EUROPEAN COMMISSION
Directorate-General
Economic and Financial Affairs

Brussels, 27 May 2015

Assessment of the 2015 Convergence Programme for

SWEDEN

(Note prepared by DG ECFIN staff)

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1. INTRODUCTION

This document assesses Sweden's April 2015 Convergence Programme (hereafter called Convergence Programme), which was submitted to the Commission on 24 April 2015 and covers the period 2014-2018[1]. Sweden's Convergence Programme for 2015 is based on the Spring Fiscal Policy Bill of 2015[2]. The parliamentary committee on finance was informed about the Convergence Programme on 21 April 2015 and it was approved by the government on 23 April 2015.

Sweden is currently subject to the preventive arm of the 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 2015 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 2015 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability 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 summarises the main conclusions.

2. MACROECONOMIC OUTLOOK

Sweden's real GDP increased by 2.1 % in 2014, its highest growth rate since 2011. Consumption remained an important engine of growth, while being supported by a sharp rebound of investment. Robust domestic demand is foreseen to remain the main driver of growth in the coming years, and the programme forecasts real GDP growth to gradually accelerate to 2.6% in 2015 and 2.7% in 2016[3]. The macroeconomic outlook has weakened somewhat compared to last year, mainly due to slower consumption and investment growth on account of more sluggish economic recovery in the rest of world.

Sweden's economy performs below its potential. As a result, the negative output gap[4] is expected to gradually narrow from -1.4% in 2014, to -0.9% in 2015, to -0.5% in 2016 and is expected to close in 2017. The recalculated output gaps differ from the output gaps presented

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[1] The English version was submitted on 29 April 2015.

[2] Government Bill 2014/15:100

[3] The external assumptions of the programme are broadly in line with those of the Commission. Nevertheless, the Convergence Programme's calculations are based on a slightly more optimistic growth projection for Sweden's main trading partners in 2015, thus a more favourable contribution of net trade to Sweden's real GDP growth.

[4] As recalculated by the Commission based on the information in the programme following the commonly agreed methodology.

in the Convergence Programme mainly due to differences in potential growth and NAWRU estimations.

Table 1: Comparison of macroeconomic developments and forecasts

	2014		2015		2016		2017	2018
	COM	CP	COM	CP	COM	CP	CP	CP
Real GDP (% change)	2.1	2.1	2.5	2.6	2.8	2.7	2.5	2.4
Private consumption (% change)	2.4	2.4	2.6	2.7	2.6	2.7	2.6	2.6
Gross fixed capital formation (% change)	6.5	6.5	4.1	2.9	4.5	4.5	3.6	3.5
Exports of goods and services (% change)	3.3	3.3	4.1	4.4	5.3	5.3	5.0	5.1
Imports of goods and services (% change)	6.5	6.5	4.7	4.3	5.6	5.7	5.0	5.3
Contributions to real GDP growth:								
- Final domestic demand	3.0	3.0	2.7	2.4	2.7	2.7	2.3	2.2
- Change in inventories	0.2	0.2	-0.1	0.0	0.0	0.0	0.0	0.0
- Net exports	-1.1	-1.1	-0.1	0.2	0.1	0.1	0.2	0.1
Output gap[1]	-1.4	-1.4	-0.8	-0.9	-0.3	-0.5	0.0	0.5
Employment (% change)	1.4	1.4	1.2	1.4	1.2	1.3	1.2	0.9
Unemployment rate (%)	7.9	7.9	7.7	7.5	7.6	7.1	6.7	6.4
Labour productivity (% change)	0.7	0.7	1.3	1.4	1.6	1.5	1.3	1.5
HICP inflation (%)	0.2	0.2	0.7	0.6	1.6	1.1	1.4	1.6
GDP deflator (% change)	1.3	1.3	1.6	1.5	1.6	1.7	1.9	1.9
Comp. of employees (per head, %	2.3	2.3	2.3	2.8	2.5	3.3	3.5	3.4
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	5.7	6.1	5.7	6.4	5.4	6.3	6.1	5.8

Note:

[1]In percent 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 2015 spring forecast (COM); Convergence Programme (CP).

The Convergence Programme's forecast is broadly in line with the Commission's 2015 spring forecast. While the programme projects GDP growth of 2.6% in 2015 and 2.7% in 2016, the Commission forecasts 2.5% and 2.8%, respectively. The Convergence Programme expects a slightly weaker growth contribution from domestic demand, which is compensated by stronger net exports. The Commission's spring forecast expects a slower decline of unemployment compared with the Convergence Programme due to a different appreciation of the skills and geographical mismatch on the labour market. The Convergence Programme's projections for private consumption growth (the tax base for indirect taxes) are in line, while wages and salaries growth (the tax base for personal income tax and social contributions) are higher than in the Commission's spring forecast. This, in turn, partly explains the Convergence Programme's lower government deficit expectations.

Overall the macroeconomic scenario underpinning the budgetary projections of the Convergence Programme appears to be based on plausible macroeconomic assumptions.

3. Recent and planned budgetary developments

3.1. Deficit developments in 2014

The general government balance worsened to -1.9% of GDP in 2014 from -1.4% of GDP in 2013, missing the -1.6% of GDP deficit target of the Convergence Programme 2014. The deterioration since 2013 is explained by the measures taken to boost the economic recovery by supporting domestic demand. The higher than expected deficit for 2014 mainly comes from higher expenditure, notably in the areas of social security and migration and integration.

3.2. Target for 2015 and medium-term strategy

The target for 2015

The Convergence Programme targets an improvement of the general government deficit from -1.9% of GDP in 2014 to -1.4% of GDP in 2015. This is broadly in line with the Commission 2015 spring forecast of a general government deficit of -1.5% of GDP in 2015. This foreseen deficit improvement is due to stronger macroeconomic growth and the "krona for krona" strategy, meaning that new reforms are fully funded by increased revenues or a decrease in other expenditures. The projected deficit for 2015 is significantly worse than foreseen in the Convergence Programme 2014, which targeted a general government deficit of -0.2% of GDP in 2015. This is mainly due to the weaker than expected macroeconomic outlook and expected further increases in expenditures related to social security and, migration and integration.

The structural balance as recalculated by the Commission based on the information in the programme following the commonly agreed methodology is expected to be -0.8% of GDP, close to the structural balance foreseen in the Commission 2015 spring forecast of -1% of GDP, respecting the MTO of a structural deficit of 1% of GDP. The difference mainly stems from a diverging outlook for the nominal deficit (0.1% of GDP) and the output gap (0.1% of GDP).

The medium-term strategy

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 -0.3% of GDP, significantly outperforming the MTO.

The MTO specified by Sweden in the Convergence Programme reflects the objectives of the Pact and is described as a minimum requirement as a member of the EU. In addition, Sweden has a national surplus target[5] which should ensure respect of the MTO.

[5] A general government budget surplus of 1% of GDP should be achieved over the business cycle.

Table 2: Composition of the budgetary adjustment

(% of GDP)	2014	2015		2016		2017	2018	Change: 2014-2018
	COM	COM	CP	COM[1]	CP	CP	CP	CP
Revenue	**51.1**	**51.2**	**51.2**	**51.3**	**51.6**	**51.8**	**52.1**	**1.0**
of which:								
- Taxes on production and imports	22.0	22.2	22.1	22.4	22.3	22.3	22.2	0.2
- Current taxes on income, wealth, etc.	17.7	17.9	17.9	17.8	18.2	18.5	18.8	1.1
- Social contributions	4.7	4.7	2.8	4.7	2.8	2.8	2.8	-1.9
- Other (residual)	6.6	6.5	8.4	6.4	8.3	8.2	8.3	1.7
Expenditure	**53.0**	**52.7**	**52.6**	**52.3**	**52.3**	**52.2**	**52.1**	**-0.9**
of which:								
- Primary expenditure	52.3	51.9	51.9	51.6	51.6	51.5	51.4	-0.9
of which:								
Compensation of employees	12.7	12.7	12.7	12.6	12.7	12.7	12.7	0.0
Intermediate consumption	8.5	8.3	8.4	8.2	8.3	8.2	8.1	-0.4
Social payments	17.5	17.5	17.3	17.5	17.4	17.4	17.3	-0.2
Subsidies	1.7	1.7	1.7	1.6	1.6	1.6	1.5	-0.2
Gross fixed capital formation	4.5	4.5	4.4	4.4	4.3	4.3	4.3	-0.2
Other (residual)	7.4	7.3	7.3	7.3	7.3	7.4	7.4	0.0
- Interest expenditure	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.0
General government balance (GGB)	**-1.9**	**-1.5**	**-1.4**	**-1.0**	**-0.7**	**-0.4**	**0.0**	**1.9**
Primary balance	**-1.2**	**-0.8**	**-0.7**	**-0.3**	**-0.1**	**0.3**	**0.7**	**1.9**
One-off and other temporary	0.0	0.0	0.1	0.0	-0.2	0.0	0.0	0.0
GGB excl. one-offs	**-1.9**	**-1.5**	**-1.5**	**-1.0**	**-0.5**	**-0.4**	**0.0**	**1.9**
Output gap[1]	-1.4	-0.8	-0.9	-0.3	-0.5	0.0	0.5	1.9
Cyclically-adjusted balance[1]	-1.1	-1.0	-0.9	-0.8	-0.4	-0.4	-0.3	0.8
Structural balance (SB)[2]	**-1.1**	**-1.0**	**-1.0**	**-0.9**	**-0.2**	**-0.4**	**-0.3**	**0.8**
Structural primary balance[2]	-0.3	-0.3	-0.3	-0.2	0.5	0.3	0.4	0.8

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 2015 spring forecasts (COM); Commission calculations.

Measures underpinning the programme

The Convergence Programme incorporates all measures proposed and announced by the government in the Spring Adjustment Budget Bill for 2015 or announced in the Spring Fiscal Bill 2015[6]. Expenditure increases result from reforms in the fields of education and labour markets in order to reduce unemployment and improve the outcomes of the school system in term of basic skills, as well as additional investment in railway infrastructure, and reforms in the welfare sector to increase the number of workers in long-term care and raise the ceiling for unemployment benefit.

[6] Govt. Bill 2014/15:99 and Govt. Bill 2014/15:100

In line with the commitment to the "krona for krona" strategy these are compensated by abolishing the reduction of social security contributions for young people and adopting some other budget top-ups measures e.g., some expenditure cuts.

Main budgetary measures

Revenue	**Expenditure**
2014	
• Lower household direct taxation (-0.4% of GDP)	• Education reforms (+0.05% of GDP)
2015	
• Lower pension savings deduction (+0.08% of GDP) • Higher taxes on vehicle, alcohol and tobacco (+0.08% of GDP) • Decreased reduction of social security contributions for young people (+0.1% of GDP)	• Education reforms (+0.1% of GDP)
2016	
• Abolished reduction of social security contributions for young people (+0.25% of GDP) • Other budget top-ups (+0.1% of GDP)	• More jobs and strenghtened competitiveness (+0.14% of GDP) • Education reforms (+0.06% of GDP) • Increased welfare and security (+0.16% of GDP) • Other reforms including swifter introduction of new arrivals and extra funds for municipalities (+0.08% of GDP)
Note: 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.	

3.3. Debt developments

Sweden's government gross debt ratio came out at 43.9% of GDP in 2014, below the 60% of GDP reference value.

The increase from 38.7% of GDP in 2013 mainly comes from the general government deficit, the revaluation of the foreign currency debt due to the weakening of the krona and to

regulatory changes[7]. The debt ratio is projected to further increase marginally in 2015, mainly due to valuation effects. The foreseen strengthening of economic growth and deficit improvement should lead to a gradual decrease of the debt ratio from 2016 onwards. The Convergence Programme's forecast on government gross debt is broadly in line with the Commission 2015 spring forecast, the difference in 2016 is mainly due to the difference in deficit projections.

General government net wealth lays mainly in the national pension funds and corresponded to 20.8% of GDP in 2014. The figure has been revised downwards by 6% in proportion of GDP compared to last year's Convergence Programme as accounts were made consistent with the national financial accounts provided by Statistics Sweden[8]. Net wealth is forecast to decline gradually as a percentage of GDP in the coming years due to projected general government deficits and strong real GDP growth.

Table 3: Debt developments

(% of GDP)	Average 2009-2013	2014	2015		2016		2017	2018
			COM	CP	COM	CP	CP	CP
Gross debt ratio[1]	**37.7**	**43.9**	**44.2**	**44.2**	**43.4**	**42.8**	**41.5**	**40.0**
Change in the ratio	0.4	5.1	0.3	0.3	-0.9	-1.4	-1.3	-1.5
Contributions [2] :								
1. Primary balance	**-0.4**	**1.2**	**0.8**	**0.7**	**0.3**	**0.1**	**-0.3**	**-0.7**
2. "Snow-ball" effect	**0.2**	**-0.6**	**-1.0**	**-1.1**	**-1.2**	**-1.2**	**-1.1**	**-1.0**
Of which:								
Interest expenditure	1.0	0.7	0.7	0.7	0.7	0.6	0.7	0.7
Growth effect	-0.3	-0.8	-1.1	-1.1	-1.2	-1.1	-1.0	-1.0
Inflation effect	-0.5	-0.5	-0.7	-0.7	-0.7	-0.7	-0.8	-0.7
3. Stock-flow adjustment	**0.6**	**4.6**	**0.6**	**0.7**	**0.0**	**-0.2**	**0.1**	**0.2**
Of which:								
Cash/accruals diff.				0.2		-0.2	0.0	0.0
Acc. financial assets				0.5		0.0	0.1	0.2
Privatisation				-0.1		-0.1	-0.1	-0.1
Val. effect & residual				0.6		0.2	0.2	0.3

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.

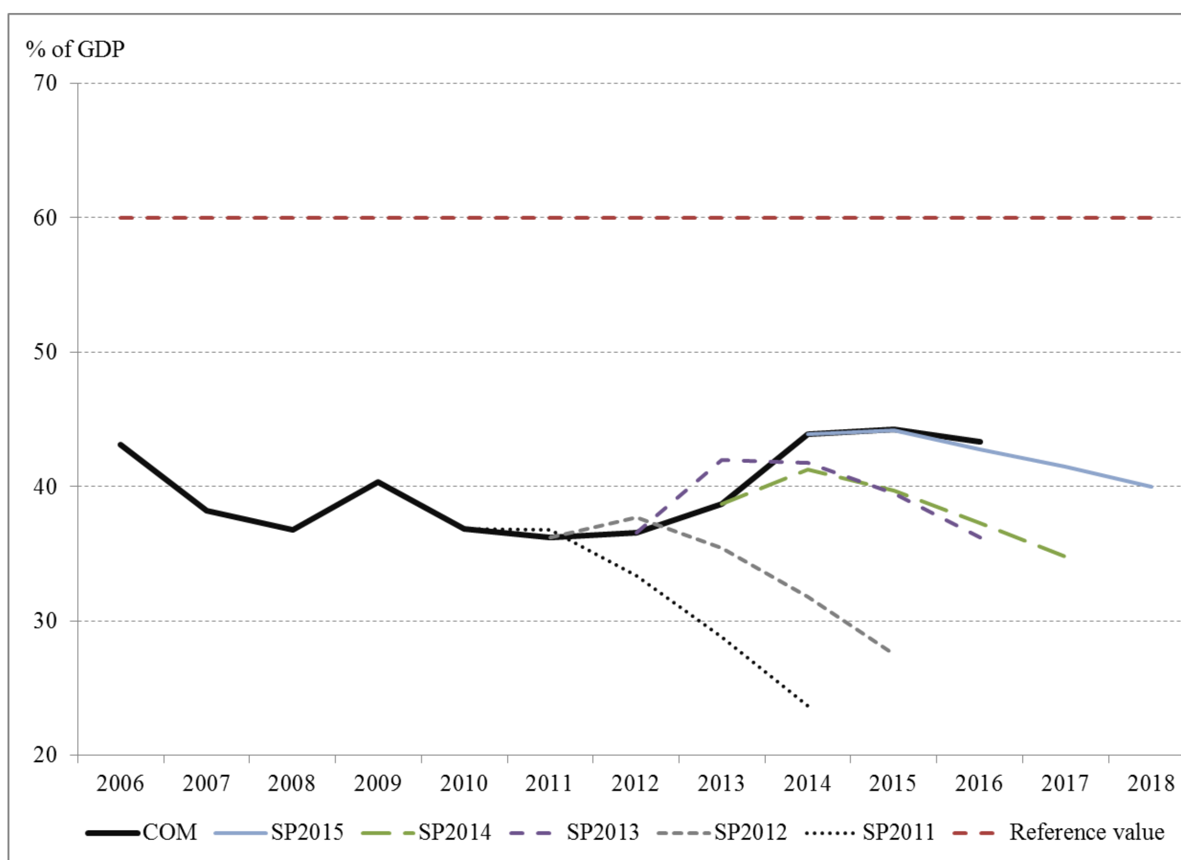
Source :

Commission 2015 spring forecast (COM); Convergence Programme (CP), Comission calculations.

[7] As of 2014, central government units besides the National Debt Office may hold outstanding repos over the turn of the year. If repos are not closed before the end of the year, both gross debt and assets increase according to the National Accounts. The repos amounted to 1.8% of GDP in Sweden in 2014, which increased the gross debt and asset level by a corresponding amount.

[8] Inter alia the premium pension system is now reported in the insurance sector.

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



Source: Commission 2015 spring forecast; Convergence Programmes

3.4. Risk assessment

Deficit developments

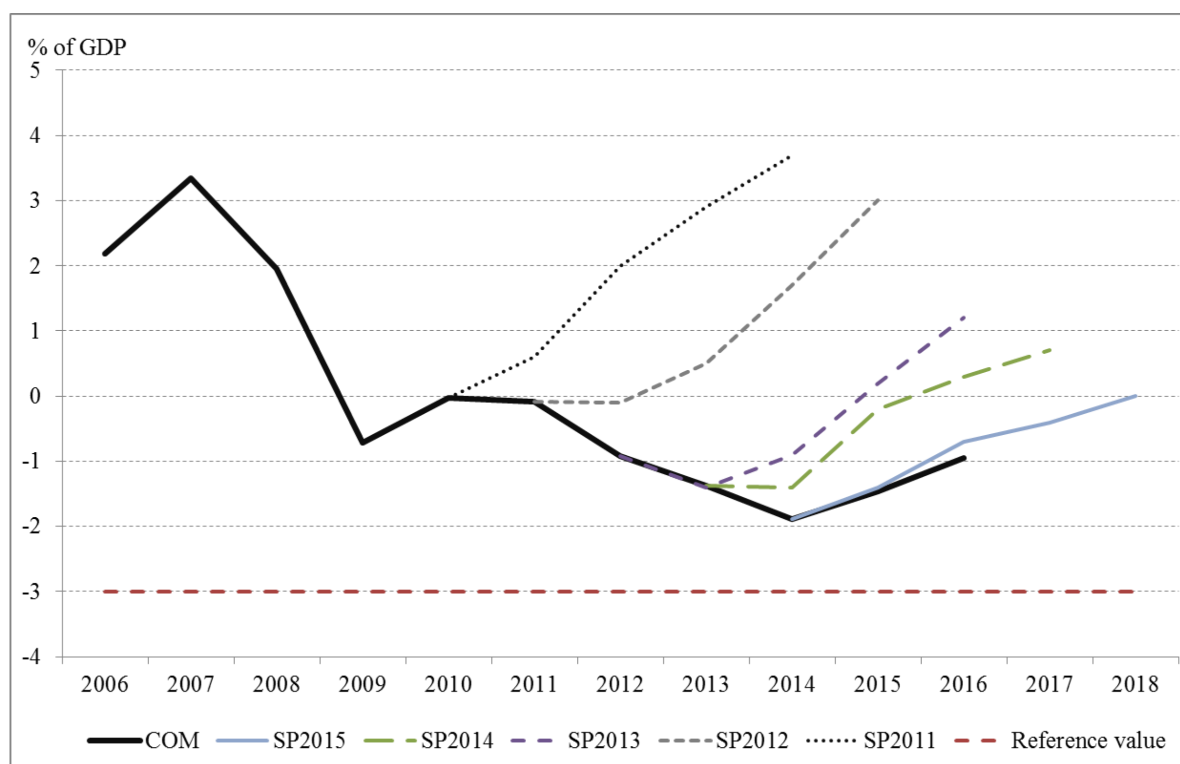
For 2015, the Convergence Programme and the Commission 2015 spring forecast are aligned regarding both the nominal and the recalculated structural general government balances.

For 2016, the Convergence Programme shows a 0.3% of GDP more optimistic deficit reduction for both the nominal and structural deficit. This is mainly due to a more favourable macroeconomic outlook.

The main risks to the fiscal forecast stem from weaker economic growth in the rest of the world ultimately affecting employment growth through lower exports. Moreover, interest rates are currently at historically low levels. Any increase would negatively affect public finances through the interest payments on public debt as well as the tax expenditures on interest deductibility. Furthermore, increased geopolitical uncertainties, including a possible further escalation of the Russian crisis, could negatively impact growth in several of Sweden's main trading partners and undermine business confidence. Finally, a correction in house prices, which rose to new historical highs in 2014, could dampen household consumption and construction investment.

On the positive side, the Riksbank's expansionary monetary policy could result in a stronger depreciation of the currency, which would support economic activity through exports.

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



Source: Commission 2015 spring forecast; Convergence Programmes

Debt developments

Short term risks to the government debt projections are 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, sound fiscal position and the strong budgetary framework. Nevertheless, short term fluctuations of the government debt in proportion to GDP can be expected from foreign exchange fluctuations (as the share of the foreign currency debt is approximately 15 per cent of the total central government debt) and from the treatment of outstanding repos[9].

4. Compliance with the provisions of the Stability and Growth Pact

Box 1. Council recommendations addressed to Sweden

On 8 July 2014, the Council addressed recommendations to Sweden in the context of the European Semester. In particular, in the area of public finances the Council recommended to Sweden to continue to pursue a growth-friendly fiscal policy and preserve a sound fiscal position, ensuring that the medium-term budgetary objective is adhered to throughout the period covered by the Convergence Programme, also with a view to the challenges posed on the long-term sustainability of public finances by an ageing population.

[9] If central government units' repos are not closed before the end of the year, both gross debt and assets increase according to the National Accounts.

Table 4: Compliance with the requirements under the preventive arm

(% of GDP)	2014	2015		2016	
Initial position[1]					
Medium-term objective (MTO)	-1.0	-1.0		-1.0	
Structural balance[2] (COM)	-1.1	-1.0		-0.9	
Structural balance based on freezing (COM)	-0.9	-1.0		-	
Position vis-a -vis the MTO[3]	At or above the MTO	At or above the MTO		At or above the MTO	
(% of GDP)	**2014**	**2015**		**2016**	
	COM	**CP**	**COM**	**CP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.0	0.0		0.0	
Required adjustment corrected[5]	-1.5	-0.1		0.0	
Change in structural balance[6]	-0.8	0.1	0.1	0.8	0.1
One-year deviation from the required adjustment[7]	0.7	0.2	0.2	0.8	0.1
Two-year average deviation from the required adjustment[7]	0.9	0.4	0.4	0.5	0.2
Expenditure benchmark pillar					
Applicable reference rate[8] *One-year deviation*[9] *Two-year average deviation*[9]	n.a. (structural balance above the MTO)				
Conclusion					
Conclusion over one year Conclusion over two years	Compliance				

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 points 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 28.).

[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.

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

[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 not at its MTO.

[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.

Source :

Convergence Programme (CP); Commission 2015 spring forecasts (COM); Commission calculations.

The programme foresees the structural balance, as recalculated by the Commission, to tilt from -1.1% of GDP in 2014 to -0.8% in 2015 before improving to -0.6% in 2016. According to the information provided in the Convergence Programme, Sweden is therefore expected to be above its medium-term objective over the program horizon. This is confirmed by the Commission 2015 spring forecast, according to which the structural balance is projected to reach -1% of GDP in 2015 before improving to -0.9% in 2016 under the no policy change

assumption. The programme then foresees the structural balance to continue to be above the MTO over the programme period.

Based on the outturn data and the Commission 2015 spring forecast, the ex-post assessment suggests compliance with the requirements in 2014. Moreover, Sweden is foreseen to be in compliance with the requirements of the preventive arm of the Pact over the programme horizon.

5. LONG-TERM SUSTAINABILITY

The analysis in this section includes the new long-term budgetary projections of age-related expenditure (pension, health care, long-term care, education and unemployment benefits) from the 2015 Ageing Report[10] published on 12 May. It therefore updates the assessment made in the Country Reports[11] published on 26 February.

Government debt stood at 43.9% of GDP in 2014. It is expected to decrease (to 40.2% in 2025), remaining well below the 60% of GDP Treaty threshold. As illustrated in Figure 3, the full implementation of the programme would put debt on a further decreasing path by 2025, remaining well below the 60% of GDP reference value in 2025.

In line with a moderate level of government debt, the medium-term sustainability gap is negative (at -1.4 % of GDP), indicating low fiscal sustainability risks in the medium term. On the other hand, in the long-term, Sweden appears to face medium fiscal sustainability risks, related in particular to the projected ageing costs over the long run, especially in the area of long-term care. The long-term sustainability gap, which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path, is indeed at 2.3 % of GDP.

Further containing age-related expenditure growth appears therefore necessary, in particular in the area of long term care, to contribute to the sustainability of public finances in the long term.

[10] See http://ec.europa.eu/economy_finance/publications/european_economy/2015/ee3_en.htm

[11] See http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm

Table 5: Sustainability indicators

	Sweden			European Union		
	2014 scenario	**No-policy-change scenario**	**Convergence Programme scenario**	**2014 scenario**	**No-policy-change scenario**	**Stability/ Convergence Programme scenario**
S2*	2.2	2.3	1.8	1.4	1.7	0.4
of which:						
Initial budgetary position (IBP)	1.3	1.3	0.8	0.4	0.5	-0.7
Long-term cost of ageing (CoA)	0.9	1.0	1.0	1.0	1.1	1.1
of which:						
pensions	-1.0	-0.8	-0.7	0.0	0.1	0.1
healthcare	0.4	0.3	0.3	0.8	0.7	0.6
long-term care	1.3	1.3	1.1	0.7	0.7	0.6
others	0.2	0.2	0.2	-0.4	-0.3	-0.2
S1**	-1.4	-1.4	-2.5	1.4	1.8	0.5
of which:						
Initial budgetary position (IBP)	-0.4	-0.4	-1.0	-0.4	-0.3	-1.6
Debt requirement (DR)	-1.1	-1.3	-1.7	1.7	1.9	1.8
Long-term cost of ageing (CoA)	0.1	0.3	0.2	0.1	0.3	0.4
S0 (risk for fiscal stress)***	0.13	:		:		
Fiscal subindex	0.10	:		:		
Financial-competitiveness subindex	0.14	:		:		
Debt as % of GDP (2014)	43.9			88.6		
Age-related expenditure as % of GDP (2014)	25.1			25.6		

Source: Commission, 2015 Convergence Programme

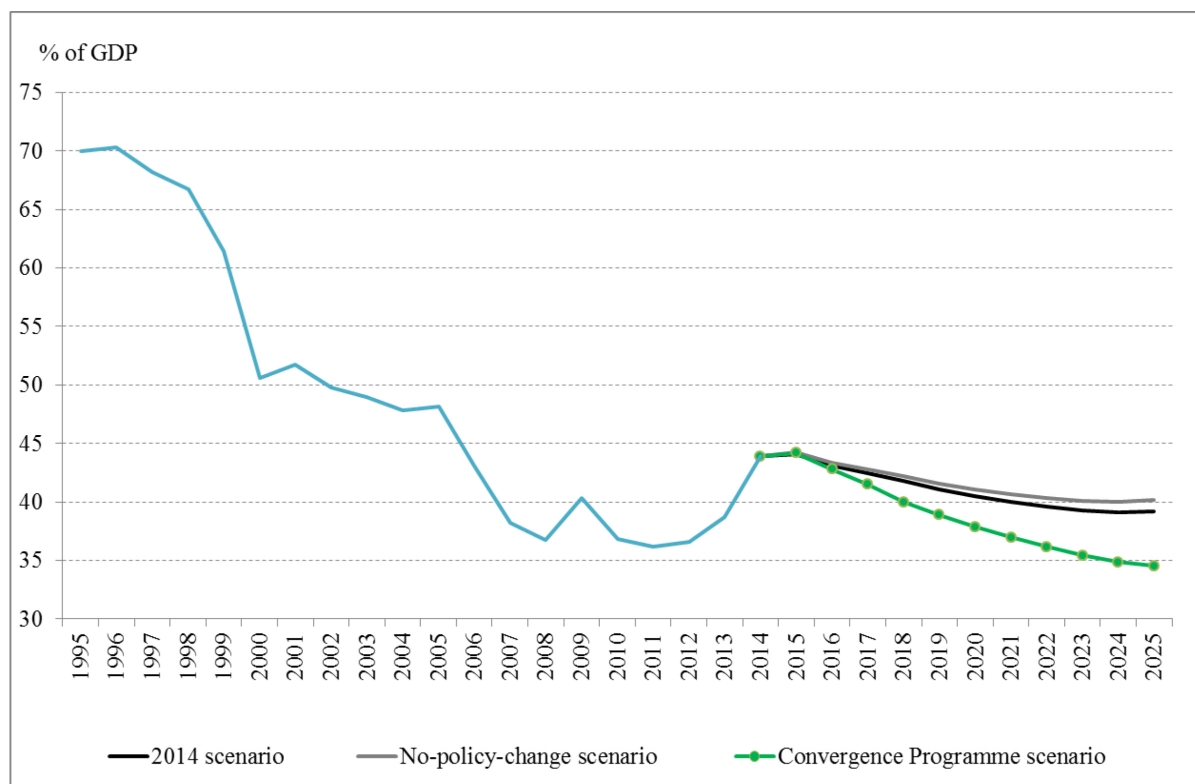
Note: the '2014' scenario depicts the sustainability gap under the assumption that the structural primary balance position remains at the 2014 position according to the Commission 2015 spring forecast; the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commission 2015 spring forecast until 2016. The 'stability 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.

* 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.

** 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 foercast 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 2016) 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.

*** 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.

Figure 3: Debt projections



Source: Commission 2015 spring forecast; Convergence Programme; Commission calculations

6. FISCAL FRAMEWORK AND QUALITY OF PUBLIC FINANCES[12]

6.1. Fiscal framework

In the past 20 years, Sweden's fiscal framework has proven very effective in putting public finances on a strong footing at both the central and local level. The framework comprises three key components[13]: (i) a surplus target stipulating that an overall budget surplus of 1% of GDP should be achieved over the business cycle; (ii) a three-year nominal expenditure ceiling for central government and the pension system; (iii) a balanced-budget rule for local authorities forbidding municipalities and counties to approve ex ante deficit budgets. In addition to the budgetary rules, the Fiscal Policy Council (FPC) was established in 2007 with the task of providing an independent evaluation of the government's fiscal policy and compliance with the fiscal rules.

Over the past years, a debate on possible changes has been focused on the level (not the principle) of the surplus target. In January 2015, the government announced that the current levels would not be reached over the present mandate period and tasked the National Institute of Economic Research to analyse the effects of changing the budget surplus target to balanced net lending (the evaluation is due in August 2015). While this would clearly lower the ambition of the fiscal framework, it does not imply a fiscal loosening over the programme horizon, as a balanced budget target is only foreseen to be reached in 2018.

[12] This section complements the Country Report published on 26 February 2015 and updates it with the information included in the Convergence Programme.

[13] For further detail on these components see Country Report Sweden 2015, SWD(2015) 46 final.

Adaptations have been made to allow the Swedish budgetary framework to comply with Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States. First, regular evaluations have been introduced of the forecasts presented in the autumn and spring Budget Bills[14]. This should improve the accuracy of the forecasts. Moreover, another legislative proposal in March 2014 codified and extended the current practice on the expenditure side of the budget to the revenue side. This implies that bills affecting government revenues will have to be proposed as part of the legislative package during the autumn and spring Budget Bills. This should further improve control and oversight of revenues, putting it on an equal footing with expenditures.

6.2. Quality of public finances

The expenditure ratio declined from around 54% of GDP in 2003 to 50% in 2008. As a result of the crisis, the ratio increased again to 53% of GDP in 2013, which is broadly in line with the average expenditure level over the past 20 years. Expenditure on social protection continues to account for more than 40% of general government expenditure

The low interest rate environment has had a positive impact on public finances through lower interest payments on the public debt as well as lower tax expenditures through the deductibility of interest payments. An increase of the interest rate would therefore negatively affect public finances.

At over 4% of GDP, public investment has been at a relatively high level. Despite the foreseen consolidation, the government plans to safeguard investment, keeping the overall investment ratio broadly stable over the programme horizon. As highlighted in the 2015 Country Report, high public sector investment is required to fulfil the need for improvements in infrastructure and housing.

Regarding revenues, the tax ratio declined by 2.4 percentage points between 2007 and 2014 reaching 42.6% of GDP. The reduction in the corporate tax rate as well as the in-work tax credit account for the largest contributors to this decline. Looking forward, the tax ratio is expected to increase to 44% by 2018, compensating for the increased expenditure in areas such as education, infrastructure and welfare.

7. CONCLUSIONS

Sweden has addressed the fiscal recommendation issued in the context of the 2014 European Semester by promoting a growth-friendly fiscal policy using its available fiscal space to boost domestic demand and therefore supporting its economic recovery.

In the meantime, Sweden's structural balance is expected to respect the MTO over the programme period and Sweden is foreseen to continue to meet the requirements under the preventive arm of the Pact.

[14] Following the conclusions of a parliamentary inquiry (SOU 2013:38, May 2013).

ANNEX

Table I. Macroeconomic indicators

	1997-2001	2002-2006	2007-2011	2012	2013	2014	2015	2016
Core indicators								
GDP growth rate	3.6	3.3	1.3	-0.3	1.3	2.1	2.5	2.8
Output gap [1]	0.0	0.0	-0.6	-1.7	-1.9	-1.4	-0.8	-0.3
HICP (annual % change)	1.5	1.5	2.0	0.9	0.4	0.2	0.7	1.6
Domestic demand (annual % change) [2]	3.0	2.5	1.9	-0.6	1.1	3.4	2.7	2.8
Unemployment rate (% of labour force) [3]	7.2	7.0	7.4	8.0	8.0	7.9	7.7	7.6
Gross fixed capital formation (% of GDP)	21.3	21.9	23.1	22.6	22.1	23.1	23.5	23.9
Gross national saving (% of GDP)	26.3	28.8	30.7	28.9	29.0	29.1	29.4	29.6
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**1.0**	**0.3**	**0.9**	**-0.9**	**-1.4**	**-1.9**	**-1.5**	**-1.0**
Gross debt	**59.7**	**47.6**	**37.7**	**36.6**	**38.7**	**43.9**	**44.2**	**43.4**
Net financial assets	**-11.4**	**4.4**	**19.8**	**22.8**	**26.0**	**n.a**	**n.a**	**n.a**
Total revenue	56.9	53.4	52.2	51.7	51.9	51.1	51.2	51.3
Total expenditure	55.9	53.1	51.3	52.6	53.3	53.0	52.7	52.3
of which: Interest	3.8	2.0	1.3	0.9	0.8	0.7	0.7	0.7
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**2.1**	**4.2**	**1.7**	**-0.4**	**0.2**	**-0.1**	**-0.6**	**-1.1**
Net financial assets; non-financial corporations	**-139.2**	**-136.6**	**-165.1**	**-178.8**	**-189.2**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**13.1**	**-12.3**	**-2.5**	**-0.5**	**1.1**	**n.a**	**n.a**	**n.a**
Gross capital formation	15.5	15.0	15.9	15.5	15.1	16.2	16.5	17.0
Gross operating surplus	24.1	24.0	24.2	23.0	22.8	22.8	23.0	23.1
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**1.0**	**1.8**	**4.5**	**7.4**	**7.7**	**7.7**	**7.7**	**7.4**
Net financial assets	**92.9**	**116.0**	**132.3**	**142.0**	**157.2**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	38.8	38.3	39.1	40.5	40.5	40.6	40.4	40.1
Net property income	3.2	2.5	4.6	5.7	5.8	5.9	5.9	5.7
Current transfers received	23.2	22.2	20.4	20.7	21.1	20.6	20.7	20.6
Gross saving	3.2	4.7	7.7	10.0	10.3	10.5	10.4	10.1
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**4.3**	**6.7**	**7.2**	**6.2**	**6.7**	**5.7**	**5.7**	**5.4**
Net financial assets	**45.3**	**29.3**	**16.9**	**16.3**	**6.2**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	6.3	7.0	5.8	4.9	5.0	3.8	3.8	3.8
Net primary income from the rest of the world	-0.4	1.2	3.2	3.1	3.6	3.7	3.5	3.4
Net capital transactions	-0.3	-0.2	-0.1	-0.2	-0.2	-0.1	-0.1	-0.1
Tradable sector	43.4	42.3	41.2	40.3	39.5	38.9	n.a	n.a
Non tradable sector	44.7	45.8	46.9	48.0	48.9	49.5	n.a	n.a
of which: Building and construction sector	4.2	4.8	5.2	4.9	4.8	5.3	n.a	n.a
Real effective exchange rate (index, 2000=100)	103.5	101.8	101.7	110.5	114.0	110.0	102.9	102.3
Terms of trade goods and services (index, 2000=100)	107.0	100.4	99.9	99.3	99.7	99.6	99.5	99.5
Market performance of exports (index, 2000=100)	100.6	101.7	99.9	100.7	98.7	99.0	99.5	100.1

Notes:

[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.

Source:
Commission 2015 spring forecast (COM); Convergence Programme (CP).