



- [Sweden 'outshines the troubled euro zone'](#)

After a long period of strong growth coupled with low debt and inflation, Sweden's economy face a cloudy future, the International Monetary Fund said in an outlook.

Summery of the report:

- Growth set to slow sharply from 4 percent in 2011 to 1 percent in 2012
- Growth prospects in major trading partners in question; krona strengthening
- Despite some strengths, the financial sector remains a concern

For years, Sweden has achieved strong growth coupled with low debt and inflation.

Recovery from the 2008 crisis was V-shaped, thanks to a fast recovery in key export markets and a decisive domestic policy response—with output at end-2011 up some 10 percent from its trough. But the outlook for growth is now clouded as two-thirds of the nation's exports and much of the banking sector's lending go to Europe, the IMF said in its regular assessment of the Swedish economy.

Sweden's record was largely built on strong policy frameworks in the context of a buoyant global economy. But the country surprised markets when GDP contracted 1.1 percent in the fourth quarter of 2011 as exports decreased markedly. The IMF estimates that GDP growth will drop from 4 percent in 2011 to 1 percent in 2012, regain steam in midyear, and come in at 2.3 percent in 2013.

Sound public finances

Sweden's economy faces 'cloudy outlook': IMF

Written by Johan Nylander

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Sweden's public finances are among the strongest in Europe. Sweden's fiscal position went from a minor deficit in 2010 to a small surplus in 2011. The government anticipates a small budget deficit for 2012. Fiscal rules target a 1 percent of GDP surplus across the business cycle. The debt in 2011 is estimated at around 37 percent of GDP.

In 2011, inflation averaged around 3 percent and fell below 2 percent in the first quarter of 2012. Inflation is expected to remain contained and stabilize around the 2 percent target.

The economy's strong fundamentals are proving a mixed blessing as Sweden continues to attract sizeable safe-haven flows. Though the country has not yet been affected to the same extent as Japan or Switzerland, these inflows have recently taken the krona to historic highs vis-à-vis the dollar and euro, further curbing export prospects.

Out of recession

Sweden's recovery from the 2008 global economic crisis was "V-shaped". In 2009, real GDP contracted by 5 percent and then grew by 6.1 percent the following year. Sweden's extensive structural reforms since the early 1990s have strengthened the economy's resilience to shocks and boosted growth and employment.

Unemployment nevertheless remains elevated relative to the immediate pre-crisis period at about 7½ percent. The number of young, older, and long-term unemployed has increased since 2007.

Household confidence is historically low if one excludes the 2008-09 crisis. Still, IMF staff anticipates that activity in 2012 will continue to be sustained by personal consumption.

Main expansionary measures in the budget bill for 2012 include lowering of the VAT rate for restaurant and catering services, extra funding for infrastructure investment, and a package of active labor market measures. To the extent there is fiscal room, the Swedish authorities also propose additional measures to further increase participation in the labor force and strengthen the tax incentives to work. Other measures under consideration include a review of corporate

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taxation, and tax cuts for pensioners. The IMF recommends better targeting of tax and expenditure measures aimed at supporting employment of vulnerable groups, as well as measures to facilitate workers' moves from non-urban to urban areas.

Slowdown effects

The IMF assessment identifies two elements in the Swedish economy that could amplify the effects of the European economic slowdown.

The price-to-income ratios in the housing market are high. The IMF estimates that house prices are 10 percent overvalued, in part because of a lack of residential investment that has pushed up house prices. IMF staff recommends deregulating rental markets and increasing the amount of land available for construction, which could reduce shortages. Deregulation would also help to increase investment in residential property, where Sweden scores among the lowest in the EU.

The central bank raised rates in 2011 from 1.25 percent to 2 percent which helped, together with stricter regulations on loan-to-value ceilings, to cool the housing market. If the housing market inflates, IMF staff recommends that policies to contain speculation-driven investment in housing be used to stabilize prices. The housing market seems to have reached its peak, though, and prices are moderating.

Complex financial sector

The financial sector is large, concentrated, and complex, and relies on short-term wholesale funding. The banking system is more than 5 times the country's GDP. Several countries with large financial systems experienced leaps in public debt during the global crisis.

Though direct exposure to the euro area periphery is low, Sweden's assets are dominated by claims on core euro area countries and the Nordic-Baltic region, both of which are vulnerable to the ongoing crisis in the euro area periphery.

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The financial sector has significant domestic and regional exposure to real estate, with an elevated level of household debt that continues to rise and is now 1.7 times disposable income. Further, house prices are decreasing in a country with a high share of interest-only mortgages but which has so far historically experienced few mortgage losses.

The Swedish authorities are imposing higher capital adequacy rules than in the EU, something that the IMF approves of, stating that “while standard stress tests reassure the resilience of the Swedish banking system, current European circumstances suggest that a shock beyond historical experience could not be disregarded.”

In sum, the Swedish economy is well placed to continue its good performance, but risks have increased, and policymakers will need to remain flexible.