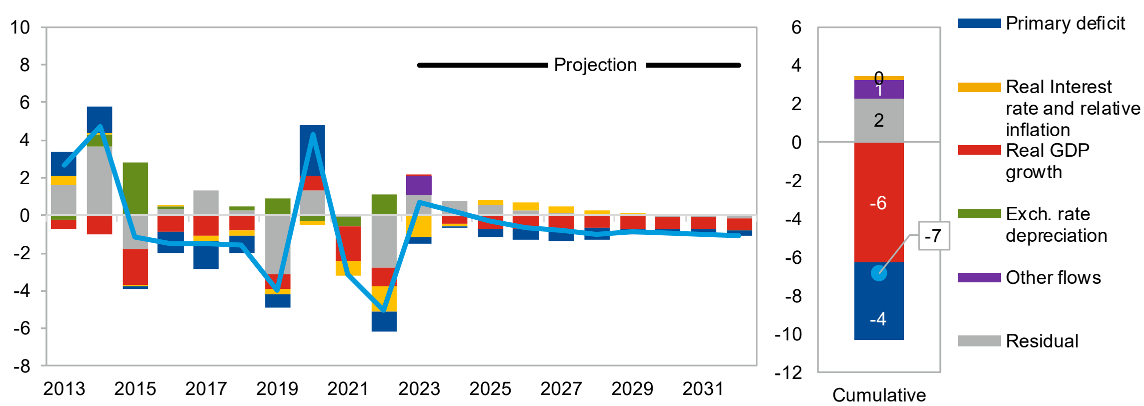
Sources: IMF staff calculations; Swedish Authorities; OECD; and Bloomberg.

Annex I. Figure 4. Public DSA—Baseline Scenario

(In percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032
Public Debt	31.3	32.0	32.2	31.9	31.3	30.4	29.4	28.6	27.6	26.7	25.6
Change in Public Debt	-5.0	0.7	0.2	-0.3	-0.6	-0.8	-1.0	-0.8	-0.9	-1.0	-1.1
Contribution of identified flows	-2.3	-0.5	-0.6	-0.8	-0.9	-1.0	-1.1	-0.8	-0.8	-0.9	-0.9
Primary deficit	-1.0	-0.4	0.0	-0.4	-0.6	-0.6	-0.6	-0.3	-0.3	-0.3	-0.3
Noninterest revenues	47.1	46.5	47.4	47.7	47.7	47.7	47.7	48.0	48.0	48.0	48.0
Noninterest expenditures	46.1	46.2	47.4	47.3	47.1	47.1	47.1	47.7	47.7	47.7	47.7
Automatic debt dynamics	-1.2	-1.0	-0.6	-0.4	-0.3	-0.3	-0.5	-0.5	-0.6	-0.6	-0.6
Real interest rate and relative inflatio	-1.4	-1.1	-0.1	0.3	0.4	0.4	0.2	0.1	0.1	0.0	0.0
Real interest rate	-1.6	-1.3	-0.2	0.3	0.4	0.4	0.2	0.1	0.1	0.0	0.0
Relative inflation	0.3	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Real growth rate	-1.0	0.1	-0.5	-0.7	-0.7	-0.7	-0.7 .	-0.7	-0.6	-0.6	-0.6
Real exchange rate	1.1	…	…	…	…	…	… .	…	…	…	…
Other identified flows	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingent liabilities	0.0	0.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other transactions	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contribution of Residual	-2.7	1.1	0.8	0.5	0.3	0.1	0.1	0.0	-0.1	-0.1	-0.2
Gross Financing Needs	-0.7	12.8	5.1	6.2	5.3	5.0	5.3	4.6	3.6	4.0	3.3
of which: debt service	0.7	12.6	5.5	6.9	6.2	5.9	6.2	5.1	4.2	4.6	3.9
Local currency	0.6	10.7	5.0	5.6	5.1	5.1	5.6	4.8	3.9	4.2	3.8
Foreign currency	0.1	1.9	0.4	1.3	1.2	0.8	0.6	0.4	0.3	0.4	0.1
Memo:											
Real GDP growth (percent)	2.8	-0.3	1.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator; percent)	7.0	6.9	3.4	2.3	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Nominal GDP growth (percent)	10.0	6.5	4.9	4.7	4.3	4.3	4.3	4.3	4.3	4.3	4.3
Effective interest rate (percent)	2.1	2.4	2.9	3.3	3.2	3.2	2.7	2.5	2.3	2.1	1.9

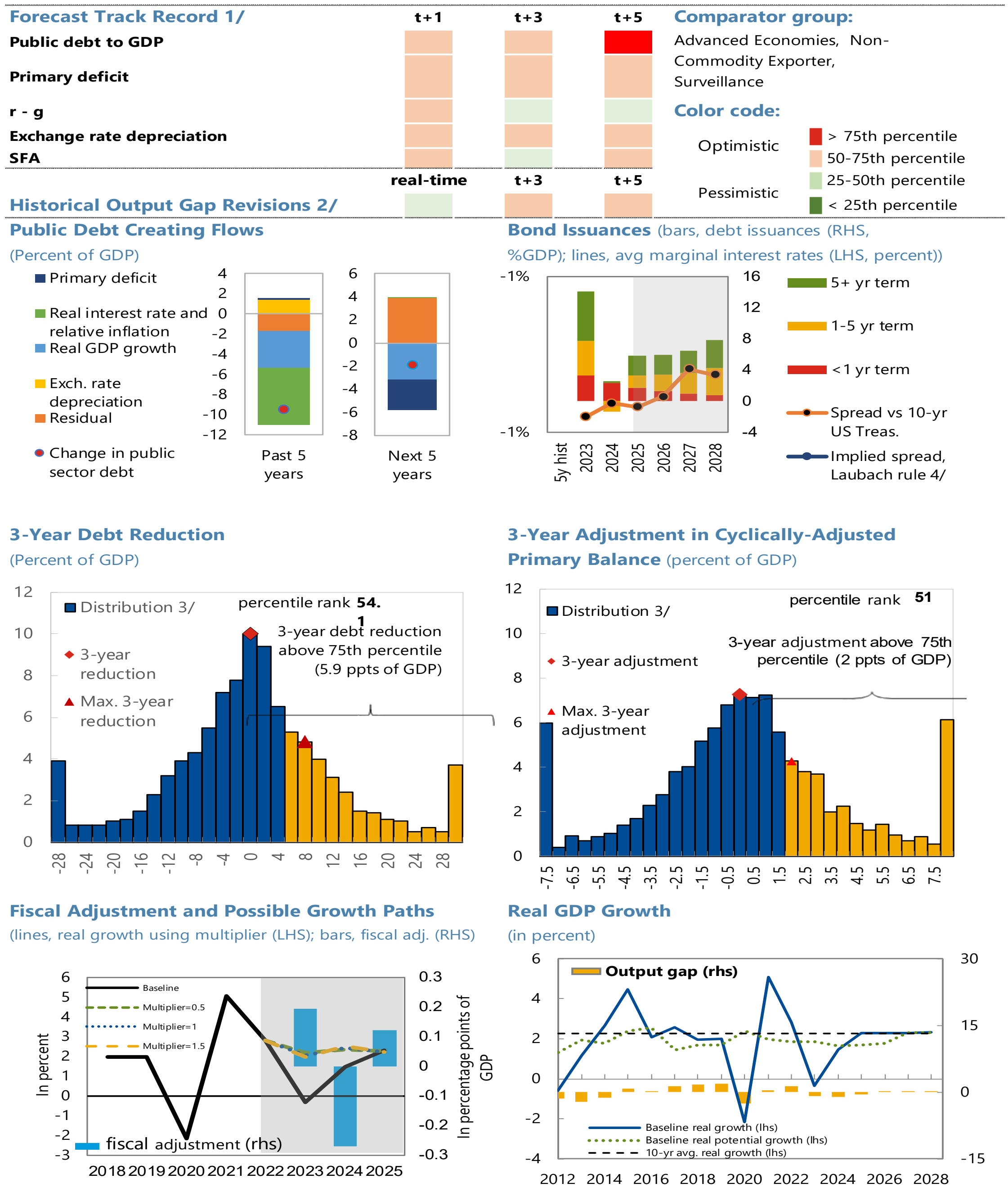
Contribution to Change in Public Debt



Staff commentary: Public debt is expected to decrease gradually due to a favorable growth dynamics and the assumption of continuing small primary surpluses till 2028 which is in line with the fiscal surplus target. After 2028 it is assumed that the authorities will adjust the surplus target to zero. Note that in 2023 we assume that the government will re-finance the Riksbank to the tune of SEK 60 bn under contingent liabilities. This still does not lead to an increase in debt to GDP.

Sources: IMF staff calculations; Swedish Authorities; OECD; and Bloomberg.

Annex I. Figure 5. Realism of Baseline Assumption



Commentary: Realism analysis does not point to major concerns: the projected fiscal adjustment and debt reduction are well within norms and slightly lower than in the past 5 years due to conservative assumptions.

Sources: IMF staff calculations; Swedish Authorities; OECD; and Bloomberg.

1/ Projections made in the October and April WEO vintage.

2/Data cpver ammia; pbersavtopms frp, 1990 to 2019 fro MAC advanced and emerging economies. Percent of sa.

3/ Starting point reflects the team’s assessment of the initail overvaluation from EBA (or EBA-Lite).

4/ The Lubach (2009) rule is a linear rule assuming bond spreads increase by about 4bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

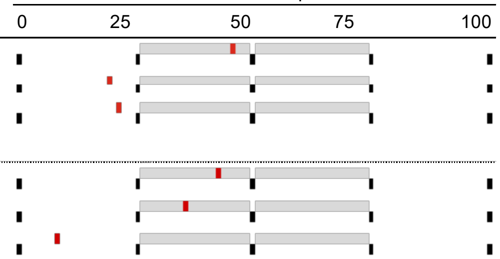
Annex I. Figure 6. Medium-term Risk Analysis

Debt Fanchart and GFN Financeability Indexes

(Percent of GDP unless otherwise indicated)

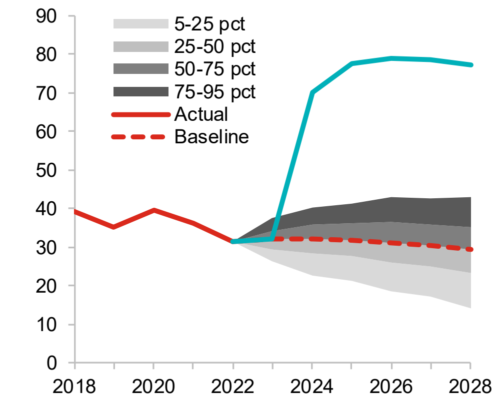
(percent of GDP unless otherwise indicated)

Module	Indicator	Value	Risk index	Risk signal
Debt fanchart module	Fanchart width	28.8	0.4	…
	Probability of debt not stabilizing (pct)	0.0	0.0	…
	Terminal debt level x institutions index	4.3	0.1	…
	Debt fanchart index	**…**	**0.5**	**Low**
GFN finance-ability module	Average GFN in baseline	6.6	2.3	…
	Bank claims on government (pct bank assets)	3.6	1.2	…
	Chg. in claims on govt. in stress (pct bank assets	0.4	0.1	…
	GFN financeability index	**…**	**3.6**	**Low**

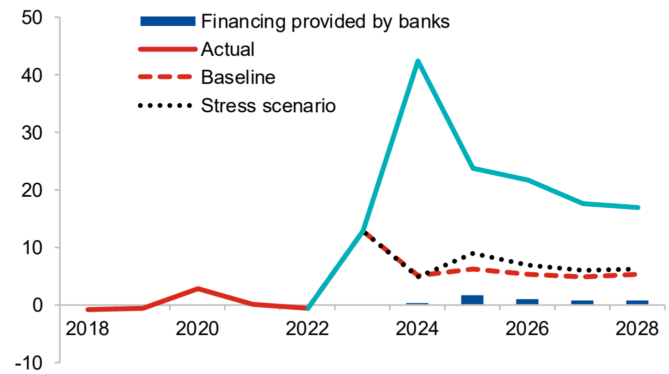


Legend: Interquartile range Sweden

Final fanchart (pct of GDP)



Gross Financing Needs (pct of GDP)

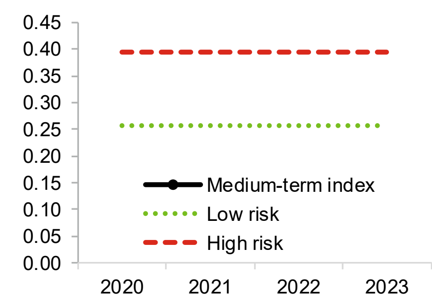


Triggered stress tests (stress tests not activated in gray)

Banking crisis Commodity prices Exchange rate Contingent liab. Natural disaster

Medium-term index

(index number)



Medium-term risk analysis

	Low risk threshold	High risk threshold	Weight in MTI	Normalized level
Debt fanchart index	1.1	2.1	0.5	0.1
GFN finaceability index	7.6	17.9	0.5	0.1
Medium-term index (MTI)	0.3	0.4	…	0.1, Low

Prob. of missed crisis, 2023-2028 (if stress not predicted): 0.0 pct.

Prob. of false alarm, 2023-2028 (if stress predicted): 92.0 pct.

Commentary: Both medium-term tools point to low level of risk; the Debt Fanchart Module and the GFN Financeability Module show that debt is on a declining path. The banking sector stress test was manually triggered by staff to assess risk from a extremely sever bank stress scenario. The size of Sweden's banking sector (about 300 percent of GDP) exposes the government to significant contingent liability risks, however, banks have thus far weathered well the tightening of financial conditions, reflecting the strength of banking supervision and macroprudential policies. Also due to well functioning resolution system, it is very unlikely for the government to assume 10 percent of banking sector assets as a liability.

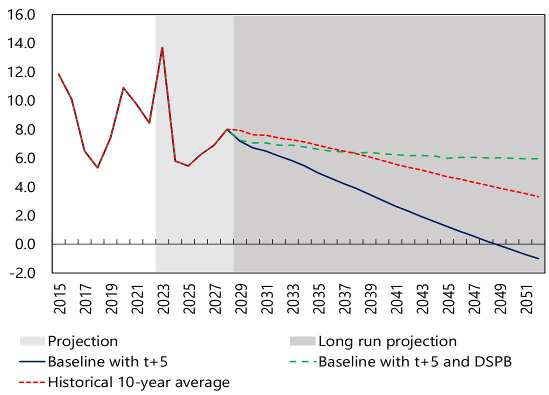
Sources: Bloomberg; IMF staff calculations; Swedish Authorities; and OECD.

Annex I. Figure 7. Long-term Risk Analysis

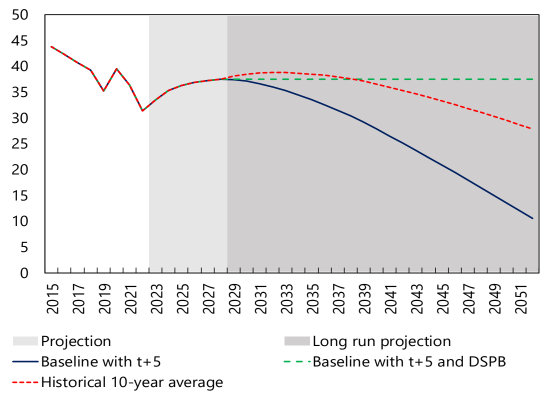
Large Amortization

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Medium-term extrapolation with debt stabilizing	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Historical average assumptions	GFN-to-GDP ratio Amortization-to-GDP ratio Amortization	
Overall Risk Indication		

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio

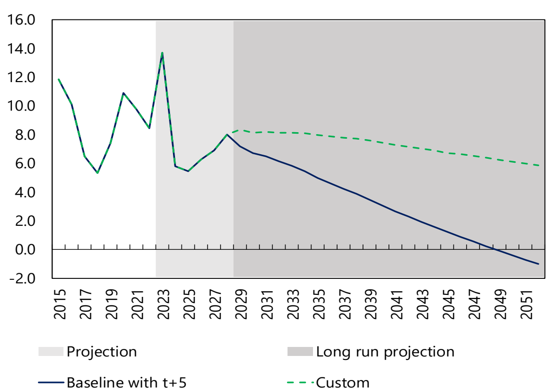


*DSPB=Debt Stabilizing Primary Balance

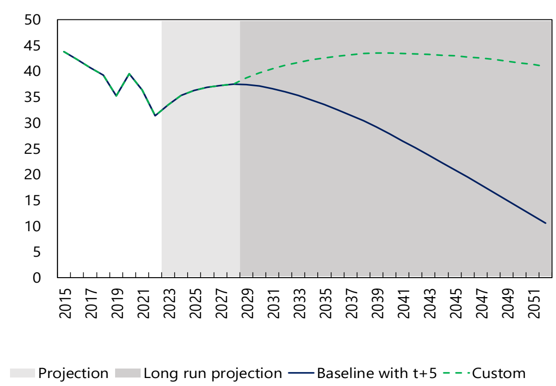
Custom

	Baseline Extension of Fifth Projection Year	Custom Baseline
Real GDP growth	2.3%	2.0%
Primary Balance-to-GDP	0.6%	-0.3%
Nominal depreciation	0.0%	2.0%
Inflation (GDP deflator)	2.0%	2.0%

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



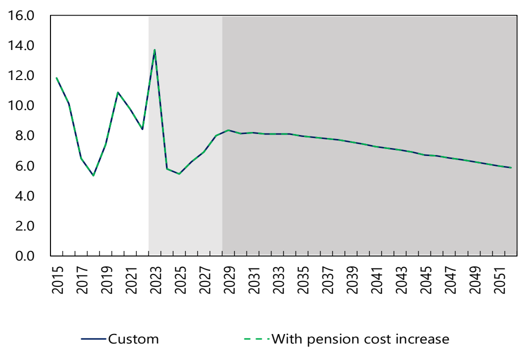
Sources: Bloomberg; IMF staff calculations; Swedish Authorities; and OECD.

Annex I. Figure 7. Long-term Risk Analysis (concluded)

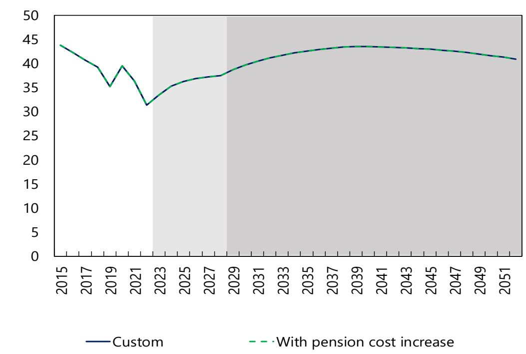
Demographics: Pension

Permanent adjustment needed in the pension system (pp of GDP per year)	To keep pension assets positive for:		
	30 years	50 years	Until 2100
	0.00%	0.81%	1.68%

GFN-to-GDP Ratio

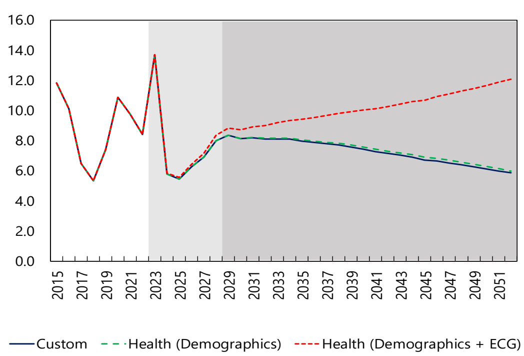


Total Public Debt-to-GDP Ratio

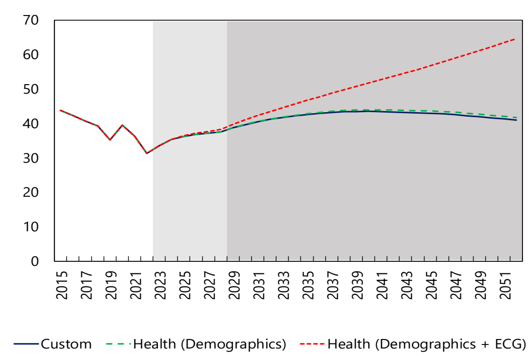


Demographics: Health

GFN-to-GDP Ratio



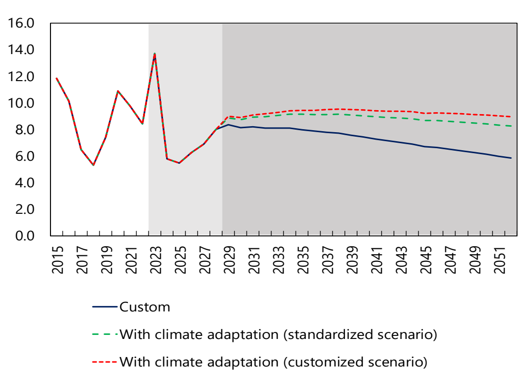
Total Public Debt-to-GDP Ratio



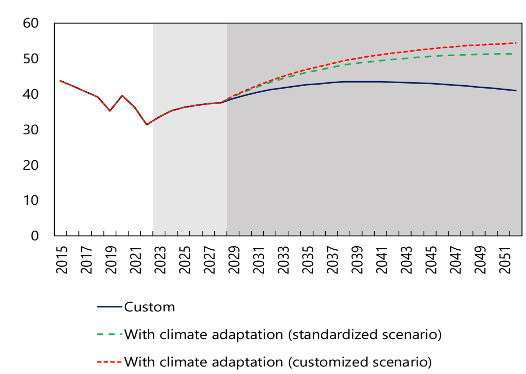
* ECG=Excess Health Care Growth (difference between avg. health care cost cpi and cpi)

Climate Change: Adaptation

GFN-to-GDP Ratio



Total Public Debt-to-GDP Ratio



* Customized scenario assumes an additional increase in the primary balance by 0.1 percentage point over the forecast horizon.

Sources: Bloomberg; IMF staff calculations; Swedish Authorities; and OECD.

Annex II. External Sector Assessment

<table>
<tr><td colspan="8">Overall Assessment: Based on preliminary estimates for 2022, the external position remains stronger than the level implied by medium-term fundamentals and desirable policies, despite a drop in the current account by 2.5 percentage points to 3.8 percent of GDP. The projected recession in 2023 and subsequent recovery are expected to bring the external balance further down before stabilizing at its long-term average of 3½ percent. However, this assessment is preliminary pending full-year data for 2022.
A complete analysis will be provided in the 2023 External Sector Report.
Potential Policy Responses: As inflation decelerates, there is scope to increase private and public investment in the green transition and the health sector which would also lower Sweden's external balance. Over the medium term, this would help Sweden attain its ambitious climate goals and prepare it for demographic challenges.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="7">Background. The Swedish net IIP is projected to reach 25.1 percent of GDP in 2022, an increase of 3.8 percentage points in line with the positive current account surplus. Gross liabilities are projected to decrease to 267 percent of GDP in 2022, with about a half being gross external debt (169 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. 50 percent of the IIP are in foreign currency.
Assessment. The net IIP is expected to rise further in the medium term, reflecting the outlook for continued CA surpluses. Sweden's foreign currency assets are almost three times as high as its foreign currency liabilities which provides a hedge against currency valuations. However, these projections are subject to uncertainty as Swedish IIP data includes large errors and omissions, which have averaged 2.2 percent of GDP in the past ten year. 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. The net IIP level and trajectory do not raise sustainability concerns.</td></tr>
<tr><td>2022 (% GDP)</td><td>NIIP: 25.1</td><td colspan="2">Gross Assets: 292.4</td><td colspan="2">Debt Assets: 83.8</td><td>Gross Liab.: 267.3</td><td>Debt Liab.: 133.6.</td></tr>
<tr><td>Current Account</td><td colspan="7">Background. The current account surplus dropped to 3.8 percent in 2022 on the back of lower net exports of goods (merchandise, manufactured goods, and mineral fuels) and high recovery-driven-imports of services (especially in travel and other business services). In 2022 gross savings declined by 0.5 percentage points to stand at 31.7 percent of GDP, while gross investment increased by 2.0 percentage points to 27.9 percent of GDP, with the decline in gross savings mainly due to the private sector. Sweden continues to be a net oil importer with the oil deficit widening from -1 to -2.2 percent of GDP. Over the medium-term, the current account is projected to return to its long-run average of 4.2 percent of GDP.
Assessment. The cyclically adjusted current account is estimated at 4.5 percent of GDP in 2022, 3.4 percentage points above the cyclically adjusted EBA norm of 1.1 percent of GDP. However, the estimated EBA norm for Sweden is low and continues to be below the actual CA outcome for the past two decades, suggesting that factors not captured by the model, such as Sweden's mandatory contributions to fully-funded pension schemes and an older labor force (with a high share of workers that are 65 years or more old), may also be driving Sweden's saving–investment balances. [Considering temporary COVID adjustments for travel (−0.3 percent of GDP), transport (−0.0 percent of GDP)] the IMF staff assesses the CA gap at 2.9 percent of GDP in 2022, with a model-estimated range of 2.5 to 3.3 percent of GDP. Policies that would explain this gap make up 0.3 percentage points with fiscal policy, which was much more contractionary compared to the rest of the world, accounting for 0.9 percent and partially offset by health (-0.1), reserves (+0.1) and credit (-0.6) gaps. However, the majority of this gap remains unexplained. Complementary EBA tools suggest that Sweden's pension system could explain about [1.5] percentage points of the gap.</td></tr>
<tr><td>2022 (% GDP)</td><td>Est. CA: 3.8</td><td>Cycl. Adj. CA: 4.6</td><td>EBA Norm: 1.1</td><td>EBA Gap: 3.5</td><td>COVID-19 Adj.: -0.3</td><td>Other Adj.:</td><td>Staff Gap: 3.2</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="7">Background. The krona depreciated by about 6 percentage points in real effective terms (OECD-ULC based) to be equal to 91 points in 2022 relative to its average index in 2021.
Assessment. The staff CA gap implies a REER gap of -9.4 percent (applying an estimated elasticity of 0.34), with a range between -8.2 to -10.6 percent (using the models, standard error of ± 0.4 percent of GDP). The REER index and level models suggest a gap of −17.4 percent and −19.4 percent, respectively, for 2022. The ULC-based REER index using OECD data depreciated and was 10.8 percent below its 30-year average (since the krona was floated in 1993) over the course of 2022. Because this indicator has fluctuated around a broadly stable level since the currency was floated, it provides a useful indication of valuation that the IMF staff prefers to use. Overall, the IMF staff assesses the krona to be undervalued between -4.9 to -15.7 percent, with a midpoint of -10.8 percent as guided by the ULC-based REER index and its standard deviation.[1]</td></tr>
</table>

Capital and Financial Accounts: Flows and Policy Measures	**Background.** The financial account plunged by 4.0 percentage points in 2022 to 4.0 percent of GDP. The change in net outflows was mainly driven by retreating portfolio investments which dropped from 10.4 to 2.2 percent of GDP (caused by a decrease in long-term debt securities) while direct investments improved from 1 to 1.6 percent of GDP. **Assessment.** Large changes in capital flows are common in countries with large financial sectors such as in Sweden where the banking sector is close to 300 percent of GDP. Risk can be mitigated by strong financial regulation and supervision and a sound financial sector. In the past years, the authorities have strengthened regulation by introducing liquidity coverage ratio requirements in foreign and domestic currency in addition to the overall liquidity coverage ratio, while banks have improved their structural liquidity positions. The recent FSAP found that the Swedish banking system appears to be resilient to large liquidity shocks despite its substantial share of wholesale funding.
FX Intervention and Reserves Level	**Background.** The exchange rate is freely floating since 1993 and there haven't been any interventions since 2002. Foreign currency reserves broadly remained constant at USD 56 billion in 2022, which is equivalent to 15 percent of the short-term external debt of monetary and financial institutions (primarily banks), about 9.3 percent of GDP and 2.7 months of imports. **Assessment.** Although the need for reserve holding is reduced under a floating exchange rate regime, it is important to maintain adequate foreign reserves, in view of the high dependence of Swedish banks on wholesale funding in foreign currency, and the disruptions in such funding that have occurred at times of international financial distress. It is reassuring that the Riksbank can quick establish swap facilities when necessary (as seen during the pandemic) and even though they were not. 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.

[1] The upper and lower range are derived by subtracting the standard deviation of the ULC-based REER index (which is 5.9 percent) from the average outcome which is the midpoint. The range is used to reflect uncertainty around the EBA estimated norm.

Annex III. Risk Assessment Matrix[1]

Risks	Likelihood of Risk	Impact of Risk	Policy Response
Intensification of regional conflict(s). Escalation of Russia's war in Ukraine or other regional conflicts and resulting economic sanctions disrupt trade (e.g., energy, food, tourism, and/or critical supply chain components), remittances, refugee flows, FDI and financial flows, and payment systems.	H	**Medium:** Sweden is not energy dependent on Russia. It is however exposed to uncertainties in trade and financial disruptions.	Fully use available fiscal space to provide targeted support to households and businesses overcome high energy prices and liquidity needs.
Abrupt global slowdown or recession. Global and idiosyncratic risk factors combine to cause a synchronized sharp growth slowdown, with outright recessions in some countries, spillovers through trade and financial channels, and downward pressures on some commodity prices.	M	**Medium:** 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.	Stand ready to implement further policy support. Maintain flow of credit by making sure fiscal and financial policies are adequately targeted and effectively deployed.
Europe: Intensifying fallout from the war in Ukraine, worsening energy crisis and supply disruptions, and monetary tightening exacerbate economic downturns and housing market corrections.	H	**Medium:** Sweden is not energy dependent on Russia. It is however exposed to uncertainties in trade and financial disruptions.	Fully use available fiscal space to provide targeted support to households and businesses overcome high energy prices and liquidity needs.
Monetary policy miscalibration. Amid high economic uncertainty and volatility, major central banks slow monetary policy tightening or pivot to loosen monetary policy stance prematurely, de-anchoring inflation expectations and triggering a wage-price spiral in tight labor markets.	M	**High:** Riksbank has already started monetary policy normalization. Bank capital adequacy is high. A need for additional tightening may have adverse spillovers to corporate and household sectors through higher debt service and reduced demand.	Maintain flow of credit by making sure financial policies are adequately targeted and effectively deployed. Reintroduce the guaranteed scheme for bank loans to businesses if needed. Fiscal risks are limited in response to a rise in global risk premia.
Significant property price decline in Sweden due structural changes. Price declines could possibly affect commercial property markets and/or residential property.	M	**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.	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.
Cyberthreats. Cyberattacks on critical physical or digital infrastructure (including digital currency platforms) trigger financial instability and disrupt economic activities.	M	**Medium:** Sweden is a highly digitalized economy, cyberattacks could significantly impair the functioning of the financial system and economy, in general.	As per FSAP recommendations, clarify roles and responsibilities for cyber security risk management; develop contingency plans and crisis protocols for large-scale attacks; enhance information sharing among agencies and with the financial sector, such as through a permanent forum and regular cyber threat intelligence reports.

[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. Climate Policy Advances and Challenges

1. **Sweden has adopted some of the most ambitious carbon reduction targets in the world but meeting these goals will require additional investment and reforms.** While Sweden performs well on many targets—it is among the top in the Climate Change Performance Index—it might not meet its EU 2030 climate goal and its own ambitious goal of having net-zero emissions by 2045 (Figure). The Swedish Environmental Protection Agency (2022) finds that reforms as of March 2022 will support meeting Sweden's 2030 goals without supplementary measures. However, it finds that its 2045 target "will not be reached with current policy instruments, but that the distance to the target is significantly smaller than the previous year." More effort is needed to reduce emissions from the largest polluters (transportation, industrial and agricultural sectors). While Sweden has one of the highest carbon tax rates in the world, it lacks a clear strategy/roadmap on lowering emissions in those sectors in a cost-efficient way (OECD, 2021). In addition, the new governments' objective of achieving fossil-free electricity by 2040 (which needs to be enacted) will require more investment in nuclear plants, wind turbines, biofuel production, hydrogen power plants, electric vehicle charging stations, and not least the power grid. A report by SWECO finds that infrastructure investments for the national electricity grid could amount to 10.3 percent of GDP until 2045. The Fiscal Policy Council (2022) finds that public financing is not the main impediment to reducing emission rather the need to streamline approval processes, stable and clear rules, and better national coordination. It suggests that climate investment needs could range between 0.4–0.8 percent of 2022 GDP per year over the coming decades, which is in addition to the planned climate related public investment, which is already part of the 12-year investment plan. In addition, Fund staff finds that investment needs for climate adaptation could be large as well (up to 0.4 percent of GDP annually).[1]

2. **Welcome steps are being taken to promote green transition while further improvements in the process are recommended.** Emissions have fallen by about a third since 1990 and the remaining two-thirds need to be eliminated between now and 2045. Broadly, four key areas are expected to be pivotal for the transition to net-zero emissions, a) more efficient use of energy and resources, b) zero-emissions electrifications, c) biomass from forestry and agriculture, and c) carbon capture and storage. With only six action plans remaining for Sweden to reach net-zero greenhouse gas emissions, the new government is expected to present a climate policy action plan which will need to focus on the way the climate transition will accelerate. According to the Climate Policy Council recommendations indicate that there is room for improvement regarding governance, coordination and upskilling, goals and policy instruments should be strengthen, while conditions for investments should improve.

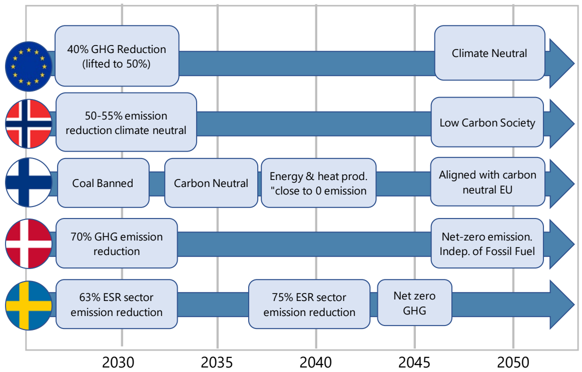
[1] Adaptation cost include estimates for investments in building new coastal protection infrastructure as well as in upgrading investment projects and retrofitting existing assets exposed to rising sea levels. For further details please see Annex 3 of the Fiscal Monitor 2020 (October).

3. Advancing technological progress of increasingly complex electricity systems is imperative. The current systems are comprised, to a large extend, of renewable, weather-dependent, and partly distributed electricity generation, which need to further develop in terms of control, storage, and transmission, designing new solutions, and rapidly commercializing those that have only been tested on a smaller scale. This applies to smart grid technologies with improved capacity to control electricity production, storage, and consumption. In February 2022, the Government approved an electrification strategy which includes an action plan for charging infrastructure and tank infrastructure as well as an upcoming district heating and cogeneration strategy. A new mandate was given to Svenska Kraftnät to expand the national transmission grid to areas within Sweden's maritime territory.

Annex IV. Figure 1. Climate Targets and Investment for Climate Change Adaptation

Nordic National Climate Targets and Ambitions

(Compared with 1990 levels)

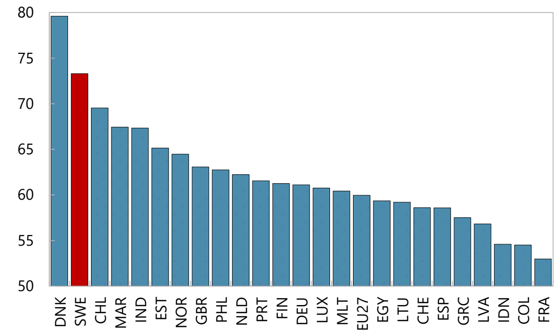


Source: Danske Bank; Danish Ministry of Climate; Energy and Utilities; Finnish Ministry of the Environment; Norwegian Ministry of Climate and Environment; Swedish Ministry of the Environment.

Notes: GHG=Greenhouse Gas; ESR=European Effort Sharing Regulation

Climate Change Performance Index Ranking, 2023

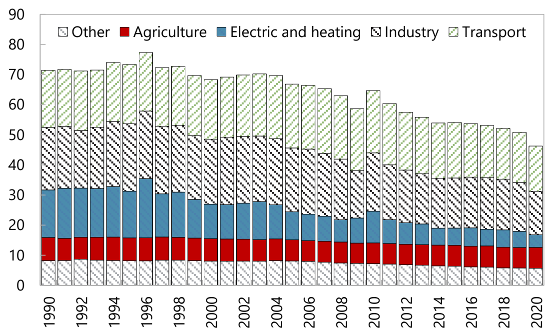
(Index)



Source: Climate Change Performance Index.

Total Greenhouse Gas Emissions by Sector

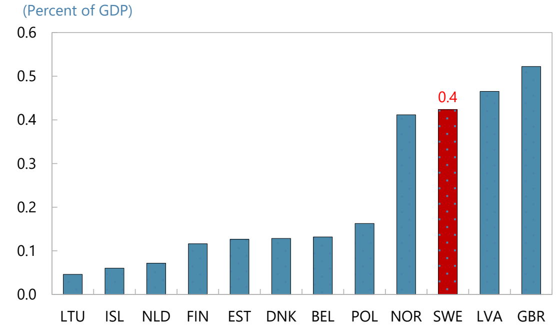
(Mton CO2-eqv.)



Source: Statistics Sweden.

Estimates of the Annual Costs to Improve Public Infrastructure for Climate Change Adaptation

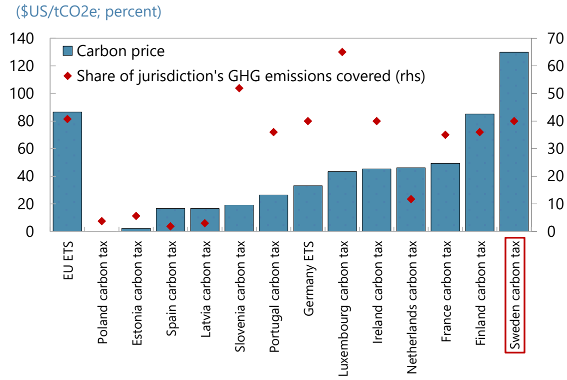
(Percent of GDP)



Source: IMF Fiscal Monitor October 2020.

EU Carbon Pricing and Coverage, 2022

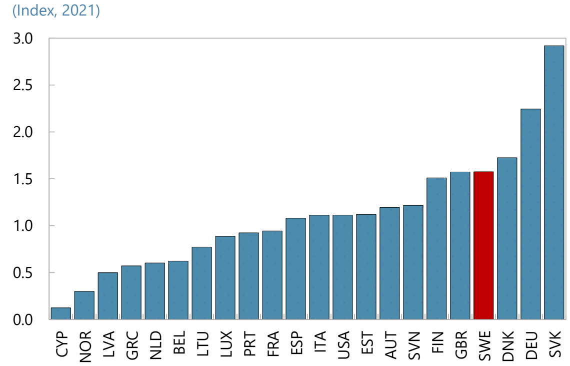
($US/tCO2e; percent)



Source: The World Bank, Carbon Pricing Dashboard.

Comparative Advantage in Low Carbon Technology Products

(Index, 2021)



Source: IMF, Climate Change Dashboard.

Annex V. 2022 FSAP: Key Recommendations

	Reference	Authority	Priority
Systemic Risk Analysis			
Employ structural models (household and CRE) to complement bank stress tests; develop tools to analyze contingent liquidity risks from derivatives loss of longer-term wholesale funding as well as corporate exposures for the largest banks.	20, 24, 27	FI	Immediate
Require investment funds to offer redemption terms that are aligned with the liquidity profile of their portfolio; consider price- and quantity-based measures (e.g. swing pricing and gates); and provide guidance on liquidity stress tests.	31	FI, MoF	Medium-Term
Macroprudential Policies and Systemic Risk Oversight			
Introduce standards on the interest rate stress-tests that banks apply for mortgage loan applicants	54	FI	Short-Term
Commission an independent study to determine the costs and benefits of the tax deductibility of mortgage interest.	54	MoF	Medium-Term
Consider higher capital requirements and/or buffers for banks' exposures to CRE risks.	57	FI	Short-Term
FSC, FI, and the Riksbank to use soft powers and joint communication to ask CRE firms to disclose their contingency funding plans in annual reports and bond prospectuses.	56	FI and Riksbank	Short-term
Banking Supervision and Regulation			
Increase resources to improve on the effectiveness of supervision and improve supervisory toolkit further by enhancing offsite monitoring and screening tools, automating the collection and analysis of supervisory data, improving internal supervisory manuals, and deploying risk dashboards covering all the key risks.	45	FI	Immediate
Enhance supervision by: (i) increasing the frequency and intrusion of onsite inspections; (ii) comprehensive onsite inspection of banks, (iii) ongoing assessment of performance of the Internal Rating Based (IRB) models and banks' internal stress test processes, (iv) well-targeted thematic reviews for smaller institutions; and (v) heightened focus on small but high-risk institutions.	44, 46	FI	Short-term
Continue integrating climate-related risks into supervisory processes and ensure alignment of practice with emerging international standards.	67	FI	Medium-term
FI should strengthen its supervision of banks and VASPs targeted at ML/TF risks especially from cross-border operations by evolving risk management tools and collecting and analyzing more granular data.	64,65		Short-term
Cyber Resilience			
Clarify roles and responsibilities for cyber security risk management; develop contingency plans and crisis protocols for large-scale attacks; enhance information sharing among agencies and with the financial sector.	59	FI, MoF, the Riksbank NCSC, MSB	Immediate
Establish and maintain a database of essential service providers and outsourcing arrangements, including to identify concentrations and dependencies.	59	FI	Immediate
Financial Market Infrastructures			
Strengthen legal frameworks for weakly regulated FMIs to enforce compliance with the PFMI and other guidelines; strengthen regulation, oversight, and supervision of key service providers Getswish and Finansiell ID-Teknik BID AB.	62	MoF, FI, the Riksbank	Short-term

	Reference	Authority	Priority
Crisis Management, Resolution and Safety Nets			
Develop crisis management capacity within and between the authorities by formalizing a watchlist process to identify banks at risk of failure.	69	FI	Immediate
Ensure bank resolution plans are fully operational by clarifying MREL regulation and removing other known barriers to resolvability; publish the approach for deploying bail-in and transfer tools and imposing losses on MREL holders.	71	NDO & FI	Immediate
Publish a policy framework describing the lender of last resort bilateral liquidity facilities, including funding in resolution.	72	Riksbank	Immediate
CBDC and Fintech**			
Extensively test the robustness and resilience of CBDC, and analyze the effectiveness of financial safeguards, and the impact on the payments and financial system.	38	Riksbank	Short-term
Facilitate exchange of information and enhance understanding of risks between Fintech firms and supervisors; collect additional data to support a more comprehensive analysis of fintech firms and conduct periodically a review of the adequacy of the regulatory perimeter.	41	FI	Medium-term
*Immediate (within 1 year), ST—Short term (within 1–2 years), MT—Medium term (within 3–5 years) **Priority for CBDC recommendations not inserted as time horizon will depend on whether the e-krona project continues.			

Annex VI. Sweden's Corporate Vulnerabilities: Focus on Commercial Real Estate

Commercial Real Estate (CRE) debt constitute a large portion of the total corporate, making the sector a substantial risk to the financial system due to funding risks as well as broader spillover effects to the real economy. Stress tests, conducted to assess the resilience of CRE, reveal that in 2020 the median interest rate coverage was above a commonly used threshold of 1.5 percent, but drops below one in a severe scenario, resulting in a ¾ of firms with debt-at-risk.[1] *CRE's concentration, interconnectedness and limited disclosure calls for close monitoring of liabilities structure and adjusting banks' capital levels to better reflect current risks.*

1. **CRE sector borrowing accounts for a large part of corporate borrowing and has become increasingly market financed.**[2] In the past few years, CRE prices have risen fast, and yields have fallen. Banks' exposure to the sector and the sector's overall debt level is high. [3] CRE loans represent between 10 and 25 percent of banks' private sector lending. The share of CRE companies' non-bank debt has increased recently (about 40 percent of total debt). While this helps diversify risks, stress tests show that this also elevates refinancing risks, which together with short interest rate fixation, could have an impact on macro-financial stability. CRE bonds account for about half of corporate bond market value. Foreign holdings of CRE bonds stand at 53 percent, exposing the sector to rapid selloffs, particularly during times of heightened global risk aversion. Among domestic investors, investment funds hold the largest share of CRE bonds, at around 21 percent. Ownership concentration has recently increased with some CRE firms buying into other CRE firms.

2. **At the same time, the sustainability of CREs' revenues is increasingly becoming subject to risks.** Owing to the pandemic-induced hybrid working model, renting—a key source of CRE earnings—is coming under stress as office vacancy rates are rising, for example, from about 3 percent in 2019 to close to 8 percent in 2021 in Stockholm, with similar trends in other major cities such as Gothenburg and Malmö. This, combined with the office yield trend, which has also been declining, is affecting CRE firms' credit rating and ability to roll over their existing debt securities in the local bond market.

3. **Staff's assessment of financial health and vulnerabilities of CRE firms is based on publicly available company financial data**. Orbis database compiles balance sheet and income statements for over 20 thousand Swedish CRE firms. However, not all the necessary data series was available for this group of firms, therefore stress tests were conducted on a sample of firms, where the largest 100 companies in the sample hold aggregate assets of around 70 percent of GDP and

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[1] Not being able to service debt without additional borrowing, raising revenue, or restructuring.

[2] Average loan duration is about 3.4 years, and bond maturity is about 5 years. About 55 percent of bonds are in foreign currency against about 6 percent of bank lending.

[3] FI's stress tests (2020) show that this may put pressure on banks to cover the shortfall in financing. According to FI's analysis (2021), the vulnerability of CRE increased under certain stress test scenarios of firms with bank loans. FI stress tests included 15000 CREs, including small CREs, which stand for around 40 percent of the loan amount and around 90 percent of the number of CREs.

debt of around 50 percent. The analysis focused on a set of customary financial ratios under current and stressed conditions.

4. A firm's capacity to service debt hinges on its interest coverage ratio (ICR). It is computed as EBIT/Interest Expense. The lower the ratio, the more the company is burdened by debt expense relative to earnings. An ICR of less than 1 implies that the firm is not generating sufficient revenues to service its debt without adjusting, such as reducing operating costs, drawing down its cash reserves, or borrowing more. In this analysis, an ICR threshold of 1.5 times is applied to account for potential vulnerabilities to funding risks, in addition to earnings risks. This is a widely used benchmark to gauge an early warning signal as firms with ICR below 1 may have already been in distress. Debt is then categorized into different risk buckets based on the level of ICRs. Debt in the bucket with lower ICR has higher probability of becoming non-performing. Firm profile is calculated as the proportion of firms with median ICR categorized within each bucket.

5. Stress tests indicate that CREs face debt servicing pressures even under a mild scenario. Stress tests were conducted on a sample of CRE firms (Figure 1). The analysis focused on a set of customary financial ratios under current and stressed conditions. In particular, shocks reflecting the adverse stress scenario were applied to gauge the response of firms' interest coverage ratio (ICR) to interest rate change, GDP change impact on revenues, and FX.[4] The joint occurrence of shocks significantly weakened the ICR, with the median ICRs falling below 1.5, and under a more severe shock below 1 (Figure 2). Debt-at-risk was found to fluctuate between 20–35 percent.[5] Medium and large-size firms were affected similarly.

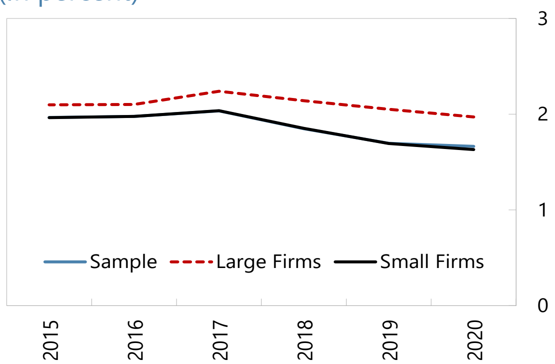
6. Given the current tightening of financial conditions, there could be broader spillover effects to the real economy. Thus far, vulnerabilities have been mitigated by the sector's healthy pre-crisis balance sheets, pre-crisis regulatory measures, and the crisis response. In the case of market funding squeeze, some CREs might be able to draw down credit lines from banks, or even benefit from bank lending beyond that, albeit at higher cost. However, some may have to shed assets or declare insolvency. Several amplification mechanisms could worsen the outlook for CREs (Figure 3). Concentration among CRE companies could lead to contagion effects among CREs.

[4] The impact was most pronounced from the changes in the first two variables (increase in advanced country policy rates (up to 400 basis points for the Swedish repo rate) and 38 percent decline in both residential and commercial real estate prices after two years).

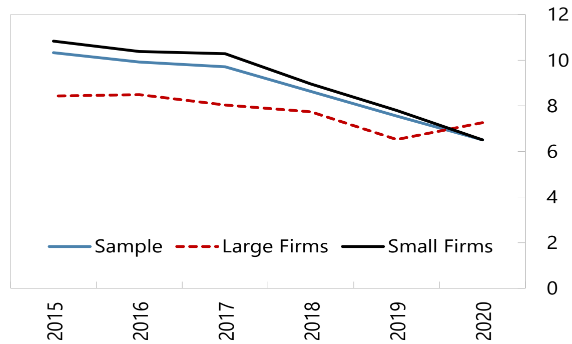
[5] The firm is not generating sufficient revenues to service its debt without making adjustments, such as reducing operating costs, drawing down its cash reserves, or borrowing more.

Annex VI. Figure 1. Selected CRE Financial Ratios

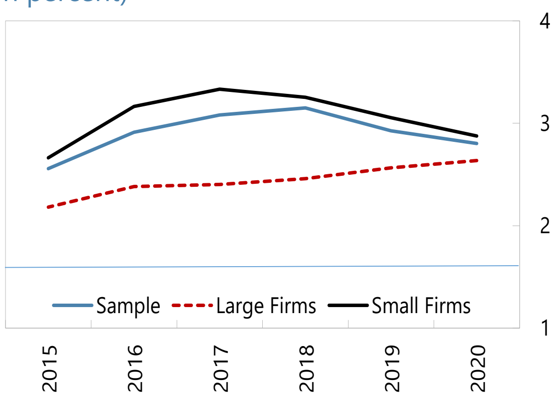
Median ROA
(In percent)



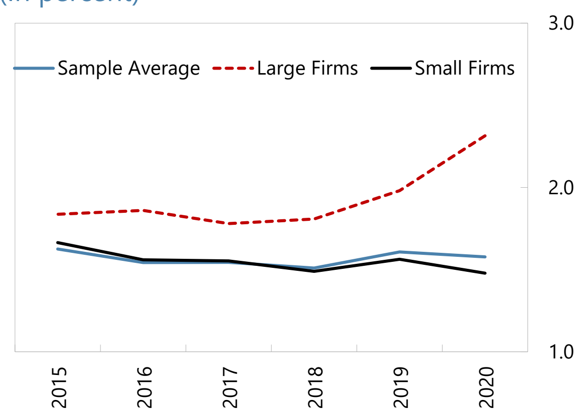
Median ROE
(In percent)



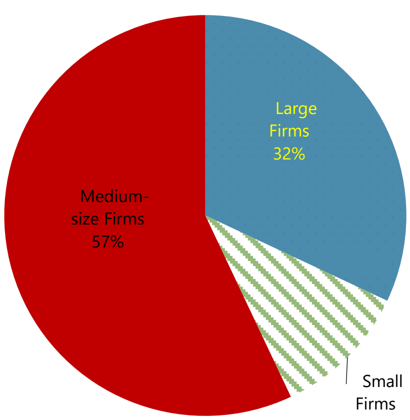
Median Interest Coverage Ratio
(In percent)



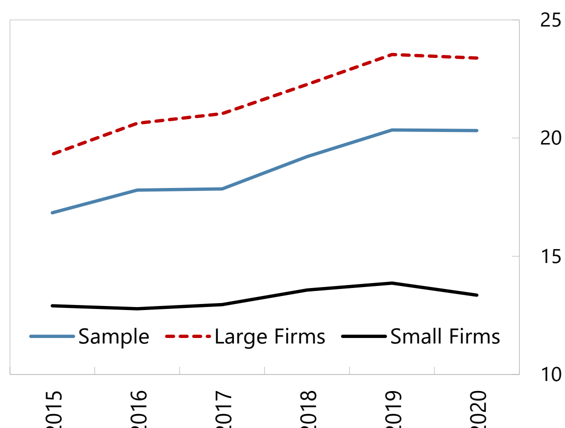
Median Total Debt/Total Equity
(In percent)



Debt at Risk by Firm Size



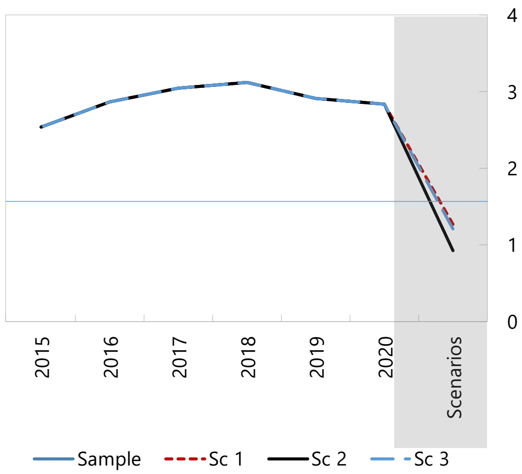
Median Net Debt/EBIT



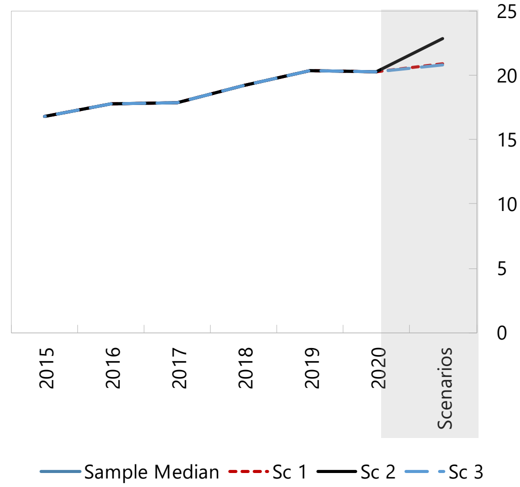
Sources: Orbis; and IMF staff estimates.

Annex VI. Figure 2. CRE Stress Test Results

Median Interest Coverage Ratio

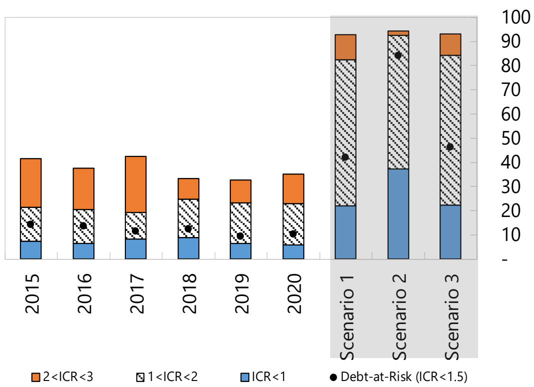


Median Net Debt to EBIT



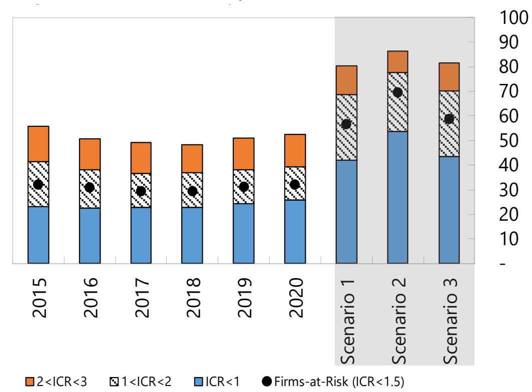
Impact on Debt at Risk

(Percent of total debt)



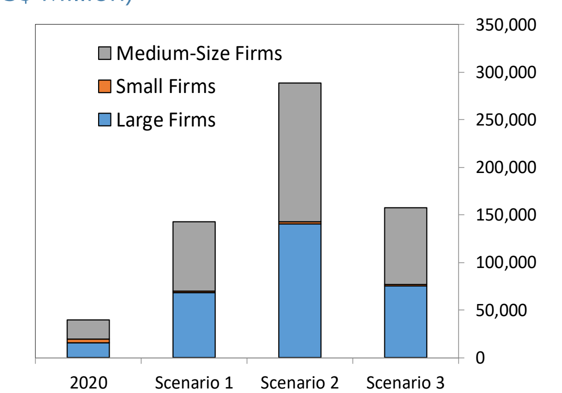
Impact on Firms at Risk

(Percent of total firms)



Debt at Risk by Firm Size

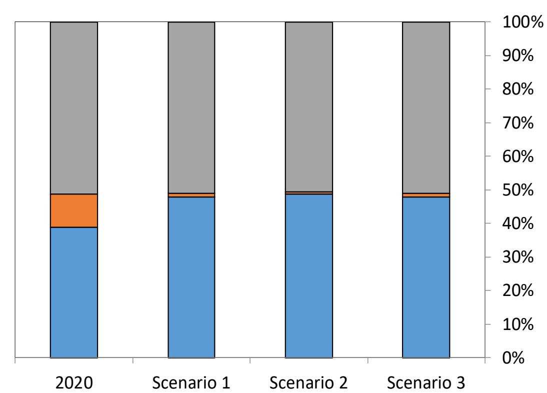
(US$ Million)



**Firm size is derived from the country's sample firms by asset size: Large=Top 2

Debt at Risk by Firm Size

(Percent of total debt at risk)



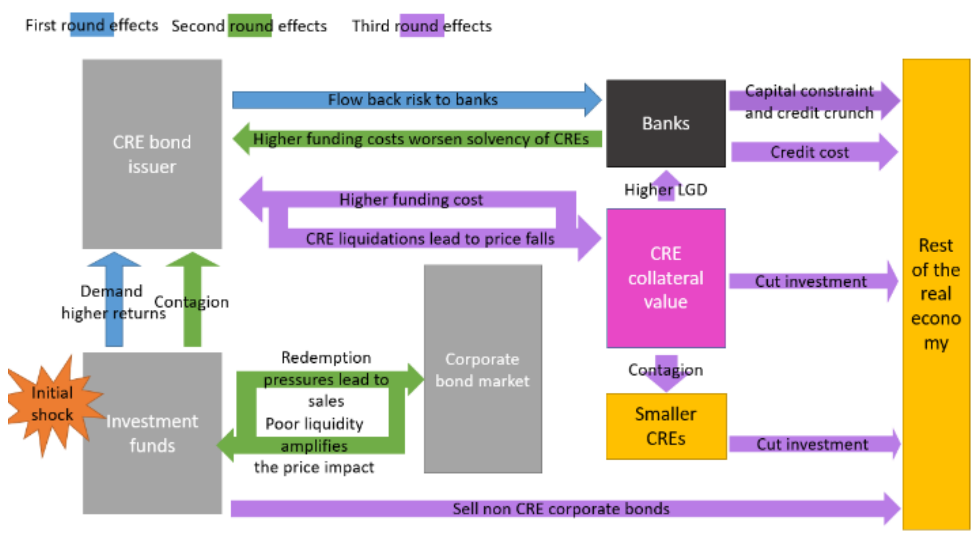
h percentile; Small=Last 25th percentile; Medium=In between.

Sources: IMF staff estimates.

7. Similarly, investors may pull back from all CREs with little discrimination for quality of underlying assets due to asymmetric and opaque information. Liquidity premia on funding costs will undermine CRE profits and lead to further increase in credit risk premia. And redemptions from investment funds would further withdraw liquidity and in turn boost funding costs. In addition to amplification mechanisms, broader spillover effects could turn a CRE shock macro-critical. Redemption requests could impact prices of securities more broadly. Liquidations of assets could lower property values across commercial real estate and possibly residential real estate, weighing on consumption and investment, and bank capital. And hits on bank capital due to provisioning charges and/or outright losses could crowd out credit to the economy. It would be advisable to consider increase capital requirements for banks with large exposures to CRE given the negative macro-outlook, which is unfolding, rising bankruptcies, high uncertainty about the future path for policy rates, and the potential spillovers which are not captured by the FSAP stress test framework.

8. Strengthening monitoring of corporate liabilities and ownership structure, especially in CRE sector, is thus imperative. CRE firms should be made to improve their disclosures, including on contingency plans when market funding dries up. The authorities could request better disclosure of firms' liabilities, especially those in foreign currency, including in the bond issuance template. Having better disclosure will also ensure investors can distinguish between more solvent and less solvent firms reducing contagion across the sector. It is advisable 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. Knowing the ownership structure will help identify interlinkages across firms as well as the associated vulnerabilities. The authorities should evaluate the need to raise capital requirements for banks for CRE exposures. The authorities should plan now for what a potential crisis intervention might be; the intervention should be designed to limit moral hazard. Ideally, interventions would be targeted to where the negative links to the real economy might be strongest.

Annex VI. Figure 3. Contagion in the CRE Market



Sources: Finansinspektionen and IMF staff estimates.

Annex VII. Authorities' Response to Past IMF Policy Recommendations

IMF 2021 Article IV Recommendations	Authorities' Actions
Fiscal Policy	
Fiscal policy should avoid returning to the surplus target prematurely. 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.	Pandemic support measures were phased out gradually by end-2021. The budget surplus was double the surplus target by 2022. The government increased support for green initiatives in the context of the EU RRF program, and its own Climate Leap and Industry Leap programs on top of already high public investments.
Structural Reforms	
Labor: 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.	Reforms are ongoing.
Housing: Making the rental market work; Taxing property to rebalance the housing market; Producing housing that is affordable; Protecting households in the transition.	Reforms have been insignificant due to housing being a politically contentious issue.
Macro-Financial Issues	
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.	Some efforts are being made to collect data, but many shortcomings persist.
AML/CFT: need for strong anti-money laundering and combating the financing of terrorism (AML/CFT) frameworks and for close regional cooperation.	New FSAP recommendations put a new focus on areas for strengthening the defenses. Regional AML/CFT is underway which will also identify areas for improvement.
e-krona: The authorities should also explore regulatory options to ensure reliable and efficient private payments, such as standards for business continuity and regulation of fees.	Testing of the e-krona is ongoing.

INTERNATIONAL MONETARY FUND

SWEDEN

STAFF REPORT FOR THE 2023 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 17, 2023

Prepared By

European Department
(In consultation with other departments)

CONTENTS

FUND RELATIONS

(As of December 31, 2022)

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

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	4,430.00	100.00
Fund holdings of currency (Exchange Rate)	3,140.79	70.90
Reserve Tranche Position	1,209.69	29.14
Lending to the Fund		
New Arrangements to Borrow	21.62	

SDR Department:	**SDR Million**	**Percent Allocation**
Net cumulative allocation	6,494.92	100.00
Holdings	6700.10	103.16

Outstanding Purchases and Loans: None

Latest Financial Arrangements: None

Projected Payments to Fund:

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

	Forthcoming				
	2023	2024	2025	2026	2027
Principal					
Charges/Interest	0.08	0.08	0.08	0.08	0.08
Total	0.08	0.08	0.08	0.08	0.08

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

Article IV Consultation: Sweden is on the 12-month consultation cycle.

FSAP Participation: A mandatory FSAP has been conducted in time for the 2023 Article IV consultation, in line with the five-year cycle for members or members' territories with financial sectors that are determined to be systemically important pursuant to Decision No. 15495-(13/111), adopted December 6, 2013.

STATISTICAL ISSUES

(As of December 31, 2022)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision is adequate for surveillance. The country has a full range of statistical publications, many of which are on the internet. The quality and timeliness of the economic database are generally very good.	
II. Data Standards and Quality	
Subscriber to the Fund's Special Data Dissemination Standard Plus (SDDS Plus) since February 11, 2015.	A data ROSC was published in September 2001, followed by an update in November 2002.

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

Government Finance Statistics: Government finance statistics (GFS) are compiled on an accrual basis according to the *ESA 2010* methodology and reported to Eurostat on a quarterly and annual basis. Fiscal data in the *GFSM 2014* framework is reported through the Eurostat convergence project with the IMF. The IMF GFS datasets cover data on the general government operations and financial balance sheet.

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

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

Financial Sector Surveillance: Sweden has reported Financial Soundness Indicators beginning from 2005 up to 2022Q3 along with metadata, which are available on the IMF's website (http://data.imf.org/).

Sweden: Table of Common Indicators Required for Surveillance

(As of December 31, 2022)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Current	Current	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	2022/12/30	2023/01/05	W	W	W
Reserve/Base Money	2022/12/30	2023/01/05	W	W	W
Broad Money	2022/12/30	2023/01/05	W	W	W
Central Bank Balance Sheet	2022/12/30	2023/01/05	W	W	M
Consolidated Balance Sheet of the Banking System	2022/12	2023/01	M	M	M
Interest Rates[2]	Current	Current	D	D	D
Consumer Price Index	2022:12	2023/01	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	2022:Q3	2022/12	Q	Q	A
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	2022:Q3	2022:12	M	M	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2022:Q3	2022:12	M	M	M
External Current Account Balance	2022:Q3	2022:Q4	Q	Q	Q
Exports and Imports of Goods and Services	2022:Q3	2022:Q4	Q	Q	Q
GDP	2022:Q3	2022/12	Q	Q	Q
Gross External Debt	2022:Q3	2022/12	Q	Q	Q
International Investment Position[6]	2022:Q3	2022/12	Q	Q	Q

1/ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
2/ Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
3/ Foreign, domestic bank, and domestic nonbank financing.
4/ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
5/ Including currency and maturity composition.
6/ Includes external gross financial asset and liability positions vis-à-vis nonresidents.
7/ Daily (D), weekly (W), monthly (M), quarterly (Q), annual (A), irregular (I); and not available (NA).

Statement by Vitas Vasiliauskas, Executive Director for Sweden, and Peter Wallin, Advisor to the Executive Director
Executive Board Meeting
March 13, 2023

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

Recent macroeconomic development and outlook

The Swedish economy developed strongly at the beginning of 2022, which also meant that the labour market strengthened. The employment rate reached new record levels and many companies found it difficult to recruit people with the competence they needed. High external price pressures resulted in rapidly rising electricity and food prices during 2022. Together with the rapid upturn in demand and supply restrictions, this led to a rise in inflation. Russia's full-scale invasion of Ukraine aggravated the situation, and to counteract the upturn in inflation monetary policy was tightened rapidly. Large price increases and rising interest expenditure had a significantly adverse effect on households' purchasing power and meant that demand slowed down in the fourth quarter of 2022.

The manufacturing industry still has large order stocks, but has seen a rapid decline in orders. As demand in Sweden and abroad is falling, industrial production and Swedish exports are expected to be significantly weaker going forward. Households' purchasing power is deteriorating due to high inflation and tighter monetary policy and households are expected to continue to reduce their consumption. The fact that households are in a tough situation at present is visible in consumer confidence and in the retail trade sales, which have fallen since spring 2022. The situation in both the retail trade and the service sector is now said to be very weak, according to the Economic Tendency Survey.

The high inflation and tighter monetary policy are also evident in the housing market, where both prices and construction have declined, and are expected to continue to decline in 2023. During the pandemic, however, housing prices rose fairly substantially and the fall means that they are back at the level prevailing prior to the pandemic. Compared with the peak in 2021, around 50 per cent fewer homes are expected to be built in 2024 and housing investment will thus weigh on growth in total gross investment in both 2023 and 2024.

After being very high during 2022, the demand for labour is expected to decline this year as a result of the expected fall in GDP. Indicators point to a weaker labour market ahead and during the current year, employment is expected to fall gradually and unemployment will rise. The Government will compensate households and companies retroactively for the high electricity prices which will contribute positively to household income and thus contribute to dampening the downturn in consumption. In the Riksbank's forecast, households' real disposable incomes will improve and both consumption and the housing market will recover during 2024 and 2025. This is expected to, together with rising demand abroad, lead to GDP growth increasing from the middle of 2024. As economic activity strengthens, the demand for labour will rise. Unemployment is assessed to peak at the end of 2024, and then begin to fall back.

Financial stability and macroprudential policy

The authorities broadly agreed with the IMF team's assessments and recommendations related to financial stability issues. They have found it helpful that the team has provided guidance with regards to timing and priority to the key recommendations. Moreover, they welcomed the IMF's positive endorsement of Sweden's continued progress in strengthening regulation, supervision, and crisis management since the last FSAP in 2016. They agreed that their determined efforts to bolster financial sector oversight and crisis preparedness, not least through large capital and liquidity buffers in the financial sector, as well as the public support measures implemented helped Sweden to weather the global COVID-19 crisis well. Looking ahead, the authorities acknowledged the importance of ensuring that the regulatory framework and supervisory capacity keep pace with the evolving landscape.

The authorities agreed with the IMF team's risk assessment and that highly leveraged commercial real estate companies constitute a key risk. They underlined that several measures have been taken to address the risks, not least the introduction of risk weight floors on CRE and residential real estate exposures as well as the reciprocation of measures by Norway and Denmark. The FSAP bank solvency stress tests indicate that the banking system appears resilient against potential shocks emanating from the CRE sector. While high profitability offsets some of the effects, the higher impact on banks that are heavily exposed to the CRE sector warrants monitoring. In this respect, the authorities concurred that macroprudential policies can help attenuate cyclical and structural risks. The authorities also agree with the IMF team's risk assessment of the households given their high level of indebtedness. However, they did not see a need to strengthen the amortization requirement.

The authorities find that data collections such as the mortgage survey, the consumer loan survey, commercial real estate loan survey as well as KRITA covering all loans to non-financial firms are examples of high-quality micro data. However, they agree that there are still data gaps, particularly for indebted households' assets and debts. The lack of such statistics in Sweden imposes constraints on the analysis of important questions linked to financial stability and monetary policy.

The authorities agreed with the need to be vigilant of risks related to the growing financial technology sector in Sweden, including increased cyber risks. The authorities noted the need for a framework for comprehensive operational and cyber resilience. Strengthening the legal framework for FMIs in order to enforce compliance with the PFMI and other guidelines as well as managing outsourcing risks in the payments area will be part of the agenda in the period ahead. The authorities took note of the insights and recommendations related to the ongoing work on a CBDC and shares the views regarding the importance of risk mitigation to deal with the risks that are addressed in the FSAP in a proper manner. The analysis and recommendations on CBDC are coherent with the authorities' views.

Prudential Supervision

The authorities welcome the IMF's acknowledgement of Sweden's continued progress in strengthening banking regulation and supervision since the last FSAP in 2016, and recognize the importance of ensuring that regulatory framework and supervisory capacity is continually enhanced to keep pace with the evolving financial landscape.
The authorities broadly agree with the FSAP assessment and recommendations on how to address the identified gaps including, amongst others, the need to further optimize existing supervisory processes and tools. The authorities take note of the IMF's assessment regarding the need to further increase the intrusiveness in the supervision and can confirm that through the risk-based approached used, Finansinspektionen (FI) can continuously aim at achieving intrusive outcomes regardless of which type of supervisory activity used. The authorities would also like to mention that measures have already been taken to reduce gaps identified, for example within IRB model supervision.

The continued strengthening of the supervisory regime for AML/CFT is another of the areas of key focus. FI has as from 1 March, 2023, established a new operational section (along-side the operational sections Bank, Insurance and Market) in which the AML/CFT supervision has been elevated to a stand-alone department to ensure an increased and continuous focus on its market-wide supervisory responsibility.

Crisis readiness, management and resolution

The cooperation between the relevant authorities in Sweden regarding crisis preparedness and crisis management has historically functioned well. The authorities share the view that progress has been made since 2016, but that further efforts are needed to get the new crisis management framework fully operational. This includes further development of the published "open bank" bail-in mechanic and further work on a policy for funding in resolution.

Monetary policy

The Riksbank agreed with the IMF team's opinion that monetary policy should remain flexible and be set against the risks surrounding inflation. The very rapid upturn in inflation last year has meant that CPIF inflation is now over 9 per cent and thus far above the inflation target. The Riksbank underestimated the inflationary impulse in the wake of the pandemic and factors that were difficult to predict, such as Russia's invasion of Ukraine and the ensuing disruptions on the European energy markets, aggravated the situation further. To bring down the high inflation, the Riksbank has raised its policy rate at every meeting since April 2022, in total from zero per cent to 3.0 per cent in February 2023. The increase has been rapid in relation to earlier phases of interest rate hikes and the effects on demand in the Swedish economy can now be seen. As it takes time before monetary policy affects inflation, those effects will only become clear this year.

A high rate of inflation creates problems in the economy. It is therefore important that inflation shows a clear downturn this year and that it is not merely due to lower energy prices. There are many indications that this will happen. But it is uncertain whether inflation will fall sufficiently quickly and far enough. There is a risk that the recent rapid price rises will develop into a changed pricing behaviour and that inflation will then, even if it slows down somewhat, become entrenched at a level that is too high.

The risks of tightening monetary policy too little in the near term are assessed to be greater than the risks of tightening too much. The Riksbank's tolerance for a continued high rate of inflation is thus low, not least in the light of unexpected unfavourable developments in inflation last year. A tighter monetary policy does mean that economic activity will weaken further, but attaining a low and stable rate of inflation within a reasonable period of time is a necessary condition for good development in the Swedish economy in the long run. If inflation is high for a long time, the negative consequences for Swedish growth and the labour market will be much greater.

In addition to a higher policy rate, the Riksbank's monetary policy motivated asset holdings have declined since the first quarter of 2022. The total maturities have been greater than the purchases, and the Riksbank ceased purchasing assets entirely at the end of 2022. In February, the Executive Board decided to reduce the Riksbank's holdings of government bonds through sales. This measure is a step towards normalisation of the Riksbank's balance sheet, now that support measures during the coronavirus pandemic have been phased out and monetary policy is being tightened by means of a higher policy rate. As always, the Riksbank is carefully monitoring developments and will evaluate the effects of the sales regularly. This is something that the IMF team also highlighted. The Riksbank may alter the volumes and terms if market conditions are unfavourable.

The Riksbank's forecast is that the policy rate will probably need to be raised somewhat further going forward. This is considered necessary to get inflation to fall back towards the target. But the uncertainty regarding monetary policy is still considerable. One factor is the higher sensitivity to interest rates in the Swedish economy, as a result of households' increased indebtedness and the short interest-rate fixation periods on their mortgages. Even in an international perspective, it appears that sensitivity to interest rates is higher in Sweden than in many other economies.

Fiscal policy

The government agrees with Staff's assessment that fiscal policy stance should support monetary policy in reducing inflation. Bringing inflation back to target is a key priority, and it is important that fiscal measures do not augment inflation by increasing aggregated demand. At the same time, vulnerable households and companies, which are hit the hardest by price increases, need to be protected. The government has accommodated for this in the 2023 budget bill, meaning a broadly neutral fiscal stance for 2023 overall.

Regarding energy support measures, a swift delivery of support measures to households and businesses has been a key priority for the government. Meanwhile, given the wide impact of the shock, the energy support package was designed to offer the greatest relief to those who saw the greatest increase in their electricity bills.

In the short term, it is important the fiscal policy balances the need to bring down the high inflation rate and the capacity to manage the downturn in the economy. However, as inflation returns to target, there will be scope for further reforms and the government has an ambitious reform agenda outlined in the *Tidö agreement* for both the medium and long term, containing areas such as employment, energy, climate, healthcare, and the schooling system. Moreover, reforms will be aimed at increasing employment and productivity in the long term. In this regard, the government will consider lowering the wage tax wedge during its term of office; however, there is no political support for higher property taxes.

Overall, the government's fiscal policy will be carefully calibrated to strike the right economic balance both in the short- and long term.

Structural issues

Labour market policy

Structural reforms that result in higher employment and productivity in the long term are key priorities for the government. Sweden has comparatively high unemployment, partly due to high labour force participation. The unemployment rate is likely to rise in the short run as a result of weaker demand in the Swedish economy. The situation is particularly difficult for foreign born– mainly those who are newly-arrived, those who have little or no education, and women with a non-European background – as many are outside of the labour force. The government plans to look at both increasing incentives to work through well-targeted tax cuts, reforms to the benefit system, as well as strengthening the possibilities for individuals to transition into the labour force. In that respect, the government shares Staff's views on the importance of supporting the youth and foreign born through improving the effectiveness of the education and training programs to facilitate their entry into the labour force. Meanwhile, the government is confident that the October 2022 reform to the employment protection framework will be implemented in a way that will be beneficial for the labour market. The changes implies that the labour laws have been adapted to today's labour market and the increased need for flexibility and security.

Housing policy

The linkage between household indebtedness and the functioning of the housing market remains a key issue to the authorities. To fundamentally address this linkage, a broad range of policy measures would need to be assessed.

On housing, the government shares Staff's assessment that improving the functionality of the housing market is a challenge. The government intends to implement reforms that increase incentives for construction, not least to make housing more available to groups of the population that have difficulties entering the housing market. It also aims to simplify the rules for building permits, as well as implement reforms that will increase access to buildable land. The government also notes that the process for building permits in Sweden is 7.5 weeks shorter than the EU average, according to the World Bank report[1]. The same report states that Swedish building rules are accessible and transparent. Regarding changes to the tax system, it is of particular importance to maintain stable and predictable rules in the housing market. Any measure in this area must be seen in a long-term perspective. Changes must be handled with great care, due to the potential effects a change may have on household's financial position, household demand and economic growth.

[1] Subnational Investment Climate Assessment 2022: Sweden, The World Bank, November 2022.