



COMMENTS ON ESTONIA'S PRELIMINARY BALANCE OF PAYMENTS FOR THE SECOND QUARTER OF 2007

- **In the second quarter of 2007, the current account deficit of the balance of payments decreased to 16.6% based on the GDP of the last four quarters, compared to the 17% of the first quarter (see Table 1 and Figure 1)¹.**
- **Based on the same quarter, the current account deficit stood at 14% of GDP in the second quarter.**
- **In absolute value, the deficit amounted to 8.5 billion kroons.**
- **Year-on-year, the surplus on services increased by a fifth and the surplus on current transfers by a fourth.**
- **The deficit in the goods account remained virtually unchanged.**
- **Foreign capital inflow mainly occurred through other investment capital.**
- **The balance of payments reserves remained at the previous year's level.**

The second-quarter slowdown in the growth of domestic demand was accompanied by slightly improving external balance. The deficit in the **goods account** – the largest component in the current account deficit – amounted to 9.7 billion kroons. In terms of volume, it was similar to the deficit recorded in the previous quarter as well as in the second quarter of 2006, reaching 16% of the GDP of the second quarter of 2007. The growth of goods exports outpaced imports both quarter-on-quarter and year-on-year. Exports totalled 32.9 billion and imports 42.6 billion kroons, increasing by 6% and 5%, respectively, year-on-year.

The main groups of export goods included machinery and equipment (mostly electronic products), mineral products, timber and timber products, and metal products. Electronic products were also the largest import articles, followed by transport vehicles, mineral and chemical products. Machinery and equipment, chemical products and transport vehicles posted the largest deficits on the goods account. Timber and timber products posted a surplus.

The share of Estonia's main trading partner – the European Union – grew slightly, comprising 68% of the exports and 76% of the imports of goods. Finland, Sweden, Latvia, Russia and the United States were the largest export partners, and Finland, Germany, Russia, Sweden and Latvia the major import partners.

The surplus on the **services account** increased by a fifth year-on-year and amounted to 4.4 billion kroons. Both the exports and imports of services grew more or less at a similar pace, year-on-year (18–19%). The surplus on the services account was mainly boosted by transport services – the largest type of services – whose surplus increased by 40%. The surplus on transport services was caused by marine, rail as well as road transport. Year-on-year, the services surplus was also boosted by construction services, whose deficit turned into a 0.4 billion surplus, and to a lesser extent by computer, information and financial services. The surplus on travel services and other business services, on the other hand, declined. The surplus on travel services diminished because their exports decreased slightly and imports increased.

The April riots in Tallinn brought along a decline in the exports of freight and passenger transport by rail and road. Nevertheless, the exports of other supporting and auxiliary transport services by rail and road increased. As a result, the surplus on these services remained virtually at the level of the previous quarter.

¹ The current account deficit without reinvested earnings, which involve no actual movement of funds, constituted 10.4% of the GDP of the last four quarters and 5.8% of the second-quarter GDP.

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

Item	2003	2004	2005					2006					2007	
	Total	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2	Q3	Q4	Total	Q1	Q2
Current account	-15,429.4	-18,310.2	-4,115.0	-5,191.2	-3,409.9	-4,637.6	-17,353.7	-7,355.8	-7,847.9	-7,429.0	-9,462.4	-32,095.0	-12,027.8	-8,548.7
Goods and services	-10,046.8	-11,937.6	-2,211.6	-2,710.3	-2,395.1	-3,760.0	-11,077.1	-5,180.2	-5,757.9	-5,939.2	-7,148.1	-24,025.4	-7,177.3	-5,215.7
Goods	-21,522.3	-25,499.0	-4,447.9	-6,334.3	-6,300.3	-6,962.3	-24,044.8	-7,113.8	-9,471.5	-10,007.2	-10,130.9	-36,723.3	-9,530.5	-9,662.3
credit (f.o.b.)	63,443.7	75,199.5	21,341.0	23,531.0	25,278.2	27,821.3	97,971.4	28,496.2	30,976.3	29,774.8	30,919.2	120,166.4	29,556.5	32,914.3
debit (f.o.b.)	-84,966.0	-100,698.5	-25,788.9	-29,865.3	-31,578.4	-34,783.6	-122,016.3	-35,610.0	-40,447.8	-39,782.0	-41,050.1	-156,889.8	-39,087.0	-42,576.6
Services	11,475.5	13,561.4	2,236.3	3,624.0	3,905.2	3,202.3	12,967.8	1,933.6	3,713.6	4,068.0	2,982.8	12,697.9	2,353.2	4,446.6
credit	30,674.0	35,703.4	7,892.4	10,336.4	10,875.6	11,096.2	40,200.7	8,295.8	11,063.0	12,726.8	11,306.1	43,391.8	10,129.7	13,143.6
debit	-19,198.5	-22,142.0	-5,656.2	-6,712.4	-6,970.5	-7,893.9	-27,233.0	-6,362.3	-7,349.4	-8,658.8	-8,323.3	-30,693.9	-7,776.5	-8,697.0
Income	-7,252.0	-7,829.0	-1,865.1	-2,798.3	-1,413.3	-1,000.6	-7,077.3	-2,159.5	-2,615.3	-1,977.9	-2,672.2	-9,424.9	-4,618.8	-3,985.0
credit	3,524.6	5,489.0	1,592.1	1,833.1	2,753.1	2,279.1	8,457.4	2,656.9	3,457.2	3,755.8	3,613.5	13,483.4	3,394.4	3,959.7
debit	-10,776.6	-13,317.9	-3,457.2	-4,631.3	-4,166.4	-3,279.7	-15,534.7	-4,816.4	-6,072.5	-5,733.7	-6,285.7	-22,908.3	-8,013.2	-7,944.7
Current transfers	1,869.4	1,456.3	-38.2	317.4	398.5	123.0	800.6	-16.1	525.3	488.1	357.9	1,355.3	-231.8	652.0
credit	3,380.8	5,252.0	1,209.9	1,440.7	1,596.2	1,645.3	5,892.2	1,483.5	1,872.5	1,843.9	1,962.3	7,162.2	1,463.3	1,762.6
debit	-1,511.5	-3,795.6	-1,248.2	-1,123.3	-1,197.8	-1,522.3	-5,091.6	-1,499.7	-1,347.2	-1,355.7	-1,604.4	-5,806.9	-1,695.1	-1,110.7
Capital and financial account (without reserve assets)	18,552.9	21,454.4	6,135.3	3,077.2	3,445.7	8,799.7	21,457.9	5,591.1	7,891.1	10,290.9	15,462.6	39,235.7	11,538.9	7,435.1
Capital account	977.8	1,149.8	136.8	142.1	240.7	720.7	1,240.3	1,251.6	724.3	1,236.1	1,470.7	4,682.6	421.9	690.4
Financial account	17,575.1	20,304.6	5,998.5	2,935.1	3,205.0	8,079.0	20,217.6	4,339.5	7,166.9	9,054.9	13,991.9	34,553.1	11,117.0	6,744.8
Direct investment	10,716.0	8,739.5	13,103.6	14,514.7	2,949.6	-3,232.4	27,335.5	5,737.3	-607.7	510.9	1,634.2	7,274.7	5,290.8	874.9
Abroad	-2,149.2	-3,388.6	-1,028.5	-2,558.3	-1,671.2	-2,681.5	-7,939.6	-2,050.9	-3,982.1	-5,323.5	-2,350.7	-13,707.1	-3,488.6	-6,776.0
In Estonia	12,865.3	12,128.1	14,132.2	17,072.9	4,620.8	-550.8	35,275.1	7,788.2	3,374.4	5,834.4	3,984.8	20,981.8	8,779.4	7,650.9
Portfolio investment	2,431.6	9,027.1	-5,803.9	-20,462.3	-5,690.0	4,396.9	-27,559.2	-12,620.4	-1,208.7	-6,784.7	3,784.1	-16,829.7	-1,141.2	-2,880.1
Assets	-5,351.6	-4,851.0	-3,675.5	-2,449.3	-4,609.4	59.3	-10,675.0	-5,766.4	-1,835.5	-7,623.6	-344.4	-15,569.9	-3,642.3	-2,069.6
Equity securities	-1,028.9	-2,893.5	-1,373.5	-1,243.1	-1,467.8	-764.5	-4,848.9	-1,231.6	-1,059.8	-685.1	-1,607.6	-4,584.0	-2,197.1	-2,742.2
Debt securities	-4,322.7	-1,957.6	-2,302.0	-1,206.2	-3,141.6	823.8	-5,826.1	-4,534.9	-775.7	-6,938.6	1,263.1	-10,986.0	-1,445.2	672.6
Liabilities	7,783.2	13,878.2	-2,128.4	-18,013.0	-1,080.6	4,337.7	-16,884.3	-6,854.0	626.7	839.0	4,128.5	-1,259.8	2,501.1	-810.6
Equity securities	1,527.0	2,205.2	-9,946.1	-9,640.0	483.6	2,750.3	-16,352.3	-498.4	499.6	839.2	2,897.7	3,738.1	3,209.7	274.5
Debt securities	6,256.2	11,673.0	7,817.8	-8,372.9	-1,564.2	1,587.3	-532.0	-6,355.5	127.2	-0.3	1,230.7	-4,997.9	-708.6	-1,085.0
Financial derivatives	-19.3	-8.3	45.4	-62.8	-74.9	-5.3	-97.6	104.2	43.1	-42.0	-26.9	78.5	-148.9	190.6
Assets	-139.2	-35.1	61.9	-42.9	-24.7	19.3	13.5	96.8	-7.3	-67.5	-202.9	-180.9	-300.4	121.1
Liabilities	120.0	26.8	-16.5	-19.8	-50.2	-24.5	-111.1	7.4	50.4	25.5	176.0	259.4	151.5	69.6
Other investment	4,446.8	2,546.4	-1,346.6	8,945.5	6,020.3	6,919.7	20,539.0	11,118.4	8,940.2	15,370.6	8,600.5	44,029.7	7,116.3	8,559.3
Assets	-2,284.6	-11,168.8	-11,914.9	5,505.8	-2,102.5	-1,861.8	-10,373.4	-5,046.5	1,127.2	8,664.1	-4,410.3	334.6	-4,967.2	-9,362.7
Long-term	-565.7	-6,052.6	-1,828.7	-3,650.3	3,125.4	7,990.1	5,636.5	-804.9	-1,519.3	-197.0	-532.8	-3,054.0	-757.2	-486.4
Short-term	-1,718.9	-5,116.1	-10,086.2	9,156.1	-5,227.9	-9,851.9	-16,009.9	-4,241.6	2,646.5	8,861.1	-3,877.5	3,388.6	-4,210.0	-8,876.3
Liabilities	6,731.4	13,715.1	10,588.3	3,439.8	8,122.8	8,781.6	30,912.4	16,164.9	7,812.9	6,706.5	13,010.8	43,695.1	12,083.5	17,922.1
Long-term	4,309.1	3,740.5	2,712.1	1,897.2	5,309.1	5,478.3	15,396.8	4,667.5	12,787.7	-5,419.1	5,955.4	17,991.5	5,588.3	12,739.6
Short-term	2,422.3	9,974.7	7,856.2	1,542.5	2,813.7	3,303.3	15,515.6	11,497.4	-4,974.7	12,125.6	7,055.4	25,703.6	6,495.3	5,182.5
Errors and omissions	-811.4	281.2	671.1	620.7	8.0	-520.1	779.7	490.4	1,762.1	346.7	-2,215.9	383.2	-244.4	1,169.0
Overall balance	2,312.1	3,425.4	2,691.4	-1,493.3	43.8	3,641.9	4,883.9	-1,274.3	1,805.4	3,208.6	3,784.3	7,523.9	-733.3	55.4
Reserve assets	-2,312.1	-3,425.4	-2,691.4	1,493.3	-43.8	-3,641.9	-4,883.9	1,274.3	-1,805.4	-3,208.6	-3,784.3	-7,523.9	733.3	-55.4

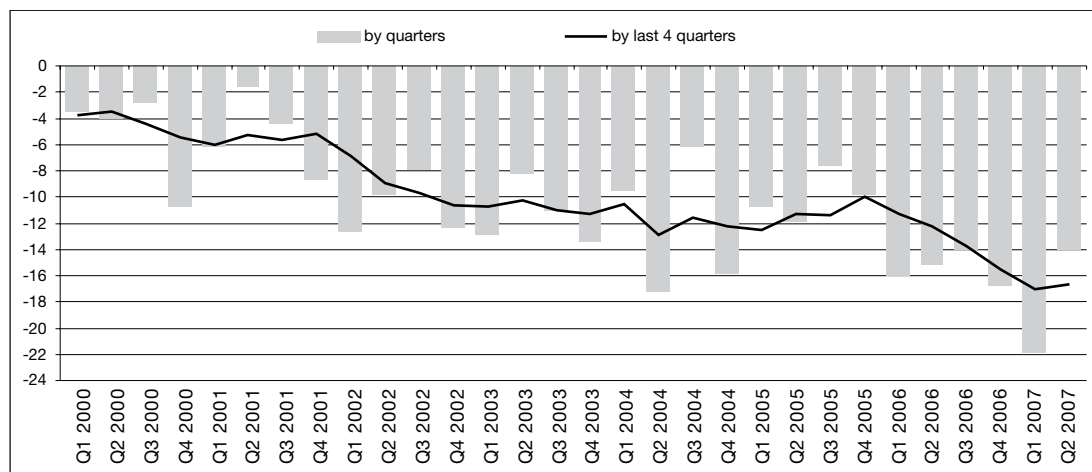


Figure 1. Current account balance (% of GDP)

As regards the structure of services exports, the share of construction services increased robustly (from 2% to 5% of total exports), whereas that of travel services decreased. In services imports, the share of transport, travel and construction services declined, whereas that of business services grew (largely on account of operational lease). The total share of transport, travel and other business services accounted for 85% of both the exports and imports of services.

The share of EU countries reached 72% in the exports and 78% in the imports of services. Estonia had the biggest surplus with Finland (2.6 billion kroons) and the biggest deficit with Cyprus (0.5 billion kroons).

Total exports of goods and services, which are the direct components of GDP, grew slightly faster than imports. Consequently, the deficit decreased by approximately 10% year-on-year and accounted for 8.6% of the second-quarter GDP (11.1% in the second quarter of 2006).

The **income account** deficit increased by a half, amounting to 4 billion kroons. The income earned by Estonian investors abroad grew by 15% and the income earned by non-residents in Estonia increased by nearly a third, reaching 4 and 7.9 billion kroons, respectively. Labour income comprised slightly less than a third of the income earned by residents abroad (i.e. less also year-on-year), the rest being investment income. Half of the investment income was direct investment income. In the second quarter, mostly credit institutions but also companies in other sectors received dividends – altogether 3 billion kroons. Residents' investment income on portfolio and direct investment abroad increased considerably as well and doubled in volume, year-on-year. As regards the income earned by non-residents in Estonia, 97% was investment income, whereas 71% of that was earned on direct investment in Estonia. Reinvested earnings accounted for 60% of non-residents' direct investment income. Non-residents' income on portfolio investment in Estonia increased by 2.6 times and accounted for 14% of the investment income. The share of income on other investment stood at 15%.

87% of residents' investment income came from the European Union: mostly from Latvia, Lithuania and Cyprus. 75% of residents' investment income belonged to the investors in financial intermediation. The majority (89%) of non-residents who earned income on investment in Estonia were mostly from the EU, particularly from Sweden, Finland and the United Kingdom. Much of their investment income came from financial intermediation (42%) and also from manufacturing, wholesale and retail trade, and real estate, renting and business activities.

The volume of **current transfers** received exceeded the volume of transfers paid by approximately 0.7 billion kroons. Both incoming and outgoing current transfers decreased slightly.

The surplus on the **capital and financial account** totalled 7.4 billion kroons in the second quarter of 2007. Capital inflow occurred mainly through other investment and to some extent also through direct investment.

The surplus on the **capital account** was 0.7 billion kroons and was mostly comprised of transfers received by the general government. Last year's large receipts from the sale of intangible fixed assets declined to zero.

The surplus on the **financial account** reached 6.7 billion kroons.

Direct investment inflow was 0.9 billion kroons bigger than outflow. Both foreign direct investment in Estonia as well as Estonia's direct investment abroad were relatively large in volume, totalling 7.7 and 6.8 billion kroons, respectively.

In the second quarter of 2006 reinvested earnings formed 84% of the direct investment in Estonia, whereas in the second quarter of 2007 the structure of direct investment changed significantly. Equity capital investment accounted for a third, reinvested earnings for 41% and other direct investment capital for 25% of the direct investment. 92% of direct investment in Estonia originated from EU countries, with 40% coming from Sweden, a third from Finland and a fifth from Denmark. 63% of direct investment was made in financial intermediation, 19% in manufacturing and 11% in wholesale and retail trade.

The structure of residents' direct investment abroad experienced major changes as well. Equity capital investment reached 6.7 billion kroons, which is over three times more than in the second quarter of 2006. Owing to the distribution of dividends, the retained profits of foreign subsidiaries and affiliated companies decreased considerably. 87% of residents' direct investment went to EU countries: mainly to Latvia (54%) and Lithuania (15%) and also to Russia, Finland and the United Kingdom. The most active foreign direct investors were those of financial intermediation (48%), real estate, renting and business activities (23%), and transport, storage and communications (12%).

The net outflow of **portfolio investment** amounted to 2.9 billion kroons. Assets grew by 2.1 billion kroons, whereas liabilities declined by 0.8 billion kroons. The growth in assets was largely driven by the 2.7 billion kroon increase in assets invested by investment funds in equity securities. Liabilities decreased primarily due to a decline in general government's debt security liabilities.

The net inflow of **other investment** remained at the level seen in the previous quarters, totalling 8.6 billion kroons. Assets (mostly short-term) increased by 9.4 billion and liabilities (mostly long-term) by 17.9 billion kroons. The growth of assets mainly stemmed from the increased volume of loans issued to non-residents by credit institutions and the higher volume of deposits with foreign banks. The growth of liabilities was also driven by credit institutions whose loan liabilities increased by 14.5 billion kroons.

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According to revised data, the current account deficit of the first quarter of 2007 was 12 billion kroons, i.e. 17% of the GDP of the last four quarters².

The preliminary balance of payments for the third quarter of 2007 will be published on the web site of Eesti Pank (<http://www.bankofestonia.info>) on 27 December 2007 at noon.

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² The revision was due to the adjustments introduced during the specification of some large-scale transactions which were primarily related to the income account and mainly to the recognition of capitalization issues by companies in portfolio investments. According to international standards, the balance of payments shall recognise capitalization issue to non-residents on disposable owner's equity both under the income of the current account and under equity capital in the financial account. Different from direct investments, in the case of which foreign direct investors' share of income on disposable owner's equity is recognised on accrual basis as reinvested earnings, no such current calculations are kept for portfolio investments – the share of income belonging to portfolio investors is recorded under the income account upon paying out dividends.