BALANCE OF PAYMENTS AND FINANCIAL MARKET

REPORT 2014:3

Statistiska centralbyrån Statistics Sweden

Balance of payments
2 nd quarter 2014

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2014

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Cover: Ateljén, SCB
Photo: iStock

URN:NBN:SE:SCB-2014-FM04BR1403ENG_pdf (pdf)

This publication will only be published on www.scb.se.

Foreword

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

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

This report comprises the results of the second quarter of 2014.

Statistics Sweden, September 2014

Folke Carlsson

Christina Ekblom

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Summary

The surplus in the current account amounted to SEK 49 billion in the second quarter, which can be compared with the same quarter last year when the surplus amounted to SEK 60 billion. This weakening in the current account is primarily due to a reduced surplus in foreign trade in goods.

Foreign trade in goods and services amounted to SEK 48 billion net during the second quarter. The net surplus for the same quarter last year was SEK 56 billion. Foreign trade in goods generated a surplus of SEK 13 billion, which can be compared with the same quarter last year when the surplus amounted to SEK 19 billion. The trade in services produced a surplus of SEK 36 billion, which is in line with the same quarter last year.

The financial account produced a net inflow of SEK 16 billion during the quarter. Direct investments, reserve assets and financial derivatives contributed capital inflows. Portfolio investments and other investments contributed capital outflows.

Balance of payments - second quarter 2014

The second quarter of 2014 saw a weakening in the current account which resulted in a surplus of SEK 49 billion. The capital account produced an outflow of nearly SEK 0.5 billion, and the financial account generated a net inflow of SEK 16 billion.

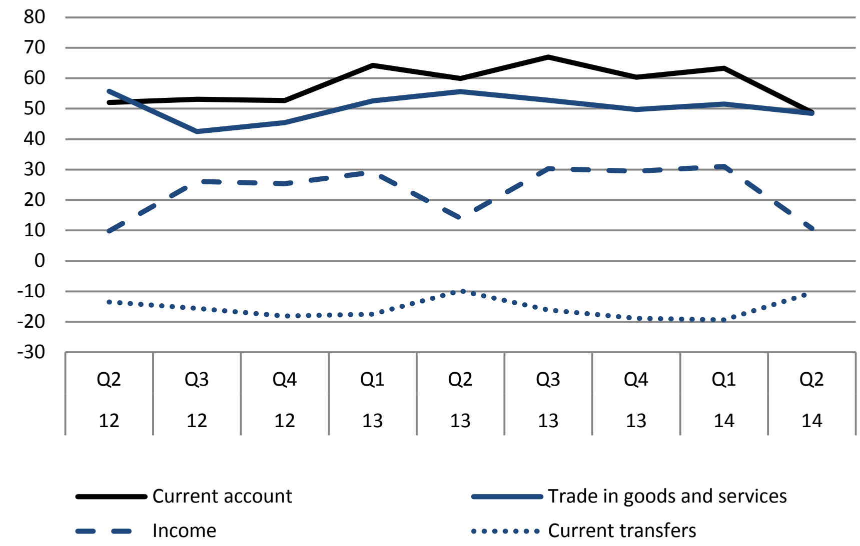
The balance of payments is comprised of the *current, capital* and *financial accounts* and is a compilation of a country's real and financial transactions with the rest of the world. Changes in value caused by e.g. changing market values and exchange rates are excluded, which is why changes in account 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 49 billion in the second quarter. This is a reduction compared to the same quarter last year when the surplus amounted to SEK 60 billion. All items in the current account contributed to the weakening, but it was primarily due to a decline in the trade in goods and services.

Graph 1: Current account and included items, billion SEK

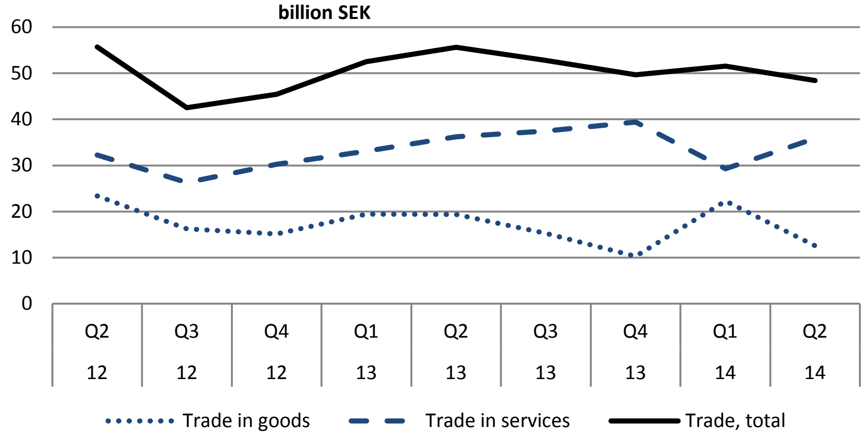


Trade in goods and services

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.

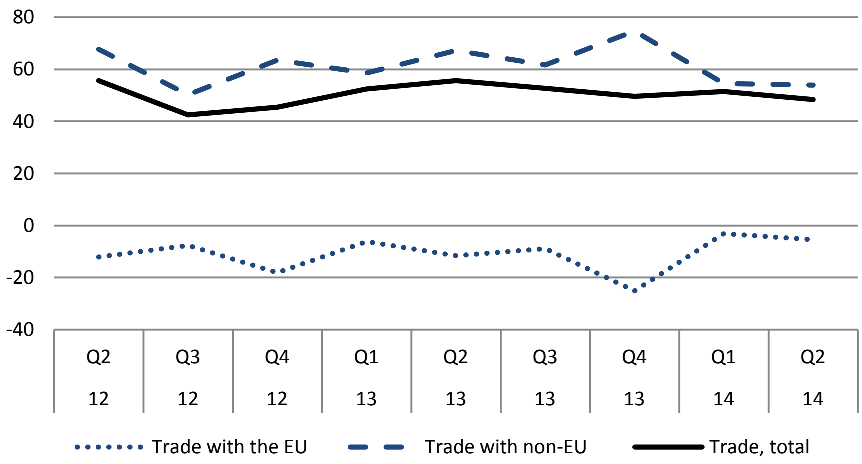
Foreign trade in goods and services amounted to SEK 48 billion net during the second quarter. The net surplus for the same quarter last year was SEK 56 billion. A reduced surplus in the trade in goods had a negative effect, while the surplus in the trade in services remained at the same level as during the second quarter 2013.

Graph 2: Trade broken down by trade in goods and trade in services, net, billion SEK



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. However, the surplus in trade with non-EU countries has declined compared with previous years while the deficit in trade with EU member states has decreased, as illustrated in Graph 3.

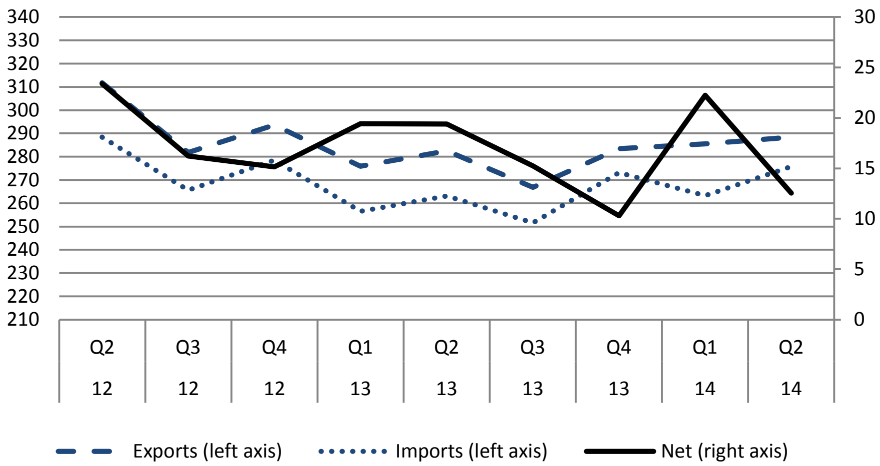
Graph 3: Trade, with the EU and with non-EU, billion SEK



Trade in goods

The surplus in trade in goods amounted to SEK 13 billion, which can be compared with the same quarter last year when the surplus amounted to SEK 19 billion. Imports and exports of goods increased slightly compared with the same quarter in the previous year. Imports increased more than exports, which led to a reduced surplus in the trade in goods.

Graph 4: Trade in goods, Exports, billion SEK

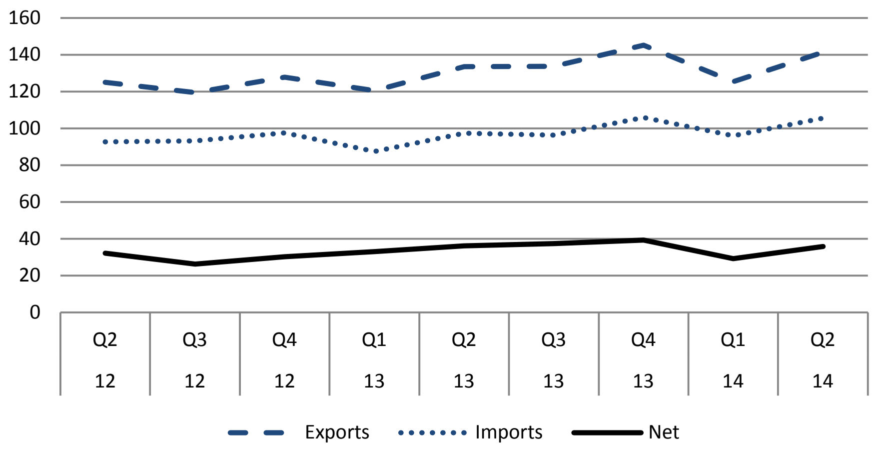


Trade in services
The trade in services generated a surplus of SEK 36 billion in the second quarter. This is in line with the same quarter last year. During the quarter export of services amounted to SEK 141 billion, while import of services amounted to SEK 106 billion. Both exports and imports have increased compared with the same quarter last year.

Among the types of services, transportation and other services contributed a surplus while travel contributed a deficit. Among other services, the largest surpluses came from other business services, computer and information services, as well as royalties and license fees.

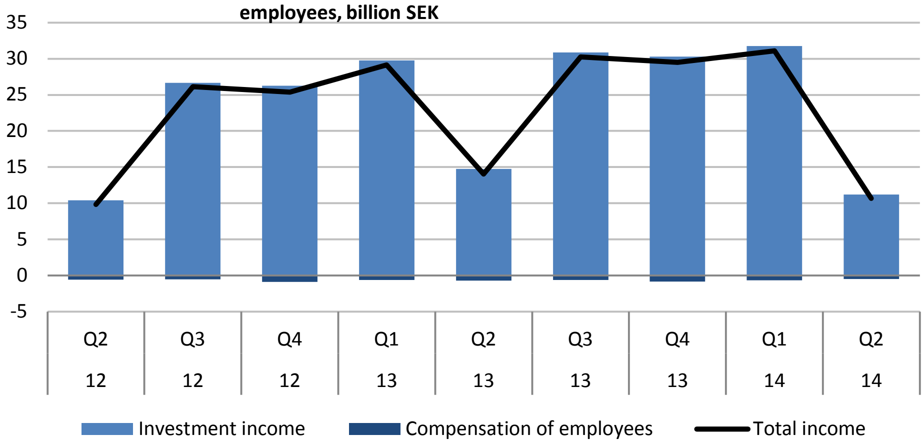
Merchanting contributes a large part of the surplus in trade in services and the surplus has increased in comparison with the same quarter in the previous year. Merchanting is found only on the exports side and represents the sales margin that arises when Swedish companies buy goods and sell them on the world market without importing them to Sweden.

Graph 5: Trade in services, billion SEK



Income
Income consists of compensation of employees and investment income. Income consists primarily of investment income while compensation of employees contributes smaller flows as illustrated in Graph 6. The surplus in income amounted to SEK 11 billion in the second quarter, of which investment income represented nearly the entire surplus while compensation of employees contributed a deficit of SEK 0.5 billion.

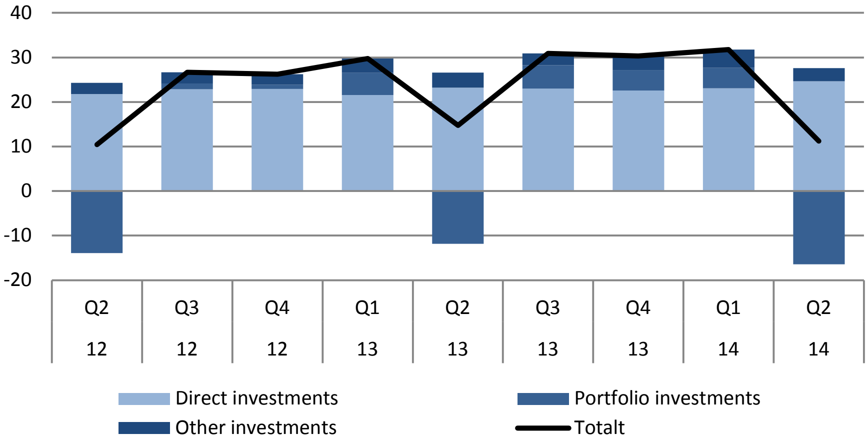
Graph 6: Total income divided on investment income and compensation of employees, billion SEK



Investment income

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

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



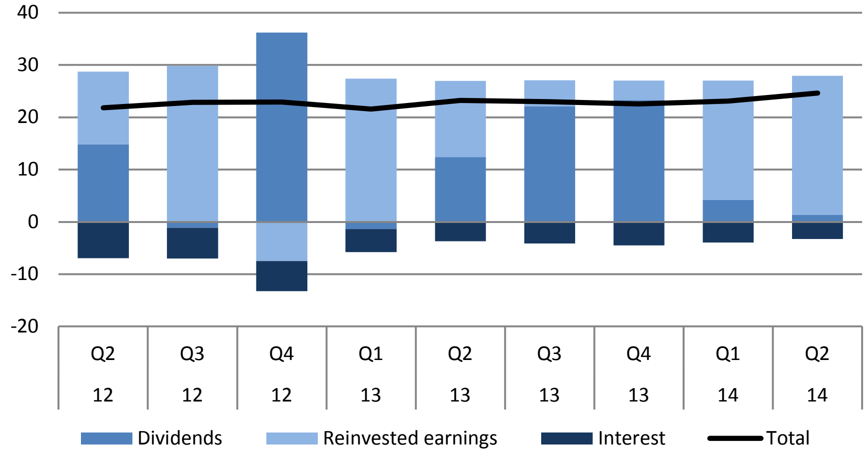
The larger part of investment income is generated by direct investments that are relatively stable over time. However, investment income from portfolio investments has seasonal variations. The surplus from investment income amounted to SEK 11 billion in the second quarter, which is slightly lower than during the same quarter last year. An increased deficit in portfolio investments has had a negative effect.

Income from direct investments

Income from direct investment generated a surplus of SEK 25 billion. Income from Swedish direct investments abroad amounted to SEK 59 billion, while income on corresponding foreign direct investment in Sweden totalled SEK 34 billion.

Dividends from abroad amounted to SEK 15 billion in the second quarter, while dividends to foreign owners amounted to nearly SEK 14 billion. Interest payments on loans in direct investment relationships made a negative contribution with a net outflow of SEK 3 billion.

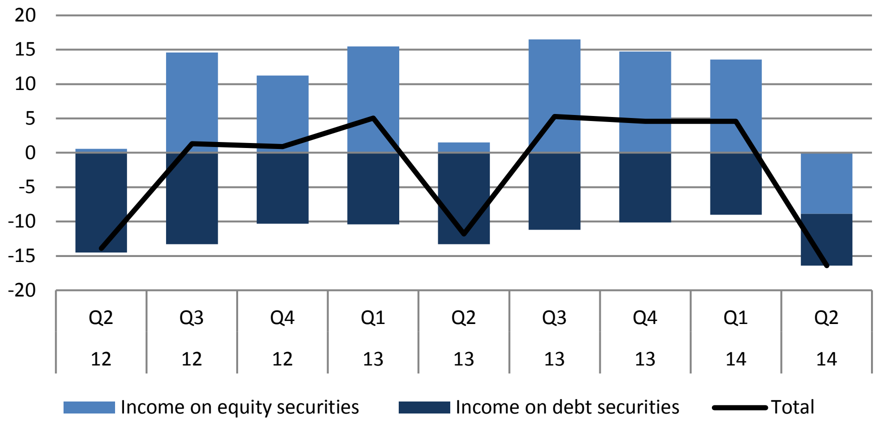
Graph 8: Income on direct investments, billion SEK



Income from portfolio investments

Income from portfolio investments consists of dividends from shares and investment funds as well as interest on debt securities. The item is subject to seasonal variation, which is primarily due to payments of stock dividends, which are booked when they are paid. 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

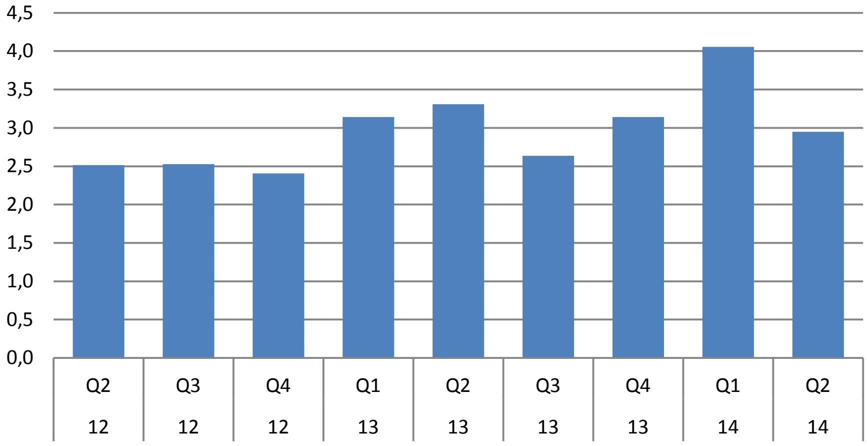


Income from portfolio investments generated a capital deficit of SEK 16 billion in the second quarter of the year, which is nearly SEK 5 billion more than in the same quarter in 2013.

Dividend payments that include dividends from investment funds generated a net outflow of nearly SEK 9 billion. Dividend income has turned from surplus to deficit when dividends from Swedish shares and investment funds increased whereas dividends from foreign shares and investment funds were at the same level as in the corresponding quarter of 2013. Income from debt securities produced an outflow of SEK 8 billion, which was nearly SEK 6 billion less that in the corresponding period of 2013. This is primarily due to a decline in interests on Swedish bonds.

Income from other investments
Income from other investments consists of income from loans and deposits. Net income on other investments amounted to SEK 3 billion in the second quarter. Income from other investments abroad resulted in a net inflow of SEK 7 billion, while income on other investments in Sweden generated a net outflow of SEK 4 billion.

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



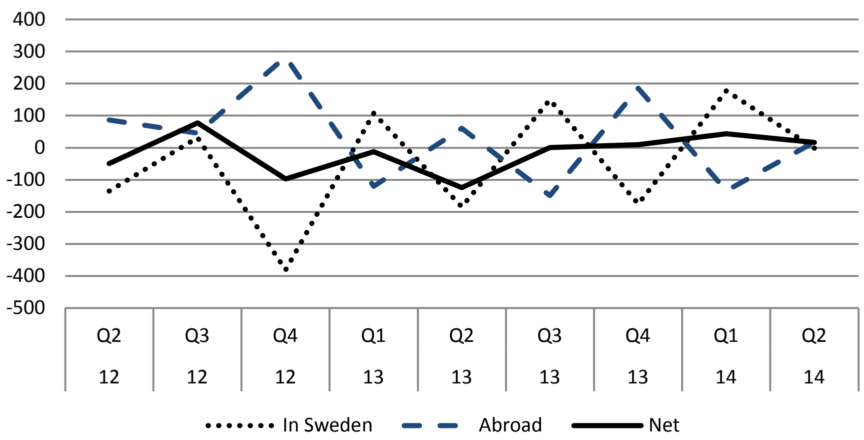
Current transfers
Current transfers include transfers of real or financial assets without a similar consideration in return, i.e. they consist mainly of donations and subsidies. This item primarily includes EU contributions and development assistance, and resulted in a net outflow of SEK 10 billion in the second quarter. Current transfers usually exhibit seasonal patterns with smaller outflows during the second 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 produced a net outflow of SEK 0.5 billion in the second 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 16 billion during the second quarter of the year. The items direct investments, financial derivatives and reserve assets contributed capital inflows, while portfolio investments and other investments contributed capital outflows.

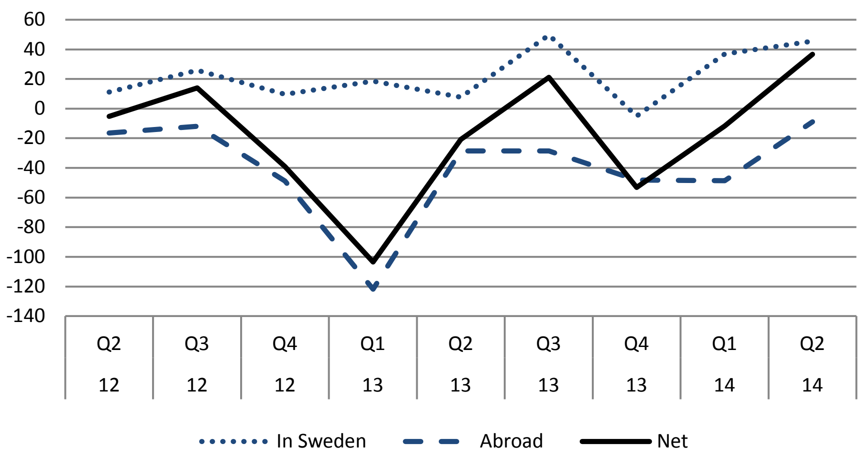
Graph 11: Financial account, billion SEK



Direct investments

Total direct investment in the second quarter produced a net inflow of SEK 37 billion. The item equity generated a larger inflow of SEK 73 billion. Equity showed inflows from direct investments abroad, as Swedish companies decreased investments abroad; it also showed inflows within foreign direct investments in Sweden, where acquisition of shares in Sweden contributed a substantial capital inflow.

Graph 12: Direct investments, billion SEK

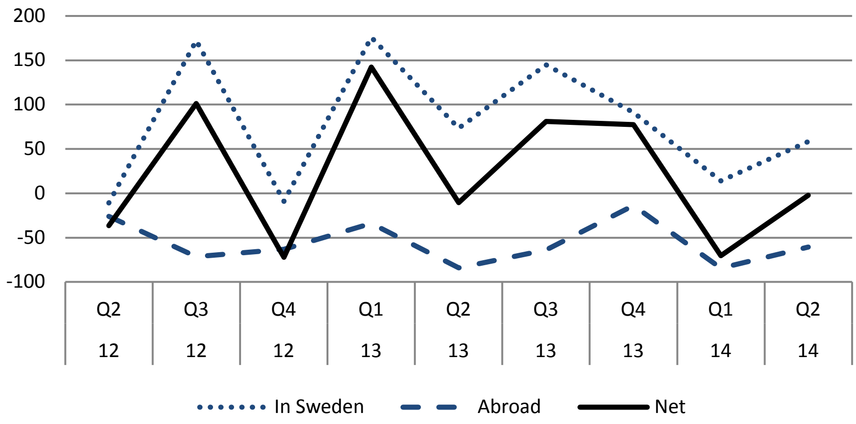


Portfolio investments

Portfolio investments consist of equities, investment 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 2 billion during the second quarter of the year. Swedish investors made net purchases of SEK 61 billion in foreign securities during the second quarter, of which SEK 45 billion was in portfolio equities and SEK 16 billion was in debt securities. Foreign investors sold Swedish bonds for SEK 46 billion net, while they purchased Swedish money market instruments for SEK 101 billion net. Trade in Swedish securities generated a total net inflow of SEK 58 billion, of which the trade in debt securities represented SEK 55 billion.

Graph 13: Portfolio investments, billion SEK

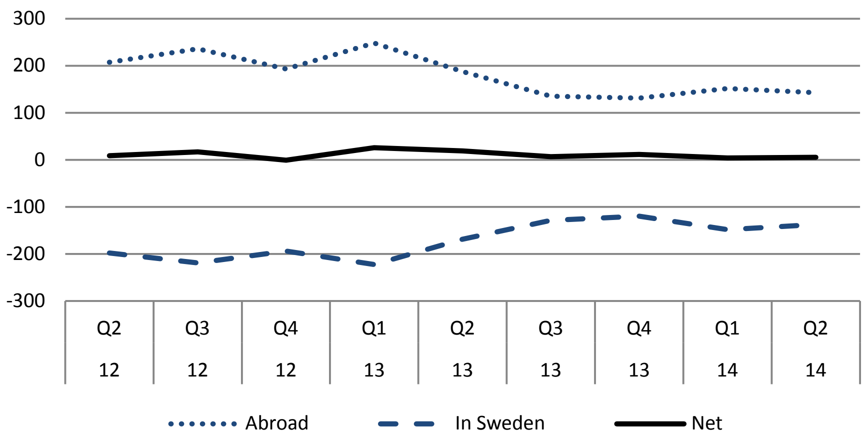


Financial derivatives

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 nearly SEK 6 billion. The largest part of the net inflow was generated by different types of swap contracts, while forwards and options produced a net outflow.

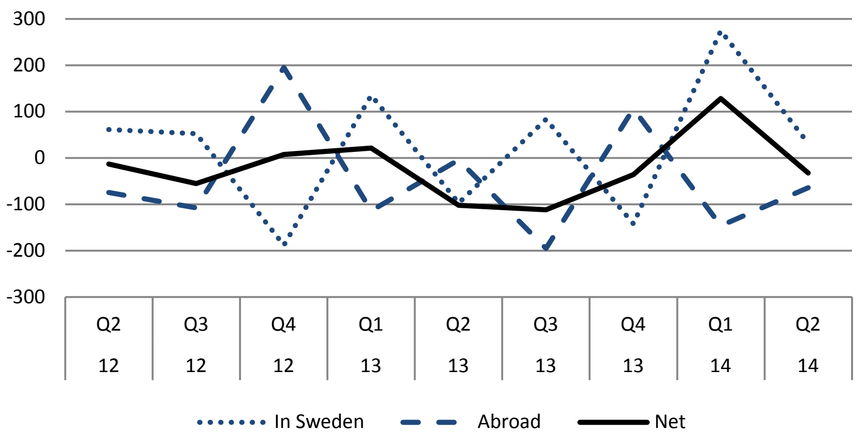
Graph 14: Financial derivatives, billion SEK



Other investments

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

Graph 15: Other investments, billion SEK



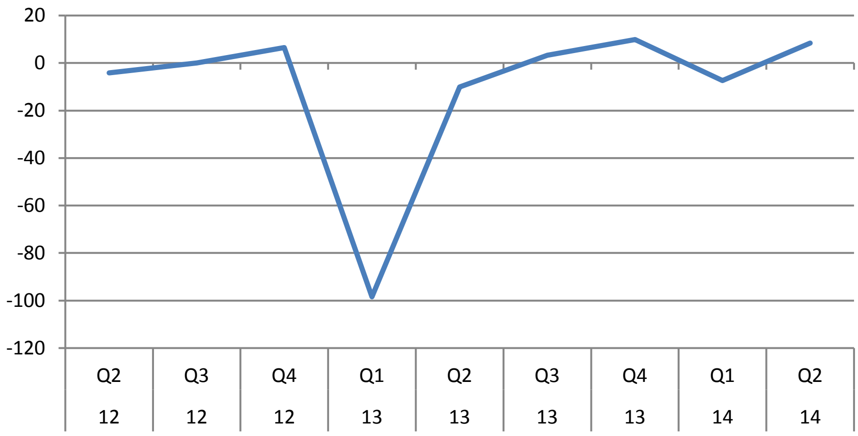
Other investments resulted in a net outflow of SEK 32 billion, primarily due to increased lending abroad. Lending to other countries produced a net outflow of SEK 64 billion while borrowing from other countries produced a net inflow of SEK 32 billion. The banking sector accounted for most of the net flows during the quarter. The banks increased both assets and liabilities abroad while non-financial enterprises decreased assets and liabilities abroad.

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 inflow of SEK 8 billion, which is mainly explained by a decrease of foreign debt securities and assets in banks. The value of reserve assets increased and amounted to SEK 443 billion at the end of the second quarter.

Graph 16: Reserve assets, billion SEK



International investment position, net

At the end of June 2014, preliminary data show that Sweden continues to have a net liability to other countries. The liability amounted to SEK 192 billion and decreased compared to estimates for the end of 2013 when it amounted to 515 billion.

Changes in the international investment position are partly due to transactions in the financial accounts, which should correspond to the size of the surplus or deficit on the current account. In addition, the international investment position is influenced by currency fluctuations and changes in share prices and interest rates. However, it is difficult to assess how much impact these factors have had on the international investment position over the last six months.

The current account has continued to contribute a substantial surplus during 2014. This is not reflected in a corresponding outflow in the financial account, which has resulted in a larger residual item. Instead, the financial account has shown inflows, while the net debt abroad has declined. Exchange rates and changes in share prices and interest rates can have a major impact on the international investment position. However, it is difficult to assess how much impact these factors have had on the investment position over the last six months. The Swedish krona has weakened against major currencies during the period. Assets in the international investment position are mainly denominated in foreign currencies, while liabilities are primarily denominated in the Swedish currency. This means that the weakening of the Swedish krona can have significantly contributed to strengthening the international investment position.

The reduced net liability stems primarily from a decreased net liability within portfolio investments. Assets in portfolio investments have increased more than liabilities, which has resulted in a reduced net liability. The value of Swedish owned equities abroad has increased, an item that shows outflows during the period. Meanwhile, the weakening of the Swedish currency against the major currencies has contributed to an increase in the value of foreign equities in Swedish kronor. The value of debt securities abroad has also increased.

It is important to point out that data on Sweden's assets and liabilities abroad are preliminary and will most likely be revised when the statistics are updated with more definitive figures.

Revisions

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

- When Quarter 1 is published, the previous four 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.

During the second quarter 2014, an exception was made in the revision policy, and the balance of payments has been revised from Quarter 1, 2013 through Quarter 1, 2014. In the revised period, net revisions of SEK 18 billion were made in the current account and SEK 23 billion in the financial account.

What is the balance of payments?

The balance of payments has been produced and summarised by Statistics Sweden on behalf of the Swedish Riksbank since 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 either satisfy domestic demand in the form of household 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 and net current transfers, F_t i.e. Swedish income earned abroad and transfers from abroad minus foreign income earned in Sweden and transfers to abroad 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 and secondary income. 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 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 household 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 savings and household savings, domestic investment can be divided up into public sector investment and private investment. This division indicates that if public sector investment exceeds its savings, and if this is not completely 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 that central government expenditure is greater than income.

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

$$BNP_t + r_t A_t = C_t + I_t + G_t + (A_{t+1} - A_t). \tag{5}$$

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

$$X_t - M_t + F_t = -(A_t - A_{t+1}) . \tag{6}$$

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

[4] Net income is 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 (6) is, as noted earlier, the current account, which consists of the sum of trade in goods and services 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 would show a net deficit, i.e. $A_t - A_{t+1} < 0$. Equation (6) 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 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 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 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 the domestic sector's external assets and liabilities. The net total of assets and liabilities is thus a measure of a country's wealth relative to other countries. Stock data are reported at market value and can be divided up exactly like the financial account, into direct investment, portfolio investment, financial derivatives, other investment, and reserve assets.[7]

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

[7] Book value is used instead of the market value in certain cases because the base for calculating market value is insufficient.

The relationship between the international investment position and 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 graph). 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**

All official statistics can be found at: **www.scb.se**
Statistics service, phone +46 8 506 948 01