BALANCE OF PAYMENTS

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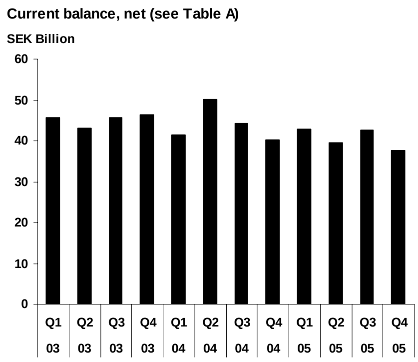
Fourth quarter 2005



The current account showed a surplus of SEK 37.8 billion for Q4 2005, which is a decline of SEK 2.4 billion compared with the same period in 2004. Surpluses were noted on the trade balance, SEK 28.9 billion, services, SEK 17.5 billion and investment income, SEK 2.2 billion. Current transfers showed a deficit of SEK 10.8 billion.

The annual figures for 2005 indicate a surplus on the current account amounting to SEK 162.6 billion. This corresponds to around 7 per cent of GDP.
Compared with the previous year, the current account balance has deteriorated by SEK 13.5 billion. This can be largely explained by the net total for trade in goods and services declining by SEK 12 billion. Within this item, trade in goods and trade in services have developed in different directions. The surplus on trade in goods has declined by SEK 29.4 billion, while the surplus on trade in services has increased by SEK 17.5 billion.

In connection with this publication, statistics on other services and public sector transfers regarding the years 1999 to 2002 have been revised. These changes are now included in the statistics available on the Riksbank's website. Statistics Sweden will insert the corresponding revisions into the National Accounts at a later date. The purpose of the revisions is to even out the break in the time series that occurred in connection with the change of collection method at the end of 2002/beginning of 2003. Comparison studies of companies' reporting prior to and after 2003 have resulted in the total net services figure for the years between 1999 and 2002 being revised upwards, while public sector transfers have been revised down in the same way.

■ The total annual change in the current account is therefore moderate, which is indicated in the list below.

Net effect on current account after revision, SEK million

	Other services	Public sector transfers	Current account total
1999	1.4	-2.5	-1.1
2000	2.8	-3.3	-0.5
2001	4.3	-3.6	0.7
2002	5.7	-4.9	0.8

The current account for Q4 showed a deficit of SEK 4.5 billion towards the EU countries, while countries outside of the EU provided a surplus of SEK 42.2 billion. For the whole year 2005 the surplus on the current account was broken down into SEK 2.9 billion with regard to EU member states and SEK 159.7 billion with regard to countries outside of the EU.

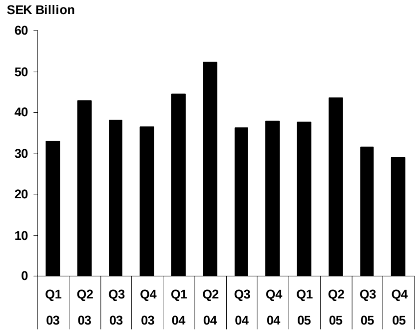
Trade in goods balance

The surplus on trade in goods amounted during 2005 Q4 to SEK 28.9 billion, which is a decline of SEK 9 billion compared with the same period in 2004. Behind this decline is a large increase in imports of goods. Exports of goods also increased over the year, but not at the same rate as imports.

Seen over the year 2005 as a whole, the surplus amounted to SEK 141.6 billion, which is a decline compared with the previous year of SEK 29.4 billion. Both exports and imports of goods involved larger amounts during 2005 than 2004. Exports of goods increased by SEK 74.2 billion, while imports increased by SEK 103.5 billion.

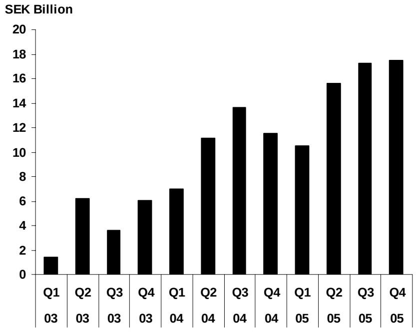
Exports of goods to EU countries rose during Q4 compared with the same period last year – from SEK 140.5 billion to SEK 150.9 billion at current prices. Imports of goods from EU countries rose by SEK 16 billion, to SEK 160 billion. Exports of goods to non-EU countries increased by SEK 15 billion, to SEK 111.7 billion, while imports rose by SEK 18.5 billion, to SEK 73.8 billion.

Trade in goods balance (see Table A)



Trade in services balance

Trade in services balance (see Table G)



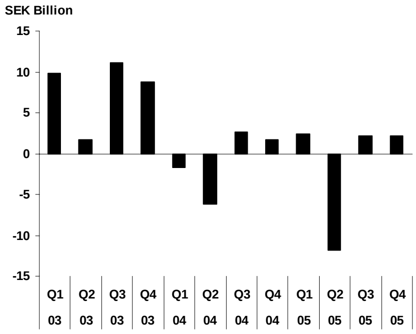
The surplus on services amounted to SEK 17.5 billion for 2005 Q4. Transportation showed a surplus of SEK 7.1 billion, while travel gave a deficit of SEK 6.9 billion. The other types of services provided a surplus of SEK 17.3 billion.

The year 2005 as a whole showed a surplus of SEK 60.8 billion in trade in services. Compared with 2004, this is an improvement of SEK 17.5 billion. It was mainly the other business services item that contributed to the improvement. Within this item, the largest increase came from merchanting. Merchanting refers to Swedish companies' purchase and further sale of goods abroad without the goods passing the Swedish borders. In 2005 the net total for this item amounted to just over SEK 40 billion.

It is worth noting that during 2005 the net surplus from services continued to increase, while the corresponding surplus for trade in goods declined. The trade in services item's percentage of the total export surplus amounted to around 30 per cent for 2005. The corresponding share for 2004 was 20 per cent.

Income balance

Income balance (see Table H)

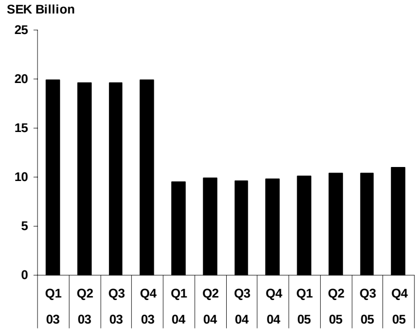


Income, which consists of compensation of employees and investment income, showed a surplus of SEK 2.2 billion during Q4 2005, which is a rise of SEK 0.4 billion compared with the previous year.

Seen over the year as a whole, the net result for 2005 was a deficit of SEK 5.1 billion, which is SEK 1.6 billion more than that for 2004.

Direct investment income balance, net

Direct investment income balance, net (see Table H)

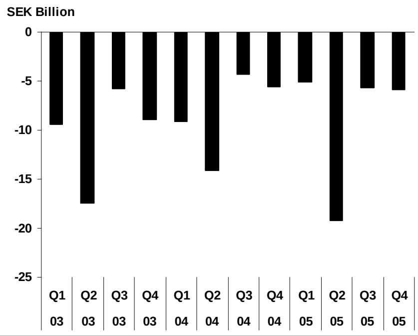


Net income on direct investment in 2005 resulted in a surplus of SEK 41.9 billion. This is in line with 2004, when income amounted to SEK 39 billion. Income from direct investment abroad amounted to SEK 175.1 billion, while income on direct investment in Sweden totalled SEK 133.2 billion.

The US tax act, Homeland Investment Act, which only applied during 2005, has had some effect on share dividends abroad over the year. This act is a tax rebate which applies in the United States and allows US companies to take home earnings generated abroad at a subsidised tax rate. This means that companies owned from the United States can profitably send earnings generated in other countries back to their owners in the United States. A not insignificant increase in dividends to the United States can be noted in the balance of payments.

Portfolio investment income balance, net

Portfolio investment income balance, net (see Table H)

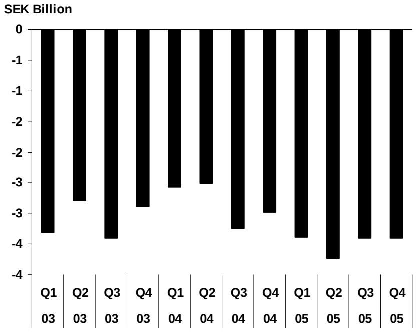


Income from portfolio investment provided a deficit of SEK 5.9 billion during 2005 Q4, which signifies an increase of SEK 0.3 billion, compared with the same period in the previous year.

During the year 2005 as a whole, income from portfolio investment abroad generated an outflow of SEK 35.8 billion. The net outflow was slightly larger than in 2004, which was due to increased interest costs on Swedish debt instruments. On the other hand, the net total of share dividends improved somewhat over the year and gave an inflow of SEK 5.8 billion.

Other investment income balance, net

Other investment income balance, net (see Table H)



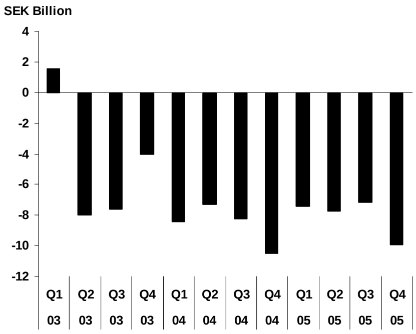
Income on other investment provided a net outflow of SEK 3.4 billion during 2005 Q4, which can be compared with a net outflow of SEK 3.0 billion during the same period in 2004.

Income on other investment provided a net outflow of SEK 14.0 billion during 2005, which can be compared with a net outflow of SEK 11.3 billion during the same period in 2004. Compared with 2004, the inflow of income on other investment abroad increased from SEK 22.6 billion to SEK 29.6 billion and the outflow of income on other investment in Sweden increased from SEK 34.0 billion to SEK 43.5 billion.

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

Current transfer and capital account balance, net

Current transfer and capital account balance, net (see Table I)

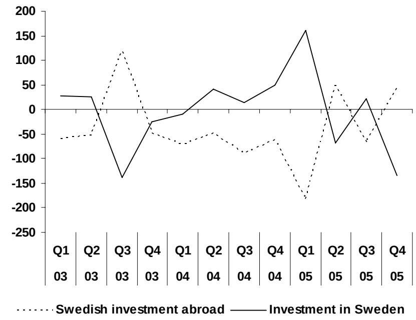


The net sum of current transfers and the capital balance gave a deficit of SEK 10 billion during 2005 Q4, which is an improvement of SEK 0.5 billion compared with the same period in 2004.

For the year 2005 as a whole, it is also possible to see a slightly improved net total of SEK 2.2 billion compared with 2004. Of the total net expenditure of SEK 32.3 billion, SEK 12.3 billion concerned EU transfers, SEK 11.6 billion foreign aid and SEK 8.4 billion other transfers.

Financial account

Financial account (see Table J)



The financial account gave a net outflow of SEK 88.2 billion during 2005 Q4. The result for the year 2005 as a whole was an outflow of SEK 177 billion. The main contributions to the outflow came from direct investment and other investment.

The surplus on the current account for 2005 of SEK 163 billion, a capital balance of SEK 2 billion and the negative financial account of SEK 177 billion gave rise to a positive errors and omissions item of SEK 12 billion. The errors and omissions item describes the net total of the transactions for which there was no explanation, and thus consists of various deficiencies in the data. One of the most important explanations for the errors and omissions item during separate quarters is periodisation errors. As the data in the balance of payments are gathered from different sources, the periodisation of transactions may differ for items that are balanced against one another. In the longer term, however, the errors and omissions should offset one another. Since the publication of the balance of payments for 2005 Q3, revisions have been made which contribute to a substantial reduction in the errors and omissions item for 2005. The largest revisions have been made to portfolio investment and other investment and have primarily concerned exchange rate adjustments in basic data reported to the Riksbank. The corresponding exchange rate adjustments have been made for the period 1997-2004. This has meant that the errors and omissions items for individual years have been significantly affected, but that the net effect for the entire period is relatively limited.

Direct investment

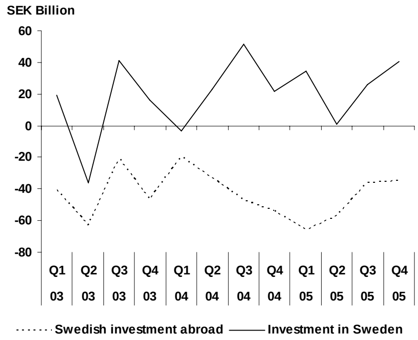
During 2005, direct investment resulted in a net outflow of SEK 92.2 billion. This flow is slightly larger than for the year 2004 as a whole, as the corresponding figure gave a net outflow of SEK 61.7 billion.

Swedish investment abroad gave an outflow of SEK 194.5 billion, which is an increase of around SEK 40 billion compared with the previous year.

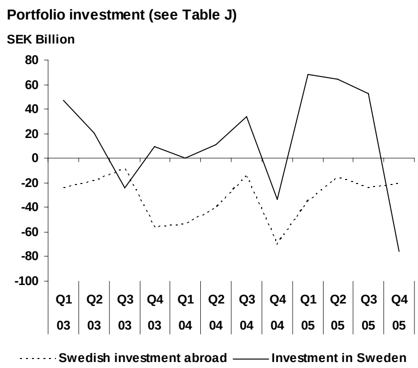
Foreign investment in Sweden totalled to an inflow of SEK 102.3 billion, which can be compared with the year 2004, when the net inflow was SEK 92.5 billion.

With regard to both direct investment abroad and direct investment in Sweden, more than half of the net flows consisted of reinvested earnings, that is, earnings not paid out as dividends to shareholders but retained within the company. It is important to note that the figures for reinvested earnings are a forecast and can be subject to revision during autumn 2006, when the results of the Riksbank's annual direct investment survey are obtained.

Direct investment (see Table J)



Portfolio investment



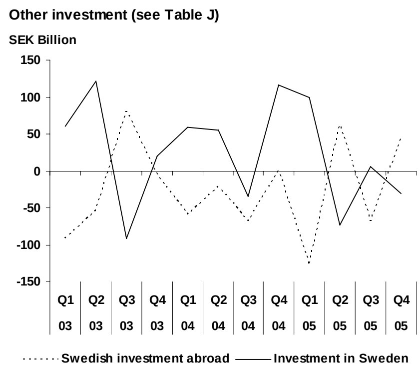
Cross-border portfolio investment generated capital outflows of SEK 96.4 billion during Q4 2005. The outflow mainly reflects several large repurchases and redemptions of foreign-owned Swedish debt securities.

Cross-border equity trading gave an inflow of SEK 11.8 billion during Q4.

During 2005 portfolio investment showed an inflow of SEK 13.8 billion compared with an outflow of SEK 167.6 for 2004. The reversal of the flows during 2005 is mainly explained by Swedish banks' new issues of debt instruments in foreign currency.

The result for portfolio investment has been revised for the period 1997 - 2005 (see also the section on errors and omissions above).

Other investment



The item other investment gave rise to a net inflow of SEK 13.7 billion during 2005 Q4. Both assets and liabilities declined during the quarter and Swedish investment abroad showed a net inflow of SEK 43.8 billion, while foreign investment in Sweden gave rise to a net outflow of SEK 30.1 billion.

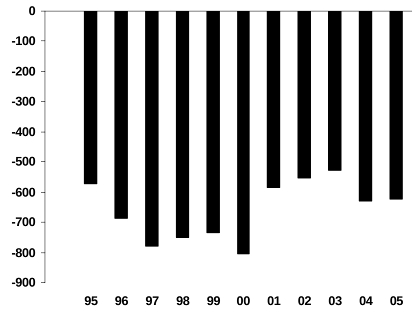
During 2005, other investment showed a net outflow of SEK 86.3 billion. Swedish investment abroad gave rise to a net outflow of SEK 89 billion, while the corresponding foreign investment in Sweden gave rise to a net inflow of SEK 2.7 billion.

The value of other investment varies considerably from one quarter to the next and it is often short-term capital movements between banks in Sweden and counterparties abroad, often in the same group, which have created these fluctuations.

This item includes borrowing, lending, deposits and repo transactions with other countries.

Since the previous quarterly publication, revisions regarding other investment have been made for the period November 1997 up to the end of September 2005. As for portfolio investment, the revisions refer to exchange rate adjustments of basic data reported to the Riksbank.

International investment position, net (see Table E)



International investment position, net

Sweden’s total external net debt amounted to SEK 624 billion in December 2005. Compared with 2004, the net debt remains almost unchanged.

Net assets in the form of direct investment have been forecast at SEK 249 billion. This is an increase of SEK 127 billion compared with 2004.

Net debt in the form of portfolio investment is calculated to have increased by SEK 133 billion since 2004, to SEK 647 billion in 2005. Behind this change are an increase in the assets in foreign equity and debt securities of SEK 516 billion and an increase in foreign investors’ holdings of Swedish securities of SEK 649 billion. This increase is mainly due to a large increase in stock market rates and to exchange rate changes. For example, the Swedish krona weakened during 2005, which meant that the value of all assets and debts denominated in foreign currency increased in value expressed in Swedish kronor.

The official compilation of Sweden's international investment position was revised to reflect market value, with the exception of direct investment, which is reported at book value. A compilation of Sweden’s external position is published as a complement, where the market value of direct investment has also been calculated. According to this, Sweden’s net foreign debt amounted to SEK 225 billion in 2005.

It is important to note that several sub-items in the international investment position for 2005, such as direct investment and portfolio shares, are forecasts. The figures should therefore be interpreted with caution.

What is the balance of payments?

In a closed economy, the level of investment is determined by the total savings in the economy. This means that if the savings decline for some reason, investments will also decline. In an open economy the relationship between savings and investment is not as clear, as global financial markets enable international capital to flow easily between countries. The balance of payments contains information on these flows. Put in simple terms, it is a compilation of a country's real and financial transactions with the rest of the world.

The balance of payments can be divided into:

- The balance on the current account, which shows trade in goods and services, wages, earnings on financial assets and liabilities as well as current transfers, such as EU subsidies and contributions.
- The capital balance, which covers EU subsidies and foreign aid for real investment as well as the purchase and sale of rights, such as patents.
- The financial balance, which can be divided into direct investment, portfolio investment, financial derivatives, other capital and the foreign currency reserve. The financial balance shows changes in external financial assets and liabilities.

Derivation of the balance of payments

A country's gross domestic product, GDP_t, is the total value of the goods and services produced in the country during a certain year t. Production is used to satisfy either domestic demand in the form of households' consumption, C_t private investment, I_t and public expenditure, G_t or to be delivered abroad in the form of exports of goods and services, X_t. Domestic demand can also be satisfied by the import of goods and services, M_t. The National Income Identity shows that a country's production during an individual year is equal to the sum of domestic demand ($C_t + I_t + G_t$) and net sales of goods and services to the rest of the world ($X_t - M_t$):

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

By adding together the net factor incomes, F_t, i.e. Swedish factor income earned abroad (Swedish wage-earners' remuneration abroad and earnings on Swedish capital abroad) minus foreign factor 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, GNI_t [2]

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

Rewriting (2) gives:

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

[1] This relationship is called an identity because it must by definition be fulfilled in every individual time period.
[2] These factor incomes are often called primary incomes. Net factor incomes consist of wages, capital earnings 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, $GNI_t - T_t - C_t$.[3]

According to (3):

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

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 the balance of trade. $X_t - M_t + F_t$ is the current account balance. Equation (4) thus shows that there is a simple connection between net investments and the balance of trade. For a given net factor 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 balance of trade 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 balance. A growing deficit in the current account balance 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.

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

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

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

The left side of the balance of payments (7) is, as mentioned earlier, the current account, which consists of the sum of the balance of trade and net factor 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 balance and the financial balance will show a net deficit, i.e. $A_t - A_{t+1} < 0$. Equation (7) thus means that the sum of the current account balance, the capital balance and the financial balance is always identical to zero.[6]

[3] This means that the national savings are identical to the sum of the public sector savings and households' savings.
[4] Net factor 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 balance of trade during certain periods of time.
[6] As a number of different sources are used to measure the items in the balance of payments, both measurement errors and periodisation errors can arise, and a residual is therefore included in the form of an errors and omissions item.

The connection to the international investment position

As the financial balance measures external net lending, a change in the balance on the current account will - by definition - always be matched by a similar change in the net external claims. A surplus on the current account is thus matched by an increase in external net claims – private or public sector. The surplus can also be reflected in an increase in the foreign currency reserve, as these transactions are included in the financial balance. 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 balance 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 relative to other countries. Stock data is reported at market value and can be divided up exactly like the financial balance, into direct investment, portfolio investment, financial derivatives, other capital and the foreign currency reserve.[7]

The relationship between the international investment position and the transactions in the balance of payments is illustrated below. Changes in the net external position are due to transactions that have been implemented and registered in the financial balance 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**

Sources and methods

There are several documents on the Riksbank's website describing which sources and methods are used to compile the balance of payments and the international investment position. The address is www.riksbank.se/statistics and choose balance of payments. Here you can also find surveys, statistics published earlier and articles.[8]

[7] In certain cases the book value is used instead of the market value, because the base for calculating market value is insufficient.
[8] This section is entirely based on one of these articles: "What role does the balance of payments play in economic analysis?", (2001) by Ericsson, Victoria and Lindström, Tomas.