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Assessment of the 2019 Convergence Programme for

Sweden

(Note prepared by DG ECFIN staff)

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CONTENTS

EXECUTIVE SUMMARY

Sweden is subject to the preventive arm of the Stability and Growth Pact. With gross public debt at 38.8% of GDP and below 60% of GDP, Sweden is compliant with the debt criterion.

The Swedish economy expanded by 2.3% in 2018 in real terms, but economic growth is expected to decline to 1.4% in 2019 and increase slightly to 1.6% in 2020, according to the Commission 2019 spring forecast. Growth is expected to be supported by net exports while domestic demand growth is set to moderate. Unemployment is set to stabilise at above 6% due to slower growth and the challenging labour market integration of the low-skilled and migrants. The macroeconomic scenario included in the Convergence Programme is broadly aligned with the Commission 2019 spring forecast and considered plausible.

In 2018, the headline budget balance reached a surplus of 0.9% of GDP. According to the Convergence Programme, the surplus of the general government budget balance is set to decrease to 0.6% of GDP in 2019 and 0.7% in 2020, before climbing to 1.1% in 2021 and 1.9% by 2022. In structural terms, based on recalculated output gaps, the budget balance stood at 0.6% of potential GDP in 2018, well above the medium-term budgetary objective (MTO, set at -1%). The structural budget surplus is expected to remain unchanged in 2019, before increasing to 0.9% in 2020. Risks to the short-term fiscal outlook mainly come from the macroeconomic side, such as a worsening of the economic climate or lower-than-projected wage growth, which would affect income tax revenue. Falling house prices could also adversely affect household consumption.

Overall, Sweden is expected to remain compliant with the MTO in 2019 and 2020.

1. INTRODUCTION

On 29 April 2019, Sweden submitted its 2019 Convergence Programme (hereafter called Convergence Programme), covering the period 2018-2022[1]. The government approved the programme on 25 April 2018 and it was submitted to the Parliament on 23 April 2019.

Sweden is currently subject to the preventive arm of the 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 27 February 2019 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 2019 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 the Commission forecast. Section 4 assesses compliance with the rules of the SGP, including based on 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

The macroeconomic scenario underlying the 2019 Convergence Programme assumes a marked weakening in real GDP growth from 2.3% in 2018 to 1.6% in 2019, driven mainly by a slowdown in investment and public consumption. The Convergence Programme expects real GDP growth to stabilise at 1.6% in 2020 and 2021 on the back of sluggish growth in the world economy, before picking up slightly in 2022 on account of strengthening domestic demand. The Convergence Programme projects a continued employment growth over the forecast period, but at a lower pace than in the preceding years. Consequently, the unemployment rate is set to stabilise around 6.4%. The Convergence Programme expects HICP inflation to remain below 2% over the programme horizon, reflecting several factors, including the absence of inflationary pressures as real GDP weakens below potential; low import price growth of around 0.5% per year throughout the forecast period; and stable and relatively moderate wage increases in the presence of a modest recovery in labour productivity.

The 2019 Convergence Programme’s projections for real GDP growth are substantially lower than in the 2018 Convergence Programme. The difference is around 0.5 percentage points for each of the years from 2018 to 2020, largely reflecting weaker private consumption and investment. Compared to the 2018 Convergence Programme the projections for 2019 and 2020 show a higher unemployment rate and somewhat lower HICP inflation, in line with softer cyclical conditions and weak inflationary pressures.

[1] The English version was submitted on 7 May 2019.

The macroeconomic scenario of the Convergence Programme is broadly in line with the Commission's 2019 spring forecast. The programme projects GDP growth of 1.6% in both 2019 and 2020, while the Commission forecasts 1.4% and 1.6%, respectively. For both years, the Convergence Programme and the Commission spring forecast expect similar growth contributions from final domestic demand. The Convergence Programme projections for private consumption growth (the tax base for indirect taxes) are also quite close to those of the Commission spring forecast, although for 2019 it assumes stronger employment growth yet weaker wage growth (the tax base for personal income tax and social contributions). The Convergence Programme expects HICP inflation to decrease in 2020, compared with a slight increase in the Commission spring forecast.

Sweden's economy is performing at its potential. The output gap, as recalculated by the Commission based on the information in the Convergence Programme following the commonly agreed methodology, is expected to be closed in 2019 before turning negative in 2020 and staying negative until the end of the period covered by the programme[2]. The (recalculated) output estimates of the Convergence Programme are very close to those in the Commission spring forecast.

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

[2] The recalculated output gaps differ from the ones presented in the programme mainly due to some differences in the methodology.

Table 1: Comparison of macroeconomic developments and forecasts

	2018		2019		2020		2021	2022
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	2.3	2.3	1.4	1.6	1.6	1.6	1.6	2.0
Private consumption (% change)	1.2	1.2	1.8	1.6	2.2	2.1	2.4	2.8
Gross fixed capital formation (% change)	3.3	3.3	-0.2	0.8	0.9	1.3	0.9	1.1
Exports of goods and services (% change)	3.5	3.5	3.1	3.5	2.9	3.1	3.2	3.5
Imports of goods and services (% change)	2.9	2.9	1.9	2.3	2.2	2.5	2.6	2.4
Contributions to real GDP growth:								
- Final domestic demand	1.6	1.6	0.8	0.9	1.2	1.2	1.2	1.3
- Change in inventories	0.4	0.4	-0.1	0.0	0.0	0.0	0.0	0.0
- Net exports	0.4	0.4	0.7	0.6	0.4	0.4	0.4	0.7
Output gap[1]	0.5	0.4	-0.1	0.0	-0.4	-0.4	-0.6	-0.3
Employment (% change)	1.8	1.8	0.8	1.3	0.6	0.2	0.4	0.7
Unemployment rate (%)	6.3	6.3	6.4	6.3	6.4	6.4	6.4	6.5
Labour productivity (% change)	0.5	0.5	0.6	0.2	1.0	1.4	1.2	1.3
HICP inflation (%)	2.0	2.0	1.5	1.6	1.6	1.3	1.7	1.8
GDP deflator (% change)	2.2	2.2	2.2	2.3	1.9	1.8	1.9	2.0
Comp. of employees (per head, % change)	3.4	3.6	3.1	2.5	3.0	3.0	3.0	3.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	3.4	2.8	4.1	3.5	4.6	3.7	3.9	4.4

Note:

[1]In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source :

Commission 2019 spring forecast (COM); Convergence Programme (CP).

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. DEFICIT DEVELOPMENTS IN 2018 AND 2019

The general government balance dropped to a surplus of 0.9% of GDP in 2018 (from 1.4% of GDP in 2017).[3] This outcome is broadly in line with the 2018 Convergence Programme, which projected a surplus of 1.0% of GDP.

For 2019, the Convergence Programme foresees a further decline of the general government balance to a surplus of 0.6% of GDP. This projected general government surplus is lower than in the 2018 Convergence Programme (1.0% of GDP) following slowing real GDP. The Commission 2019 spring forecast expects a lower general government surplus (0.4% of GDP) than the Convergence Programme as it forecasts a somewhat less favourable macroeconomic environment.

[3] The Convergence Programme reports a surplus of 0.7% of GDP, but Statistics Sweden has subsequently revised this figure to the above-mentioned 0.9% of GDP.

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 1.9% of GDP and a recalculated structural balance of 2.1% of GDP by the end of the programme, significantly outperforming Sweden's MTO. These new targets are not significantly different from those included in the 2018 Convergence Programme.

The Convergence Programme is consistent with the new fiscal governance reform package 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 as a benchmark.

For 2020, under a no-policy-change assumption, the Convergence Programme expects a general government surplus of 0.7% of GDP, larger than the Commission 2019 spring forecast (0.4% of GDP). This is largely since the Convergence Programme revenue projections are higher than those of the Commission spring forecast.

Over time, the Convergence Programme forecasts both revenues and expenditures to fall as a share of GDP. However, expenditures are expected to grow at a slower pace than revenues, resulting in a gradual increase in the general government surplus of close to 2% of GDP by 2022, comparable with the 2018 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 0.6% of GDP in 2019 and 0.9% of GDP in 2020, 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, which reaches 2.1% of GDP in 2022 (compared to 1.7% of GDP in 2021 envisaged in the 2018 Convergence Programme). The structural balance in the Commission 2019 spring forecast is 0.5% of GDP in 2019 and 0.6% in 2020 respectively.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2018	2019		2020		2021	2022	Change: 2018-2022
	COM	COM	CP	COM	CP	CP	CP	CP
Revenue	**50.8**	**50.2**	**49.9**	**49.9**	**49.7**	**49.6**	**49.4**	**-1.1**
of which:								
- Taxes on production and imports	22.5	22.3	22.1	22.2	22.0	21.9	21.8	-0.7
- Current taxes on income, wealth, etc.	18.7	18.4	18.4	18.1	18.4	18.4	18.4	-0.1
- Social contributions	3.4	3.4	2.8	3.5	2.8	2.7	2.7	-0.1
- Other (residual)	6.2	6.1	6.6	6.0	6.5	6.6	6.5	-0.2
Expenditure	**49.9**	**49.8**	**49.3**	**49.5**	**49.0**	**48.5**	**47.6**	**-2.2**
of which:								
- Primary expenditure	49.4	49.3	48.9	49.0	48.6	48.2	47.3	-2.0
of which:								
Compensation of employees	12.7	12.6	12.6	12.5	12.5	12.4	12.2	-0.5
Intermediate consumption	8.0	7.9	7.8	7.9	7.7	7.6	7.4	-0.7
Social payments	16.3	16.3	16.0	16.1	15.8	15.5	15.2	-1.1
Subsidies	1.6	1.6	1.6	1.6	1.7	1.6	1.6	0.0
Gross fixed capital formation	4.8	4.8	4.8	4.9	4.9	5.0	4.8	0.1
Other (residual)	6.0	6.0	6.1	5.9	6.1	6.0	6.0	0.0
- Interest expenditure	0.5	0.5	0.4	0.5	0.4	0.3	0.3	-0.2
General government balance (GGB)	**0.9**	**0.4**	**0.6**	**0.4**	**0.7**	**1.1**	**1.9**	**1.2**
Primary balance	**1.4**	**0.9**	**1.0**	**0.9**	**1.1**	**1.4**	**2.2**	**1.0**
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	**0.9**	**0.4**	**0.6**	**0.4**	**0.7**	**1.1**	**1.9**	**1.2**
Output gap[1]	0.5	-0.1	0.0	-0.4	-0.4	-0.6	-0.3	-0.8
Cyclically-adjusted balance[1]	0.6	0.5	0.6	0.6	0.9	1.4	2.1	1.4
Structural balance[2]	**0.6**	**0.5**	**0.6**	**0.6**	**0.9**	**1.4**	**2.1**	**1.4**
Structural primary balance[2]	1.1	1.0	1.0	1.1	1.3	1.7	2.4	1.2

Notes:

[1]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.

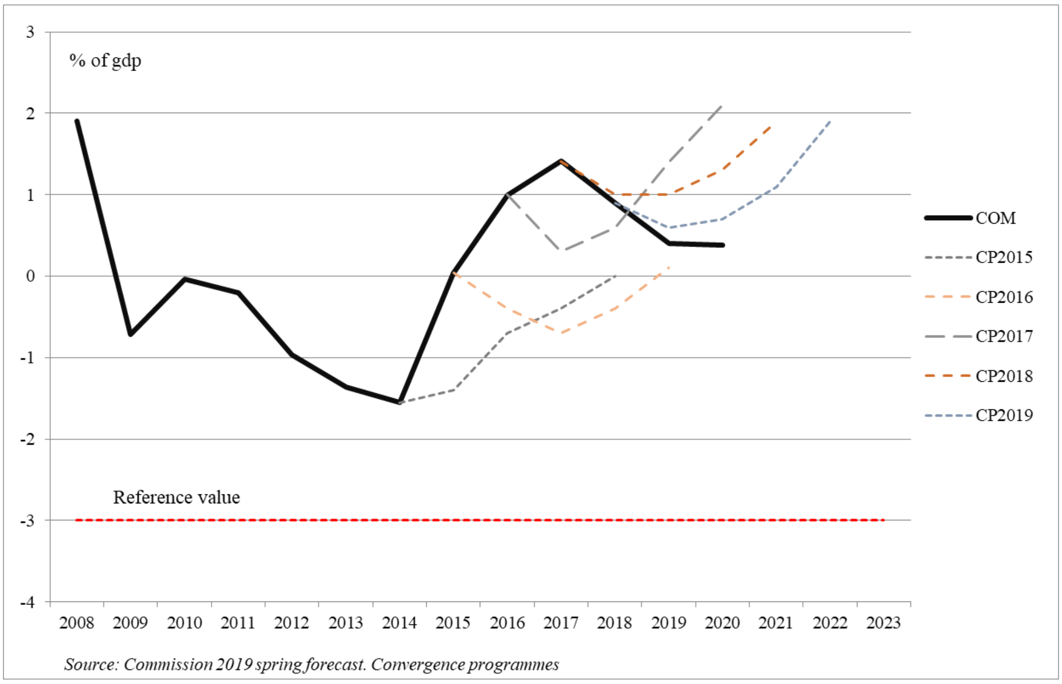
[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source :

Convergence Programme (CP); Commission 2019 spring forecasts (COM); Commission calculations.

In the Convergence Programmes of 2015, 2016 and 2017 the projected government balance for those years was lower than the actual outturns (see Figure 1). Conversely, both the 2018 and the 2019 Convergence Programmes expect higher surpluses than the Commission in its 2019 spring forecast.

Figure 1: Government balance projections in successive programmes (% of GDP)



3.3. MEASURES UNDERPINNING THE PROGRAMME

The Convergence Programme discusses measures contained in the budget for 2019.[4] In total, these measures are estimated to have an effect on the general government finances of approximately -0.6% of GDP in 2019 and -0.1% of GDP in 2020 and -0.2% of GDP in 2021. Overall, the 2019 budget implies a weakening of public finances by about SEK 18 billion compared to 2018. It largely results from income tax cuts: the basic income tax deduction for persons older than 65 is increased, and the earned income tax deduction is expanded in combination with an increase in the tax threshold for state income tax. In addition, higher expenditure for defence, the police and the judiciary also contribute to the expected lower surplus in 2019. Government grants to municipalities are higher (SEK 8 billion) and include increased targeted grants in health care and general government grants.

Reflecting the economic policy of the new government, measures in 2019 also include increased support for housing investments, broadband coverage and improved labour market integration. On the revenue side, taxes on fuels and chemicals are raised. All these items have been included in the Commission's spring forecast.

According to the Convergence Programme, the Swedish government intends to address the following key priorities with its economic policy in the coming years (see the table below for figures on the aggregate level). On the expenditure side, measures aim to address the labour market integration of low-skilled and migrants and to bridge the skills gap that has resulted in more than one hundred thousand unfilled vacancies. Measures to address climate change,

[4] The analysis covers the consolidated effects of the caretaker government budget bill, the opposition's amendments as approved by the Riksdag as well as the government's spring complementary bill presented in April 2019 and based on the January agreement between the government and the Centre party and Liberals.

housing shortage and the transition to a fossile-free welfare economy will also be prioritised, as will a strengthened school system. The government also focuses on strengthening the police and judiciary with, for example, the training and appointment of ten thousand new posts within the until 2024.

On the revenue side, overall tax revenues are expected to decrease in 2019 by around 0.4% of GDP largely on account of income tax cuts. As from 2020, the Convergence Programme expects a more stable development, with marginal revenue dropping below 0.1% of GDP. The government is implementing a gradual green tax shift to boost the effectiveness of climate policy and at the same time to ensure revenues for policy measures.

As this year, last year's Convergence Programme included earmarked funds to local governments (0.1% in 2019). Municipal income taxes are the main source of revenue for local governments, but they have increasingly become reliant on general government grants to tackle the challenges of integration of migrants and in providing qualitative welfare services. There are also spending needs at the local level for schools and health care linked to demographic developments, for which a long-term funding strategy is necessary.

While the Convergence Programme includes the broad policy priorities as summarised above, it does not provide a description of the main budgetary measures and an assessment of their quantitative effects on the general government balance. The budgetary effect of the government's economic policy in 2018-22 is only provided on an aggregate level in billions of Swedish krona (SEK) and in comparison to the previous year and not relative to GDP developments. This does not comply with the guidelines laid down in the Code of Conduct.

Main budgetary measures included in the Programme

Revenue	**Expenditure**
2018	
	• 0.6% of GDP
2019	
• -0.4% of GDP	• 0.3% of GDP
2020	
	• 0.1% of GDP
2021	
	• 0.1% of GDP
2022	
	• -0.2% of GDP

Note: The table refers to the main measures included in the 2019 Convergence Programme that have an incremental budgetary impact over the programme period. The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.

3.4. DEBT DEVELOPMENTS

Sweden's government gross debt ratio has been well below the 60% of GDP reference value and has been on a downward trend since a number of years. It reached 38.8% of GDP in 2018, which is lower than the average over the period 2013-2017.

Similar to the Commission 2019 spring forecast, the Convergence Programme projects debt as a proportion of GDP to decrease further in 2019 and 2020. In 2019, prudent fiscal policy, economic growth and an exceptional SEK 70 billion reduction of loan-financed foreign currency reserves by the Riksbank account for the reduction. In 2020, sustained economic growth, along with the inflation effect are set to more than compensate the interest expenditure, serving to reduce the debt ratio further.

The foreseen sustained economic growth, together with the solid fiscal framework is expected to imply a further gradual decrease of the debt ratio. Until the end of the programme period, the Convergence Programme expects a decrease of roughly 10 percentage points to 28.2% of GDP. The new fiscal framework tasks the government to report deviations of more than 5 percentage points from the debt anchor of 35% of GDP to the Riksdag. Based on the Convergence Programme the debt ratio is set to fall below 30% of GDP in 2022.

Table 3: Debt developments

(% of GDP)	Average 2013-2017	2018	2019		2020		2021	2022
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**42.7**	**38.8**	**34.4**	**34.5**	**32.4**	**32.8**	**30.9**	**28.2**
Change in the ratio	0.6	-2.0	-4.5	-4.3	-1.9	-1.7	-1.9	-2.7
Contributions[2] *:*								
1. Primary balance	**-0.5**	**-1.4**	**-0.9**	**-1.0**	**-0.9**	**-1.1**	**-1.4**	**-2.2**
2. "Snow-ball" effect	**-1.2**	**-1.3**	**-0.8**	**-1.0**	**-0.7**	**-0.8**	**-0.8**	**-0.9**
Of which:								
Interest expenditure	0.6	0.5	0.5	0.4	0.5	0.4	0.3	0.3
Growth effect	-1.1	-0.9	-0.5	-0.6	-0.5	-0.5	-0.5	-0.6
Inflation effect	-0.7	-0.9	-0.8	-0.8	-0.6	-0.6	-0.6	-0.6
3. Stock-flow adjustment	**2.3**	**0.7**	**-2.7**	**-2.2**	**-0.3**	**0.2**	**0.3**	**0.4**
Of which:								
Cash/accruals diff.				-0.1		0.0	-0.1	0.0
Acc. financial assets								
Privatisation				-0.1		-0.1	-0.1	-0.1
Val. effect & residual				-2.0		0.4	0.5	0.5

Notes:

[1] End of period.

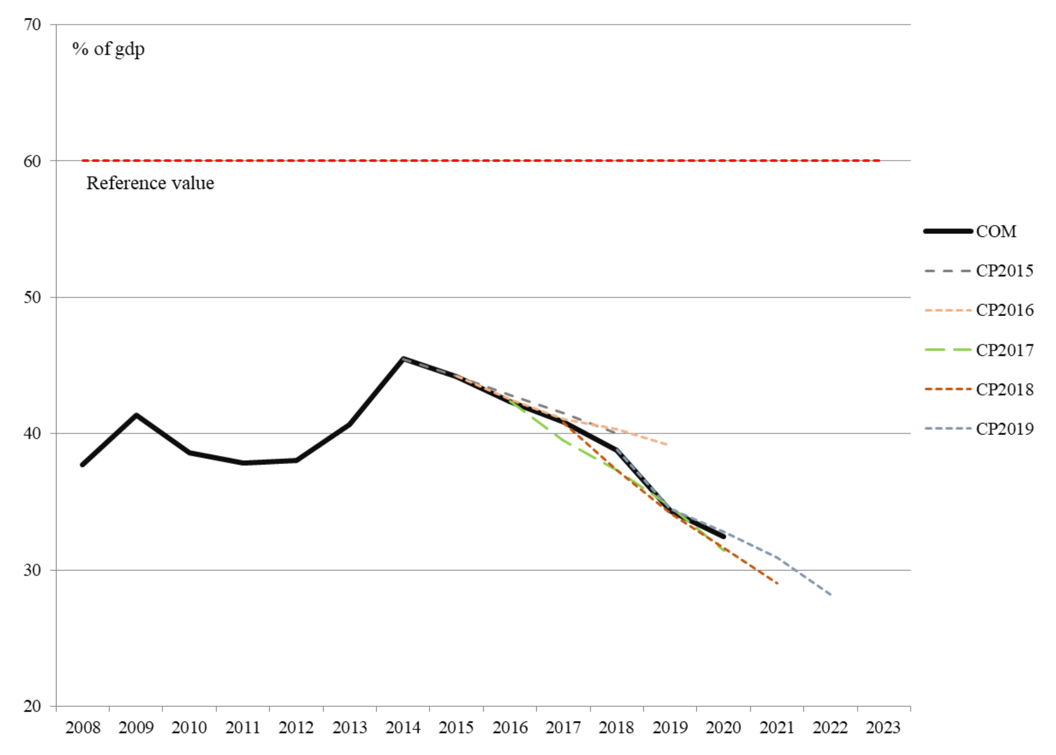
[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets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

Source :

Commission 2019 spring forecast (COM); Convergence Programme (CP), Commission calculations.

The projection of government debt (see Figure 2) has been stable since 2015 with expectations of a downward trend in line with the actual outcome. Looking at 2019 and 2020, both the 2018 and the 2019 Convergence Programmes expected debt to fall further, as did the Commission 2019 spring forecast.

Figure 2: Government debt projections in successive programmes (% of GDP)



Source: Commission 2019 spring forecast. Covergence programmes

3.5. RISK ASSESSMENT

For 2019 and 2020, the Convergence Programme and the Commission 2019 spring forecast project similar general government balances, although the Commission forecasts smaller surpluses. While the discrepancy is somewhat larger when looking at the recalculated structural balance, in both cases the MTO of a structural deficit of 1% of GDP is expected to be respected.

The Convergence Programme acknowledges risks stemming from the external environment as well as from domestic imbalances – notably macroeconomic stability risks associated with the housing market and household debt. Given Sweden’s dependance on trade, any weaker-than-expected economic growth in the rest of the world ultimately affects growth and employment. The uncertainty surrounding economic policies in several countries and risks stemming from an escalation of the imposition of tariffs could impact Sweden's main trading partners through a combination of less trade and higher risk premia. The ensuing negative impact on Sweden's exports and investment might reduce economic growth.

House prices broadly stabilised from 2018 onwards but downside risks to growth remain related to the risk house prices significantly decreasing further. This could adversely affect consumer confidence and lead to lower residential investment, household consumption and ultimately lower growth.

The sensitivity analysis in the Convergence Programme suggests a very limited impact on public finances in a scenario with lower potential productivity growth compared to the baseline projection. This stems from the assumption that weaker private consumption and wage growth would be broadly offset by lower public spending and investment. Sweden has a robust budgetary framework and a long track record of fiscal soundness and of respecting its obligations under the preventive arm of the SGP. In light of this, the risks outlined above are unlikely to have a negative impact on budgetary compliance.

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

Sweden is subject to the preventive arm of the Stability and Growth Pact and should ensure compliance with its MTO. Under the European Semester in July 2018 the Council considered that Sweden complied with the Stability and Growth Pact. Based on the outturn data and the Commission 2019 spring forecast, the ex-post assessment suggests compliance with the preventive arm requirements in 2018.

The 2019 Convergence Programme projects the recalculated structural balance to reach a surplus of 0.6% of GDP in 2018 and 2019 before increasing to 0.9% of GDP in 2020.

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 2019 spring forecast, according to which the structural balance is projected to reach 0.5% of GDP in 2019 and to improve to 0.6% in 2020 under the no-policy-change assumption.

Therefore, Sweden is projected to comply with the requirements of the preventive arm of the Pact in both 2019 and 2020. Beyond 2020, the programme indicates that the structural balance is set to remain significantly above the MTO over the programme period.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2018	2019	2020
Background budgetary indicators[1]			
Medium-term budgetary objective (MTO)	-1.0	-1.0	-1.0
Structural balance[2] (COM)	0.6	0.5	0.6
Setting the required adjustment to the MTO			
Structural balance based on freezing (COM)	0.9	0.5	-
Position vis-à-vis the MTO[3]	At or above the MTO	At or above the MTO	At or above the MTO
Required adjustment[4]	0.0	0.0	0.0
Required adjustment corrected[5]	-2.2	-1.9	-1.5
Corresponding expenditure benchmark[6]	8.8	8.6	7.0

Compliance with the required adjustment to the MTO					
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Change in structural balance[7]					
One-year deviation from the required adjustment[8]					
Two-year average deviation from the required adjustment[8]					
Expenditure benchmark pillar					
Net public expenditure annual growth corrected for one-offs[9]	Compliant				
One-year deviation adjusted for one-offs[10]					
Two-year deviation adjusted for one-offs[10]					
Finding of the overall assessment					

Legend

'*Compliance*' - the recommended structural adjustment or a higher adjustment is being observed.

'*Some deviation*' - a deviation from the recommended structural adjustment is being observed, but it is below the threshold for a significant deviation.

'*Significant deviation*' - a deviation which has reached or breached the threshold for a significant deviation (i.e. 0.5% of GDP over one year, 0.25% of GDP over two years on average).

Notes

[1] 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 point is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] 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.). In case of a SDP, the requirement corresponds to the Council recommendation when available; otherwise it refers to the Commission recommendation to the Council.

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] 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.

[7] Change in the structural balance compared to year t-1. Ex post assessment (for 2018) is carried out on the basis of Commission 2019 spring forecast.

[8] The difference of the change in the structural balance and the corrected required adjustment.

[9] Net public expenditure annual growth (in %) corrected for discretionary revenue measures, revenue measures mandated by law and one-offs (nominal)

[10] 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.

Source :

Convergence Programme (CP); Commission 2019 spring forecast (COM); Commission calculations.

5. DEBT SUSTAINABILITY ANALYSIS AND FISCAL RISKS

Sweden does not appear to face fiscal sustainability risks in the short and medium run[5].

Based on the Commission 2019 spring forecast and a no-fiscal policy change scenario beyond the forecast horizon, government debt, forecast at 34.4% of GDP in 2019, is expected to decrease to 17.4% in 2029, thus remaining significantly below the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to peak in 2019. A sensitivity analysis indicates similar risks[6]. Overall, this highlights low risks to debt sustainability in the medium term. The full implementation of the Convergence Programme would also put debt on a stronger decreasing path, with debt remaining below the 60% of GDP reference value in 2029.

The low risks in the medium term are confirmed by the fiscal sustainability risk indicator S1[7], primarily related to the favourable initial budgetary position. The full implementation of the Convergence Programme would put the sustainability risk indicator S1 at -7.1 percentage points of GDP. Based on the debt sustainability analysis and the S1 indicator, overall medium-term fiscal sustainability risks are, therefore, low.

The long-term fiscal sustainability risk indicator S2 is at 1.2 percentage points of GDP. The S2 indicator thus confirms that in the long term, Sweden appears to face low fiscal sustainability risks despite projected ageing costs. This is primarily due to the favourable initial budgetary position,. Full implementation of the programme would put the S2 indicator at -0.1 percentage point of GDP, leading to even lower long-term risk[8]. The debt sustainability analysis discussed above points to low risks so that, overall, long-term fiscal sustainability risks are assessed as low.

[5] This assessment is based on the short-term fiscal sustainability risk indicator S0. See note in Table 5 for a definition of the indicator.

[6] Sensitivity analysis includes several deterministic debt projections, as well as stochastic projections (see Fiscal Sustainability Report 2018 for more details).

[7] See the note to Table 5 for a definition of the indicator.

[8] The projected costs of ageing that are used to compute the debt projections and the fiscal sustainability indicators S1 and S2 are based on the projections of the 2018 Ageing Report.

Table 5: Debt sustainability analysis and sustainability indicators

Time horizon				Commission Scenario		Convergence Programme Scenario	
Short-term				**LOW risk**			
S0 indicator [1]				0.2			
	Fiscal subindex			0.0	LOW risk		
	Financial & competitiveness subindex			0.3	LOW risk		
Medium-term				**LOW risk**			
DSA [2]				LOW risk			
S1 indicator [3]				-4.4	LOW risk	-7.1	LOW risk
of which	Initial Budgetary Position			-2.5		-4.3	
	Debt Requirement			-2.2		-3.0	
	Cost of Ageing			0.3		0.2	
		of which	Pensions	-0.4		-0.3	
			Health care	0.1		0.1	
			Long-term care	0.4		0.3	
			Other	0.1		0.1	
Long-term				**LOW risk**			
DSA [2]				LOW risk			
S2 indicator [4]				1.2	LOW risk	-0.1	LOW risk
of which	Initial Budgetary Position			-0.6		-1.8	
	Cost of Ageing			1.8		1.8	
		of which	Pensions	-0.4		-0.3	
			Health care	0.6		0.5	
			Long-term care	1.4		1.2	
			Other	0.3		0.3	

Source: Commission services; 2019 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 2019 forecast until 2020. 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 2033. This adjustment effort corresponds to a cumulated improvement in the structural primary balance over the 5 years following the forecast horizon (i.e. from 2021 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 2018.

6. FISCAL FRAMEWORK

A revised Swedish fiscal framework has taken effect in 2019, the details of which have been described in the Commission's country report[9]. The framework revisions essentially entail 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 was 1% of GDP. In the Convergence Programme the authorities report that, on an ex post basis, the surplus target was not reached, based on the measure of the backward-looking 8-year average of the general government balance (-0.1% of GDP in 2018). The authorities argue that while the surplus was below the target of 1% of GDP, it increased successively over the 8-year-period.

Effective in 2019, the net lending surplus target was lowered to 1/3% of GDP and the structural balance rule was 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 of the Convergence Programme would in the medium term result in a surplus above the new surplus rule. 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 2029.

Sweden also has an expenditure ceiling for the central government, which required the government 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. The budget margin amounted to 4% of the expenditure ceiling in 2018, and the Fiscal Policy Council expects it to remain roughly unchanged in the coming years. Finally, Sweden has a balanced budget requirement for local authorities, where any deficit must normally be corrected within three years time. According to the Convergence Programme, the balanced budget objective was met in 2018, but expenditure is increasing faster than revenue. Even so the government expects municipalities to comply with the rule also going forward, with a net surplus of SEK 17 billion in 2019 (representing 1.9% of tax income and general government grants).

The Fiscal Policy Council is not involved in the endorsement or assessment of the macroeconomic scenario underpinning the Convergence Programme. However, in its 2019 annual report, it noted that while fiscal policy is expected to be in line with the new surplus target of 1/3% of GDP going forward, neither the present target, nor the previous one of 1% of GDP was met based on the measure of the backward-looking 8-year average. The Fiscal Policy Council also called for the government to explain the principles and considerations underlying the proposed level of the expenditure ceiling. 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. The planned and forecast fiscal performance, however, appears to broadly comply with the requirements of the reformed national numerical fiscal rules.

[9] European Commission, Country report Sweden 2019, 27.02.2019:
https://ec.europa.eu/info/sites/info/files/file_import/2019-european-semester-country-report-sweden_en.pdf.

7. SUMMARY

In 2018, Sweden's structural balance stood at 0.6% of GDP, thus achieving the MTO. The consolidated gross debt stood at 38.8% of GDP at the end of 2018, significantly below the Treaty threshold of 60% of GDP. The debt-to-GDP ratio is projected to decrease further in 2019. This is confirmed by the Commission 2019 spring forecast.

Overall, Sweden's structural balance is expected to remain above the MTO in both 2019 and 2020 and the country is therefore foreseen to continue to meet the requirements under the preventive arm of the Stability and Growth Pact.

8. ANNEXES

Table I. Macroeconomic indicators

	2001-2005	2006-2010	2011-2015	2016	2017	2018	2019	2020
Core indicators								
GDP growth rate	2.6	1.7	2.1	2.7	2.1	2.3	1.4	1.6
Output gap [1]	-0.3	-0.1	-1.4	0.5	0.3	0.5	-0.1	-0.4
HICP (annual % change)	1.8	2.1	0.7	1.1	1.9	2.0	1.5	1.6
Domestic demand (annual % change) [2]	1.8	2.1	2.2	3.2	2.7	2.0	0.7	1.2
Unemployment rate (% of labour force) [3]	6.7	7.3	7.8	6.9	6.7	6.3	6.4	6.4
Gross fixed capital formation (% of GDP)	21.9	23.2	22.9	23.9	25.0	25.4	24.9	24.6
Gross national saving (% of GDP)	28.2	30.9	28.3	28.3	29.3	29.7	29.9	30.0
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	0.2	1.3	-0.8	1.0	1.4	0.9	0.4	0.4
Gross debt	50.0	40.2	41.2	42.4	40.8	38.8	34.4	32.4
Net financial assets	-5.2	13.9	19.9	22.6	26.0	24.9	n.a	n.a
Total revenue	53.2	52.1	50.1	50.8	50.9	50.8	50.2	49.9
Total expenditure	53.0	50.7	50.9	49.8	49.4	49.9	49.8	49.5
of which: Interest	2.2	1.4	0.8	0.5	0.5	0.5	0.5	0.5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	3.3	2.2	-1.2	-3.9	-3.6	-4.3	-3.9	-3.5
Net financial assets; non-financial corporations	-127.2	-170.4	-193.4	-229.7	-239.0	-220.1	n.a	n.a
Net financial assets; financial corporations	-9.5	-2.5	-7.6	-1.5	5.7	4.4	n.a	n.a
Gross capital formation	15.3	15.9	16.2	16.8	17.6	18.1	17.6	17.2
Gross operating surplus	23.5	24.5	23.8	24.1	23.9	23.5	23.4	23.5
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	2.3	3.6	6.7	6.6	5.8	7.1	7.8	7.9
Net financial assets	117.0	145.2	173.5	208.7	210.8	194.7	n.a	n.a
Gross wages and salaries	38.7	38.7	40.1	39.5	39.6	39.7	39.4	39.1
Net property income	2.6	4.2	5.6	7.1	6.5	6.3	6.4	6.4
Current transfers received	22.5	21.0	20.8	20.1	19.8	19.5	19.6	19.4
Gross saving	5.0	6.9	9.6	10.1	9.5	10.7	11.4	11.4
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	6.1	7.4	4.8	3.8	3.7	3.4	4.1	4.6
Net financial assets	24.8	13.8	7.6	-0.1	-3.5	-4.0	n.a	n.a
Net exports of goods and services	6.7	6.4	4.7	4.4	3.7	3.4	4.2	4.7
Net primary income from the rest of the world	0.8	2.8	2.0	0.7	1.5	1.6	1.5	1.5
Net capital transactions	-0.1	-0.2	-0.2	-0.1	-0.1	0.0	0.0	0.0
Tradable sector	43.4	42.4	40.9	39.5	39.4	39.8	n.a	n.a
Non tradable sector	44.8	45.7	47.5	48.9	49.0	48.6	n.a	n.a
of which: Building and construction sector	4.6	5.3	5.0	5.4	5.6	5.7	n.a	n.a
Real effective exchange rate (index, 2000=100)	101.4	100.3	109.2	103.8	104.4	100.6	98.2	97.9
Terms of trade goods and services (index, 2000=100)	101.4	99.8	99.7	101.1	100.5	99.0	99.2	99.5
Market performance of exports (index, 2000=100)	101.9	100.3	99.5	98.9	97.9	98.6	99.1	98.8

Notes:

[1] The output gap constitutes the gap between the actual and potential gross domestic product at 2015 market prices.

[2] The indicator on domestic demand includes stocks.

[3] 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.

Source :
AMECO data, Commission 2019 spring forecast

Mandatory variables not included in the Convergence Programme

The Convergence Programme does not include all data referring to a number of mandatory variables. In table 7 on "Long-term sustainability of public finances 2019" there is no data for 2007 as regards total expenditure, age-related expenditures and total revenue. For table 7a on "Contingent liabilities" there is no data for 2019 as regards public guarantees. Finally, for table 8 on "Basic assumptions" there is no data for world import volumes, excluding EU. Not included mandatory variables do not impede the Commission's ability to assess the Convergence Programme based on the Programme's assumptions.