EUROPEAN
COMMISSION

Brussels, 5.6.2019
COM(2019) 527 final

Recommendation for a

COUNCIL RECOMMENDATION

on the 2019 National Reform Programme of Sweden and delivering a Council opinion on the 2019 Convergence Programme of Sweden

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies[1], and in particular Article 9(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances[2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 21 November 2018, the Commission adopted the Annual Growth Survey, marking the start of the 2019 European Semester for economic policy coordination. It took due account of the European Pillar of Social Rights, proclaimed by the European Parliament, the Council and the Commission on 17 November 2017. The priorities of the Annual Growth Survey were endorsed by the European Council on 21 March 2019. On 21 November 2018, on the basis of Regulation (EU) No 1176/2011, the Commission also adopted the Alert Mechanism Report, in which it identified Sweden as one of the Member States for which an in-depth review would be carried out.

(2) The 2019 country report for Sweden[3] was published on 27 February 2019. It assessed Sweden's progress in addressing the country-specific recommendation adopted by the

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] SWD(2019) 1026 final.

Council on 13 July 2018, the follow-up given to the recommendations adopted in previous years and Sweden's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 27 February 2019[4]. The Commission's analysis led it to conclude that Sweden is experiencing macroeconomic imbalances. In particular, overvalued house price levels coupled with a continued rise in household debt poses risks of a disorderly correction. The high household debt has continued to grow as a share of GDP. There was a correction of house prices in the second half of 2017 and since then they have gradually stabilised. Nevertheless, valuation indicators suggest that house prices remain high relative to fundamentals. Although the banking sector appears adequately capitalised, a disorderly correction would negatively affect the financial sector given the large exposure to household mortgages. In such a case, there could also be negative spill-overs to neighbouring countries given the systemic financial interlinkages. Structural bottlenecks for housing supply persist and construction output has weakened. Although steps have been taken in recent years in the macro prudential field to address mortgage debt growth, the impact so far appears limited. Key policy gaps remain, particularly in relation to tax incentives for home ownership and the functioning of housing supply and the rental market.

(3) On 26 April 2019, Sweden submitted its 2019 National Reform Programme and, on 29 April 2019, its 2019 Convergence Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds ('ESI Funds') for the 2014-2020 period. As provided for in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council[5], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of that provision in guidelines on the application of the measures linking the effectiveness of the ESI Funds to sound economic governance[6].

(5) Sweden is currently in the preventive arm of the Stability and Growth Pact. In its 2019 Convergence Programme, the government plans to achieve a surplus of 0.6% of GDP in 2019, which is expected to strengthen further over the programme horizon. Based on the recalculated structural balance[7], the medium-term budgetary objective — a structural deficit of 1% of GDP — is planned to be overachieved throughout the programme period. According to the 2019 Convergence Programme, the general government debt-to-GDP ratio is expected to fall to 34.5% in 2019 and to continue declining to 28.2% in 2022. Sound public finances and a stable economic growth are set to be the main drivers behind the declining general government debt-to-GDP ratio.

[4] COM(2019) 150 final.

[5] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

[6] COM(2014) 494 final.

[7] Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

The macroeconomic scenario underpinning those budgetary projections is plausible. Based on the Commission 2019 spring forecast, the structural balance is forecast to register a surplus of 0.5% of GDP in 2019 and 0.6% of GDP in 2020, above medium-term budgetary objective. Overall, the Council is of the opinion that Sweden is projected to comply with the provisions of the Stability and Growth Pact in 2019 and 2020.

(6) Household debt has continued to rise from already high levels. Household debt grew by 5.5% in 2018, reaching about 88% of GDP and 186% of disposable income, which is among the highest in the EU. This was driven mainly by higher mortgage borrowing linked to high house prices, coupled with structural distortions favouring mortgage-financed property purchases. Sweden has implemented several macro-prudential measures in recent years, including a strengthened repayment rule for high debt-to-income mortgages in force since March 2018, and a decision to raise the countercyclical capital buffer for banks from September 2019. However, the policy steps taken so far appear to have had limited overall impact on the growth of mortgage lending and no policy action has been taken to reform the tax incentives for home ownership and mortgage debt.

(7) While house prices declined in late 2017 and have since been broadly stable, this follows a long period of strong price rises, and valuations remain well above economic fundamentals. Key issues include tax incentives favouring home ownership and mortgage debt, and accommodative credit conditions coupled with still relatively low mortgage repayment rates. Despite a significant increase in new construction over the past five years, a shortage remains, particularly of affordable homes around major cities. New housing supply failed to reach projected near-term needs, estimated at about 90 000 new homes per year for 2018-2020. This shortage is linked to structural inefficiencies, such as limited competition in the construction sector due to barriers to entry for small and foreign firms and the ability of large developers to control land resources. The housing stock is not used efficiently. In the rental market, below-market rents create lock-in and ‘insider/outsider’ effects. In the owner-occupancy market, capital gains taxes reduce homeowner mobility. The housing shortage makes it harder for people to change jobs and can contribute to intergenerational inequality. The Swedish authorities are continuing to gradually implement the ‘22-point plan’ to increase residential construction and improve the efficiency of the housing sector. So far, there have been no concrete policy steps to liberalise tight rental market regulations and revise the capital tax on owner-occupied homes, although in January 2019 the new government announced plans to introduce reforms in these areas, subject to preparatory inquiry work.

(8) Labour shortages are emerging in some sectors, such as in construction, education and information and communication technologies. Ensuring a supply of specialist human capital is vital to support research and development investment as well as digitalisation. Investing in education and skills, including digital skills, will help to address those challenges. So far, the educational outcomes have improved somewhat, but there is a large and increasing educational performance gap between different social groups. Demographic developments will lead to an increase in the number of pupils, exacerbating the present shortage of teachers. The situation of non-EU migrants and their descendants and the effects of recently adopted programmes deserve closer monitoring, as the school integration of foreign-born pupils, and the sustainable inclusion of the low-skilled and non-EU migrants (in particular women) into the labour market remain a challenge.

(9) Maintaining investments in transport infrastructure can contribute to improved labour mobility, regional cohesion and housing market and foster Sweden's long-term productivity growth. The government has announced considerable investments in transport infrastructure through the national plan for infrastructure 2018-2029 to upgrade the different transport modes (in particular railway and road). The plan contains major investments to develop the railway system, promoting the switch in goods transport from roads to railways, thus also helping to reduce emissions. Maintaining high levels of investment in research and development, favourable framework conditions and a broader innovation base are key to securing Sweden's position as innovation leader. Sweden's innovation model has traditionally relied on a limited number of large, globally active, technology companies. It would be important to create an environment that also nurtures the innovation potential of SMEs and start-ups. Sweden's innovation capacity could also be further improved by increased collaboration between academia and SMEs.

(10) Preventing money laundering has become a priority for Sweden against the background of an evolving money laundering scandal related to one of the largest financial institutions in the country. The Swedish and Estonian financial supervisors have started a joint investigation, together with their Latvian and Lithuanian counterparts. While Sweden’s anti-money laundering framework has been strengthened in 2017, when the money laundering act entered into force, continued work to identify and correct any remaining deficiencies of the framework remain important. Challenges remain and the supervisor still needs to adopt additional measures and guidelines on how to strengthen supervision in this area. Attention should be paid to the effective implementation of these measures, once adopted.

(11) The programming of EU funds for the period 2021-2027 could help address some of the gaps identified in the recommendations, in particular in the areas covered by Annex D to the country report[8]. This would allow Sweden to make the best use of those funds in respect of the identified sectors, taking into account regional disparities.

(12) In the context of the 2019 European Semester, the Commission has carried out a comprehensive analysis of Sweden’s economic policy and published it in the 2019 country report. It has also assessed the 2019 Convergence Programme and the 2019 National Reform Programme and the follow-up given to the recommendations addressed to Sweden in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Sweden, but also their compliance with Union rules and guidance, given the need to strengthen the Union’s overall economic governance by providing Union-level input into future national decisions.

(13) In the light of this assessment, the Council has examined the 2019 Convergence Programme and is of the opinion that Sweden is expected to comply with the Stability and Growth Pact.

(14) In the light of the Commission’s in-depth review and this assessment, the Council has examined the 2019 National Reform Programme and the 2019 Convergence Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendation (1) below.

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8 SWD(2019) 1026 final.

HEREBY RECOMMENDS that Sweden take action in 2019 and 2020 to:

1. Address risks related to high household debt by gradually reducing the tax deductibility of mortgage interest payments or increasing recurrent property taxes. Stimulate investment in residential construction where shortages are most pressing, in particular by removing structural obstacles to construction. Improve the efficiency of the housing market, including by introducing more flexibility in rental prices and revising the design of the capital gains tax.
2. Focus investment related economic policy on education and skills, maintaining investment in sustainable transport to upgrade the different transport modes, in particular railways, and research and innovation, taking into account regional disparities.
3. Ensure effective supervision and the enforcement of the anti-money laundering framework.

Done at Brussels,

For the Council
The President