

Rating Object	Rating Information	
KINGDOM OF SWEDEN Long-term sovereign rating Foreign currency senior unsecured long-term debt Local currency senior unsecured long-term debt	Assigned Ratings/Outlook: AAA /stable	Type: Initial Rating, unsolicited
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Rating Action

Neuss, 03 March 2017

Creditreform Rating has published the unsolicited long-term sovereign rating of "AAA" for the Kingdom of Sweden. Creditreform Rating has also published Sweden's unsolicited ratings for foreign and local currency senior unsecured long-term debt of "AAA". The outlook is stable.

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Key Rating Drivers

1. Strong macroeconomic performance; Swedish economy continues to outpace its peers and display GDP growth above EU-average, though growth is likely to edge down somewhat; considerable macro-financial risks resulting from high debt levels of private households and adverse house price dynamics
2. Highly prudent fiscal policy; modest government indebtedness leaves the sovereign with substantial fiscal headroom to cushion the economic cycle or mitigate shocks on the economy
3. Due to outstanding quality of institutional conditions and sound economic policy-making, Sweden is one of the most business-friendly countries worldwide
4. Improving net international investment position which is set to advance further as current account surpluses should be sustained

Reasons for the Rating Decision

Our assessment of the Kingdom of Sweden's exceptionally high creditworthiness is based on the country's very high institutional quality, moderate government debt, and robust GDP growth considering the economy's already high per-capita income levels.

First and foremost, the economy is characterized by a very strong macroeconomic performance. Sweden has a very wealthy economy with GDP per capita estimated to post at USD 49,678 (2016, in PPP terms), the ninth highest per-capita income in the world. The country exhibits a track record of persistent growth faster than the EU average since joining the European Union in 1995. Between 1996 and 2015, Sweden's economy expanded on average by 2.5%, outpacing growth in the EU (1.7%) by a considerable margin.

Though displaying very high per-capita income levels, Sweden continues to grow at comparatively high rates. After expanding by 4.1% in 2015, Sweden's real GDP growth slowed down to a still high 3.3% in 2016, mainly driven by strong domestic demand. Both public and private consumption expenditures continued to grow at solid rates (3.1 and 2.2%, respectively). While public consumption increased due to higher costs related to the large inflow of refugees from 2015, private consumption spending benefitted from buoyant labor market conditions and increasing real wages in the current low-inflation environment. According to latest data provided by Statistics Sweden, investment grew by 5.9% y-o-y in 2016. Investment growth was mainly propelled by vibrant construction activities. In particular, dwelling investments, which have been expanding at double-digit rates since Q4-13, have further strengthened over the course of the year. Meanwhile, import growth (3.7%) outpaced that of exports (3.4%) on the back of vivid domestic demand.

In our view, Sweden's growth prospects remain favorable, although Swedish output growth is likely to further pull back this year. We forecast GDP to expand by 2.4% and domestic demand to remain the main growth driver, though investment and government spending will lose some steam. We believe that residential investment is about to weaken somewhat, mainly due to land and capacity constraints in the stretched construction sector. While we expect solid private consumption growth rates as the strong labor market performance and rising wages are to remain in place, the drag from net exports should slowly subside due to waning import growth and exports benefitting from improving growth perspectives in the euro area.

Labor supply and capital accumulation are likely to boost Sweden's potential growth going forward. Firstly, the economy's capital stock and thus currently high levels of investment are supportive of future production capacities. In 2015, Sweden was spending close to a quarter of its total output (23.7% of GDP) on investment (EU-28: 19.9% of GDP). Secondly, the economy has seen strong employment growth over the past ten years – the labor participation rate has risen to 86.7% of the active population (Q3-16), up from 82.1% in Q1-05. Thus, Sweden exhibits the highest labor participation rate in the EU-28 (avg. 77.6%).

In addition, the economy's population is growing due to recent high migration inflows. According to the Swedish Migration Agency, the number of applicants was some 273,000 in 2014-16 as compared to less than 270,000 in 2006-13. Given that the majority of immigrants are at working age, Sweden's potential growth rate could be lifted in the medium term. However, the successful integration of refugees into the labor market will take time and financial resources. The migrant unemployment rate has hovered around 16% since 2010, while the national unemployment rate has dropped from 8.6 (2010) to 6.9% (2016). At the same time, skill mismatches on the labor market appear to represent a structural challenge. Most of the job creation in the recent past was concentrated in highly skilled professions. While employment which requires tertiary education has increased by 23.6% in 2010-15, the number of low-skilled workers employed declined by 12.9%. To improve labor market outcomes for low-skilled workers and foreign-born residents, the Swedish government is planning to provide additional funds for adult education, as well as for vocational and language training for immigrants.

Sweden's AAA credit rating is buttressed by the exceptionally high quality of the country's institutions. As measured by the World Bank's World Governance Indicators, Sweden's quality of policy formulation and implementation is ranked 9th out of 209 countries. Moreover, the country achieves very high scores with regard to democratic participation and the quality of law and contract enforcement – ranking 2nd in terms of voice & accountability and rule of law, respectively.

The sovereign's strong institutions are also conducive to its business environment, strengthening the competitiveness of the country's private corporate sector. The Doing Business report, ranking Sweden 9th out of 190 economies (7th/32 OECD high-income), confirms this view. The World Bank highlights, in particular, the quality of Sweden's property registration. To register property, only one procedure which is completed after 7 days is required in Sweden. This compares well to an average of 4.7 procedures taking 22.4 days in OECD high-income countries. Also, Sweden offers attractive conditions for entrepreneurs, as indicated by the EU 2016 SME performance review. The time necessary to start a new business halved from 10 to 5 days in 2015, while Sweden's performance concerning start-up financing conditions remained among the best in the EU-28.

The very high institutional quality is also mirrored in the realm of monetary policy. We believe that the economy benefits from the credible commitment of the Swedish central bank to its inflation target. In light of subdued inflation, the Riksbank has pursued a very accommodative monetary policy in recent years. Despite HICP-inflation having picked up from 0.7 (2015) to 1.1% (2016) and inflation expectations gradually approaching the central bank's 2%-target, the executive board decided to continue with its current policy stance on its December meeting. In order to push up inflation to close to 2% by the end of 2018, the Riksbank announced it would keep the repo rate at -0.50% and expand its ongoing government bond buying program by another SEK 30bn. The total volume of bond purchases will be stepped up to SEK 275bn, or 6.6% of 2015 GDP, by the end of June 2017.

With regard to the government's current fiscal metrics, Sweden is in a very strong position. Standing at 43.9% of GDP in 2015, Sweden's debt-to-GDP ratio further decreased to 41.4% of GDP in Q3-16 – far below debt levels in the EU-28 (avg. 83.3% of GDP). Last year, Sweden should have reached a small budget surplus, though government projections pointed to a minor deficit earlier in 2016. The lower-than-forecasted increase of government consumption due to a declining number of asylum seekers and strong tax revenues both had a positive budgetary impact.

Going forward, we expect Sweden's fiscal policy stance to loosen somewhat. In its budget proposal for 2017, the authorities envisage additional spending worth SEK 23.6bn this year, with most of the funds (SEK 10bn) to be spent on welfare. However, additional spending is not fully financed by limited expenditure cuts and tax increases on chemicals and alcohol. As a result, Sweden's headline balance should deteriorate somewhat in 2017.

In terms of its fiscal framework, Sweden shows a track record of excellence. The country has implemented a general government net lending target as well as an expenditure ceil-

ing on the central government level and a balanced budget requirement for local governments. Compliance with these fiscal rules is monitored by a Fiscal Council established in 2007. In view of Sweden's progress on debt consolidation, most parties represented in the Riksdagen agreed to ease fiscal rules somewhat (Jun-16). Thus, the fiscal headline surplus target, which has to be achieved over the business cycle, will be lowered from 1 to 0.33% of GDP, effective from 2019. Notably, this change will be complemented by the introduction of a general government debt anchor of 35.0% of GDP.

The country's large banking sector, which is reflected in an asset-to-GDP ratio of some 293% in 2016, could be a potential source of fiscal turbulence. Still, we believe that Sweden's low government debt levels, coupled with the revised fiscal framework, provide the government with sufficient flexibility to respond to adverse economic events. In general, we consider Swedish banks to be sound in terms of asset quality and capital buffers. Regulatory tier 1 capital to RWA crossed the 20%-mark by Q2-15, further increasing to 22.2% and non-performing loans made up for only 1.0% of total loans outstanding (Q3-16) – one of the lowest NPL-ratios in the EU-28. Nevertheless, we see risks emanating from the liability side of bank balance sheets, as Swedish banks are heavily reliant on wholesale funding. EBA data from Q3-16 indicates that debt securities contributed 43.2% to total liabilities against 18.8% in the EU-28. Furthermore, banks have a large and growing exposure to mortgage lending. Lending for house purchase accounted for 82.0% (Dec-16) of credit outstanding to private households, leaving the Swedish banking sector vulnerable to falling housing prices.

Against this backdrop, rising housing prices and private household debt have to be vigilantly monitored. Driven by a growing population, low interest rates and tax incentives, housing prices have been rapidly growing since 2013. Although y-o-y-growth gradually decelerated to 7.1 % in Q3-16, the Swedish housing market has experienced a sharp increase in real prices of 34.3% as compared to Q3-13. Growth of housing prices outpaced that of household income, the price-to-income-ratio stood 19.0% above its 10y-average in Q2-16 (OECD data), signaling a potential overvaluation of real estate. The rising housing prices are all the more concerning, as these are accompanied by strong increases in private household indebtedness. Already starting from elevated levels, the debt burden of Swedish households climbed to 88.4% of GDP in Q3-16. Thus, Swedish households are among the most indebted in the EU-28 and Riksbank is expecting debt accumulation to rise further. However, risks associated with household debt should be largely mitigated by the households' sizeable asset position (288.1% of GDP), though 111.6% of GDP are invested in rather illiquid insurance, pensions and standardized guarantees.

To contain further rising household debt and to safeguard the stability of the domestic banking system, the authorities adopted some macroprudential measures last year. Since June 2016, new mortgage loans with LTV's above 50% have to be amortized by at least 1% annually. To make mortgage lending less attractive for banks, counter-cyclical capital buffers for mortgage debt were raised from 1 to 1.5% (Jun-16) and will be further increased to 2% of risk-weighted assets, effective from March 2017. Moreover, the Swedish government has presented a 22-point-plan addressing the housing shortage. The

proposals include the provision of state-owned land for construction and a review of building regulations to speed up planning procedures and reduce construction costs. However, the rather rigid rent regulation is still in place and tax deductibility of mortgage interest payments remains untouched.

Concerning its external position, Sweden shows no major imbalances. The Swedish current account balance has consistently been in surplus for more than 20 years. After the Swedish current account had peaked at 8.2% of GDP in 2007, the country's external balance gradually decreased to 4.7% of GDP (2015), and this downward trend should have continued in last year (2016e: 4.2% of GDP). The declining trend of Sweden's current account was mainly driven by the deteriorating trade of goods balance, which more than halved from 6.0 (2007) to 2.7% of GDP (2015). Sluggish growth in export of goods can be attributed to the product mix of Swedish exporters, which is tilted towards capital goods. As investment activity remained subdued in many important export markets, this specialization has hampered Swedish export performance in recent years. At the same time, Sweden's net international investment position has grown from 3.3% in 2015 to 10.9% of GDP in Q3-2016.

Rating Outlook and Sensitivity

Our Rating outlook on the long-term sovereign rating of "AAA" is stable, as we assume that the risk situation underlying the key factors affecting sovereign credit risk – including macroeconomic performance, institutional structure, fiscal sustainability, and foreign exposure – will remain fundamentally unchanged in the near term.

We could lower our rating if medium-term growth falls significantly short of our expectations and/or in the event of a notable increase of the sovereign's debt-to-GDP-ratio. In particular, such a scenario could materialize if housing prices decline sharply. We assume that falling housing prices would weaken private consumption of highly indebted households. At the same time, worsening asset quality could put pressure on financing conditions of the Swedish banking sector. As a result of rising costs for wholesale funding on international capital markets, financing conditions for Swedish corporates could be tightened – with a negative impact on corporate investment and growth.

Moreover, GDP growth could be dampened if growth in Sweden's key trading partners fails to meet our current forecasts. In general, Sweden's export performance appears to be sensitive with regard to the further developments in the European Union. As of 2015, the EU-28 accounted for 57.2% of Sweden's total exports. Hence, we believe that a prolonged period of low growth or renewed financial turbulences in the European Union would take a toll on Sweden's trade and growth going forward.

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Ratings*

Long-term sovereign rating AAA /stable

Foreign currency senior unsecured long-term debt AAA /stable

Local currency senior unsecured long-term debt AAA /stable

*) Unsolicited

Economic Data

[in %, otherwise indicated]	2011	2012	2013	2014	2015	2016e	2017e
Real GDP growth	2.7	-0.3	1.2	2.6	4.1	3.3	2.4
GDP per capita (PPP, USD)	43,719	44,058	44,907	46,256	48,199	49,678	51,317
Inflation rate, y-o-y change	1.4	0.9	0.4	0.2	0.7	1.1	1.5
Default history (years since default)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Life expectancy at birth (years)	81.8	81.7	82.0	82.0	n.a.	n.a.	n.a.
Fiscal balance/GDP	-0.2	-1.0	-1.4	-1.6	0.2	0.4	-0.3
Current account balance/GDP	5.8	5.7	5.3	4.6	4.7	n.a.	n.a.
External debt/GDP	179.5	192.0	191.7	174.9	180.1	179.2	n.a.

Appendix

Regulatory Requirements

This sovereign rating is an unsolicited credit rating. Neither the rated sovereign nor a related third party participated in the credit rating process. Creditreform Rating AG had no access to the accounts, representatives or other relevant internal documents for the rated entity or a related third party.

The rating was conducted on the basis of Creditreform Rating's "Sovereign Ratings" methodology. Creditreform Rating AG ensures that methodologies, models and key rating assumptions for determining sovereign credit ratings are properly maintained, up-to-date, and subject to a comprehensive review on a periodic basis. A complete description of Creditreform Rating's rating methodologies is published on the following internet page: www.creditreform-rating.de.

A Rating Committee was called consisting of highly qualified analysts of Creditreform Rating AG. The quality of information available on the rated entity was considered satisfactory. The analysts and committee members declared that the rules of the Code of Conduct were complied with and that the rating action was and is free of any existing or potential conflicts of interest. The analysts presented the results of the quantitative and qualitative analyses and provided the Committee with a recommendation for the rating decision. After the discussion of the relevant quantitative and qualitative risk factors, the Rating Committee arrived at a unanimous rating decision. The weighting of all risk factors is described in Creditreform Rating's "Sovereign Ratings" methodology. The main arguments that were raised in the discussion are summarized in the "Reasons for the Rating Decision".

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