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Assessment of the 2016 Convergence Programme for

Sweden

(Note prepared by DG ECFIN staff)

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1. Introduction

This document assesses Sweden's April 2016 Convergence Programme (hereafter called Convergence Programme), which was submitted to the Commission on 28 April 2016 and covers the period 2015-2019¹. Sweden's Convergence Programme for 2016 is based on the Spring Fiscal Policy Bill of 2016². The parliamentary committee on finance was informed about the Convergence Programme on 26 April 2016 and it was approved by the government on 28 April 2016.

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

This document complements the Country Report published on 26 February 2016 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 2016 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 Stability and Growth Pact, 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 and the quality of public finances. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

Real GDP in Sweden rose by 4.1 % in 2015, its fastest rate since 2010. Private and public consumption were important growth drivers, but exports and investment contributed as well. The programme forecasts real GDP growth to remain robust at 3.8% in 2016 before slowing down to 2.2% in 2017. In both years a buoyant labour market and increased government consumption are set to be the main growth engines. Last year's programme projected real GDP growth of 2.7% in 2016. Therefore, the macroeconomic outlook for 2016 has significantly improved since in particular consumption and investment growth have been revised up. This revision takes into account higher public expenditure required to integrate the high number of asylum seekers. In addition, an accommodative monetary policy in Sweden and in the euro area is expected to support investment and exports. For 2017, the macroeconomic outlook is slightly weaker than projected last year (which assumed real GDP growth to reach 2.5%), with lower investment growth and negative contribution from net exports on the account of a more uncertain external environment.

Sweden's economy performs above its potential. As a result, the output gaps as recalculated by the Commission following the commonly agreed methodology, is expected to turn positive from -0.5% in 2015, to 0.5% in 2016, to 0.1% in 2017 and is expected to close in 2018³. The

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The English version was submitted on 28 April 2016.

² Government Bill 2015/16:100

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

recalculated output gaps in the programme differ from the ones estimated in the Commission's 2016 spring forecast mainly due to differences in projected total factor productivity growth.

Table 1: Comparison of macroeconomic developments and forecasts

	20	15	20	16	20	17	2018	2019
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	4,1	4,1	3,4	3,8	2,9	2,2	1,8	2,1
Private consumption (% change)	2,6	2,6	2,8	3,0	2,9	2,7	2,5	2,6
Gross fixed capital formation (% change)	7,3	7,3	4,0	3,9	3,2	2,3	2,5	3,4
Exports of goods and services (% change)	5,9	5,9	4,1	5,9	4,3	3,7	3,6	4,0
Imports of goods and services (% change)	5,4	5,4	4,3	5,9	4,6	4,2	4,2	4,0
Contributions to real GDP growth:								
- Final domestic demand	3,6	3,6	3,4	3,5	2,8	2,3	2,0	2,0
- Change in inventories	0,1	0,1	-0,1	0,0	0,0	0,0	0,0	0,0
- Net exports	0,4	0,4	0,1	0,2	0,1	-0,1	-0,1	0,2
Output gap ¹	-0,5	-0,5	0,2	0,5	0,4	0,1	0,0	0,3
Employment (% change)	1,5	1,5	1,6	1,7	1,6	1,6	0,8	0,7
Unemployment rate (%)	7,4	7,4	6,8	6,8	6,3	6,3	6,4	6,5
Labour productivity (% change)	2,6	2,4	1,8	2,1	1,4	0,6	1,0	1,4
HICP inflation (%)	0,7	0,7	0,9	1,0	1,2	1,5	1,7	1,9
GDP deflator (% change)	1,9	1,9	2,7	1,7	1,8	1,9	2,0	2,2
Comp. of employees (per head, % change)	3,6	3,6	3,1	2,6	3,2	3,5	3,3	3,4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	4,7	5,7	5,6	6,4	5,5	6,0	5,8	5,7

Note:

¹In % 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 2016 spring forecast (COM); Convergence Programme (CP).

The Convergence Programme's forecast is broadly in line with the Commission's 2016 spring forecast. While the programme projects GDP growth of 3.8% in 2016 and 2.2% in 2017, the Commission forecasts 3.4% and 2.9%, respectively. The Convergence Programme expects a stronger growth contribution from domestic demand and net exports in 2016 compared with the Commission's spring forecast. For 2017 domestic demand is projected to be weaker by 0.5pp than the Commission's spring forecast, while net exports are set to contribute negatively (-0.1pp compared with 0.1pp in the Commission 2016 spring forecast). The Convergence Programme's projections for investment are lower than the Commission's spring forecast as the programme assumes lower growth in the construction sector excluding housing. While the Convergence Programme's projections for private consumption growth (the tax base for indirect taxes) are similar to the ones of the Commission spring forecast, the increase in wages and salaries (the tax base for personal income tax and social contributions) is broadly in line with the one contained in the Commission 2016 spring forecast.

Overall the macroeconomic scenario underpinning the budgetary projections of the Convergence Programme is plausible until 2016 and cautious thereafter.

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

The general government balance improved significantly to a balanced budget (0.0% of GDP) in 2015 from a deficit of 1.6% of GDP in 2014, while the target of the Convergence Programme 2015 was a deficit of 1.4% of GDP. The strong improvement is explained by a better than expected Q4-2015 GDP growth, which led to an overall GDP growth of 4.1% in 2015. Moreover, a temporary high corporate tax payment (SEK 15 billion or roughly 0.3% of GDP) in Q4-2015 significantly improved the budget balance. No extraordinary measures were taken in 2015 explaining the substantial improvement compared to the Convergence Programme target.

3.2. Medium-term strategy and targets

The purpose of the programme is to reach a balanced budget by the end of the programme period. This would result in a recalculated structural balance of -0.1% of GDP, significantly outperforming the MTO.

The MTO specified by Sweden in the Convergence Programme, a structural balance of -1% of potential GDP, reflects the objectives of the Pact and is consistent with the updated minimum MTO for 2017 onwards. In addition, Sweden has national budgetary policy goals, among which a 1% surplus target and an expenditure ceiling setting limits for expenditure developments (see section 6 for further details), which should ensure respect of the MTO.⁴

The Convergence Programme foresees a deterioration of the general government deficit from 0.0% of GDP in 2015 to -0.4% of GDP in 2016. This is fully in line with the Commission 2016 spring forecast (-0.4% of GDP). This development is mainly due to expenditure increases linked to the reception and integration of refugees (SEK 38 billion or roughly 0.8% of GDP), which are expected to decline over time, as well as increasing expenditure linked to sickness benefits (in 2016 SEK 108 billion or 2.3% of GDP, expected to increase on average by 2 pps. per year over the next three years). Taken together, expenditure growth is outpacing revenue growth, in spite of an overall positive economic development. Nevertheless, the projected deficit for 2016 is still smaller than foreseen in the Convergence Programme 2015, which targeted a general government deficit of -0.7% of GDP because the general government deficit in 2015 was significantly better than assumed in the 2015 Convergence Programme due to higher economic growth. Both the Convergence Programme as well as the Commission 2016 spring forecast expects a general government deficit of -0.7% of GDP in 2017.

The structural balance as recalculated by the Commission following the commonly agreed methodology is expected to stand at -0.8% of GDP in both 2016 and 2017, respecting the MTO of a structural deficit of 1% of GDP. According to the Convergence Programme, the deterioration in the structural balance in 2016 and 2017 is linked to the development of various tax bases in a manner unfavourable to general government revenues as well as to the expenditures for migration and integration, sickness benefits but also old-age pensions expenditure etc. The time profile of the Programme expects a gradual improvement of the structural balance as of 2018, so that it would reach -0.1% of GDP in 2019. The structural

⁴ A parliamentary committee has been tasked to review the general government net lending target and a final report is foreseen in October 2016.

balance foreseen in the Commission 2016 spring forecast is -0.5% of GDP in 2016 and -0.9% in 2017 respectively, and the difference mainly stems from methodological differences and from a diverging outlook for the output gap (see section 2). The Convergence Programme expects a fairly constant expenditure-to-GDP ratio, standing at 50.4% in 2015 and peaking at 51% in 2017 and 2018 before falling back to 50.6% in 2019. Also on the revenue side, the development over time is characterized by a stable ratio: going from 50.4% of GDP in 2015 to 50.7% in 2019.

Table 2: Composition of the budgetary adjustment

COM COM CP COM CP CP CP CP CP CP CP C	(% of GDP)	2015	20	16	20	17	2018	2019	Change: 2015-2019
of which: - Taxes on production and imports 22,0 22,0 22,2 22,1 22,2 22,2 22,1 0,1 - Current taxes on income, wealth, etc. 18,3 18,1 18,3 18,2 18,5 18,8 18,8 0,5 - Social contributions 3,7 3,6 2,7 3,6 2,8 2,8 2,8 -0,9 - Other (residual) 6,4 6,0 6,9 5,8 6,8 6,8 7,0 0,6 Expenditure of which: 50,4 50,1 50,5 50,4 51,0 50,6 0,2 Of which: - Primary expenditure 50,0 49,7 50,0 49,9 50,5 50,4 49,9 -0,1 Of which: - Primary expenditure 50,0 49,7 50,0 49,9 50,5 50,4 49,9 -0,1 Compensation of employees 12,4 12,3 12,5 12,3 12,7 12,7 12,6 0,2 Intermediate consumption 8,3 8,5		COM	COM	CP	COM	CP	CP	CP	СР
- Taxes on production and imports - Current taxes on income, wealth, etc. 18,3 18,1 18,3 18,1 18,2 18,5 18,8 18,8 0,5 - Social contributions 3,7 3,6 2,7 3,6 2,8 2,8 2,8 2,8 -0,9 - Other (residual) 6,4 6,0 6,9 5,8 6,8 6,8 7,0 0,6 Expenditure 50,4 50,1 50,5 50,4 51,0 51,0 50,6 0,2 of which: - Primary expenditure consumption 8,3 8,5 8,3 8,5 8,3 8,2 8,1 -0,2 Social payments 17,1 16,9 17,0 16,9 17,1 17,1 17,1 17,1 0,0 Subsidies 1,7 1,6 1,6 1,5 1,5 1,5 1,5 1,5 -0,2 Gross fixed capital formation 4,3 4,4 4,4 4,4 4,4 4,4 4,4 4,4 4,4 4,3 0,0 Other (residual) 6,2 6,1 6,3 6,1 6,5 6,3 6,2 0,0 - Interest expenditure 0,5 0,1 0,0 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 Primary balance (GGB) 0,0 -0,4 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 O,0 GGB excl. one-offs 0,0 -0,4 -0,5 -0,7 -0,7 -0,7 -0,4 0,1 0,1 O,1 Output gap¹ -0,5 0,2 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance² 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4 -0,1 -0,4 Structural balance² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4	Revenue	50,4	49,8	50,1	49,7	50,3	50,6	50,7	0,3
Current taxes on income, wealth, etc.	of which:								
etc.	- Taxes on production and imports	22,0	22,0	22,2	22,1	22,2	22,2	22,1	0,1
- Social contributions	- Current taxes on income, wealth,								
Cother (residual)	etc.	18,3	18,1	18,3	18,2	18,5	18,8	18,8	0,5
Expenditure of which: 50,4 50,1 50,5 50,4 51,0 50,6 0,2 - Primary expenditure of which: 50,0 49,7 50,0 49,9 50,5 50,4 49,9 -0,1 Compensation of employees Intermediate consumption Social payments 12,4 12,3 12,5 12,3 12,7 12,7 12,6 0,2 Social payments 17,1 16,9 17,0 16,9 17,1 17,1 17,1 0,0 Subsidies 1,7 1,6 1,6 1,5 1,5 1,5 1,5 -0,2 Gross fixed capital formation Other (residual) 6,2 6,1 6,3 6,1 6,5 6,3 6,2 0,0 - Interest expenditure 0,5 0,5 0,5 0,5 0,5 0,5 0,6 0,7 0,2 General government balance (GGB) 0,0 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 Primary balance 0,5 0,1 0,0 -0,2	- Social contributions	3,7	3,6	2,7	3,6	2,8	2,8	2,8	-0,9
of which: 50,0 49,7 50,0 49,9 50,5 50,4 49,9 -0,1 of which: Compensation of employees 12,4 12,3 12,5 12,3 12,7 12,7 12,6 0,2 Intermediate consumption 8,3 8,5 8,3 8,5 8,3 8,2 8,1 -0,2 Social payments 17,1 16,9 17,0 16,9 17,1 17,1 17,1 0,0 Subsidies 1,7 1,6 1,6 1,5 1,5 1,5 1,5 -0,2 Gross fixed capital formation 4,3 4,4 4,6 6,5 6,3 <td< td=""><td>- Other (residual)</td><td>6,4</td><td>6,0</td><td>6,9</td><td>5,8</td><td>6,8</td><td>6,8</td><td>7,0</td><td>0,6</td></td<>	- Other (residual)	6,4	6,0	6,9	5,8	6,8	6,8	7,0	0,6
- Primary expenditure of which: Compensation of employees I12,4 I12,3 I12,5 I12,3 I12,7 I12,7 I12,6 O,2 Intermediate consumption Social payments I17,1 I6,9 I17,0 I6,9 I17,1 I11,1 I	Expenditure	50,4	50,1	50,5	50,4	51,0	51,0	50,6	0,2
of which: 12,4 12,3 12,5 12,3 12,7 12,7 12,6 0,2 Intermediate consumption 8,3 8,5 8,3 8,5 8,3 8,5 8,3 8,2 8,1 -0,2 Social payments 17,1 16,9 17,0 16,9 17,1 17,1 17,1 0,0 Subsidies 1,7 1,6 1,6 1,5 1,5 1,5 1,5 -0,2 Gross fixed capital formation 4,3 4,4 4,4 4,4 4,4 4,4 4,4 4,4 4,4 4,4 4,4 4,3 0,0 Other (residual) 6,2 6,1 6,3 6,1 6,5 6,3 6,2 0,0 - Interest expenditure 0,5 0,5 0,5 0,5 0,5 0,5 0,6 0,7 0,2 General government balance 0,5 0,1 0,0 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary 0,	of which:								
Compensation of employees 12,4 12,3 12,5 12,3 12,7 12,6 0,2	- Primary expenditure	50,0	49,7	50,0	49,9	50,5	50,4	49,9	-0,1
Intermediate consumption 8,3 8,5 8,3 8,5 8,3 8,2 8,1 -0,2	of which:								
Social payments 17,1 16,9 17,0 16,9 17,1 17,1 17,1 0,0	Compensation of employees	12,4	12,3	12,5	12,3	12,7	12,7	12,6	0,2
Subsidies 1,7 1,6 1,6 1,5 1,5 1,5 1,5 -0,2 Gross fixed capital formation 4,3 4,4 4,4 4,4 4,4 4,4 4,3 0,0 Other (residual) 6,2 6,1 6,3 6,1 6,5 6,3 6,2 0,0 - Interest expenditure 0,5 0,5 0,5 0,5 0,5 0,6 0,7 0,2 General government balance 0,0 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 Primary balance 0,5 0,1 0,0 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary 0,0 0,0 0,1 0,0	Intermediate consumption	8,3	8,5	8,3	8,5	8,3	8,2	8,1	-0,2
Gross fixed capital formation 4,3 4,4 4	Social payments	17,1	16,9	17,0	16,9	17,1	17,1	17,1	0,0
Other (residual) 6,2 6,1 6,3 6,1 6,5 6,3 6,2 0,0 - Interest expenditure 0,5 0,5 0,5 0,5 0,5 0,6 0,7 0,2 General government balance (GGB) 0,0 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 Primary balance 0,5 0,1 0,0 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary GGB excl. one-offs 0,0 -0,4 -0,5 -0,7 -0,7 -0,4 0,1 0,1 Output gap¹ -0,5 0,2 0,5 0,4 0,1 0,0 0,3 0,8 Cyclically-adjusted balance² 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4	Subsidies	1,7	1,6	1,6	1,5	1,5	1,5	1,5	-0,2
- Interest expenditure 0,5 0,5 0,5 0,5 0,5 0,6 0,7 0,2 General government balance (GGB) 0,0 -0,4 -0,4 -0,7 -0,7 -0,7 -0,4 0,1 0,1 Primary balance 0,5 0,1 0,0 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary 0,0 0,0 0,1 0,0 0,0 0,0 0,0 0,0 0,0 GGB excl. one-offs 0,0 -0,4 -0,5 -0,7 -0,7 -0,4 0,1 0,1 Output gap¹ -0,5 0,2 0,5 0,4 0,1 0,0 0,3 0,8 Cyclically-adjusted balance¹ 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4	Gross fixed capital formation	4,3	4,4	4,4	4,4	4,4	4,4	4,3	0,0
General government balance (GGB) 0,0 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 Primary balance 0,5 0,1 0,0 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary GB excl. one-offs 0,0 0,0 0,1 0,0 </td <td>Other (residual)</td> <td>6,2</td> <td>6,1</td> <td>6,3</td> <td>6,1</td> <td>6,5</td> <td>6,3</td> <td>6,2</td> <td>0,0</td>	Other (residual)	6,2	6,1	6,3	6,1	6,5	6,3	6,2	0,0
(GGB) 0,0 -0,4 -0,4 -0,7 -0,7 -0,4 0,1 0,1 Primary balance 0,5 0,1 0,0 -0,2 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary 0,0 0,0 0,1 0,0 <td>- Interest expenditure</td> <td>0,5</td> <td>0,5</td> <td>0,5</td> <td>0,5</td> <td>0,5</td> <td>0,6</td> <td>0,7</td> <td>0,2</td>	- Interest expenditure	0,5	0,5	0,5	0,5	0,5	0,6	0,7	0,2
Primary balance 0,5 0,1 0,0 -0,2 -0,2 0,2 0,8 0,3 One-off and other temporary GGB excl. one-offs 0,0 0,0 0,1 0,0 0,1 0,1 0,1 0,1 0,1 0,0 0,3 0,8 Cyclically-adjusted balance ¹ 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance ² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1	General government balance								
One-off and other temporary 0,0 0,0 0,1 0,0 0,1 0,1 0,1 0,1 0,1 0,1 0,1 0,1 0,3 0,8 Cyclically-adjusted balance ¹ 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance ² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4	(GGB)	0,0	-0,4	-0,4	-0,7	-0,7	-0,4	0,1	0,1
GGB excl. one-offs 0,0 -0,4 -0,5 -0,7 -0,7 -0,4 0,1 0,1 Output gap ¹ -0,5 0,2 0,5 0,4 0,1 0,0 0,3 0,8 Cyclically-adjusted balance ¹ 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance ² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4	Primary balance	0,5		0,0			0,2		0,3
Output gap 1 -0,5 0,2 0,5 0,4 0,1 0,0 0,3 0,8 Cyclically-adjusted balance 1 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance 2 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4		-	· ·	-		· ′	· '	,	
Cyclically-adjusted balance ¹ 0,3 -0,5 -0,7 -0,9 -0,8 -0,4 -0,1 -0,4 Structural balance ² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4	GGB excl. one-offs	0,0	-0,4	-0,5	-0,7	-0,7	-0,4	0,1	0,1
Structural balance ² 0,3 -0,5 -0,8 -0,9 -0,8 -0,4 -0,1 -0,4		-0,5	0,2	0,5	0,4	0,1	0,0	0,3	0,8
	Cyclically-adjusted balance ¹	0,3	-0,5	-0,7	-0,9	-0,8	-0,4	-0,1	-0,4
		0,3	-0,5	-0,8	-0,9	-0,8	-0,4	-0,1	-0,4
Structural primary balance $0.8 0.0 -0.3 -0.4 -0.3 0.2 0.6 -0.2$	Structural primary balance ²	0,8	0,0	-0,3	-0,4	-0,3	0,2	0,6	-0,2

Notes.

<u>Source</u>:

Convergence Programme (CP); Commission 2016 spring forecasts (COM); Commission calculations.

Previous Convergence Programmes included more ambitious targets for the general government balance. Notably, last year's projection did not include the carry-over stemming from a more positive outturn for 2015 and projected a development towards a balanced budget by 2018, while this year's Convergence Programme projects an adjustment path as

¹Output 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.

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

outlined above, reaching a balanced budget only in 2019. This delay is due to, inter alia, the large expenditure linked to the reception and integration of migrants.

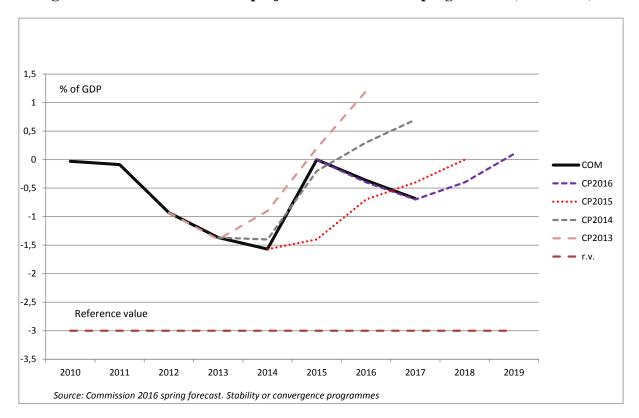


Figure 1: Government balance projections in successive programmes (% of GDP)

Source: Commission 2016 spring forecast; Convergence Programmes

3.3. Measures underpinning the programme

The Convergence Programme describes measures proposed and announced by the government in the Budget Bill for 2016, the Spring Adjustment Budget Bill for 2016 or announced in the Spring Fiscal Bill 2016⁵. In total, these measures are estimated to increase general government net lending by roughly 1% of GDP in both 2016 and 2017. Overall, the key priorities of the Swedish government, as reflected in expenditure increases resulting from recent and forthcoming reforms, remain addressing challenges in the labour market and tackle unemployment (roughly 0.3% and 0.4% of GDP in 2016 and 2017 respectively), and supporting an improvement in the field of education and basic skills attainment performance among young and newly arrived (roughly 0.1% and 0.2% of GDP in 2016 and 2017 respectively). In addition, reforms in the welfare sector (roughly 0.3% of GDP in both 2016 and 2017) and additional funding in support of the local government sector were prioritised (roughly 0.2% of GDP in both 2016 and 2017). As Sweden has been receiving a high number of asylum seekers in recent years, the reception and integration of migrants is also a key priority.

On the revenue side, overall tax revenues are expected to increase by almost 6% in 2016 and close to 5% in 2017. The programme encompasses higher income tax rates for high-income earners and the elimination of reduced social security contributions for young people in two

⁵ Govt. Bill 2015/16:1, Govt. Bill 2015/16:99 and Govt. Bill 2015/16:100.

steps, expected to raise tax revenues by roughly 0.6% of GDP in 2016 and 0.1% of GDP in 2017 respectively. It also reduces personal income tax deductions applicable to certain types of services, for instance for house repair and maintenance and for domestic services. Further tax increases in 2016 relate predominantly to labour taxes (by 8.6% due to the combined effect of an increase in the tax bases and tax hikes) and to local government taxes.

The programme reports the expected effect on general government net lending broken down by respective Government Bill and by grouping measures together. While the Convergence Programme hence outlines the measures, the information could be more transparent in terms of detailing the expenditure and revenue effects of specific measures in relation to GDP. The Convergence Programme assumes "one-off and other temporary measures" amounting to 0.1% of GDP in 2016, but it does not specify the nature of these measures further and they have not been included in the Commission 2016 spring forecast.

3.4. Debt developments

Sweden's government gross debt ratio came out at 43.4% of GDP in 2015, below the 60% of GDP reference value. The increase from the average debt level of 39.3% of GDP over the time period 2010-14 was mainly due to statistical factors linked to changing accounting standards.⁶

The debt ratio is projected to decrease in 2016, as a proportion to GDP, on the back of strong growth and valuation effects. The foreseen sustained economic growth and deficit improvement should imply a further gradual decrease of the debt ratio until the end of the period, i.e. the Convergence Programme expects the debt ratio to stand at 39.1% in 2019. The Convergence Programme's forecast on government gross debt is trending in the same direction as the Commission's 2016 spring forecast, albeit with a slower time-profile.

⁶ As of 2014, central government units besides the National Debt Office may hold outstanding repos over the turn of the year, contrary to previous practice. If repos are not closed before the end of the year, both gross debt and assets increase according to the National Accounts.

Table 3: Debt developments

(0/ CCDD)	Average	2015	20	16	2017		2018	2019
(% of GDP)	2010-2014	2015	COM	CP	COM	CP	CP	CP
Gross debt ratio ¹	39,3	43,4	41,3	42,5	40,1	41,1	40,3	39,1
Change in the ratio	0,9	-1,3	-2,2	-0,9	-1,2	-1,4	-0,8	-1,2
Contributions ² :								
1. Primary balance	-0,1	-0,5	-0,1	0,0	0,2	0,2	-0,2	-0,8
2. "Snow-ball" effect	-0,4	-2,0	-2,0	-1,8	-1,4	-1,2	-0,9	-1,0
Of which:								
Interest expenditure	0,9	0,5	0,5	0,4	0,5	0,5	0,6	0,7
Growth effect	-0,9	-1,7	-1,4	-1,6	-1,2	-0,9	-0,7	-0,8
Inflation effect	-0,4	-0,8	-1,1	-0,7	-0,7	-0,8	-0,8	-0,9
3. Stock-flow	1,4	1,2	0,0	0,9	0,0	-0,4	0,3	0,6
adjustment	1,4	1,2	0,0	0,9	0,0	-0,4	0,3	0,0
Of which:								
Cash/accruals diff.				0,2		-0,8	0,1	0,5
Acc. financial assets				0,0		0,0	0,0	0,0
Privatisation				-0,1		-0,1	-0,1	-0,1
Val. effect & residual				0,8		0,6	0,4	0,1

Notes:

Source:

Commission 2016 spring forecast (COM); Convergence Programme (CP), Comission calculations.

Last year's Convergence Programme assumed a very similar debt ratio development as this year's Programme and both are largely in line with the trend reflected in the Commission's 2016 spring forecast, albeit with a somewhat different time profile. Previous Programmes also assumed a declining trend, but from a lower level with the shift largely due to a change in the above-mentioned accounting standards.

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.

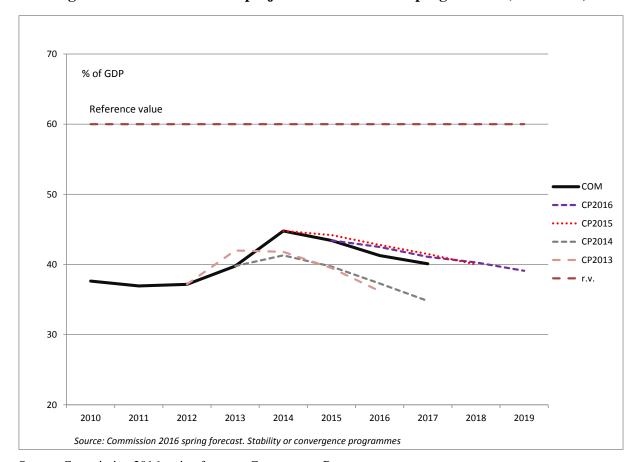


Figure 2: Government debt projections in successive programmes (% of GDP)

Source: Commission 2016 spring forecast; Convergence Programmes

3.5. Risk assessment

For 2016 and 2017, the Convergence Programme and the Commission 2016 spring forecast are fully aligned regarding the general government balances. The recalculated structural balance is expected to be -0.8% of GDP in both 2016 and 2017 in the Convergence Programme. While the corresponding structural balance time-profile of the Commission 2016 spring forecast is somewhat steeper, in both circumstances the MTO of a structural deficit of 1% of GDP is expected to be respected.

Based on this outlook, a key risk to the fiscal forecast would stem from the assessment of macroeconomic developments. In this context, naturally the actual number of asylum seekers coming to Sweden will be influential. Since the publication of the Spring Budget Bill, the Migration Board has revised its forecast downwards: while the policy proposals were based on the Board's previous main scenario of 100000 asylum seekers in 2016, it has now been shifted down to 60000 (ranging from 40000 to 100000 persons). Consequently, the expected expenditure would be shifted downwards accordingly. On the other hand, the sharp increase in the number of asylum seekers that occurred in Q4-2015 had not been foreseen by the Migration Board and it cannot be excluded that an upward revision may be required at a later stage.

With Sweden being a small, open economy any weaker-than-expected economic growth in the rest of the world ultimately affect growth and employment through lower exports. Furthermore, currency fluctuations can have marked effects for Swedish exports, and recently the Swedish krona has been appreciating (in this context, the Riksbank has signalled its readiness to intervene if necessary). Finally, a potential correction in house prices, which rose to new historical highs in 2015, could dampen household consumption and construction investment.

Short term risks to the government debt projections are thus mainly related to macroeconomic, fiscal risks as well as currency fluctuations. These risks are however low considering Sweden's long track record of fiscal soundness respecting its obligations under the preventive arm of the SGP, its sound fiscal position and the relatively robust budgetary framework.

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

Based on the outturn data and the Commission 2016 spring forecast, the ex-post assessment suggests the adjustment path towards the MTO in 2015 was appropriate and in line with the requirement of the preventive arm of the Pact. Sweden, which was already above its medium-term objective in 2014, further improved its structural balance by 0.6 pp in 2015 achieving a structural surplus of 0.3% of GDP.

The programme foresees the structural balance, as recalculated by the Commission, to worsen from 0.3% of GDP in 2015 to -0.8% in 2016 and in 2017. Despite this deterioration, 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 2016 spring forecast, according to which the structural balance is projected to reach -0.5% of GDP in 2016 and to deteriorate to -0.9% in 2017 under the no-policy-change assumption. The programme thus foresees that the structural balance will remain above the MTO over the programme period, improving in 2018 and 2019.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2015 2016 2017							
Initial position ¹								
Medium-term objective (MTO)	-1,0	-	1,0	-1,0				
Structural balance ² (COM)	0,3	_1	0,5	-(0,9			
Structural balance based on freezing (COM)	0,3	_1	0,5		-			
Position vis-a -vis the MTO ³	At or above the MTO	At or abov	ve the MTO	At or above the MTO				
(% of GDP)	2015	2016		20	17			
` ′	COM	CP	COM	CP	COM			
Structural balance pillar				Т				
Required adjustment ⁴	0,0	(),0	0,0				
Required adjustment corrected ⁵	-0,7	-	1,3	-0,5				
Change in structural balance ⁶	0,6	-1,1	-0,7	0,0	-0,5			
One-year deviation from the required	1,3	0.2		0,6	0,1			
adjustment ⁷	1,5	0,2	0,5	0,0	0,1			
Two-year average deviation from the required	1,0	0,7	0,9	0,4	0,3			
adjustment ⁷	1,0	0,7	0,9	0,4	0,3			
Expenditure benchmark pillar								
Applicable reference rate ⁸								
One-year deviation ⁹	n.a. (structural balance above the MTO)							
Two-year average deviation ⁹								
Conclusion								
Conclusion over one year	Compliance							
Conclusion over two years	Compilation							

Notes

Source:

Convergence Programme (CP); Commission 2016 spring forecast (COM); Commission calculations.

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 points (p.p.) 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.).

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

⁶ Change in the structural balance compared to year t-1. Expost assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast.

⁷ The difference of the change in the structural balance and the corrected required adjustment.

⁸ 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.

⁹ 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 run.⁷

Based on Commission forecasts and a no-fiscal policy change scenario beyond forecasts, government debt, at 43.4 % of GDP in 2015, is expected to decrease (to 41.3 % in 2026), thus remaining below the 60% of GDP Treaty threshold. This highlights low risks for the country from debt sustainability analysis in the medium term. The full implementation of the Convergence Programme would keep debt on a slightly more decreasing path until 2026.

The medium-term fiscal sustainability risk indicator S1 is at -1.4 pps. of GDP, primarily related to the low level of government debt contributing with -1.5 pps. 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 -3.0 pps. of GDP, leading to even lower medium-term risk. Overall, risks to fiscal sustainability over the medium-term are, therefore, low.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 2.2 % of GDP. In the long-term, Sweden therefore appears to face medium fiscal sustainability risks. This is equally related to both the initial budgetary position and the projected ageing costs, which both contribute 1.1 pps. of GDP. Full implementation of the Convergence Programme would nonetheless put the S2 indicator at 1.1 pps. of GDP, leading to a lower long-term risk.

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This conclusion is based on the short-term fiscal sustainability risk indicator S0, which incorporates 14 fiscal and 14 financial-competitiveness variables. The fiscal and financial-competitiveness sub-indexes (reported in table 5) are based on the two sub-groups of variables respectively. For sustainability risks arising from the individual variables, by country, see the Commission's Fiscal Sustainability Report 2015 (page 67).

Table 5: Sustainability indicators

Time horizon			cy Change enario	Stability / Convergence Programme Scenario		
Short Term		LO	W risk			
S0 indi	icator ^[1]			0.1		
	0.1	LOW risk				
Financial & competitiveness subindex (2015)				LOW risk		
Medium Term		LO	W risk			
DSA [2]		LOV	W risk			
S1 indi		-1.4	LOW risk	-3.0	LOW risk	
of	of which					
	IBP			-0.1		3
	Debt Requirement			1.5	-1	9
	CoA				0.2	
Long Term			MEDIUM risk		LOW	/ risk
S2 indi	icator ^[4]			2.2	1	.1
of	which					
	IBP			1.1	0	.1
	СоА		1.1		0.9	
	of which					
		Pensions		0.8	-0	0.6
		нс		0.3	0	.3
		LTC		1.3	1	.1
		Other		0.2	0	.2

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. 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 2015 Ageing Report.

- [1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indexes, thresholds are respectively at 0.35 and 0.45.
- [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. See Fiscal Sustainability Report 2015.
- [3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating an cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.
- [4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

6. FISCAL FRAMEWORK

The main Swedish numerical rule, the 1% of GDP surplus target over the economic cycle encompasses the finances of the general government, i.e. including both central and local governments and the pension system. The fulfilment of the surplus target has traditionally been assessed against five indicators⁸. A long-standing uncertainty regarding the monitoring of this rule is that the relative weight the government puts on each of the indicators is not defined. As the objective is also meant to be fulfilled over the economic cycle (as opposed to in each calendar year, to improve the efficiency of the fiscal stabilisation policy) there is also uncertainty regarding the suitable period of evaluation.

Regarding ex post compliance, the authorities acknowledge in the Convergence Programme that the surplus target has not been attained, based on the measure of 10-year average of the general government balance (0.3% of GDP in 2015). Also, the seven-year indicator stood at -0.9% of GDP in 2015, i.e. almost 2 percentage points below the target. In its annual reports, the Fiscal Policy Council has signalled the issue of non-compliance for several years, including in 2016.

Looking forward, the envisaged budgetary balances laid down in the programme would lead Sweden in the direction of a gradual closing of the gap in the medium term. However, the government estimates that the current net lending target will not be attained until "a few years after 2019". At the same time, the government has confirmed that a process of revisiting the current national budgetary policy goals is underway. A parliamentary committee has been tasked to review the general government net lending target and a final report is foreseen in October 2016. The report is meant to conclude on the experiences from the fiscal policy framework so far and advice on the appropriate level of the general government net lending target going forward. It should also evaluate the impact of the target level on public finances and the Swedish economy in general.

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

The Fiscal Policy Council is not involved in the endorsement or assessment of the macroeconomic scenario underpinning the Convergence Programme.

7. CONCLUSIONS

In 2015, Sweden achieved a significant improvement of the structural balance, which stood at 0.3% of GDP, significantly above the MTO. On the other hand, expenditure increases linked primarily to the reception and integration of migrants are expected to decrease over time.

Overall, Sweden's structural balance is expected to remain at the MTO in both 2016 and 2017 and is therefore foreseen to continue to meet the requirements under the preventive arm of the Pact.

These are the following ones: (i) the 10-year average of the general government balance; (ii) a corresponding cyclically adjusted average; (iii) a seven-year moving average (including the three preceding years, the current year and the three following years); (iv) a corresponding cyclically adjusted average; and (v) the structural budget balance.

8. ANNEX

Table I. Macroeconomic indicators

	1998-	2003-	2008-	2013	2014	2015	2016	2017
	2002	2007	2012	-	-	-	-	-
Core indicators	<u> </u>							- 0
GDP growth rate	3,4	3,5	0,5	1,2	2,3	4,1	3,4	2,9
Output gap ¹	0,2	1,0	-1,6	-2,4	-2,1	-0,5	0,2	0,4
HICP (annual % change)	1,5	1,5	1,9	0,4	0,2	0,7	0,9	1,2
Domestic demand (annual % change) ²	2,9	3,2	0,8	1,6	3,4	3,8	3,5	3,0
Unemployment rate (% of labour force) ³	6,5	7,0	7,8	8,0	7,9	7,4	6,8	6,3
Gross fixed capital formation (% of GDP)	21,6	22,4	22,8	22,3	23,5	24,2	24,0	24,0
Gross national saving (% of GDP)	26,9	30,1	29,8	28,0	28,0	29,4	30,0	29,9
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	1,0	1,3	0,0	-1,4	-1,6	0,0	-0,4	-0,7
Gross debt	56,1	45,3	37,8	39,8	44,8	43,4	41,3	40,1
Net financial assets	-13,7	2,2	14,5	18,6	19,3	n.a	n.a	n.a
Total revenue	55,9	53,4	51,4	51,0	50,2	50,4	49,8	49,7
Total expenditure	54,9	52,2	51,4	52,4	51,7	50,4	50,1	50,4
of which: Interest	3,4	1,8	1,2	0,8	0,7	0,5	0,5	0,5
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	1,8	4,0	1,1	-0,7	-1,5	-2,2	-0,7	-0,3
Net financial assets; non-financial corporations	-129,7	-150,9	-166,5	-188,2	-201,9	n.a	n.a	n.a
Net financial assets; financial corporations	3,2	-3,6	-2,9	-2,9	-2,5	n.a	n.a	n.a
Gross capital formation	15,7	15,5	15,6	15,5	16,6	17,3	17,1	17,0
Gross operating surplus	23,6	24,5	23,8	22,8	23,2	23,7	24,4	24,4
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	1,4	1,8	5,4	7,3	7,0	7,2	6,7	6,5
Net financial assets	106,2	130,8	143,1	166,8	186,8	n.a	n.a	n.a
Gross wages and salaries	39,0	38,1	39,6	40,7	40,6	40,0	39,4	39,4
Net property income	3,1	2,8	5,0	5,3	5,4	5,7	5,7	5,6
Current transfers received	22,8	21,9	20,5	21,2	20,6	20,1	19,5	19,3
Gross saving	3,8	4,9	8,5	9,9	9,9	10,2	9,6	9,3
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	4,5	7,4	6,7	5,2	4,1	4,7	5,6	5,5
Net financial assets	34,1	21,6	11,7	5,8	-1,7	n.a	n.a	n.a
Net exports of goods and services	6,2	7,1	5,4	4,5	3,7	4,3	5,2	5,3
Net primary income from the rest of the world	-0,1	1,9	3,2	2,7	2,2	2,3	2,2	2,1
Net capital transactions	-0,3	-0,2	-0,1	-0,2	-0,1	-0,2	-0,2	-0,3
Tradable sector	43,2	42,2	40,8	39,4	39,0	39,1	n.a	n.a
Non tradable sector of which: Building and construction sector	44,9	45,9	47,3	49,0	49,6	49,5	n.a	n.a
	4,3	5,0	5,1	4,8	5,3	5,7	n.a	n.a
Real effective exchange rate (index, 2000=100)	101,0	102,8	103,2	114,7	110,3	104,3	106,8	107,3
Terms of trade goods and services (index, 2000=100)	105,4	100,1	99,7	99,6	99,9	100,8	103,6	103,8
Market performance of exports (index, 2000=100)	100,9	101,9	100,0	97,7	97,9	100,2	100,7	100,7
Notes:	,>		,0	~ · • • ·	• • -	,-	,,	,,

Notes

<u>Source</u>:

AMECO data, Commission 2016 spring forecast

¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 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.