Balance of Payments

Third quarter 2008

Statistiska centralbyrån Statistics Sweden

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Statistics Sweden
2008

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Foreword

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

The balance of payments is a compilation of Sweden's real and financial transactions with the surrounding world and is divided in to current account, capital account and the financial account.

This report comprises the result for the third quarter of 2008.

Statistics Sweden November 2008,

Lars Melin

Christina Ekblom

Contents

Balance of payments

The balance of payments for the third quarter of 2008 resulted in a surplus in the current account of SEK 63.4 billion, a slight negative capital account and a surplus of SEK 16.6 billion in the financial account.

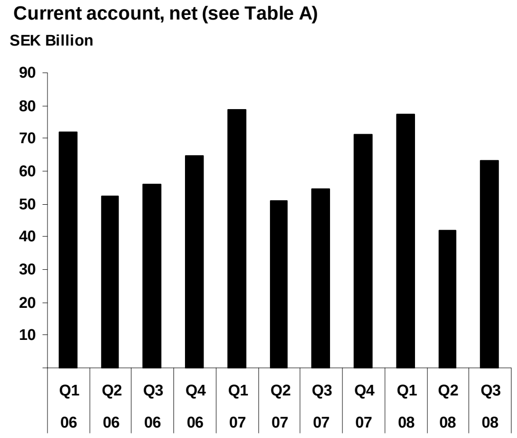
Both the trade in goods and trade in services worsened compared to the previous quarter, when exports of goods and services decreased by 10 percent and 2 percent, respectively. Trade in goods amounted to SEK 24.6 billion and trade in services amounted to 23.7 billion. Import of goods also decreased while the import of services increased by a couple of billion, compared in the same period.

Direct investment together with other capital generated a high net inflow during the quarter, while portfolio investments generated net outflows, which gave rise to SEK 16.6 billion in the financial account.

The central government's sale of Vin & Sprit AB accounted for much of the net inflow of direct investment. Portfolio investments abroad resulted in a capital outflow of SEK 69.0 billion during the third quarter of 2008. The largest flows were again to be found in trade in foreign shares and interest bearing money market instruments.

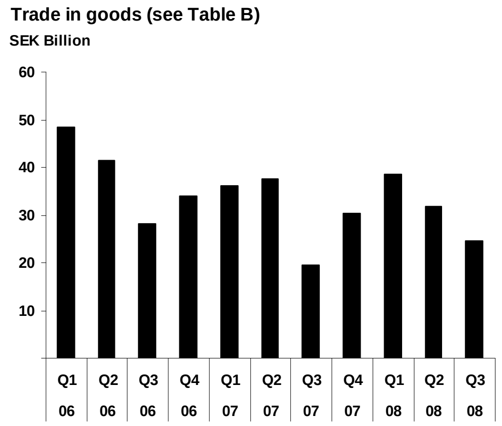
The large inflow of other capital can be explained by the Swedish Riksbank having prepared the reserve assets to maintain liquidity and stability in the Swedish financial market. The reserve assets' change in transactions amounted to -57.6 billion during the third quarter, which can be compared to +0.9 billion in the last quarter. An increase in the reserve assets is listed with a minus sign in the balance of payments when such signifies that holdings in foreign currency has increased.

Current account



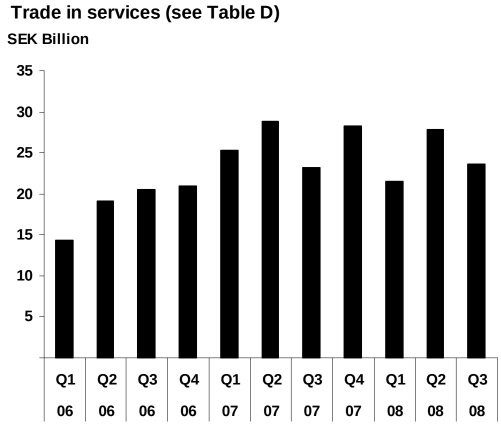
In the third quarter the current account resulted in a surplus of SEK 63.4 billion and was, thus, strengthened by 21.3 billion compared to the second quarter. The large increase can be partially explained by the weak current account that was apparent in the second quarter of 2008 and in part by the continued strong trade in services during the third quarter. Trade in goods resulted in a surplus of approximately SEK 25 billion which is decrease by SEK 7 billion from the second quarter. *Transfers* decreased compared to the previous quarter and increases slightly compare to the corresponding period year 2007 by SEK 0.5 billion each. The item *Compensation of employees* is almost unchanged and was at the same level as the previous quarter with a net outflow of nearly SEK 0.5 billion.

Trade in goods



Trade in goods resulted in a surplus of SEK 24.6 billion in the third quarter. The Swedish export of goods decreased compared to this year's first two quarters. Exports decreased compared to the previous quarter by 10 percent, but increased by 7 percent compared to the third quarter of last year. Imports also decreased by approximately 9 percent compared to the previous quarter.

Trade in services



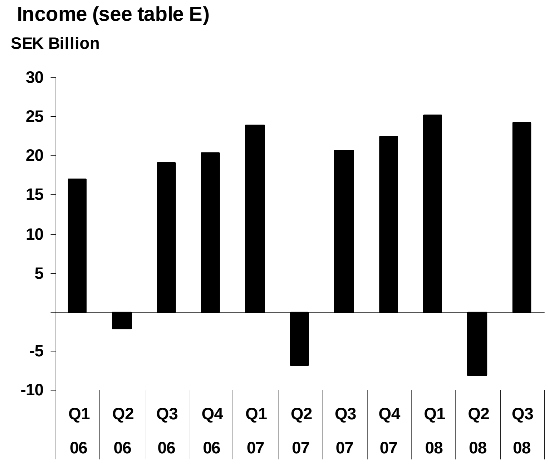
The third quarter's trade in services amounted to SEK 23.7 billion, which is a decrease by SEK 4.2 billion compared to the previous quarter. Exports decreased by SEK 2 billion from the previous quarter and amounted to SEK 110.3 billion and imports amounted to SEK 86.7 billion after an increase of over SEK 2 billion. The sub-items contributing the majority of the positive net result are *Transport, Computers and information services* and *Other business services.*

Both the export and import of transport increased during the quarter compared to the previous quarter. Transport in total generated a surplus of SEK 7.8 billion, which is somewhat lower than the previous quarter. This is a sharp increase pf SEK 2 billion compared to the corresponding quarter of 2007.

The item *Travel* produced a net outflow of SEK 2.5 billion for the third quarter. If there are powerful seasonal variations in this item, the best comparisons are to be made with the corresponding period of last year, when the item generated a net outflow of SEK 2.6 billion.

The item other service forms generated an export decrease of approximately 11 percent from the previous quarter. The import of other service forms also decreased during the third quarter. Sub-items *Technical services* and *Licenses and Royalties* made up the largest export decreases. *Licenses and Royalties* together with *Computer services* also account for decreases among imports.

Income

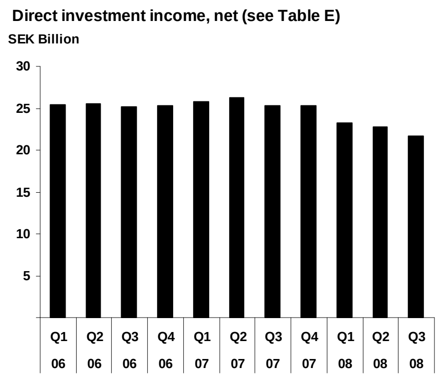


Income, consisting of salaries and returns on capital, showed a surplus of SEK 24.2 billion during the third quarter, which is a distinctive change from the previous quarter when the income resulted in a deficit of SEK 8.1 billion. The item has increased by SEK 3.6 billion compared to the corresponding period of last year. Income from direct investment resulted in a large net inflow and nearly accounted for the entire surplus of this quarter. Income from portfolio investments resulted in a net inflow of SEK 3.5 billion.

Returns on capital from other investment resulted in a net outflow of SEK 0.5 billion, which can be compared to a net outflow of SEK 1.2 billion in the previous quarter.

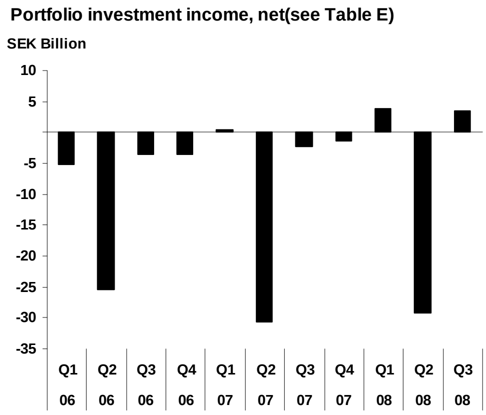
The item Compensation of employees generated a net outflow of SEK 0.4 billion, which is a slight change in comparison to the previous quarter and corresponding period of last year.

Direct investment income, net



Income on direct investment showed a net inflow of SEK 21.7 billion during the third quarter of 2008. Income from direct investment abroad amounted to SEK 64.3 billion, while income on corresponding foreign direct investment in Sweden totalled SEK 42.6 billion. The net inflow has decreased by SEK 3.6 billion compared to the third quarter of 2007. This can be explained by the net outflow for the sub-item loan under direct investment conditions having more than doubled compared to the third quarter of 2007. It can also be explained by the net inflow for repatriated dividends having decreased by SEK 1.6 billion compared to the corresponding quarter of 2007.

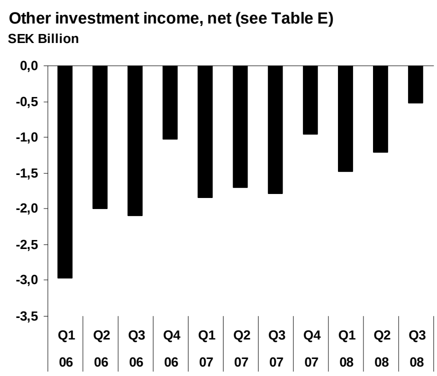
Portfolio investment income, net



Income on portfolio investment resulted in a net inflow of SEK 3.5 billion during the third quarter of 2008, which is an increase of SEK 5.9 billion compared to the same period last year. The main reason is due to a drop in the net outflow of share dividends by SEK 5.0 billion.

During the first three quarters of 2008, income from portfolio investments abroad generated an outflow of SEK 21.8 billion, which is comparable to the outflow of SEK 32.6 billion for the same period in 2007. The net outflow of the interest item fell from SEK 26.6 to 22.8 billion. Net share dividends, however, increased to a net inflow of SEK 1.1 billion, which also can be compared to an outflow of SEK 6.0 billion for the corresponding period of 2007. Dividends from British and American shares made up the majority of the increase.

Other investment income, net

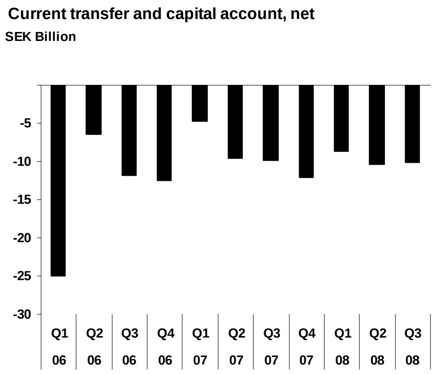


Income from other investments gave rise to a net outflow of SEK 0.5 billion during the third quarter 2008, which can be compared to the net outflow of

SEK 1.8 billion during the same period in 2007. Thus far in the year, income from other investment has given rise to a net outflow of SEK 3.2 billion.

Income from other investment consists of earnings on loans and bank deposits etc. The largest contributions to this item come from Swedish banks' income on their assets and liabilities towards counterparts abroad.

Current transfers and capital account, net

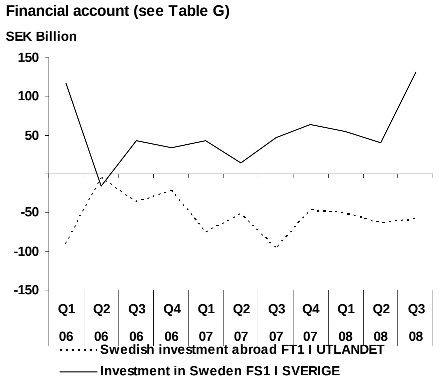


Current transfers and capital account produced a deficit of SEK 10.1 billion during the third quarter, which is an almost unchanged outflow compared to the previous quarter.

EU transfers showed a deficit of SEK 3.4 billion, which can be compared to the SEK 3.6 billion in outflows for the same period of 2007. Transactions associated with EU membership make up SEK 4.7 billion in outflow, which is SEK 1.0 billion lower than the previous quarter. Even foreign aid amounted to a net outflow of SEK 3.0 billion.

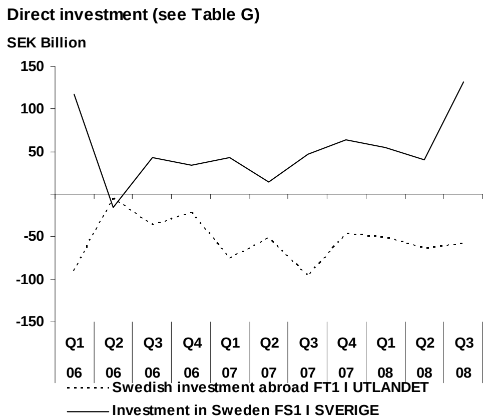
The item other, that is to say all other transfers that are not associated with the EU or foreign aid, resulted in a net outflow of SEK 3.7 billion, which is a increase in outflow by SEK 1.2 billion from the quarter before.

Financial account



The financial account resulted in a surplus of SEK 16.6 billion for the third quarter of 2008. The large inflow from direct investment contributed to this quarter's surplus, which is distinct difference from the previous quarter, when portfolio investments made up the majority of the surplus. Other investment contributed to the net inflow by SEK 65.2 billion. During the quarter, portfolio investments showed a net outflow of SEK 69.0 billion. These three items have changed drastically compared to the quarter before, which is normal for the financial account, where broad variations in flow are natural. During the quarter the Swedish Riksbank having prepared the reserve assets to maintain liquidity and stability in the Swedish financial market.

Direct investment

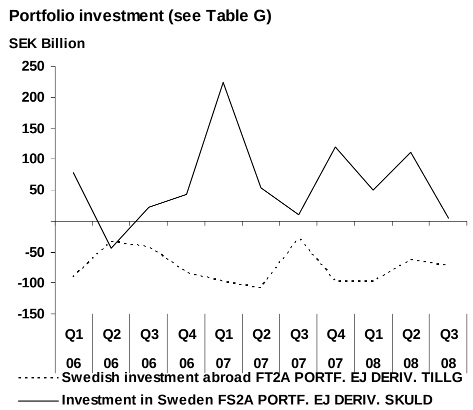


The third quarter of 2008 showed large flows in direct investment, which resulted in a net inflow of SEK 72.8 billion, compared to a net inflow of SEK 49.9 billion for the corresponding quarter of 2007. Among other things, the large net inflow can be explained by the French company Pernod Ricard's purchase of shares in Vin & Sprit AB and the German company Volkswagen AG's purchase of Scania shares. Aside from which the sub-item shows a large net inflow for the quarter through loans for direct investment in Sweden.

Swedish direct investment abroad amounted to a net outflow of SEK 58.7 billion during the third quarter of 2008. The equity sub-item shows a net outflow of SEK 39.5 billion to be compared to a net outflow of SEK 94.6 billion for the corresponding quarter in 2007. The loan sub-item shows a net inflow of SEK 26.2 billion, compared to a net inflow of SEK 45.5 billion for the corresponding quarter of 2007. The loan section is affected by multinational groups' handling of the short-term internal liquidity and alterations in the flows between quarters are thus the norm.

Foreign direct investment in Sweden produced a net inflow of SEK 131.4 billion during the third quarter of 2008. The equity sub-item showed a net inflow of SEK 41.9 billion, of which sales of Vin&Sprit and Scania shares accounted for the largest flows. The loan sub-item showed a net inflow of SEK 70.8 billion, compared to a net inflow of SEK 25.2 billion for the corresponding quarter in 2007.

Portfolio investment



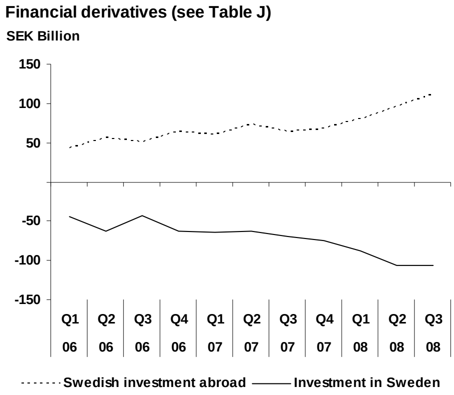
Cross-border portfolio investment generated capital outflows of SEK 69.0 billion during the third quarter of 2008, which can be compared to SEK 19.9 billion for the same period the year before. The largest flows were again to be found in trade in foreign shares and interest bearing money market instruments.

Swedish investors net purchased foreign money market instruments denominated in SEK as well as other currencies during the third quarter of 2008, while they decreased their holdings of foreign treasury bonds. The National Debt Office accounted for a large part of these outflows as the liquidity from the sale of Vin & Sprit shares was invested in foreign denominated money market instruments.

Cross-border equity trading resulted in a net outflow of SEK 13.1 billion during the quarter, which was higher than the net outflow of SEK 11.4 billion for the same period last year. Swedish investors net purchased mainly shares from Finland, Norway and Ireland while they net sold German and English shares.

In total, portfolio investment resulted in a net outflow of SEK 69.8 billion during the first three quarters of 2008. The figure for the same period of last year was a net inflow of SEK 53.6 billion.

Financial derivatives

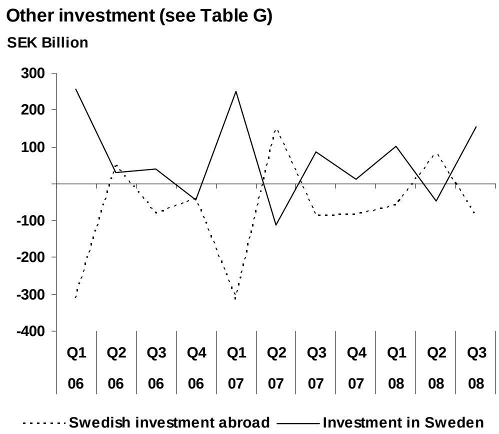


Financial derivatives continued to generate a large capital inflow during the third quarter of 2008, which resulted in a net outflow of SEK 5.4 billion.

This is thus the first quarter since the start of 2007 with a net inflow. The corresponding quarter of 2007 instead produced capital outflow of SEK 6.1 billion.

The flows concerning financial derivatives consist primarily of realised positive and negative values of derivative contracts during the period (inflow and outflow respectively). Option premiums that have been paid for and received are also included in the flows.

Other investment and reserve assets



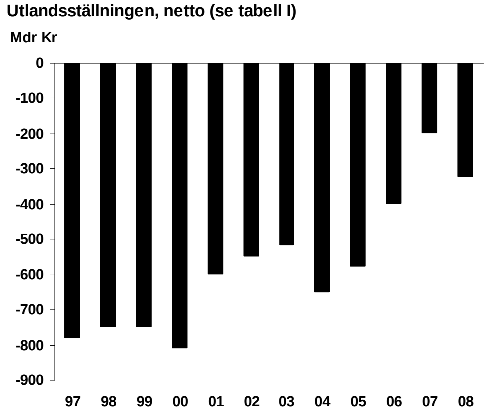
Other investment gave rise to a net inflow of 65.2 billion during the third quarter of 2008. Swedish investment abroad gave rise to a net outflow of SEK 90.7 billion while corresponding foreign investment in Sweden resulted in a net inflow of SEK 155.9 billion.

Other investment covers transactions regarding deposits and borrowing, lending, repurchase transactions toward and from abroad. Borrowing from foreign countries increased sharply during the third quarter of 2008 compared to the previous quarter. Sweden's Riksbank contributed the largest increase.

This is due to the Riksbank having large amount of repurchase agreements (repo) during September, which was done to increase the liquidity of reserve assets. A repo transaction is an agreement whereby one party is obligated to sell a security to another party in exchange for liquid funds. Repo transactions consist of two parts, one is the security sold and another is the agreement to repurchase the security at a future point in time.

These large flows are also reflected in the reserve assets, which are the Riksbank's holdings in gold and foreign securities and currency. Reserve assets are tasked with defending the value of the Swedish kronor. Reserve assets should be able to be used to provide temporary liquidity support for Swedish financial players in order to maintain financial stability.

International investment position, net



The international investment position is compiled twice a year. Swedish net liability to foreign countries increased by SEK 112 billion to SEK 321 billion during the first half of 2008, according to preliminary figures.

Net assets in the form of direct investment have been forecasted to SEK 353 billion, which is a marginal increase compared to last year.

Net debt in the form of portfolio investments (portfolio shares and debt securities) amounted to SEK 568 billion, which is a decrease of SEK 14 billion compared to 2007.

The remaining net debt, excluding direct investment and portfolio investments increased somewhat during portfolio first half of 2008. The reserve assets have decreased by SEK 15 billion during 2008 and stand at SEK 186 billion after the first half of 2008.

The official compilation of Sweden's international investment position was revised to reflect market value, with the exception of direct investment, which is reported at book value. A compilation of Sweden's international investment position is also published as a complement, where market value for direct investment has been calculated, this is only done annually. According to this compilation, Sweden's net assets abroad for 2007 equalled SEK 426 billion.

Those factors of greatest significance for the development of the international investment position include: SEK exchange rate, share prices on the stock market in Sweden and abroad, and the market value of direct investment companies.

It is important to note that several sub-items in the international investment position for 2007, such as direct investment and portfolio shares, are forecasts. The figures should therefore be interpreted with caution.

What is the balance of payments?

The balance of payments has been produced and summarised by Statistics Sweden on commission for the Swedish Riksbank since September 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, investments 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. Put in simple terms, it is a compilation of a country's real and financial transactions with the rest of the world.

The balance of payments can be divided into the following.

- Current accounts, 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, which can be divided into direct investment, portfolio investment, financial derivatives, other investment and the reserve assets. The financial account shows changes in external financial assets and liabilities.

Derivation of the balance of payments

A country's gross domestic product, GDP_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 households' consumption, C_t, private investment, I_t, and public expenditure, 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 ($X_t - M_t$):

$$GDP_t = C_t + I_t + G_t + X_t - M_t.^{1} \qquad (1)$$

By adding together the net incomes, F_t, i.e. Swedish income earned abroad (Swedish wage-earners' remuneration abroad and earnings on foreign capital abroad) minus foreign income earned in Sweden (foreign wage-earners' remuneration in Sweden and earnings on foreign capital in

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

Sweden) it is possible to rewrite (1) in terms of gross national income, GNI_t:[2]

$$GNI_t = C_t + I_t + G_t + X_t - M_t + F_t \,. \tag{2}$$

Rewriting (2) gives:

$$GNI_t - C_t - G_t = S_t = I_t + X_t - M_t + F_t \,, \tag{3}$$

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 households' savings, $GNI_t - T_t - C_t$.[3]

According to:

$$S_t - I_t = X_t - M_t + F_t \,. \tag{4}$$

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 trade in goods. $X_t - M_t + F_t$ is called the current account. Equation (4) thus shows that there is a simple connection between net investments and trade in goods. 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 deficit in the trade in goods 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 households' 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 the consolidated public sector's savings and households' savings, domestic investments can be divided up into public sector investment and private investment. This division indicates that if the public sector's 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 on the current account. A growing deficit in the current account can thus be a sign among many that the central government's expenditure is greater than its 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] These incomes are often called primary incomes. Net incomes consist of wages, capital earnings and current transfers.

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

[4] Net incomes are assumed to be constant in the short term.

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

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

where A_t are the net external assets during period t and $r_t A_t$ is the interest earnings 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).

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

The left side of the balance of payments (7) is, as mentioned earlier, the current account, which consists of the sum of trade in goods and net incomes. 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 on 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 foreign currency reserve, 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 abroad (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 service abroad than it buys from abroad. 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 reports in the form of stock data on all domestic sector assets and liabilities abroad. The net total of assets and liabilities is thus a measure of a country's wealth relative to other countries. Stock data is 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

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

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

and asset prices. In addition, the stocks can be affected by, for instance, 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 changes	Other corrections	**Closing balance**

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