European Commission

ISSN 2443-8014 (online)

# In-Depth Review 2024

## Sweden

INSTITUTIONAL PAPER 277 | MARCH 2024

EUROPEAN ECONOMY

Economic and Financial Affairs

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https://economy-finance.ec.europa.eu/ecfin-publications_en.

Luxembourg: Publications Office of the European Union, 2024

PDF ISBN 978-92-68-13778-9 ISSN 2443-8014 doi:10.2765/210059 KC-BC-24-004-EN-N



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European Commission
Directorate-General for Economic and Financial Affairs

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## Sweden

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This in-depth review presents the main findings of the Commission's staff assessment of macroeconomic vulnerabilities for Sweden for the purposes of Regulation (EU) No 1176/2011 on the prevention and correction of macroeconomic imbalances. It provides technical input to the Commission for the Communication "European Semester – 2024 Spring Package" that will set out the Commission's assessment as to the existence of imbalances or excessive imbalances in Sweden. That Communication will be published in June 2024. The current version has been presented and discussed with the Member States in the Economic Policy Committee of the Council.

This publication reproduces staff working document SWD(2024) 85 final, that was discussed with Member States in the Economic Policy Committee of the Council on 20 March 2024.

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# 1. INTRODUCTION

**This in-depth review (IDR) analyses the evolution of Sweden's vulnerabilities related to the real estate market and high private debt and – possibly - newly emerging risks.** This year's IDR, which follows the 2024 Alert Mechanism Report (AMR) published in November 2023, assesses the persistence or unwinding of the vulnerabilities identified last year, potential emerging risks, and relevant policy progress and policy options that could be considered for the future ([1]).

**Sweden's economy contracted in 2023 due to rising interest rates and high inflation and is set to broadly stabilise in 2024 ([2]).** High inflation and the subsequent monetary policy tightening, combined with the prevalence of variable interest rates and high household debt, pushed down household consumption and housing construction. Housing construction in the rental sector also suffered from the stricter financial conditions for commercial real estate (CRE) companies. Overall investment is estimated to have decreased by 1.2% in 2023, driven by a decline in housing construction.

Altogether, real GDP is estimated to have fallen by 0.1% in 2023. According to the Commission's Winter 2024 interim forecast, GDP is set to increase by 0.2% in 2024, with household consumption and housing investment expected to remain weak. Household budgets, on average, are set to remain tight due to limited real growth in disposable income and higher interest burden, while net wealth is falling. The economy is expected to grow by a modest 1.6% in 2025, when these effects are forecast to fade. Inflation is forecast to decline from 5.9% in 2023 to 1.7% in 2024, before rising to 1.9% in 2025. Unemployment is expected to increase moderately from 7.6% in 2023 to 8.5% in 2025.

Risks to the economy are tilted to the downside with the greatest risks coming from the labour and the real estate markets. If the labour market deteriorates more significantly than currently foreseen, the resulting loss in income and higher level of uncertainty could trigger a less orderly unwinding of remaining vulnerabilities in the real estate market.

**High integration with Germany and some non-EU partners, makes Sweden prone to spillovers resulting from economic developments in these economies ([3]).** The Swedish economy is highly dependent on imports of German and Dutch goods and services, while Germany and the US are major destinations for Sweden's exports ([4]). On external demand, the largest shares of total value added in the Swedish economy are generated to satisfy domestic demand in the US, China and Germany, while Swedish domestic demand is mostly dependent on value added generated

([1]) European Commission (2023), Alert Mechanism Report 2024, COM(2023) 902 final; and European Commission (2023), Alert Mechanism Report 2024, SWD(2023) 901 final.

([2]) Forecast figures for GDP growth and inflation come from the Commission's Winter 2024 interim Forecast (European Economy, Institutional Paper 268). All other forecast data used in the IDR come from the Commission's Autumn 2023 Forecast (European Economy, Institutional Paper 258), unless stated otherwise, and all calculations are carried out using these data to ensure the coherence of their various components. The cut-off date for the data for the preparation of this IDR was 20 February 2024. Actual outturn data that have become available after the Autumn and Winter interim Forecasts, and before the cut-off date for the IDR, are used and supersede figures from those forecasts.

([3]) In the context of the multiple disrupting shocks that affected the world economy and the EU in the past few years, Commission Services have run an exercise to estimate the spillovers and the degree of exposures of Member States' economies to various partners and industries, in terms of nominal trade, value-added trade, inflation and financial assets. See European Commission Institutional Paper 2024 (forthcoming) - Economic spillovers and exposures in the EU.

([4]) Germany and the Netherlands account for 14.1% and 9.9% of Sweden's imports, while Germany and the US account for 8.5% and 8.3% of Sweden's exports, respectively.

in Germany, the US and China. The Swedish economy is highly integrated with the world economy, risking further fall-out in foreign demand than initial trade disruptions would suggest.

# 2. ASSESSMENT OF MACROECONOMIC VULNERABILITIES

**In recent years, Sweden has been marked by vulnerabilities related to the real estate market and to high private debt.** Over the past decade, real estate prices have risen faster than income and rents, accompanied by a rise in private debt. This has exposed the Swedish economy to changes in monetary and financing conditions. The household debt-to-GDP ratio is very high and the debt servicing costs have increased, leaving households and the corporate sector more vulnerable to adverse economic developments. House prices have declined but still remain high. Commercial real estate (CRE) has also seen a correction in its valuation and is an additional source of concern due to its high leverage. The financial sector is highly exposed to real estate but is financially sound with large buffers against adverse developments.

## Assessment of the gravity, evolution and prospects of macroeconomic vulnerabilities

*Private sector debt*

**Private debt has declined over 2022 and early 2023 but remains high.** After peaking at 214% of GDP in 2021, private debt has since been falling, reaching 200% of GDP in 2023. This decline was mainly driven by inflation acting to increase the denominator. Conversely, credit flows continued to raise debt levels but at a slower rate than in earlier years. Private debt had returned to the 2019 relative to GDP by 2023, still well above both the fundamental (135% of GDP) and prudential (120% of GDP) benchmarks (see Table 2.2).

**Non-financial corporations owed the largest share of debt, amounting to 117% of GDP in 2023.** Sweden's non-financial corporate debt-to-GDP ratio remains among the highest in the EU, although it decreased to 120% in 2022. This is still 9 percentage points higher than in 2019. It remained broadly unchanged in the first half of 2023. Credit flows decreased, but remain high, at 7.1% of GDP in 2022. The interest rate burden is high and has recently increased. CRE is a particular source of concern given falling prices and its funding structure. Risks associated with corporate debt outside CRE are mitigated by the high share of cross-border intra-group lending and increasing corporate liquidity buffers.

**The household debt-to-GDP ratio is very high but has been declining since peaking in 2020.** After doubling over two decades, the household debt-to-GDP ratio declined over 2021-2023 on the back of strong nominal output growth (Graph 2.3 b). The debt ratio, though, still remains well above the fundamental benchmark and the prudential threshold (see Table 2.2). Since mid-2022, credit flows to households have also contracted from high levels, following a strong increase in borrowing costs that saw prices decline and transactions drop. Interest rates on new loans for house purchase rose from 1.3% at the end of 2021 to 4.8% by November 2023. The future course of the household debt ratio hinges strongly on the interest rate and the associated credit flow dynamics: as long as credit flows stay as low as they are now, the debt ratio would continue to fall (see also Box 1). If and when credit flows pick up to historic averages, however, the debt ratio will start rising again.

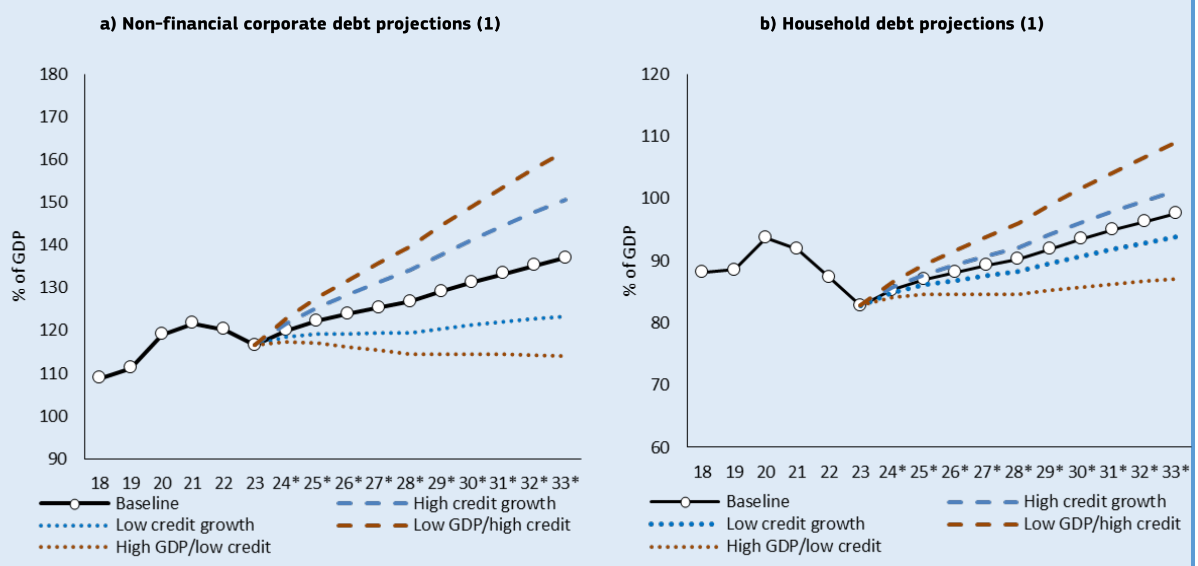
## Box 1: Sweden - Medium-term household and non-financial corporate debt projections

**This Box summarises non-financial corporate (NFC) and household debt-to-GDP projections for Sweden over the next decade, based on scenario analysis to take into account different underlying assumptions.**

**The corporate debt-to-GDP ratio is projected to increase under the baseline scenario by 20 percentage points until 2033, to 137%.** The baseline scenario takes the 2023 forecasts as a starting point and foresees an average real GDP growth of 1.7%, in line with Commission projections, and assumes credit flows of 6.2% of GDP, corresponding to the country-specific median annual credit flow to GDP ratio over 2018-2023, until 2033 (Graph 2.1 a). In this scenario, credit flows would be above the credit-to-GDP ratio that would stabilise the NFC debt ratio over the projection horizon, at 3.9%. Under an adverse scenario of credit flows being 1.6% of GDP higher – corresponding to half the intercile range of the annualised quarterly credit flow to GDP ratio over 2018-2023 – the NFC debt-to-GDP ratio would be 14 percentage points higher. A permanent negative 1% GDP growth shock would increase the NFC debt-to-GDP ratio by another 11 percentage points.

**If credit flows normalise, the household debt-to-GDP ratio is projected to start rising again.** The baseline scenario takes the 2023 debt ratio forecast of 83% as a starting point, and assumes as determining parameters an average real GDP growth of 1.7% and credit flows of 4.4% of GDP, well above the debt-stabilising credit-to-GDP ratio of 2.8%) for the period 2024-2033. It projects that the household debt ratio will resume its rising trend observed over the last two decades before the interruption in recent years on the back of strong passive deleveraging and plummeting credit flows as of mid-2022, reaching 97.5% 2033 (Graph 2.1 b). Graph 2.1 b considers alternative scenarios on credit flows that account for observed country-specific variabilty in credit flows since 2018 and permanent GDP shocks of 1 percentage point above or below the baseline scenario. Under the most adverse scenario considered (high credit flows and low GDP growth), the household debt-to-GDP ratio would rise to an all-time high of 109% by 2033.

Graph 2.1: **Private debt projections, based on scenario analysis for Sweden**




(1) For the NFC and HH debt projections, the baseline refers to the country-specific median annual credit flow to GDP ratio over 2018-2023. The high/low credit scenario assumes a higher/lower credit flow to GDP ratio, with the difference to the baseline calculated as half the intercercile range of the annualised quarterly credit flow to GDP ratio over Q1-2018-Q3-2023. The latter is based on the moving sum of quarterly GDP. The high (low) GDP shock scenario reflects a permanent 1 percentage point increase (decrease) in GDP growth.

**Source:** Eurostat, Ameco, Commission services calculations.

**Although household debt has fallen relative to GDP in the last couple of years, the debt service burden has risen.** Despite high inflation in 2023, wage agreements were moderate and wage increases were limited. As a result, real wage growth and growth of real household disposable income growth was negative. At the same time, debt service costs increased sharply due to higher mortgage rates (Graph 2.3 c). Given the mortgage maturity structure, Swedish households are among the most interest-sensitive in the EU. The vast majority of loans have an interest fixation period of less than 1 year and this proportion has increased over time; in mid-2023, 89% of new mortgages had a variable interest rate, up from 69% in mid-2013. As a result, Swedish households' interest payments increased from 3.7% of gross disposable income in Q3-2021 to 7.6% in Q3-2023, leaving Swedish households facing the highest interest payment in the EU ([5]). Moreover, the impact of interest increases varied widely among the population in line with the large differences in debt levels.

**Those having acquired a house more recently are likely to be disproportionately affected by increased debt service costs.** New entrants in the purchase market have larger debt both in nominal and in real terms than earlier purchasers. In its yearly survey of the Swedish mortgage market, Sweden's Financial Supervisory Authority has repeatedly found that younger first-time buyers generally take on higher mortgages relative to their income and relative to the value of the property ([6]). The quadrupling of exceptions from the amortisation requirement granted by banks for individual mortgages, albeit from a very low level, also suggests increasingly difficult conditions for more households ([7]). Among these exceptions, the 31-40 age group is overrepresented – a group that will have little seniority in the housing market.

*Housing market*

**Real estate prices remain high despite recent reductions, but it is currently difficult to assess underlying developments in prices.** Following years of strong increases, house prices have declined 7% in nominal terms since Q2-2022, undoing most of their surge during the COVID-19 pandemic (Graph 2.3 a). The true price development and, hence, the realised correction in house prices is more difficult to assess under current circumstances: with a very low number of transactions it is harder to estimate the average house price because different segments of the housing market probably react differently to changes in demand and supply. This could lead to composition effects, with the most attractive houses selling faster. In any case, house prices still appear to be overvalued and are well above the historic price-to-income ratio and the historic rent developments.

**The number of housing transactions has dropped, as the housing market is adjusting to higher interest rates.** New housing construction dropped sharply and real estate transactions declined strongly during 2022 (Graph 2.3 e). The Swedish National Board of Housing, Building and Planning estimates that about 27 000 homes (including 25 000 new ones) were started in 2023, a decrease of approximately 55% compared to 2022 ([8]). The low number of transactions suggests that the housing market has not yet adjusted fully to the tightening of financial conditions.

**The low number of transactions suggests that the housing market has not yet adjusted fully to the tightening of financial conditions**. Although house prices have fallen, the increase in interest rates that prospective entrants face means that buying a house is still more expensive, now, for new entrants to the housing market than with higher prices but at much lower interest rates, earlier. These new entrants, representing around 30% of housing transactions will, therefore, need to see further price declines or lower interest rates if they are to enter the market on comparable terms

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([5]) As interest receipts also increased, the resulting net interest burden (paid-received) increased from 3.5% to 4.4% of gross disposable income over the same period. Source: ECB Quarterly Sector Accounts: D41G: Interests received by households, before FISIM allocation.

([6]) Finansinspektionen (2023), *The Swedish Mortgage Market 2023.*

([7]) Finansinspektionen (2023), *Financial Stability Report November 2023.*

([8]) https://www.boverket.se/sv/samhallsplanering/bostadsmarknad/bostadsmarknaden/byggprognos/rev-oktober-2023/.

to prior to the interest rates increases (9). In parallel, existing homeowners, that would be eager to adjust their housing consumption in terms of floor space or quality or both, face a shift from a seller's to a buyer's market due to a lack of demand from new entrants. Banks also contribute to the reduction in transactions as they are becoming more cautious and prefer the current home to be sold before a loan is given to finance the acquisition of a new home. Overall, the drop in demand relative to supply, visible in the rising numbers of properties that are for sale, is not yet reflected in house price expectations (10).

**House prices could correct further, risking feedback effects on housing demand.** Households remain, so far, relatively optimistic about future house price developments. This optimism seems to hinge on the expected decline in interest rates outweighing any risks to the economy. A return of price increases does not appear likely for 2024, however, as real disposable income will not have recovered, and the market seems to not yet have adjusted to the interest rate increases (see above paragraph). While continued labour market strength and pandemic-related excess savings have supported household resilience, higher-for-longer interest rates and lower labour demand could trigger a further, more sizeable adjustment in the housing market. Such an adjustment risks igniting feedback effects to the economy that may result in further downward pressure on the economy. The Bank for International Settlements (2023) suggests a relatively high wealth effect of house prices in Sweden with a 10% decline in house prices reducing household consumption by 2% (11). The short interest fixation period, together with high indebtedness, is a major reason for the high wealth effect. This raises the risk of negative feedback loops should the labour market and economy slow more than expected.

**Commercial real estate is also correcting and there are risks of further corrections.** Quote prices for commercial real estate (CRE) have declined some 6% since their peak in 2022, which is somewhat less than the price decline in residential real estate (12). CRE rents are indexed to inflation while vacancies remain low (although they have increased recently), leading to increased cash inflows. These rent increases have provided support to valuations. In parallel, transactions have also declined in the CRE market, complicating the interpretation of quoted prices. However, several CRE companies, notably those with a weak credit rating and/or high leverage, have had difficulties accessing the bond market and the sector as a whole has faced significantly higher financing costs. In particular, lower-rated CRE companies faced difficulty in rolling over funding, forcing some to restructure or sell parts of their portfolio. For others, banks have stepped in with securitised loans, substituting market funding. Vulnerabilities in the CRE market are significant as the text in Box 2 explains.

(9) Swedish government (2022), *Start-up loans to first-time buyers of dwellings,* Report of the Inquiry on Proposal to facilitate first-time buyers in the housing market.

(10) SEB Housing Price Indicator, 11 December 2023.

(11) Bank for International Settlements (2023), *Annual Report.*

(12) Handelsbanken (2023), *The Ins and Outs of Swedish Real Estate,* November 2023.

**Box 2: Sweden - commercial real estate vulnerabilities**

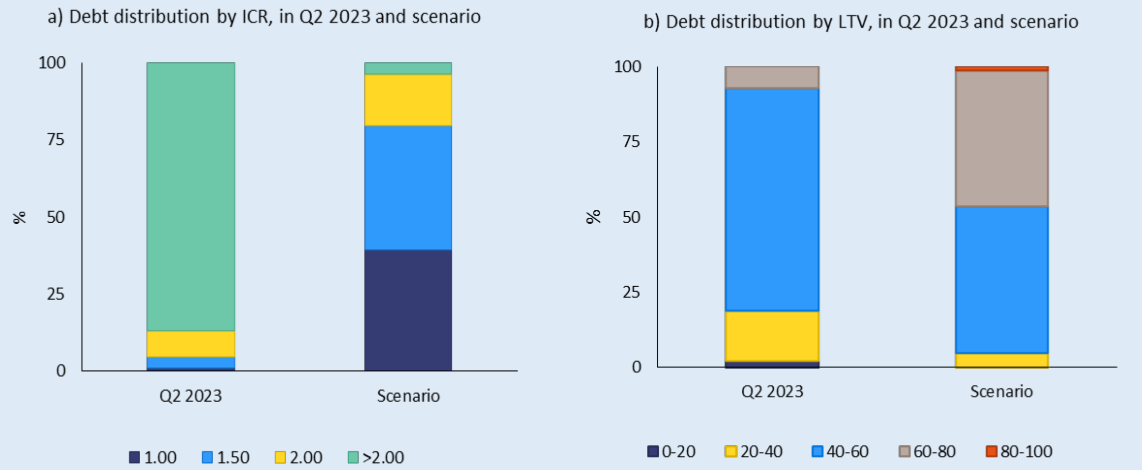
The financial structure of many commercial real estate (CRE) companies depends largely on debt - both bank loans and bonds, making interest one of the main expenditures of these companies. The recent increase in nominal interest rates significantly increased this type of expenditure for CRE companies. This increase is still going on as CRE companies roll over funding. On the income side, however, the developments are positive. The higher inflation has also led to an increase in rental yields, as rents are usually indexed to inflation. Also supporting rental income, vacancies remained low or at least have not picked up, as unemployment remains low. The relation between the main source of income (rents) and interest expenditure for these companies is captured by the interest coverage ratio (ICR) indicator. This ratio is used regularly when assessing the financial soundness of CRE companies. Generally, a ratio of 2 or above is associated with investment grade – an important threshold for funding conditions. Whereas the ICR concerns cash flows, the loan-to-value (LTV) ratio is the benchmark for the leverage on CRE balance sheets. The leverage reflected in the LTV is important as it indicates how much value banks and other fixed income providers can recuperate from a bankruptcy.

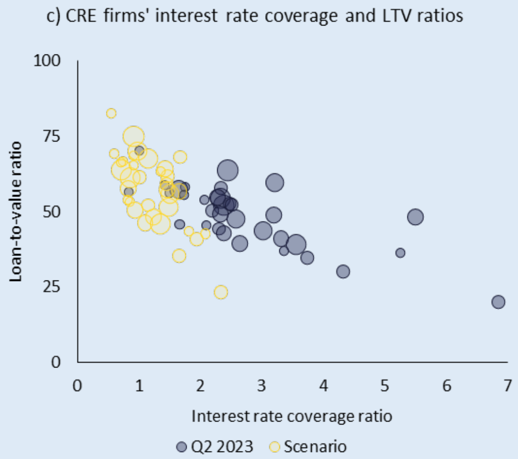
The Swedish financial authorities, Finansinspektionen (FSR 2023, 2) and the Riksbank (FSR 2023:2), have examined the impact of the expected change in CRE prices and interest rates on LTVs and ICRs for the main CRE companies in Sweden. Graphs 2.2 a and c show that in a scenario with 15% lower valuations and interest rates at 6%, the ICR would fall below the investment grade threshold of 2 for almost all CRE companies. CRE companies with ICRs below 1.0 in this scenario are responsible for around 40% of the debt. Furthermore, Graph 2.2 b shows how the shock would impact the respective LTV ratios of the companies. Almost 50% of the debt would be due by companies with an LTV ratio above 60%, which before the synthesised fall in value corresponded to less than 10% of the debt of these companies. The lower ICRs means that some companies could have a difficult time paying back their lenders. Meanwhile the LTVs, although elevated, are still below 100%. This shows that bank loans are relatively less than the value of the collaterals, mitigating the risk for the financial system in case  a fall in prices materialise.

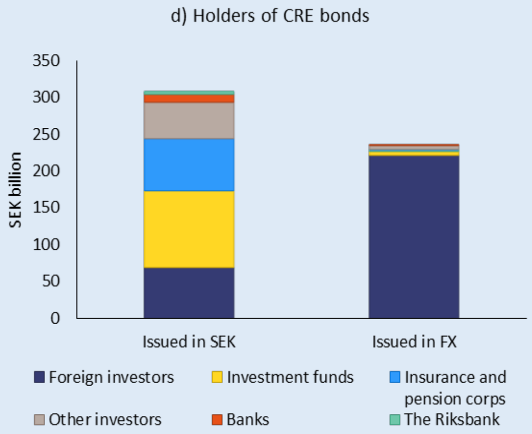
In Q2-2023 Swedish banks had the highest real estate exposure through loans in all of Europe at 20% (see Swedbank, 2023, 'Kommersiella Fastigheters Utsikter'). However, they represent a relatively small share of the holders of CRE bonds (Graph 2.2 d), as investment funds, insurance and pension corporations, and other investors all are larger lenders to CRE companies. The biggest holders of CRE bonds, however, are foreign investors, which would indicate a potential risk for spillover effects into other countries if the sector were to further decline.

The major risk to the CRE market seems to be a more protracted economic downturn which also would affect real estate demand. So far, exceptionally healthy balance sheets of the corporate sector (see the Commission's 2023 Spring Forecast) have allowed for the hoarding of labour and office space. This is unlikely to persist if the downward risks to the economy materialise and unemployment increases faster than currently predicted. Downside risks related to higher-than-expected interest rates could also compound the outlook for Swedish real estate.

Graph 2.2: **Selected CRE indicators**






Graphs a), b) and c) refer to a sample of 34 major property companies as of Q2-2023. The loan-to-value (LTV) ratio is defined as the ratio of total interest-bearing liabilities to total assets and the interest coverage ratio (ICR) is defined as the ratio of operating income to interest expense. The ICR is expressed on a rolling 12-month basis. The size of the bubbles reflects the size of the companies' total interest-bearing liabilities. The graphs compare the ICR and LTV ratio in Q2-2023, to a scenario where property values would fall by 15% and where the ICR is calculated with an assumption that all companies have an average funding cost of 6%, given operating profit and interest-bearing liabilities as of Q2-2023. Graph d) refers to the end of Q3-2023 and is created from merging real estate debt from bonds together with composition of CRE bond holders (CRE companies defined by the Riksbank as companies owning real estate mainly for rental purposes, including office spaces, commercial property, residential property, hotels, logistics and industrial property, which differs marginally from the definition of the real estate sector which has been applied in the data set containing real estate debt from bonds).

**Source:** The Riksbank and European Commission departments.

**Structural factors continue to impede the good functioning of the housing market.** Contrary to some other Member States, Sweden's overall housing stock is larger than the number of households. That means that there is sufficient residential real estate(i.e., number of dwellings) to 'provide a roof' for all households. The housing market is, however, facing a structural deficiency in the form of a mismatch between housing stock and housing needs. This mismatch is affected by geographical and demographic factors, and by the funding and house ownership structures of the market. From a regional perspective, there is an undersupply of buildings close to centres of economic activity. The highest demand for residential real estate is in major cities, where prices have also risen the most in recent years. In more remote areas, demand is lower, except for certain areas in the north of Sweden. In the north a green industry is developing.

In terms of demographics, there is a divide in housing affordability and in the size of housing units, with older households having larger living space per member of the household but low debt service costs, and younger households having less living space and higher debt servicing costs (Graph 2.3 d). Handelsbanken (2023) calculates that newcomers need 3-5 years of savings for the 15% downpayment if not benefiting from a sponsor ([13]). Older generations take up double the floor space of some younger families - both in acquired and in rented housing (SCB) ([14]).

Finally, long-standing issues with rental regulation and misaligned fiscal incentives compound problems in the purchase market. The rental market is split between rentals with rents well below market rents and rentals for which rents are more aligned with market rates. The cheap rentals with high market value have long waiting lists and are therefore not an alternative for younger households. Consequently, these younger households have to resort to higher rents - leaving less to save from their disposable income. While saving and paying higher rents, these households do not receive the tax subsidy on debt-financed housing. Only when acquiring a home can they benefit from mortgage interest deductibility.

([13]) Handelsbanken (2023), *The Ins and Outs of Swedish Real Estate*, November 2023.

([14]) Household finances data for 2022, Statistics Sweden.

**The pro-cyclical construction cycle drives the volatility of the housing market and is likely to result in supply constraints in the near future.** Sweden's housing market is relatively pro-cyclical compared to other Member States. Housing production is relatively price elastic in Sweden (OECD, 2015). As house prices increased over the past decade, and interest rates fell, residential real estate construction increased in 2022 to a level not seen since the early 90s. Quick and unexpected changes to monetary conditions were rapidly integrated into mortgage costs as well as to construction costs, and have led to a drop in both house prices and new production since Q2-2022. According to the latest leading indicators on housing construction, this could result in lower supply in the coming 2 years. If housing market conditions have improved by then, the lower production could put upward pressure on house prices - thus starting a new cycle of housing construction. However, uncertainty about the costs of housing loans could partly counteract this. Policy actions could alleviate these constraints on the Swedish housing market (see below).

*Banking sector*

**The banking sector is financially strong despite its high exposure to the real estate sector.** Swedish banks have seen their profits jump due to an increased interest margin and a low level of non-performing loans. The capital adequacy ratio remains high (although the ratio of unweighted own funds is comparatively low) and deposits are at a high level. The increased interest margin (temporarily) compensates for lower volume growth, which had been the driver of profit growth as the interest margin compressed in the previous decade (Graph 2.3 f). Despite the solid financial metrics, the banking sector's exposure to real estate is large. Around four fifths of banks' lending is linked to real estate, with exposures in relative importance being: (1) mortgages to households, (2) commercial real estate, (3) tenant-owner associations, (4) construction companies, and (5) real estate agents (see European Commission, 2023 ([15])).

According to the European Banking Authority (EBA), 57% of total exposures to non-financial corporations is related to real estate activities (as of September 2023). Whereas mortgages to households are securitised through covered bonds, loans to CRE remain on the banks' balance sheets. These CRE loans on the banks' balance sheets are relatively large. According to the EBA, around 39% of all bank loans to non-financial corporations were CRE-related, which is relatively high compared to other European countries. The ratio of non-performing loans to total loans (NPL ratio) for CRE (0.3%) is, however, by far the lowest of all EU Member States, while provisions are the highest. Macro-prudential requirements mitigate the risks stemming from the real estate sector, including through a risk-weight floor and through a recently raised counter-cyclical capital buffer.

## Assessment of MIP-relevant policies

**Limited steps have been taken to address factors behind the identified macroeconomic vulnerabilities.** Policy action in 2023 has been limited to raising the counter-cyclical capital buffer, announced already in 2022, and some supply-side measures of which the impact cannot yet be judged (see Table 2.2). The macro-prudential tools of loan-to-value cap and the amortisation

([15]) European Commission (2023), *In-Depth Review of the Macro-Economic Imbalances – Sweden.*

requirement have limited household debt accumulation and very likely prevented an even larger impact from the recent, mostly unanticipated, interest increases ([16]).

**The structural drivers that have contributed to high house prices and high indebtedness remain in place.** In particular, the tax expenditures promoting debt-financed housing acquisition and low recurrent property taxation have not been addressed. As a result, tax expenditures due to higher tax deductions are implicitly borne by all taxpayers, including those renting and/or saving to buy their first house and the benefits accrue to sellers. The preferred policy option is to phase out the mortgage interest deductibility, but a partial improvement could still occur if these tax expenditures were recalibrated so as to be restricted to reduce overall fiscal costs and market distortions. For instance, tax deductibility could be linked to the purchase price of the first house bought. Sweden has a comparatively low recurrent property tax level. Mobility in the housing market would be supported by raising housing costs for cohorts occupying larger floor space. An increase in recurrent property taxation linked to housing consumption based on floor space per household member would limit the incentive to overconsume housing and promote mobility. The European Commission (2022, IDR) has flagged the issue of foregone tax revenues as a consequence of low recurrent property taxation ([17]).

**A range of policy measures could help to address high real estate prices and high private indebtedness.** Measures that increase supply in housing and reduce debt-driven housing demand could address both high real estate prices and high private indebtedness in Sweden. Earlier IDRs have concluded that reforms aimed at limiting mortgage interest deductibility, to reform the rental market to bring the rents of the older stock of rental housing closer to market rents and raise recurrent property taxation by increasing the cap and by adjusting the reference value more frequently, would likely be effective policy measures to address the vulnerabilities. New policy challenges have emerged in recent years. The debt of tenant-owner associations, mortgaged on the multi-family dwellings occupied by the tenant-owners, do not fall under prudential regulations for mortgage cap on the loan-to-value and the amortisation requirement. Consequently, as last year's IDR pointed out, tenant-owners of apartments indirectly hold more debt than their individual loan suggests.

Recent experience has shown that the debt servicing costs of tenant-owner associations can lead to large and unexpected swings in housing costs, similar to and in tandem with mortgages held by households. Including the debt of these tenant-owner associations under macro-prudential thresholds could help prevent excessive debt servicing costs (with a view to protecting consumers) that are unanticipated because of overly optimistic expectations on repayment capacity. However, is it not only the high level of debt that makes the broad group of indebted homeowners vulnerable to changing financing conditions. These indebted homeowners also have very short interest fixation periods. One factor holding back a lengthening of fixation periods is the compensation fee that needs to be paid to the bank in case the period for which interest rates of a loan are fixed is extended, e.g. moving from a variable interest rate to a 2-year fixed interest rate. The inquiry into adjusting this interest compensation fee has recently presented its finding ([18]), a first step in introducing a policy to reduce the interest rate sensitivity of households.

The earlier-identified need for a database with individual wealth data ([19]) still persists. Such a database is needed to assess the impact of policy changes across the wealth distribution. Other

([16]) Finansinspektionen (2017), *Amortisation requirement has reduced household debt",* FI Analysis nr 10, 6 April 2017; Finansinspektionen (2021), *Overall assessment of macro prudential measures,* 30 June 2021.

([17]) European Commission (2022), *In-Depth Review of the Macro-Economic Imbalances – Sweden.*

([18]) [Utredning om ändrade regler för beräkning av ränteskillnadsersättning - Regeringen.se]

([19]) European Commission (2023), *In-Depth Review of the Macro-Economic Imbalances – Sweden*; International Monetary Fund (2023), *Sweden – Staff Report for the Article IV consultation.*

policies to consider include tightening the amortisation requirement to avoid a build-up of debt when financial conditions become looser and introducing a debt-to-income limit to offset higher leverage in case of softer LTV requirements.

Table 2.1: **MIP-relevant policy progress in Sweden:**

| Vulnerability | Policies enacted since January 2023 | Policies in progress since January 2023 |
|---|---|---|
| **Private debt** | | Proposal to lower interest deductibility on consumer loans not secured by a house, boat or vehicle before a full phase-out on 1 January 2026 |
| **Housing** | Simplification in the regulations governing building permits (31 Dec 2023)<br><br>Bill on certified construction companies (31 Dec 2022)<br>Private right of initiative (31 Dec 2023)<br><br>Investment support for rental and student housing | |
| **Banks** | Rise in counter-cyclical capital buffer<br><br>Extension of the risk-weight floors for CRE and RRE | |

## CONCLUSION

**Sweden's economy is being affected by the unwinding of its long-standing macroeconomic vulnerabilities and further risks remain despite recent developments.** Over the past decade, real estate prices have consistently risen faster than income and rents, primarily due to increasingly favourable financial conditions. These price increases have been accompanied by a rise in private debt, which has increased the exposure of the Swedish economy to changes in monetary and financing conditions. The rapid increase in interest rates since Q2-2022 affected property prices and directly impacted the debt service burden of households and of commercial real estate (CRE) companies. For potential home buyers, the increase in mortgage rates makes housing less affordable, and, while a correction in house prices is part of the necessary rebalancing, it also increases uncertainty and leads to a fall in housing demand. The turnover in residential real estate has declined sharply, as has the construction of new homes. Real income has declined, reducing repayment capacity and triggering a fall in household housing consumption.

The economy fell into an overall recession last year and there is a risk of unemployment growing faster if the economy performs worse than it is predicted to do this year and next. CRE prices appear not to have adjusted fully yet and there is a risk that the interest coverage ratio will decline to below safety levels if interest rates remain high and valuations decline. Strong metrics of the financial sector, reflected in high profit margins and risk-weighted capital ratios, serve as a bulwark against the transmission of real estate problems to the wider economy. However, the financial sector is highly exposed to real estate, with profits seemingly driven by loan volumes given the low interest margins in place until the beginning of Russia's aggression against Ukraine. In the initial phase of the tightening cycle, the interest margins have increased and further strengthened the solidity of the Swedish financial sector.

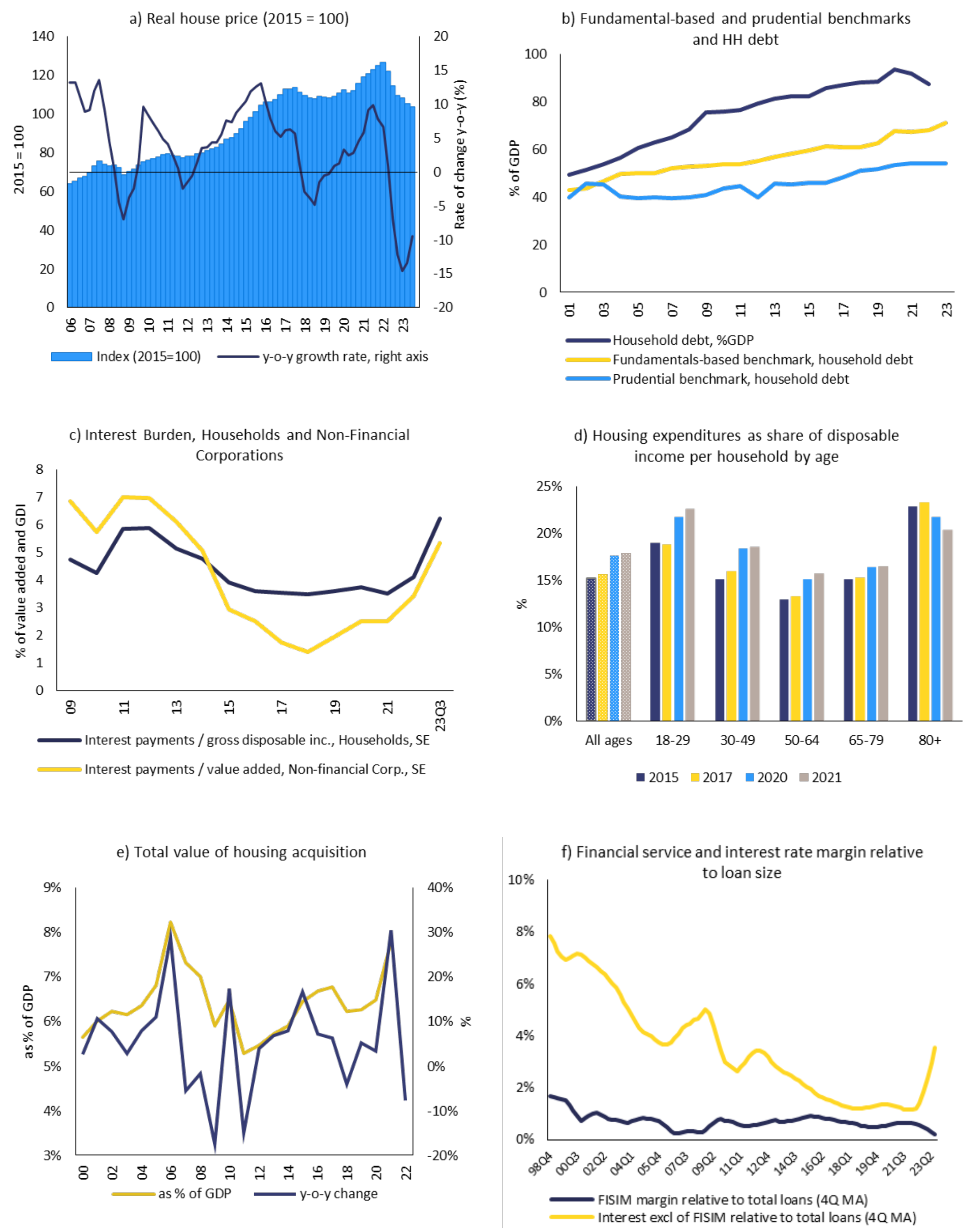
**Policy progress has been limited and without firmer policy action some of the structural features behind the identified vulnerabilities will persist.** The tax system has continued to favour home ownership through low recurrent property taxation and to promote debt-financed housing acquisition through the generous tax deductibility of mortgage interest payments. The rental market has seen limited reform and average rents are still well below market rents, resulting in long waiting lists and a very low vacancy rate relative to other EU countries. These policy factors behind the macroeconomic vulnerabilities still need to be addressed.

Policymakers are increasingly aware of the risks associated with the financial situation of CRE companies, and have expanded analyses in this area. The capital buffers required for lending to CRE companies provides a large safety margin for banks and the risk are primarily for lower construction through a lack of funding.  Reforms have focused on easing building regulation and these reforms are part of Sweden's recovery and resilience plan (RRP). The extent to which these reforms address supply-side issues still needs to be assessed.

Currently, the biggest challenge, is to avoid a renewed surge in debt-financed housing acquisition while not risking an uncontrolled unwinding of existing imbalances. Lowering the financial burden of lengthening interest fixation periods will help to lengthen these periods and cushion the impact of interest rate movements on household budgets. The proposal to adjust the interest compensation fee is a positive step in this direction. Strengthening borrower-based measures would help reduce the risks of increased indebtedness of Swedish households. Sweden does not have an explicit debt-to-income limit that would restrain households in assuming too much debt ([20]).

([20]) ESRB (2024), Follow-up report on residential real estate sector vulnerabilities, 1 February 2024.

Graph 2.3: **Selected graphs, Sweden**




***Source:*** Eurostat, Ameco, ECB, SCB and European Commission departments calculations.

Table 2.2: **Selected economic and financial indicators (Part 1), Sweden**

| all variables y-o-y % change, unless otherwise stated | 2003-07 | 2008-12 | 2013-19 | 2020 | 2021 | 2022 | 2023 | forecast 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|
| Real GDP | 3.5 | 0.7 | 2.6 | -2.2 | 6.1 | 2.9 | -0.5 | -0.2 | 1.3 |
| *p.m.: Real GDP (Winter 2024 interim Forecast)* | | | | | | | *-0.1* | *0.2* | *1.6* |
| Contribution to GDP growth: | | | | | | | | | |
| Domestic demand | 2.8 | 1.0 | 2.4 | -1.5 | 5.4 | 2.3 | -0.9 | 0.0 | 0.9 |
| Inventories | 0.2 | -0.1 | 0.1 | -0.7 | 0.4 | 1.1 | -0.4 | 0.0 | 0.1 |
| Net exports | 0.5 | -0.1 | 0.1 | 0.0 | 0.3 | -0.5 | 0.8 | -0.2 | 0.3 |
| Output gap (2) | 1.1 | -1.6 | 0.1 | -3.9 | 0.0 | 1.1 | -1.0 | -2.5 | -2.7 |
| Unemployment rate | 6.7 | 7.9 | 7.2 | 8.5 | 8.8 | 7.5 | 7.6 | 8.5 | 8.6 |
| Harmonised index of consumer prices (HICP) | 1.5 | 1.9 | 1.3 | 0.7 | 2.7 | 8.1 | 5.9 | 1.8 | 2.2 |
| *p.m.: HICP (Winter 2024 interim Forecast)* | | | | | | | | *1.7* | *1.9* |
| HICP excluding energy and unprocessed food (y-o-y) | 0.9 | 1.6 | 1.2 | 1.5 | 1.6 | 5.5 | 7.4 | 2.8 | 2.2 |
| GDP deflator | 1.5 | 1.7 | 2.9 | 2.0 | 2.6 | 6.0 | 6.7 | 2.7 | 2.0 |
| **External position** | | | | | | | | | |
| Current account balance (% of GDP), balance of payments | 6.8 | 6.1 | 3.4 | 5.9 | 7.1 | 5.8 | 6.9 | 4.7 | 4.8 |
| Trade balance (% of GDP), balance of payments | 6.5 | 5.2 | 3.4 | 4.5 | 4.8 | 3.2 | . | . | . |
| Primary income balance (% of GDP) | 1.8 | 2.6 | 1.5 | 3.5 | 4.0 | 4.4 | . | . | . |
| Secondary income balance (% of GDP) | -1.4 | -1.7 | -1.6 | -2.1 | -1.8 | -1.7 | . | . | . |
| Current account explained by fundamentals (CA norm, % of GDP) (3) | 0.6 | 0.5 | 0.2 | 0.4 | 0.4 | 0.5 | 0.6 | 0.5 | 0.5 |
| Required current account to stabilise NIIP above -35% of GDP over 20Y (% of GDP) (4) | -0.5 | -0.2 | 0.0 | 0.4 | 0.9 | 1.3 | 1.4 | 1.7 | 0.0 |
| Capital account balance (% of GDP) | -0.1 | -0.2 | -0.1 | 0.1 | 0.0 | 0.1 | . | . | . |
| Net international investment position (% of GDP) | -12.9 | -8.9 | 1.8 | 7.4 | 19.0 | 30.9 | . | . | . |
| NENDI - NIIP excluding non-defaultable instruments (% of GDP) (5) | -23.0 | -22.1 | -13.5 | -12.6 | -2.7 | -9.6 | . | . | . |
| Net FDI flows (% of GDP) | 2.8 | 2.5 | 0.9 | 0.7 | 1.3 | 2.6 | . | . | . |
| **Competitiveness** | | | | | | | | | |
| Unit labour costs (ULC, whole economy) | 1.0 | 2.8 | 3.2 | 3.4 | -0.3 | 2.6 | 6.0 | 3.8 | 3.0 |
| Nominal compensation per employee | 3.9 | 3.0 | 2.7 | 2.5 | 4.6 | 2.8 | 3.9 | 4.1 | 4.0 |
| Labour productivity (real, hours worked) | 2.7 | 0.1 | 1.1 | 1.1 | 3.5 | 0.6 | -1.9 | 0.1 | 0.7 |
| Real effective exchange rate (ULC) | -0.6 | 1.9 | -2.3 | 0.4 | 2.9 | -5.9 | -8.5 | -1.3 | 0.3 |
| Real effective exchange rate (HICP) | 1.0 | 0.3 | -3.0 | 2.6 | 3.1 | -6.3 | . | . | . |
| Export performance vs. advanced countries (% change over 5 years) | . | -7.9 | -7.6 | 3.2 | 5.3 | 0.9 | . | . | . |
| **Private sector debt** | | | | | | | | | |
| Private sector debt, consolidated (% of GDP) | 151.2 | 190.5 | 196.5 | 212.7 | 213.5 | 207.5 | 199.3 | . | . |
| Household debt, consolidated (% of GDP) | 59.7 | 75.1 | 85.7 | 93.7 | 91.9 | 87.3 | 82.8 | . | . |
| Household debt, fundamental benchmark (% of GDP) (6) | 49.8 | 53.8 | 60.6 | 67.6 | 67.2 | 67.9 | 71.3 | . | . |
| Household debt, prudential threshold (% of GDP) (6) | 40.9 | 41.3 | 48.1 | 53.5 | 54.2 | 54.2 | 54.2 | . | . |
| Non-financial corporate debt, consolidated (% of GDP) | 91.5 | 115.4 | 110.8 | 119.0 | 121.7 | 120.2 | 116.5 | . | . |
| Corporate debt, fundamental benchmark (% of GDP) (6) | 50.9 | 51.6 | 54.1 | 59.8 | 60.1 | 60.8 | 64.2 | . | . |
| Corporate debt, prudential threshold (% of GDP) (6) | 55.3 | 55.0 | 61.6 | 67.2 | 66.0 | 65.4 | 65.6 | . | . |
| Private credit flow, consolidated (% of GDP) | 11.1 | 7.8 | 9.9 | 14.5 | 16.2 | 10.3 | 5.7e | . | . |
| Household credit flow, consolidated (% of credit stock) | 9.0 | 6.3 | 5.8 | 5.4 | 6.5 | 3.7 | . | . | . |
| Non-financial corporate credit flow, consolidated (% of credit stock) | 11.2 | 7.5 | 8.1 | 14.0 | 15.3 | 10.4 | . | . | . |
| Net savings rate of households (% of net disposable income) | 4.7 | 10.4 | 13.5 | 17.0 | 15.5 | 13.0 | . | . | . |

(e) Estimate based on ECB quarterly data.
(1) Potential output is the highest level of production that an economy can reach without generating inflationary pressures. The methodology to compute the potential output is based on K. Havik, K. Mc Morrow, F. Orlandi, C. Planas, R. Raciborski, W. Roeger, A. Rossi, A. Thum-Thysen, V. Vandermeulen, The Production Function Methodology for Calculating Potential Growth Rates & Output Gaps, COM, European Economy, Economic Papers 535, November 2014.
(2) Deviation of actual output from potential output as % of potential GDP.
(3) Current accounts in line with fundamentals ('current account norms') are derived from reduced-form regressions capturing the main determinants of the saving-investment balance, including fundamental determinants, policy factors and global financial conditions. See L. Coutinho et al. (2018), 'Methodologies for the assessment of current account benchmarks', European Economy, Discussion Paper 86/2018, for details.
(4) This benchmark is defined as the average current account required to reach and stabilise the NIIP at -35% of GDP over the next 20 years. Calculations make use of Commission's T+10 projections.
(5) NENDI is a subset of the NIIP that abstracts from its pure equity-related components, i.e. foreign direct investment (FDI) equity and equity shares, and from intracompany cross-border FDI debt, and represents the NIIP excluding instruments that cannot be subject to default.
(6) Fundamental benchmarks are derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds identify a threshold above which banking crises become more likely. The fundamentals-based and the prudential benchmarks are calculated following Bricongne, J. C., Coutinho, L., Turrini, A., Zeugner, S. (2019), 'Is Private Debt Excessive?', Open Economies Review, 1-42.

***Source:*** Eurostat and ECB as of 20 February 2024, where available; European Commission for forecast figures (autumn forecast 2023).

Table 2.2: **Selected economic and financial indicators (Part 2), Sweden**

| all variables y-o-y % change, unless otherwise stated | 2003-07 | 2008-12 | 2013-19 | 2020 | 2021 | 2022 | 2023 | forecast 2024 | 2025 |
|---|---|---|---|---|---|---|---|---|---|
| **Housing market** | | | | | | | | | |
| House price index, nominal | 10.1 | 3.2 | 6.4 | 4.2 | 10.1 | 3.6 | . | . | |
| House price index, deflated | 9.0 | 1.5 | 4.8 | 3.3 | 8.1 | -3.2 | . | . | |
| Overvaluation gap (%) (7) | -6.4 | 2.4 | 22.0 | 26.0 | 33.1 | 29.3 | 21.4 | . | |
| Price-to-income overvaluation gap (%) (8) | -7.6 | 1.2 | 24.5 | 31.8 | 37.9 | 34.7 | 14.9 | . | |
| Residential investment (% of GDP) | 3.7 | 3.7 | 5.0 | 4.9 | 5.3 | 5.3 | . | . | |
| **Government debt** | | | | | | | | | |
| General government balance (% of GDP) | 1.2 | -0.1 | 0.3 | -2.8 | 0.0 | 1.3 | -0.2 | -0.7 | -0.6 |
| General government gross debt (% of GDP) | 45.8 | 38.2 | 41.2 | 39.9 | 36.5 | 32.9 | 30.4 | 30.1 | 29.6 |
| **Banking sector** | | | | | | | | | |
| Return on equity (%) | . | 10.0 | 11.4 | 8.1 | 10.0 | 10.0 | . | . | |
| Common Equity Tier 1 ratio | . | 10.1 | 20.7 | 20.8 | 20.9 | 20.3 | . | . | |
| Gross non-performing debt (% of total debt instruments and total loans and advances) (9) | . | 0.6 | 1.1 | 0.8 | 0.8 | 0.7 | . | . | |
| Gross non-performing loans (% of gross loans) (9) | . | . | 1.2 | 1.0 | 1.0 | 0.8 | 0.9 | . | |
| Cost of borrowing for corporations (%) | . | . | 1.3 | 1.4 | 1.5 | 4.2 | 5.5 | . | |
| Cost of borrowing for households for house purchase (%) | . | . | 1.5 | 1.4 | 1.4 | 3.4 | 4.7 | . | |

(7) Unweighted average of price-to-income, price-to-rent and model valuation gaps. The model valuation gap is estimated in a cointegration framework using a system of five fundamental variables; total population, real housing stock, real disposable income per capita, real long-term interest rate and price deflator of final consumption expenditure, based on Philiponnet, N., Turrini, A. (2017), 'Assessing House Price Developments in the EU', European Economy - Discussion Papers 2015 - 048, Directorate-General for Economic and Financial Affairs (DG ECFIN), European Commission. Price-to-income and price-to-rent gaps are measured as the deviation to the long-term average (from 1995 to the latest available year).
(8) Price-to-income overvaluation gap measured as the deviation to the long-term average (from 1995 to the latest available year).
(9) Domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.

***Source:*** Eurostat and ECB as of 2024-02-20, where available; European Commission for forecast figures (autumn forecast 2023).

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