



COMMENTS ON ESTONIA'S PRELIMINARY BALANCE OF PAYMENTS FOR THE FIRST QUARTER OF 2006

- **Estonia's fast economic growth accompanied by increased consumption and investment needs kept the current account deficit of Estonia's balance of payments high in the first quarter of 2006. The deficit accounted for 12% of the expected GDP of the last four quarters (see Table 1 and Figure 1)¹. In absolute value, it was the highest quarterly deficit (6.9 billion kroons) outpacing by more than a half the first quarter 2005 deficit.**
- **The external balance was mainly affected by the foreign trade balance – exports increased fast yet imports outpaced that.**
- **Foreign capital inflow occurred mainly in the form of direct investment capital.**
- **The balance of payments reserves decreased by 1.3 billion kroons.**

The **goods account** had a deficit comparable to the current account deficit, namely 6.7 billion kroons, increasing minimally quarter-on-quarter and by 2.3 billion kroons year-on-year. The exports of goods amounted to 27.1 billion kroons and imports to 33.8 billion kroons, having grown 27% and 31%, respectively, year-on-year.

The main groups of export goods included electronic and timber products as well as fuel. Electronic products dominated also in imports, followed by fuel, chemical products, and transport vehicles. Machinery and equipment, chemical and mineral products, and transport vehicles mainly contributed to the deficit of the goods account; timber and timber products posted a surplus.

Estonia's main trading partner was the European Union, whose share amounted to nearly 70% of both the exports and imports of goods. Finland, Sweden, Latvia, Russia, the United States and Germany were the largest export partners, and Finland, Russia, Germany, Sweden and Lithuania the major import partners.

The surplus of the **services account** was 1.9 billion kroons, having decreased by nearly 0.3 billion kroons, year-on-year. The exports of services grew 5% and the imports 12%. The surplus in services declined mainly owing to transport and travel services with their exports increasing and imports decreasing. As regards transport services, the surplus decreased mostly in sea and rail transport. The exports of trade services have been significantly increasing over the last quarters and so has the surplus in merchanting and other trade-related services. Transport services constituted 44%, travel services 22%, and other business services 20% of the total services turnover.

In the services sector, Estonia's major trading partners were the EU Member States, which accounted for 67% of the exports and 72% of the imports. Estonia had the biggest surplus with Finland (1.1 billion kroons) and the biggest deficit with Egypt (0.2 billion kroons).

Total exports of goods and services, which are the direct components of GDP, grew slower than imports. As a result, the deficit of the goods and services account increased from 5.9% in the first quarter of 2005 to 11.1% of the GDP of the last four quarters in the first quarter of 2006.

¹ The current account deficit without reinvested earnings, which involve no actual movement of funds, constituted 7.5% of the expected GDP of the last four quarters.

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

	2002	2003	2004					2005					2006
	Total	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total	Q1
Current account	-12,908.0	-15,415.6	-3,616.7	-6,714.5	-2,659.1	-5,361.3	-18,351.6	-4,474.9	-5,230.9	-4,006.4	-4,426.2	-18,138.4	-6,937.6
Goods and services	-8,564.6	-10,199.6	-1,874.8	-4,988.7	-1,572.0	-3,483.2	-11,918.7	-2,149.5	-2,823.2	-2,338.2	-3,356.9	-10,667.8	-4,767.3
Goods	-18,455.3	-21,666.7	-4,647.5	-8,737.1	-5,921.4	-6,193.0	-25,499.0	-4,366.8	-6,208.4	-6,166.0	-6,554.7	-23,295.8	-6,698.6
credit (f.o.b.)	57,948.7	63,443.7	16,930.6	18,019.9	19,183.0	21,066.0	75,199.5	21,409.6	23,606.6	25,320.7	27,811.2	98,148.2	27,079.4
debit (f.o.b.)	-76,404.0	-85,110.4	-21,578.1	-26,756.9	-25,104.4	-27,259.1	-100,698.5	-25,776.4	-29,815.0	-31,486.7	-34,366.0	-121,444.0	-33,778.0
Services	9,890.7	11,467.1	2,772.7	3,748.4	4,349.4	2,709.8	13,580.3	2,217.3	3,385.2	3,827.7	3,197.9	12,628.1	1,931.3
credit	28,164.3	30,674.0	7,334.1	9,479.4	9,969.1	8,883.7	35,666.4	7,872.9	10,098.5	10,796.6	11,068.2	39,836.2	8,265.0
debit	-18,273.6	-19,206.9	-4,561.4	-5,731.0	-5,619.8	-6,173.9	-22,086.1	-5,655.6	-6,713.3	-6,968.9	-7,870.3	-27,208.2	-6,333.7
Income	-5,391.1	-7,375.2	-1,954.2	-1,763.3	-1,169.3	-3,064.2	-7,950.9	-2,494.9	-2,976.4	-1,839.9	-1,418.2	-8,729.3	-2,149.5
credit	3,371.3	3,449.5	647.7	1,238.8	1,912.0	1,686.0	5,484.4	1,579.8	1,837.0	2,773.0	2,273.2	8,463.0	2,323.8
debit	-8,762.4	-10,824.8	-2,601.8	-3,002.1	-3,081.2	-4,750.2	-13,435.3	-4,074.6	-4,813.4	-4,612.9	-3,691.4	-17,192.3	-4,473.3
Current transfers	1,047.7	2,159.2	212.3	37.4	82.2	1,186.1	1,518.0	169.5	568.7	171.6	348.8	1,258.7	-20.9
credit	2,065.6	3,670.7	687.3	1,028.8	972.0	2,588.6	5,276.7	1,398.1	1,670.3	1,350.4	1,848.6	6,267.4	1,430.1
debit	-1,017.9	-1,511.5	-475.0	-991.3	-889.8	-1,402.5	-3,758.7	-1,228.6	-1,101.5	-1,178.8	-1,499.8	-5,008.7	-1,451.0
Capital and financial account (without reserve assets)	13,055.3	18,260.3	3,307.6	7,116.2	3,616.6	7,492.4	21,532.8	6,698.7	3,266.6	4,521.3	8,748.6	23,235.2	6,456.7
Capital account	636.4	685.2	65.3	154.4	117.6	808.0	1,145.3	469.0	327.3	181.3	789.9	1,767.5	1,175.3
Financial account	12,418.9	17,575.1	3,242.4	6,961.8	3,499.0	6,684.4	20,387.5	6,229.7	2,939.3	4,340.0	7,958.7	21,467.6	5,281.4
Direct investment	2,611.8	10,716.0	2,058.8	1,840.0	835.3	4,012.7	8,746.9	13,786.5	15,458.3	2,654.5	-2,880.1	29,019.2	6,085.2
Abroad	-2,188.4	-2,149.2	-1,007.9	-834.5	-988.9	-557.3	-3,388.6	-892.2	-2,529.8	-1,642.1	-2,663.2	-7,727.3	-1,667.5
In Estonia	4,800.2	12,865.3	3,066.7	2,674.5	1,824.3	4,570.0	12,135.5	14,678.6	17,988.1	4,296.6	-216.9	36,746.4	7,752.7
Portfolio investment	2,442.4	2,431.6	-681.0	5,569.3	-2,234.9	6,449.2	9,102.6	-5,576.7	-20,959.0	-5,331.6	4,454.7	-27,412.6	-12,028.2
Assets	-3,182.9	-5,351.6	-767.7	-183.7	-2,443.1	-1,381.2	-4,775.7	-3,692.5	-2,575.7	-4,609.4	59.3	-10,818.4	-5,620.8
Equity securities	9.1	-1,028.9	-441.6	-565.5	-544.6	-1,341.8	-2,893.5	-1,373.5	-1,243.1	-1,467.8	-764.5	-4,848.9	-1,215.9
Debt securities	-3,192.0	-4,322.7	-326.2	381.7	-1,898.4	-39.4	-1,882.2	-2,319.0	-1,332.6	-3,141.6	823.8	-5,969.5	-4,405.0
Liabilities	5,625.3	7,783.2	86.7	5,753.1	208.1	7,830.4	13,878.3	-1,884.2	-18,383.2	-722.2	4,395.4	-16,594.2	-6,407.4
Equity securities	912.2	1,526.9	147.3	459.6	707.1	891.3	2,205.3	-9,703.8	-10,127.2	842.0	2,809.3	-16,179.6	-64.5
Debt securities	4,713.1	6,256.2	-60.5	5,293.4	-499.0	6,939.1	11,673.0	7,819.5	-8,256.0	-1,564.2	1,586.1	-414.6	-6,342.9
Financial derivatives	-63.7	-19.3	68.1	-42.6	-62.2	28.3	-8.3	45.4	-62.8	-74.9	-5.3	-97.7	101.5
Assets	-43.2	-139.2	56.5	-5.5	-18.7	-67.4	-35.1	61.9	-42.9	-24.7	19.3	13.5	96.8
Liabilities	-20.5	120.0	11.7	-37.1	-43.5	95.7	26.8	-16.5	-19.8	-50.2	-24.6	-111.2	4.7
Other investment	7,428.4	4,446.8	1,796.4	-405.0	4,960.8	-3,805.8	2,546.4	-2,025.4	8,502.7	7,092.0	6,389.5	19,958.8	11,122.9
Assets	695.1	-2,284.6	-1,763.9	-4,918.3	2,163.0	-6,649.6	-11,168.8	-12,047.9	5,477.4	-2,127.6	-2,008.9	-10,706.9	-4,923.9
Long-term	-1,083.0	-565.7	-1,154.6	-1,903.9	250.0	-3,244.1	-6,052.6	-1,961.8	-3,678.6	3,096.5	7,975.9	5,432.1	-851.5
Short-term	1,778.1	-1,718.9	-609.3	-3,014.4	1,913.0	-3,405.5	-5,116.1	-10,086.1	9,156.1	-5,224.1	-9,984.8	-16,139.0	-4,072.3
Liabilities	6,733.3	6,731.4	3,560.3	4,513.3	2,797.8	2,843.8	13,715.1	10,022.5	3,025.3	9,219.6	8,398.3	30,665.7	16,046.7
Long-term	1,829.0	4,309.1	692.3	998.8	-512.4	2,561.8	3,740.5	2,690.0	1,886.7	6,055.0	5,454.0	16,085.6	4,610.2
Short-term	4,904.3	2,422.3	2,868.0	3,514.5	3,310.1	282.0	9,974.7	7,332.5	1,138.6	3,164.6	2,944.3	14,580.1	11,436.5
Errors and omissions	779.5	-532.7	-159.3	323.4	1,060.2	-980.1	244.2	467.6	471.1	-471.1	-680.4	-212.8	-793.4
Overall balance	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	-1,274.3
Reserve assets	-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	1,274.3

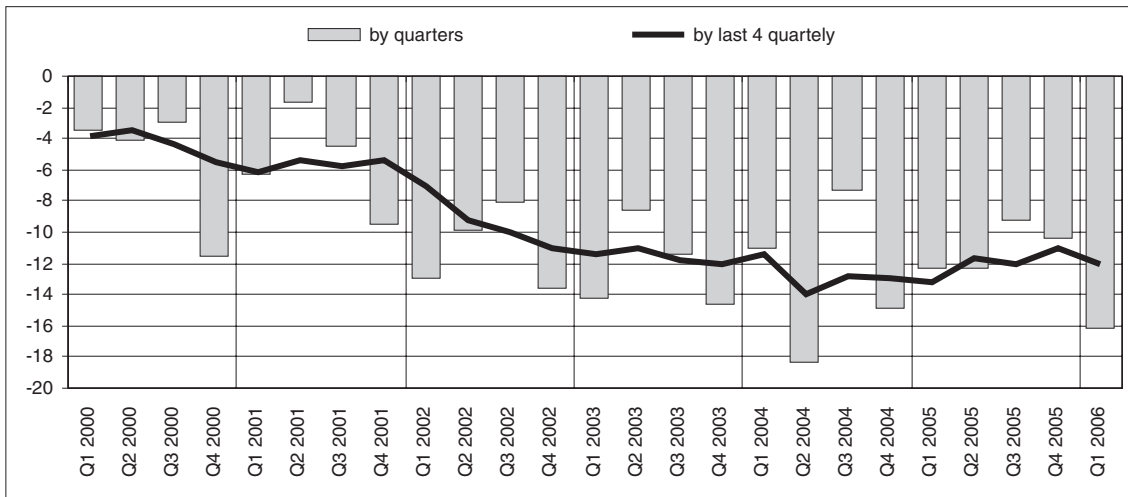


Figure 1. Current account balance of GDP (%)

The deficit of the **income account** decreased 14%, amounting to 2.1 billion kroons. The income earned by Estonian investors abroad (credit turnover) grew by a half and reached 2.3 billion kroons. Labour income comprised 45% of that and the rest was investment income, half of which were reinvested earnings. The income earned by non-residents on the capital invested in Estonia and on compensations of employees (debit turnover) stood at 4.5 billion kroons. 96% of non-residents' income came from investment income, which largely consisted of reinvested earnings (70% of the total investment income). Excluding from the income account reinvested earnings, which involve no actual movement of funds, the income account had a surplus of 0.1 billion kroons.

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 56% and the latter 36%. 46% of residents' labour income was earned in Finland, 21% in the United Kingdom, 8% in Sweden, 7% in Ireland, and 5% in the United States. In Estonia, mainly Finnish (45%), Swedish (21%), Polish (9%), Ukrainian (9%), and Russian (9%) residents earned on labour income.

90% of residents' and non-residents' investment income came from the European Union: 32% of residents' investment income came from Latvia, 19% from Cyprus, and 16% from Lithuania; 33% of non-residents' investment income from Sweden and 25% from Finland. Investors of financial intermediation earned 66% of residents' investment income, the share of transport, storage and communications investors was 15% and the investors of real estate, renting and business activities accounted for 11%. 42% of non-residents' investment income was earned on financial intermediation, 14% on real estate, renting and business activities, 13% on manufacturing, and 10% on wholesale and retail trade.

The surplus of the **current transfers and capital accounts** nearly doubled year-on-year, amounting to 1.2 billion kroons. The growth can mainly be attributed to the capital account (sales of emission quotas), as the incoming and the outgoing current transfers were almost balanced.

The surplus of the **FINANCIAL ACCOUNT** decreased by a third compared with the fourth quarter of 2005, constituting 5.3 billion kroons. Foreign capital inflow occurred mainly in the form of direct investment. The net outflow of portfolio investment and the net inflow of other investment were almost equal.

The positive balance of **direct investment** was 6.1 billion kroons. Foreign direct investment in Estonia increased by 7.8 billion and direct investment of Estonian residents abroad by 1.7 billion kroons.

Other direct investment capital accounted for 44%, reinvested earnings for 38%, and equity capital investment for 18% of the direct investment inflow. Direct investment mainly came from Sweden (62%) and Finland (15%);

the share of the European Union reached 93%. 67% of direct investment was made in financial intermediation, 14% in real estate, renting and business activities, and 12% in wholesale and retail trade.

Like in the structure of non-residents' direct investment, reinvested earnings accounted for 38%, other direct investment capital for 54%, and equity capital investment only for 8% of residents' foreign direct investment. Most of the investment went to Cyprus (35%), Latvia (31%), and Lithuania (17%). The share of the European Union was 92%. The investors in transport, storage and communications (33%), financial intermediation (27%), real estate, renting and business activities (19%), and wholesale and retail trade (16%) made the largest investments.

The negative balance of **portfolio investment** was 12 billion kroons. Portfolio investment claims increased by 5.6 billion and liabilities decreased by 6.4 billion kroons, quarter-on-quarter. Claims increased mainly due to the general government's investments in debt securities and money market instruments, other sectors' investments in equity securities, and credit institutions' investments in money market instruments. Liabilities decreased primarily due to a decline in credit institutions' liabilities related to debt securities and money market instruments.

The net inflow of **other investment** amounted to 11.1 billion kroons. Claims increased by 4.9 billion kroons, quarter-on-quarter, mainly owing to the increase in the short-term claims of credit institutions (loans, currency and deposits). Other investment liabilities grew by 16 billion kroons mostly as a result of the increase in long-term and short-term debt liabilities, currency and deposits, and other liabilities of credit institutions.

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According to revised data, the current account deficit for 2005 was 18.1 billion kroons, i.e. 11% of GDP.

The preliminary balance of payments for the second quarter of 2006 will be published on the web site of Eesti Pank (<http://www.bankofestonia.info>) at noon on 25 September 2006.

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