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# Assessment of the 2018 Convergence Programme for

# Sweden

(Note prepared by DG ECFIN staff)

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#### 1. Introduction

On 26 April 2018, Sweden submitted its 2018 Convergence Programme (hereafter called Convergence Programme), covering the period 2017-2021<sup>1</sup>. The government approved the programme on 26 April 2018 and it was submitted to the Parliament on 16 April 2018.

Sweden is currently subject to the preventive arm of the Stability and Growth Pact (SGP) and should preserve a sound fiscal position which ensures compliance with the medium-term budgetary objective (MTO).

This document complements the Country Report published on 7 March 2018 and updates it with the information included in the Convergence Programme

Section 2 presents the macroeconomic outlook underlying the Convergence Programme and provides an assessment based on the Commission 2018 spring forecast. The following section presents the recent and planned budgetary developments, according to the Convergence Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Convergence Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework. Section 7 provides a summary.

### 2. MACROECONOMIC DEVELOPMENTS

Real GDP in Sweden rose by 2.4 % in 2017. Domestic demand was the key growth driver, notably housing investment along with private consumption. The Convergence Programme forecasts real GDP growth to stay vigorous, at 2.8 % in 2018, before easing to 2.2 % in 2019. In 2018, private consumption on the back of a strong labour market, solid investment and exports are set to be the main growth engines. In 2019 the decline in housing investment is expected to dampen growth.

Last year's programme projected real GDP to grow at 2.1 % in 2018 and 2.0 % in 2019. The macroeconomic outlook has therefore improved. For both years, export growth has been revised upwards taking into account the stronger external environment. For 2018, investment is also making a higher contribution to real GDP growth than projected in last year's programme since the government postponed some public investment disbursements to 2018. In addition, the economy is benefitting from the continued accommodative monetary policy in Sweden and the euro area.

The macroeconomic scenario of the Convergence Programme is broadly in line with the Commission 2018 spring forecast. The programme projects GDP growth of 2.8 % in 2018 and 2.2 % in 2019, while the Commission forecasts 2.6 % and 2.0 %, respectively. For both years, the Convergence Programme expects a stronger growth contribution from final domestic demand compared with the Commission spring forecast. The Convergence Programme projection for investment in 2018 is higher than the Commission spring forecast on account of different assumptions on the growth profiles in the construction sector excluding housing. In addition, the Convergence Programme projections for private consumption growth (the tax base for indirect taxes) are higher than the ones of the Commission spring forecast as it

<sup>&</sup>lt;sup>1</sup> The English version was submitted on 22 May 2018.

assumes a slightly better labour market and additional spending from the increase in child allowances and pensioners' tax cuts. It also assumes stronger wage growth (the tax base for personal income tax and social contributions) in both 2018 and 2019 than the Commission spring forecast due to different appreciations of labour force growth and labour shortage.

Sweden's economy is performing at its potential. The output gap, as recalculated by the Commission based on the information in the programme following the commonly agreed methodology, is expected to remain closed in 2018 before turning slightly negative in 2019 and staying negative until the end of the period covered by the programme<sup>2</sup>. The (recalculated) 2019 output gap in the programme is slightly lower than that estimated in the Commission 2018 spring forecast, mainly due to differences in projected total factor productivity growth.

Overall the macroeconomic scenario underpinning the budgetary projections of the Convergence Programme is plausible.

Table 1: Comparison of macroeconomic developments and forecasts

	20	17	20	18	20	19	2020	2021
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	2.4	2.4	2.6	2.8	2.0	2.2	2.1	1.8
Private consumption (% change)	2.4	2.4	2.3	2.5	2.2	2.6	2.6	2.8
Gross fixed capital formation (% change)	6.0	6.0	3.7	4.3	1.9	2.0	2.1	2.0
Exports of goods and services (% change)	3.7	3.7	4.7	4.9	3.7	3.7	3.6	3.4
Imports of goods and services (% change)	5.0	5.0	4.3	4.8	3.5	3.3	3.6	3.4
Contributions to real GDP growth:								
- Final domestic demand	2.6	2.6	2.3	2.6	1.7	1.8	1.9	1.7
- Change in inventories	0.1	0.1	0.0	-0.1	0.0	0.0	0.0	0.0
- Net exports	-0.3	-0.3	0.3	0.3	0.3	0.3	0.2	0.2
Output gap <sup>1</sup>	0.1	0.0	0.1	0.1	-0.3	-0.1	-0.2	-0.6
Employment (% change)	2.3	2.3	1.6	1.4	1.3	0.6	0.5	0.3
Unemployment rate (%)	6.7	6.7	6.3	6.2	6.3	6.2	6.1	6.1
Labour productivity (% change)	0.1	0.1	1.0	1.4	0.7	1.6	1.6	1.4
HICP inflation (%)	1.9	1.6	1.9	1.5	1.7	1.8	1.9	
GDP deflator (% change)	2.1	2.0	2.1	2.0	2.3	1.8	1.9	
Comp. of employees (per head, % change)	2.1	2.3	2.7	3.6	2.4	3.3	3.3	3.2
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4.0	3.0	4.0	3.4	4.3	3.7	3.7	3.6

## Note:

<sup>1</sup>In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

#### <u>Source</u> .

Commission 2018 spring forecast (COM); Convergence Programme (CP).

<sup>&</sup>lt;sup>2</sup> The recalculated output gaps differ from the ones presented in the programme mainly due to some differences in the methodology.

### 3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

### 3.1. DEFICIT DEVELOPMENTS IN 2017 AND 2018

The general government balance improved marginally to a surplus of 1.3 % of GDP in 2017 after a surplus of 1.2 % of GDP in 2016, while the 2017 Convergence Programme envisaged a surplus of 0.3 % of GDP. This overperformance is due to strong economic performance and lower expenditures in part related to the integration of refugees.

For 2018, the Convergence Programme foresees a slight deterioration of the general government balance from a surplus of 1.3 % of GDP in 2017 to 1.0 % of GDP in 2018. The Commission 2018 spring forecast expects a lower general government surplus as it forecasts a less favourable macroeconomic environment. However, the projected general government surplus for 2018 has improved compared to the one of the 2017 Convergence Programme (from 0.6 % of GDP to 1.0 % of GDP) on the back of lower than expected expenditures (mainly transfers) as labour market conditions have strengthened and migrant-related expenditure are lower than envisaged.

### 3.2. MEDIUM-TERM STRATEGY AND TARGETS

The purpose of the Convergence Programme is to maintain and further increase the general government and the structural balance surpluses until the end of the programme period, while mobilizing resources to strengthen the Swedish model of inclusive growth and welfare. Consistent with these objectives the government has set a target for general government net lending, expenditure ceilings, a local governments balanced budget requirement; and a debt anchor.

The MTO specified by Sweden in the Convergence Programme, a structural balance of -1 % of GDP, reflects the objectives of the Pact and is consistent with the minimum updated requirement as a member of the EU. The Convergence Programme's objectives would result in a general government surplus of close to 2 % of GDP and a recalculated structural balance of 2.2 % of GDP by the end of the programme, significantly outperforming Sweden's MTO. These new targets are not significantly different than the ones included in the 2017 Convergence Programme

The Convergence Programme is consistent with the new fiscal governance reform package adopted in late 2017, taking effect in 2019, which aims at ensuring fiscal sustainability. The main element of the package is the lowering of the net lending target over the economic cycle from 1 % of GDP to 1/3 % of GDP. Consistent with this surplus target, the structural balance rule is complemented by a new debt anchor set at 35 % of GDP, serving as a benchmark.

For 2019, the Convergence Programme expects, under a no-policy-change assumption, a general government surplus of 1.0 % of GDP, larger than the Commission 2019 spring forecast (0.9 % of GDP). Largely due to the fact that the Convergence Programme projections for private consumption growth (the tax base for indirect taxes) are higher than the ones of the Commission spring forecast.

Over time, the Convergence Programme forecasts revenues to remain stable as a share of GDP while expenditures are expected to grow at a slower pace than GDP, resulting in an gradual increase in the general government surplus of close to 2 % of GDP by 2021, marginally lower compared with the 2017 Convergence Programme.

The structural balance as recalculated by the Commission based on the information in the programme following the commonly agreed methodology is expected to stand at 0.9 % of

GDP in 2018 and 1.0 % of GDP in 2019, respecting the MTO of a structural deficit of 1 % of GDP. The time profile of the programme expects a gradual improvement of the structural balance, so that it would reach 2.2 % of GDP in 2021 (lower by 0.1 percentage point envisaged in the 2017 Convergence Programme). The structural balance in the Commission 2018 spring forecast is 0.8 % of GDP in 2018 and 1.0 % in 2019 respectively.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2017	20	18	20	19	2020	2021	Change: 2017-2021
	COM	COM	CP	COM	CP	СР	СР	СР
Revenue	50.3	49.7	49.5	49.3	49.2	49.1	49.1	-1.1
of which:								
- Taxes on production and imports	22.4	22.3	22.2	22.2	22.0	21.9	21.8	-0.6
- Current taxes on income, wealth,								
etc.	18.6	18.3	18.2	18.3	18.1	18.2	18.2	-0.4
- Social contributions	3.3	3.3	3.3	3.3	3.3	3.3	3.3	0.0
- Other (residual)	6.0	5.7	5.8	5.5	5.8	5.7	5.8	-0.1
Expenditure	49.1	48.9	48.6	48.4	48.2	47.9	47.2	-1.9
of which:								
- Primary expenditure	48.7	48.6	48.3	48.2	47.8	47.5	46.8	-1.9
of which:								
Compensation of employees	12.6	12.6	12.7	12.6	12.6	12.6	12.4	-0.2
Intermediate consumption	7.8	7.9	7.6	7.8	7.5	7.4	7.2	-0.6
Social payments	16.6	16.4	16.1	16.2	15.8	15.5	15.3	-1.3
Subsidies	1.6	1.5	1.6	1.5	1.6	1.6	1.6	0.0
Gross fixed capital formation	4.5	4.6	4.5	4.6	4.6	4.7	4.6	0.1
Other (residual)	5.6	5.5	5.8	5.4	5.7	5.7	5.6	0.0
- Interest expenditure	0.4	0.3	0.3	0.2	0.4	0.4	0.4	0.0
General government balance								
(GGB)	1.3	0.8	1.0	0.9	1.0	1.3	1.9	0.8
Primary balance	1.6	1.1	1.3	1.1	1.3	1.7	2.4	0.9
One-off and other temporary	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	1.3	0.8	1.0	0.9	1.0	1.3	1.9	0.8
Output gap <sup>1</sup>	0.1	0.1	0.1	-0.3	-0.1	-0.2	-0.6	-0.6
Cyclically-adjusted balance <sup>1</sup>	1.2	0.7	0.9	1.0	1.0	1.4	2.2	1.0
Structural balance <sup>2</sup>	1.2	0.7	0.9	1.0	1.0	1.4	2.2	1.0
Structural primary balance <sup>2</sup>	1.6	1.0	1.2	1.3	1.4	1.8	2.6	1.0

#### Notes:

#### Source:

Convergence Programme (CP); Commission 2018 spring forecasts (COM); Commission calculations.

Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

<sup>&</sup>lt;sup>2</sup>Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

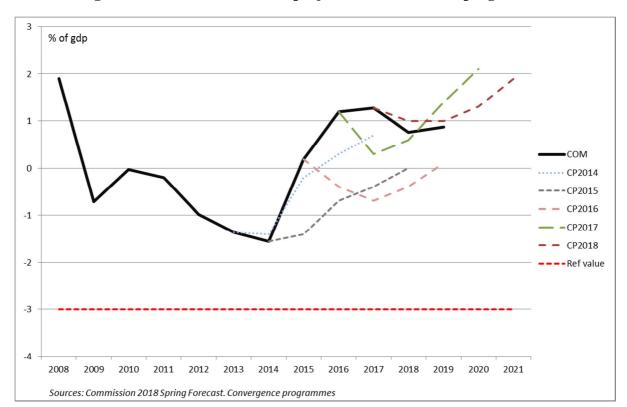


Figure 1: Government balance projections in successive programmes

#### 3.3. MEASURES UNDERPINNING THE PROGRAMME

The Convergence Programme includes measures proposed and announced by the government in the Budget Bill for 2018. In total, these measures are estimated to have an effect on the general government finances of roughly -0.8 % of GDP in 2018 and of -1.2 % of GDP in 2019.

Overall, the key priorities of the Swedish government, as reflected in expenditure increases resulting from recent and forthcoming reforms, are focusing on specific areas, such as welfare, climate and the environment and security. Important goals include tackling unemployment whereas the objective is to have the lowest umployment rate in the EU by 2020 (0.2 % of GDP in 2018 and 2019), improving education outcome (0.1 % of GDP in 2018 and 2019), and supporting the challenge of becoming one of the first fossil-fuel free countries in the world (roughly 0.1 % of GDP in 2018 and 0.2 % of GDP in 2019). The government has also earmarked funds to local governments (0.1 % of GDP in 2019).

On the revenue side, overall tax revenues are expected to decrease between 2017 and 2018 by around 0.15 % of GDP. According to the Budget Bill, this decrease comes from changes in tax legislation, resulting in tax cuts of 0.2 % of GDP in 2018, and include mainly a reduced tax rate for pensioners and reduced taxation of employees stock options. As for 2019, the expected revenues decrease would amount to roughly 0.3 % of GDP and the main source of financing would come in the form of expenditure reductions (approximately standing at 0.4 % of GDP). Tax increases would represent 0.1 % of GDP in 2018 and 2019 respectively and consist mainly of a new tax on air travel.

# 3.4. **DEBT DEVELOPMENTS**

Sweden's government gross debt ratio was 40.6 % of GDP in 2017, below the 60 % of GDP reference value, lower than the average over the time period 2012-2016, and is 1.5 percentage points lower than in 2016.

The debt ratio as a proportion of GDP is projected to decrease in 2018 on the back of strong growth and a surplus in the primary balance. In 2019, sustained economic growth along with the inflation effect and the primary balance improvement are set more than compensate the interest expenditure, serving to reduce the debt ratio.

The foreseen sustained economic growth and increasing primary balance surpluses should imply a further gradual decrease of the debt ratio until the end of the programme period by over 10 percentage points. The Convergence Programme forecast on government gross debt is trending in the same direction as the Commission's 2018 spring forecast, albeit at a slightly faster pace.

**Table 3: Debt developments** 

(0/ of CDD)	Average	2017	20	18	2019		2020	2021
(% of GDP)	2012-2016	2017	COM	CP	COM	CP	CP	CP
Gross debt ratio <sup>1</sup>	42.1	40.6	38.0	37.3	35.5	34.2	31.6	29.0
Change in the ratio	0.9	-1.5	-2.6	-3.3	-2.5	-3.1	-2.6	-2.6
Contributions <sup>2</sup> :								
1. Primary balance	-0.1	-1.6	-1.1	-1.3	-1.1	-1.3	-1.7	-2.4
2. "Snow-ball" effect	-0.9	-1.5	-1.5	-1.6	-1.3	-1.2	-0.9	-0.6
Of which:								
Interest expenditure	0.7	0.4	0.3	0.3	0.2	0.3	0.4	0.5
Growth effect	-0.9	-1.0	-1.0	-1.1	-0.7	-0.8	-0.7	-0.5
Inflation effect	-0.6	-0.8	-0.8	-0.8	-0.9	-0.7	-0.6	-0.6
3. Stock-flow	1.9	1.6	0.0	-0.4	0.0	-0.6	0.0	0.5
adjustment	1.9	1.0	0.0	-0.4	0.0	-0.0	0.0	0.5
Of which:								
Cash/accruals diff.				-0.2		0.0	0.1	0.0
Acc. financial assets								
Privatisation				-0.1		-0.1	-0.1	-0.1
Val. effect & residual				0.2		-0.6	0.0	0.6

#### Notes:

#### Source.

Commission 2018 spring forecast (COM); Convergence Programme (CP), Commission calculations.

<sup>&</sup>lt;sup>1</sup> End of period.

<sup>&</sup>lt;sup>2</sup> The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

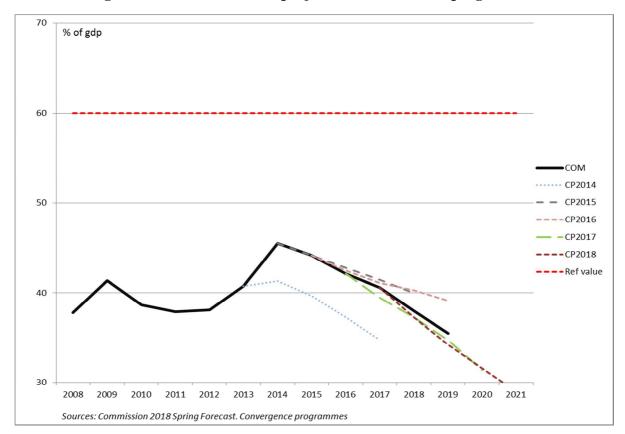


Figure 2: Government debt projections in successive programmes

#### 3.5. RISK ASSESSMENT

For 2018 and 2019, the Convergence Programme and the Commission 2018 spring forecast are close regarding the general government balances, although the Commission forecasts smaller surpluses. The recalculated structural balance is expected to be 0.9 % of GDP in 2018 and 1.0 % of GDP in 2019 in the Convergence Programme. These figures are close to those of the Commission 2018 spring forecast which expects 0.7 % of GDP in 2018 and 1.0 % of GDP in 2019. In both cases the MTO of a structural deficit of 1 % of GDP is thus expected to be respected.

Sweden is a small and open economy heavily dependent on its exports. Therefore, any weaker-than-expected economic growth in the rest of the world ultimately affects growth and employment through lower exports. The uncertainty surrounding economic policies in several countries and risks stemming from an escalation on the imposition of tariffs could impact some of Sweden's main trading partners in the EU. As Sweden's exports and income might decline, investment might slow as well further reducing growth.

After two decades of strong growth, house prices declined in the last quarter of 2017. Prices have broadly stabilised so far albeit at a lower level. However, downside risks remain in case house prices were to significantly decrease further. In turn, this could adversely affect consumer confidence and expectations and lower residential investment, household consumption, and could ultimately lower growth. The Convergence Programme also acknowledges that a further decline in house price poses risks to macroeconomic stability.

Considering Sweden's long track record of fiscal soundness and respecting its obligations under the preventive arm of the SGP, its sound fiscal position and the robust budgetary framework, the risks outlined above are assessed to be relatively low.

# 4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Sweden is subject to the preventive arm of the Stability and Growth Pact. In 2017, the Council did not address an SGP-related country-specific recommendation to Sweden in the context of fiscal compliance under the European Semester since the Council was of the opinion that Sweden complies with the Stability and Growth Pact. Based on the outturn data and the Commission 2018 spring forecast, the ex-post assessment suggests compliance with the preventive arm requirements in 2017.

The 2018 Convergence Programme projects the recalculated structural balance to temporarily decline from a surplus of 1.2 % of GDP in 2017 to a surplus of 0.9 % in 2018 before reverting to 1.0 % of GDP in 2019.

According to the information provided in the Convergence Programme, Sweden is expected to remain above its MTO - a structural balance of -1 % of GDP. This is confirmed by the Commission 2018 spring forecast, according to which the structural balance is projected to reach 0.7 % of GDP in 2018 and to improve to 1.0 % in 2019 under the no-policy-change assumption.

Therefore, Sweden is projected to be in compliance with the requirements of the preventive arm of the Pact in both 2018 and 2019. Beyond 2019, the programme indicates that the structural balance is set to remain significantly above the MTO over the programme period, with a positive margin to the limit value.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2017	20	18	2019				
Initial position <sup>1</sup>								
Medium-term objective (MTO)	-1.0	-1	-1.0		.0			
Structural balance <sup>2</sup> (COM)	1.2	0	.7	1.0				
Structural balance based on freezing (COM)	0.8	0	.7	-				
Position vis-a -vis the MTO <sup>3</sup>	At or above the MTO	At or above the MTO		At or above the MTO				
(% of GDP)	2017	2018		2019				
(% of GDF)	COM	CP	COM	CP	COM			
G4 4 11 1 91								

# Structural balance pillar Required adjustment Required adjustment corrected Change in structural balance One-year deviation from the required adjustment Two-year average deviation from the required adjustment Expenditure benchmark pillar Applicable reference rate One-year deviation adjusted for one-offs Two-year deviation adjusted for one-offs PER MEMORIAM: One-year deviation PER MEMORIAM: Two-year average deviation COM CP COM PER MEMORIAM: One-year adjustment Applicable reference rate One-year deviation adjusted for one-offs PER MEMORIAM: One-year deviation One-year deviatio

#### Notes

#### Source.

 $Convergence\ Programme\ (CP);\ Commission\ 2018\ spring\ forecast\ (COM);\ Commission\ calculations.$ 

<sup>&</sup>lt;sup>1</sup> The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

<sup>&</sup>lt;sup>2</sup> Structural balance = cyclically-adjusted government balance excluding one-off measures.

<sup>&</sup>lt;sup>3</sup> Based on the relevant structural balance at year t-1.

<sup>&</sup>lt;sup>4</sup> Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

<sup>&</sup>lt;sup>5</sup> Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

<sup>&</sup>lt;sup>6</sup> Change in the structural balance compared to year t-1. Ex post assessment (for 2017) is carried out on the basis of Commission 2018 spring forecast.

<sup>&</sup>lt;sup>7</sup> The difference of the change in the structural balance and the corrected required adjustment.

Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

<sup>&</sup>lt;sup>9</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

<sup>&</sup>lt;sup>10</sup> Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

# 5. FISCAL SUSTAINABILITY

Sweden does not appear to face fiscal sustainability risks in the short and medium run<sup>3</sup>.

Based on the Commission 2018 spring forecasts and a no-fiscal policy change scenario beyond the forecast horizon, government debt, forecast at 40.6% of GDP in 2017, is expected to decrease to 16.9% in 2028, thus remaining significantly below the 60% of GDP Treaty threshold. Even under the sensitivity analysis the debt-to-GDP ratio remains significantly below the threshold indicating low risk to fiscal sustainability. Overall, this highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Convergence Programme would also put debt on a continuously decreasing path to 2028, albeit at a faster face, with debt remaining below the 60% of GDP reference value in 2028.

The medium-term fiscal sustainability risk indicator S1<sup>5</sup> is at -4.5 percentage points of GDP, primarily related to the favourable initial budgetary position contributing with -2.8 percentage points of GDP, thus indicating low risks in the medium term. The full implementation of the Convergence Programme would put the sustainability risk indicator S1 at -7.0 percentage points of GDP, leading to even lower medium-term risk. Overall, risks to fiscal sustainability over the medium term are, therefore, low. Fully implementing the fiscal plans in the Convergence Programme would further decrease those risks.

The long-term fiscal sustainability risk indicator S2 is at 1.1 % of GDP. In the long term, Sweden therefore appears to face low fiscal sustainability risks, primarily due to the favourable initial budgetary position which partly compensates the projected ageing costs. Full implementation of the programme would put the S2 indicator at -0.2 percentage point of GDP, leading to even lower long-term risk. <sup>6</sup>

<sup>&</sup>lt;sup>3</sup> This assessment is based on the short-term fiscal sustainability risk indicator S0. See note in Table 5 for a definition of the indicator.

<sup>&</sup>lt;sup>4</sup> Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Debt Sustainability Monitor 2017 <a href="https://ec.europa.eu/info/publications/debt-sustainability-monitor-2017">https://ec.europa.eu/info/publications/debt-sustainability-monitor-2017</a> en for more details).

<sup>&</sup>lt;sup>5</sup> See the note to Table 5 for a definition of the indicator.

<sup>&</sup>lt;sup>6</sup> The projected costs of ageing used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the updated projections, endorsed by the EPC on 30 January 2018, and to be published in the forthcoming Ageing Report 2018.

**Table 5. Fiscal Sustainability Assessment** 

Time horizon				on Scenario	Convergence Programme Scenario		
Short Term			LO	W risk			
S0 indi	cator <sup>[1]</sup>			0.1			
	Fiscal subindex	0.0	LOW risk				
	Financial & competitiv	eness subindex	0.2	LOW risk			
Medium Term			LO	W risk			
DSA <sup>[2]</sup>	DSA <sup>[2]</sup>						
S1 indi	cator <sup>[3]</sup>		-4.5	LOW risk	-7.0	LOW risk	
of v	which			•		ı	
	Initial Budgetary Position	on	-	2.8	-4	1.3	
	Debt Requirement		-	2.0	-2.9		
	Cost of Ageing			0.2	0.2		
	of which				_		
		Pensions	-	0.4	-0.3		
		Health-care		0.1	С	.1	
		Long-term care	1	0.4	С	.3	
		Other		0.2	С	.1	
Long Term			LO	W risk	LOV	V risk	
S2 indi	cator <sup>[4]</sup>			1.1	-(	).2	
of v	which						
	Initial Budgetary Position	on	-	0.8	-2	2.0	
	Cost of Ageing			1.8		7	
	of which				_		
		Pensions	-	0.5	-(	).4	
		Health-care		0.6	C	.5	
		Long-term care		1.4		3	
Source: Commission cond		Other		0.4	C	.3	

Source: Commission services; 2018 stability/convergence programme.

Note: the 'Commission' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2018 forecast covering until 2019 included. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2018 Ageing Report.

- [1] The S0 indicator of short term fiscal challenges informs the early detection of fiscal stress associated to fiscal risks within a one-year horizon. To estimate these risks S0 uses a set of fiscal, financial and competitiveness indicators selected and weighted according to their signalling power. S0 is therefore a composite indicator whose methodology is fundamentally different from the S1 and S2 indicators, which quantify fiscal adjustment efforts. The critical threshold for the overall S0 indicator is 0.46. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.36 and 0.49\*.
- [2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections\*.
- [3] The S1 indicator is a medium-term sustainability gap; it measures the upfront fiscal adjustment effort required to bring the debt-to-GDP ratio to 60 % by 2032. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2020 for Commission scenario and from last available year for the SCP scenario); it must be then sustained, including financing for any additional expenditure until the target date, arising from an ageing population. The critical thresholds for S1 are 0 and 2.5, between which S1 indicates medium risk. If S1 is below 0 or above 2.5, it indicates low or high risk, respectively\*.
- [4] The S2 indicator is a long-term sustainability gap; it shows the upfront and permanent fiscal adjustment required to stabilise the debt to-GDP ratio over the infinite horizon, including the costs of ageing. The critical thresholds for S2 are 2 and 6, between which S2 indicates medium risk. If S2 is below 2 or above 6, it indicates low or high risk, respectively.
- \* For more information see Fiscal Sustainability Report 2015 and Debt Sustainability Monitor 2017.

# 6. FISCAL FRAMEWORK

The Swedish fiscal framework which has the dual objective to maintain fiscal discipline and macroeconomic stability was amended in late 2017, taking effect in 2019. The revised framework essentially includes a new benchmark for public debt, and a lower surplus target for the general government. The Convergence Programme is based on the amended rules.

The main Swedish fiscal rule is the surplus target for the general government (including the pension system) over the economic cycle. The applicable surplus target until 2018 has stood at 1% of GDP. In the Convergence Programme the authorities report that, on an ex post basis, the surplus target has not been reached, based on the measure of the backward-looking 8-year average of the general government balance (-0.2 % of GDP in 2017). The authorities argue that this performance is explained partly by the effects of the protracted recession on general government finances, but also by unfunded measures, including several tax reductions that were implemented before 2015.

Effective in 2019, the net lending surplus target is lowered to 1/3 % of GDP and the structural balance rule is complemented by the introduction of a debt anchor set at 35 % of GDP, serving as a benchmark consistent with the surplus target. Looking forward, the envisaged budgetary balances laid down in the programme would lead Sweden in the direction of a surplus in the medium term above the new lowered surplus rule, with a structural balance of 1.2 % of GDP in 2017, 0.7 % in 2018 and 1.0 % in 2019. With full implementation of the Convergence Programme debt would fall below the debt anchor starting in 2019 and would remain on a decreasing path to 2028.

Sweden also has an expenditure ceiling for central government expenditure and the government has had to propose an expenditure ceiling for the third year ahead in the budget bill. Under the expenditure ceiling, there is a budget margin of a specified size which acts as a buffer if expenditure develops in an unexpected way because of cyclical developments. Finally, Sweden has a balanced budget requirement (with possibility to set rainy day funds) for local authorities.

The Fiscal Policy Council is currently not involved in the endorsement or assessment of the macroeconomic scenario underpinning the Convergence Programme. However, in its 2017 annual report, it noted that the government forecasts had a systematic tendency to overestimate GDP growth and general government net lending. The Fiscal Policy Council report also signalled the non-compliance with the 1 % surplus target over the economic cycle. It noted that average net lending had fallen short of the target in every eight-year period from 2005–2012 to 2011–2018.

In conclusion, based on the information provided in the Convergence Programme, the past fiscal performance in Sweden appears to comply only partially with the requirements of the applicable national numerical fiscal rules. However, the planned and forecast fiscal performance appears to broadly comply with the requirements of the reformed national numerical fiscal rules.

# 7. SUMMARY

In 2017, Sweden achieved an improvement of the structural balance, which stood at 1.2 % of GDP, significantly outperforming the MTO. The consolidated gross debt stood at 40.6 % of GDP at the end of 2017, significantly below the Treaty threshold of 60 % of GDP. The debt ratio is projected to decrease further in 2018, as a proportion to GDP.

Overall, Sweden's structural balance is expected to remain above the MTO in both 2018 and 2019 and is therefore foreseen to continue to meet the requirements under the preventive arm of the Pact.

# 8. ANNEXES

**Table I. Macroeconomic indicators** 

	2000-	2005-	2010-					1
	2004	2009	2014	2015	2016	2017	2018	2019
Core indicators								
GDP growth rate	3.0	1.0	2.4	4.5	3.2	2.4	2.6	2.0
Output gap <sup>1</sup>	0.0	0.3	-1.7	-0.1	0.4	0.1	0.1	-0.3
HICP (annual % change)	1.9	1.9	1.0	0.7	1.1	1.9	1.9	1.7
Domestic demand (annual % change) <sup>2</sup>	2.1	1.4	2.6	4.3	3.3	2.9	2.4	1.8
Unemployment rate (% of labour force) <sup>3</sup>	6.5	7.1	8.1	7.4	6.9	6.7	6.3	6.3
Gross fixed capital formation (% of GDP)	21.8	23.1	22.6	23.6	24.1	24.9	25.3	25.1
Gross national saving (% of GDP)	27.8	30.7	28.4	28.8	29.4	29.8	30.1	30.2
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	0.5	1.7	-0.8	0.2	1.2	1.3	0.8	0.9
Gross debt	50.4	42.3	40.2	44.2	42.1	40.6	38.0	35.5
Net financial assets	-7.0	10.5	19.7	19.0	22.8	n.a	n.a	n.a
Total revenue	53.8	52.8	50.3	49.8	50.6	50.3	49.7	49.3
Total expenditure	53.3	51.1	51.1	49.6	49.4	49.1	48.9	48.4
of which: Interest	2.5	1.6	0.9	0.4	0.4	0.4	0.3	0.2
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	2.5	2.6	-0.5	-2.2	-3.6	-3.5	-3.2	-2.6
Net financial assets; non-financial corporations	-126.4	-164.6	-186.8	-215.7	-217.7	n.a	n.a	n.a
Net financial assets; financial corporations	-7.2	-1.8	-8.2	-2.2	-3.9	n.a	n.a	n.a
Gross capital formation	15.5	15.7	15.8	16.9	17.2	17.9	18.1	18.0
Gross operating surplus	23.3	24.3	23.7	24.9	24.0	23.8	24.2	24.5
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	2.3	2.9	6.4	6.3	7.0	6.4	6.4	6.0
Net financial assets	112.0	141.2	164.8	200.7	205.1	n.a	n.a	n.a
Gross wages and salaries	38.9	38.6	40.0	39.5	39.4	39.5	39.3	39.1
Net property income	2.9	3.7	5.5	6.2	6.7	6.1	6.0	6.0
Current transfers received	22.6	21.3	20.9	20.3	19.9	19.7	19.6	19.3
Gross saving	4.9	6.2	9.3	9.6	10.3	9.8	9.9	9.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	5.6	7.5	5.2	4.4	4.6	4.0	4.0	4.3
Net financial assets	28.6	14.7	10.6	-1.8	-6.3	n.a	n.a	n.a
Net exports of goods and services	6.5	6.8	4.8	4.9	4.8	4.2	4.1	4.4
Net primary income from the rest of the world	0.5	2.6	2.3	1.3	1.1	1.4	1.4	1.3
Net capital transactions	-0.1	-0.2	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Tradable sector	43.6	42.5	41.2	40.6	39.9	39.7	n.a	n.a
Non tradable sector	44.7	45.6	47.1	48.0	48.5	48.7	n.a	n.a
of which: Building and construction sector	4.5	5.2	5.0	5.1	5.3	5.5	n.a	n.a
Real effective exchange rate (index, 2010=100)	102.2	100.6	108.5	103.0	103.1	103.7	99.7	98.9
Terms of trade goods and services (index, 2010=100)	102.7	99.5	99.6	100.6	100.9	100.3	99.4	99.6
Market performance of exports (index, 2010=100)	101.6	100.7	99.6	100.3	99.5	99.0	98.9	98.5
Notes:								

#### Notes:

Source:

AMECO data, Commission 2018 spring forecast

<sup>&</sup>lt;sup>1</sup> The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices.

<sup>&</sup>lt;sup>2</sup> The indicator on domestic demand includes stocks.

<sup>&</sup>lt;sup>3</sup> Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.