



COMMENTS ON ESTONIA'S PRELIMINARY BALANCE OF PAYMENTS FOR 2005

- **Rapid economic growth in Estonia and a slight recovery of global economy in 2005 led to improved external balance of Estonia – the current account deficit of the balance of payments formed 10.5% of the expected GDP (see Table 1 and Figure 1), compared to the 12.7% deficit in 2004. In absolute value, the deficit amounted to 17.3 billion kroons, which is 4% less than in 2004.**
- **The deficit of the goods and services accounts amounted to 6.4% of the expected GDP (7.8% in 2004).**
- **External balance was affected by the fast growth of goods exports as well as by the large imports of capital goods arising from high investment activity.**
- **The first half of 2005 witnessed extraordinary capital movements between accounts on the financial account, which were mainly related to the buying up of the shares of Hansapank. The changes reflected in a decrease in portfolio investment and an increase in direct investment.**
- **Foreign capital inflow occurred mainly in the form of other investment capital.**
- **The balance of payments reserves increased by nearly 5 billion kroons.**

The largest component of the current account deficit, the **goods account** deficit, decreased by 1.7 billion kroons year-on-year, amounting to 23 billion kroons, which formed 14% of the estimated GDP of 2005. The exports of goods increased 31%, i.e. 24 billion kroons year-on-year, reaching 99 billion kroons. Compared to 2004, the growth of goods imports was outpaced by that of exports and amounted to 22%, i.e. 22 billion kroons. Thus, the debit turnover of the goods account stood at 122 billion kroons. Compared to the data of 2004, the robust increase in the goods turnover can be attributed to the EU accession as well as to changes in the reporting system used in the first months of 2004 (transition to Intrastat reporting in declaring intra-Community trade).

The main groups of export goods included machinery and equipment, timber and timber products, furniture, metal and textile products. Machinery and equipment dominated also in imports, followed by chemical products, metal products, and transport vehicles.

Estonia's main trading partner was the European Union, whose share amounted to 78% in the exports and to 76% in the imports of goods. The partners with the largest goods turnover were Finland, Sweden, Germany, Latvia, and Lithuania from the EU, and Russia, Belarus and Ukraine from the CIS countries. As regards other countries, the United States and Norway had the largest goods turnover in terms of exports, and China and Japan in terms of imports.

The surplus of the **services account** was 12.6 billion kroons, having decreased by 1.2 billion kroons, i.e. 8%, year-on-year. The dynamics of the services turnover was mainly driven by transport services, whereas the

¹The current account deficit without reinvested earnings, which involve no actual movement of funds, constituted 6.2% of the expected GDP based on the last four quarters.

Table 1. Estonia's balance of payments (EEK m)

	2001	2002	2003	2004					2005				
	Total	Total	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total
Current account	-5,889.5	-11,882.9	-15,401.9	-3,625.7	-6,217.5	-1,924.9	-6,194.9	-17,963.0	-3,920.8	-4,961.2	-3,775.6	-4,628.1	-17,285.8
Goods and services	-3,623.7	-8,318.2	-9,700.5	-1,776.8	-4,526.2	-1,132.3	-3,629.4	-11,064.7	-1,973.4	-2,755.0	-2,398.9	-3,377.7	-10,504.9
Goods	-13,783.9	-17,995.6	-21,483.1	-4,568.2	-8,348.4	-5,525.8	-6,360.8	-24,803.2	-4,213.9	-6,150.1	-6,249.1	-6,444.6	-23,057.7
credit (f.o.b.)	58,667.1	58,333.6	63,599.8	16,952.4	18,124.9	19,254.4	20,729.3	75,061.0	21,643.5	23,737.2	25,393.7	27,943.8	98,718.3
debit (f.o.b.)	-72,451.0	-76,329.2	-85,082.8	-21,520.6	-26,473.3	-24,780.1	-27,090.1	-99,864.2	-25,857.4	-29,887.3	-31,642.8	-34,388.4	-121,775.9
Services	10,160.2	9,677.4	11,782.6	2,791.4	3,822.2	4,393.5	2,731.4	13,738.5	2,240.5	3,395.1	3,850.2	3,066.9	12,552.7
credit	28,866.5	28,279.7	30,819.9	7,330.0	9,469.9	9,924.7	8,866.7	35,591.3	7,888.2	10,085.1	10,804.8	10,919.1	39,697.2
debit	-18,706.3	-18,602.3	-19,037.3	-4,538.6	-5,647.7	-5,531.2	-6,135.3	-21,852.8	-5,647.7	-6,690.0	-6,954.6	-7,852.2	-27,144.5
Income	-4,926.1	-5,423.1	-7,411.2	-2,226.0	-2,197.9	-1,389.4	-3,166.2	-8,979.6	-2,219.0	-2,843.2	-1,537.1	-1,587.1	-8,186.3
credit	2,994.7	3,339.3	3,422.1	640.0	1,231.1	1,904.3	1,678.3	5,453.6	1,561.9	1,800.0	2,739.3	2,067.1	8,168.2
debit	-7,920.8	-8,762.4	-10,833.3	-2,866.0	-3,429.0	-3,293.7	-4,844.5	-14,433.2	-3,780.8	-4,643.2	-4,276.4	-3,654.1	-16,354.5
Current transfers	2,660.3	1,858.4	1,709.7	377.2	506.6	596.8	600.7	2,081.2	271.5	636.9	160.4	336.7	1,405.5
credit	3,174.1	2,876.3	3,221.4	851.1	1,388.9	1,487.0	2,007.7	5,734.7	1,349.0	1,646.8	1,339.2	1,835.9	6,170.8
debit	-513.8	-1,017.9	-1,511.7	-473.9	-882.3	-890.1	-1,407.0	-3,653.4	-1,077.5	-1,009.9	-1,178.8	-1,499.2	-4,765.4
Capital and financial account (without reserve assets)	4,863.1	12,739.6	18,232.9	3,534.8	7,544.1	4,290.7	7,077.8	22,447.3	6,548.0	2,697.9	3,737.8	8,960.3	21,944.0
Capital account	90.0	320.7	655.7	27.7	154.7	554.5	317.8	1,054.7	462.8	321.1	181.3	789.9	1,755.2
Financial account	4,773.1	12,418.9	17,577.2	3,507.1	7,389.4	3,736.2	6,760.0	21,392.6	6,085.1	2,376.7	3,556.5	8,170.4	20,188.7
Direct investment	5,901.3	2,611.8	10,716.7	2,344.7	2,205.7	1,068.1	4,104.3	9,722.7	13,274.1	14,836.0	2,233.3	-3,056.4	27,286.9
Abroad	-3,528.3	-2,188.4	-2,149.2	-1,007.9	-834.5	-988.9	-557.3	-3,388.6	-997.4	-2,524.3	-1,642.0	-2,470.4	-7,634.0
In Estonia	9,429.6	4,800.2	12,865.9	3,352.5	3,040.3	2,057.0	4,661.6	13,111.3	14,271.5	17,360.3	3,875.2	-586.1	34,920.9
Portfolio investment	-665.0	2,442.4	2,431.7	-700.4	5,628.1	-2,228.7	6,431.5	9,130.5	-5,338.0	-20,648.4	-5,541.9	4,928.2	-26,600.1
Assets	-2,100.2	-3,182.9	-5,351.6	-767.7	-183.7	-2,419.0	-1,381.2	-4,751.6	-3,507.3	-2,422.9	-4,808.8	508.8	-10,230.1
Equity securities	236.5	9.1	-1,028.9	-441.6	-565.5	-544.6	-1,341.8	-2,893.5	-1,237.6	-1,194.9	-1,517.8	-399.8	-4,350.2
Debt securities	-2,336.5	-3,192.0	-4,322.7	-326.2	381.7	-1,874.3	-39.4	-1,858.1	-2,269.7	-1,227.9	-3,291.0	908.7	-5,879.9
Liabilities	1,435.2	5,625.3	7,783.3	67.3	5,811.8	190.2	7,812.7	13,882.1	-1,830.7	-18,225.5	-733.1	4,419.4	-16,370.0
Equity securities	568.4	912.2	1,526.9	147.3	459.6	707.1	891.3	2,205.3	-9,703.8	-10,127.2	842.0	2,785.7	-16,203.3
Debt securities	866.8	4,713.1	6,256.3	-80.0	5,352.2	-516.9	6,921.4	11,676.8	7,873.0	-8,098.4	-1,575.1	1,633.7	-166.7
Financial derivatives	-34.7	-63.7	-19.3	68.1	-42.6	-62.2	28.3	-8.3	46.8	-62.8	-74.9	4.0	-86.9
Assets	-0.3	-43.2	-139.2	56.5	-5.5	-18.7	-67.4	-35.1	63.3	-42.9	-24.7	28.6	24.3
Liabilities	-34.4	-20.5	120.0	11.7	-37.1	-43.5	95.7	26.8	-16.5	-19.8	-50.2	-24.6	-111.2
Other investment	-428.5	7,428.4	4,448.1	1,794.7	-401.9	4,959.0	-3,804.1	2,547.8	-1,897.8	8,252.0	6,940.0	6,294.6	19,588.8
Assets	-3,716.7	695.1	-2,284.6	-1,763.9	-4,918.3	2,163.0	-6,649.6	-11,168.8	-11,945.4	5,277.0	-2,267.9	-1,932.1	-10,868.4
Long-term	-322.7	-1,083.0	-565.7	-1,154.6	-1,903.9	250.0	-3,244.1	-6,052.6	-1,825.9	-3,678.6	3,096.5	7,991.8	5,583.8
Short-term	-3,394.0	1,778.1	-1,718.9	-609.3	-3,014.4	1,913.0	-3,405.5	-5,116.1	-10,119.6	8,955.7	-5,364.4	-9,923.9	-16,452.1
Liabilities	3,288.2	6,733.3	6,732.7	3,558.6	4,516.4	2,796.0	2,845.5	13,716.5	10,047.6	2,974.9	9,207.9	8,226.7	30,457.2
Long-term	1,814.4	1,829.0	4,310.4	690.0	1,001.2	-514.1	2,563.5	3,740.6	2,689.3	1,889.9	6,047.6	5,395.1	16,021.9
Short-term	1,473.8	4,904.3	2,422.3	2,868.6	3,515.2	3,310.1	282.0	9,975.9	7,358.3	1,085.0	3,160.3	2,831.7	14,435.3
Errors and omissions	296.2	70.1	-518.9	-377.5	-601.5	-348.0	268.1	-1,058.9	64.3	770.1	81.6	-690.3	225.7
Overall balance	-730.2	926.8	2,312.1	-468.4	725.1	2,017.7	1,151.0	3,425.4	2,691.4	-1,493.3	43.8	3,641.9	4,883.9
Reserve assets	730.2	-926.8	-2,312.1	468.4	-725.1	-2,017.7	-1,151.0	-3,425.4	-2,691.4	1,493.3	-43.8	-3,641.9	-4,883.9

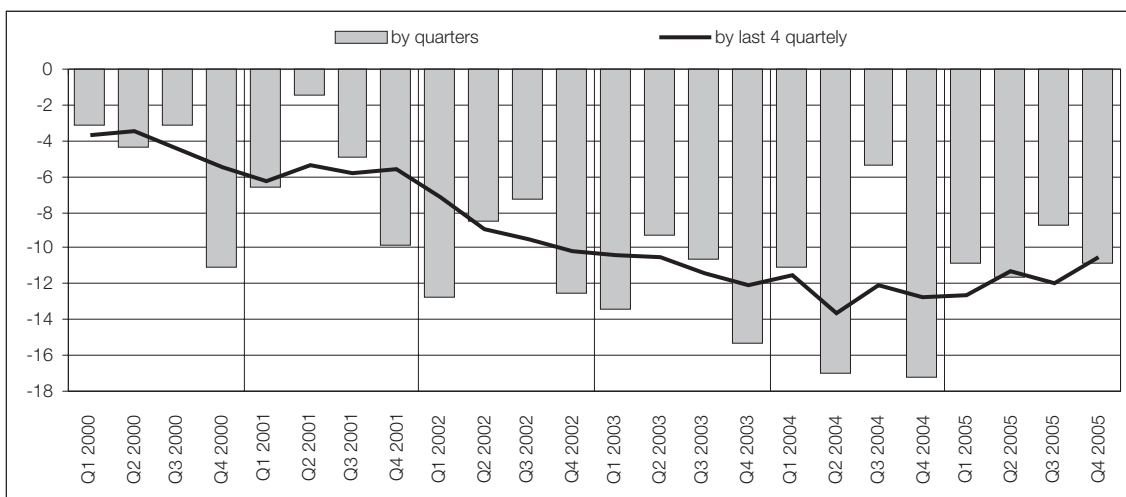


Figure 1. Current account balance of GDP (%)

imports of transport services grew much faster than the exports. The share of transport services in the total services turnover remained more or less the same, i.e. 41%, year-on-year. The shares of travel services and other business services decreased slightly and accounted for 26% and 17%, respectively, in the total services turnover. The turnover of construction services grew considerably – the volume of both the imports and exports of construction services more than doubled. The share of construction services in the services turnover increased from 4% to 7%, year-on-year.

In the services sector, Estonia's major trading partners were the EU Member States, which accounted for 69% of the exports and 75% of the imports. Estonia had the biggest surplus with Finland (7.7 billion kroons) and Russia (2.3 billion kroons), and the biggest deficit with Germany (1.4 billion kroons).

The growth rate of the total exports of goods and services, which are the direct components of GDP, outpaced that of imports. As a result, the deficit of goods and services account decreased from 7.8% in 2004 to 6.4% of the expected GDP in 2005.

The **income deficit** decreased 9%, amounting to 8.2 billion kroons. The income earned by Estonian investors abroad (credit turnover) grew by a half and reached a record 8.2 billion kroons. The income earned by non-residents on the capital invested in Estonia and on compensations of employees (debit turnover) increased 13% and stood at 16.4 billion kroons. Labour income formed 38% of the residents' total income earned abroad and 4% of non-residents' total income earned in Estonia. The rest of income was investment income.

Accession to the EU and the free movement of workers contributed significantly to the labour income earned by residents abroad and by non-residents in Estonia: the former grew 60% and the latter nearly doubled. 38% of residents' labour income was earned in Finland, 17% in the United Kingdom, 14% in the US, and 10% in Ireland as well as in Sweden. In Estonia, mainly Finnish and Swedish residents earned on labour.

Direct investment income accounted for 60%, portfolio investment income and other investment income both for a fifth of residents' investment income from abroad. As to non-residents' investment income earned in Estonia, direct investment income formed 80%, the share of portfolio investment income was 9% and that of other investment 11%. The share of reinvested earnings was 57% both in residents' as well as non-residents' direct investment income. Excluding from the income account reinvested earnings, which involve no actual movement of funds, the income account had a deficit of 1 billion kroons.

87% of residents' and non-residents' investment income came from the European Union. 31% of residents' investment income came from the Baltic States and 16% from Cyprus. Both Finland and Sweden accounted

for 28% of non-residents' investment income. Investors of financial intermediation earned 61% and those of transport, storage and communications earned 19% of residents' investment income. 35% of non-residents' investment income was earned on financial intermediation, 19% on real estate, renting and business activities, and 16% on manufacturing.

The surplus of the **transfers account** (current and capital transfers) remained unchanged, year-on-year, reaching 7.8 billion kroons. The incoming transfers grew 14% and the outgoing transfers increased by a third.

The positive balance of the **FINANCIAL ACCOUNT** was 20.2 billion kroons in 2005. Foreign capital inflow occurred mainly in the form of other investment capital. Large capital movements between the accounts of direct investment and portfolio investment mainly stemmed from the buying up of the shares of Hansapank, which reflected in an increase in direct investment and a decrease in portfolio investment.

As a result of the takeover of Hansapank, the positive balance of **direct investment** reached a record 27.3 billion kroons. Excluding the takeover of Hansapank, foreign direct investment in Estonia amounted to 7.9 billion and Estonian residents' direct investment abroad to 7.6 billion kroons.

Equity capital investment accounted for 80% of the direct investment inflow to Estonia, the rest being reinvested earnings and other direct investment capital. Excluding the takeover of Hansapank, foreign direct investment largely consisted of reinvested earnings. 99% of direct investment came from the EU, whereas 82% came from Sweden and 15% from Finland. 88% of direct investment was made in financial intermediation and 7% in manufacturing.

Like in the structure of non-residents' direct investment, equity capital investment also formed a considerable share (66%) of residents' foreign direct investment. Reinvested earnings accounted for 23% and other investment capital for 11%. Most of the investment went to Latvia (27%), Russia (23%), and Lithuania (21%). The share of the European Union was 64%. The investors of financial intermediation (57%), real estate, renting and business activities (14%), transport, storage and communications (8%), and wholesale and retail trade (8%) made the largest investments.

The negative balance of **portfolio investment** also posted a record of 26.6 billion kroons. Portfolio investment claims increased by 10.2 billion and liabilities decreased by 16.4 billion kroons. Claims increased mainly due to investment of other sectors in foreign equity and debt securities and the general government's investments in money market instruments. Liabilities decreased primarily because of a decline in credit institutions' liabilities related to equity securities (the takeover of Hansapank).

The net inflow of **other investment** amounted to 19.6 billion kroons. Claims increased by 10.9 billion kroons. Long-term claims decreased by 5.6 billion kroons, whereas short-term claims increased by 16.5 billion kroons mostly owing to currency and deposits of credit institutions and trade credit claims of other sectors. Other investment liabilities grew by 30.5 billion kroons mainly as a result of an increase in long-term and short-term debt liabilities of credit institutions.

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According to revised data, the current account deficit of the balance of payments for the third quarter of 2005 was nearly 3.8 billion kroons, i.e. 11.9% of the GDP of the last four quarters.

The preliminary balance of payments for the first quarter of 2006 will be published on the web site of Eesti Pank (<http://www.bankofestonia.info>) at noon on 26 June 2006.

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