August 2002
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Sweden: 2002 Article IV Consultation—Staff Report; Staff Statement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Sweden

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2002 Article IV consultation with Sweden, the following documents have been released and are included in this package:

- the staff report for the 2002 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **May 16, 2002,** with the officials of **Sweden** on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on July 8, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of **July 31, 2002** updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its July 31, 2002 discussion** of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Sweden.

The document(s) listed below have been or will be separately released.

Selected Issues Paper,
Financial System Stability Assessment, and
Report on the Observance of Standards and Codes—Fiscal Transparency and
Data Modules—A Note on Recent Developments

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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SWEDEN

Staff Report for the 2002 Article IV Consultation

Prepared by Staff Representatives for the
2002 Consultation with Sweden

Approved by Ajai Chopra and Martin Fetherston

July 8, 2002

- A staff team comprising Messrs. Thakur (Head), Horváth, Mehrez (all EU1), and Schimmelpfennig (FAD) visited Stockholm during May 6–16, 2002. The mission met State Secretary of the Ministry of Finance Mr. Hegelund, Riksbank Governor Mr. Bäckström, other senior officials, as well as representatives of the Confederation of Trade Unions, the Confederation of Swedish Enterprises, the private financial sector and the academic community. Mr. Törnqvist, Advisor, Nordic-Baltic Office, joined the discussions.
- As part of the Article IV consultation, a Financial System Stability Assessment draft report was presented to the authorities by a team headed by Mr. Johnston (MAE).
- The authorities published the Concluding Statement of the mission and have expressed their intention to publish this staff report.
- The minority Social Democratic government, ruling with the support of the Left and Green parties, faces parliamentary elections in September 2002.
- Sweden has accepted the obligations of Article VIII; and subscribes to the Special Data Dissemination Standard. Data provision is timely and facilitates effective surveillance (Appendix I).
- In concluding the last Article IV Consultation, Executive Directors commended the design and steadfast implementation of Sweden's medium-term fiscal framework, and strongly endorsed the authorities' commitment to the fiscal surplus target of 2 percent of GDP over the cycle. They emphasized the importance of a continued commitment to the Riksbank's inflation targeting framework. Directors also underlined the importance of further balanced reductions in taxes and spending, and a continued pursuit of structural reforms to raise potential growth.

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Main Websites for Swedish Data

Data in this Staff Report reflects information received by June 24, 2002. In many cases, more recent data can be obtained directly from the following internet sources:

Statistics Sweden .... http://www.scb.se/eng/index.asp

The Riksbank .... http://www.riksbank.se/

Ministry of Finance .... http://www.finans.regeringen.se/

National Institute of Economic Research .... http://www.konj.se

Additional information and documentation on Swedish economic statistics can be found at the Fund's SDDS website................................ http://dsbb.imf.org/country/swecats.htm
and at
Statistics Sweden's Economic Data Portal: http://www.scb.se/ekonomi/ekonomieng.asp#area

Sweden—Executive Summary: Staff Report for the 2002 Article IV Consultation

Background and Outlook: Strong growth in 1997–2000 was followed by a slowdown in 2001, triggered by the global economic weakness and slump in the technology sector. Resource utilization still remained high and sectoral labor shortages persisted, which, together with transitory influences, kept inflation well above the 2 percent target. Following a period of accommodating monetary conditions, the Riksbank raised its policy rate in early 2002 by 50 basis points. The krona strengthened since late 2001, reversing its prolonged weakness. Public finances remained strong, with fiscal policy firmly anchored in the medium-term framework. Aided by an expansionary fiscal stance, a recovery has begun and is expected to gather speed in the second half of 2002. Despite structural reforms in recent years, remaining product and labor market rigidities could hold back growth in the medium-term.

Policy discussions centered on the following key issues:

- The appropriate macroeconomic policy stance in light of the incipient recovery and the persistence of inflation pressures.
- The medium-term fiscal framework and the ongoing debate on the implications for stabilization policy if Sweden were to adopt the euro.
- The need to refocus on the structural policy agenda, particularly on competition, deregulation, labor and housing market policies, and escalating absenteeism.

Authorities and staff agreed that:

- The Riksbank's wait-and-see approach with a tightening bias was appropriate given the fragility of the recovery and the upside risks to medium-term inflation.
- Fiscal policy should continue to abide by the well-established medium-term framework.
- Continued structural reforms were critical for raising economic growth. Key areas included product-market deregulation to enhance competition, and measures to increase labor market flexibility.
- Sweden's financial system was sound and complied well with international codes and standards—as concluded by the Fund's Financial Sector Stability Assessment—but measures to address potential vulnerabilities were desirable.

The staff recommended that:

- The 2003 budget should complete the authorities' program of phased income tax cuts. The new government should pursue an agenda of further balanced reductions in taxes and spending.
- The medium-term fiscal framework should retain the surplus target of 2 percent of GDP over the cycle, which is set to provide for the costs of the demographic transition and also allows adequate room for stabilization policy. However, some modifications to the expenditure ceilings would be useful.
- The authorities should give renewed impetus to structural reforms so as to raise potential growth. In particular, improving incentives is critical for addressing the mounting erosion of labor supply due to the escalating problem of sickness absenteeism as well as early and disability retirement. Progress toward reducing public ownership in competitive sectors and liberalizing the rental housing market would be desirable for raising labor and product market flexibility.

I. Introduction and Background

1. **Sweden's strong performance of the past five years is rooted in a credible, rule-based macroeconomic policy framework** (Table 1). The Riksbank's inflation targeting regime coupled with the authorities' steadfast implementation of a medium-term fiscal framework aimed at a general government surplus of 2 percent of GDP over the cycle has restored policy credibility and financial stability following the crisis of the early 1990s. Strong public finances have enabled a process of gradual reduction in the high tax burden to begin. Structural reforms reinforced by EU membership have helped raise efficiency and mitigated distortions associated with Sweden's large welfare state.[1] These policies paved the way for growth averaging over 4 percent per annum during 1998–2000 driven by large productivity gains, especially in the technology sector. The authorities also made substantial progress in addressing the coming demographic challenge by implementing a pension reform that restored actuarial balance to the public pension scheme.

2. **The global economic weakness and slumping domestic demand led to a slowdown in 2001.** Following impressive growth in 2000, exports suffered their weakest year in a quarter century, as telecom exports—the driving force behind the recent rapid growth—fell by about 35 percent. Private consumption stagnated under the weight of adverse confidence and wealth effects from the continued plunge in stock prices, despite rising disposable income. The weak krona and supportive fiscal and monetary policies, however, helped contain the severity of the slowdown (Figure 1).

3. **Despite the slowdown, resource utilization remained high and sectoral labor shortages persisted.** Participation rates remained among the highest in the world, notably for women and older people. With continued low unemployment (Figure 2), wage growth accelerated to 4¼ percent, reflecting strains, particularly in the services, construction and local government sectors. Wages grew by more than in the main trading partners, exacerbating the adverse impact of the cyclical slowdown in productivity growth on unit labor costs. With a sharp but brief slowdown in activity following a prolonged period of rapid growth, the size of the output gap was more than usually uncertain.[2]

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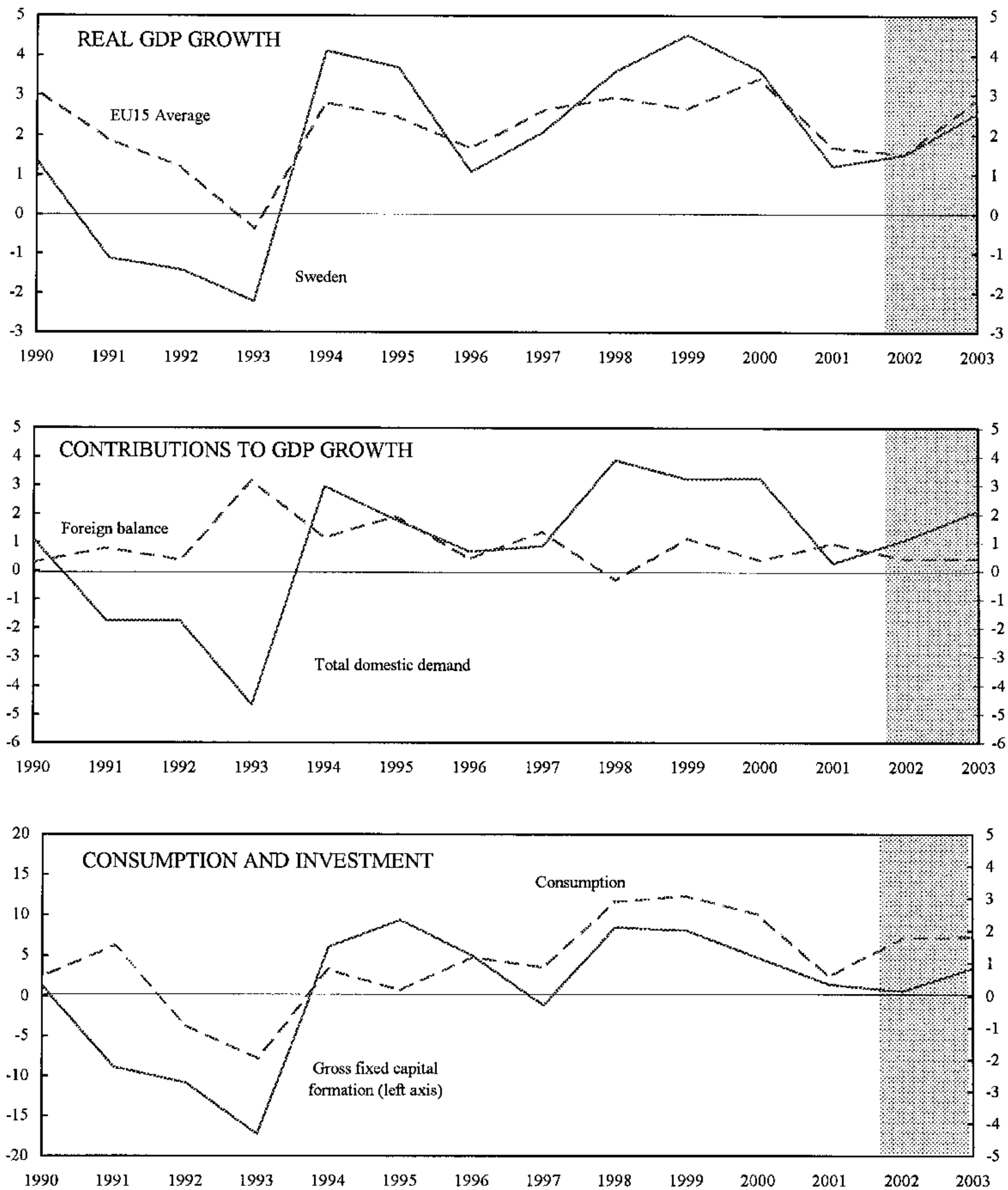
[1] The Selected Issues Paper for the last consultation (Country Report 01/169) provides a detailed survey and assessment of the Swedish welfare state's achievements and the challenges it faces.

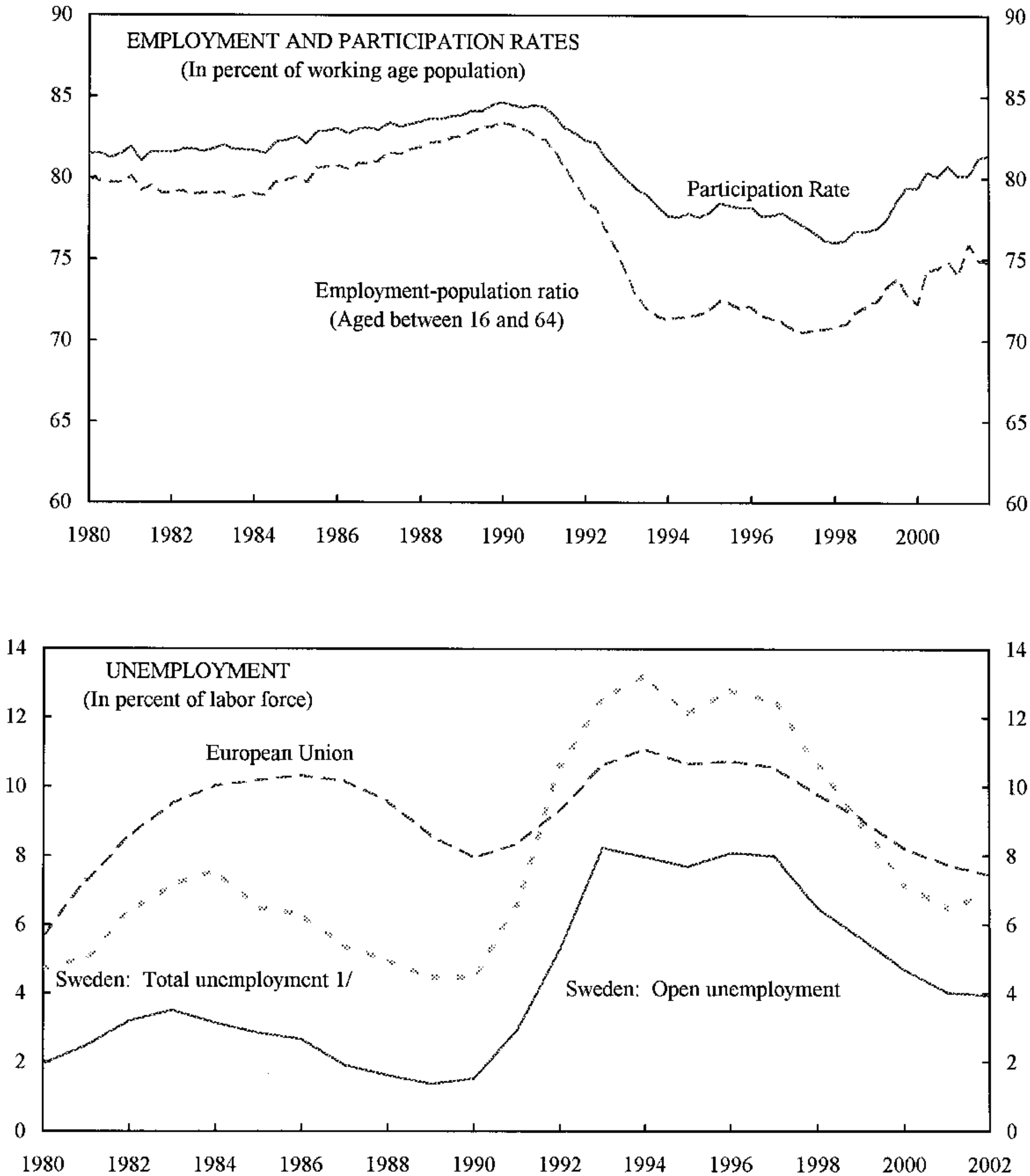
[2] Sweden's historical potential growth rate of around 2 percent over the past three decades rose to 2¼–2½ percent during 1998–2000, reflecting the impact of structural reforms and the emergence of a thriving technology sector. However, potential growth may have fallen back since then as a result of a fall in effective labor supply and weaker productivity growth as the contribution of the technology sector has diminished. With the resulting uncertainty about potential output levels, the estimates of the output gap for 2001 span a range of –0.7 to 0.8 percent of potential GDP, with the staff estimate around the middle of the range.

Figure 1. Sweden: Output Developments and Prospects
(Annual percentage change)



Sources: Statistics Sweden; and staff projections.

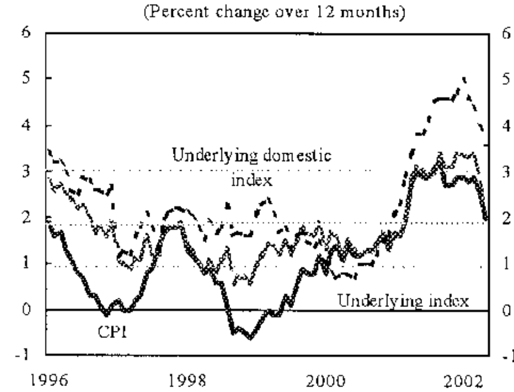
Figure 2. Sweden: Labor Market Developments



Sources: Statistics Sweden and OECD.
1/ Open unemployment plus participants in active labor market programs that are excluded from open unemployment (e.g., retraining, and youth employment schemes).

4. **Inflation persisted well above the Riksbank's target of 2 percent, reflecting transitory influences as well as the high degree of resource use** (Figure 3). Four years of falling unemployment and rapid growth intensified resource pressures as output overtook potential in 2000. While demand pressures eased as growth slowed down, structural rigidities combined with a sequence of relative price shocks contributed to the persistence of wage and price inflation. At the same time, the fading of the beneficial effects of earlier deregulation in telecom and electricity sectors, together with one-off factors such as animal disease and higher oil prices added to inflation pressures. Headline inflation remained at the upper edge of the Riksbank's tolerance band of ±1 percent around its target, before falling to 2 percent in May 2002. Domestic underlying inflation peaked at 5 percent in January 2002, but imported inflation remained low, mitigated by a lower-than-expected pass-through of the depreciation, which was widely seen as temporary.

Sweden: Headline and Underlying Inflation 1/
(Percent change over 12 months)



1/ The underlying index is the CPI excluding changes in indirect taxes and subsidies and interest costs for owner-occupied housing, the domestic component also excludes changes in import prices.

5. **The krona has turned around, reversing a trend of prolonged weakness** (Figure 4). In the fifteen months through September 2001, the krona depreciated by 16 percent against the euro. Relatively low Swedish interest rates (Figure 5), the bursting of the bubble on Sweden's technology-centered equity market, as well as the relaxation of investment rules for pension funds from 2001 led to sizable portfolio outflows, contributing to this weakening. The Riksbank intervened in June 2001 to stem the krona's slide and followed it up with a rise in the policy interest rate. In the event, the krona continued its fall through September 2001 before appreciating by 4½ percent against the euro through May 2002—prompted in part by political signals about the possible adoption of the euro. Competitiveness, nevertheless, remained adequate as suggested by the continued healthy growth of exports other than those of information technology products, and large current account surpluses. Relative unit labor costs have declined by about 10 percent vis-à-vis the main trading partner countries in the past three years.

Sweden: Trade-weighted and Euro Exchange Rate

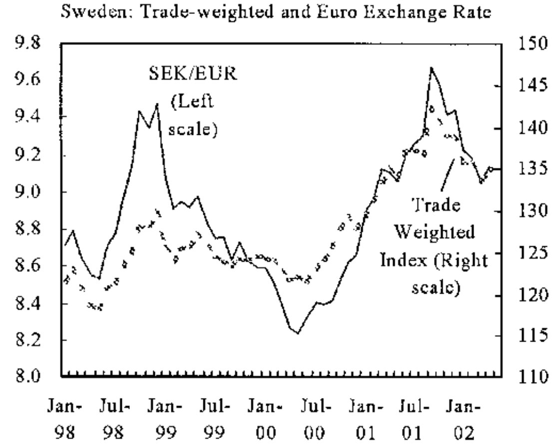
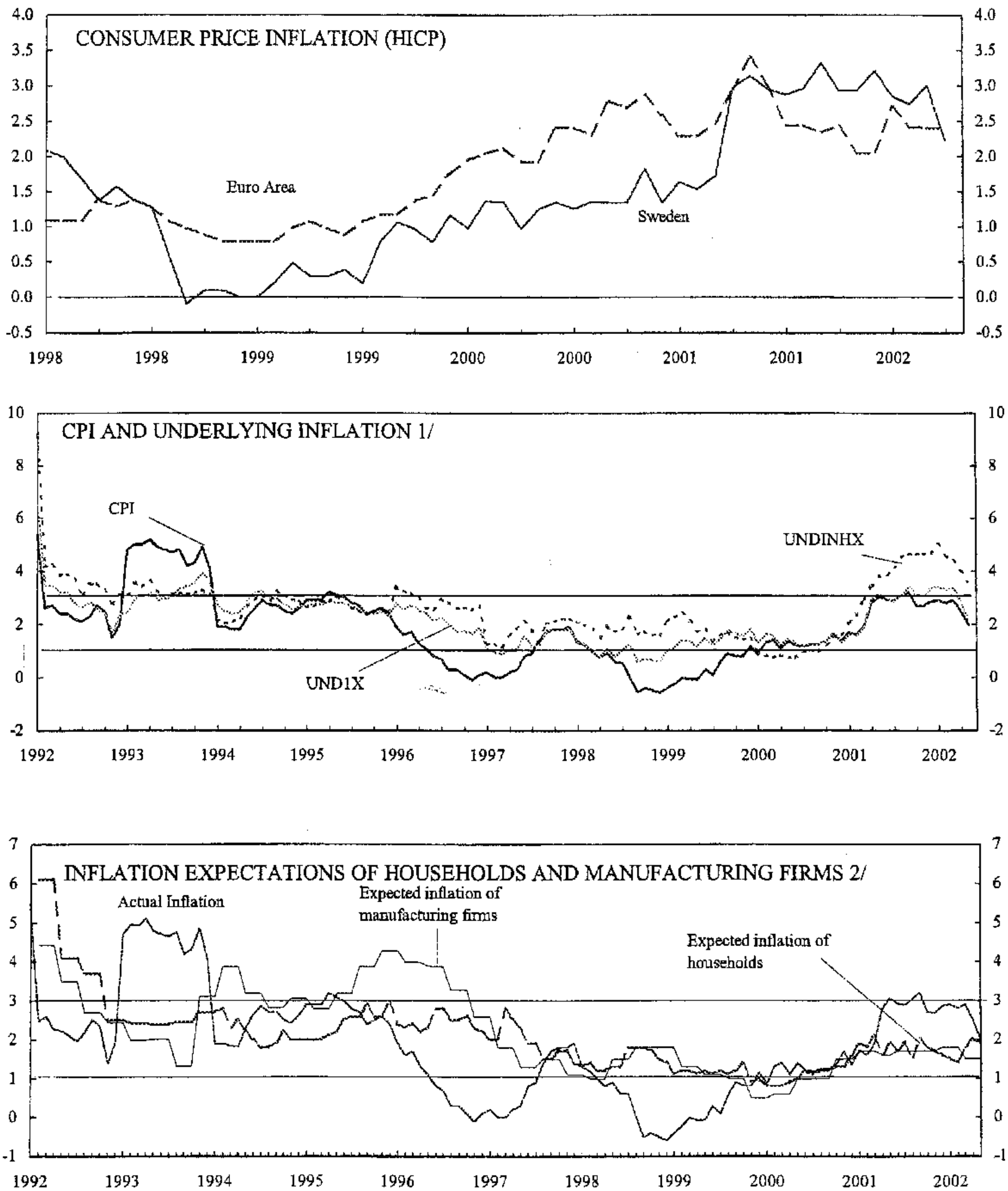


Figure 3. Sweden: Inflation Developments
(Percent change from a year ago)

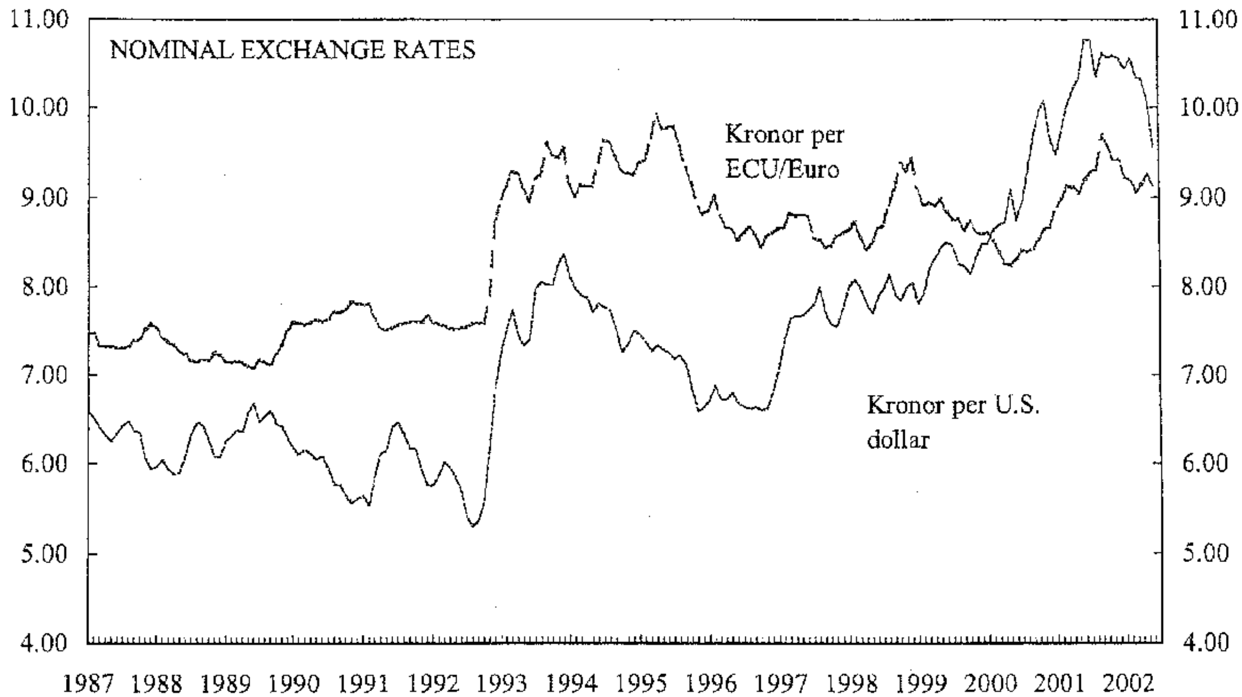


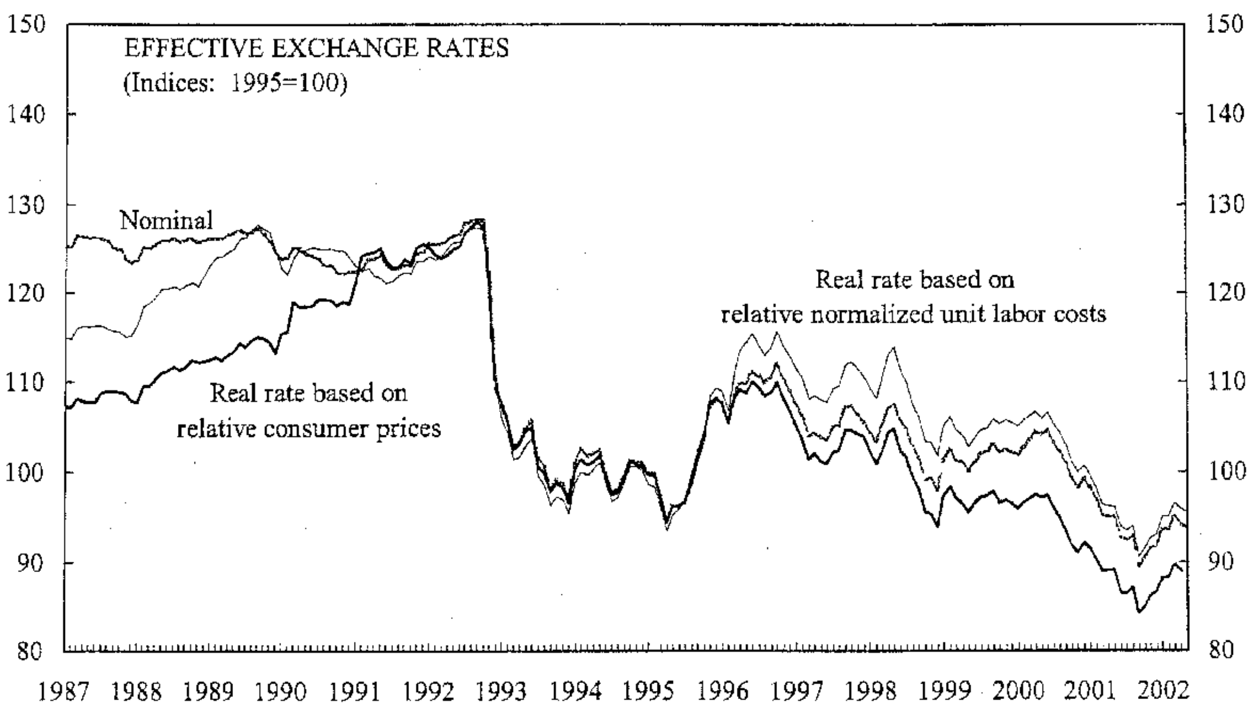
Sources: Statistics Sweden and the Riksbank.

1/ UND1X = CPI excluding changes in indirect taxes and subsidies and interest costs for owner-occupied housing; UNDINHX also excludes changes in import prices; the horizontal lines indicate a 1 percent range around the 2 percent inflation target.

2/ Inflation expected one year ahead.

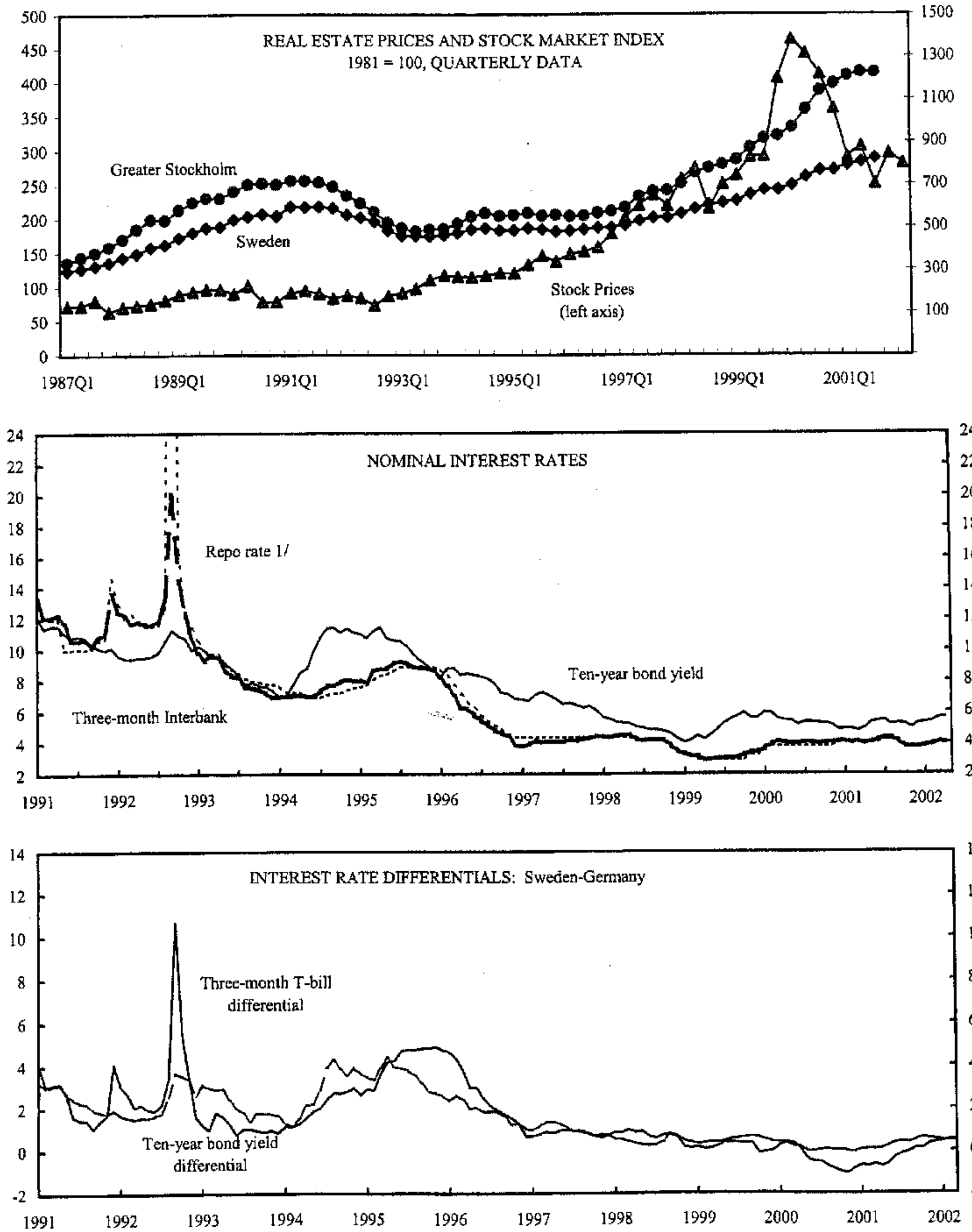
Figure 4. Sweden: Exchange Rate Developments





Source: IMF, International Financial Statistics

Figure 5. Sweden: Asset Price and Interest Rate Developments

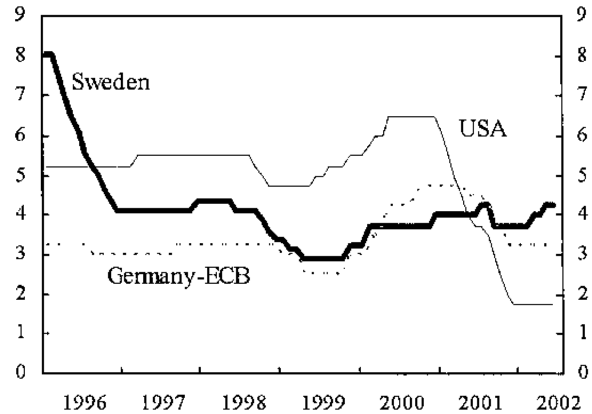


Sources: Statistics Sweden; Riksbank; IMF, International Financial Statistics, and INS.
1/ Repo rate was 63 percent in September 1992.

II. THE POLICY SETTING AND THE SHORT-TERM OUTLOOK

6. **The weak krona and low interest rates made for accommodating monetary conditions in 2001.** The krona's weakness, especially during a period of high resource use, led to concerns on the part of the Riksbank about growing inflation risks. However, it refrained from raising rates, except for the 25 basis point increase in July 2001 to back up its intervention. Indeed, in the aftermath of the uncertainty following September 11 and in concert with the worldwide move toward policy easing, interest rates were cut by 50 basis points. As uncertainty subsided, this easing was fully reversed in March-April 2002 to rein in persistent inflation pressures, contributing—together with the strengthening krona—to some tightening of monetary conditions. Although subsequently policy rates were kept unchanged, a tightening bias was maintained.

Sweden, US, and ECB: Policy Interest Rates
(In percent, 1996–2002)



7. **Public finances remain strong, with fiscal policy firmly anchored in the medium-term framework** (Table 2 and Figure 6). The framework is based on three elements: (i) a general government surplus target of 2 percent of GDP over the cycle; (ii) nominal ceilings on central government primary expenditure and old-age pension spending; and (iii) an ex ante balanced budget requirement for local governments. In 2001, the general government surplus rose to about 5 percent of GDP, benefiting from large dividend distributions and exceptionally high revenues from capital gains taxes. The fiscal stance—calculated as the change in the structural balance—was nevertheless expansionary to the tune of 1 percent of GDP.[3]

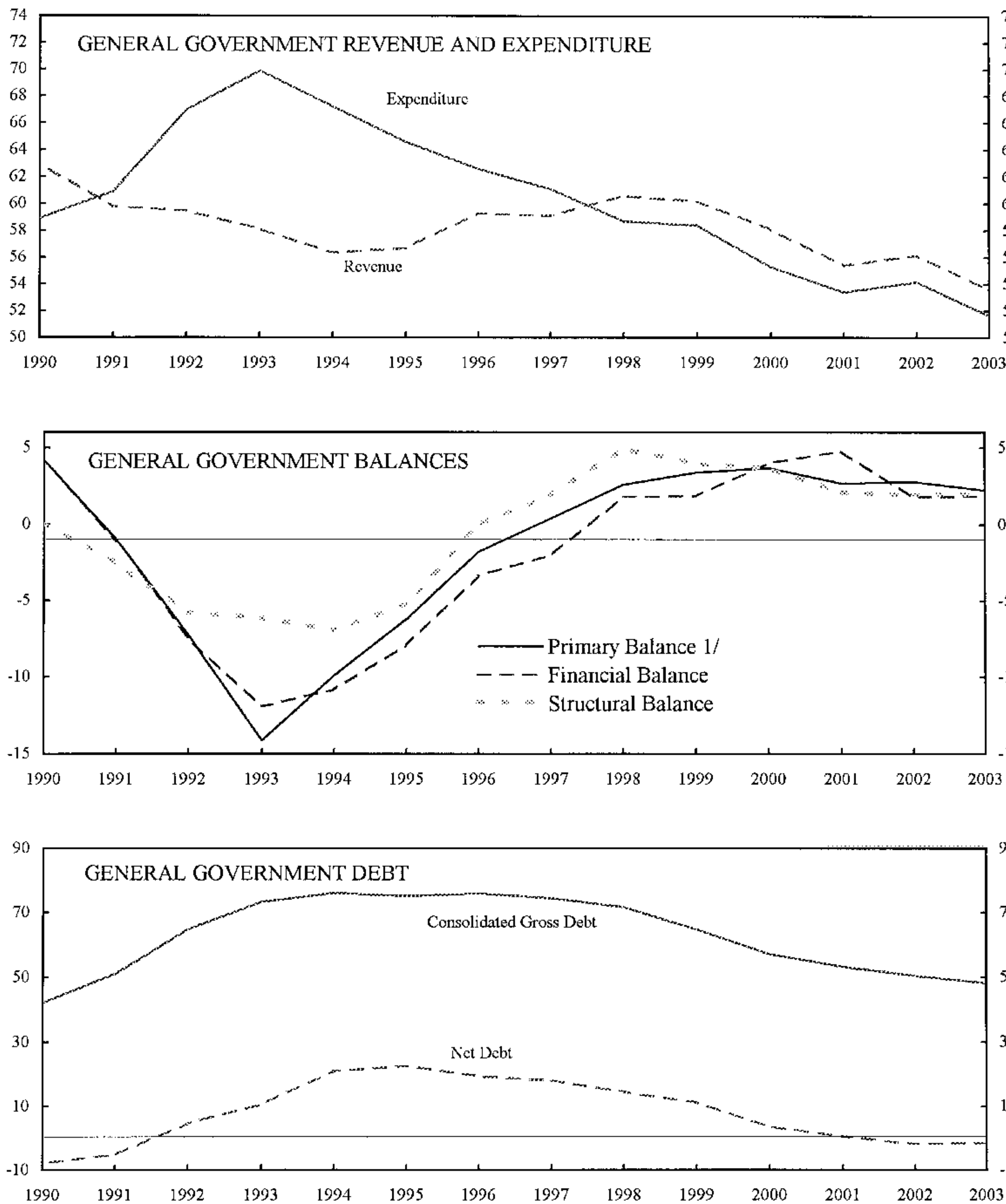
Sweden: General Government Finances, 2000–04
(In percent of GDP unless otherwise indicated)

	2000 Act.	2001 Act.	2002 Proj.	2003 Proj.	2004 Proj.
Total revenue	58.4	59.2	56.4	55.9	55.6
of which : taxes and charges	51.9	53.5	50.7	50.3	49.9
Total expenditure	54.7	54.4	54.5	54.1	53.8
Transfers	22.2	22.0	22.2	22.2	22.3
Consumption	26.2	26.7	26.9	26.5	26.1
Capital expenditure	2.2	2.3	2.4	2.4	2.4
Interest expenditure	4.2	3.4	3.0	3.0	2.9
Overall balance	3.7	4.8	1.8	1.8	1.8
Primary balance	4.7	6.0	2.6	2.4	2.3
Cyclically adjusted balance	3.7	5.3	2.9	2.3	2.0
Structural balance 1/	4.3	3.3	2.6	2.6	2.1
Memorandum item:					
Output gap (in percent of potential)	-0.1	-0.7	-1.5	-0.8	-0.3

Source: Ministry of Finance.
1/ Cyclically adjusted balance corrected for timing of tax receipts.

[3] The Ministry of Finance calculates the structural balance as the cyclically adjusted balance corrected for the timing of some tax receipts, so as to measure the structural balance on a full accruals basis. Large payments of corporate and capital gains taxes, which accrued in 2000, were received in 2001.

Figure 6. Sweden: Fiscal Developments and Prospects
(In percent of GDP)



Sources: Statistics Sweden and Ministry of Finance.
1/ Excluding interest expenditure and income.

8. **The 2002 budget continued the authorities' reform strategy.** The third phase of the income tax reform—which gradually offsets earlier increases in social security contributions by income tax credits—was implemented, and the threshold for the state income tax was raised, lowering the marginal tax on labor. A number of other taxes were also reduced, with estimated tax cuts amounting to about 1 percent of GDP[4]. On the expenditure side, several benefits were raised with the intention of raising labor supply and improving education and health. With some offsetting cuts, expenditures rose by about ½ percent of GDP. With the fading out of one-off factors and a strong cyclical impact, the general government surplus is projected at 1.8 percent of GDP, which would be consistent with the medium-term surplus target.

9. **An economic recovery has begun and is expected to gather speed in the second half of the year.** National accounts estimates for the first quarter of 2002 suggest that private consumption has begun to pick up, buoyed by large gains in disposable income and continued strong employment. Rising foreign demand is likely to sustain net exports even with some further krona appreciation. Assuming a healthy pick-up in the world economy, activity is projected to strengthen further in 2003. The key downside risks to growth are possible adverse confidence effects from the continuing difficulties of the world telecom sector—Ericsson, the leading Swedish telecom company, continues to suffer from large losses and declines in its share price—and a weaker-than-expected global recovery. A shrinking effective labor supply and continuing product and labor market rigidities could also undermine the supply response. The baseline projection is for inflation to recede toward the Riksbank's two percent target over the two-year horizon, albeit still remaining somewhat above it. The negative output gap emerging in 2002 (on staff estimates) is expected to close in 2003. Upside risks to inflation include wage pressures stemming from increasing resource utilization and a possible adverse impact of higher recent inflation on expectations.

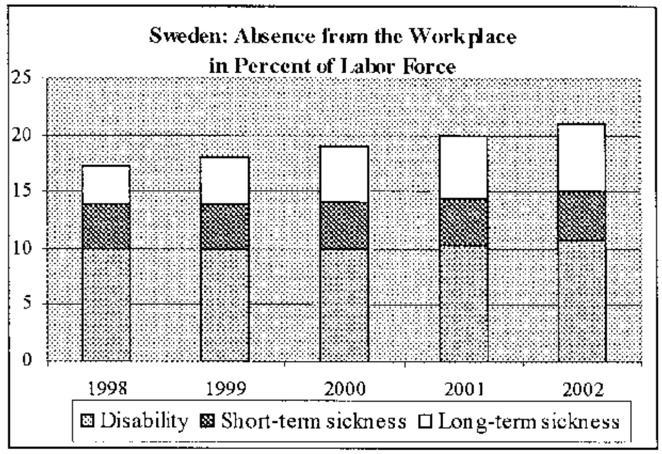
Sweden: Demand and Output
(Annual percent change)

	2000	2001	2002	2003
Domestic	3.6	0.3	1.2	2.3
Private	3.1	0.2	2.1	2.3
Government	1.4	1.4	1.2	0.8
Gross	8.0	-1.0	-0.6	4.0
Imports	11.0	-3.9	1.8	5.8
Exports	9.8	-1.4	2.3	5.5
GDP	3.6	1.2	1.5	2.5

Source: Staff estimates and projections.

[4] Taxes on pension benefits were marginally reduced and the real estate tax rate was lowered to offset the effects of rising house assessment values on the tax liability. Also, the wealth tax exemption was raised, and the VAT on books and periodicals was reduced from 25 to 6 percent. The green tax swap—raising the burden on greenhouse gas emission while lowering other taxes—was continued.

10. **Despite structural reforms in recent years, product and labor market rigidities could hold back growth in the medium-term.** The Swedish price level substantially exceeds the EU average in part due to market imperfections, notably in construction and retail trade. A compressed wage scale and relatively high marginal effective tax rates also contribute to work disincentives. In recent years, a surge in sickness absenteeism and continued high levels of disability retirement have led to diminishing effective labor supply. Finally, de facto rent control and employment protection regulations limit labor market flexibility. These factors could constrain potential growth in the coming years.



III. The Policy Discussions

11. The discussions centered on the following main themes:

- The appropriate **stance of macroeconomic policy** in the light of the incipient but still fragile recovery, the uncertainty about the output gap and the persistence of inflation pressures;

- The **medium-term fiscal framework** and the ongoing debate on the implications for stabilization policy if Sweden were to decide to adopt the euro;

- The need to refocus on the **structural policy agenda**—particularly in the areas of competition and deregulation, labor and housing market policies, and the growing problem of absenteeism—to raise potential growth.

A. Monetary Policy

12. **Persistent inflation concerns made the recent monetary tightening inevitable.** The authorities explained that unabated inflation pressures and upside risks to inflation prompted the decision to raise the policy rate by ½ percent earlier this year. There was agreement that this tightening should go some way toward containing inflation and wage pressures, and had underlined the Riksbank's commitment to safeguarding the inflation target. Following a period in which Swedish policy interest rates were among the lowest in Europe, they now were above those in the euro area and the United States. As to the question of whether the tightening should have taken place earlier, officials noted the uncertainties clouding the world economic outlook as well as prospects for the Swedish economy around the turn of the year. In hindsight, however, it seemed clear that the degree of resource use in the economy had been underestimated.

13. **The authorities argued that following the recent interest rate hike, a policy of wait-and-see was appropriate.** There was reason to hope that the cyclical recovery in productivity combined with the projected moderate rise in unemployment and easing resource strains should contain unit labor costs to a level consistent with the inflation target. The mission agreed with the authorities that given the fragility of the prospective recovery, a wait-and-see approach with a tightening bias was appropriate. However, it emphasized that risks to the inflation target remained. If productivity failed to rebound or wage growth remained high, pressures on inflation—which is already above target—could accentuate as the recovery gathers pace. The authorities acknowledged these risks and stated their readiness to take prompt policy action if necessary.

14. **The authorities expressed confidence that in the event of a decision to adopt the euro, Sweden's sound macroeconomic fundamentals should ensure a smooth transition.** Recent opinion polls suggested an incipient shift in public opinion in favor of the euro. An official decision to join would depend on the outcome of a referendum which the government has publicly signaled would be held in 2003. Sweden's fiscal position was strong, public debt was below 60 percent of GDP and macroeconomic fundamentals were satisfactory. In view of Sweden's recent inflation record and the fact that its inflation target was in line with that of the euro area with which it conducts most of its trade, the possibility of a conflict between the inflation and exchange rate objectives was viewed as remote. Thus, officials were confident that the transition from the inflation-targeting regime to exchange rate stability under ERM2 would be smooth. The mission saw little reason to disagree with this assessment.

15. **The soundness of the financial system was confirmed by the FSSA assessment.** The authorities expressed broad agreement with the conclusions of the recent FSAP exercise. Noting the potential sources of vulnerability—concentration of exposure to a few counterparties and residual risks in the securities settlement system, officials expressed their intention to strengthen further regulatory and supervisory arrangements and crisis management capabilities (Box 1).

B. Fiscal Policy

16. **The authorities and the staff agreed that the fiscal policy stance for 2002–03 was appropriate and in line with the medium-term fiscal framework.** The planned moderate stimulus in 2002 and the return to a broadly neutral stance in 2003 were viewed as consistent with the expected cyclical evolution. The stance for 2003 would, of course, be reassessed at budget time as the outlook becomes clearer. The mission welcomed the government's commitment to keep expenditures within the expenditure ceiling despite mounting pressures from escalating sickness and disability payments, but expressed some concern that no

Box 1. Financial Sector Stability Assessment and Recommendations[1/]

Sweden's financial sector is sound, efficient, and well supervised. Four major financial groups—active in insurance, securities and cross-border banking, with extensive operations throughout the Nordic area—dominate the sector. Supervision and regulation conform with the relevant standards and codes, and best transparency practices were observed in all areas. Financial sector resilience was documented by financial soundness indicators (Table 3) and validated by sophisticated stress tests.

Stress tests showed Sweden's financial system to be resilient to potential severe shocks. Stress tests covered large shocks to: (a) equity and real estate prices; (b) exchange rates and interest rates; and (c) prolonged economic stagnation. Significant vulnerabilities appeared only in the presence of contagion effects in the event of these shocks. Such effects can be amplified by the complex nature of the largest Swedish financial groups, which operate—and are systemically important—in several neighboring countries, with activities spanning various, closely related business areas. The insurance sector had minimal reinsurance exposures, and life insurance was protected by rules allowing lower payouts if its net capital position deteriorated. The Swedish financial sector was also found to be resilient to further distress in the telecoms sector.

Bank supervision showed a high degree of compliance with Basel standards. It is evolving toward a more pro-active, risk-focused approach emphasizing effective consolidated supervision in collaboration with other supervisors. The FSAP mission recommended increasing staffing of the financial supervisor (FI), broadening its range of available corrective measures, increasing the cross-border harmonization of approaches to emergency liquidity assistance, and enhancing the credibility of the regime for winding-up large financial institutions.

Insurance, securities regulation and supervision, and the payment system were compliant with core principles. The mission recommended enhancing the supervisor's capacity to conduct fit and proper tests for insurance companies, improving oversight of the exchanges, and strengthening rules regarding issuers and mutual fund companies, especially those owned by financial groups.

The mission found that the central securities settlement system did not comply with all applicable recommendations. It recommended improving the supervision of clearing and settlement, and implementing risk management measures to prevent unwinding and to contain the present systemic risk in the clearing system.

Sweden demonstrated a high degree of compliance with the IMF Code on Monetary and Financial Transparency. The mission recommended clarifying the respective responsibilities of the Riksbank and FI, notably concerning the supervision of the payment system.

Sweden's regime for **anti-money laundering and combating terrorist financing** was found to comply with the relevant guidelines.

1/ See the accompanying FSSA document for further details.

specific contingency measures had yet been identified. Staff also saw expenditure restraint as critical for continued achievement of the general government surplus target.

17. **The fiscal framework is well designed and would serve Sweden well over the medium-term.** The discussion of the potential modification of the fiscal framework was partly triggered by proposals recently put forth by the government-appointed Johansson Commission on the implications for stabilization policy in case Sweden decides to join the euro area. The Commission's suggestions—which will be debated over the next several months—include an increase in the surplus target to 2½–3 percent of GDP and the introduction of designated cyclical margins under the expenditure ceilings. The mission argued against raising the surplus target which, inter alia, would impose a strong bias against much-needed further tax reductions; however, some modifications of the expenditure ceiling may be warranted (see Box 2 and the Selected Issues paper). The authorities expect to formally react to the Commission's proposals by the end of this year.

18. **The agenda for income tax reform remained to be completed.** The authorities were doubtful whether the envisaged fourth and final phase of the income tax reform—estimated to cost around 0.7 percent of GDP—could be implemented in 2003. They saw insufficient headroom to absorb the associated revenue decline, and were concerned that the resulting discretionary stimulus could be cyclically ill timed. The mission underlined the adverse supply-side effects of a delay coupled with the envisaged rise in social insurance replacement rates. It argued for completing the income tax reform and implementing offsetting expenditure cuts, consistent with the authorities' strategy of continued balanced reductions in taxation and spending. More broadly, the staff reiterated that a further streamlining of the extensive welfare state would be desirable in order to address the emerging challenges of globalization, European integration, and demography.[5]

19. **The authorities seek to rein in escalating expenditures on sick leave, disability and early retirement through measures for better occupational health**. Long-term sickness absence climbed dramatically since 1998, more than doubling spending on sickness insurance. Almost a quarter million workers were absent from work for over 60 days in 2001. The government has prepared an 11-point program focusing on improving the work environment and treatment for patients, and on helping re-integrate the long-term sick into work. Some changes in eligibility rules may also be considered. See paragraph 22 for further details.

20. **The authorities' medium-term goal is a balanced reduction in taxes and spending, but no concrete proposals are on the agenda.** Sweden's tax burden remains among the highest in the world. The authorities argued that this was partly due to Sweden's practice of taxing benefits, though they agreed that accounting for this effect did not alter the

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[5] For a detailed discussion of these issues, see Box 3 of the last staff report (SM/01/257) and Country Report 01/169.

Box 2. The Medium-Term Fiscal Framework[1/]

Sweden has a well-established fiscal framework that has served the authorities well. The surplus target is set to ensure fiscal sustainability in the face of the demographic transition. The expenditure ceilings have prevented overruns that otherwise may well have occurred over the last years during which the surplus target was often exceeded by a sizable margin. The experience so far also suggests some room for improvement in the framework, particularly regarding the design of the expenditure ceilings.

A government-appointed commission has recently proposed several changes to Sweden's fiscal framework, in the context of the possibility of Sweden joining the euro area. The commission suggested raising the general government surplus target to 2½-3 percent of GDP and introducing dedicated cyclical margins under the expenditure ceilings. The commission argued that raising the surplus target would be necessary to provide sufficient room for stabilization policy once the Stability and Growth Pact (SGP) framework, and thereby the deficit ceiling of 3 percent of GDP becomes binding and an independent monetary policy is no longer possible. Expenditures are currently set below the expenditure ceilings with a margin to provide some room for new policies and a safety cushion for cyclical overspending. So far, the margins have all too often been completely used up for discretionary expenditure increases. Dedicated cyclical margins would address this problem.

The surplus target of 2 percent of GDP is designed to prepare public finances for the adverse effects of ageing over the coming decades. On current projections, (see Appendix I to the Spring Budget, 2001) therefore, there is no need to raise the surplus target on sustainability grounds. The surplus target would also offer considerable room for stabilization policy (5 percent of GDP) if Sweden joins the euro area and the SGP ceiling becomes binding. For example, with a negative output gap of around 4 percent, automatic stabilizers would lead to a worsening of the overall balance of around 3 percent of GDP, leaving 2 percent of GDP for discretionary measures. Only at a negative output gap of 6 percent would automatic stabilizers use up the entire margin for stabilization. However, in such a case of very severe recession, the SGP deficit ceiling would likely not apply, and there would be additional scope for discretionary measures. The EU Commission's (2002) minimum benchmark for the structural deficit is 0.8 percent which would allow automatic stabilizers to work during typical downturns without threatening the deficit ceiling. Taken together, in the staff's view, the reasons for increasing the surplus target are not compelling. Moreover, increasing the surplus target would come at the cost of reduced scope for much-needed tax cuts.

Box 2. The Medium-Term Fiscal Framework (continued)

The expenditure ceilings have been instrumental in keeping a tight rein on spending in the face of large budget surpluses. However, three related weaknesses have emerged. First, the ceilings are not explicitly linked to the surplus target. Second, the margins under the ceilings that are in part set to allow for cyclical overspending have all too often been used up for discretionary increases. Third, the ceilings are not designed to induce symmetric expenditure fluctuations over the cycle. Thus, the expenditure ceilings do not guarantee that the surplus target is achieved, nor do they ensure that expenditures do not become pro-cyclical.

A modified expenditure rule should be clearly linked to the surplus target to ensure that elements of the fiscal framework are consistent. The link should be explained in the budget documents. A cyclically neutral expenditure path could be calculated from structural revenue projections and the surplus target. Actual expenditure would fluctuate around this path over the cycle, with overspending during downturns being offset by under-spending during upturns. The overall balance would fluctuate around the surplus target due to cyclical expenditure and revenue movements. To ensure that common problems associated with estimating structural revenues do not lead to missing the surplus target over the cycle, a cumulative limit could be set on missing the surplus target. In case the overall balance falls systematically short of the surplus target over several years, adjustments would be required.

Nevertheless, given the generally positive experience with expenditure ceilings in Sweden, a ceiling could be set with a margin over the expenditure path. This ceiling would help to control spending pressures that are likely to persist given Sweden's strong fiscal position. Limiting cyclical overspending during downturns risks making expenditures pro-cyclical. However, the overall fiscal stance is likely to be still counter-cyclical as revenues, which typically have a larger automatic stabilizer element, would still be counter-cyclical.

1/ For a more detailed exposition, see the accompanying Selected Issues Paper.

ranking. Noting that the tax burden is concentrated on labor, the mission argued that the tax wedge on labor income—combined with generous benefits—created strong disincentives to work. While the phased income tax reform has reduced somewhat the marginal tax on labor, scope for further reduction remained. Other aspects of the tax system which merited changes included the wealth tax that in practice did not apply to the wealthiest. On the expenditure side, the mission advocated further outsourcing of the provision of some public services to realize efficiency gains; some outsourcing has already occurred in areas such as childcare and elderly care. Finally, the mission urged an early refocusing on reform efforts after the forthcoming elections.

C. Structural Policies and Other Issues

21. **The authorities and staff saw continued structural reforms as critical for raising the potential growth rate.** The authorities pointed to substantial progress made in recent years. In 2001, Sweden had achieved the highest degree of implementation of EU internal market directives. Competition rules and their enforcement have been tightened, and legislative changes aimed at enhancing the efficiency of public procurement and improving financial market competition were being finalized. Staff acknowledged this progress, but stressed that the economy was operating close to its capacity limits, leaving little slack to increase output without productivity gains. To ensure such gains—also the key medium-term source of growth—Sweden needed to address several interrelated issues: raising effective labor supply and improving labor market flexibility; reducing housing market rigidities; and enhancing product and services market competition.

22. **There was agreement on the need to address the mounting erosion of labor supply due to escalating absenteeism as well as early and disability retirement.** The authorities expressed concerns about this trend—keeping a fifth of the labor force away from the workplace in 2001—and agreed that, if not reversed, it would adversely impact the labor market, growth prospects, and public finances. However, they argued that the issue was complex and that the increase could not be attributed primarily to disincentives from the tax-benefit system. Cuts in public spending, particularly in health and education in recent years may have raised stress in the workplace, while the share of older workers, who are more prone to sickness, had risen. Moreover, current levels of absenteeism were not unprecedented in Swedish experience: similar high levels in the early 1990s were reversed, suggesting that the current rise may level off. The officials also underlined the overriding objective of maintaining generous sickness benefits for those in need. Staff noted that while the authorities' program to address the many dimensions of occupational health was a useful step, large work disincentives for low-wage workers and the lack of incentives for employers to limit long-term sickness were important components of the problem that needed to be addressed. In addition, eligibility criteria would need to be tightened. Easing employment protection rules, and further focusing active labor market policies on the long-term unemployed and on supporting job search could also bring employment gains.

23. **The authorities agreed that de facto rent control depressed housing investment and impeded labor mobility, but had no plans for significant deregulation of rental housing.** Rents in Sweden reacted sluggishly to market conditions owing partly to the dominance of municipal housing companies in the rental market. Together with the limited availability of building permits, this contributed to housing investment languishing at a third of the average for the advanced economies during the past 5 years. As a result, large cities with rapid job growth experienced housing shortages. Thus, workers found it hard to move, resulting in regional labor shortages that contributed to wage pressures. Staff suggested freely negotiated rents at least for new contracts, and raising housing supply through enhanced competition in construction. However, citing institutional and legal constraints, the authorities favored improving the flexibility of rent setting in the framework of the current system, which they saw as critical to safeguarding distributional objectives.

24. **A persistent 20 percent excess of the Swedish price level over the EU average highlights the need for further product and services market deregulation.** While about half of the differential is explained by tax differences, the remainder reflects weak competition, especially in the construction and building materials sectors, transportation, and retail trade. The authorities emphasized progress in deregulation, and their stepped-up enforcement of EU rules against concerted anti-competitive practices and the abuse of dominant market positions. They also pointed to ongoing work to raise the efficiency of public procurement and to open up the gas market—the only remaining sheltered network industry—to competition in 2003. Staff noted that divestment of public ownership—including enterprises owned by municipalities—in competitive sectors would further raise competition and help streamline the public sector. However, the authorities saw no urgent need for action in this regard.

25. Sweden has signed all international conventions **against money laundering**, including the international convention for the suppression of the Financing of Terrorism, with enabling legislation coming into force in July 2002. Legislation also conforms to the standards of the OECD's **Anti-Bribery Convention**, to which Sweden is a signatory.

IV. Staff Appraisal

26. **The Swedish economy displayed considerable resilience in the face of the worldwide slowdown in economic growth in 2001.** This resilience was rooted in sound macroeconomic policies and structural reforms implemented over the past decade. Looking ahead, the challenge is to create the basis for sustainable high growth in the medium term by shifting the focus of the policy agenda toward enhancing productivity and labor supply.

27. **Economic activity is projected to pick up in the second half of this year and to gather pace into 2003.** However, the incipient recovery is still somewhat fragile, vulnerable to the continued weakness of the telecom sector, and adverse confidence effects from declining asset markets. Moreover, large wage increases, low productivity growth, and rigidities in product and labor markets could undermine the economy's supply response.

28. **The persistence of high headline and underlying inflation has become a cause for concern.** Several transitory factors related to weather, animal diseases and energy prices accounted for part of the rise in inflation. Nevertheless, indicators of underlying inflation have risen sharply as well. The rise in inflation reflects the high degree of resource utilization and wage inertia, particularly in the service sector.

29. **The gradual tightening of the monetary stance by the Riksbank in recent months underlines its commitment to meeting the inflation target.** The cyclical recovery in productivity combined with the projected moderate rise in unemployment and the easing of labor shortages should contain unit labor costs to a level consistent with the inflation target. The recent increases in the policy interest rate should help restrain wage and price pressures stemming from a rise in inflation expectations. However, there are risks. Unemployment is low and there are scant signs of a slowdown in the growth of labor costs. As the recovery

gathers pace with inflation already high, demand pressures, combined with labor and product market distortions, could push inflation above the target. All in all, a wait-and-see approach is appropriate in light of the uncertain outlook, but the Riksbank should stand ready for further monetary tightening if inflation pressures do not decline.

30. **The fiscal stance in 2002 and 2003 appears consistent with cyclical developments.** The moderately expansionary stance this year should help support the still fragile recovery, while the shift to a broadly neutral stance in 2003 corresponds well to the expected rise in resource utilization. By the time the 2003 budget is formulated, a better picture of the cyclical position will be available, based on which the fiscal stance can be adjusted. It would be desirable to implement the announced fourth and final step of the income tax reform in 2003. The government needs to regain control over the rapidly rising budgetary costs of sickness absences, and of early and disability retirement. Otherwise, the expenditure ceilings may well be breached, which could undermine the credibility of the fiscal framework. In this context, the government's firm commitment to keep expenditures within the ceilings is welcome. Reining in expenditures is also important for continued achievement of the surplus target. While the projected surpluses appear consistent with the 2 percent target over the cycle, any further overspending would likely require fiscal adjustment.

31. **The medium-term fiscal framework will serve the Swedish economy well in the coming years.** The recent proposals of the Johansson Commission for changes in the fiscal framework in the event of euro area membership will continue to be debated in the period ahead. In broad terms, the staff sees the surplus target of 2 percent on average over the cycle as adequate, offering considerable room for stabilization policy during downturns even under the deficit ceiling of the Stability and Growth Pact. However, a modification of the expenditure rule may be warranted, given that the budget margins—partly intended for cyclical fluctuations—have all too often been used up for discretionary increases in spending. A modified expenditure rule should be explicitly linked to the surplus target and structural revenue projections.

32. **The focus of fiscal as well as structural policies—independent of the EMU debate—should be on strengthening the supply side of the Swedish economy.** Beyond the current program of tax reform, it is important for the government to follow through on its general intention to pursue further a balanced lowering of taxation and spending aimed at reducing distortions and maximizing growth and welfare. In this context, reducing the high marginal effective tax rates on labor income and a structural reform of the wealth tax would be the key measures.

33. **The recent favorable performance of employment should not obscure the need for further reforms to enhance the functioning of the labor market.** Wage growth needs to be restrained to reflect gains in productivity. Active labor market policies should continue to shift toward the long-term unemployed, job search support and improvements in the efficiency of programs. Finally, labor mobility should be enhanced by easing employment protection rules and by reducing housing market distortions through liberalizing the rental housing market, and promoting competition in the construction sector.

34. **The decline in unemployment has brought moral hazard problems associated with the welfare system to the surface.** The sharp rise in absenteeism on account of sickness has emerged as an issue with major implications for public finances and the economy's supply potential. These developments contribute to higher costs, lower productivity, and a large increase in public spending. It is essential to reform the system of sickness benefits so as to rein in absenteeism while ensuring generous social benefits to those in need. The government's program of improving occupational health is a step in this direction. However, greater emphasis would need to be placed on changes in the incentive structure and on tightening eligibility criteria.

35. **The authorities should give renewed impetus to the process of enhancing competition in the economy.** The momentum of deregulation seems to have slowed in recent years. Although notable progress was made in liberalizing product markets, particularly in the utilities and telecom sectors, greater efforts to strengthen competition are needed in retail distribution, pharmaceuticals, air transport, and especially construction and rental housing. Further progress in privatizing public enterprises operating in competitive markets would also be desirable.

36. **The staff's recent assessment of Sweden's financial system concluded that the system was sound and complied well with international codes and standards.** While the economic slowdown has weakened the performance of the four major financial groups, stress tests as well as recent experience indicate that they remain robust to market and credit risks in the event of a downturn. Nevertheless, concentration of their exposures to a relatively small number of counterparties and residual risks in the securities settlement system are potential sources of vulnerability. Regulatory and supervisory arrangements comply well with international standards. In light of the systemic importance of large Swedish banks in several countries, the authorities' plans to develop further their arrangements for crisis prevention and management in consultation with other relevant jurisdictions are welcome.

37. **The Swedish authorities are to be commended for their high level of official development assistance** (0.73 percent of GNP), which they intend to raise further.

38. Sweden is expected to remain on the standard 12-month consultation cycle.

Table 1. Selected Economic Indicators

	1997	1998	1999	2000	2001	2002 1/	2003 1/	Average 2004–06 1/
Real economy (in percent change)								
Real GDP	2.1	3.6	4.5	3.6	1.2	1.5	2.5	2.6
CPI	0.5	-0.1	0.5	1.0	2.6	2.3	2.2	2.0
Open unemployment rate (in percent)	8.0	6.5	5.6	4.7	4.0	4.2	4.1	4.0
Participation in labor market programs (in percent)	4.5	4.1	3.3	2.6	2.5	2.4	2.3	...
Gross national saving (percent of GDP)	19.0	19.7	20.7	21.6	20.9	20.3	20.7	21.8
Gross domestic investment (percent of GDP)	15.2	16.0	16.8	17.2	17.2	17.1	17.1	18.1
Public finance (in percent of GDP)								
General government balance	-1.6	2.1	1.3	3.7	4.8	1.8	1.8	1.9
Structural balance 2/	-0.8	4.4	2.9	4.2	2.8	1.8	2.1	1.9
General government debt	74.5	71.8	64.8	55.2	52.0	49.8	47.4	44.7
Money and credit (12-month, percent change)								
M0	3.0	5.1	12.0	1.9	8.8	...	...	...
M3	1.3	2.1	9.9	2.1	6.2	...	...	...
Credit to non-bank public	6.4	6.8	5.6	9.1	8.9	...	...	...
Interest rates (year average)								
Three-month interbank rate	4.1	4.2	3.1	4.0	4.3	...	...	...
Ten-year government bond yield	6.7	5.0	5.0	5.4	5.4	...	...	...
Balance of payments (in percent of GDP)								
Trade balance	10.4	9.1	8.3	7.8	7.2	7.0	7.3	6.3
Current account	2.9	2.8	3.7	3.3	3.2	3.2	3.2	3.1
Reserves (gold valued at SDR 35 per ounce end of period, in billions of SDRs)	11.0	14.3	15.3	15.1	15.0	...	...	...
Reserve cover (months of imports of goods and services)	2.1	2.7	2.8	2.5	2.7	...	...	...
Exchange rate (period average, unless otherwise stated)								
Exchange rate regime	Floating exchange rate							
Present rate (June 24, 2002)	US$ 1 = SKr 9.32							
Nominal effective rate (1995=100)	106.4	104.9	102.8	101.7	93.9	...	...	...
Real effective rate (1995=100) 3/	103.3	100.4	96.7	95.2	87.9	...	...	...

Sources: Statistics Sweden; Riksbank; IMF, International Financial Statistics; INS; and staff estimates.

1/ Staff projections.

2/ In percent of potential GDP, also adjusted for timing of tax revenues.

3/ Based on relative normalized unit labor cost in manufacturing.

Table 2. Sweden: General Government Financial Accounts, 1997–2003

	1997 Act.	1998 Act.	1999 Act.	2000 Act.	2001 Act.	2002 Proj.	2003 Proj.
				(In billions of krona)			
Total revenue	1,073	1,144	1,179	1,225	1,284	1,265	1,318
Primary revenue	992	1,064	1,109	1,158	1,234	1,215	1,262
Tax revenue (incl. charges)	928	995	1,040	1,088	1,160	1,139	1,184
Nontax revenue	64	68	69	70	74	76	77
Interest receipts	82	80	70	67	49	51	56
Total expenditure	1,103	1,105	1,152	1,148	1,179	1,224	1,274
Primary expenditure	983	996	1,053	1,059	1,105	1,156	1,205
Current expenditure	933	964	1,005	1,014	1,055	1,102	1,148
Transfers	449	455	468	465	477	498	524
Consumption	484	509	536	549	578	604	624
Capital expenditure	50	32	48	45	50	54	57
Interest payments	120	108	99	89	74	68	70
Overall balance	-29	39	27	77	105	41	44
Central government	-30	18	75	24	205	-14	-16
Pension system	10	25	-41	48	-102	48	58
Local governments	-10	-4	-7	5	2	8	2
Primary balance	8	68	57	99	129	58	57
				(In percent of GDP)			
Total revenue	58.9	60.0	58.8	58.4	59.2	56.4	55.9
Primary revenue	54.4	55.8	55.3	55.2	56.9	54.1	53.5
Tax revenue (incl. charges)	50.9	52.2	51.9	51.9	53.5	50.7	50.3
Nontax revenue	3.5	3.6	3.5	3.3	3.4	3.4	3.3
Interest receipts	4.5	4.2	3.5	3.2	2.3	2.3	2.4
Total expenditure	60.5	58.0	57.5	54.7	54.4	54.5	54.1
Primary expenditure	53.9	52.3	52.5	50.5	51.0	51.5	51.1
Current expenditure	51.2	50.6	50.1	48.3	48.7	49.1	48.7
Transfers	24.6	23.9	23.4	22.2	22.0	22.2	22.2
Consumption	26.5	26.7	26.7	26.2	26.7	26.9	26.5
Capital expenditure	2.7	1.7	2.4	2.2	2.3	2.4	2.4
Interest payments	6.6	5.7	5.0	4.2	3.4	3.0	3.0
Overall balance	-1.6	2.1	1.3	3.7	4.8	1.8	1.8
Central government	-1.6	1.0	3.7	1.1	9.5	-0.6	-0.7
Pension system	0.5	1.3	-2.0	2.3	-4.7	2.1	2.5
Local governments	-0.5	-0.2	-0.3	0.3	0.1	0.3	0.1
Primary balance	0.5	3.5	2.8	4.7	6.0	2.6	2.4
Memorandum items:							
Gross public debt							
in billion krona	...	...	...	1,438	1,304	1,285	1,285
in percent of GDP	...	...	...	68.5	60.2	57.2	54.5
Nominal GDP (in billion krona)	1,824	1,905	2,005	2,098	2,167	2,245	2,356

Sources: National authorities; and Fund staff calculations.

Table 3. Sweden: Indicators of External and Financial Vulnerability
(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001	
External Indicators							
Exports of goods and services (annual percentage change, in U.S. dollars)	5.3	-0.4	2.8	0.9	2.5	-9.5	
Imports of goods and services (annual percentage change, in U.S. dollars)	5.0	-0.1	6.0	1.5	5.8	-11.5	
Current account balance	2.5	2.9	2.8	3.7	2.6	3.3	
Capital and financial account balance	-1.5	0.9	0.4	-3.1	-1.6	-3.3	
Direct investment, net	0.2	-0.7	-2.0	16.1	-8.4	-1.6	
Portfolio investment, net	-4.7	-4.9	-6.5	-14.7	-2.6	-2.7	
Central Bank reserves (end of period, in billions of U.S. dollars)	20.6	12.0	16.9	18.0	17.7	15.6	
Exchange rate against US dollar (SEK, period average)	6.7	7.6	7.9	8.3	9.2	10.3	
Exchange rate against Euro (SEK, period average)	8.5	8.7	8.9	8.8	8.4	9.2	
Effective exchange rate (TCW-Index, annual percentage change)	8.9	-3.9	-2.2	-1.3	0.2	-9.4	
Real effective exchange rate (based on CPI, annual percentage change)	8.4	-4.9	-2.8	-3.1	-1.9	-8.0	
Financial Markets Indicators							
Consolidated public sector gross debt (end of period)	80.3	78.5	76.0	65.2	55.3	55.9	
3-month T-bill yield (nominal, in percent per annum)	3.9	4.4	3.5	3.4	4.1	3.7	
3-month T-bill yield (ex post real, in percent per annum)	3.4	3.9	3.6	2.9	3.0	1.1	
Spread of 3-month T-bill vs. Germany (percentage points, end of period)	2.5	0.8	0.7	0.2	-0.4	0.4	
Spread of 10-year T-bill vs. Germany (percentage points, end of period)	1.8	1.0	0.4	0.5	0.1	0.5	
General stock index (annual percentage change)	24.8	47.0	16.2	29.2	-11.9	-19.9	
Real estate price index (annual percentage change)	0.8	7.0	9.6	9.2	11.0	6.6	1/
Credit to households (growth rate in percent)	2.2	5.5	6.4	9.0	7.4	8.9	
Financial Sector Risk Indicators							
Risk-weighted capital adequacy ratio (CAR) in four major banks	12.5	10.9	10.4	11.4	9.9	10.0	
Tier 1 capital ratio in four major banks	7.8	7.0	6.9	7.7	6.8	7.1	
Share of foreign exchange loans in percent	12.0	14.3	15.3	14.8	17.3	17.9	
Share of foreign exchange deposits in percent	14.0	20.0	19.4	16.4	24.2	23.1	
Banks' return on capital after tax in percent	22.6	18.9	14.2	16.0	15.7	13.0	
Ratio of households' financial liabilities to financial assets in percent	70.2	65.0	63.0	51.0	64.6	65.4	

Sources: Riksbank; Statistics Sweden; National Debt Office; and staff calculations.

1/ End 3rd quarter 2001.

Sweden: Fund Relations

(As of May 31, 2002)

I. **Membership Status**: Joined 08/31/51; Article VIII

II.	**General Resources Account:**	**SDR Million**	**Percent of Quota**
	Quota	2,395.50	100.00
	Fund holdings of currency	1,582.44	66.06
	Reserve position in Fund	813.07	33.94
	Financial Transaction Plan transfers (net)	68.00	

III.	**SDR Department:**	**SDR Million**	**Percent of Allocation**
	Net cumulative allocation	246.53	100.00
	Holdings	124.22	50.39

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None

VII. **Exchange Arrangements:** The Krona has been floating since November 19, 1992. Under Decision 144-(52/51), Sweden has amended restrictions vis-à-vis the Federal Republic of Yugoslavia (Serbia and Montenegro) and maintains restrictions vis-à-vis Angola (EBD/96/91, 7/12/96) and Iraq (EBD/90/286, 9/10/90).

VIII. **Article IV Consultation:** Discussions for the 2001 Article IV consultation were held in Stockholm, June 11–20, 2001 and the staff report (SM/01/257) was issued on August 15, 2001. The consultation was completed by the Executive Board on August 31, 2001.

IX. **Technical Assistance:** None

X. **Resident Representative:** None

SWEDEN: STATISTICAL ISSUES

National accounts

1. The overall structure of the **national accounts** follows the *System of National Accounts 1993 (1993 SNA)* and the *ESA 95*. The scope of the accounts is consistent with international standards and agreed practices. The data comprise both quarterly and annual accounts; for the latter, a full set of institutional sector accounts, including financial accounts, is compiled. Constant price series are based on Laspeyres chain indices. The delimitation of the economy, the production and asset boundary, and the classifications used are in accordance with internationally recommended systems. Recording is done on an accrual basis taking into account the new EU rules for recording of taxes and social contributions.

Prices

2. The **Consumer Price Index (CPI)** and the **Producer Price Index (PPI)** follow internationally agreed practices and standards in terms of concepts, definitions and use classifications. The scope of the indices follows international standards concerning both weights and the coverage of prices collected. Thus the CPI covers all resident household consumption of goods and services classified according to the Classification of Individual Consumption by Purpose (COICOP), and the PPI includes all resident market-enterprise production of goods classified according to the Combined Nomenclature (CN). The CPI weights and prices refer to market prices; the PPI weights refer to basic prices and the prices collected exclude taxes. The prices collected for the CPI are mid-month prices; the PPI prices are based on average monthly prices.

Government finance statistics

3. Statistics Sweden compiles the **general government** statistics in the context of the national accounts based on the *ESA 95*, which is broadly consistent with the *1993 SNA*. The available data provide a minimum set of variables for fiscal policy. The general government statistics cover the budgetary and extra-budgetary (self-financed) central government, social security funds, and local governments.

4. In documents that accompany the budget, the Ministry of Finance presents an analytical framework showing the previous year's general (and central) government aggregates for revenue, expenditure, and net lending/borrowing along with annual forecasts.

Monetary statistics

5. With regard to the **monetary statistics**, monthly balance sheet data for the Riksbank and the credit institutions are disseminated separately on the Riksbank Internet website. The institutional coverage of these data comprises the central bank and the other depository corporations (ODCs) or deposit money banks that are engaged in financial intermediation and issue liabilities included in the definition of broad money used by the Riksbank. The

monetary and credit aggregates that are disseminated for these institutions are based on international principles of classification and sectorization.

6. However, monetary statistics are not presented in the form of an analytical framework in which the consolidated monetary liabilities of the Riksbank and the ODCs as a group are linked to the claims of these corporations on the nonresident and resident sectors of the economy. While the building blocks exist to construct a monetary survey in which the intrasectoral claims and liabilities of the depository corporation would be consolidated, the absence of this framework complicates the interpretation of the monetary statistics.

Balance of payments statistics

7. Sweden's **balance of payments** statistics are compiled in broad conformity with the conceptual framework of the fifth edition of the IMF's *Balance of Payments Manual (BPM5).* Supplementary guidelines issued by Eurostat and the European Central Bank (ECB) also inform the present structure of BOP statistics. Resident institutional units are classified in accord with the *BPM5*'s concepts of economic territory, residence, and center of economic interest. Classification and sectorization of the BOP are largely consistent with *BPM5*; recent initiatives on the reclassification of financial derivatives in line with revised international standards represent an important contribution in advancing the methodological soundness of Sweden's BOP statistics.

Sweden: Core Statistical Indicators
as of June 20, 2002

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	General Government Balance	GDP/ GNP	External Debt/ Debt Service
Date of Latest Observation	June 14, 2002	May 31, 2002	May 31, 2002	May 2002	April 2002	May 31, 2002	April 2002	April 2002	April 2002	End - 2001	1st Quarter 2002	End-2001
Date Received	June 15, 2002	June 15, 2002	June 15, 2002	June 15, 2002	June 14, 2002	June 15, 2002	June 6, 2002	June 11, 2002	June 11, 2002	April 15, 2002	June 6, 2002	April 15, 2002
Frequency of Data	Daily	Weekly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annually	Quarterly	Annually
Frequency of Reporting	Daily	Weekly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annually	Quarterly	Annually
Source of Update	Commercial	Riksbank	Riksbank	Riksbank	Riksbank	Commercial	Statistics Sweden	Statistics Sweden	Riksbank	Ministry of Finance	Statistics Sweden	Riksbank
Mode of Reporting	On Line	Publication	Publication	On-Line	On-Line	On-Line	On-Line	On-Line	On-Line	Publication	On-Line	On-Line
Confidentiality	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public	Public
Frequency of Publication	Daily	Weekly	Weekly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Annually	Quarterly	Annually

Statement by the IMF Staff Representative
July 31, 2002

The following information on economic and financial developments, which has become available since the release of the staff report (SM/02/207, 7/9/02), does not change the thrust of the staff appraisal.

1. **Growth in early 2002 was subdued but there are signs of a pickup.** National accounts data for the first quarter show that GDP grew by 1.1 percent over a year earlier. However, the activity index—comprising industrial production, public sector working hours, retail sales, and merchandise trade—that has closely tracked GDP in the past, rose by 2.3 percent in the 12 months through May. The consumer confidence index has stabilized at a higher level despite falling equity prices, and the open unemployment rate in June was 4 percent compared with 4.2 percent a year ago. These developments are broadly consistent with the staff's projection of 1½ percent growth for 2002.

2. **Headline inflation in June held steady at a 12-month rate of 2 percent.** Underlying inflation also stayed at 2.2 percent—the same as in May—while its domestic component (excluding imported goods and services) fell to 3.4 percent.

3. **Equity prices fell sharply, with Ericsson suffering further sharp losses.** The Stockholm All Share Index was down by 35 percent this year through July 29. The fall was driven in part by the plummeting share price of Ericsson, which was exacerbated by Moody's July 26 decision to cut the telecoms equipment maker's credit rating to noninvestment status.

4. **The Riksbank left the policy interest rate unchanged at 4.25 percent.** In its July 4, 2002 Executive Board meeting, the central bank also retained its tightening bias in light of continuing concerns about strains on resource utilization. Short and long-term interest rate differentials with the euro area have remained stable and low. The krona appreciated further in June against the euro, but reversed this gain in July. The trade-weighted exchange rate has appreciated by 4½ percent in the first half of 2002.

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IMF Concludes 2002 Article IV Consultation with Sweden

On July 31, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Sweden.[1]

Background

Sweden's strong macroeconomic performance of the past five years is rooted in a credible, rule-based policy framework consisting of the Riksbank's inflation targeting regime and a sound medium-term fiscal framework. Strong public finances have enabled a process of gradual reduction in the high tax burden to begin. Structural reforms reinforced by EU membership have helped raise efficiency and mitigated distortions associated with Sweden's large welfare state. These policies paved the way for growth averaging over 4 percent per annum during 1998–2000 driven by large productivity gains, especially in the technology sector. A thorough pension reform has restored actuarial balance to the public pension scheme in the face of the coming demographic challenge.

A cyclical slowdown in domestic demand coupled with global economic weakness led to slower growth in 2001. Private consumption stagnated despite rising disposable income, owing to adverse confidence and wealth effects from the continued plunge in stock prices. Exports

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

suffered their weakest year in a quarter century, as telecom exports—the driving force behind the recent rapid growth—fell by about a third. The weak krona and supportive fiscal and monetary policies, however, helped contain the severity of the slowdown.

Even though growth slowed down, resource utilization remained high. This, together with structural rigidities and a sequence of relative price shocks, contributed to the persistence of wage and price inflation. The fading of the beneficial effects of earlier deregulation in telecom and electricity sectors, and one-off factors such as animal disease and higher oil prices also added to inflation pressures. As a result, inflation remained well above the Riksbank's 2 percent target, before falling to 2 percent in May 2002. Wage growth accelerated to 4¼ percent, exceeding that in the main trading partners, exacerbating the adverse impact of the cyclical slowdown in productivity growth on relative unit labor costs.

The krona has turned around, reversing a trend of prolonged weakness. Relatively low Swedish interest rates, the bursting of the bubble on Sweden's technology-centered equity market, as well as the relaxation of investment rules for pension funds from 2001 led to sizable portfolio outflows, contributing to depreciation pressures. In the fifteen months through September 2001, the krona depreciated by 16 percent against the euro, but appreciated by 4½ percent against the euro through May 2002—prompted in part by political signals about the adoption of the euro.

While the Riksbank was concerned about growing inflation risks, it cut its policy rate by 50 basis points following September 11 in concert with the worldwide move toward policy easing. As uncertainty subsided, this easing was fully reversed in March-April 2002 to rein in persistent inflation pressures, contributing —together with the strengthening krona—to some tightening of monetary conditions. Although subsequently policy rates were kept unchanged, a tightening bias was maintained.

Public finances remain strong, with fiscal policy firmly anchored in the medium-term framework consisting of a general government surplus target, nominal expenditure ceilings for central government, and a balanced budget requirement for local governments. In 2001, the general government surplus rose to about 5 percent of GDP, benefiting from large dividend distributions and exceptionally high revenues from capital gains taxes. The fiscal stance—calculated as the change in the structural balance corrected for these timing effects in revenues—was nevertheless expansionary to the tune of 1 percent of GDP.

An economic recovery has begun and is expected to gather speed in the second half of the year. With a projected pick-up in domestic demand and in the world economy, activity is expected to strengthen further in 2003. The key downside risks to growth are possible adverse confidence effects from the continuing difficulties of the world telecom sector and a weaker-than-expected global recovery. Inflation is projected to recede toward the Riksbank's 2 percent target over the two-year horizon.

Structural problems may hold back medium-term growth. The Swedish price level substantially exceeds the EU average in part due to market imperfections, notably in construction and retail trade. A compressed wage scale and relatively high marginal effective tax rates contribute to work disincentives. In recent years, a surge in sickness absenteeism and continued high levels of disability retirement have eroded effective labor supply. Finally, de facto rent control and employment protection regulations limit labor market flexibility.

Executive Board Assessment

Directors noted that sound macroeconomic policies, underpinned by a rules-based framework, together with the structural reforms implemented over the past decade, have been instrumental in Sweden's recent strong economic performance. Economic growth has been relatively robust, employment rates are high, the general government and the external current account register large surpluses, and the public debt is declining. Directors observed that the sound policy framework has increased the resilience of the Swedish economy and helped maintain positive growth in the face of the current global economic slowdown.

Directors noted that economic activity is projected to pick up from the second half of this year, on the strength of rising external demand and a favorable competitive position. However, they stressed that the outlook is uncertain. In the near term, the projected recovery remains vulnerable to continued difficulties of the world telecom sector, and adverse confidence effects from declining equity markets. More fundamentally, Directors expressed concern that a shrinking effective labor supply and continuing rigidities in product and labor markets could undermine the economy's supply response. Thus, they recommended more emphasis on policies for enhancing productivity and labor supply to create the basis for sustainable high growth.

Directors endorsed the monetary tightening by the Riksbank earlier this year, and welcomed the decline in headline inflation to around the target level in recent months. However, they cautioned that, if the recovery gathers pace as projected, demand pressures—combined with labor and product market distortions—could again push inflation above the target. In light of this concern, Directors supported a "wait-and-see" approach, with a bias toward further tightening of monetary policy in the near term. Directors also expressed confidence that, in the event of a decision to adopt the euro, Sweden's sound macroeconomic fundamentals should ensure a smooth transition from the inflation-targeting regime to exchange rate stability.

Noting remaining uncertainties—and some fragility—in the projected recovery of the economy, Directors supported Sweden's near-term fiscal plans. In particular, they considered that a moderately expansionary stance in 2002 is warranted, and that the shift to a broadly neutral stance in 2003 is appropriate. They stressed the importance of implementing the announced fourth and final step of the income tax reform in 2003, with parallel measures to contain expenditure.

Directors praised the design and steadfast implementation of Sweden's medium-term fiscal framework. They considered the targeting of a surplus of 2 percent of GDP over the business cycle to be appropriate. This target was generally viewed as giving sufficient room for stabilization policy during downturns, even given the deficit ceiling of the Stability and Growth

Pact, while allowing enough scope to bring down Sweden's high tax burden. Directors noted that the surpluses projected by the authorities appear to be consistent with this target. They welcomed the authorities' firm commitment to nominal expenditure ceilings: this is essential to ensure that the general government surplus target will continue to be met. Directors stressed, however, that continued spending pressures may necessitate further adjustment efforts. They considered that a modification of the expenditure rule could prove useful, particularly to ensure that discretionary spending does not use up the cyclical margins built into the budget by the authorities.

Directors stressed that fiscal and structural policies should focus on strengthening the economy's supply side. Beyond the current program of tax reform, the authorities should follow through on their intention to pursue a further balanced lowering of taxation and spending, aimed at reducing distortions and maximizing growth and welfare. Key measures in this context would include reducing the high marginal effective tax rates on labor income, reforming the wealth tax, and containing the rapidly rising budgetary costs of early retirement and sickness absence.

Concerning the system of sickness benefits, Directors considered it essential to put in place reforms that would rein in escalating absenteeism, while ensuring adequate social benefits to those in need. The sharp rise in absenteeism has contributed to higher costs, lower productivity, and a large increase in public spending, with adverse implications for public finances and the economy's supply potential. While Directors saw the government's program of improving occupational health as an important first step, they urged greater emphasis on changes in the incentive structure to address moral hazard issues. They suggested tightening eligibility criteria, as well as increasing employers' financial responsibility.

Directors encouraged the authorities to enhance labor mobility by easing employment protection rules and by liberalizing the rental housing market. The case for reviewing policies affecting the integration of immigrant labor into the labor force was also mentioned. Directors saw a need for further widening the compressed wage structure, restraining wage growth to reflect gains in productivity, and focusing active labor market policies toward the long-term unemployed and job search support.

Directors noted that the momentum of deregulation seems to have slowed in recent years. They stressed the need to enhance competition in the economy, especially in retail distribution, air transport, pharmaceuticals, construction, and rental housing. They also noted that further progress in privatizing public enterprises operating in competitive markets would be desirable.

Directors welcomed the favorable findings of the Financial System Stability Assessment, which concluded that Sweden's financial system, and its regulatory and supervisory arrangements, comply with international codes and standards. They noted that stress tests, as well as recent experience, indicate that the major financial groups remain robust to market and credit risks in the event of a downturn. However, the concentration of the major financial groups' exposures to a relatively small number of counterparties, and residual risks in the securities settlement system, are considered potential sources of vulnerability that need close monitoring. In light of the systemic importance of large Swedish banks in several countries, Directors welcomed the authorities' intentions to review and strengthen the resources and powers of the supervisory authority, and to address the risks in the securities settlement system. They commended also the recent joint Nordic risk management exercise, and the authorities' plans to develop further their arrangements for crisis prevention and management in consultation with other relevant jurisdictions. Directors also welcomed the authorities' legislative efforts to combat money laundering and the financing of terrorism.

Directors praised the high level of Swedish official development assistance and welcomed the authorities' intention to raise it further from its current level of 0.73 percent of GNP.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board. The Staff Report for the 2002 Article IV Consultation with Sweden is also available.

Selected Economic Indicators

	1997	1998	1999	2000	2001	2002 1/	2003 1/
Real economy (change in percent)							
Real GDP	2.1	3.6	4.5	3.6	1.2	1.5	2.5
Domestic Demand	0.9	4.2	3.5	3.6	0.3	1.2	2.3
CPI	0.5	-0.1	0.5	1.0	2.6	2.3	2.2
Open unemployment rate (in percent)	8.0	6.5	5.6	4.7	4.0	4.2	4.1
Participation in labor market programs (in percent)	4.5	4.1	3.3	2.6	2.5	2.4	2.3
Gross national saving (percent of GDP)	19.0	19.7	20.7	21.6	20.9	20.3	20.7
Gross domestic investment (percent of GDP)	15.2	16.0	16.8	17.2	17.2	17.1	17.2
Public finance (in percent of GDP)							
General government balance	-1.6	2.1	1.3	3.7	4.8	1.8	1.8
Structural balance 2/	-0.8	4.4	2.9	4.2	2.8	1.8	2.1
General government debt	74.5	71.8	64.8	55.2	52.0	49.8	47.4
Money and credit (12-month, percent change)							
M0	3.0	5.1	12.0	1.9	8.8	...	...
M3	1.3	2.1	9.9	2.1	6.2	...	...
Credit to non-bank public	6.4	6.8	5.6	9.1	8.9	...	...
Interest rates (year average)							
Three-month interbank rate	4.1	4.2	3.1	4.0	4.3	...	...
Ten-year government bond yield	6.7	5.0	5.0	5.4	5.4	...	...
Balance of payments (in percent of GDP)							
Trade balance	10.4	9.1	8.3	7.8	7.2	7.0	7.3
Current account	2.9	2.8	3.7	3.3	3.2	3.2	3.2
Reserves (gold valued at SDR 35 per ounce end of period, in billions of SDRs)	11.0	14.3	15.3	15.1	15.0	...	...
Reserve cover (months of imports of goods and services)	2.1	2.7	2.8	2.5	2.7	...	...
Exchange rate (period average, unless otherwise stated)							
Exchange rate regime	Floating exchange rate						
Present rate (June 24, 2002)	US$ 1 = SKr 9.32						
Nominal effective rate (1995=100)	106.4	104.9	102.8	101.7	93.9	...	...
Real effective rate (1995=100) 3/	103.3	100.4	96.7	95.2	87.9	...	...

Sources: Statistics Sweden; Riksbank; IMF, International Financial Statistics; INS; and IMF staff estimates.

1/ Staff projections.
2/ In percent of potential GDP, also adjusted for timing of tax revenues.
3/ Based on relative normalized unit labor cost in manufacturing.

Statement by Benny Andersen, Alternate Executive Director and Åke Törnqvist, Advisor to the Executive Director for Sweden
July 31, 2002

Our authorities wish to express their appreciation to the staff for the constructive discussions in Stockholm and for the insightful and balanced reports on the Article IV Consultation and the FSAP. They also found the Selected Issues Paper quite useful. Our authorities' views are very much in line with the assessments of the reports. They agree with the staff that while the stance of fiscal and monetary policy is appropriate for the time being, vigilance is required in view of the risks at hand. Moreover, our authorities agree that further structural measures may be needed in order to foster a sustainable, high growth rate.

The Swedish economy has started to recover from the relatively brief but considerable slowdown in growth in 2001, caused mainly by international developments and problems in the telecommunications sector. High credibility of economic policy has permitted a supportive stance of both fiscal and monetary policy. Inflation is currently in line with the inflation target after a year of higher inflation, that was mostly the result of a number of temporary supply-side factors.

GDP growth is expected to be around 1.5 percent in 2002, before accelerating above the potential rate in 2003 and 2004. While conditions are in place for an upswing in economic growth, the recent developments in domestic and international financial markets have led to increased uncertainty.

Fiscal Policy

The central target of fiscal policy, adopted by the Government and the Parliament, is to maintain an average general government surplus equivalent to 2 percent of GDP over the business cycle. The main aim is to strengthen the financial position of the general government sector in preparation for the consequences of the pending demographic changes over the next few decades. Simultaneously, the surplus target creates sufficient scope for avoiding excessive deficits in a recession, in line with the fiscal framework of the EU.

In the Government Budget Bill for 2002, the Government stated that the target for the surplus should remain at 2 percent of GDP. It was also said that a lower surplus would be accepted if the economic situation developed less favorably than expected. Economic growth is now predicted to be substantially weaker than was foreseen in the Government Budget Bill. Growth has been revised downward from 2.4 to 1.4 percent and the surplus in the general government sector's finances is estimated at 1.8 percent. The strength of the public finances has allowed the automatic stabilizers to work fully in the downturn. It has also permitted a degree of discretionary fiscal expansion to support growth and employment without jeopardizing the medium-term fiscal policy objectives.

Between 2002 and 2003, the surplus in public finances is expected to remain unchanged. Expenditure reforms already announced will lead to a reduction in the surplus of 0.4 percent of GDP, which will offset the tightening arising from, among other things, a continued improvement in net property income. A broadly neutral fiscal stance seems appropriate for 2003. The Government will assess the possibilities to go ahead with the fourth step of the income tax reform in the Budget Bill for 2003. This is the final step in a series of income tax reductions to compensate for earlier increases in social security contributions as well as increases of the threshold level for the state income tax, the fourth step amounting to 0.7 percent of GDP. The assessment will be dependent on the economic situation as well as the development of public finances.

Monetary Policy

Monetary policy in 2001 was conducted against the background of an increasingly pronounced international slowdown combined with rising domestic inflation. This challenging combination complicated monetary policy decisions, particularly as the krona also depreciated. The Riksbank decided to raise the repo rate in July and lower it in September, following the terrorist attacks in the USA. The situation became clearer early this year. The assessment that inflation one to two years ahead might be somewhat above the inflation target warranted a less expansionary monetary policy. The repo rate was accordingly raised in March and April by 50 basis points in total. As the temporary price effects ceased to influence inflation figures during the spring, inflation fell back in line with the target. The inflation outcome might also to some extent have been influenced by the appreciation of the krona in 2002. Still, both wage increases and resource utilization remain relatively high despite the slowdown and inflationary expectations are judged to be slightly above the inflation target.

The Riksbank agrees with the staff that the degree of uncertainty in the forecast remains large. The development in stock markets may have a negative effect on future growth, despite relatively good data on economic activity lately. But a risk of higher inflation associated with the high level of resource utilization and the inflation propensity in a broader sense within the Swedish economy remains. Thus, it is reasonable to assume that monetary policy will be gradually shifted in a less expansionary direction in the future.

Structural Policies

The labor market situation continues to be strong and open unemployment is still below 4 percent, which was the Government's target to be reached in the year 2000. The policy must now focus on efforts to increase employment and participation rates with the aim to support labor supply. The number of persons in labor market programs and in exceptional education initiatives has started to decrease and this trend will continue. Income tax reductions as well as the cap on day care charges are strengthening labor supply incentives. Our authorities share the staff's concern about sick leave developments. The Government is actively working with this issue, in accordance with an 11-point program launched in last year's budget bill. The program includes discussions between the Government and the Social Partners, economic incentives for employers to take preventive measures to reduce health problems among their employees and other measures to improve the environment at work. Incentives in the systems for early retirement and for sick leave are, as the staff emphasize, important. But it is equally important to provide adequate income support for those who for medical reasons permanently or temporarily cannot work. Thus, reducing net replacement rates are not a priority option.

The Government is implementing measures to increase competition and promote lower prices. The competition rules are being tightened in order to increase the effectiveness of the legislation. EU rules in this area are fully applied. The authorities are looking into additional measures to increase competition in the network industries, in the electricity market and in domestic aviation as well as in important sectors such as foodstuffs and building materials. Public procurement is being made more efficient.

FSAP

The Swedish authorities appreciate the opportunity to have had Sweden's financial sector assessed by the Fund. The assessment is an important tool for evaluating financial sector conditions and is from our perspective beneficial. It provides a valuable input into the efforts further to strengthen the financial sector by enhanced legislation, supervision and oversight. The authorities share most of the views expressed by the mission. In the few cases in which that is not the case, the views of the authorities are clearly stated in the report. Nevertheless, a few additional comments may be pertinent.

Like in a number of other countries, Sweden's banking sector has become highly concentrated. In addition, financial institutions in countries like Sweden nowadays run a more internationally integrated cross-border business. This results in a number of challenges for the authorities, which are important to address. The report will be very useful for this purpose.

The report recommends that the authorities take special action on two main issues.
The first issue is the structure of the Swedish securities settlement system. Sweden, like a number of other countries, has a multilateral net settlement process that is not protected against the default of a participant. Such a process does not comply with international standards. The authorities have taken action and the Swedish Central Securities Depository (VPC) has decided to eliminate the risk of unwinding of transactions. In June the Executive Board of the Riksbank decided to act as settlement agent for the cash leg in the way proposed by the VPC. The intent is to implement the new process during the first half of 2003.
The second issue is the resources and powers of the supervisory authority. On July 11, 2002, the Government commissioned a report on the future role and resources of Finansinspektionen, the Swedish financial supervisory authority. The Finance Minister stressed that the scope for the inquiry should be to strengthen Finansinpektionen both with resources and formal power. The background for the inquiry is the changes in regulation that currently are being initiated both nationally and internationally, as well as the assessment made by the Fund. The report is due on February 28, 2003.

These two issues show that the authorities are ready to take swift action, building on the work of the FSAP mission.

The authorities believe that the FSAP process is important for stabilizing the financial sector globally. That objective is enhanced by a high level of transparency, not least with respect to countries with a well-developed financial sector. Hence, the authorities consent to the Fund's publication of the FSSA report.

Finally, our authorities wish to thank Mr. Thakur and his team and Mr. Johnston and his team for excellent cooperation during the Article IV Consultation and the FSAP.