Balance of Payments

Third quarter 2010

Statistiska centralbyrån Statistics Sweden

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Foreword

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

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

The report comprises the results of the third quarter of 2010.

Statistics Sweden, December 2010

Folke Carlsson

Christina Ekblom

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Summary

The balance of payments for the third quarter of 2010 shows a somewhat worsened current account. The net trade balance decreased and resulted in a capital inflow of SEK 18.0 billion, while the trade in services remained largely unchanged. The banks reduced their borrowing abroad, resulting in an outflow in the financial account.

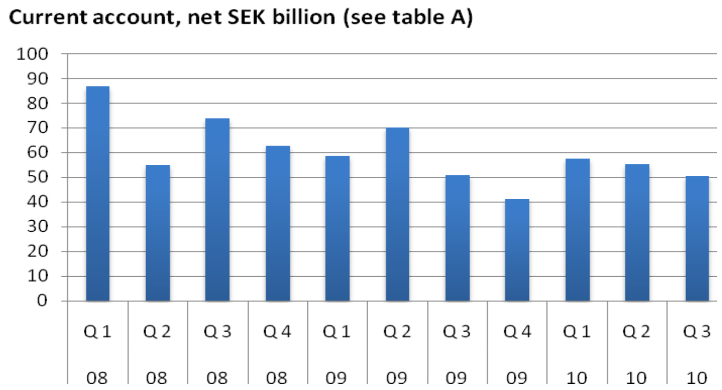
The surplus in the current account continued to worsen and amounted to SEK 50.3 billion. Trade in goods amounted to SEK 18.0 billion, a clear decrease compared to the previous period. After the downturn of 2009, trade is now increasing again, and imports as well as exports have risen during the year. However, the strong Swedish krona has lowered exports during the quarter, resulting in a weaker trade in goods. Nevertheless, trade in services was relatively unchanged.

The financial account resulted in a net outflow of SEK 60.8 billion during the quarter. The decrease in borrowing abroad by Swedish banks was behind a net outflow of SEK 87.3 billion for the item other investments. Purchases by Swedish investors of foreign securities also generated an outflow of capital. The number of cross-border acquisitions of enterprises was low during the quarter, contributing to the low net outflow of SEK 1.5 billion in direct investments.

Balance of Payments third quarter 2010

The balance of payments for the third quarter of 2010 resulted in a surplus in the current account of SEK 50.3 billion, a slight negative capital balance and a deficit of SEK 60.8 billion in the financial account. As previously, the capital account gave a negative result.

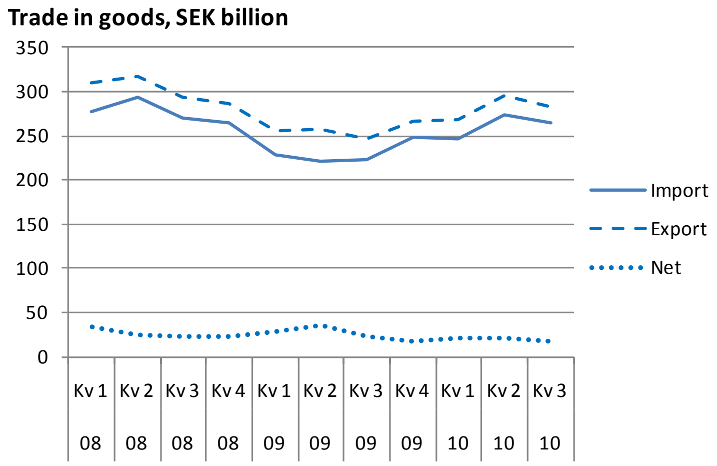
Current account



The current account resulted in a surplus of SEK 50.3 billion net for the third quarter, which is a worsening of SEK 5 billion compared to the quarter before. Trade in goods and services account for a significant part of this surplus, and resulted in a capital inflow of SEK 49.2 billion in the third quarter.

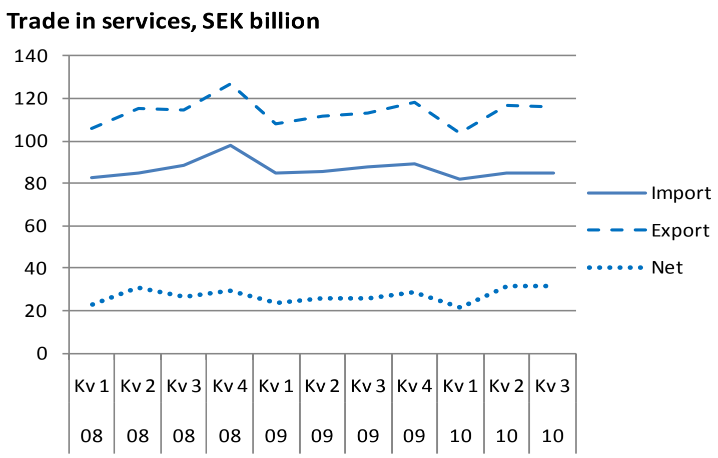
Foreign trade in goods and services

Following the sharp economic downturn of 2009, world trade is now beginning to pick up again. The increased demand is also reflected in Swedish exports that have quickly recovered during 2010. Trade in goods resulted in a capital inflow of roughly SEK 18.0 billion net. However, this is worse than the same quarter one year ago. This trend is because imports of goods have accelerated faster than exports of goods. One factor that has strongly influenced trade in goods is the development of the Swedish krona; during the year it has become over 9 percent stronger. This means that Swedish goods are more expensive abroad, and can thus explain why Swedish exports have only made a weak recovery compared to imports. Compared to the previous year, exports increased by 16 percent and imports by 18 percent.



Trade in services continued at a high level, amounting to SEK 31.2 billion this quarter. Compared to the third quarter last year, this is an increase of nearly 23 percent, due to exports becoming strong while imports fell back.

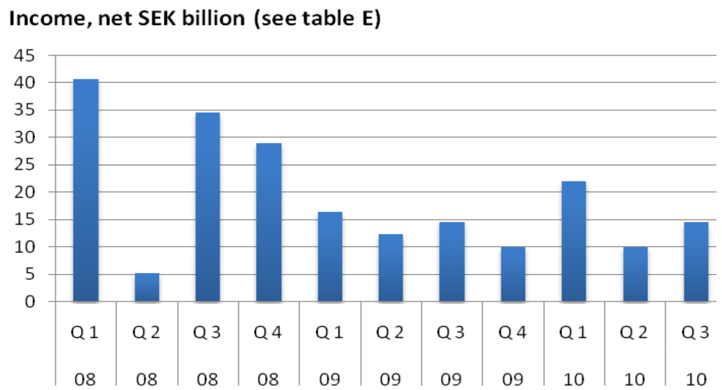
The increase from last year is explained nearly entirely by the development in the item other business services, which increased by nearly SEK 9 billion. The other business services also increased compared to the previous quarter. Among other things, the item consists of merchanting, legal services and other business services. The merchanting margin increased significantly by an entire 34 percent. Imports of diverse business and technical services such as marketing and R&D dropped by 12 percent, and imports of these types of services were equal to the exports.



The item for travel is highly affected by the seasons, and comparisons are best made with the corresponding quarter of the previous year. Exports of travel consist of foreign travellers' consumption when travelling in Sweden while imports correspond to expenses of Swedes when travelling abroad. Exports as well as imports increased by 8 percent. Swedish travellers' consumption abroad still exceeds foreign travellers' consumption in Sweden, but these levels are becoming more similar, seen over a longer period. All in all, this resulted in a relatively small deficit for the item travel, SEK 2.0 billion.

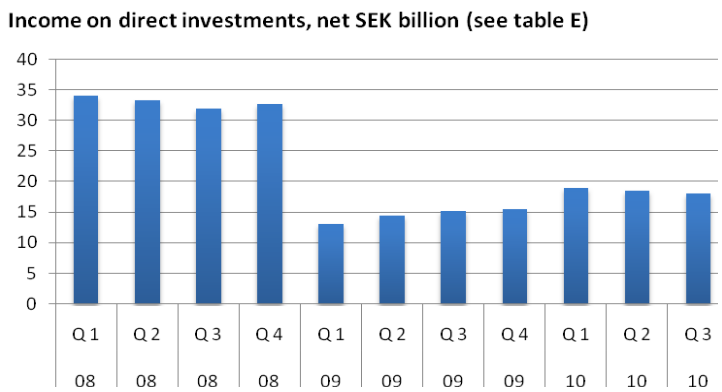
Exports of services have become more important for Sweden's export, and now comprises about a third of all exports. At the same time, goods and services have become more dependent of each other where the use of immaterial rights such as licenses and royalties are important even for producing industrial companies. However, acquisition of immaterial rights is included in the aggregate other in the Capital Account and resulted this quarter in an increased deficit as a result of stronger imports.

Income



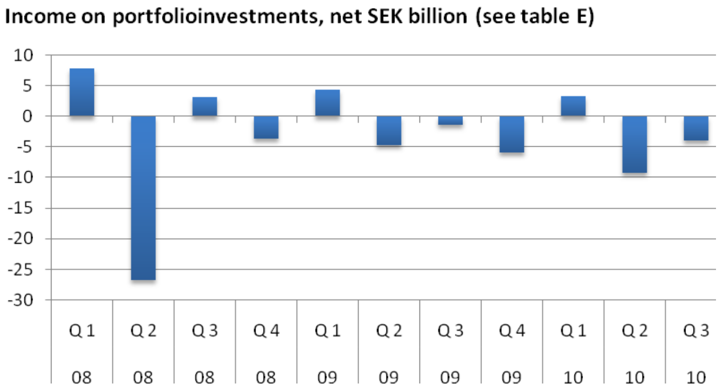
Income, which consists of both compensation of employees and return on invested capital, resulted in a capital inflow of SEK 14.4 billion. This is the same level as the same period last year. The item compensation of employees resulted in a net outflow of SEK 0.5 billion, which was also the same level as in 2009. Investment income in turn consists of earnings on direct investment, portfolio investments as well as other investments.

Income on direct investments



After the profits of companies collapsed during the economic downturn, an upward turn has now begun. Earnings on capital for companies in direct investment relationships that were earlier preliminary for 2009 have been replaced by results from the annual survey on direct investments. Results are divided equally among the four quarters. According to estimations, dividends for 2010 will rise.

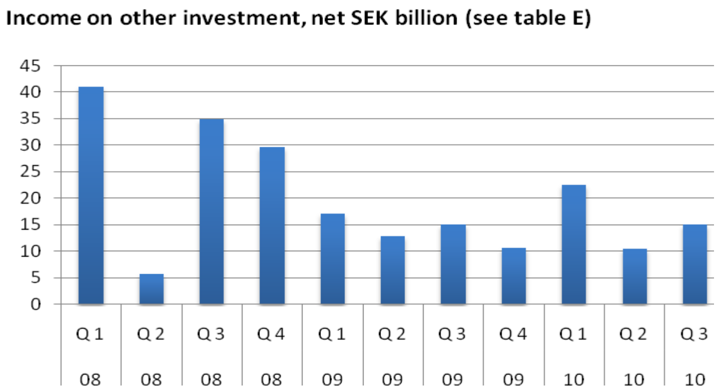
Income on portfolio investments



Earnings on portfolio investments resulted in a net outflow of SEK 3.9 billion during the third quarter. During the same period in 2009, earnings amounted to SEK 1.4 billion. Low interest rates on the international capital markets resulted in lower earnings on foreign bonds, while earnings on Swedish bonds rose instead, compared to last year. This is largely because long-term borrowing has increased somewhat at the expense of the short-term borrowing that has declined. Earnings on Swedish money market instruments also decreased as a result of this borrowing.

There were no dividends for Swedish shares and funds during the quarter, since they are usually distributed during the spring. Dividends on foreign shares increased compared to the same period last year. A considerable amount of these are related to funds, which are also re-invested.

Income on other investments

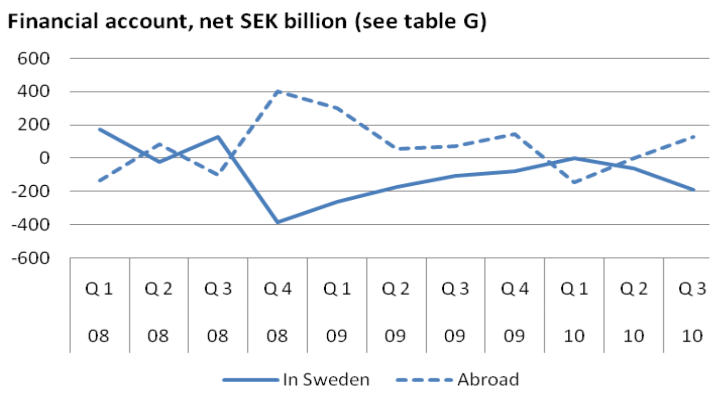


Income on other investments gave rise to a net inflow of SEK 932 billion, which can be compared to the net inflow of SEK 1.4 billion during the same period in 2009.

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

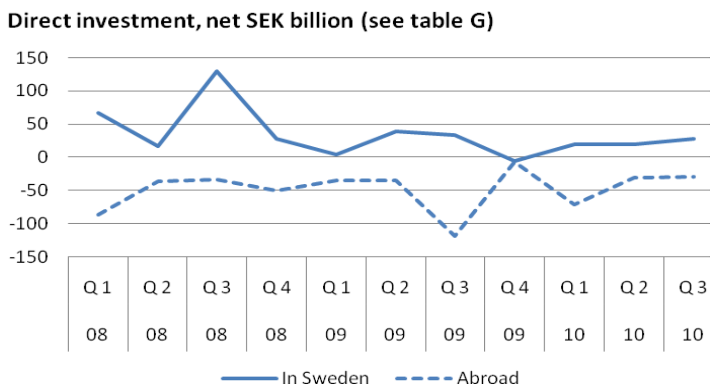
Interest on loans to other countries decreased considerably compared to interest on loans from other countries. This also contributed to lower earnings. The decrease is because interest costs of companies increased during the quarter.

Financial account



The financial account resulted in a net outflow of SEK 60.8 billion for the third quarter of 2010. This is the third quarter in a row that the financial account generated a relatively large capital outflow of SEK 275.7 billion in total during the first three quarters of the year. Above all, other investments contribute to the deficit during the quarter with a net outflow of SEK 87.3 billion. Portfolio investments resulted in a deficit of SEK 9.6 billion while the foreign exchange reserve generated an inflow of SEK 32.8 billion.

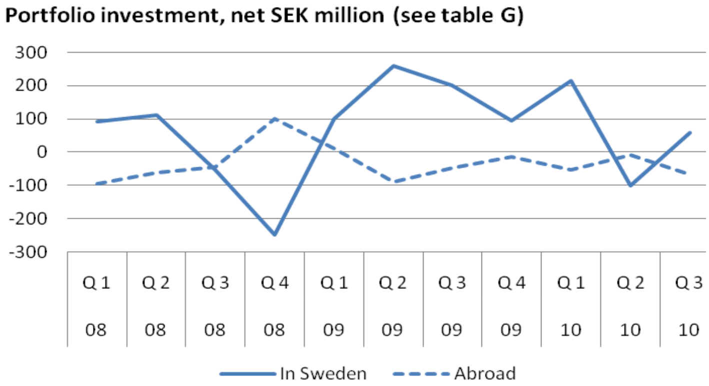
Direct investment



Direct investments produced a net outflow of SEK 1.5 billion during the quarter. Similar to the first six months of 2010, activity in direct investments has been relatively low, with regard to the gross level. Swedish direct investments abroad resulted in a net outflow of SEK 29.1 billion. The outflow is mainly due to the item called reinvested earnings. Foreign direct investments in Sweden produced a net inflow of SEK 27.6 billion during the fourth quarter. Even in this case, the flow was mainly due to reinvested earnings.

The number of cross-border acquisitions of companies together with reorganisation of groups of companies of considerable size has been relatively low during the third quarter. The regular financing operations, concerning internal receivables and liabilities, that is, the item for loans, resulted in a net inflow of SEK 10.6 billion.

Portfolio investments



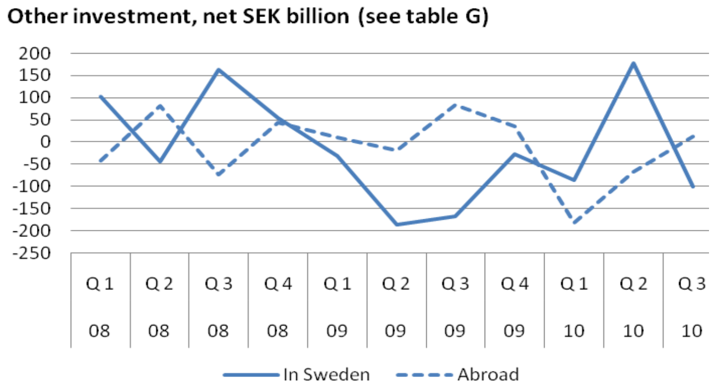
Cross-border portfolio investments during the third quarter of the year resulted in a net capital inflow of SEK 9.6 billion. The outflow was mainly due to continued Swedish interest in foreign securities. Swedish investors made net purchases of foreign bonds and money market instruments for SEK 46.4 billion. The majority of this outflow was for purchases of German bonds. It is worth noting that even Swedish investors made net sales of Italian, British and Irish bonds.

Large investments were also made in foreign shares and funds for SEK 21.8 billion. British shares and funds drew the greatest interest.

Foreign portfolio investments in Sweden resulted in a net inflow of SEK 58.6 billion during the quarter. Above all, issues by Swedish banks abroad are behind the net inflow.

Trade in Swedish shares and funds generated inflow during the quarter for a total of SEK 5.8 billion. Swedish bank shares attracted the greatest interest among foreign investors.

Other investments



Other investments produced a net outflow of SEK 87.3 billion in the third quarter of 2010. Other investments for the first three quarters have resulted in a net outflow of SEK 244.1 billion, in line with the previous year. Less borrowing abroad by the Riksbank and other banks has led to the decrease. Non-financial companies have also reduced their borrowing abroad, at the same time as they increased their deposits during the quarter.

Loans etc. to other countries showed a net inflow of SEK 13.0 billion, and the corresponding foreign investments in Sweden led to a net outflow of SEK 100.4 billion.

The value of other investments varies considerably from one quarter to the next and it is usually short-term capital movements between banks in Sweden and counterparts abroad that have created these fluctuations. Other investments sometimes include deposits and borrowing, lending and reo transactions to and from other countries.

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 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. It is simply a summary of a country's real and financial transactions with the rest of the world.

The balance of payments 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. 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 is divided into direct investments, portfolio investments, financial derivatives, other investments and the foreign exchange reserve. The financial account shows changes in external financial assets and liabilities.

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 households' consumption, C_t, private investment, I_t, and public sector fees 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 ($X_t - M_t$):

$$BNP_t = C_t + I_t + G_t + X_t - M_t.^{1} \tag{1}$$

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, 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 households' 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 account. $X_t - M_t + F_t$ 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 the trade in goods during certain periods of time.

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

where A_t are the net external assets during period t and $r_t A_t$ are 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):

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

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 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 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 services 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 in relation to the rest of the world. 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]

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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.

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, 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**