BALANCE OF PAYMENTS AND FINANCIAL MARKET

REPORT 2013:4

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Balance of Payments

Third quarter

Balance of Payments

Third quarter 2013

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2013

Balance of Payments. Third quarter 2013

Statistics Sweden
2013

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Foreword

The balance of payments has been compiled and summarised by Statistics Sweden on behalf of the Swedish Riksbank since 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 covers the results of the third quarter of 2013.

Statistics Sweden, November 2013

Folke Carlsson

Christina Ekblom

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Summary

The financial account is characterised by inflows in portfolio investments, as Swedish banks have increased their borrowing in debt securities issued abroad. At the same time, other investments are producing outflows as Swedish banks have increased their asset holdings abroad.

In addition, the Swedish government's sale of shares in Nordea was reflected in portfolio investments and other investments. The sale of the shares contributed to capital inflows in portfolio investment. At the same time, capital outflows were generated in other investments because the Swedish National Debt Office increased its deposits abroad. Portfolio investments produced a net inflow of SEK 90 billion, while other investments resulted in a net outflow of SEK 110 billion.

The current account generated a surplus of SEK 54 billion in the third quarter, which is in line with the same period last year. The surplus in the trade in goods and services has declined, while the surplus in income has increased.

Balance of payments, third quarter 2013

The current account generated a surplus of SEK 54 billion in the third quarter, which is in line with the same quarter last year. The capital account produced an outflow of SEK 2 billion, and the financial account generated a net outflow of SEK 15 billion.

The balance of payments is comprised of the *current, capital* and *financial accounts* and is a compilation of a country's real and financial transactions with the rest of the world. Changes in value caused by e.g. changing market values and exchange rates are excluded, which is why changes in account positions cannot be fully explained by balance of payments transactions.

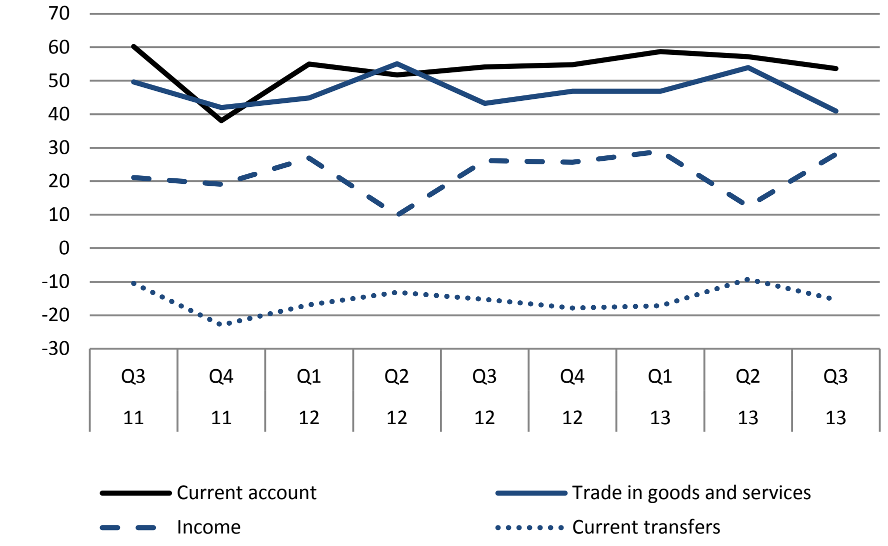
The c*urrent account* gives a picture of a country's real flows with the world and consists of trade in goods and services, income and current transfers, such as EU contributions. The *capital account* consists primarily of EU contributions and development assistance for real investments and represents a very small part of the balance of payments. The *financial account* is divided into direct investments, portfolio investments, other investments, financial derivatives and reserve assets. The financial account shows how a deficit in the current and capital accounts is financed, or which investments are made in the case of a surplus.

The relationship between the current, capital and financial accounts is such that the sum of these items will be zero. However, due to measurement errors, accruals, etc. errors and omissions arise as a residual. Thus, the current and capital accounts show if a country is a net lender or net borrower.

Current account

The current account generated a surplus of SEK 54 billion in the third quarter, which is in line with the same quarter last year. The surplus in trade in goods and services has declined slightly, while the surplus in income increased slightly. Graph 1 below shows that most of the surpluses are generated from the trade in goods and services.

Graph 1: Current account and included items, billion SEK

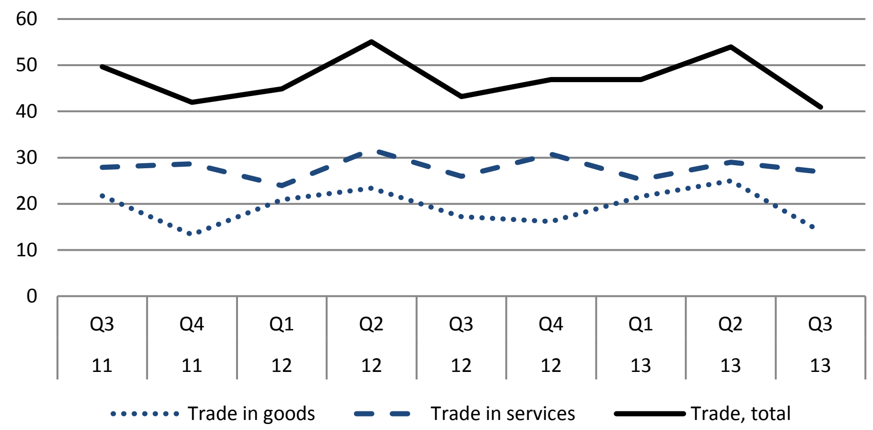


Trade in goods and services

International trade in goods and services, which is the net of exports and imports, was positive in the third quarter and amounted to SEK 41 billion. The net surplus for the same quarter last year was SEK 43 billion. A smaller surplus in the trade in goods contributed negatively, while the surplus in trade in services increased slightly.

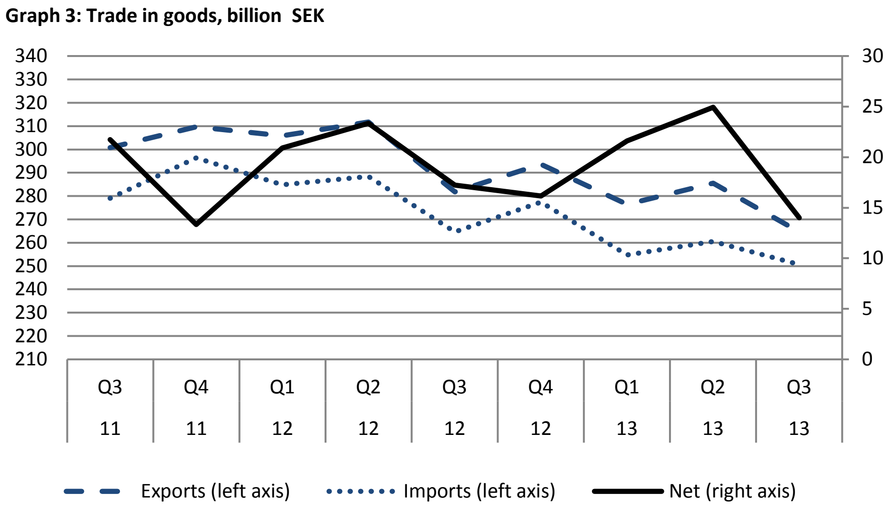
The trade in goods is the net value of the goods imported and exported to and from Sweden and the trade in services is the corresponding net value for services. Graph 2 shows that the trade in services represented the larger part of the surplus in foreign trade.

Graph 2: Trade in goods and services, billion SEK

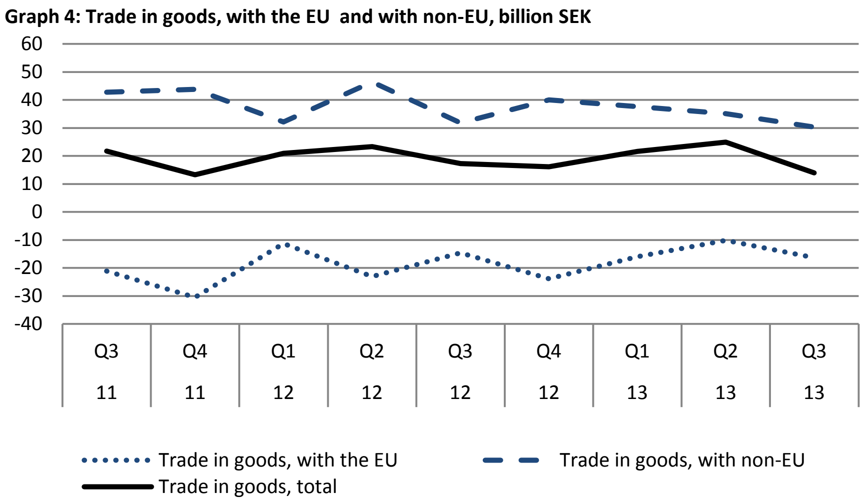


Trade in goods

The surplus in the trade in goods decreased to SEK 14 billion in the third quarter, compared with SEK 17 billion in the same quarter last year. Both exports and imports decreased compared with the same quarter last year. Exports decreased more than imports, resulting in a lower surplus in the trade in goods.

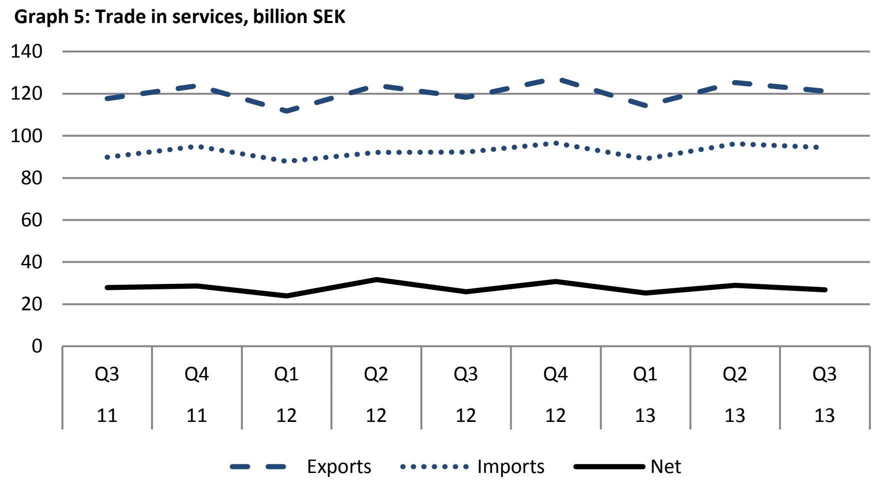


Trade in goods with countries outside the EU continues to show a surplus, while the trade in goods with EU countries shows a deficit.



Trade in services

Foreign trade in services during the third quarter resulted in a surplus of SEK 27 billion. This is in line with the same quarter last year when the surplus amounted to SEK 26 billion. Export of services during the quarter amounted to SEK 121 billion, while import of services amounted to SEK 94 billion. Both exports and imports increased slightly compared with the same quarter last year.

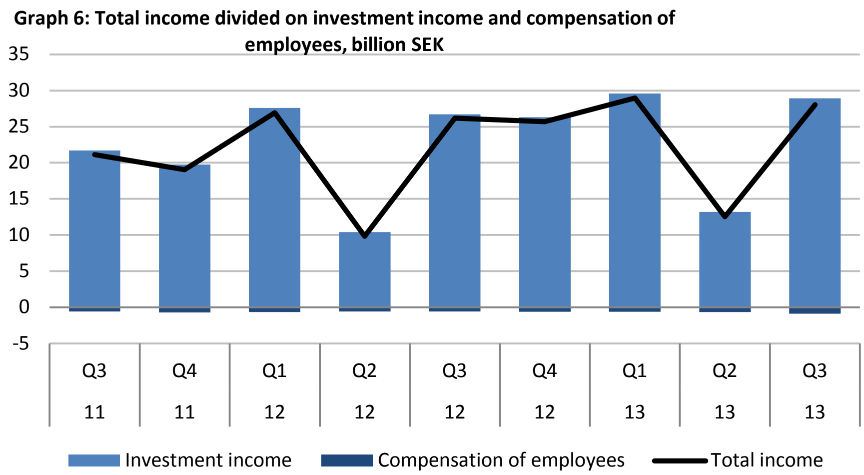


Among the types of services, transportation contributed a surplus of SEK 5 billion, while travel contributed a deficit of SEK 8 billion, and other services contributed a surplus of SEK 30 billion. The deficit in the item travel means that imports exceed exports. Imports refer to the consumption of Swedes when travelling abroad while exports refer to foreign consumption when travelling in Sweden. Among other services, merchanting contributed the largest surplus followed by data and information services as well as royalties and license fees.

Merchanting contributes a large part of the surplus in trade in services and the surpluses have continued to increase in comparison with the same quarter in the previous year. Merchanting is found only under exports and is the sales margin that occurs when Swedish companies buy goods and sell them on the world market without importing them to Sweden.

Income

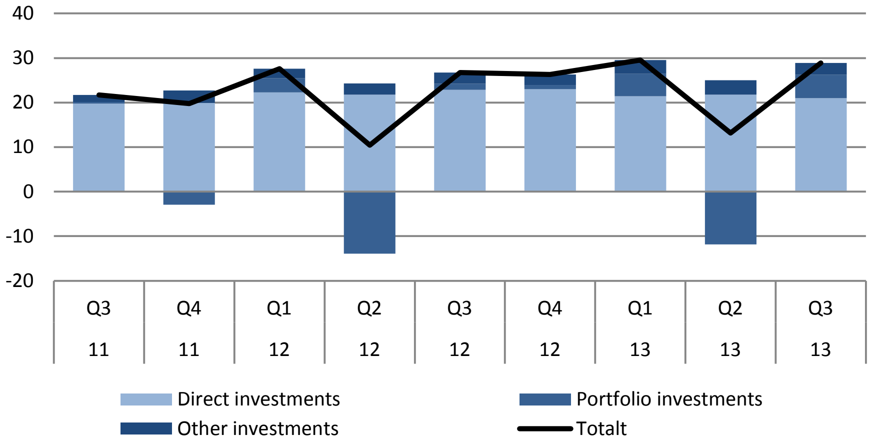
Income consists of compensation of employees and investment income. Investment income contributes the major part of incomes, which is also illustrated in Graph 6. The surplus in income amounted to SEK 28 billion in the third quarter.



Investment income

Investment income in the current account is the return on Sweden's assets and liabilities abroad and is divided into *direct investments*, *portfolio investments* and *other investments*.

Graph 7: Investment income divided by asset classes, billion SEK



Investment income contributes a surplus of SEK 29 billion, which is slightly higher compared with the same period last year. The increased surplus in investment income derives mainly from the return on portfolio investments.

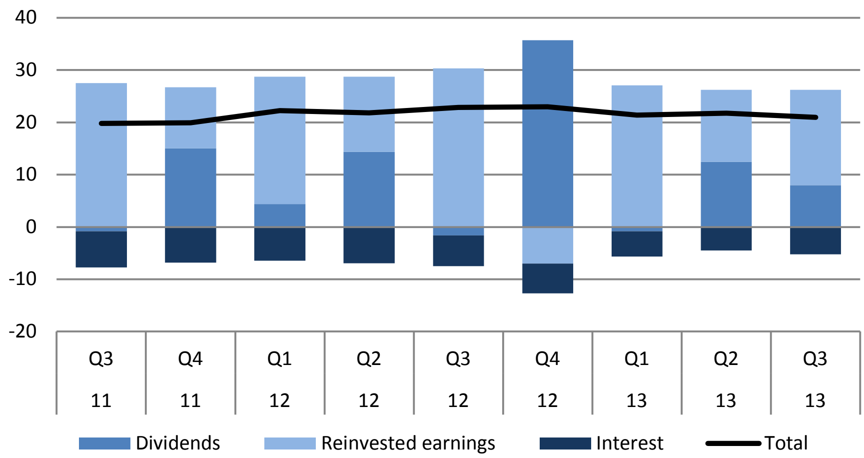
Income from direct investments

Income from direct investment generated a surplus of SEK 21 billion in the third quarter. Income from Swedish direct investments abroad amounted to SEK 55 billion, while income on foreign direct investment in Sweden totalled SEK 34 billion.

Dividends received from foreign direct investment amounted to SEK 13 billion, while dividends paid to foreign shareholders amounted to SEK 5 billion. This means that a large portion of the income has been reinvested. Interest rates on loans in direct investment relationships made a negative contribution with an outflow of SEK 5 billion.

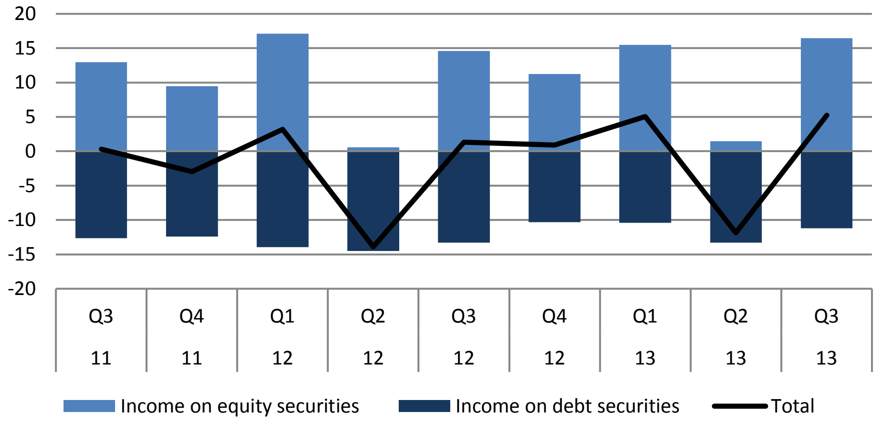
With the publication of this quarterly report, the preliminary values for income for 2012 have been replaced by final values.

Graph 8: Income on direct investments, billion SEK



Income from portfolio investments
Income from portfolio investments consists of dividends from equities and interest on fixed income securities. The item is subject to seasonal variation, which is primarily due to dividend payments of equities. Dividend payments in Swedish companies are generally realised in the second quarter, which results in greater outflows during that quarter.

Graph 9: Income on portfolio investments, billion SEK



Income from portfolio investments generated a capital surplus of SEK 5 billion in the third quarter, which is nearly SEK 4 billion more than in the same quarter of 2012.

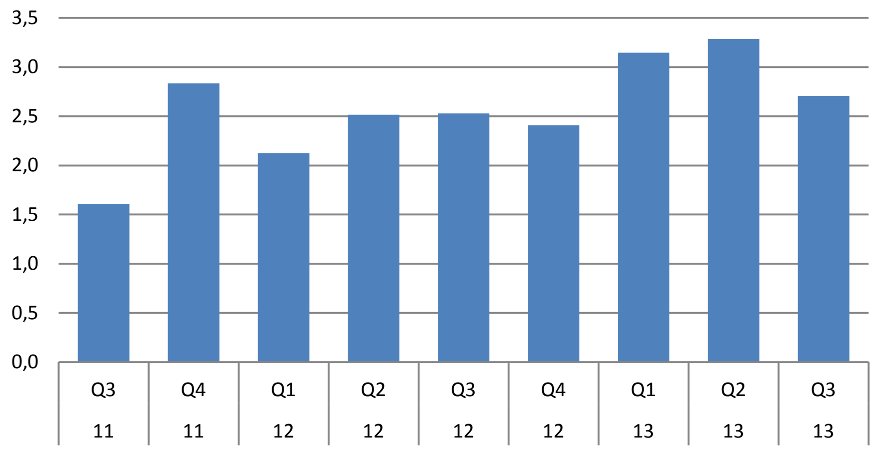
Dividend payments that include both dividends and income from mutual funds increased by SEK 2 billion compared with the same quarter in 2012.

The outflow of interest payments from debt securities decreased by SEK 2 billion compared with the corresponding period in 2012. This is mainly due to rising interest rates on foreign bonds.

Income from other investments
Income from other investments consists of income from loans and deposits, and therefore correlates with the development of Sweden's positions for other investments.

Net income from other investments amounted to SEK 3 billion in the third quarter. Income from other investments abroad resulted in a net outflow of nearly SEK 7 billion, while the return on other investments in Sweden resulted in a net outflow of SEK 4 billion.

Graph 10: Income on other investments, billion SEK



Current transfers

Current transfers include transfers of real or financial assets without a similar consideration in return. This item primarily *includes EU contributions* and *development assistance* and resulted in an outflow of SEK 15 billion in the third quarter.

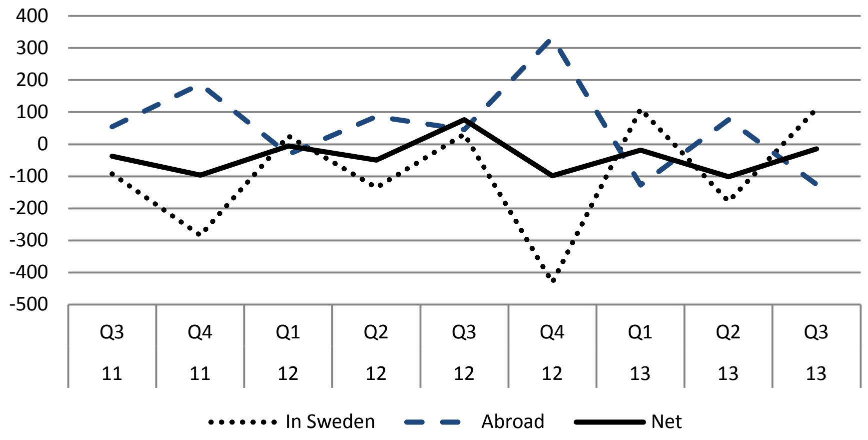
Capital account

The capital account consists mainly of *EU contributions* and *development assistance* for investments, but also includes *"transfer of rights"* (patents, copyrights, etc.). The capital account recorded a net outflow of SEK 2 billion in the third quarter.

Financial account

The financial account consists of *direct investments, portfolio investments, other investments, financial derivatives* and *reserve assets*, which generated net outflows of SEK 15 billion during the third quarter of the year. The item other investments recorded a capital outflow of SEK 110 billion. Direct investments contributed to the capital outflows. However, portfolio investments resulted in a capital inflow of SEK 90 billion. The items financial derivatives and reserve assets generated capital inflows.

Graph 11: Financial account, billion SEK

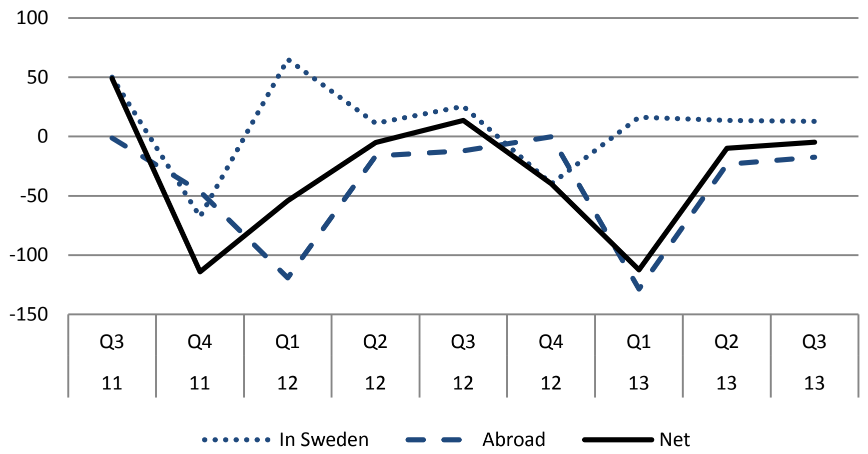


Direct investments

In total, direct investment produced a net outflow of SEK 5 billion in the third quarter. Swedish direct investments abroad resulted in a net outflow of SEK 18 billion, while foreign direct investments in Sweden resulted in a net inflow of SEK 13 billion. There were not many large transactions during the quarter.

Reinvested earnings accounted for a large portion of the flows in both Swedish direct investments abroad and foreign direct investments in Sweden. Reinvested earnings is a residual item in the statistics and refers to earnings that are not distributed to shareholders but remain in the company instead.

Graph 12: Direct investments, billion SEK



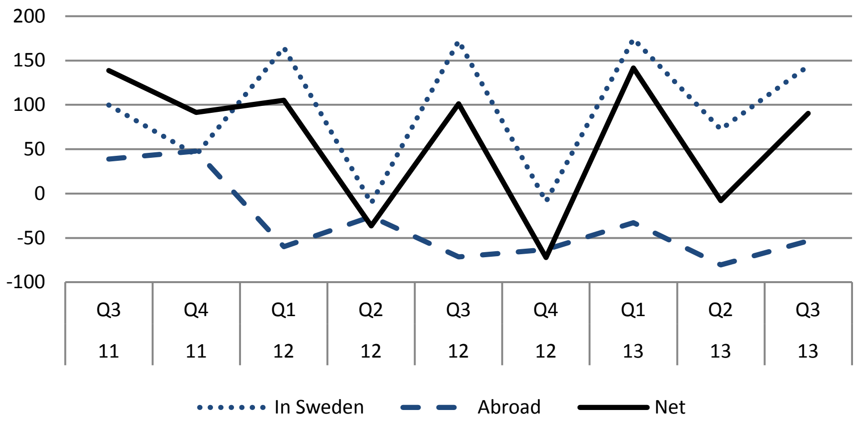
Portfolio investments

Portfolio investments consist of equities, mutual funds and fixed income securities. An equities holding is recognised as a portfolio investment if ownership is less than 10 percent of the share capital or voting rights. If the ownership share is greater than 10 percent, it is defined as a direct investment.

Portfolio investments abroad resulted in a net capital inflow of SEK 90 billion in the third quarter of the year. Foreign investors purchased Swedish fixed income securities for SEK 111 billion during the quarter. Swedish banks increased their borrowing in fixed income securities by SEK 76 billion. Swedish investors bought foreign bonds for SEK 41 billion and foreign equities and mutual funds for SEK 22 billion.

Foreign investors bought Swedish equities, totalling a net SEK 33 billion in the quarter. The Swedish government sold its remaining shares in Nordea during the quarter. A large part of the share sold was purchased by foreign investors.

Graph 13: Portfolio investments, billion SEK

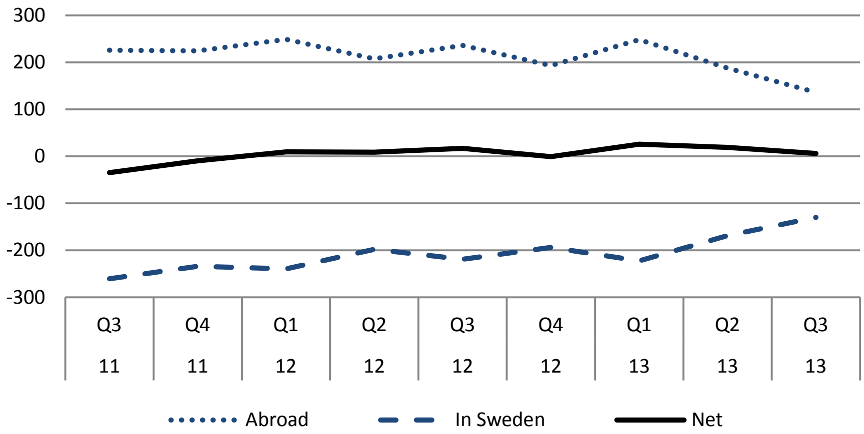


Financial derivatives

Transactions in financial derivatives consist primarily of swap contracts in interest rates and foreign exchange; the foremost holders are the major Swedish banks. Positive market valued contracts with foreign counterparties are defined as assets, and a negative market valued contract is similarly defined as a debt contract.

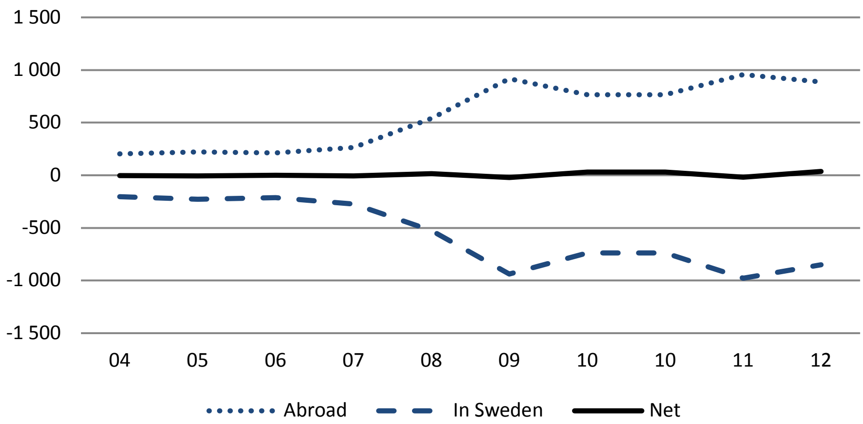
Financial derivatives generated a net inflow of SEK 7 billion in the third quarter. The largest part of the net inflow was generated by different types of swap contracts.

Graph 14: Financial derivatives, billion SEK



As a result of the global financial crisis, the market values of debt and asset contracts increased, which have generated larger flows in financial derivatives in recent years. The values of positions in financial derivatives are shown in Graph 15.

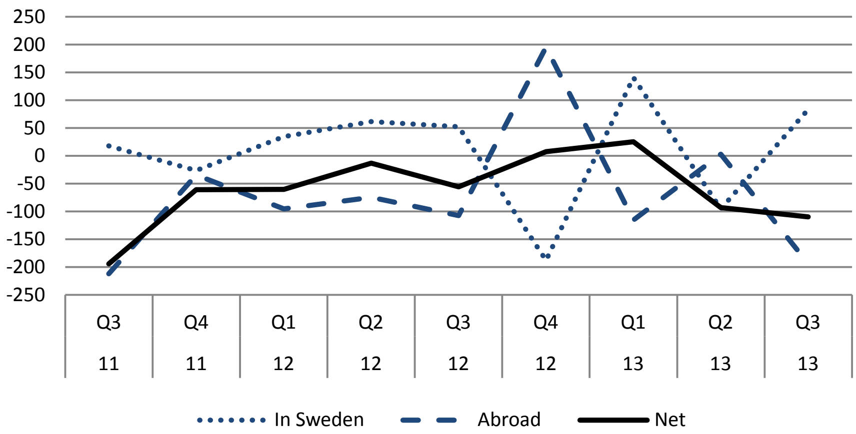
Graph 15: Financial derivatives, investment position value, 2004-2012, billion SEK



Other investments

Other investments mainly consist of loans by the bank sector to and from other countries, excluding debt securities. These include promissory note loans, deposits and repos.

Graph 16: Other investments, billion SEK



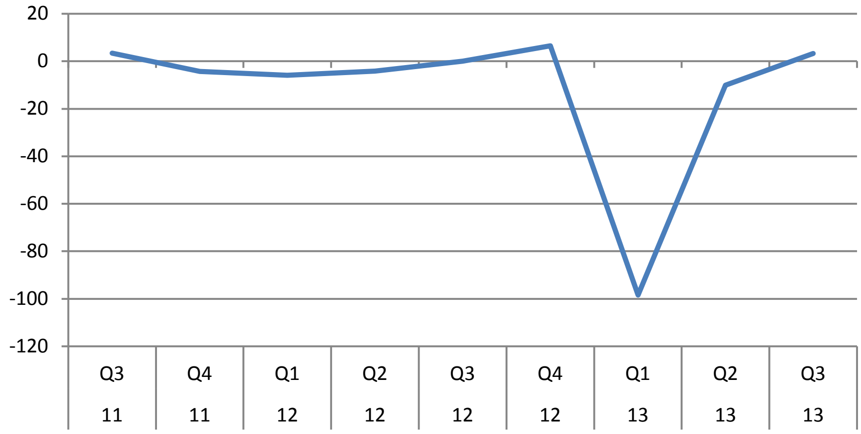
Other investments accounted for a net inflow of SEK 110 billion during the quarter. Lending to other countries produced a net outflow of SEK 194 billion, while borrowing from other countries produced a net inflow of SEK 84 billion. As before, banks accounted for most of the net outflow in the quarter, but also the Swedish National Debt Office contributed to the outflows after increasing its foreign deposits as a result of the Swedish government's sale of its remaining holdings in Nordea. Non-financial companies increased their bank deposits abroad and reduced borrowing from abroad, which also contributed to the net outflow.

Reserve assets

Sweden's reserve assets consist of the Riksbank's reserves of gold and securities in foreign currencies. Its main purpose comprises providing temporary liquidity support to insolvent banks, fulfilling Sweden's part in the International Monetary Fund (IMF) and, if necessary, intervening on the foreign exchange market.

Foreign exchange reserves generated a net inflow of SEK 3 billion in the third quarter, mainly due to a reduction in foreign bank deposits and fixed income securities. Reserve assets decreased slightly and totalled SEK 427 billion at the end of the third quarter.

Graph 17: Reserve assets, billion SEK



Revisions

Sweden's revision policy for the current account is as follows:

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

As an exception, additional periods are revised if there have been changes in methodology or new data have been added that materially alter the picture of the current account.
The current account has been revised from Quarter 1 2011 through Quarter 2 2013. During the revised period, revisions of SEK 3 billion net were made in the current account and SEK 40 billion net 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 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 main aggregates in the balance of payments are *the current account*, *the capital account*, and the *financial account.*

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 investments, I_t, and public expenditures, 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 ($X_t - M_t$):

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

By adding together the net factor 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 Sweden) it is possible to rewrite (1) in terms of gross national income, BNI_t:[2]

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

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

[2] This factor income is often called primary income. Net factor income consists of wages/salaries, capital earnings and current transfers.

Rewriting (2) gives:

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

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, $BNI_t - T_t - C_t$.[3]

According to (3) the following applies:

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

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 and services $X_t - M_t + F_t$ is called the current account. Equation (4) thus shows that there is a simple connection between net investments and trade in goods and services. 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 and services 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 large 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 into the consolidated public sector's savings and households' savings, domestic investments can be divided 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 expenditures are 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 expenditures in each time period are limited by the income in the same period and the country's possibilities to borrow:

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

[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 co-vary with the trade in goods and services during certain periods of time.

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 noted earlier, the current account, which consists of the sum of trade in goods and net factor incomes. The term $(A_t - A_{t+1})$ on the right side shows how the net external assets change over time. 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 with 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 may also be reflected in an increase in foreign exchange reserves, 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 example, 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 outflow of 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 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]

[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 a residual is included in the form of an item for errors and omissions.

[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 figure). 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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