CONCLUDING STATEMENT

SWEDEN: Staff Concluding Statement of the 2021 Article IV Mission

FOR IMMEDIATE RELEASE

Washington, DC—February 2, 2021: *The Swedish economy entered the COVID-19 pandemic on a solid footing and with substantial buffers created through prudent fiscal and financial management. Although the pandemic hit the economy hard, the recession was moderated by strong support measures and structural features of the economy, which has a high share of jobs that can be performed remotely, a relatively small hospitality sector, and a large export sector. The less stringent containment strategy at the beginning of the pandemic seems to have altered the timing of the economic fallout, which intensified towards the middle of the year. While the fiscal stance is appropriate, there is scope for additional support if the recovery or inflation expectations falter, and for recalibration of the support measures, including by adapting their design to further facilitate structural transformation. The Riksbank should also stand ready to complement fiscal support as needed. It is also important to enhance monitoring of household and private sector balance sheets in order to inform the authorities' management of the buildup of risks. Over the medium term, the strive for inclusive growth can be strengthened by advancing structural reforms and increasing growth-enhancing and green spending to meet health and demographic challenges.*

Sweden's economy fared better than many of its European neighbors, thanks to a large and swift macroeconomic policy response and unique structural features of the economy. As a result, the fall in output in 2020 is projected at around 3 percent, which is less than the EU average. The crisis also highlighted the long-standing inequities in the labor market, and the increase in unemployment was larger than in countries that suffered a deeper recession. Temporary employment, which is more common in the hospitality sector and among the youth and foreign-born, decreased substantially. Sweden's infection and mortality rates have been somewhat above the EU average but much higher than in its Nordic peers.

The authorities' large support package was timely and adequate, and helped avert a financial crisis. The government announced a broad support package for 2020 amounting to about 12 percent of GDP, which appropriately included additional resources for the health care system, a short-term work scheme, grants to companies, labor and education support, tax cuts, as well as tax deferrals and loan guarantees. Like in other countries, the actual uptake was less than the sizable package. As a result, the fiscal balance is expected to have moved from a small surplus in 2019 to an estimated deficit of around 4 percent of GDP in 2020, taking advantage of the flexibility in the fiscal framework, which appropriately anchors the fiscal balance to an average over the cycle and allows for deviations in times of crises. Finansinspektionen took timely macroprudential measures, including by reducing the countercyclical buffer, temporarily suspending the amortization requirement, and urging banks to refrain from paying out dividends. The Riksbank launched sizeable measures to prevent a credit crunch and stabilize markets. The policy (repo) rate was kept at zero since it moved from negative territory effective January 2020 just prior to the pandemic. However, the overnight lending rate was reduced, and ample liquidity was provided, including through a funding-for-lending facility, weekly market operations at longer maturities at the repo rate, and the asset purchase program.

While the recovery is expected to start this year, downside risks have recently increased. The recovery could be delayed by a new wave of infections, mutations of the virus, a slower-than-expected rollout of vaccinations, and any necessary tightening of the containment measures. At the same time, the expansionary policies and easy financing conditions, while averting a financial crisis, are contributing to a buildup in vulnerabilities.

Sweden has substantial fiscal space to deploy additional support should short-term downside risks materialize. There is room for increasing public expenditure over the medium term to enhance growth and achieve Sweden's ambitious green and inclusion objectives. Furthermore, it is desirable to review the design of the support measures to facilitate structural transformation. For instance, the short-term work scheme could be made more flexible to be more supportive for temporary workers and new hiring, and to incentivize retraining. It is important to not prematurely return to the surplus target. At the same time, as the economy starts to recover, the support measures should be gradually withdrawn in a coordinated and well-communicated manner to strike a balance between avoiding economic scarring and prolonging support of non-viable firms.

It is vital to address Sweden's long-term structural challenges and market distortions, including to tackle the limited employment prospects for the foreign-born and youth, shortages in affordable housing, and demographic shifts. It is encouraging that the 2021 Budget Bill contained higher spending on training and education, as well as lower social security contributions for the youth and initiatives geared towards the foreign-born, especially women. A further reduction of the high labor tax wedge is also desirable. Gradually increasing property taxes from their extremely low level together with other reforms would make the housing market more dynamic and facilitate labor mobility. The overly regulated rental market, with its long queues, favors existing tenants. In this regard, we welcome the ongoing public inquiries aimed at presenting proposals to improve the functioning of the rental market. Introducing a simpler market-based system that is complemented with adequate housing allowances would be more transparent and effective in meeting both the economic and social objectives. In addition, streamlining the complex local regulations would help increase supply and competition in the construction sector, thus driving down cost.

Decisive monetary policy actions have ensured ample liquidity for households and businesses. The monetary policy stance has been appropriate and the expansion of the Riksbank's asset purchase program contributed importantly to stabilizing the corporate and mortgage bond markets. Inevitably such operations can contribute to a buildup in vulnerabilities due to reduced risk pricing and possible formation of asset bubbles. In view of this, and as liquidity constraints seem to have been alleviated and weak demand and solvency issues are becoming more important, the policy mix should focus on fiscal support, while the Riksbank should stand ready to complement fiscal measures as needed. In this connection, the Riksbank's recent communication that all policy options will be considered in case the recovery or inflation expectations falter is reassuring. Any amendments to the Riksbank law should preserve its operational independence and ability to quickly deploy a broad range of instruments in future crises.[1] The Riksbank is at the forefront of exploring central bank digital currency. The e-krona pilot project will help design an e-krona proposal in a way that maximizes the benefits while minimizing risks, including for financial intermediation and cybercrime.

Long-standing financial vulnerabilities require continued vigilance and enhanced data collection. The financial sector has been buttressed by past prudent macro-financial policies and a prompt policy response to the crisis. Banks entered the crisis with high profitability and strong capital buffers. Although some indicators have unsurprisingly worsened, banks' performance remains robust. However, some long-standing financial vulnerabilities related to exposures to the commercial real estate (CRE) sector and high household debt need better data collection[2] for increased monitoring and evaluation, and possible further strengthening of prudential regulations, especially for CRE. Since an increasing part of CRE funding takes place through the issuance of bonds, the corporate bond market requires close monitoring from a financial stability perspective. So far, volatility has been mitigated by the support measures, in particular the low funding costs resulting from monetary policy action. But a

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[1] For more details, see IMF Country Report No. 20/239.

[2] In this regard, the recently launched inquiry on household balance sheet statistics is welcome.

prolonged recession, as well as accelerated shifts to e-commerce, teleworking, and less travel could result in dwindling revenue streams of CRE companies with high exposure to sectors affected by the crisis. The acceleration in house prices could also increase household debt further. Finally, the amendments of the Swedish anti-money laundering framework and its enforcement are welcome, and the robust implementation of recent reforms should continue to sustain financial stability and reduce reputational risks.

An IMF team conducted virtual meetings during January 19–29, 2021. The mission was led by Khaled Sakr and met with Minister of Finance Magdalena Andersson, Minister of Financial Markets and Housing Per Bolund, and Riksbank Governor Stefan Ingves; other senior officials; and representatives of parliamentary finance committee, labor unions, the banking sector, and academics. The mission would like to thank the Swedish authorities for the close collaboration and to express appreciation for the candid and insightful discussions.