



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

- **Estonia's economic growth remained fast, which along with high consumption and investment needs led to a slight deterioration in the external balance. The current account deficit accounted for 12.4% of the expected GDP of the last four quarters in the third quarter of 2006 (see Table 1 and Figure 1) ¹. In absolute value, the deficit amounted to 6.6 billion kroons, exceeding the year-ago level by nearly 70% and remaining slightly below the level of the previous quarter.**
- **The current account deficit was boosted by the increase in the foreign trade deficit.**
- **Other investment capital accounted for most of the foreign capital inflow.**
- **Like in previous quarters, capital inflow also occurred through the capital account.**
- **The balance of payments reserve assets increased by 3.2 billion kroons.**

The record large deficit on the **goods account** exceeded the current account deficit by nearly 2.9 billion kroons, totalling 9.5 billion kroons and accounting for 18% of the estimated third-quarter GDP. The exports of goods amounted to 29.4 billion kroons and imports to 38.9 billion kroons, having grown 16% and 24% respectively, year-on-year. The increase in the deficit of transport vehicles, mineral and chemical products contributed the most to the goods account deficit.

The main export groups included electronic and oil products, timber and timber products and metal products. Electronic products were also the largest import group, followed by oil products, transport vehicles and chemical products. Machinery and equipment, transport vehicles, and chemical and mineral products posted the largest deficits on the goods account. Timber and timber products posted an over a million-kroon surplus.

Estonia's main trading partner was the enlarged European Union, whose share amounted to 64% of the exports and 73% of the imports of goods. Exports to the EU Member States decreased both in volume and share. One of the underlying reasons was the decline in the output volume of the electronics industry. At the same time, the exports of oil products increased 2.3 times year-on-year and were destined to non-EU countries. Year-on-year, the share of CIS countries (Russia in particular) has grown both in exports as well as imports. Finland, Sweden, Latvia, Russia and Gibraltar were the largest export partners, and Finland, Russia, Germany, Sweden and Lithuania the major import partners.

The surplus on the **services account** was 4.2 billion kroons, having increased by 0.4 billion kroons year-on-year. The exports of services grew 14% and the imports 16%. The surplus on services grew mainly owing to transport services, especially the sea transport of passengers and goods. The exports of transport services outpaced the imports, being facilitated by the enlargement of the shipping company AS Tallink Grupp. The services surplus was also boosted by the computer and information services, which have posted relatively modest turnovers

¹ The current account deficit without reinvested earnings, which involve no actual movement of funds, constituted 8.3% of the expected GDP of the last four quarters.

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

Item	2002		2003		2004					2005					2006		
	Total	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3		
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	-6,362.4	-6,815.9	-6,634.4		
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	-3,862.5	-4,622.3	-5,269.6		
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	-5,743.7	-8,534.4	-9,490.1		
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	28,381.0	30,796.7	29,446.5		
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	-34,124.7	-39,331.1	-38,936.7		
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	1,881.2	3,912.1	4,220.5		
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	8,192.8	11,210.1	12,270.8		
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	-6,311.6	-7,298.0	-8,050.3		
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	-2,375.5	-2,694.1	-1,432.0		
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	2,322.3	2,986.0	3,365.9		
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	-4,697.8	-5,680.0	-4,798.0		
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	-124.3	500.4	67.2		
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	1,336.8	1,846.6	1,418.2		
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	-1,461.1	-1,346.2	-1,351.0		
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	5,898.6	7,690.1	10,483.0		
Capital account	636.4	685.2	65.3	154.4	117.6	808.0	1,145.3	468.9	327.3	181.3	789.9	1,767.5	1,191.3	1,300.7	957.8		
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	4,707.3	6,389.5	9,525.3		
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	5,766.9	-504.8	576.1		
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	-1,830.7	-3,635.2	-4,883.1		
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	7,597.7	3,130.4	5,459.1		
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	-11,975.2	-1,292.8	-6,416.5		
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	-5,618.7	-1,725.0	-7,766.0		
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	-1,243.2	-1,044.8	-860.5		
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	-4,375.5	-680.2	-6,905.5		
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	-6,356.5	432.3	1,349.5		
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	-29.0	329.1	1,288.5		
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	-6,327.5	103.1	61.0		
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	103.8	42.1	-34.9		
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	-7.3	-59.2		
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	7.0	49.4	24.3		
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	10,811.8	8,144.9	15,400.7		
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	-5,138.4	1,097.6	8,545.5		
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	-866.7	-1,547.0	-279.8		
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	-4,271.7	2,644.6	8,825.3		
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	15,950.2	7,047.3	6,855.2		
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	4,623.7	12,727.1	-1,818.5		
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	11,326.5	-5,679.8	8,673.7		
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	-810.6	931.2	-640.0		
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	4883.9	-1,274.3	1,805.4	3,208.6		
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	-4883.9	1,274.3	-1,805.4	-3,208.6		

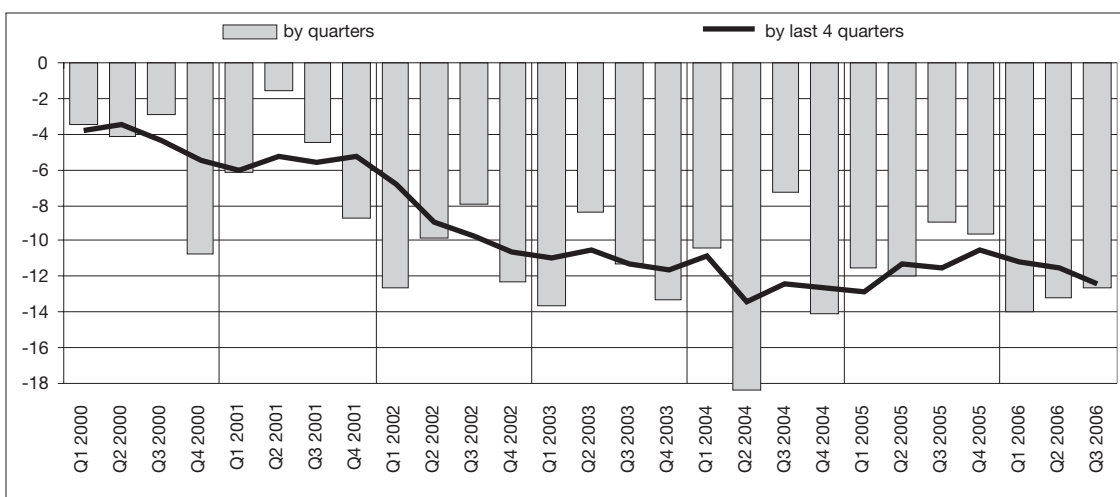


Figure 1. Current account balance (% of GDP)

so far. The surplus on the second largest type of services, namely travel services, decreased 10%. The surplus on other business services, which held the third position, shrank approximately 50%. The structure of the total turnover of the services account remained virtually unchanged: transport services accounted for 42%, travel services for 30% and other business services for 16%.

In the services sector, Estonia's major trading partners were the EU Member States that accounted for 73% of the exports and 76% of the imports. Estonia had the biggest surplus with Finland (2.6 billion kroons) and the biggest deficit with Germany (0.4 billion kroons).

Total exports of goods and services, which are the direct components of GDP, grew slower than imports. As a result, the deficit on the goods and services account increased from 6.4% in the third quarter of 2005 to 8.7% of the expected GDP of the last four quarters in the third quarter of 2006.

The deficit on the **income account** decreased 20%, amounting to 1.4 billion kroons. The income earned by Estonian investors abroad (credit turnover) grew 21% and reached nearly 3.4 billion kroons. Labour income comprised 42% of that and the rest was investment income, 61% 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 4.8 billion kroons. 94% of non-residents' income came from investment income, 70% of which consisted of reinvested earnings. Excluding from the income account reinvested earnings, which involve no actual movement of funds, the income account had an almost 0.6 billion-kroon surplus.

The free movement of workers has been further boosting residents' labour income earned abroad as well as non-residents' income earned in Estonia. The former increased 76% and the latter 87% in the third quarter of 2006, totalling 1.4 and 0.3 billion kroons respectively. As for residents' income from abroad, most of it was earned in Finland, the United Kingdom, Ireland and Sweden. In Estonia, mainly Finnish, Swedish, Polish and Ukrainian residents earned on labour income.

Most of residents' investment income came from the European Union (84%). Residents received investment income predominantly from Latvia and Lithuania, and to a lesser extent from Russia and Germany. The largest share of residents' investment income (63%) belonged to the investors in financial intermediation. The share of the investors in real estate, renting and business activities, as well as in wholesale and retail trade was smaller. The majority of non-residents who earned investment income in Estonia came from the EU Member States (94%). In Estonia, mostly Swedish, Finnish, UK and German investors earned on investment. As regards non-residents' investment income, the bulk of it was earned on financial intermediation, wholesale and retail trade, and manufacturing.

The total surplus on the **current transfers and capital account** almost tripled year-on-year, amounting to 1 billion kroons. The growth can largely be attributed to the capital account (receipts from the EU structural funds and sales of emission quotas). The modest surplus on current transfers was even smaller than the year before.

The surplus on the **FINANCIAL ACCOUNT** increased by nearly a half quarter-on-quarter, constituting 9.5 billion kroons. Foreign capital inflow occurred mainly through other investment and to some extent also through direct investment.

Direct investment inflow was 0.6 billion kroons bigger than outflow. Foreign direct investment in Estonia increased by 5.5 billion and direct investment of Estonian residents abroad by 4.9 billion kroons.

Reinvested earnings accounted for about 60%, other direct investment capital for 26%, and equity capital investment for 15% of the direct investment inflow. Direct investment came from Sweden and Finland for the most part; the share of the European Union was nearly 100%. Over half of direct investment was made in financial intermediation, a fifth in manufacturing and a tenth in construction.

Equity capital investment accounted for 58%, reinvested earnings for 24% and other direct investment capital for 18% in the structure of residents' direct investment abroad. Investment went mainly to Finland, Lithuania and Latvia. The share of the European Union was 82%. Investors in real estate, renting and business activities made approximately a half and financial intermediaries a third of the investment abroad.

The deficit on **portfolio investment** was 6.4 billion kroons. Portfolio investment assets increased by 7.8 billion kroons, quarter-on-quarter. This stemmed from the rise in the assets in general government's debt securities and money market instruments as well as in credit institutions' debt securities. Liabilities grew by 1.3 billion kroons as a result of the increase in the liabilities arising from the equity securities of other sectors.

The net inflow of **other investment** amounted to 15.4 billion kroons. Assets decreased by 8.5 billion kroons, quarter-on-quarter, mostly owing to the decline in the currency and deposits assets of credit institutions. Other investment liabilities grew by 6.9 billion kroons, mainly as a result of the increase in the currency and deposits liabilities of credit institutions and in the loan and trade credit liabilities of other sectors.

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According to revised data, the current account deficit of the second quarter of 2006 was 6.8 billion kroons, i.e. 11.5% of the GDP of the last four quarters.

The preliminary balance of payments for 2006 will be published on the web site of Eesti Pank (<http://www.bankofestonia.info>) on 26 March 2007 at noon.

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