# BALANCE OF PAYMENTS


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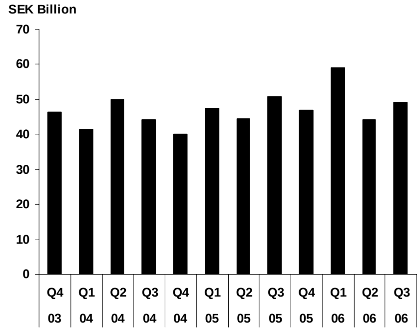
## Third quarter

The current account showed a surplus of SEK 49 billion for 2006 Q3, which is a decrease of SEK 1.7 billion compared with the same period in 2005. Seen over the first three quarters, the total current account surplus is SEK 152.1 billion, which is an increase of SEK 9.3 billion compared with the corresponding period last year.

Current balance, net (see Table A)

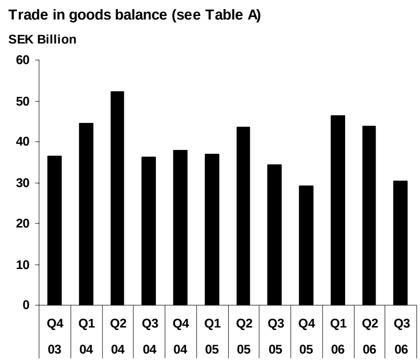



The surplus for Q3 stems largely from trade in goods and services. The total surplus amounted to SEK 52.5 billion, broken down into a trade balance of SEK 30.4 billion and trade in services balance of SEK 22.2 billion. Income also showed a surplus of SEK 7.9 billion, while current transfers gave a deficit of SEK 11.4 billion.

Since the previous report in August, substantial revisions have been made to income which in turn have led to an increase in the published current account surplus for the years 2005 and 2006. A more detailed account of the reasons for this can be found under the section direct investment income.

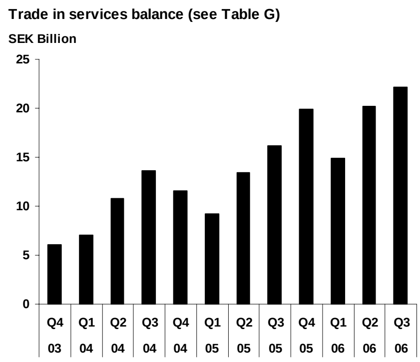
When seasonally adjusted, the surplus on the current account was SEK 54.5 billion, which is at the same level as 2005 Q3.

## Trade in goods balance




The surplus on trade in goods amounted during 2006 Q3 to SEK 30.4 billion, which is a reduction of SEK 4 billion compared with the same period in 2005. The factors behind this net decline are increased values of both exports and imports, of SEK 18.2 billion and SEK 22.3 billion respectively.

## Trade in services balance



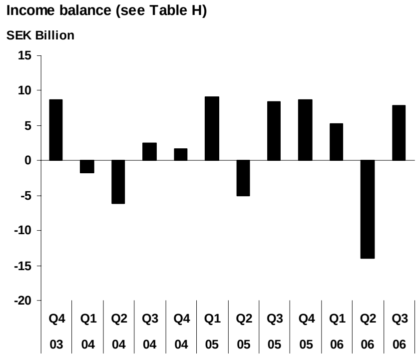

The surplus on trade in services amounted to SEK 22.2 billion for 2006 Q3, which is an improvement of SEK 6 billion on the same period last year. This is the largest surplus measured in trade in surpluses for an individual quarter. Transportation showed a surplus of SEK 6 billion, which is on the same level as 2005 Q3. The travel item contributed a deficit of SEK 2.3 billion, which is SEK 2.2 billion less than the deficit in 2005 Q3. The other types of services showed a surplus of SEK 18.4 billion, which is an improvement of SEK 3.7 billion.

Seen over the first three quarters, the net services figure amounts to SEK 57.4 billion, which is an increase of SEK 18.6 billion compared with the same period last year. Positive contributions to this development came from travel, providing SEK 4.8 billion and other types of services, SEK 14 billion, while transportation remained largely unchanged.

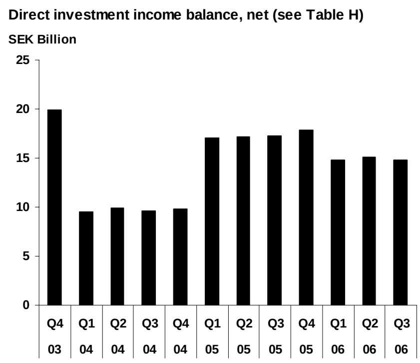
Under the item other types of services, the main source of a substantial increase was the item other business services, and within this, merchanting, i.e. mediation of goods abroad. The surplus has increased by SEK 8.8 billion for the first three quarters compared with last year.

## Income balance

Income, which consists of compensation of employees and investment income, showed a surplus of SEK 7.9 billion during 2006 Q3, which is slightly lower than the previous year. As mentioned earlier, the income item has undergone a revision which means that the net figure has increased for the years 2005 and 2006.



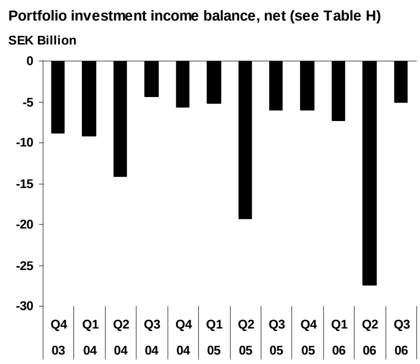
## Direct investment income balance, net




Net income on direct investment in 2006 Q3 showed a surplus of SEK 14.8 billion. Income from direct investment abroad amounted to SEK 52.1 billion, while income on direct investment in Sweden totalled SEK 37.3 billion. A positive earnings trend in companies has provided an increase in income on direct investment abroad of SEK 4 billion and on direct investment in Sweden of SEK 6.4 billion compared to 2005 Q3.

Most of the income from direct investment consists of profits arising in direct investment companies. The Riksbank measures these profits in an annual survey, where the result is then broken down over four quarters. A minor part of the income on direct investment consists of interest on loans between direct investment companies. The survey result has also been used as a basis for forecasting income in 2006, which has also led to revisions for that year.

## Portfolio investment income balance, net




Income on portfolio investment gave rise to net outflows of SEK 5.1 billion during Q3 this year. This is a decrease in the net outflow of SEK 22.4 billion compared with the previous quarter, when seasonally large dividends on Swedish shares were paid to foreign investors.

Most of the income consisted of interest on bonds and money market instruments. The quarter generated an interest cost for Swedish debt securities of SEK 20.6 billion, while holdings of foreign bonds and money market instruments provided income of SEK 8 billion.

Dividends on Swedish shares gave an outflow of SEK 0.4 billion, while dividends on foreign shares gave an inflow of SEK 7.9 billion.

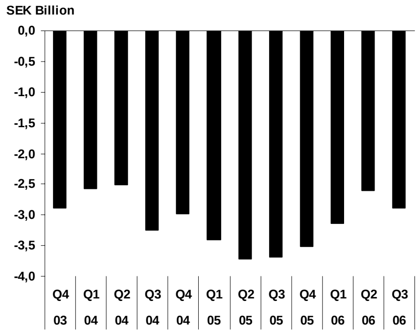
## Other investment income balance, net

Income on other investment provided a net outflow of SEK 2.9 billion during 2006 Q3, which can be compared with a net outflow of SEK 3.7 billion during the same period in 2005.

Compared with 2005 Q3, the inflow of income on other capital abroad increased from SEK 7.5 billion to SEK 11.6 billion and the outflow of income on other capital in Sweden increased from SEK 11.2 billion to SEK 14.5 billion.

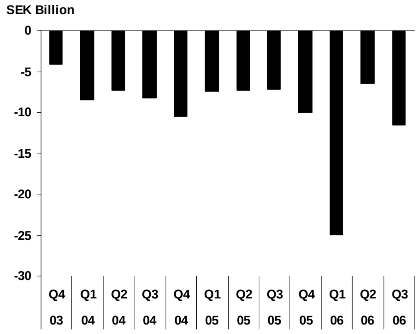
Income from other investment consists of earnings on loans and bank deposits, etc. The largest contributions to this item come from Swedish banks' income from assets and liabilities abroad.

**Other investment income balance, net (see Table H)**



## Current transfer and capital account balance, net

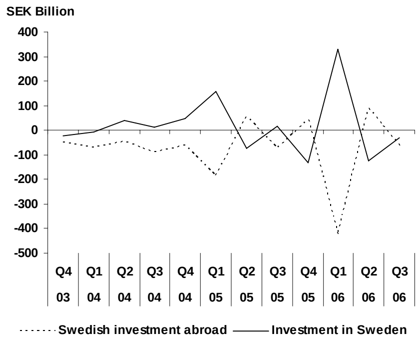
Current transfer and capital account balance, net (see Table I)




The net sum of current transfers and the capital balance gave a deficit of SEK 11.5 billion during Q3 this year, which is SEK 4.3 billion more than the deficit during the corresponding period last year. The net sum of EU transfers showed a deficit of SEK 5.5 billion, which is SEK 3.2 billion more than during the corresponding period last year. This is largely explained by the fact that EU subsidies were lower than in the previous year. Foreign aid remained at the same level as last year, amounting to SEK 2.8 billion. The deficit for other transfers was SEK 3.2 billion, which is SEK 1 billion more than last year.

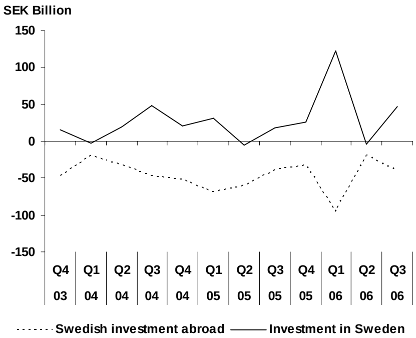
## Financial account

Financial account (see Table J)




The financial account gave a net outflow of just over SEK 90 billion during 2006 Q3. It was mainly portfolio investment and other investment that affected the result. So far this year the financial account has shown a net outflow of SEK 221 billion.

Direct investment (see Table J)




## Direct investment

During 2006 Q3, direct investment resulted in a net inflow of SEK 6.1 billion.

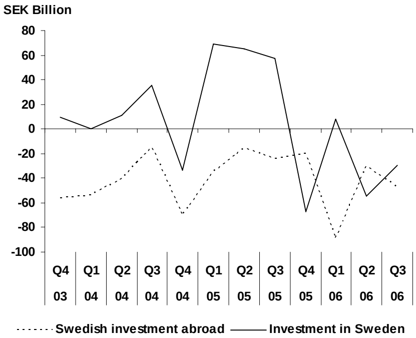
Swedish direct investment abroad generated an outflow of SEK 40.3 billion in 2006 Q3. This can be compared with an outflow of SEK 38.9 billion for the same period in 2005. Foreign direct investment in Sweden gave a net inflow of SEK 46.4 billion, which can be compared with a net inflow of SEK 18.5 billion for the same period in 2005.

The item reinvested earnings for direct investment has contributed large gross flows both for direct investment abroad and direct investment in Sweden. Reinvested earnings are calculated as total profits minus dividends paid out. The total profits for 2006 have been revised in connection with the completion of the 2005 direct investment survey, and in connection with this the forecast for 2006 has been adjusted.

Direct investment is an item that varies considerably over time, for many different reasons. The variation is partly due to the number and size of direct investment transactions following the level of activity in the economy and partly due to the way large corporate groups choose to manage their internal liquidity. This can result in short-term loans and deposits within multinational corporations often having a large impact on the direct investment item.

## Portfolio investment

Portfolio investment (see Table J)

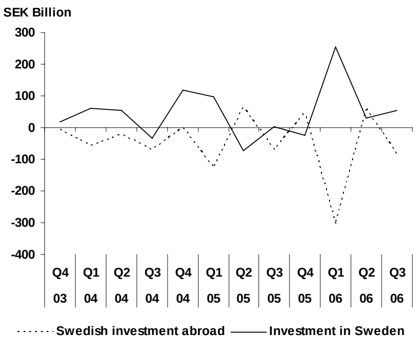



Cross-border portfolio investment gave a net outflow of SEK 77 billion during 2006 Q3. This can be compared with the previous quarter, when the net outflow was SEK 84.7 billion. The large net outflows during Q3 are a combination of foreign investors reducing their holdings of assets in Sweden at the same time as Swedish investors have increased their holdings of assets abroad.

During Q3 this year, Swedish investors made net purchases of foreign debt securities corresponding to SEK 33.7 billion. These mainly comprised foreign bonds denominated in foreign currency. Net purchases of foreign equity securities at the same time totalled SEK 14.1. Foreign investors reduced their holdings in Swedish debt securities, which caused capital outflows of SEK 33.7 billion. The outflow was due to both trade and redemption. At the same time, they increased their assets in Swedish equity securities by SEK 4.4 billion.

## Other investment

Other investment (see Table J)




The item other investment gave rise to a net outflow of SEK 30.8 billion during 2006 Q3. Swedish investment abroad showed a net outflow of SEK 84.7 billion and the corresponding foreign investment in Sweden showed a net inflow of SEK 53.8 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.

## International investment position, net

The Swedish net foreign debt amounted to SEK 512 billion at the end of June, according to preliminary figures. Swedish assets abroad were estimated at SEK 5,907 billion and debts abroad at SEK 6,419 billion.

The data for 2005 has been revised following the completion of the Riksbank's annual survey on direct investment and portfolio investment, and shows assets of SEK 5,597 billion and debts of SEK 6,166 billion. Sweden's net foreign debt thus amounted to SEK 570 billion at the end of 2005.

For June 2006, net assets in the form of direct investment are forecast at SEK 329 billion. This is an increase of SEK 34 billion compared with 2005. When the Riksbank's direct investment survey for 2005 was completed, a revision was made to the figures for 2005 that had been published earlier. This revision entailed stipulating the value of Sweden's net direct investment assets in 2005 as SEK 295 billion, which was SEK 61 billion higher than the forecast published earlier.

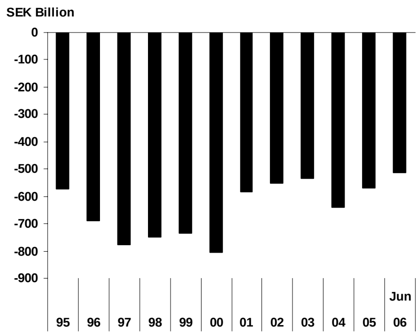
The result of this year's survey will be presented in a report to be published at the beginning of December.

The value of Swedish portfolio investment assets was calculated to be SEK 2,363 billion in June 2006, while the corresponding liabilities amounted to SEK 2,982 billion

Swedish holdings of foreign shares increased by SEK 23 billion, to SEK 1,632 billion. This upturn is largely explained by net trade but also by changes in value during the period resulting from international stock market developments and a stronger Swedish krona. Foreign debt securities showed a decline during the first half of the year. Holdings amounted to SEK 731 billion, which is a decline of SEK 32 billion. This decline is mainly an effect of the krona appreciation during the first half of the year.

Foreign holdings of Swedish equity securities increased by SEK 12 billion, to SEK 1,136 billion. This upturn is largely explained by increases in value. Foreign holdings of Swedish bonds and money market instruments declined by SEK 26 billion, to SEK 1,846 billion compared with December 2005. This reduction is largely due to net sales of securities for a total of SEK 43 billion.

International investment position, net (see Table E)



Since the previous publication, the Riksbank's annual survey of Swedish portfolio assets abroad has been completed, which has led to revisions of earlier forecasts regarding stocks of foreign shares in 2005. A report on Swedish investors' holdings of foreign portfolio shares and debt securities in 2005 can be ordered from pi@riksbank.se.

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 241 billion in June.

It is important to note that several sub-items in the international investment position in June, 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 ($X_t - M_t$):

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

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):

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

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.

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

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).

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

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.