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In-Depth Review for Sweden

in accordance with Article 5 of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances

Accompanying the

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN INVESTMENT BANK

Economic policy coordination in 2021: overcoming COVID-19, supporting the recovery and modernising our economy

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CONTENTS

Executive summary 1

1. Assessment of Macroeconomic Imbalances 2

2. Thematic Issue: Household debt and Housing market 9

LIST OF TABLES

Table 1.1: Assessment of Macroeconomic Imbalances Matrix - Sweden 6
Table 1.2: Selected economic and financial indicators, Sweden 8
Table 2.1: Household debt indicators, Sweden 11
Table 2.2: Selected housing indicators, Sweden 12

LIST OF GRAPHS

Graph 2.1: Thematic Graphs: Household debt and housing 13
Graph 2.2: Thematic Graphs: Household debt and housing (cont.) 14

EXECUTIVE SUMMARY

The 2021 Alert Mechanism Report concluded that an in-depth review should be undertaken for Sweden to examine further the persistence of imbalances or their unwinding. In February 2020, Sweden was identified as experiencing "macroeconomic imbalances", in particular involving overvalued house price levels coupled with a continued rise in household debt. It should be noted that the context of the assessment of vulnerabilities in this year's in-depth review (IDR) for Sweden is markedly different from last year. Also, the evolution of the COVID-19 pandemic, the strength of the recovery, and possible structural implications of the crisis are all still surrounded by high uncertainty, requiring caution in the assessment. In general, policy action over the past year focused on cushioning the impact of the COVID-19 shock and facilitating the recovery. This should support adjustment in the medium term. Looking forward, the Recovery and Resilience Plan provides an opportunity to address imbalances, investment and reforms needs.

Main observations and findings of this IDR analysis are:

- **This IDR is informed by the 2021 spring forecast, which expects a recovery in economic activity in Sweden with the easing of the COVID-19 crisis.** After the drop of 2.8% in 2020, real GDP is projected to increase by 4.4% this year and 3.3% next year, allowing the economy to recover its pre-pandemic level in 2021.

- **The private debt-to-GDP ratio increased significantly in 2020, to an estimated 217% and is set to stay high**. Household debt, in particular mortgage debt, grew significantly and is the main risk stemming from private debt, with most non-financial corporations generally having a financially sound balance sheet. After equaling 176% of gross disposable income (89% of GDP) in 2019, the household debt ratio is expected to have reached 186% in 2020 (95% of GDP). Strong policy measures supported household income throughout the COVID-19 crisis, thereby reducing the risk to household finances, including the short-term work programme and suspension of the amortization requirement. Sweden has taken some policy measures to promote housing construction and housing supply through investment subsidies and amendments to the building and planning act. Accelerating house prices, a strong economic recovery and the continued prevalence of the main structural drivers to take on mortgage debt (low property taxes and mortgage interest deductibility as well as short supply of affordable housing) are expected to result in a further increase in private debt to above the Commission's prudential threshold and fundamental benchmark. Mortgage growth continued apace in 2020 (5.5% y-o-y in 2020, the same rate as 2019) in spite of the pandemic and accelerated to 6.6% y-o-y in the first two months of 2021. While banks are overall well capitalised and profitable, their elevated exposure to the commercial real estate market, which might be subject to structural changes due to the COVID-19 crisis (broader use of teleworking and online commerce), warrants vigilance. Moreover, Swedish banks benefited from several policy measures that released capital buffers and provided liquidity in response to the COVID-19 crisis.

- **After some moderation in recent years, house price growth accelerated in the wake of the COVID-19 pandemic.** House prices in Sweden have risen to record highs irrespective of the economic fall-out from the COVID-19 crisis. Real house price growth was 0.5% in 2019 and 3% in 2020, and prices have continued increasing at an accelerated rate in early 2021. There is a risk of overvaluation as indicated by house price developments in comparison with disposable income and house rents. The very low interest rate and a growing population have made the overvaluation less visible in the Commission's broader fundamental benchmark. Interest rates are unlikely to decrease further, though, and population growth has been skewed to those with lower income and, hence, less likely to acquire a house given current prices and banks' lending policies. Land used for construction has become an increasingly valued asset over the year, and prices of (semi-)detached houses have increased notably faster than of apartments during the pandemic.

1. ASSESSMENT OF MACROECONOMIC IMBALANCES

Introduction

In February 2020, over the previous annual cycle of surveillance under the Macroeconomic Imbalances Procedure, Sweden was identified as experiencing "macroeconomic imbalances", in particular involving overvalued house price levels coupled with a continued rise in household debt. The 2021 Alert Mechanism Report published in November 2020 concluded that a new in-depth review (IDR) should be undertaken for Sweden with a view to assess the persistence or unwinding of imbalances.

The context of the assessment of vulnerabilities this year is markedly different from last year's IDRs, which took place before the COVID-19 pandemic. The evolution of the pandemic, the strength of the recovery, and possible structural implications of the crisis are still surrounded by high uncertainty requiring caution in the assessment. Policy action over the past year focused on cushioning the impact of the COVID-19 shock and on facilitating the recovery. Follow-up to country-specific recommendations from 2019 and 2020, including those that are MIP-relevant, is taking place in the context of the assessment of the Recovery and Resilience Plans (RRPs). The analysis of policies in the present report was finalised before the formal submission of Sweden's RRP. It is therefore without prejudice to the Commission's assessment of RRPs, which is ongoing at the time of publication of this report.

The assessment follows a similar structure as the IDRs that were included in Country Reports in recent annual cycles. This chapter presents the main findings for the assessment of imbalances, also summarised in the MIP assessment matrix. The assessment is backed by a thematic chapter that looks more at length at household debt and the housing market. Spillovers and systemic cross-border implications of imbalances are also taken into account. In addition, also assessments of structural issues made in previous IDRs and in the context of fiscal assessments are considered where relevant.

Macroeconomic context

In 2021, the Swedish economy is forecast to rebound strongly and exceed the pre-pandemic activity level on the back of a robust recovery in consumer demand and a more favourable external environment. Economic activity expanded again in the first quarter of 2021 after a modest fall in the last quarter of 2020, consistent with the limited size of sectors heavily affected by the COVID-19 crisis. Real GDP growth is projected to gather pace in the second quarter and continue growing in the second half of 2021, with private consumption set to expand vigorously as restrictions are eased and supply constraints in parts of the manufacturing sector are overcome. The strong increase in household consumption over the forecast horizon is underpinned by a progressive decline in the household savings rate, coupled with supportive labour market trends, moderate inflation, and gains in financial wealth. Government consumption is expected to be lifted by ample fiscal stimulus, although bottlenecks in the provision of health care and social services limit expenditure during the first half of 2021. Fiscal support is set to be scaled back in 2022, thus somewhat moderating its positive impact on real GDP growth. Exports are on track for a robust expansion on the back of the global recovery, supported by strong competitiveness. This is mirrored in a further strengthening of the current account over the forecast horizon. Investment growth is forecast to remain relatively modest given the strength of the upturn, as capital formation did not retrench strongly in 2020.

In 2022, the level of real GDP is forecast to well exceed the 2019 level. Overall, real GDP is forecast to grow by 4.4% in 2021 and 3.3% in 2022.The gross saving rate of households, which reached a record high at the peak of the COVID-19 pandemic, is expected to fall to below the 2019 savings rate in 2022 in the wake of strong recovery in private consumption. Temporary unemployment support schemes, along with relief measures for businesses, have successfully cushioned the labour market impact of the crisis, particularly in hard-hit labour intensive service sectors. The unemployment rate is expected to decrease slightly to just over 8% in 2021 and decrease further to 7.5% in 2022. HICP inflation is projected to increase markedly to 1.8% in 2021, chiefly due to higher commodity prices, but to fall back to just above

1% in 2022, reflecting weak underlying cost pressures. Risks to the outlook appear to be tilted slightly to the upside, given the extent of excess saving among households and the opportunities for businesses to scale up investment in view of favourable financing conditions.

Imbalances and their gravity

Private sector debt has been on an increasing trend for more than two decades. Household debt grew the fastest in the past two decades, reaching 89% of GDP (176% of gross disposable income) at the end of 2019. Debt of non-financial corporations grew at a more moderate pace from a higher initial value and stood at 115% of GDP at the end of 2019. In the year before the COVID-19 pandemic, 2019, the indebtedness of the non-financial corporate sector increased by 5.7% of GDP and household debt by 4.2% of GDP). Private debt was 49% pps above the Commission's prudential benchmark and 38% pps above its fundamental benchmark in 2019.

The housing market quickly recovered from an initial drop at the beginning of COVID-19, and house price growth has accelerated as the pandemic continued. Nominal house prices grew by 4.2% y-o-y in 2020 (3.0% in real terms), strengthening from 2.5% y-o-y in 2019 (0.5% in real terms) and a decline by 0.9% in 2018 (real house prices declined by 3.3% y-o-y). Transaction volumes and values grew by 4.7% y-o-y and 4.5% y-o-y respectively in 2019 following a decline by 1.7% and 0.5% y-o-y respectively in 2018. However, indications for the number of transactions are mixed for 2020. The valuation metrics suggest house prices were overvalued in 2019 against income and rents although the low interest rate and population growth left house prices somewhat below the fundamentals benchmark.

Evolution, prospects and policy responses

The growth of private debt accelerated during the COVID-19 crisis. Consolidated private sector debt reached a new high of 218% of GDP in 2020 with both the debt of non-financial corporations (NFC) and household-related debt above their prudential thresholds. The increase reflects the drop in GDP and financing needs of the private sector in light of the COVID-19 crisis. NFC debt is estimated to have reached 123% of GDP in 2020. In reaction to the COVID-19 pandemic, corporates drew on credit lines with banks to accommodate fluctuations in cash flows and liquidity in the corporate bond market. NFC debt is viewed as less problematic because of large and supportive asset and equity positions, with the exception of commercial real estate (CRE). Debt of CRE amounted to some 26% of GDP in 2019, more than one fifth of all NFC debt. The CRE business model is more exposed to changing business patterns resulting from the COVID-19 pandemic and, following its earlier reports, the IMF (2021) ([1]) recently pointed to the high exposure of Swedish banks to CRE. CRE debt makes up 44% of the total non-financial corporation loans of Sweden's seven largest banks.

Household debt stood at an estimated 94% of GDP in 2020 and grew strongly at the beginning of 2021. Mortgage loans to households continued to grow throughout 2020, despite the strong contraction in economic activity. Credit flows to households accelerated to 5% of GDP in 2020 and mortgage loan growth in particular continued to be strong in the first months of 2021. Real net disposable income declined by only 0.7% in 2020 and is projected to increase relatively strongly in 2021. During the COVID-19 crisis household income has been supported by policy measures which, among other things, helped cushion the impact of the COVID-19 pandemic on unemployment. The employment of members of households with fixed employment, which tend to have higher rates of home ownership, has overall remained well-protected during the COVID-19 pandemic. Since the trough of the COVID-19 crisis in spring 2020, involuntary savings and positive wealth effects, from equity markets in particular, have shored up the aggregate balance of the household sector. These factors, coupled with possible shifts in preferences and low interest rates, which households expect not to change much in the foreseeable future, have supported house price increases and the further extension of mortgage credit in particular. This effect is likely to have occurred in households that recently experienced a rise in both housing and financial wealth, thus increasing wealth inequality and potentially fuelling the top end of the housing market further.

([1]) IMF, 2021 art IV Sweden Staff Report, https://www.imf.org/en/Publications/CR/Issues/2021/03/24/Sweden-2021-Article-IV-Consultation-Press-Release-and-Staff-Report-50303

House prices in Sweden have risen to record highs irrespective of the economic fall-out from the COVID-19 crisis. Real house prices have on average grown faster than disposable income over the past 25 years as supply fell short of demand in particular in the fast growing metropolitan regions. The increase of about 200% over this period outpaced house price rises in most other EU countries. After some moderation in recent years, house price growth has picked up again in the course of 2020 and accelerated further in early 2021. There is a clear risk of overvaluation as indicated by house price developments in comparison with disposable income and house rents. The very low interest rate and increase in population have made the overvaluation less visible in the Commission's broader fundamental benchmark. Interest rates are unlikely to decrease further, though, and population growth has been skewed to those with lower income and, hence, less likely to acquire a house given current prices and banks' lending policies

Strong policy action to cushion the economic impact of the COVID-19 pandemic supported housing demand and ultimately house prices. Both direct income support and other measures supported the housing market. Several policy actions in addition to very low policy and mortgage interest rates worked to reduce the cost of house ownership. These included the suspension of the amortisation requirement, a higher ceiling and abolished standard income for deferred capital gains tax, reduced liquidity constraints in the financial system (liquidity support including covered bonds purchases, release of the countercyclical capital buffer, temporary easing of liquidity coverage ratios, encouraging suspension of dividend payments). Health restrictions constrained spending and increased savings at a time when preferences likely shifted to larger living spaces due to increased telework.

However, limited policy steps have been taken to lower housing market imbalances. The Swedish authorities have taken some measures to promote housing construction and housing supply, increase the supply of buildable land, to increase residential mobility and to improve the functioning of the rental market. These include an intensification of the investment support for rental housing and housing for students and amendments to the building and planning act. Several inquiries have been launched to ease administrative procedures or liberalize rent setting.

House price growth is expected to slow, but structural factors fuelling house prices such as a favourable tax treatment and a regulated rental market remain in place. As financial conditions are set to tighten gradually with the projected recovery, while policy stimulus from fiscal and financial supervision would be scaled down, house price growth is expected to reduce. Still, distortions remain in place with a continued tax bias favouring increases in household debt and supporting house prices. Moreover, the rental market still offers limited alternatives to the to-buy market.

The housing market and private debt risk metrics are skewed by the strong policy response to the COVID-19 pandemic. The labour market and household income have received strong support from the Swedish government either directly or indirectly through the support given to employers. In addition, monetary policy has become more accommodative with a large acceleration of money growth (M1 grew at 15.3% y-o-y in 2020, the highest rate in at least two decades and almost double the two-decade-average of 8.0% y-o-y growth) and historically low interest rates. A tapering of the global policy response poses risks of a lagged reaction to the fall-out from the COVID-19 pandemic, e.g. an increase in the debt service burden of households and postponed structural adjustments in the corporate sector to the post-pandemic situation.

The banking sector continues to have sound financial and capital ratios but have a large exposure to housing and commercial property loans. On average Swedish banks have among the lowest non-performing loans ratios in the EU at just under 1.0% in the third quarter of 2020 (1.0% in 2019). The return on equity of banks dropped from 10.6% in 2019 to 0.9% in the first quarter of 2021 as the COVID-19 crisis unfolded before veering back to 3.0% in the second and 5.3% in the third quarter of 2020. Swedish banks benefited from several policy measures in response to the COVID-19 crisis, notably liquidity support and the release of the countercyclical capital buffer, which was lowered from 2.5% to zero on 13 March 2020. However, bank balance sheets remain heavily skewed towards housing and commercial property loans. These are exposed to the risks described above.

Overall assessment

Vulnerabilities associated with household debt and the housing market remained visible throughout the COVID-19 pandemic. Household debt increased in 2020 and credit growth to households strengthened throughout the year. The housing market quickly recovered from an initial drop at the beginning of COVID-19 and house price growth has accelerated as the pandemic continued, further stretching valuations.

Rising house prices and debt from already elevated levels contrast with an economy that has not fully recovered and in which policy support still stands to be unwound. In an adverse scenario, a large and disorderly correction of house prices would lead to a negative interaction between credit and economic growth. This could spill over to other countries in the region through the financial system.

Policy measures are under implementation but have not sufficiently addressed housing debt and house price imbalances. Policy action has been limited although the inquiries raise expectations for future policy changes in particular for the supply side of the housing market. The overall policy framework still provides an incentive for debt accumulation feeding into house price increases. Policy gaps remain for housing-related taxation and for the functioning of housing supply and the rental market.

Table 1.1: **Assessment of Macroeconomic Imbalances Matrix - Sweden**

	Gravity of the challenge	Evolution and prospects	Policy response
	Imbalances (unsustainable trends, vulnerabilities and associated risks)		
Private debt	Sweden continues to have one of the highest levels of private debt in the EU, at 204% of GDP in 2019. High private indebtedness increases the country's vulnerability to macroeconomic shocks, as subsequent deleveraging may lead to sharp corrections in consumption and investment. Household debt is a particular concern; it stood at 176% of disposable income and 89% of GDP at the end of 2019 (about 20 percentage points above the Commission's prudential benchmark, and 15 percentage points above the fundamental benchmark). Households have good repayment ability and assets, but the distribution of debt and assets is uneven and a large part of household assets is exposed to liquidity and/or market risks.	Household debt has grown at a nominal rate in the range of about 5 to 8 % per year since the start of this decade, significantly outpacing GDP growth. As the rate of credit growth by monetary financial institutions to households slowed somewhat in the course of 2018, the household debt ratio stabilised at around 176 % of disposable income and remained at that level in 2019. However, the Riksbank projects that household debt will start to rise again to over 190 % of disposable income by 2022.	The amortization requirement was suspended in April 2020 in response to the pandemic and the related economic crisis. The suspension will expire in September and the FSA has announced that it will not be renewed, thereby reintroducing the amortization requirement again in September 2021. Policy gaps remain regarding the incentives to take on mortgage debt. The full and unconditional tax deductibility of mortgage interest payments and the low ceiling on recurrent property taxation have not been addressed.
	Non-financial corporate debt is relatively high compared to other EU countries, but it is matched by the high value of corporate assets and significant equity cushions. It mainly reflects a large share of international companies. Exposure to external financing is high. Banks' elevated exposure to the commercial real estate market, which might be subject to structural changes due to Covid-19 (broader use of teleworking and online commerce), warrants vigilance.	The corporate debt-to-GDP ratio has started to rise again after a period of 'passive' deleveraging. The ratio stood at 122% of GDP in 2020, up from 115% of GDP in 2019. Relative to gross financial assets debt declined from 80% to 75%.	
	Banks are well capitalised, non-performing loans remain among the lowest in the EU, and profitability is among the highest. These indicators somewhat mitigate, but do not fully offset, risks stemming from high private sector indebtedness. The reliance of Swedish banks on wholesale funding could amplify the impact of a sharp housing adjustment.	Banks are increasingly exposed to the real estate market: loans to households and non-financial corporations holding real estate have increased further, and constitute about four fifths of the major banks' total domestic lending, around three quarters of which is mortgage loans to households. Also, the exposure to the commercial real estate market including through construction firms has increased.	The countercyclical capital buffer was lowered to 0% in response to the crisis. Several other policy actions, including quantitative easing an liquidity support, helped in particular in the first, acute phase of the crisis.
	Swedish banks serve a large share of the market in the Nordic-Baltic region, thus representing a source of possible spillovers in the event of sudden deleveraging needs.	At the same time, the major bank's loan-to-deposit ratios remain among the highest and leverage ratios among the lowest in the EU.	
Housing sector	In spite of moderation in recent years, Swedish house prices continue to appear significantly overvalued. Price-to-income and price-to-rent ratios were about 36-53 % above their long-term average as of end-2020. A model-based estimate suggests prices are slightly below fundamentally justified levels (but this partly reflects	House prices have grown almost steadily over the last 20 years. After peaking at 12 % in 2015, real house price growth started tapering out, slowing to 7.4 % in 2016 and 4.8 % in 2017, and decreasing by 3.3% in 2018. In 2019, house prices have broadly stabilised and in 2020 they had recovered to stand 3.0% higher than a year earlier.	The authorities have taken several measures. Demand side measures amount to the suspension of the amortization requirement and raised ceiling on deferred capital gains from SEK 1.45 million to SEK 3 million in combination with the abolishment of the interest payments on the amount of the capital gains deferred. Supply side measures taken have been the

(Continued on the next page)

Table (continued)

exceptionally low interest rates and population growth). These valuation gaps are among the highest in the EU. The overall valuation gap stood at 28.4% at the end of 2020.

High house prices are driven structurally by a combination of structural bottlenecks to housing supply, especially in the main urban areas, combined with favourable tax treatment of home ownership and mortgage debt.

Overvalued house prices combined with a large mortgage debt stock entail risks of a disorderly correction and adverse consequences for the real economy and potentially the banking sector.

In spite of earlier moderation, prices remain higher than seems justified based on fundamentals, implying risks of a disorderly correction. The latter could be triggered by, for instance, an external shock or a rapid rise in mortgage interest rates.

Housing investment has rebounded sharply over the period of 2013-2017 years, but construction output has started to decline in 2018 in the wake of the house price falls, with further moderation in 2019 and 2020. New housing supply still does not meet overall projected needs irrespective of recent price increases and the strong increase in the value of built land, at a pace above that of the dwellings, suggests buildable land is in scarce supply.

investment support for rental housing and housing for students, amendments to the building and planning act. Several inquiries have been launched with an aim to ease administrative procedures or to liberalize rent setting.

However, policy gaps remain, in particular regarding complex planning and building regulations, revision of municipalities' incentives to support new construction, weak competition in the construction sector and the high level of rent control.

Main takeaways

- Sweden is characterised by important sources of stock imbalances in the form of high household debt associated with elevated house prices, which represents a risk as it exposes Sweden to potential adverse shocks and a possible disorderly correction with harmful implications for the real economy and the banking sector and possible spill-over effects to countries with a strong presence of Swedish banks.
- Household indebtedness has increased at a rate of 5-8% per year in nominal terms. Household indebtedness as share of disposable income has increased in 2020 and is likely to continue increasing going forwards. After the correction and stabilisation over 2017-2019, house prices have gradually recovered and are set to increase further to above levels that appear overvalued.
- Policy measures have still not sufficiently addressed housing debt and house price imbalances. Irrespective of policy actions and the inquiries started, the overall policy framework still provides an incentive for debt accumulation feeding into house price increases. Still policy gaps remain for housing-related taxation and for the functioning of housing supply and the rental market.

Source: European Commission Services

Table 1.2: **Selected economic and financial indicators, Sweden**

	2004-07	2008-12	2013-18	2019	2020	forecast 2021	2022
Real GDP (y-o-y)	3.8	0.7	1.4	1.4	-2.8	4.4	3.3
Potential growth (y-o-y)	2.7	1.8	1.3	1.8	1.0	1.4	1.6
Private consumption (y-o-y)	3.3	1.7	2.6	1.2	-4.7	3.8	5.5
Public consumption (y-o-y)	0.5	1.4	0.6	0.3	-0.5	5.0	-1.9
Gross fixed capital formation (y-o-y)	6.9	-0.5	4.0	-3.1	0.6	2.0	3.6
Exports of goods and services (y-o-y)	7.7	0.8	3.3	4.8	-5.2	7.8	4.4
Imports of goods and services (y-o-y)	7.5	1.2	4.2	1.3	-5.8	6.8	3.7
Contribution to GDP growth:							
Domestic demand (y-o-y)	3.2	1.0	1.4	-0.2	-2.1	3.5	2.8
Inventories (y-o-y)	0.1	-0.1	0.1	-0.1	-0.8	0.2	0.0
Net exports (y-o-y)	0.5	-0.1	-0.1	1.6	0.0	0.7	0.5
Contribution to potential GDP growth:							
Total Labour (hours) (y-o-y)	0.6	0.7	0.5	0.5	0.2	0.4	0.5
Capital accumulation (y-o-y)	0.7	0.6	0.5	0.8	0.4	0.5	0.5
Total factor productivity (y-o-y)	1.4	0.5	0.3	0.5	0.4	0.5	0.6
Output gap	1.7	-1.6	-0.7	-0.2	-4.8	-2.5	-1.4
Unemployment rate	6.8	7.8	7.3	6.8	8.3	8.2	7.5
GDP deflator (y-o-y)	1.4	1.7	1.8	2.7	1.4	1.6	1.8
Harmonised index of consumer prices (HICP, y-o-y)	1.3	1.9	0.8	1.7	0.7	1.8	1.1
Nominal compensation per employee (y-o-y)	4.0	3.0	1.7	3.2	2.3	2.2	2.5
Labour productivity (real, person employed, y-o-y)	2.9	0.3	0.3	0.8	-1.5	.	.
Unit labour costs (ULC, whole economy, y-o-y)	1.1	2.8	1.7	2.4	3.9	-1.6	0.5
Real unit labour costs (y-o-y)	-0.3	1.0	-0.1	-0.2	2.5	-3.2	-1.3
Real effective exchange rate (ULC, y-o-y)	-0.3	1.2	-1.5	-4.1	.	.	.
Real effective exchange rate (HICP, y-o-y)	-0.8	0.0	-2.1	-3.8	3.1	3.9	-0.8
Net savings rate of households (net saving as percentage of net disposable income)	4.7	10.3	13.2	16.1	17.6	.	.
Private credit flow, consolidated (% of GDP)	12.7	7.8	7.8	9.9	11.7	.	.
Private sector debt, consolidated (% of GDP)	153.3	190.5	196.6	204.2	217.2	.	.
of which household debt, consolidated (% of GDP)	61.3	75.1	84.7	88.9	95.3	.	.
of which non-financial corporate debt, consolidated (% of GDP)	92.1	115.4	112.0	115.2	121.9	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	.	0.9	0.9	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	4.3	2.0	-1.7	-2.4	0.8	1.3	0.9
Corporations, gross operating surplus (% of GDP)	25.4	24.5	23.8	23.8	23.9	25.2	25.0
Households, net lending (+) or net borrowing (-) (% of GDP)	0.5	3.9	5.4	6.9	7.7	8.0	6.3
Deflated house price index (y-o-y)	10.1	1.5	9.6	0.5	3.0	.	.
Residential investment (% of GDP)	3.9	3.7	4.7	4.7	4.9	.	.
Current account balance (% of GDP), balance of payments	7.1	6.1	3.8	5.1	5.2	5.8	6.5
Trade balance (% of GDP), balance of payments	6.7	5.2	3.5	4.1	4.1	.	.
Terms of trade of goods and services (y-o-y)	-0.4	-0.1	-0.3	0.7	0.7	0.0	0.5
Capital account balance (% of GDP)	-0.2	-0.2	-0.1	0.0	0.1	.	.
Net international investment position (% of GDP)	-11.8	-8.9	-3.5	17.6	17.9	.	.
NENDI - NIIP excluding non-defaultable instruments (% of GDP) (1)	-21.4	-22.1	-18.2	-7.9	-2.8	.	.
IIP liabilities excluding non-defaultable instruments (% of GDP) (1)	122.5	153.3	163.4	146.2	144.3	.	.
Export performance vs. advanced countries (% change over 5 years)	6.5	-5.8	-8.6	-5.3	8.2	.	.
Export market share, goods and services (y-o-y)	-0.7	-4.3	-1.2	1.8	5.2	-0.1	-0.9
Net FDI flows (% of GDP)	2.3	2.5	2.5	1.0	0.9	.	.
General government balance (% of GDP)	1.9	0.0	-0.2	0.6	-3.1	-3.3	-0.5
Structural budget balance (% of GDP)	.	.	0.2	0.7	-0.4	-1.9	0.2
General government gross debt (% of GDP)	44.9	38.2	41.2	35.0	39.9	40.8	39.4
Tax-to-GDP ratio (%) (3)	46.2	43.5	43.7	43.7	43.6	43.4	43.9
Tax rate for a single person earning the average wage (%) (4)	30.3	25.4	24.9	24.5	24.7	.	.
Tax rate for a single person earning 50% of the average wage (%) (4)	26.0	20.4	20.1	19.6	19.7	.	.

(1) NIIP excluding direct investment and portfolio equity shares
(2) domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
(3) The tax-to-GDP indicator includes imputed social contributions and hence differs from the tax-to-GDP indicator used in the section on taxation
(4) Defined as the income tax on gross wage earnings plus the employee's social security contributions less universal cash benefits, expressed as a percentage of gross wage earnings
Source: Eurostat and ECB as of 2021-05-05, where available; European Commission for forecast figures (Spring forecast 2021)

2. THEMATIC ISSUE: HOUSEHOLD DEBT AND HOUSING MARKET

Household debt entering the COVID-19 crisis

The ratio of household debt to GDP in Sweden has been increasing almost continuously for a decade, and the ratio of debt to gross disposable income is amongst the highest in the EU. The ratio of household debt to GDP has increased from an average of 60% in the period 2003-2007 to 89% in 2019 (Table 2.1 and Graphs 2.1(b)). Household debt liabilities comprise mostly long-term bank debt (Graph 2.1(a)) and the accumulation of debt has been mostly related to a dynamic flow of credit transactions (Graphs 2.1(c)). The household debt stock in 2019, at 89% of GDP, was significantly above the prudential and the fundamentals-based benchmarks (Graphs 2.1(b)). The household debt to household gross disposable income reached 176% in 2019.

On aggregate, the household sector holds a significant stock of assets, with currency and deposits covering close to 50% of debt liabilities, but the distribution of these assets and liabilities is skewed. The ratio of debt to gross financial assets was roughly 27% in 2019 (Table 2.1). Household currency and deposits amounted to 42% of GDP in 2019 and are estimated to have increased in 2020. Non-performing loans have been low at around 1.5%. Non-performing loans have been low, at around 1.0%. The positive aggregate numbers, however, need to be nuanced from the perspective of their distribution. A significant share of the gross financial assets of households corresponds to insurance and pensions, while another one is covered by equity (including tenant-owner rights) and investment fund shares, which are typically less liquid (Graph 2.1(e)). ([2]) In addition, the distribution of liquid assets appears to be skewed also with households with the largest interest expenses having the least liquid assets. ([3])

Credit developments and repayment capacity

Net bank lending to households in percent of GDP increased in 2020, also given the possibility of payment breaks, and the output contraction. Net bank credit transactions have been overall positive in 2020 and are increasing in 2021, adding to the stock of bank debt (Graph 2.2(a)). Most of the increase in lending is observed in mortgage debt, which represents the largest share of household bank debt (Graph 2.1(f)). A temporary exemption from amortisation payments was introduced in April 2020 to allow households with mortgages greater buffers in uncertain times. As of January 2021, a total of 230,000 households in the banks' mortgage portfolios had been granted a temporary exemption. In a sample of new borrowers in 2020 of Finansinspektionen covering the major banks, roughly 9 per cent had applied for and been granted exemption from amortising all or parts of their new mortgages. For the new borrowers in the sample, the gain was on average SEK 4,500/month. ([4]) Given the better outlook for the Swedish economy, the exemption will expire on 31 August 2021. The interest burden of households remained low in 2020, close to the average costs in the euro area (Graph 2.2(b)).

The household debt-to-GDP ratio is forecast to increase in 2020, owing to the positive net credit transactions and the negative GDP growth. The ratio of debt-to-GDP of the household sector is estimated to increase to 95% in 2020, owing to positive net credit flows (transactions) and to the positive GDP growth (Table 2.1 and Graph 2.1(c)).

Household debt to disposable income is also estimated to increase further, while the household saving ratio, although relatively high, has not increased markedly. Household income in 2020 has been supported by a range of government measures and has remained fairly stable in 2020. However, given the positive net credit transactions, the ratio of household debt to gross disposable income is

([2]) On the classification of tenant-owners rights see https://www.scb.se/contentassets/99af4dcf7296448db1386574e1aa6b9b/mis2014-1.pdf

([3]) https://www.fi.se/contentassets/d1254aa424dc4ccdbd21bcc01dff44db/fi-analys-28-hushalls-tillgangar-sammanfattn-eng.pdf

([4]) https://www.fi.se/contentassets/1f11d50883754a7da8c217457e154d46/den-svenska-bolanemarknaden-2021-summary-eng.pdf estimated to increase by 10 pps to 186% of GDP in 2020. The household savings rate is relatively high in Sweden, having increased to close to 18% of gross disposable income in 2019, and increasing further in 2020.

New borrowers take on large mortgages relative to value and income, possibly reflecting an optimism bias in house price growth expectations, particularly among younger generations. Younger generations in the housing market have not experienced severe house price declines, but rather mostly house price growth and steady declines in the interest rate. Graph 2.2(b) shows the realized annual changes in house prices and the long-term benchmark yield. Housing market and interest rate developments have been benign for recent buyers. In particular groups that entered the housing market since 2005 have encountered the highest average house price increase (6.0%) and the lowest volatility in house prices (standard deviation of 4.7%). ([5]) In contrast, all buyers have experienced annual declines in the nominal interest rate of some 0.3% per annum. As a consequence, the younger generation of home buyers may be prone to an optimism bias. Hjalmarsson and Österholm (2019, 2020) indeed find that the youngest age groups have the most optimistic expectations for both house price and interest rate developments. ([6]) Finansinspektionen reports that new mortgage owners continue to take on larger mortgages with both the loan-to-value and the loan-to income ratios increasing in 2020. ([7]) Finansinspektionen shows that new the youngest age groups have loan-to-value ratios of 84% (18-30 years) and 77% (31-50 years). These are much higher than for older groups. At the same time, there are indications that households with large loans tend to have limited liquid buffers to accommodate interest rate changes while being most exposed to changes in income. ([8]) Already at very low levels and with a large expansion of the Riksbank's balance sheet realized, nominal mortgage rates are unlikely to decline further and are rather likely to increase, leading to an increase in future interest payments and a possible decline in real house prices.

Housing Market

Despite the COVID-19 crisis, house price growth has accelerated over recent months, driving prices to new all-time highs. The house price increase and the increase in mortgage credit has been unusual given the decline in disposable income and the marginal decrease only in mortgage rates (Graph 2.2(c)). The divergence in prices for apartments and detached/semi-detached houses has also been notable. Semi-detached and detached houses increased at their fastest rate on record according to the HOX Valueguard index in February (20.3% y-o-y; average annual growth rate since 2005 is 5.8%), whereas apartment prices grew at a rate (8.0% y-o-y) just above average (7.4% y-o-y).

Several factors might explain the run-up of house prices and the divergence between houses and apartments, but evidence is still inconclusive. Structural factors ([9]) have been driving up house prices and, in tandem, household debt (a non-functioning rental market and taxation favouring housing investment). As a sign of the misalignment between rents and prices, rent inflation since 2010 has been considerably lower than that of prices (Graph 2.2(f)). Construction has been falling behind demand for a number of years and slowed down considerably in 2019 (Graph 2.2 (e)). As a sign of demand, the value of buildable land for housing purposes reached its highest point since 1980 (Graph 2.2 (f)). Additional factors are needed to explain the recent spurt in house prices and the divergence between apartments and detached/semi-detached houses. Factors that could explain part of the surge are the additional increase in the already high savings rate and changes in preferences. ([10]) In addition, the changes to the capital gains taxation has freed up additional equity for existing homeowners, in particular for those having gained most from earlier house price growth – possibly allowing them to advance to a detached or semi-detached house. The temporary suspension of the amortization requirement might have provided further support to housing demand.

([5]) The lower bound of the 95% confidence interval since 2005 has been a nominal price rise of 3.1% against 0.6% for the full sample.

([6]) Hjalmarsson, E. and P. Österholm (2020), "*Heterogeneity in households' expectations of housing prices – evidence from micro data*", Journal of Housing Economics, Vol. 50, December 2020; and Hjalmarsson, E. and P. Österholm (2019), "*A micro-data analysis of households' expectations of mortgage rates*", Economics Letters, Vol. 185, December 2019.

([7]) Finansinspektionen, The Swedish Mortgage Market (2021), https://fi.se/en/published/reports/swedish-mortgage-reports/the-swedish-mortgage-market-2021/

([8]) Finansinspektionen Analysis nr 28, "Liquid assets of Swedish households", 21 January 2021

([9]) See, European Commission (2020), *Country report Sweden 2020*

([10]) See Riksbank's Monetary Policy report of April 2021 for a first analysis into these drivers.

Valuation gaps had stabilised in 2019 but as the increase in prices picks up steam, the risks of overvaluation re-emerge. The price-to-income gap was 31.9% in 2019 (Graph 2.2(f)), the highest in the EU. The number of years of income needed to buy an average dwelling is relatively high at 10 years and growing, and internal benchmark metrics point to overall overvaluation (Table 2.2. and Graph 2.2 (d)). Residential investment has declined from 2017 to 2029, but resumed an upward path in 2020 (Graph 2.2 (e)) and house price growth is forecast to decline in 2021 (0.2% nominal).

Table 2.1: **Household debt indicators, Sweden**

	Source	2003-07	2008-12	2013-18	2019	2020	2021f	20Q1	20Q2	20Q3	20Q4
Stocks											
Debt, consolidated (% of GDP)	*(a,d)*	60	75	84	89	95		90	92	93	95
Debt, consolidated (% of potential GDP)	*(a,b,d)*	60	74	84	89	91		89	90	90	91
Prudential threshold (% of GDP)(1)	*(c)*	47	54	67	72	68	68				
Fundamental benchmark (% of GDP)(1)	*(c)*	58	66	72	74	79	79				
Debt (% of gross disposable income)	*(a,b,d)*	130	151	167	176	186		178	181	183	186
Interest paid (% of gross disposable income) (3)	*(a,b)*	3.9	3.8	1.7	1.7	1.6		1.6	1.6	1.5	
Debt (% of gross financial assets)	*(a,d)*	30.3	33.6	29.5	27.6	26.9		29.7	28.3	27.2	26.9
Share of variable rate loans for house purchase (%)	*(d)*	61.6	71.9	79.9	66.8	61.6					
Domestic loans in forex (% of dom. loans)	*(d)*	0.1	0.1	0.1	0.1	0.1					
Flows											
Credit flows (transactions, % of GDP) (4)	*(a)*	5.4	4.7	4.8	4.4	5.1	1.0	1.1	1.3	1.2	1.5
Benchmark for flows (% of GDP)	*(c)*	3.9	3.7	3.5	3.6	3.5	3.3				
Savings rate (% gross disposable income)	*(b)*	7.7	13.1	15.6	18.5	20.1	20.4				
Investment rate (% gross disposable income)	*(b)*	6.7	6.0	6.3	6.5	6.5	6.1				
p.m. Bank HH NPLs (% of HH loans) (2)	*(d)*			*1.3*							

(f) European Commission forecast
(1) Benchmarks for flows (% of GDP) are estimated on the basis of non-consolidated flows.
(2) Gross non-performing bank loans and advances to Households and non profit institutions serving households (% of total gross bank loans and advances to Households and non profit institutions serving households).
(3) Quarterly data is annualized.
Sources: (a) Eurostat, (b) Ameco, (c) European Commission calculations, (d) ECB.

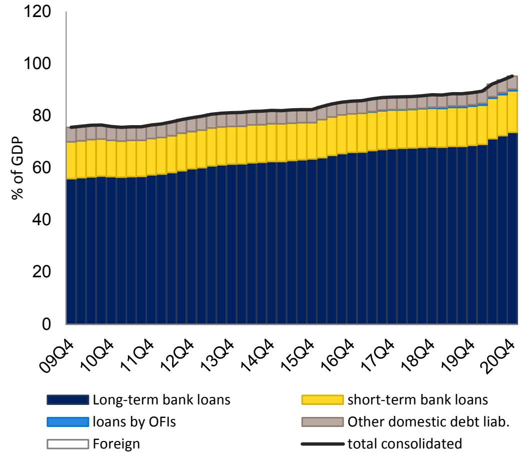
Table 2.2: **Selected housing indicators, Sweden**

	Unit	Source	2003-07	2008-12	2013-17	2018	2019	2020	20Q1	20Q2	20Q3	20Q4
House price developments												
Real house price, yoy growth	%	(a)	9.0	1.6	7.4	-3.3	0.5	3.0	2.8	2.2	2.5	4.5
Nominal house price, yoy growth	%	(a)	10.1	3.2	8.5	-0.9	2.5	4.2	4.5	3.3	3.7	5.3
Price to income in level [1]	years	(b)	7.5	8.2	9.7	10.4	10.2	10.7	10.6	10.1	11.2	10.9
Valuation gaps												
Price to income gap [2]	%	(c)	-4.4	4.8	23.6	32.1	29.9	36.3	34.5	34.9	36.5	39.0
Price to rent gap [2]	%	(c)	-12.4	6.8	32.1	48.7	49.7	53.1	52.4	52.2	53.1	54.8
Model valuation gap [3]	%	(c)	-3.4	-3.8	1.5	-3.0	-5.6	-4.1	-4.1	-5.9	-4.9	-1.7
Average house price gap [4]	%	(c)	-6.7	2.6	19.0	25.9	24.7	28.4	27.6	27.1	28.2	30.7
Housing credit												
Mortgages (% GDP)	%	(d)	40.2	55.7	63.0	67.9	69.5	76.8				
Mortgages, yoy growth	%	(d)	12.2	10.1	4.2	1.3	3.1	10.1				
Housing supply												
Residential construction - dwellings (% GDP)	%	(e)	3.7	3.7	4.7	5.2	4.7	4.9				
Residential construction - dwellings, yoy growth	%	(e)	9.8	-4.6	11.0	-6.4	-7.9	2.3				
Non-residential construction (% GDP)	%	(e)	4.8	5.4	5.3	5.9	6.0	6.0				
Value added in the construction sector, yoy growth	%	(e)	6.2	-0.7	3.0	2.3	3.3	1.1				
Building permits, yoy growth	%	(a)	15.8	-1.8	21.9	-16.6	-10.2	9.5				
Number of transactions, yoy change	%	(f)	5.1	-2.5	2.9	-4.8						
Other housing market indicatos												
Share of owner-occupiers, with mortgage or loan	%	(a)	54.0	57.9	56.4	51.7	51.4					

(') Forecast. The forecast of house prices is computed on the basis a housing valuation model shared with Member States in the context of the EPC LIME working group. The forecasts represent real house price percentage changes expected based on economic fundamentals (population, disposable income forecast, housing stock, long-term interest rate, and the price deflator of private final consumption expenditure), as well as the error correction term summarising the adjustment of prices towards their long-run relation with fundamentals. The source for the forecast of other variables is Ameco.
(1) Price to income in level is the number of years of income necessary to buy an assumed 100m2 dwelling. See Bricongne, J-C, A Turrini, and P Pontuch, 2019, "Assessing House Prices: Insights from HouseLev, a Dataset of Price Level Estimates", Discussion Paper 101, European Commission, available in "https://ec.europa.eu/info/publications/assessing-house-prices-insights-houselev-dataset-price-level-estimates_en".
(2) Price to income and price to rent gaps are measured in deviation to the long term average (from 1995 to the latest available year).
(3) The model valuation gap is estimated in a cointegration framework with nominal house prices as the dependent variable and five fundamental explanatory variables: total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure. See Philiponnet and Turrini, Assessing House Price Developments in the EU (2017) available in "https://ec.europa.eu/info/publications/economy-finance/assessing-house-price-developments-eu_en" and revision notes presented to LIME in October 2019 and June 2020.
(4) The average house price gap is the simple average of the price-to-inome, price-to-rent and model valuation gaps.
Source: (a) Eurostat, (b) OECD, (c) European Commission calculations, also based on national sources, (d) ECB, BIS, (e) Ameco

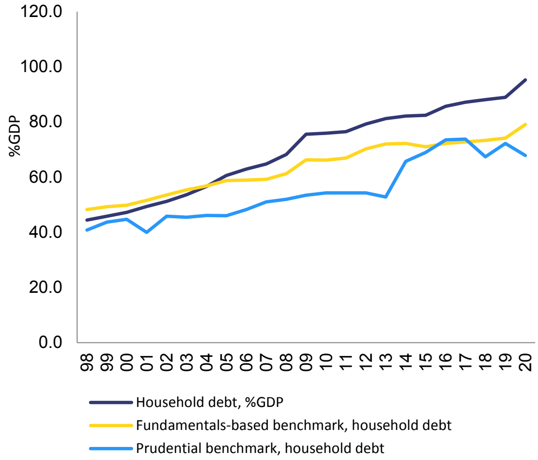
Graph 2.1: **Thematic Graphs: Household debt and housing**

(a) Household debt liabilities by creditor



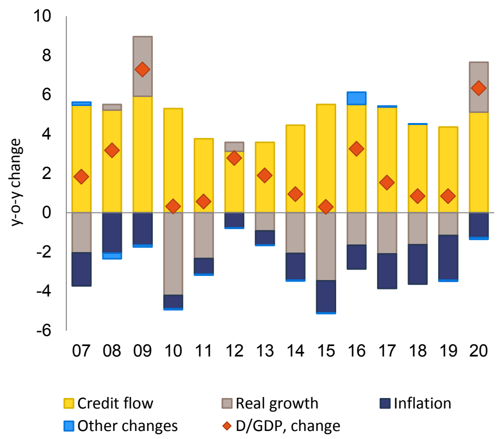
Source: Calculations based on Eurostat and ECB

(b) Household debt and benchmarks



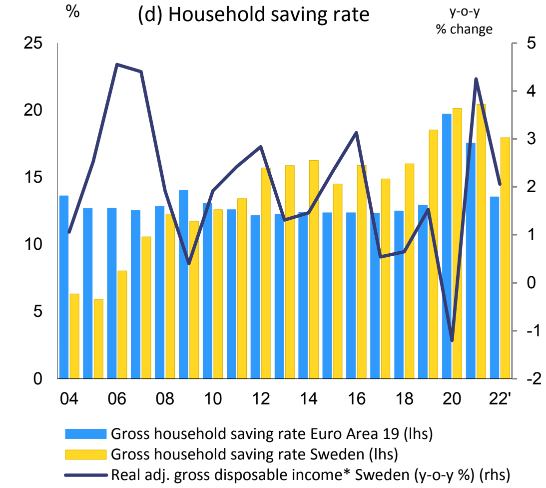
Source: Eurostat and European Commission

(c) Decomposition of household debt flows



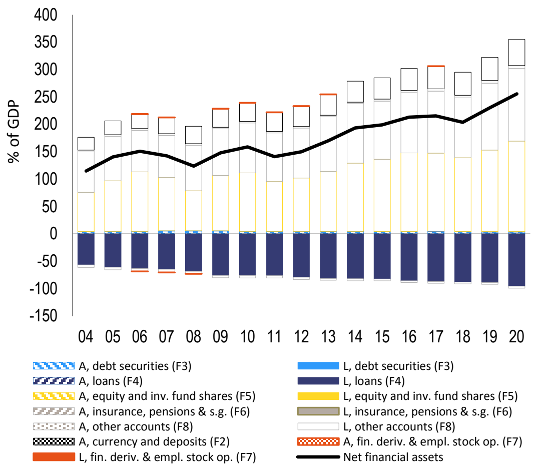
Source: Eurostat and Ameco

(d) Household saving rate



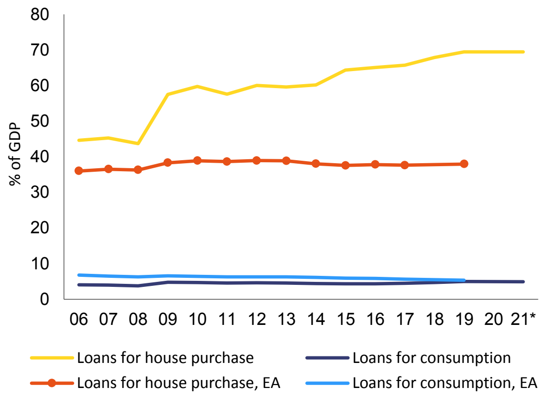
Source: Eurostat

(e) Household balance sheets



Source: Eurostat

(f) Bank loans to households by type

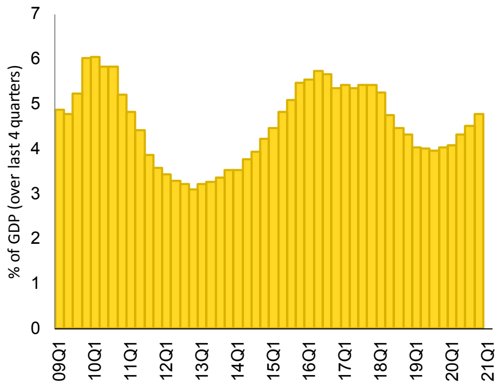


Source: ECB BSI

Source: European Commission Services

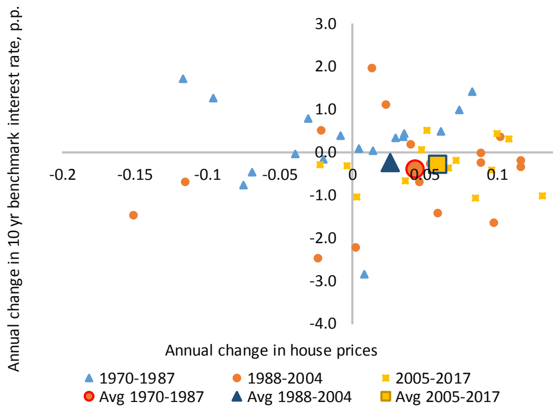
Graph 2.2: Thematic Graphs: Household debt and housing (cont.)

(a) Bank loans to households (net flows)



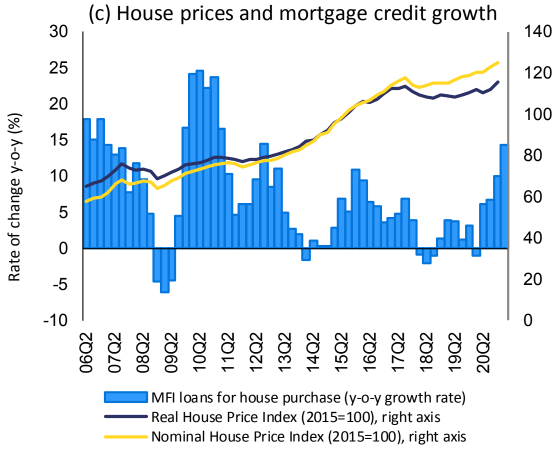
Source: ECB BSI

(b) Changes in house prices and interest rates



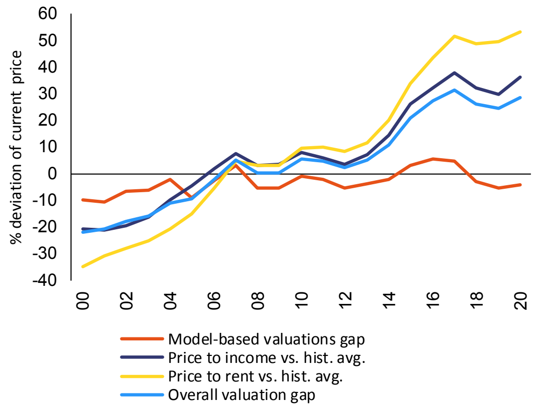
Source: Den svenska bolånemarknaden 2021

(c) House prices and mortgage credit growth



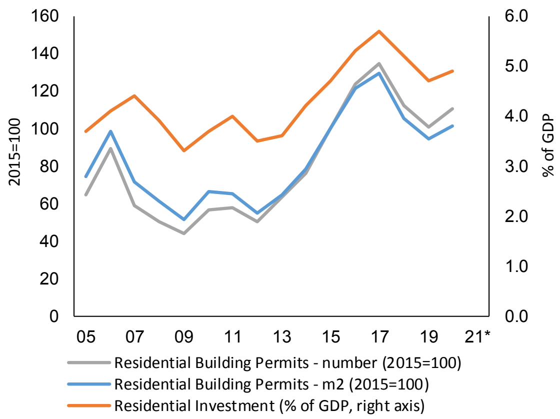
Source: ECB Bank Lending Survey

(d) House prices valuation gaps



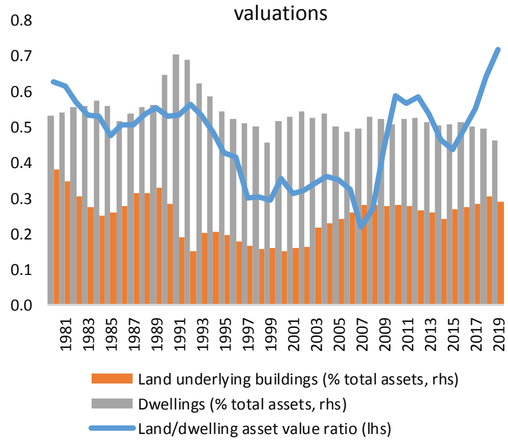
Source: ECB Bank Lending Survey

(e) Residential Investment and building permits



Source: Calculations based on Eurostat, ECB

(f) Land and dwellings shares in total assets and valuations



Source: Macrobond/SCB. Total assets include financial and non-financial assets.

Source: European Commission Services