BALANCE OF PAYMENTS

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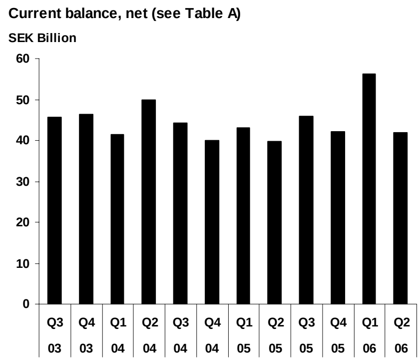
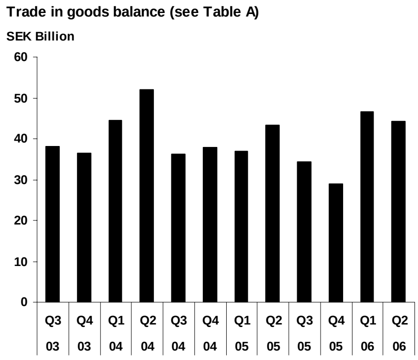
Second quarter 2006

The current account showed a surplus of SEK 41.9 billion for 2006 Q2, which is an increase of SEK 2.1 billion compared with the same period in 2005. The trade in goods balance remained at the same level as in the previous year, the trade in services balance improved by SEK 3.9 billion and transfers by SEK 2.8 billion. Income showed an entirely different development, declining by SEK 5.5 billion.

The current account for Q2 showed a surplus with regard to EU countries of SEK 13.7 billion, while the surplus for countries outside of the EU amounted to SEK 28.2 billion.





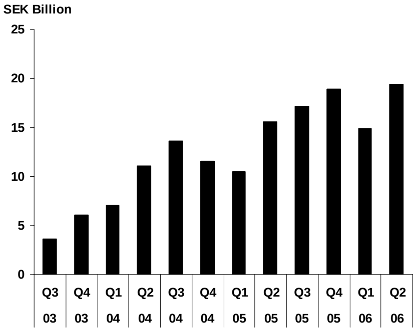
Trade in goods balance

The surplus on trade in goods amounted during Q2 this year to SEK 44.3 billion, which is an increase of SEK 0.9 billion compared with 2005 Q2. Exports rose by SEK 23.1 billion, while the corresponding increase for imports was SEK 22.2 billion.

Exports of goods to EU countries rose during Q2 compared with the corresponding period last year – from SEK 145.6 billion to SEK 162 billion. Imports of goods from EU countries also increased, from SEK 149.6 billion to SEK 163.6 billion, which implies a negative trade balance with the EU of SEK 1.5 billion for Q2. The trade in goods balance in relation to non-EU countries showed a surplus of SEK 45.8 billion, which is a decline of SEK 1.6 billion compared with the same period last year.

Trade in services balance

Trade in services balance (see Table G)



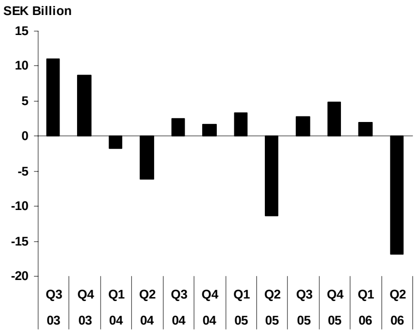
The surplus in trade in services amounted to SEK 19.5 billion for 2006 Q2, which is an improvement of SEK 3.9 billion on the same period last year. Factors behind this improvement are an increase in services exports of SEK 13.2 billion and an increase in services imports of SEK 9.2 billion.

All of the main items in the services balance – transportation services, travel and other types of service – indicate improved net totals compared with Q2 last year. The net figures for transportation improved by SEK 0.4 billion, travel by SEK 1.8 billion and other types of service by SEK 1.7 billion.

The surplus on other types of service amounted to SEK 18.2 billion, which is an improvement of SEK 1.7 billion on the same period last year. The main reason behind this improvement is Swedish companies' purchase and sale abroad of goods that do not cross the Swedish border, what is known as merchanting. The merchanting service is defined as the trade margin, i.e. the difference between the purchase price and the sale price. During Q2 the surplus amounted to SEK 11.1 billion, which is SEK 1.7 billion more than the previous year and corresponds to the total improvement in other types of service.

Income balance

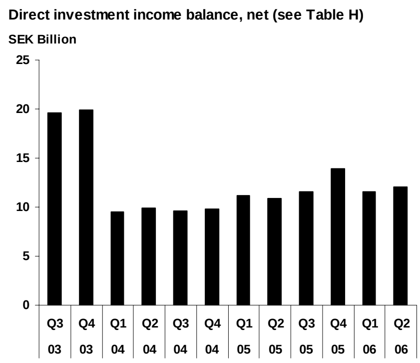
Income balance (see Table H)



Income, which consists of compensation of employees and investment income, showed a deficit of SEK 16.8 billion during Q2 2006, which is a deterioration of SEK 5.5 billion compared with the same period last year. The deterioration stems from earnings on capital, while the compensation of employees item remains largely unchanged. Earnings on capital showed seasonally large negative balances during Q2.

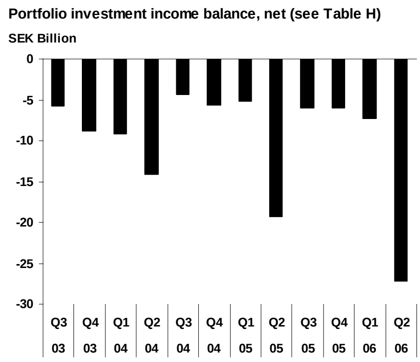
Direct investment income balance, net

A net inflow of SEK 12 billion was reported for 2006 Q2 with regard to direct investment income. Income from direct investment abroad amounted to SEK 48.7 billion, while income on corresponding investment in Sweden totalled SEK 36.7 billion. This item consists mainly of profits in direct investment companies and, to a lesser extent, of interest on loans within a direct investment relationship.



Portfolio investment income balance, net

Portfolio investment income, which consists of share dividends and interest payments, gave a net outflow of SEK 27.1 billion during 2006 Q2. Income on foreign investments in Swedish securities amounted to a total of SEK 52 billion during the period. The corresponding figure for Swedish investments abroad was SEK 24.8 billion. The second quarter of the year entails seasonally large dividend payments, which mainly affect the outflow side.

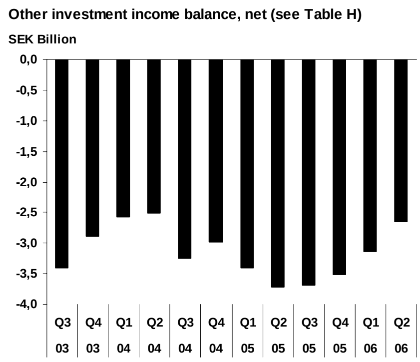


Other investment income balance, net

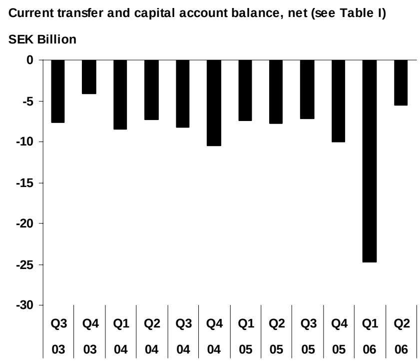
Income on other capital provided a net outflow of SEK 2.7 billion during 2006 Q2, which can be compared with a net outflow of SEK 3.7 billion during the same period in 2005.

Compared with 2005 Q2, the inflow of income on other capital abroad increased from SEK 7.5 billion to SEK 10.8 billion and the outflow of income on other capital in Sweden increased from SEK 11.2 billion to SEK 13.4 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

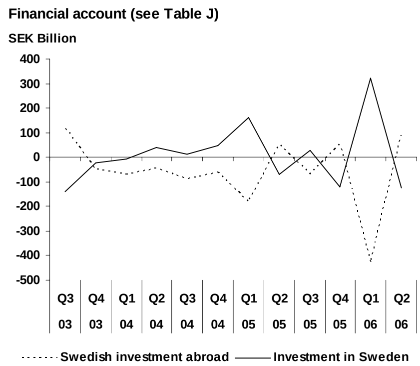


The net sum of current transfers and the capital balance gave a deficit of SEK 5.5 billion during Q2 this year, which is an improvement of SEK 2.3 billion compared with the same period in 2005.

Transactions linked to EU membership showed a deficit of SEK 2.8 billion, which is SEK 1.5 billion less than last year. The deficit for foreign aid increased slightly compared with last year and amounted to SEK 3 billion.

The item other transfers – that is, all other transfers not connected to foreign aid or the EU – has shown a positive development compared with the same quarter last year.

Financial account



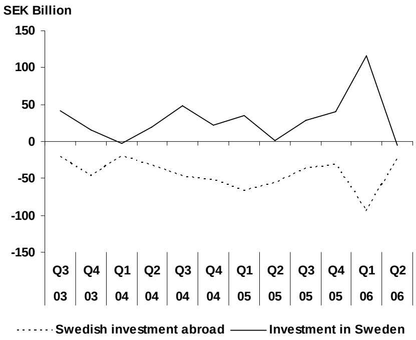
The financial account gave a net outflow of SEK 35 billion during 2006 Q2. This result is largely attributable to portfolio investment and direct investment during the period. The financial account for the first half of 2006 showed an outflow of SEK 140 billion.

Direct investment

During 2006 Q2, direct investment totalled in a net outflow of SEK 28.9 billion. Swedish investment abroad gave an outflow of SEK 23.7 billion during the quarter, while foreign investment in Sweden resulted in an outflow of SEK 5.2 billion.

The major change in the net figures compared with Q1, which resulted in a net inflow of SEK 22 billion, is attributable to the foreign takeover of Skandia during Q1 and some large corporate business deals during Q2. During Q2 there have been large loan flows and Swedish acquisitions of previously foreign-owned companies. The sub-item reinvested earnings for foreign direct investment in Sweden has generated an outflow, which is because large dividends have been paid to foreign owners. Reinvested earnings consists of the total profit minus dividends received, where the profits for 2005 are a forecast and may be revised when the annual direct investment survey has been completed.

Direct investment (see Table J)

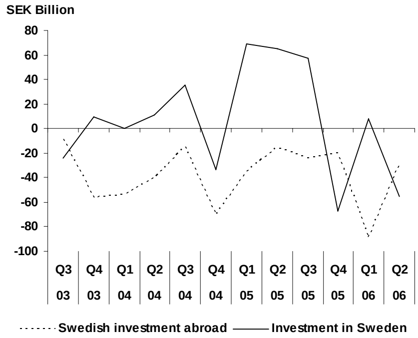


Portfolio investment

Cross-border portfolio investment generated capital outflows of SEK 84.9 billion during 2006 Q2. The outcome for the first half of 2006 was capital outflows of SEK 166 billion. During the first half of 2005 portfolio investment led to net inflows of SEK 83.7 billion as a result of extensive new issues abroad denominated in foreign currency.

The result during Q2 is largely explained by Swedish investment in foreign shares, which amounted to SEK 35.1 billion. During the first half of the year, investment in foreign shares has amounted to SEK 96.6 billion. Foreign investment in Swedish shares during Q2 provided net outflows of SEK 8.8 billion, compared with net inflows of SEK 4.9 billion during the previous quarter. Other factors contributing to the outcome for the quarter are that foreign investors chose to reduce their holdings in government bonds, both SEK-denominated and foreign currencies, and that bank certificates denominated in foreign currency reached maturity. Swedish investment in foreign debt securities resulted in net inflows of SEK 5.2 billion as a result of net sales.

Portfolio investment (see Table J)



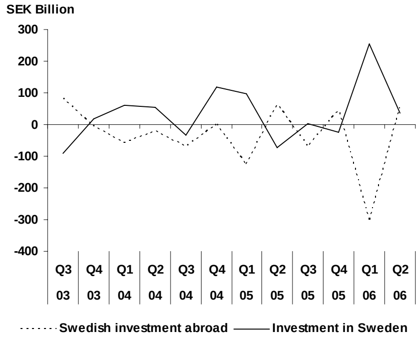
Other investment

The item other investment gave rise to a net inflow of SEK 89.7 billion during 2006 Q2. Swedish investment abroad gave rise to a net inflow of SEK 54.9 billion, while the corresponding foreign investment in Sweden gave rise to a net inflow of SEK 34.9 billion.

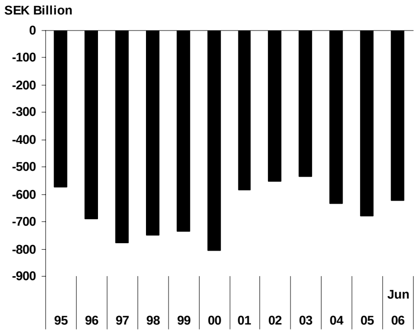
The value of investment in other capital varies considerably from one quarter to the next and it is often short-term capital movements between banks in Sweden and counterparties abroad, often in the same group, which have created these fluctuations.

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

Other investment (see Table J)



International investment position, net (see Table E)



International investment position, net

The Swedish net foreign debt declined by SEK 60 billion to SEK 621 billion during the first half of 2006, according to preliminary figures.

Net assets in the form of direct investment have been forecast at SEK 261 billion. This is an increase of SEK 27 billion compared with December 2005.

Net debt in the form of portfolio investment declined by SEK 12 billion, to SEK 663 billion. During the first half of the year, foreign investors' net sales of Swedish shares amounted to around SEK 4 billion, but favourable stock market developments led to the value of their holdings increasing; these amounted to SEK 1,147 billion at the end of June. Swedish investors experienced a lower increase in the value of their holdings of foreign shares, primarily due to the krona appreciating. Swedish holdings of foreign shares amounted to SEK 1,570 billion. Swedish assets in foreign debt securities amounted to SEK 731 billion and foreign assets in Swedish debt securities totalled SEK 1,816 billion.

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 265 billion in June.

It is important to note that several sub-items in the international investment position, 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):

$$S_t - I_t = X_t - M_t + F_t . \qquad (4)$$

The difference between S_t and I_t is often called net external investment and the difference between X_t and M_t is called the 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.

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

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).

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

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]

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[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.