Balance of Payments

Third quarter 2012

Statistiska centralbyrån Statistics Sweden

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Statistics Sweden
2012

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Foreword

The balance of payments has been compiled and published by Statistics Sweden on behalf of the Swedish Riksbank since 2007.

The balance of payments is a summary of Sweden's real and financial transactions with the rest of the world and is divided into the current account, the capital account and the financial account.

This report includes the results of the third quarter of 2012.

Statistics Sweden, November 2012

Folke Carlsson

Christina Ekblom

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Summary

The current account gave a surplus of SEK 66 billion in the third quarter, which is weaker compared to the same quarter last year when the surplus amounted to SEK 72 billion. This weakening in the current account is mainly due to a reduced foreign trade surplus. Foreign trade in services was, however, on a level with the third quarter of 2011.

The foreign trade in goods surplus amounted to SEK 17 billion. In the same quarter last year, the surplus amounted to 23 billion. Both the export and import of goods decreased. Exports fell more than imports, however, leading to a weaker trade in goods. It was primarily the export of goods to countries in the EU that decreased.

The financial account gave a capital inflow of SEK 51 billion, generated mainly by portfolio investments. A large share of the inflow came from cross-border trade in Swedish debt securities. Issues by Swedish banks on foreign capital markets also contributed to the capital inflow. At the same time, the banks increased their lending to other countries which generated outflows in other investment.

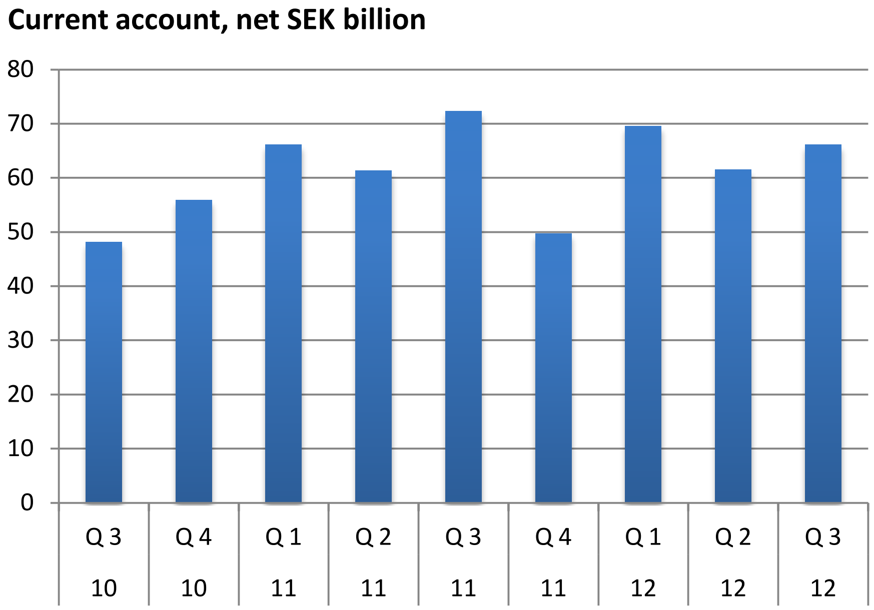
In connection with the publication of the balance of payments for the third quarter of 2012, a time series from 1950 on a yearly basis and from 1982 on a quarterly basis has also been published. The international investment position has also been published on a yearly basis from 1982. A text on the development of the balance of payments from 1950 to 2011 is therefore presented at the end of the publication.

Balance of payments, third quarter 2012

The balance of payments for the third quarter showed a surplus in the current account of SEK 66 billion and a slightly negative capital account, while the financial account gave a capital inflow of SEK 51 billion.

The current account

The current account comprises trade in goods and services, income as well as current transfers. During the year's third quarter, the surplus in the current account decreased and amounted to SEK 66 billion. In the same quarter last year, the surplus amounted to SEK 72 billion. The weakening in the current account is mainly due to a downturn in the trade in goods.



Foreign trade in goods and services

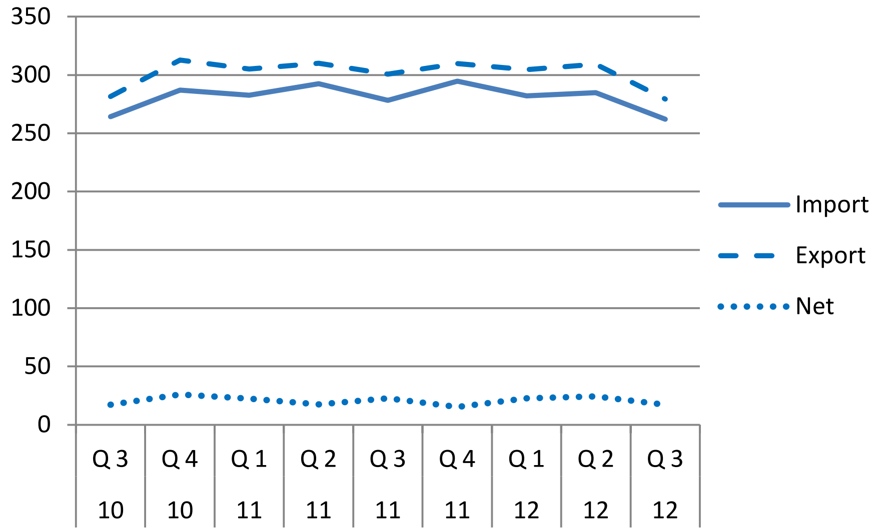
The total net trade in goods and services gave a surplus of SEK 53 billion during the quarter, which can be compared to a surplus of SEK 58 billion during the same quarter in 2011. The decrease depends mostly on a subdued surplus in foreign trade in goods.

The deficit in trade in goods and services with EU countries amounted to slightly less than SEK 16 billion, which is an increase from a deficit of SEK 11 billion during the same quarter of 2011. The surplus in trade thereby continues to be generated from trade with countries outside the EU.

The trade balance
The trade balance amounted to SEK 17 billion, which can be compared to the third quarter of 2011, when it amounted to SEK 23 billion. Both exports and imports of goods fell compared to the same quarter in 2011. Exports of goods amounted to SEK 279 billion and imports of goods totalled SEK 262 billion, which can be compared to the corresponding amounts of SEK 301 billion and SEK 278 billion in 2011. The fact that exports of goods decreased more than imports of goods explains the weaker trade balance.

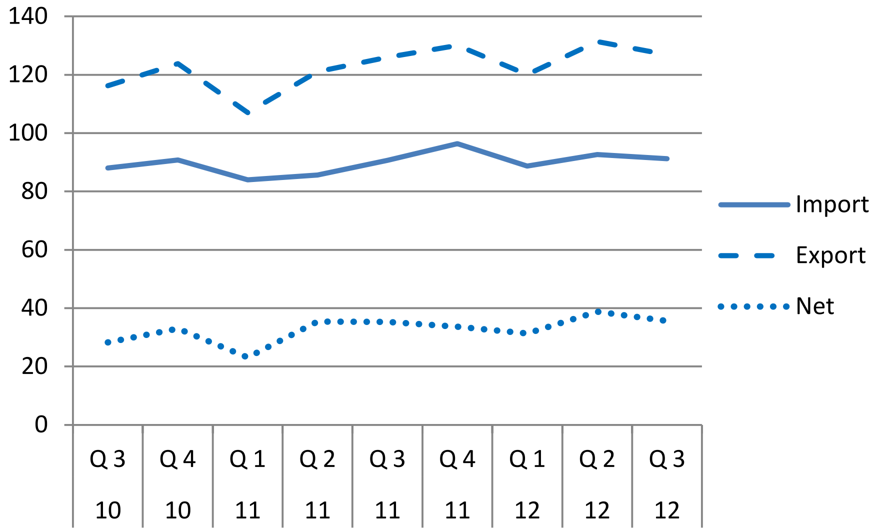
It was primarily exports of goods to countries in the EU that decreased. In total, exports of goods to EU countries amounted to SEK 155 billion, which is a decrease of almost 10 percent compared to the third quarter of 2011.

Trade in goods, SEK billion



Trade in services
Foreign trade in services generated a surplus of SEK 36 billion in the third quarter. This is on a par with the same period last year when the surplus was SEK 35 billion. During the quarter, exports of services amounted to SEK 127 billion, while imports of services amounted to SEK 91 billion. Trade in services shows a surplus with both EU and non-EU countries respectively.

Trade in services, SEK billion



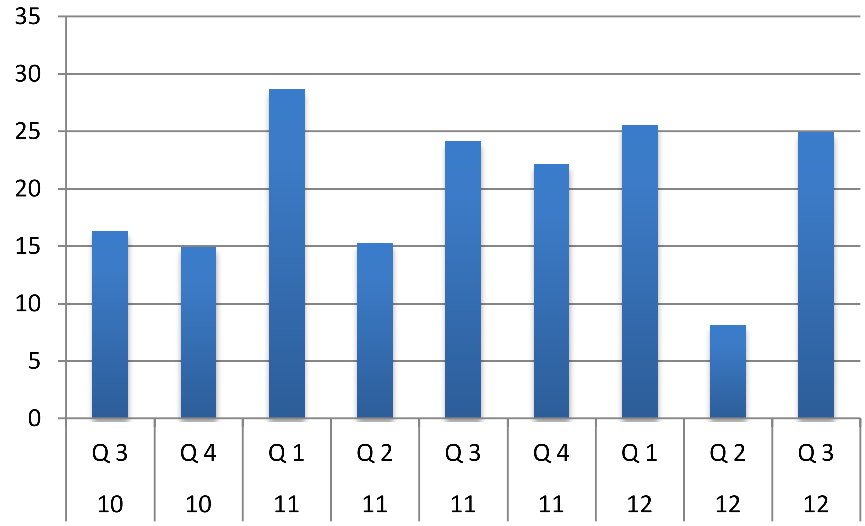
Among the different types of services, Other business services and Computer and information services contribute the largest surplus. Compared to the same quarter last year, the items Travel and Other business services have developed positively while the items Construction services and Computer and information services have developed negatively. This has resulted in the trade in services being on a par with the same quarter of last year.

The Travel item includes goods and services that travellers purchase when travelling in other countries. Travel exports, which consist of foreign travellers' consumption when travelling in Sweden, amounted to SEK 31 billion in total during the quarter. Travel imports, i.e. Swedish people's expenses when travelling abroad, amounted to SEK 30 billion. In total, therefore, Travel contributed a surplus of just over SEK 1 billion.

Income

Income consists of compensation of employees and investment income. Investment income is responsible for the largest share of the income and generated an inflow of SEK 26 billion. Total income provided an inflow of SEK 25 billion for the third quarter, which is on a level with the same period in 2011.

Income, net SEK billion

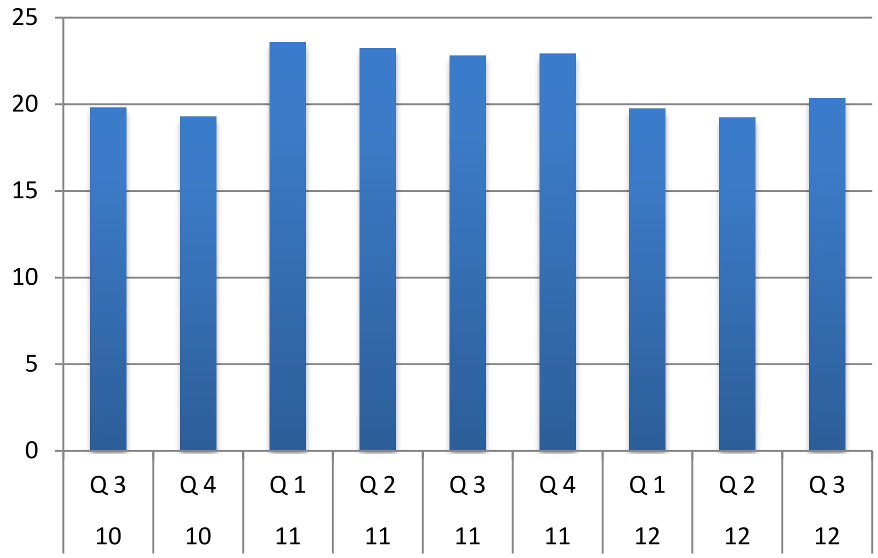


Direct investment income

Income on direct investment resulted in a net inflow of SEK 20 billion. Income from Swedish direct investment abroad amounted to SEK 55 billion and exceeded income from foreign direct investment in Sweden which amounted to SEK 35 billion.

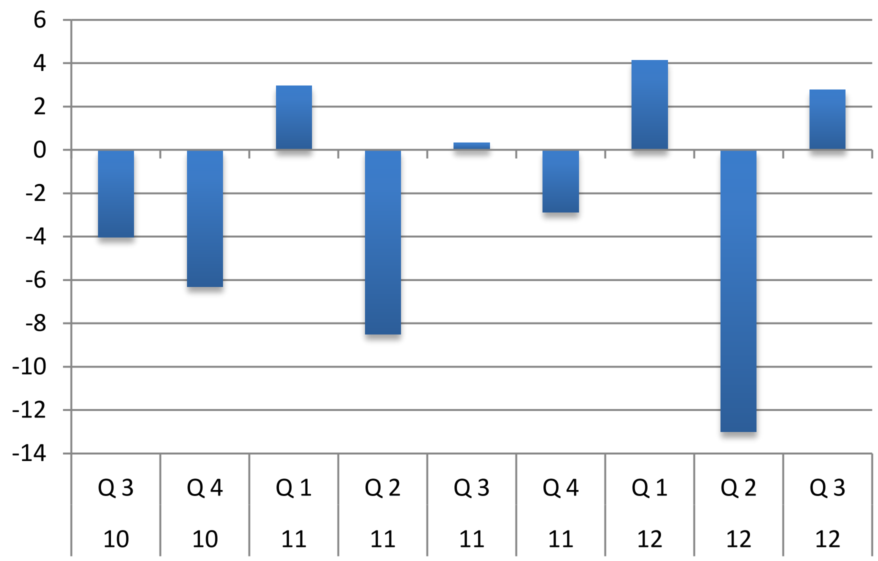
The dividends were relatively small even if we consider the fact that dividends have been historically low during the third quarter. As in previous years, this means that a large proportion of the earnings have been reinvested in the form of reinvested earnings. Interest on direct investment loans contributed negatively with an outflow of SEK 6 billion.

Income on direct investments, net SEK billion



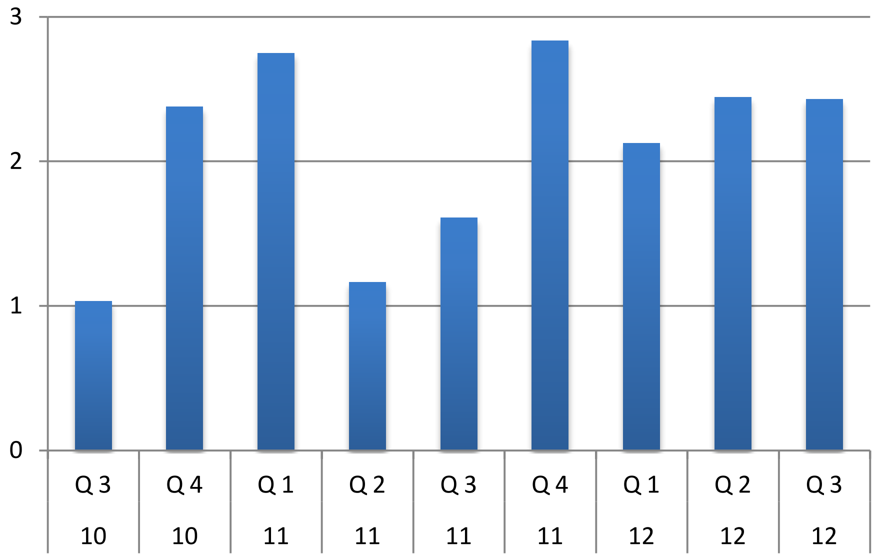
Portfolio investment income
Portfolio investment income generated a capital inflow of SEK 3 billion, which is an increase compared to the same period last year. This is explained by the fact that the income from foreign shares was higher during the third quarter of the year compared to the same quarter in 2011.

Income on portfolioinvestments, net SEK billion



Other investment income
Other investment income, which consists of interest on loans and deposits, gave a surplus of just over SEK 2 billion for the third quarter of 2012. This is an increase of almost SEK 1 billion compared to the same quarter last year. The increase can be explained by the fact that the assets of Swedish banks in the form of loans to other countries have increased at the same time as their liabilities in relation to other countries have remained constant during the time period.

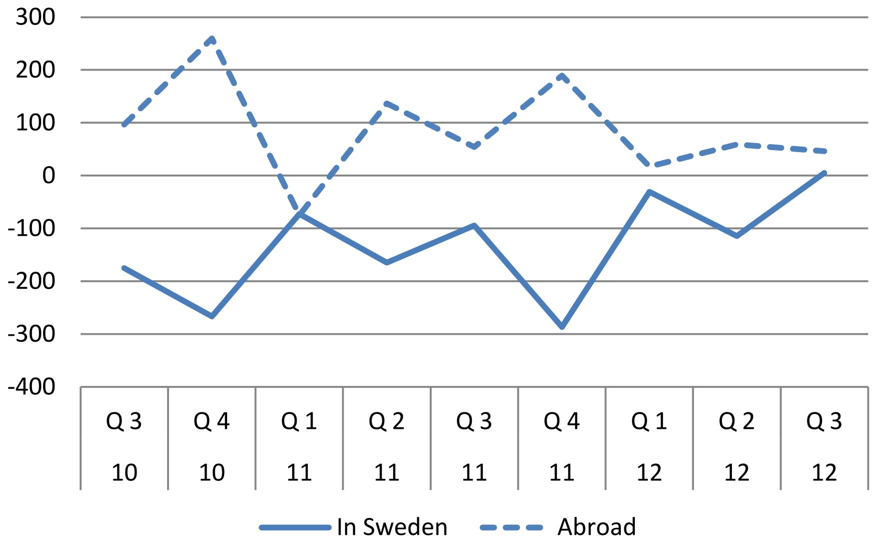
Income on other investment, net SEK billion



Financial account

The financial account gave a net inflow of SEK 51 billion during the quarter. Direct investment, portfolio investment and financial derivatives showed net inflows while other investment and the reserve assets showed net outflows.

Financial account, net SEK billion

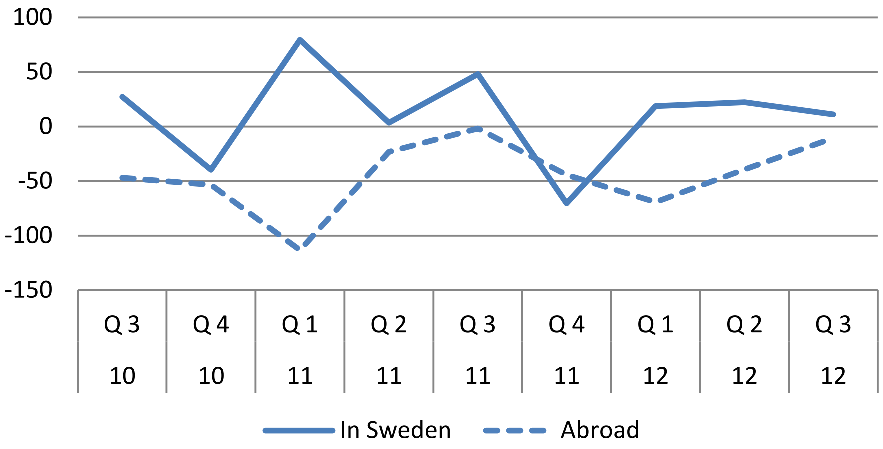


Direct investment

Direct investment generated a small net inflow during the third quarter. Swedish direct investment abroad gave an outflow of SEK 11 billion and foreign direct investment in Sweden gave an inflow of SEK 11 billion, generating a net flow of almost zero.

Reinvested earnings were responsible for the largest share of the flows both in Swedish direct investment abroad and foreign direct investment in Sweden. The Reinvested earnings item is a residual item in the statistics that refers to income that is not distributed to shareholders but instead remains in the company.

Direct investment, net SEK billion

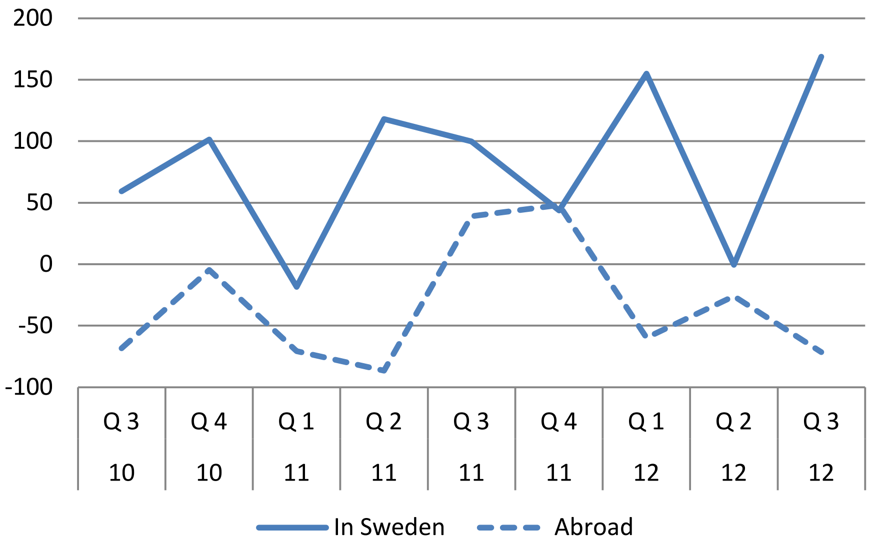


Portfolio investment

Portfolio investment abroad gave a net capital inflow of SEK 97 billion during the third quarter of 2012. A large share of the inflow came from cross-border trade in Swedish debt securities, which generated a net inflow of SEK 157 billion. The inflow is explained to a large extent by Swedish banks continuing their borrowing abroad in the form of issues of debt securities. In the third quarter, foreign investors also showed an interest in bonds issued by housing credit institutions and non-financial corporations.

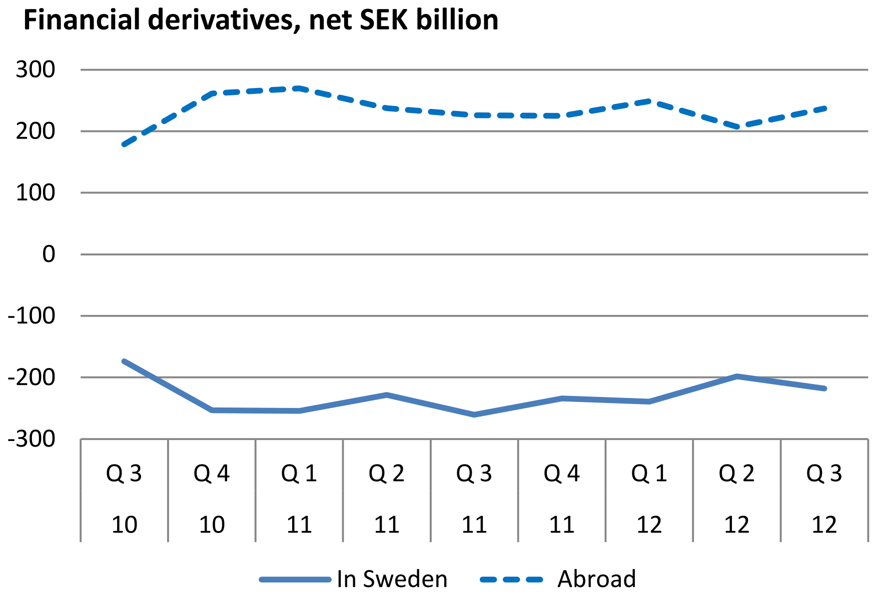
Swedish investors bought foreign debt securities for SEK 35 billion net during the quarter. Substantial interest continued to be shown in foreign shares. Swedish investors made net purchases of foreign shares and funds for SEK 37 billion.

Portfolio investment, net SEK billion



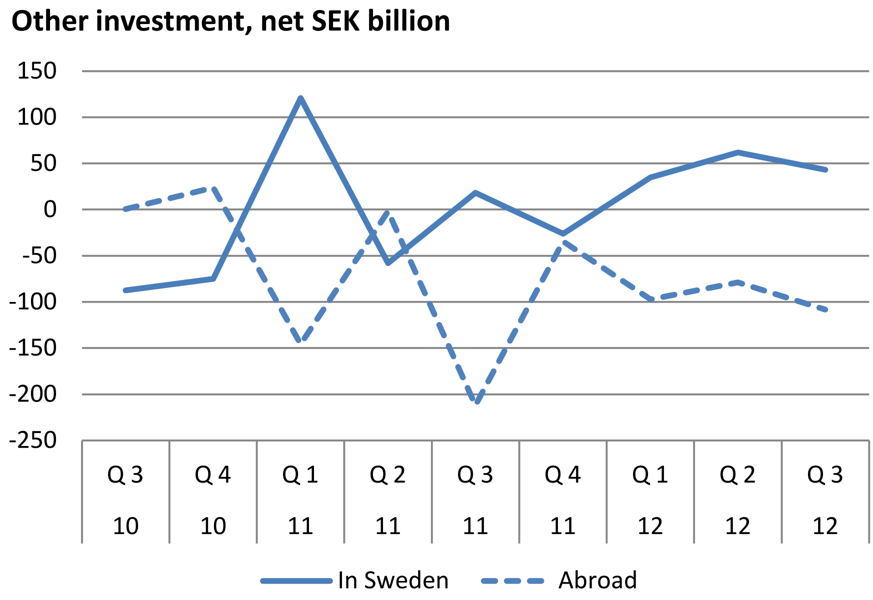
Financial derivatives

Financial derivatives generated net inflows of SEK 19 billion during the third quarter of the year. Flows in financial derivatives are mostly generated when contracts mature but also when premiums are paid in and out. Inflows are generated when contracts with positive market values mature.



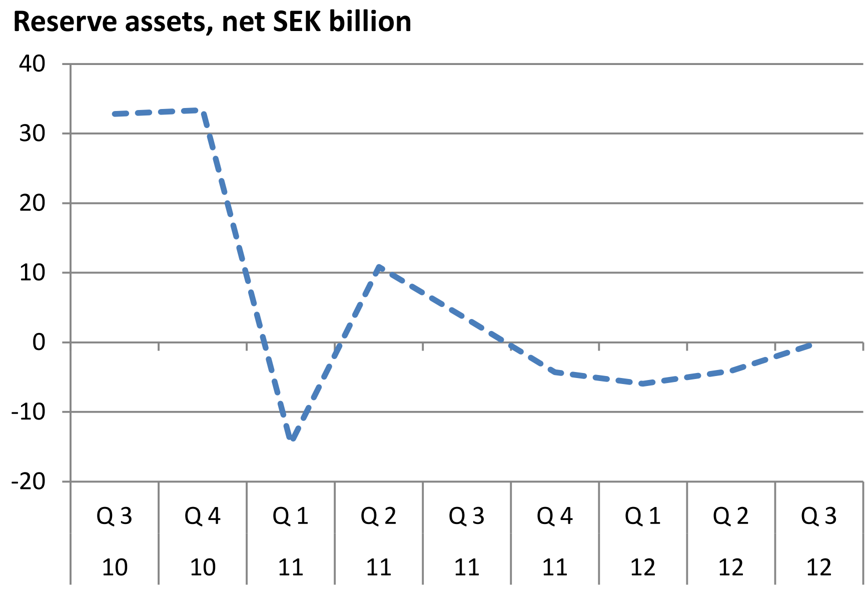
Other investment

Other investment mainly consists of loans by the bank sector to and from other countries, excluding loans of securities that are included in portfolio investment. The item has generated outflows ever since the third quarter of 2010 and this is also the case for this quarter. The outflow of SEK 65 billion net for the quarter is explained mostly by Swedish banks increasing their lending to other countries. At the same time as the bank sector's lending generated large outflows in other investment, the same sector generated capital inflows in the portfolio investment item.



The reserve assets

During the quarter, the reserve assets generated outflows of SEK 9 million. The main purpose of the reserve assets is so that the Riksbank can use them to fulfil its undertakings. These undertakings include giving temporary liquidity support to insolvent banks, fulfilling Sweden's obligations vis-à-vis the International Monetary Fund (IMF) and if necessary intervening on the currency market. It is therefore important that the investments are made in liquid assets such as government bonds.



Balance of payments 1950-2011

In connection with the publication of the third quarter 2012, Statistics Sweden is publishing the balance of payments on a yearly basis from 1950 and on a quarterly basis from 1982. The international investment position is also being published on a yearly basis from 1982. The first official balance of payments was published in 1922 by the Ministry of Finance.

Since 1950, significant changes have taken place in the world around us, which have influenced both the statistics and collection methods. Crucial events have been the currency devaluations between 1977 and 1983, the currency deregulation in 1989 and the conversion to a variable exchange rate in 1992. A number of financial crises have occurred in between and Sweden was greatly affected by the drastic rise in oil prices in 1974. The 1990s saw the purging of the Swedish economy in the wake of the major banking and property crisis and the IT bubble burst in the early 2000s. In the autumn of 2008, the American investment bank Lehman Brothers went bankrupt and extraordinary measures were implemented to combat a total financial meltdown. This then gave rise to the ongoing European debt crisis, the effect of which has begun to surface in the Swedish economy especially this autumn.

The three main items in the balance of payments consist of the current account, the capital account and the financial account. The current account mostly comprises all current transactions of goods and services as well as capital income on Sweden’s assets and liabilities. The financial account shows how surpluses or deficits in the current account are invested or financed abroad. The discrepancy that occurs due to measurement error, periodisation, etc. is included in the errors and omissions item. Since the start of the current time series in 1950, these items have been affected by the abovementioned economic crises and regulatory adjustments.

Economic regulatory adjustments and crises are reflected in the statistics

The 1970s saw low economic growth in Sweden and the current account generated deficits for most of the periods. The Swedish krona was first devalued in 1977 to stimulate the Swedish economy. Despite a weaker krona, the deficit in the current account continued to grow and came to a head in 1982. The deterioration was mainly due to a high and persistent inflation rate which had a negative effect on Sweden’s competitiveness. In order to revitalise the Swedish economy, the krona was devalued on two more occasions, in 1982 and in 1983. Swedish exports increased and the current account improved considerably. At the same time as the Swedish economy expanded, the late 1980s saw large parts of the Swedish finance market deregulated, the effects of which included the value of financial assets rising to unsustainable levels. When the asset prices fell at the beginning of the 1990s, Sweden’s competitiveness worsened again as did the current account. In the autumn of 1992, the Swedish Riksbank was forced to go from a fixed to a floating exchange rate and the Swedish krona fell like a stone. The weaker krona coupled with the purging of the Swedish economy in the 1990s has contributed to the current account constantly showing a surplus ever since 1994.

Similar to the current account, the financial account has also been affected by previous devaluations, deregulations and economic crises. A decisive factor in the development of the financial account was the currency deregulation in 1989. Before then, all trading in securities with other countries had been prohibited and the deregulation therefore led to a dramatic expansion of the portfolio investment item over the following few years.

The ongoing financial crisis gave a weaker current account in 2009

The most recent and ongoing financial crisis is also reflected in the balance of payments. The year after the collapse of Lehman Brothers, 2009, Sweden experienced a major downturn in production and the consequent fall in GDP was the largest since the Second World War. The same year saw the current account deteriorate by nearly 30 percent compared to the year before. The effects of the crisis on the financial account were also palpable. Banks and housing credit institutions, for example, found it difficult to renew their credits on international credit markets, which led to considerable outflows of Swedish portfolio investments during 2008. The large fall in GDP in 2009 was however followed by an even larger upturn in 2010 and the Swedish economy has performed strongly since then in comparison to many other European countries. Economic indicators in recent months indicate however that Sweden is once again facing a slowdown. How apparent the forthcoming economic slowdown will be and what effect it will have on the balance of payments remain to be seen.

Revisions

Sweden’s revision policy for the balance of payments is as follows:

- When publishing Quarter 1, the previous 4 quarters are revised
- When publishing Quarter 2, the previous 13 quarters are revised
- When publishing Quarter 3, the previous 10 quarters are revised
- When publishing Quarter 4, the previous 11 quarters are revised

By way of exception, further periods can be revised if methodological changes have been made or new data have arisen that provide a substantially changed picture of the balance of payments.

When publishing 2012 Quarter 3, the normal revision policy has been abandoned. The balance of payments has been revised from 1998 Quarter 1 up to and including 2012 Quarter 2. During the revised period, net revisions of SEK 38 billion occurred in the current account and of SEK -90 billion in the financial account.

What is the balance of payments?

The balance of payments has been produced and summarised by Statistics Sweden on behalf of the Swedish Riksbank since 2007.

In a closed economy, the level of investment is determined by the total savings in the economy. This means that if the savings decline for some reason, investment will also decline. In an open economy, the relationship between savings and investment is not as clear, as global financial markets enable international capital to flow easily between countries. The balance of payments contains information on these flows. Simply put, it is a summary of a country's real and financial transactions with the rest of the world

and can be divided into the following:

- The current account, including regular transactions in goods and services, return on financial assets and debts, and regular transfers such as EU subsidies and fees.
- The capital account, which covers EU subsidies and foreign aid for real investment as well as the purchase and sale of rights, such as patents.
- The financial account, divided into direct investment, portfolio investment, financial derivatives, other investment and the reserve assets. The financial account shows changes in financial assets and liabilities in relation to the rest of the world.

Derivation of the balance of payments

A country's gross domestic product, BNP_t, is the total value of the goods and services produced in the country during a certain year t. Production is used to satisfy either domestic demand in the form of household consumption, C_t, private investment, I_t, and public spending, G_t, or to be delivered abroad in the form of exports of goods and services, X_t. Domestic demand can also be satisfied by the import of goods and services, M_t. The "National Income Identity" shows that a country's production during an individual year is equal to the sum of domestic demand ($C_t + I_t + G_t$) and net sales of goods and services to the rest of the world ($X_t - M_t$):

$$BNP_t = C_t + I_t + G_t + X_t - M_t . \quad (1)$$

[1]

By adding together the net factor income, F_t, i.e. Swedish factor income earned abroad (compensation of Swedish employees in other countries and income from Swedish capital abroad) minus foreign factor income earned in Sweden (compensation of foreign employees in Sweden and income

[1] This relationship is called an identity because it must by definition be fulfilled in every individual time period.

from foreign capital in Sweden) can (1) be rewritten in terms of the gross domestic product, BNI_t:[2]

$$BNI_t = C_t + I_t + G_t + X_t - M_t + F_t . \qquad (2)$$

Rewriting (2) gives:

$$BNI_t - C_t - G_t = S_t = I_t + X_t - M_t + F_t , \qquad (3)$$

where S_t refers to the total national savings in the economy. The national savings consist of the consolidated public sector savings, $T_t - G_t$, where T_t is tax income, and household savings, $BNI_t - T_t - C_t$.[3]

According to (3) the following applies:

$$S_t - I_t = X_t - M_t + F_t . \qquad (4)$$

The difference between S_t and I_t is often called net external investment and the difference between X_t and M_t is called the trade balance. $X_t - M_t + F_t$ is the current account. Equation (4) thus shows that there is a simple connection between net investment and the trade balance. For a given net income, changes in the difference between S_t and I_t will always be followed by corresponding changes in the difference between X_t and M_t. Equation (4) also shows that it is not possible in the short term to reduce a foreign trade deficit without at the same time increasing national savings or reducing domestic investment.[4] It is also interesting to note that equation (4) means that if household savings are as great as domestic investment, public sector savings will develop roughly in line with net exports over time.[5]

In the same way as national savings can be divided up into consolidated public sector savings and household savings, domestic investment can be divided up into public sector investment and private investment. This division indicates that if public sector investment exceeds its savings, and if this is not completely counteracted by a savings surplus in the private sector, it must by definition be matched by a deficit in the current account. A growing deficit in the current account can thus be a sign that central government expenditure is greater than income.

By combining the national income identity (1) with the national budget restriction, it is possible to derive the balance of payments. According to the budget restriction, the country’s total expenditure in each time period is limited by the income in the same period and the country’s possibilities to borrow:

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[2] This factor income is often referred to as primary income. Net factor income consists of salaries, investment income and current transfers.

[3] This means then that national savings are identical to the sum of public sector savings and household savings.

[4] Net factor income is assumed to be constant in the short term.

[5] This relationship means in actual fact that the public sector budget balance will covary with the trade balance during certain periods of time.

$$BNP_t + r_t A_t = C_t + I_t + G_t + (A_{t+1} - A_t). \qquad (6)$$

where A_t are the net external assets during period t and $r_t A_t$ are the interest income on these assets. The net assets in turn consist of the capital account and the financial account. It is simple to obtain the balance of payments from (1) and (6):

$$X_t - M_t + F_t = -(A_t - A_{t+1}). \qquad (7)$$

The left side of the balance of payments (7) is, as mentioned earlier, the current account, which consists of the trade balance and net factor income. The term $(A_t - A_{t+1})$ on the right side shows how the net external assets change over time. Please note that if Swedes make net purchases of foreign assets, the capital account and the financial account will show a net deficit, i.e. $A_t - A_{t+1} < 0$. Equation (7) thus means that the sum of the current account, the capital account and the financial account is always identical to zero.[6]

The connection to the international investment position

As the financial account measures external net lending, a change in the current account will - by definition - always be matched by a similar change in the net external claims. A surplus in the current account is thus matched by an increase in external net claims - private or public sector. The surplus can also be reflected in an increase in the reserve assets, as these transactions are included in the financial account. A deficit on the current account instead means that the net purchaser abroad must pay either by selling external assets or by increasing external liabilities.

This means that if, for instance, Sweden were to buy more assets abroad than are sold to other countries (this is the same as saying that the net total of the financial account is less than zero), Sweden must at the same time sell more goods and services to other countries than it buys from them. Put simply, the total outward payments from a country must correspond to the total inflow of payments.

The international investment position shows a country's total net debt and is reported in the form of stock data on all the domestic sector's external assets and liabilities. The net total of assets and liabilities is thus a measure of a country's wealth relative to other countries. Stock data are reported at market value and can be divided up exactly like the financial account, into direct investment, portfolio investment, financial derivatives, other investment and the reserve assets.[7]

The relationship between the international investment position and the transactions in the balance of payments is illustrated below. Changes in the net external position are due to transactions that have been implemented and registered in the financial account and to changes in exchange rates and asset prices. In addition, the stocks can be affected by, for instance,

[6] Because there are a number of sources for measuring the items in the balance of payments, measurement errors, such as periodisation errors, can arise. A residual in the form of an errors and omissions item has therefore been included.

[7] In certain cases the book value is used instead of the market value, because the base for calculating market value is insufficient.

write-downs of claims (an example of other corrections in the diagram). If the current account shows a deficit or surplus over a longer period of time, this entails a build-up of either a net liability or a net asset.

	Changes in the international investment position depending on				
Opening balance	Transactions	Price changes	Exchange rate - fluctuations	Other - corrections	**Closing balance**