BALANCE OF PAYMENTS AND FINANCIAL MARKET

REPORT 2014:2

Statistiska centralbyrån Statistics Sweden

Balance of payments
1st quarter 2014

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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 first quarter of 2014.

Statistics Sweden, June 2014

Folke Carlsson

Christina Ekblom

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Summary

The surplus in the current account during the first quarter amounted to SEK 61 billion, which represented a strengthening of nearly SEK 1 billion compared with the same quarter last year. Trade in services gained strength while trade in goods was weakened.

Foreign trade in services generated a surplus of SEK 30 billion in the first quarter. This is an increase of nearly SEK 5 billion compared with the same period last year. Foreign trade in goods generated a surplus of SEK 16 billion, which represents a decrease of SEK 6 billion compared with the same period in 2013.

Other investments generated a net inflow of SEK 105 billion during the quarter. Borrowing increased during the quarter by SEK 250 billion, while lending abroad resulted in a net outflow of SEK 146 billion. The banking sector was behind most of the borrowing and lending.

Balance of payments, first quarter 2014

The first quarter of 2014 saw a strengthening in the current account which resulted in a surplus of SEK 61 billion. The capital account produced an outflow of nearly SEK 1 billion, and the financial account generated a net inflow of SEK 18 billion.

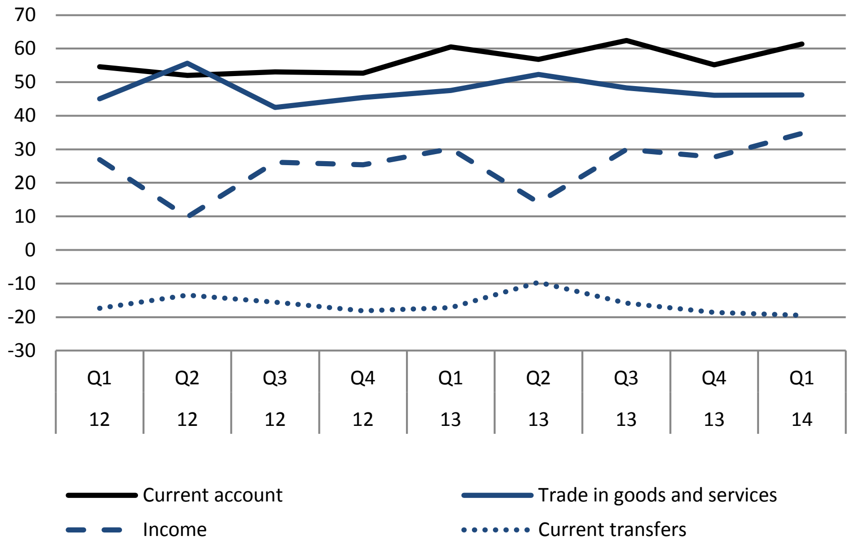
The balance of payments is comprised of the *current, capital* and *financial accounts* and is a compilation of a country's real and financial transactions with the rest of the world. Changes in value caused by e.g. changing market values and exchange rates are excluded, which is why changes in account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

The 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., a residual item arises as a residual of the discrepancies. 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 61 billion in the first quarter, which is in line with the same quarter last year. The surplus in income increased while the surplus in the trade in goods and services decreased slightly. The deficit in current transfer payments was somewhat larger than for the same period last year. Graph 1 below shows that most of the surpluses are generated from the trade in goods and services.

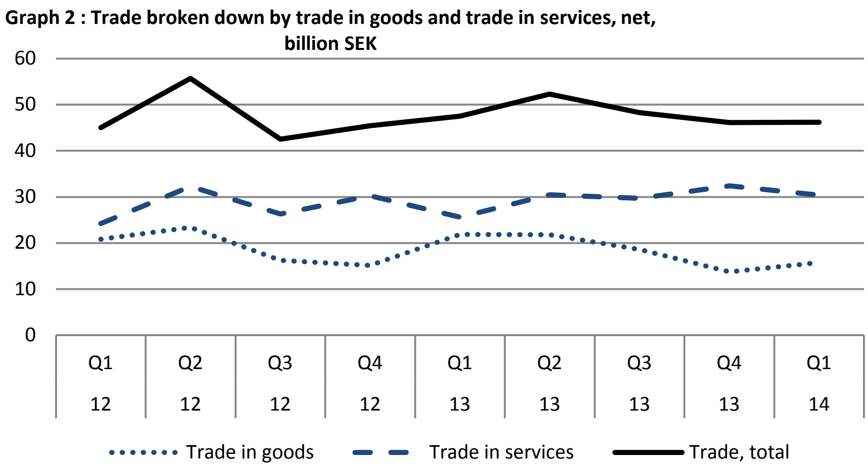
Graph 1: Current account and included items, billion SEK



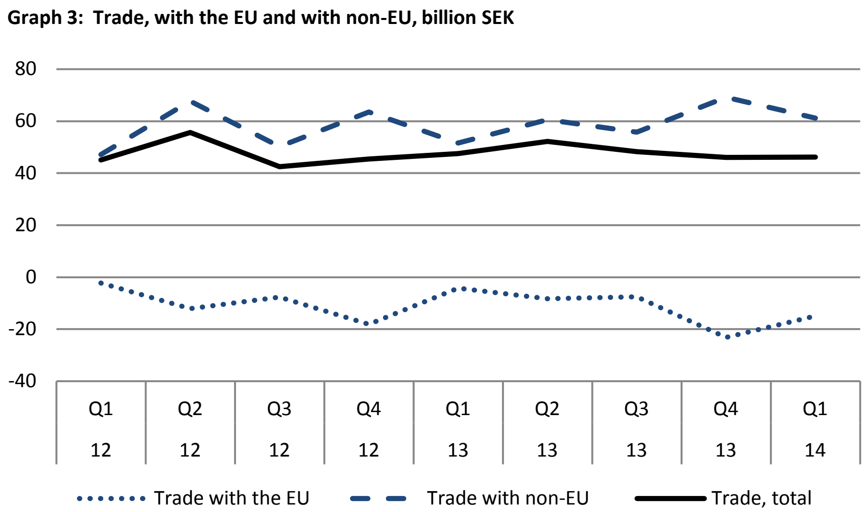
Trade in goods and services

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.

Foreign trade in goods and services amounted to SEK 46 billion net during the first quarter. The net surplus for the same quarter last year was SEK 48 billion. A reduced surplus in the trade in goods contributed negatively, while the surplus in the trade in services increased.



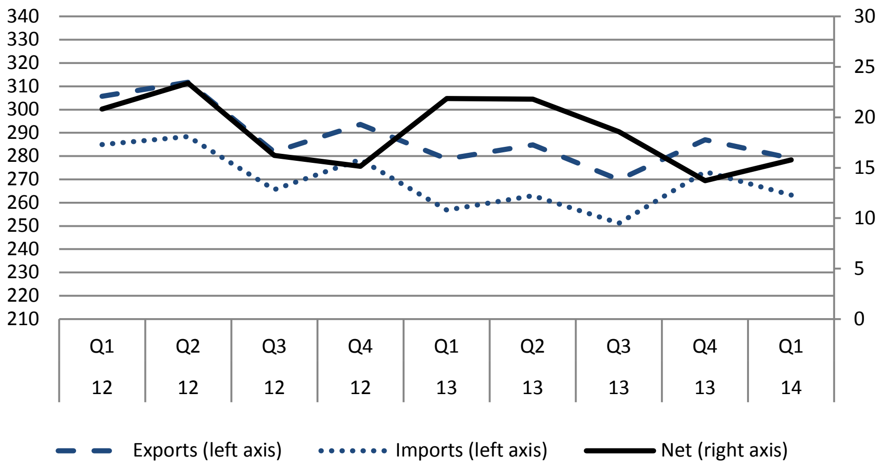
There is still a large surplus on trade in goods and services with non-EU countries, while trade with EU member states generates a deficit. During the first quarter, the deficit in the trade in goods and services with EU member states amounted to SEK 15 billion, which can be compared with a deficit of SEK 4 billion during the first quarter of 2013. Trade with non-EU countries generated a surplus of SEK 61 billion, which can be compared with a surplus of SEK 52 billion during the same quarter last year.



Trade in goods

The surplus in trade in goods amounted to SEK 16 billion in the first quarter, which can be compared with the same quarter last year when the surplus amounted to SEK 22 billion. Imports increased while exports remained at about the same level as during the first quarter of 2013, which resulted in a smaller surplus in trade in goods.

Graph 4: Trade in goods, Exports and imports, billion SEK

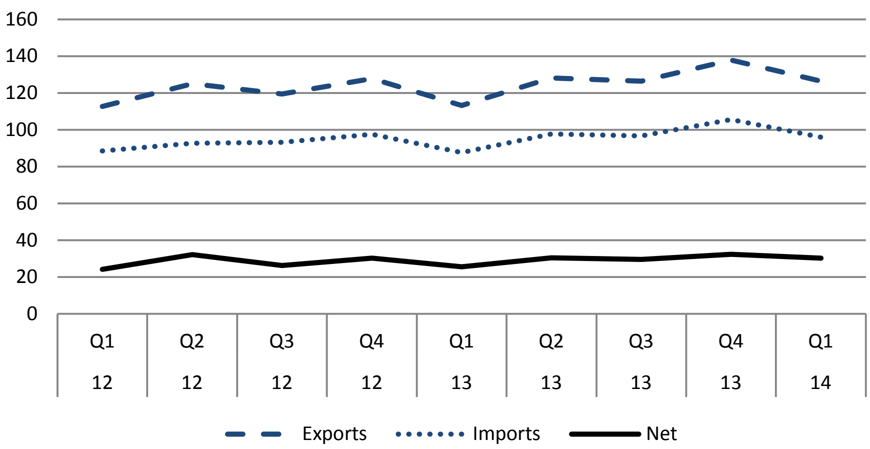


Trade in services

Foreign trade in services during the first quarter resulted in a surplus of SEK 30 billion, which represents an increase compared with the same quarter last year when the surplus amounted to SEK 26 billion. Both exports and imports have increased compared with the same quarter last year. Exports have increased more than imports, creating an increased surplus in trade in services.

Among the types of services, merchanting and computer and information services generated the largest surplus, while travel continued to show a significant deficit. The increased surplus in trade in services arises primarily from an increased surplus in computer and information services, where exports increased more than imports. Increased surpluses in merchanting and royalties and license fees also contributed to a strengthening of trade in services.

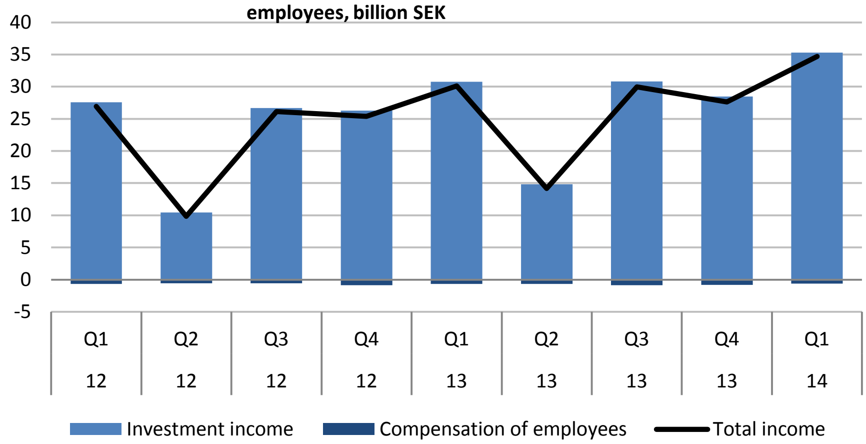
Graph 5: Trade in services, billion SEK



Income

Income consists of compensation of employees and earnings on invested capital. Income consists primarily of investment income while compensation of employees contributes smaller flows as illustrated in Graph 6. In the first quarter, the surplus in income amounted to SEK 35 billion, of which investment income accounted for a surplus of just over SEK 35 billion while compensation of employees contributed a deficit of nearly SEK 1 billion.

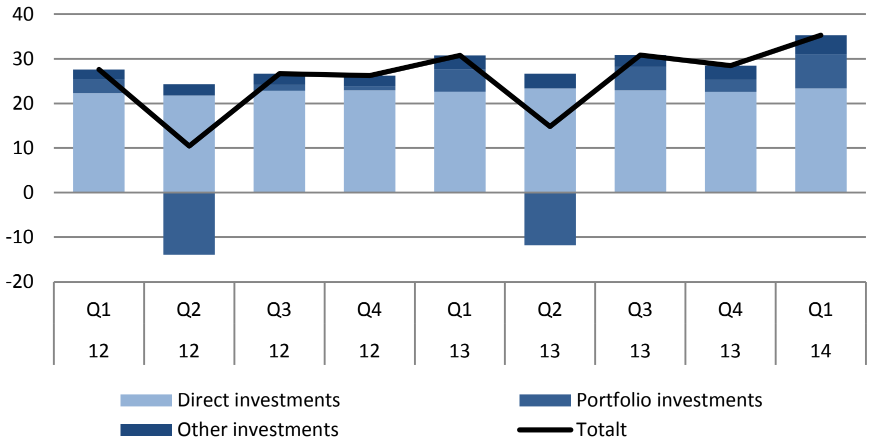
Graph 6: Total income divided on investment income and compensation of employees, billion SEK



Investment income

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

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



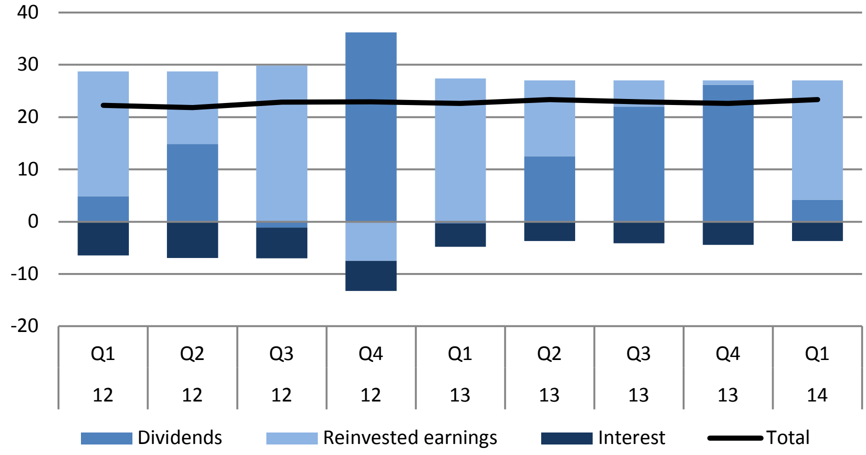
The larger part of investment income is generated by direct investments that are relatively stable over time. However, income from portfolio investments has seasonal variations. The surplus from investment income amounted to SEK 35 billion in the first quarter, which is somewhat higher than during the same quarter last year.

Income from direct investments

Income from direct investment generated a surplus of SEK 23 billion in the first quarter. Income from Swedish direct investments abroad amounted to SEK 56 billion, while income on corresponding foreign direct investment in Sweden totalled SEK 33 billion.

Dividends were relatively small during the quarter, which is normal during the first quarter. Thus, a large part of the profits remains in the companies, which results in larger flows of reinvested earnings. Reinvested earnings is a residual item in the statistics that refers to income that is not distributed to shareholders but instead remains in the company. Interest rates on loans in direct investment relationships contributed to a deficit of nearly SEK 4 billion.

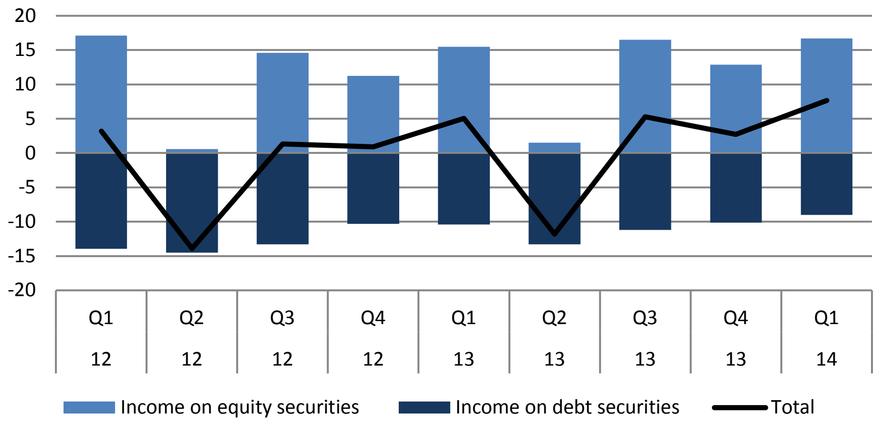
Graph 8: Income on direct investments, billion SEK



Income from portfolio investments

Income from portfolio investments consists of dividends from equities and mutual funds as well as interest on debt 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. This is in contrast to foreign companies that have a more even distribution of dividend payments over the year.

Graph 9: Income on portfolio investments, net, billion SEK



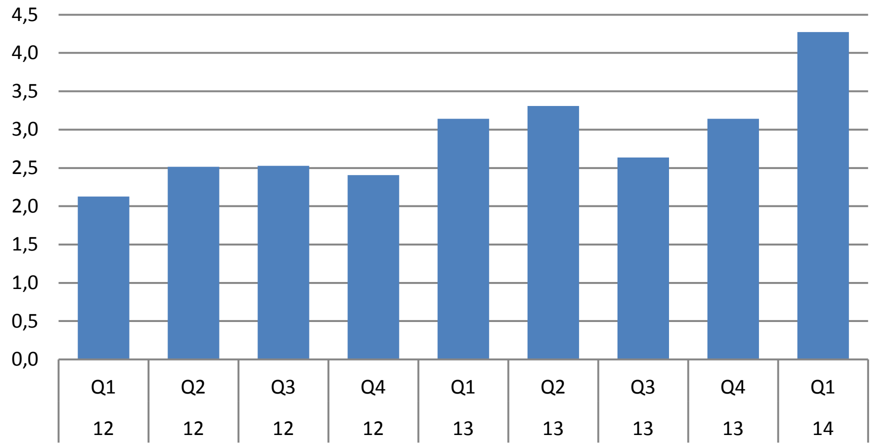
Income from portfolio investments generated a capital surplus of SEK 8 billion in the first quarter of the year, which is nearly SEK 3 billion more than in the same quarter of 2013.

Dividends which include dividends from mutual funds increased by just over SEK 1 billion compared with the same quarter in 2013. This is because dividends on foreign shares and mutual funds increased, while dividends on Swedish shares and mutual funds are on the same level as in the corresponding quarter in 2013. During the first quarter, the outflow in interest payments on debt securities amounted to SEK 9 billion, which is just over SEK 1 billion less than in the corresponding period in 2013.

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

Net income on other investments during the first quarter amounted to SEK 4 billion. Other investment income in other countries resulted in an inflow of nearly SEK 8 billion, while other investment income in Sweden generated an outflow of nearly SEK 4 billion.

Graph 10: Income on other investments, net, billion SEK



Current transfers

Current transfers include transfers of real or financial assets without a similar consideration in return, i.e. they consist mainly of donations and subsidies. This item primarily includes EU contributions and development assistance, and resulted in a net outflow of SEK 20 billion in the first quarter. Current transfers tend to exhibit seasonal patterns with higher payments in the first quarter which was the case this quarter with a larger fee payment to the EU.

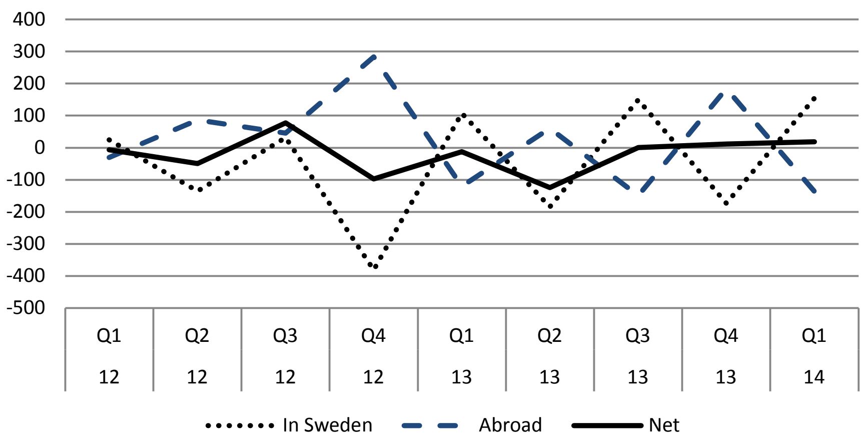
Capital account

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 generates smaller flows compared with current transfers. The capital account recorded a net outflow of nearly SEK 1 billion in the first quarter.

Financial account

The financial account consists of *direct investments, portfolio investments, other investments, financial derivatives* and *reserve assets*, which generated net inflows of SEK 18 billion during the first quarter of the year. The items other investments and financial derivatives contributed capital inflows, while the items portfolio investments, direct investments and reserve assets contributed capital outflows.

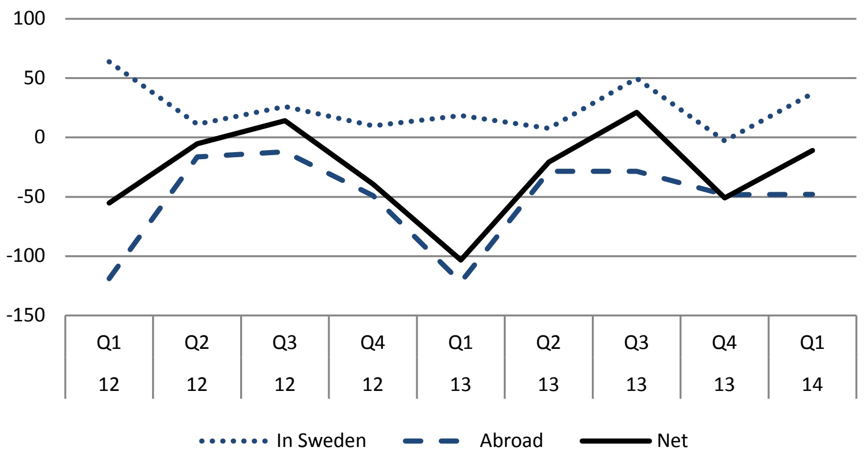
Graph 11: Financial account, billion SEK



Direct investments

Direct investments consist of equity and loans and refers to cross-border investments with ownership of 10 percent or more. Direct investments produced a net outflow of SEK 11 billion in the first quarter. Swedish direct investments abroad resulted in a net outflow of SEK 48 billion, while foreign direct investments in Sweden generated a net inflow of SEK 37 billion. Large transactions were made in Swedish direct investments abroad with outflows in equity. For loans, counterparts are booked with inflows. This is a mirror image of the fourth quarter of 2013, when equity gave inflows and loans gave outflows.

Graph 12: Direct investments, billion SEK



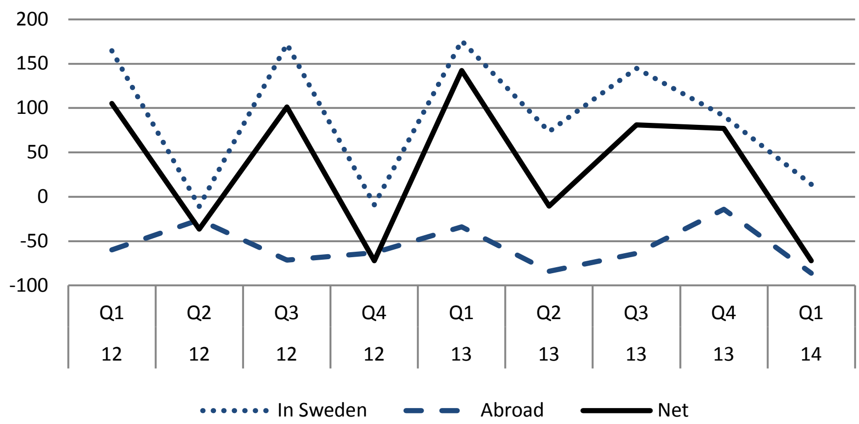
Portfolio investments

Portfolio investments consist of equities, mutual funds and debt securities. An equities holding is recognised as a portfolio investment if ownership is less than 10 percent of the share capital or voting rights.

Portfolio investments abroad generated a capital outflow of SEK 72 billion during the first quarter of the year. The outflow is mainly due to net purchases of foreign securities by Swedish investors. During the period, Swedish investors made net purchases of foreign debt securities for SEK 56 billion and foreign equities and mutual fund units for SEK 30 billion.

During the first quarter, foreign investors made net purchases of Swedish equities and mutual fund units for SEK 10 billion.

Graph 13: Portfolio investments, billion SEK

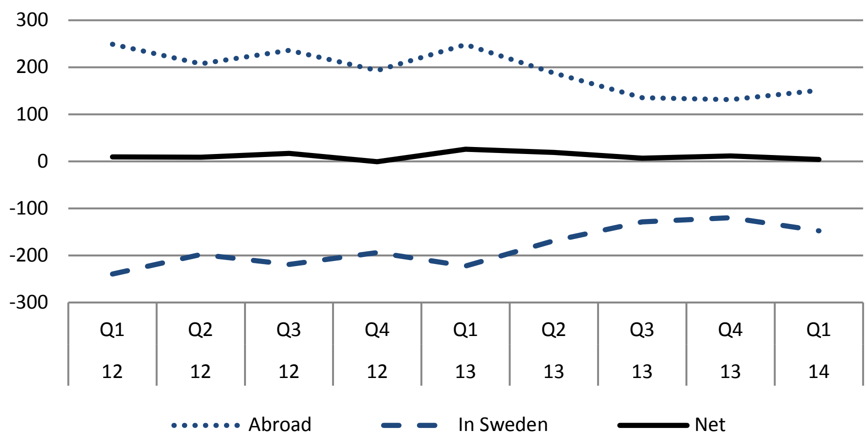


Financial derivatives

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 an asset, and a negative market valued contract is similarly defined as a debt contract.

Financial derivatives generated a net inflow of SEK 4 billion in the first quarter. The largest part of the net inflow was generated by different types of swap contracts.

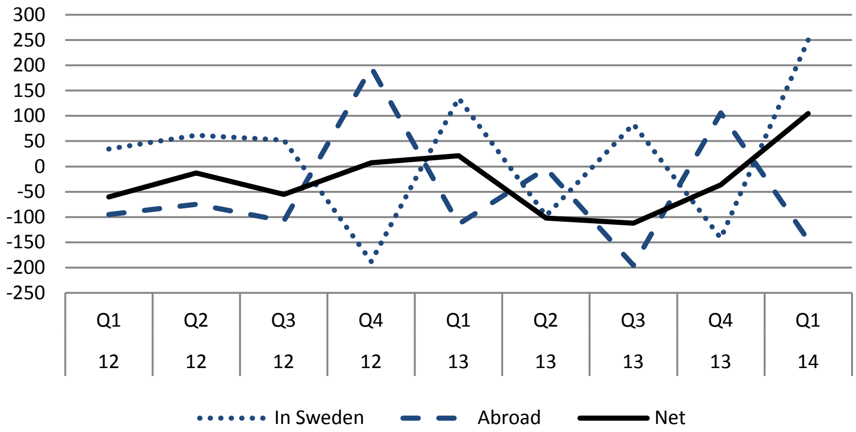
Graph 14: Financial derivatives, billion SEK



Other investments

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

Graph 15: Other investments, billion SEK



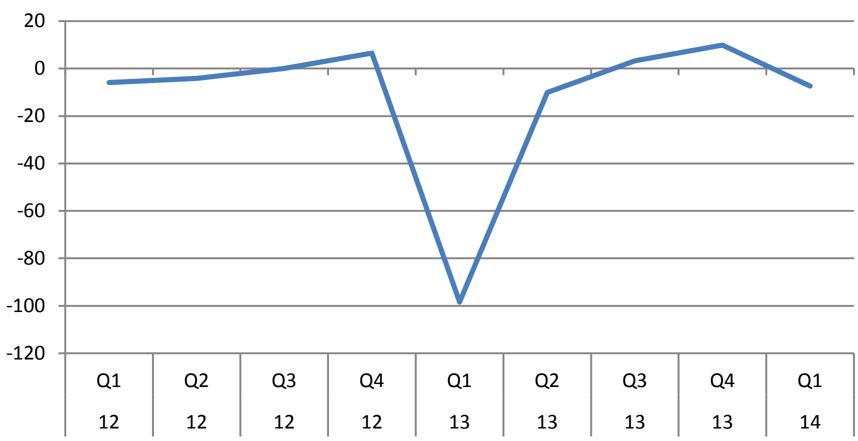
During the quarter, other investments generated a net inflow of SEK 105 billion. Borrowing increased during the quarter and resulted in a net inflow of SEK 250 billion. The banking sector accounted for most of the inflow. Lending abroad resulted in a net outflow of SEK 146 billion. Again, the banking sector accounted for most of the flow.

Reserve assets

Sweden's reserve assets consist of the Swedish Riksbank's gold reserves and securities in foreign currencies. Their main purpose is to provide temporary liquidity support to insolvent banks, fulfil Sweden's obligations vis-a-vis the International Monetary Fund (IMF) and, if necessary, intervene on the foreign exchange market.

Reserve assets generated a net outflow of SEK 7 billion during the first quarter. The outflow is partly explained by the acquisition of bonds but also to an increase in currency, coins and deposits with other central banks. Reserve assets increased by SEK 15 billion and amounted to SEK 435 billion at the end of the first quarter.

Graph 16: Reserve assets, billion SEK



Revisions

Sweden's revision policy for the balance of payments 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 balance of payments.

The balance of payments has been revised from Quarter 1, 2013 through Quarter 4, 2013. During the revised period, revisions of SEK 10 billion net were made in the current account and SEK 15 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 September 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. Simply put, it is a summary 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 households' consumption, C_t, private investment, 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 ($X_t - M_t$):

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

By adding together the net incomes, F_t i.e. Swedish income earned abroad (Swedish employees' compensation 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]

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

Rewriting (2) gives:

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

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

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

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 up into consolidated public sector's savings and households' 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 counterbalanced 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 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:

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

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):

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

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

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 can also be reflected in an increase in the reserve assets, as these reserve transactions are included in the financial account. A deficit on the current account instead means that the net acquisitions abroad must be paid either by divesting 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 is reported 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]

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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 a residual is included 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 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 fluctuations	Other corrections	**Closing balance**

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