Kingdom of Sweden
Rating Report

AAA STABLE OUTLOOK

Credit strengths

- Wealthy, diversified economy
- Strong fiscal framework and low level of public debt
- Robust external position

Credit challenges

- High levels of household and corporate debt
- Risk of a severe housing market correction

Rating rationale:

Wealthy, diversified economy: Sweden's economy recovered quickly from the Covid crisis. Growth in 2021 was supported by private consumption, investments and contact-related services. Inflationary pressures are causing a slowdown since mid-2022 with economic growth expected to turn negative in 2023.

Robust fiscal framework and low public debt ratio: A credible fiscal policy framework enabled the government to implement an effective fiscal response to the Covid-19 pandemic with a focus on the green transition and inclusion objectives. It also puts the government in a strong position to shield households from rising energy prices and from increased military spending. The rating is supported by the strong fiscal framework, which anchors the debt-to-GDP ratio at 35% (+/-5%).

Robust external position: Sweden is an open, diversified economy that has benefited from current account surpluses over the last two decades and has a net external creditor position. Paired with a good level of reserves, the latter shields the country from short-term shocks.

Rating challenges include: i) financial stability risk, including from high levels of household and corporate debt; and ii) risk of a severe correction in the housing market.

Sweden's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aaa	0	+1/3	AAA
Public Finance Risk		20%	aaa		+2/3	
External Economic Risk		10%	aa-		+1/3	
Financial Stability Risk		10%	aaa		-1/3	
ESG Risk	Environmental	5%	aaa		+1/3	
	Social	7.5%	bb+		0	
	Governance	12.5%	aaa		+1/3	
Indicative outcome		**aaa**			**+2**	
Additional considerations					**0**	

Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's 'Sovereign Ratings' methodology. Source: Scope Ratings.

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced over the next 12 to 18 months.

Positive rating-change drivers

- N/A

Negative rating-change drivers

- Significant deterioration in the fiscal outlook
- Significant deterioration in the economic outlook, for example resulting from a sharp correction in the housing market

Ratings and Outlook

Foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Lead Analyst

Eiko Sievert
+49 69 6677389-79
e.sievert@scoperatings.com

Team Leader

Dr Giacomo Barisone
+49 69 6677389-22
g.barisone@scoperatings.com

Scope Ratings GmbH

Neue Mainzer Straße 66-68
60311 Frankfurt am Main

Phone +49 69 6677389-0

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891-0
Fax +49 30 27891-100

info@scoperatings.com
www.scoperatings.com

Bloomberg: RESP SCOP

Domestic Economic Risks

- **Growth outlook:** Sweden's economy rebounded quickly from the Covid-19 crisis, growing by 4.8% in 2021 following a contraction of 2.8% in 2020. By early-2021, economic output reached pre-pandemic levels on the back of strong private consumption, recovering investments and contact-related services. The strong growth momentum continued during the first half of 2022 but has since slowed significantly due to the fallout from the Russia-Ukraine war. While the two countries account for less than 2% of Swedish exports, wider inflationary pressures and the close interconnection with European electricity markets caused energy prices to surge. This has resulted in increasingly tighter financial conditions and a slowdown in the housing market. We expect GDP to increase by 2.7% in 2022, but contract by 0.3% in 2023.

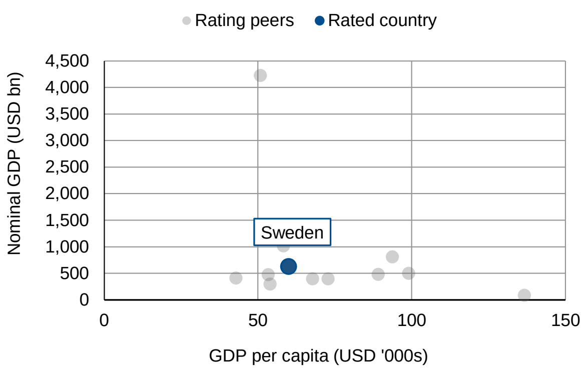
- **Inflation and monetary policy:** Inflation has been increasing rapidly since mid-2021, rising from 2.4% in August 2021 to 9.0% in August 2022. Even when excluding the impact of higher energy prices, core inflation was still exceptionally high at 6.8%, well above the Riksbank's target of 2%. Inflation is projected to increase further in the short term, reaching 11% at the beginning of next year before easing in 2024. In response, the Riksbank's Executive Board raised the policy rate by 1 percentage point to 1.75% in September and, while the outlook remains highly uncertain, further policy rate hikes are expected. We now expect the policy rate to reach 2.25% by the end of 2022. In addition, the Riksbank is expected to cease asset purchases by the end of the year. Asset holdings have already started to decline in 2022 and currently amount to just over SEK 856bn as maturing assets exceeded purchases.

- **Labour markets:** Sweden's labour market has recovered strongly from the Covid-19 shock. With labour markets remaining tight despite the slowing economic growth, the employment rate reached its highest level in more than a decade at 69.3% in August. Similarly, the unemployment rate fell to 6.9% in August, remaining well below the pre-pandemic level of 7.4% in January 2020. While wage growth has been muted so far, the large increase in inflation and broad labour shortages across most sectors and regions is likely to push up wages. In combination with slower economic growth, we expect this to result in a higher unemployment rate, averaging 7.7% in 2023, up from 7.4% in 2022.

Overview of Scope's qualitative assessments for Sweden's *Domestic Economic Risks*

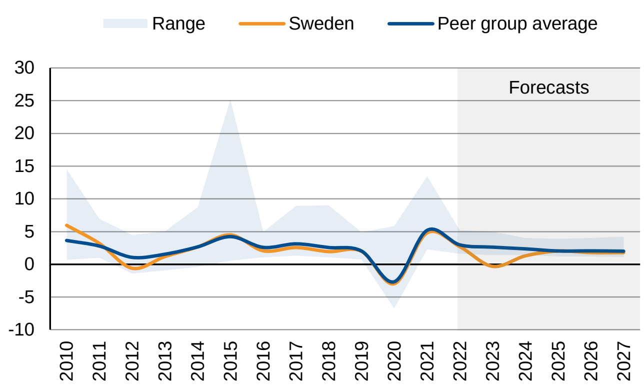
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Neutral	0	Moderate growth potential
	Monetary policy framework	Neutral	0	Riksbank is a credible and effective monetary authority
	Macroeconomic stability and sustainability	Strong	+1/3	Competitive economy, favourable business environment and highly skilled labour force, healthy labour market with high employment and labour force participation rates

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

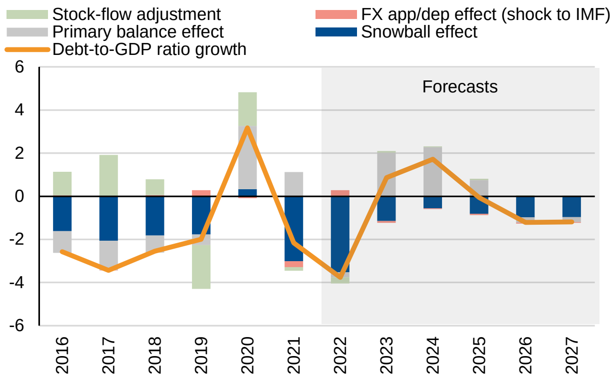
Public Finance Risks

- **Fiscal outlook:** The strength and resilience of the public finance position enabled the government to adopt a large package of fiscal measures during the Covid-19 pandemic. This amounted to SEK 385bn of budgeted measures in 2020-21 (7.2% of 2021 GDP) and an additional SEK 989bn (18.4% of 2021 GDP) in various forms of liquidity, loans and guarantees. Government projections from May 2022 published in the convergence programme estimate a surplus of 0.2% of GDP this year due to higher revenue from consumption taxes as a result of higher inflation. We expect budget deficits of around 2% of GDP in 2022 and 2023 reflecting an expected outflow of capital from tax accounts, partially offsetting higher tax income, and a fiscal policy set to remain expansionary in the short term. This particularly reflects increased expenditure in social care services to support Ukrainian refugees and higher defence spending given the objective to spend 2% of GDP in the near term, up from SEK 76.6bn (1.3% of GDP) in the 2022 budget. Moreover, we expect additional support to help with rising electricity prices, beyond the 0.3% of 2021 GDP already introduced in March.
- **Debt trajectory:** The debt-to-GDP ratio increased from 35% in 2019 to almost 40% in 2020, before declining to 37% last year. We expect debt-to-GDP to fall below pre-pandemic levels this year, reaching 33.5%. Slower economic growth and rising spending pressures are then expected to increase debt levels to around 36% by 2024 before gradually declining. The debt level is therefore set to remain within the limit of the 35% (+/-5%) of GDP threshold specified in the fiscal framework. Sweden's debt level remains one of the lowest among EU member states.
- **Debt profile and market access:** Sweden benefits from strong market access and low financing costs. In line with other highly rated countries, the 10-year government bond yield has increased since March 2022, rising from 0.4% to more than 2% in September. Given the expected persistence of an expansionary fiscal policy, borrowing requirements for 2022-23 will be SEK 52bn higher than forecasted by the Swedish National Debt Office in February, and interest payments are projected to increase slightly given rising interest rates. The Debt Office is planning to meet the higher borrowing requirements by increased short-term borrowing, increasing the volume of treasury bills while keeping the volume of government bonds and inflation-linked bonds constant.

Overview of Scope's qualitative assessments for Sweden's *Public Finance Risks*

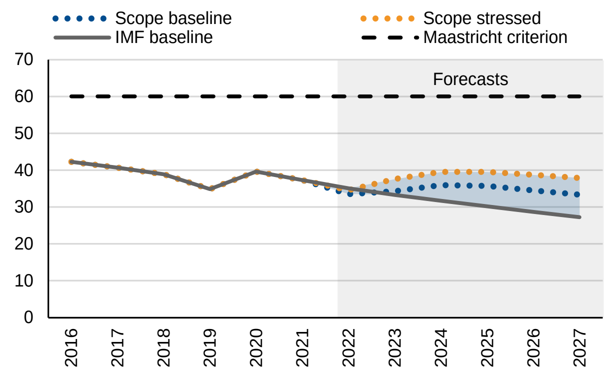
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Fiscal policy framework	Strong	+1/3	Appropriate countercyclical response to the Covid-19 crisis, track record of prudent fiscal policies
	Debt sustainability	Strong	+1/3	Declining public debt trajectory in the mid to long term
	Debt profile and market access	Neutral	0	Excellent market access, low government financing costs, relatively short debt maturity

Contributions to changes in debt levels, pps of GDP



Source: Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

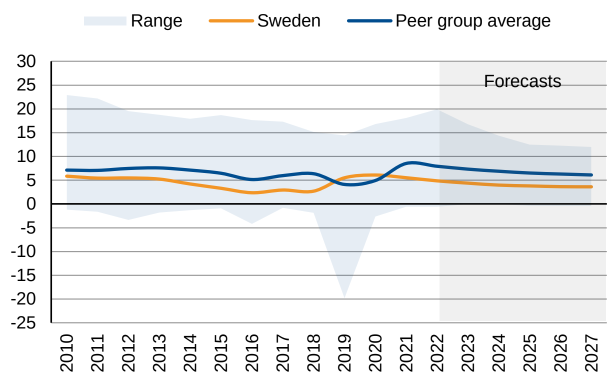
External Economic Risks

- **Current account:** Sweden has been running consistent, albeit declining, current account surpluses for the past two decades. The current account surplus widened to 6.1% of GDP in 2020, but has since been declining, reaching 2.4% in Q2 2022. The decline is due to higher imports of services and a weaker export performance. Particularly car and truck manufacturers were impacted by supply chain disruptions which hampered production. However, full order books of exporters and the easing of supply chain problems indicate continued stable activity in the sector. We expect that the wider economic slowdown will result in a slowing of new orders and therefore a decrease in goods exports next year. The IMF projects that the current account balance will stabilise at just under 4% in the medium term.
- **External position:** Sweden's external debt stood at 178.1% of GDP in Q2 2022, 8 pps higher than in 2021, but significantly lower compared with 2009 debt levels of around 200% of GDP. External debt is mainly related to financial institutions (60% of total external debt), intercompany lending (21%) and non-financial corporates (15%), while the central bank and government account for the remaining 5%. Sweden's international reserves amounting to 11% of GDP in July 2022, provide a buffer against financial market volatility.
- **Resilience to shocks:** Official reserve assets averaged USD 44bn in 2021 (7% of GDP) and stood at USD 44.2bn in July 2022. Given Swedish banks' high dependence on wholesale funding in foreign currency and the disruptions that can occur to such funding in times of financial distress, it is important for Sweden to maintain adequate levels of foreign reserves. Sweden's net international investment position continued to improve, reaching 20% of GDP in 2021. It increased further during the first half of 2022 mainly due to a greater decline of the Swedish stock market compared with international stock markets. This reflected that foreign-held assets in Sweden decreased more in value than Swedes' assets abroad.

Overview of Scope's qualitative assessments for Sweden's *External Economic Risks*

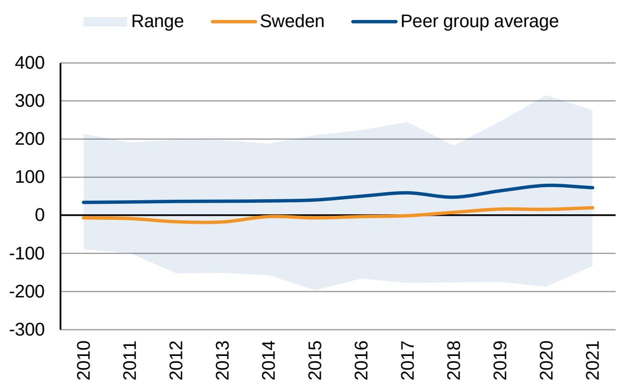
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Current account resilience	Neutral	0	External sector competitiveness underpins track record of current account surpluses
	External debt structure	Neutral	0	High external debt, especially as concerns the financial institutions sector, in line with peers
	Resilience to short-term shocks	Strong	+1/3	Net external creditor position

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

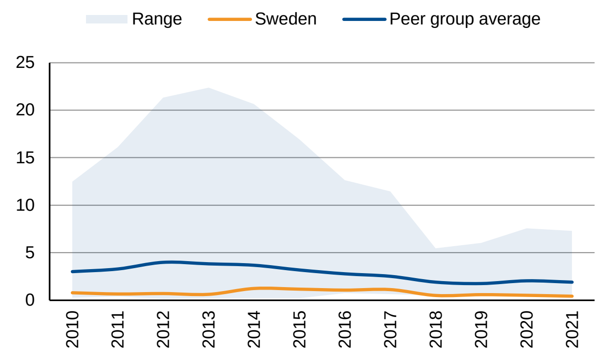
Financial Stability Risks

- **Banking sector:** The Swedish banking sector is large. It is concentrated in five major banks that are highly interconnected and dependent upon global financial markets for funding. The sector remained resilient during the Covid-19 crisis, supported by significant capital buffers, stable CET1 ratios of around 20% and low levels of non-performing loans. Given rising energy and commodity prices, the risk of an economic slowdown and expectations of higher interest rates, the Swedish Financial Supervisory Authority decided in June to increase the countercyclical capital buffer to 2%, effective from June 2023. The rise in mortgage rates and the correction in house prices poses a challenge for the banking sector. Stress tests conducted by the Financial Supervisory Authority indicate that banks could suffer higher credit losses if financing costs remain elevated as highly leveraged real estate companies would face lower earnings.
- **Private debt:** Private sector debt stood at 268% of GDP, the highest on record and the highest among Nordic economies. Debt levels of Swedish households fell slightly during the pandemic from a peak of 95% in Q1 2021 to 92% in Q1 2022. However, their debt-to-income ratio has increased by more than 35 pps in the past 10 years and exceeded 200% in early 2022. Household debt mainly relates to mortgages and as nearly half of mortgages have refinancing terms of less than one year, rapidly rising interest rates are expected to pressure household incomes. Debt levels of non-financial corporations also remain at their highest level on record at 181% of GDP in Q1 2022. Corporate debt has mainly grown in the form of bank loans and more than 40% of total loans relate to real estate companies where refinancing risks have increased.
- **Financial imbalances:** The HOX Index (which measures Swedish residential real estate prices) reached its peak of 303.4 in March 2022. Since then, it has declined every month, falling 8.7% by August. Further falls in house prices are widely expected reflecting a broad market correction in response to rapidly rising interest rates. One of the main vulnerabilities in the Swedish banking sector relates to its growing exposure to the commercial real estate sector, representing between 10% and 25% of banks' lending. Additional risks for the banking sector stem from the high degree of cross-border activity. While direct exposure to the Russia-Ukraine war is low, several Swedish banks have operations and investments in the more exposed Baltic countries.

Overview of Scope's qualitative assessments for Sweden's *Financial Stability Risks*

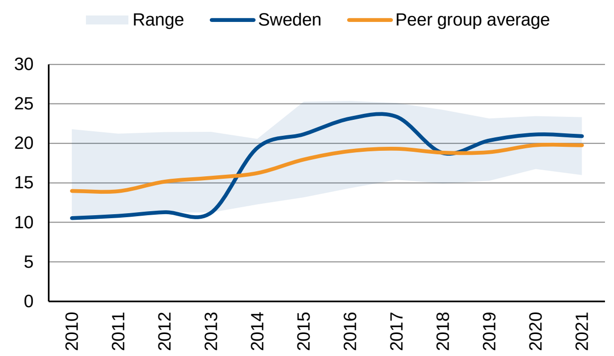
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	High bank capitalisation levels, dependent on global financial markets for funding
	Banking sector oversight	Neutral	0	Prudent oversight under Riksbank and FSA
	Financial imbalances	Weak	-1/3	High private sector indebtedness, large size of the banking sector vis-à-vis the real economy, high interconnectedness in the financial system

Non-performing loans, % of total loans



Source: World Bank, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

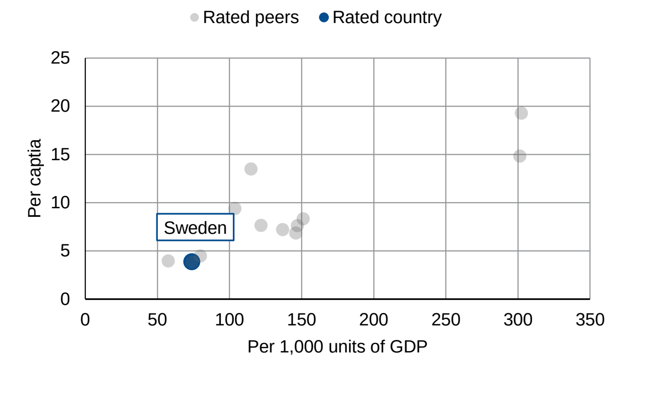
ESG Risks

- **Environment:** Sweden is on track to meet its EU greenhouse gas (GHG) emission reduction target of 50% by 2030. In addition, it aims to meet 100% of its electricity needs from renewable sources by 2040 and become a net-zero economy by 2045. According to the Climate Policy Council of Sweden, however, policies need to be further strengthened in order to achieve the ambitious neutrality target in 2045. In 2021, around 29% of energy consumption came from fossil fuels, 22% from nuclear and 49% from renewable sources, in particular hydropower. The country has a low dependence on natural gas, which accounts for only 2% of its total energy consumption. Of that, approximately 13% is imported from Russia, along with just 8% of Sweden's total crude oil imports, mitigating risks of shortages or supply disruptions. Sweden was one of the first countries to implement a carbon tax in 1991 and currently imposes it at SEK 1200 (around EUR 110) per tonne, which is among the highest levels in the world, although still applied to a limited share of carbon emissions.
- **Social:** Sweden has relatively favourable demographics, with a working age population projected to remain stable over the medium term, and an advanced social safety net, contributing to low income inequality. The national employment rate is well above the EU average (80.7% of the total population aged 20 to 64 in 2021 vs an EU average of 73.1%) and the gender-employment gap is among the lowest in the EU (5.3% of total population in 2021 vs 11%). The level of digital skills is very high when compared with other EU countries.
- **Governance:** In September's general elections the right-wing coalition including the Moderates, Sweden Democrats, Christian Democrats and Liberals secured 176 of 349 seats in the Riksdag, against 173 obtained by the Centre-Left which includes the ruling Social Democrats. The Moderates' leader Ulf Kristersson has been mandated to form a new government, a process which is likely to take some time and that could also result in the formation of a minority government which relies on one of the right-wing parties outside the coalition to obtain a majority in Parliament. The far-right Sweden Democrats, having obtained 76 seats, will play a fundamental role in the creation of a new ruling coalition. It also remains to be seen how much their anti-immigration and Eurosceptic positions will influence the new government's policy programmes.

Overview of Scope's qualitative assessments for Sweden's *ESG Risks*

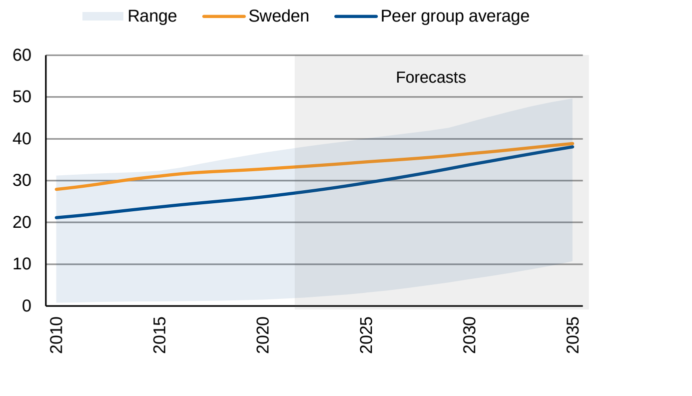
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Environmental factors	Strong	+1/3	High environmental standards, ambitious targets for achieving carbon neutrality by 2045, very high carbon taxes
	Social factors	Neutral	0	Relatively favourable demographics, advanced social safety net, healthy labour market
	Governance factors	Strong	+1/3	High-quality institutions and stable political environment

CO_2 emissions per GDP and GHG per capita, $mtCO_2e$



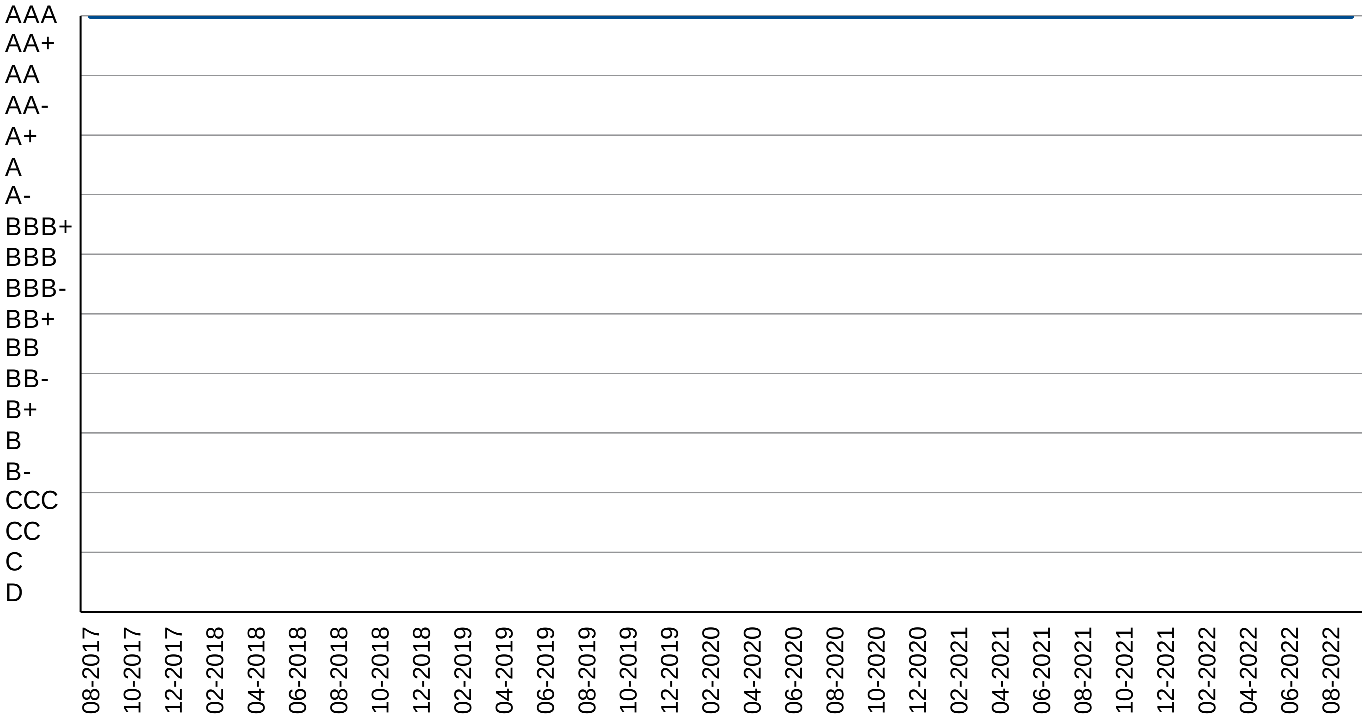
Source: European Commission, Scope Ratings

Old age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard embedding a methodological reserve-currency adjustment.

Peer group*
Denmark
Finland
Germany
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Core variable	Source	2017	2018	2019	2020	2021
GDP per capita, USD '000s	IMF	53,459	54,296	51,694	52,170	60,029
Nominal GDP, USD bn	IMF	541.0	555.5	533.9	541.5	627.4
Real growth, %	IMF	2.6	2.0	2.0	-2.9	4.8
CPI inflation, %	IMF	1.9	2.0	1.7	0.7	2.7
Unemployment rate, %	World Bank	6.7	6.4	6.8	8.3	8.7
Public debt, % of GDP	IMF	40.7	38.9	34.9	39.6	37.3
Interest payment, % of revenue	IMF	-0.1	-0.1	-0.1	-0.2	-0.2
Primary balance, % of GDP	IMF	1.4	0.8	0.5	-2.9	-1.1
Current account balance, % of GDP	IMF	3.0	2.7	5.5	6.1	5.5
Total reserves, months of imports	IMF	2.8	2.5	2.4	2.8	2.4
NIIP, % of GDP	IMF	-0.9	7.9	16.4	15.8	20.0
NPL ratio, % of total loans	IMF	1.1	0.5	0.6	0.5	0.4
Tier 1 ratio, % of RWA	IMF	23.2	23.1	18.5	18.8	21.1
Domestic credit to private sector, % of GDP	World Bank	131.3	131.9	131.1	139.2	-
CO_2 per EUR 1,000 of GDP, $mtCO_2e$	EC	85.0	80.6	82.7	80.6	-
Income inequality (bottom 50%), % of adults	World Bank	24.1	24.3	24.3	23.8	23.8
Labour-force participation rate, %	World Bank	82.7	83.0	83.1	-	-
Old-age dependency ratio, %	UN	32.0	32.2	32.5	32.8	33.1
Composite governance indicators*	World Bank	1.7	1.7	1.7	1.6	-

* Average of the six World Bank Worldwide Governance Indicators

Appendix IV. Economic development and default indicators

IMF Development Classification	Advanced economy
5y USD CDS spread (bps) as of 7 October 2022	18.0

Scope Ratings GmbH

Headquarters Berlin

Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main

Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

Paris

10 avenue de Messine
F-75008 Paris

Phone +33 6 62 89 35 12

Oslo

Karenslyst allé 53
N-0279 Oslo

Phone +47 21 62 31 42

Madrid

Paseo de la Castellana 141
E-28046 Madrid

Phone +34 91 572 67 11

Milan

Via Nino Bixio, 31
20129 Milano MI

Phone +39 02 30 31 58 14

Scope Ratings UK Limited

London

52 Grosvenor Gardens
London SW1W 0AU

Phone +44 20 7824 5180

info@scoperatings.com
www.scoperatings.com

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