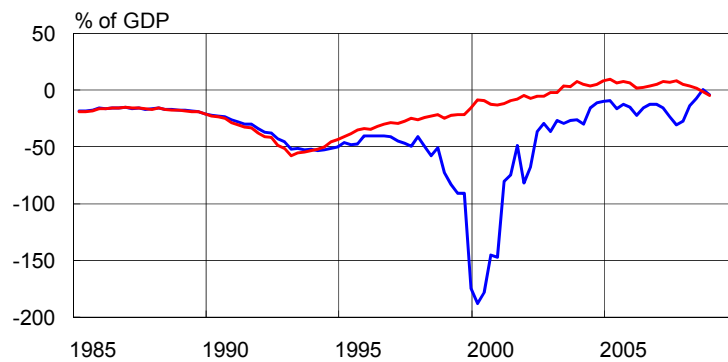


Finland's Balance of Payments

Preliminary Review • 2008

Finland's net international investment position
(assets – liabilities), 1985–2008



— Net international investment position
— Net international investment position excl. equity items

Sources: Bank of Finland and Statistics Finland.



Bank of Finland

Financial Markets and Statistics

Statistics

29.5.2009

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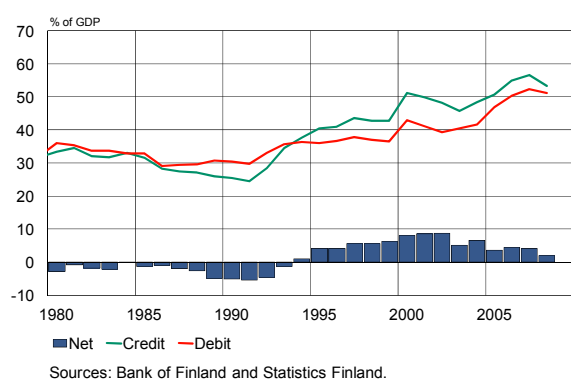
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1 Overview of Finland's balance of payments and international investment position

In 2008, the current account surplus contracted by half from the previous year, amounting to no more than about 2% of GDP. The year was exceptional especially for portfolio investment, as falling share prices and sales of securities reduced external portfolio assets and liabilities.

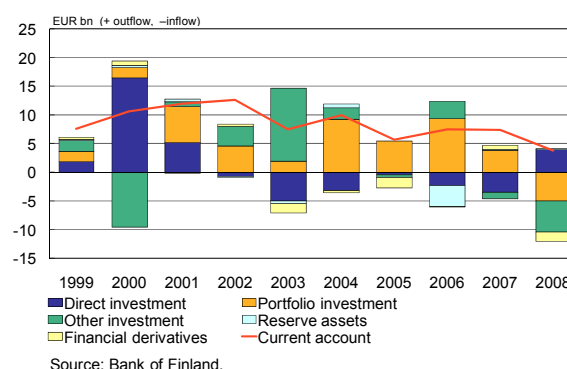
The current account surplus amounted to EUR 3.8 billion in 2008, representing about 2% of GDP. The surplus was cut by half from the previous year. However, the weakening of the current account did not start until the latter part of the year, as the surplus of earlier in the year was still generated as before. The main factors contributing to the retrenchment of the surplus can be seen in the deterioration of both goods trade and the income account. The largest items on the income account are inward and outward flows in interest and dividend payments.

Chart 1. Current account credits and debits, 1980–2008



In 2008, inflows of capital amounted to EUR 7.8 billion. These capital inflows were mainly related to portfolio investment and deposits, as portfolio and deposit assets decreased and portfolio and deposit liabilities increased at the same time. The year was highly exceptional for portfolio investment in particular owing to the situation where inflows of capital were higher than outflows, last seen in 1994. Specifically employment pension funds and mutual funds reduced their holdings of foreign securities. The central government and credit institutions other than banks, in turn, were responsible for an increase in portfolio liabilities. On the other hand, the central government also increased its holdings of foreign securities.

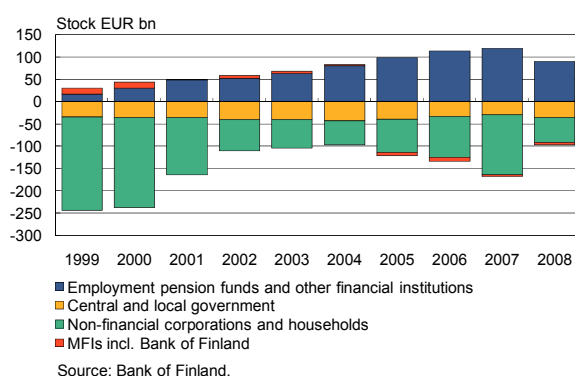
Chart 2. Capital movements by investment type, 1999–2008



The stock of employment pension funds' holdings of foreign securities declined for the first time since 1996, when these pension funds started to invest in foreign securities. The fall in stock was partly due to securities sales by employment pension funds, but mainly resulted from valuation changes in securities. Central government net liabilities (external liabilities – assets) grew by some EUR 5 billion, mainly on account of a decline in external deposit assets.

By contrast, net liabilities of non-financial corporations contracted in 2008 to less than half from the previous year, because of a fall in the market values of Finnish listed company shares.

Chart 3. Finland's external assets and liabilities by sector, 1999–2008



Direct investment witnessed a switch in the direction of capital flows in 2008, as there was a net outflow of capital for the first time in six years.

Finland's net international investment position was almost close to balance at the end of 2008, as there were nearly equal amounts of external assets and liabilities. Also, the net international investment position excluding equity items was practically close to balance.

Chart 4. Finland's net international investment position (assets – liabilities), 1985–2008

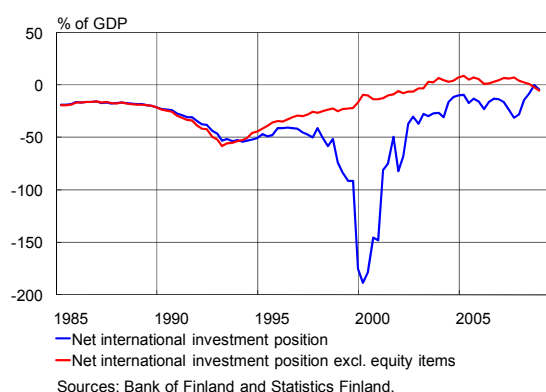


Table 1. Finland's external assets and liabilities by investment type in 2008

| EUR m | Investment stock, 31 Dec 2007 | Net capital flows, 2008 | Exchange rate and other valuation changes, 2008 | Investment stock, 31 Dec 2008 |
|------------------------------------|----------------------------------|----------------------------|---|----------------------------------|
| Direct investment ¹ | 16 076 | 3 979 | -895 | 19 161 |
| Abroad | 78 672 | 1 112 | 2 507 | 82 292 |
| In Finland | 62 596 | -2 867 | 3 402 | 63 131 |
| Portfolio investment ² | -83 971 | -4 939 | 46 198 | -42 712 |
| Assets | 173 916 | -2 001 | -41 099 | 130 816 |
| Liabilities | 257 887 | 2 938 | -87 297 | 173 528 |
| Other investment ² | 10 529 | -5 466 | 3 546 | 8 609 |
| Assets | 84 426 | 6 089 | 3 317 | 93 832 |
| Liabilities | 73 897 | 11 555 | -229 | 85 223 |
| Financial derivatives ² | 1 561 | -1 587 | 986 | 961 |
| Reserve assets | 5 695 | 192 | 107 | 5 994 |

¹ Abroad – In Finland.

² Assets – liabilities.

Source: Bank of Finland.

2 Current account

The current account surplus was cut by half in 2008. The main factors underlying this contraction were both the weakening of goods trade and the income account. The balance of trade deteriorated throughout the year, with the exception of a few months. The trade surplus finally settled at about a third lower than in 2007. The income account deficit continued to widen and was EUR 1 billion larger than in 2007.

2.1 Current account in brief

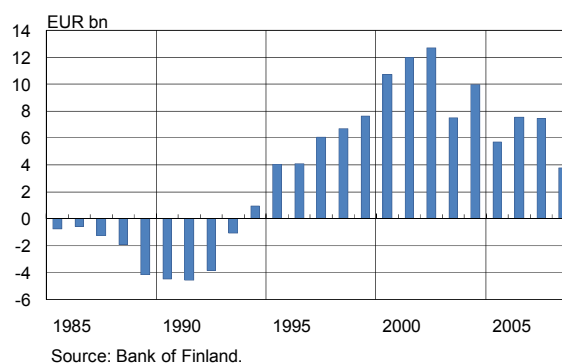
The current account surplus remained at EUR 3.8 billion in 2008, compared to almost EUR 7.5 billion a year earlier. The current account has been showing a surplus for the last 15 years, and this level observed in 2008 was last seen in the middle of the 1990s. The reduction of the current account surplus stemmed from the balance of trade and the income account that was in sizeable deficit.

Table 2. Current account, 2004–2008

| EUR m | | 2004 | 2005 | 2006 | 2007 | 2008 |
|-------------------|--------|--------|--------|--------|--------|--------|
| Current account | Net | 9 969 | 5 697 | 7 554 | 7 455 | 3 789 |
| Goods | Net | 10 245 | 7 698 | 9 133 | 8 746 | 6 192 |
| | Credit | 49 125 | 52 661 | 61 697 | 65 780 | 65 605 |
| | Debit | 38 880 | 44 963 | 52 564 | 57 033 | 59 412 |
| Services | Net | 490 | -583 | -877 | 720 | 778 |
| | Credit | 12 212 | 13 666 | 13 945 | 17 017 | 16 707 |
| | Debit | 11 722 | 14 249 | 14 822 | 16 297 | 15 929 |
| Income | Net | 142 | -245 | 640 | -626 | -1 623 |
| | Credit | 10 560 | 11 580 | 14 620 | 17 251 | 15 193 |
| | Debit | 10 418 | 11 825 | 13 979 | 17 877 | 16 816 |
| Current transfers | Net | -908 | -1 173 | -1 343 | -1 386 | -1 559 |
| | Credit | 1 598 | 1 609 | 1 551 | 1 614 | 1 614 |
| | Debit | 2 506 | 2 781 | 2 893 | 3 000 | 3 173 |

Source: Bank of Finland.

Chart 5. Finland's current account, 1985–2008



Source: Bank of Finland.

In goods trade, the value of exports remained almost the same as a year earlier, whereas the value of imports increased by 4%.¹ The relative share of services trade of the current account has remained fairly stable in recent years. In 2008, the services account recorded a surplus of EUR 0.8 billion.

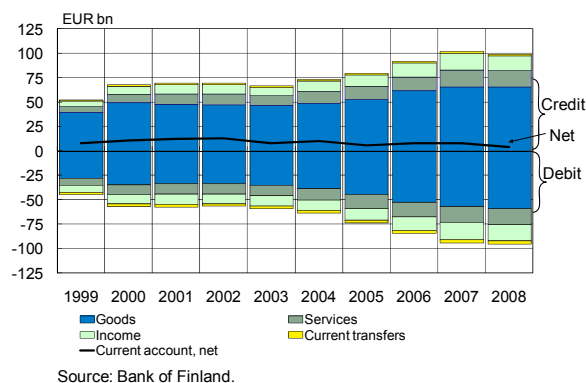
Inward income has increased over the last four years by more than 40%. On the other hand, outward income has grown by even more, ie over 60%. Income transfers mainly comprise investment income such as interests and dividends, as well as compensation of employees.

Changes in current transfers were moderate in 2008. There was an accrued deficit of EUR 1.6 billion, which is just under EUR 200 million more than in 2007. The general government sector recorded a current transfer deficit of EUR 2.0 billion, while other

¹ BOP goods trade data differ from the Board of Customs' foreign trade statistics because of freight and insurance cost adjustments: in BOP statistics, the share of foreign carriers and insurers is deducted from the Board of Customs' cif-based goods imports and entered in transportation and insurance costs. In 2008, 4.9% and 0.2% of goods imports was transferred to transportation and insurance costs respectively.

sectors posted a surplus of EUR 0.4 billion. In all, Finland received EUR 1.6 billion in current transfers from abroad, and paid almost EUR 3.2 billion abroad. A significant part of current transfers consists of payments between Finland and the EU.

Chart 6. Distribution of credit and debit in current account, 1999–2008



2.2 Goods, services and investment income

In contrast to growth in previous years, exports of goods declined slightly in 2008. The main reason for the weak performance was the collapse in exports in November and December 2008. In November, the value of exports dropped by nearly 20% and in December by more than 15% compared with the corresponding value in the previous year. Overall, November and December absorbed the value growth of EUR 1.7 billion in goods exports accrued in the whole period of January to October.

Growth in the value of goods imports also remained lower than in previous years, but still continued in 2008. In the first half of the year, the value of imports was largely boosted by a strong, over 40%, rise in the price of crude oil. In October, the price of oil fell to the level seen a year earlier and growth in the import value came to a halt at the same time. As was the case in goods exports, also goods

imports experienced a collapse in value in the period November to December. The value of imports declined by 13% and 15%, respectively, for November and December, from the previous year's corresponding values. Value growth in goods imports from January to October amounted to EUR 3.7 billion, of which the collapse occurred in November and December eroded EUR 1.3 billion.

Chart 7. Annual change in value of goods trade, 1999–2008

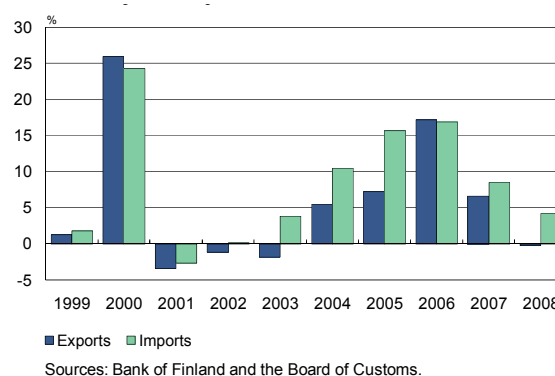
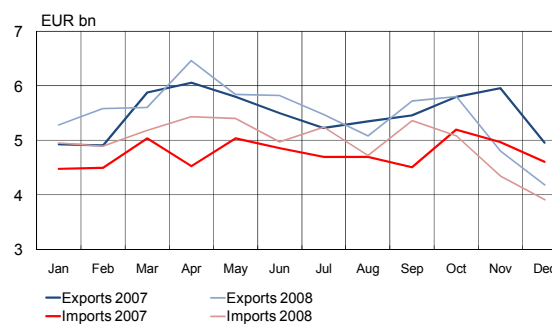


Chart 8. Finnish trade in goods, monthly data, 2007–2008

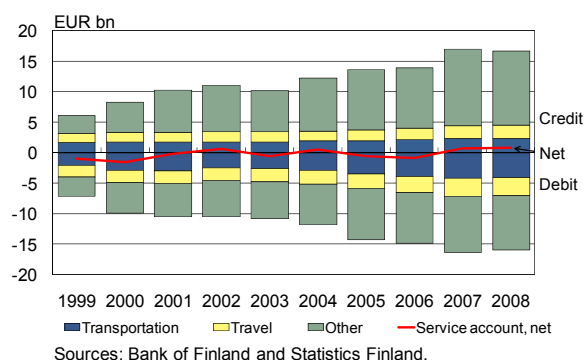


The services account posted a surplus of EUR 0.8 billion in 2008. The change with respect to the previous year was small. The value of service income fell by almost 2% and that of service expenditure by more than 2% from the previous year.

Transportation services have been in deficit since the 1980s. In 2008, the deficit was almost EUR 1.7 billion, which is 7% less than a year ago. The value of

exports and imports of transportation services amounted to EUR 2.4 billion and EUR 4.1 billion respectively. The BOP transportation services comprise sea, air and other transport and the related freight and insurance costs.²

Chart 9. Current account in 1999–2008: breakdown of services exports and imports



Income from travel to Finland increased slightly more than expenditure on travel abroad in 2008. Income from travel services totalled EUR 2.1 billion, which is a good 3% more than a year earlier. Expenditure on travel services, in turn, amounted to EUR 3 billion, about 2% more than a year ago.

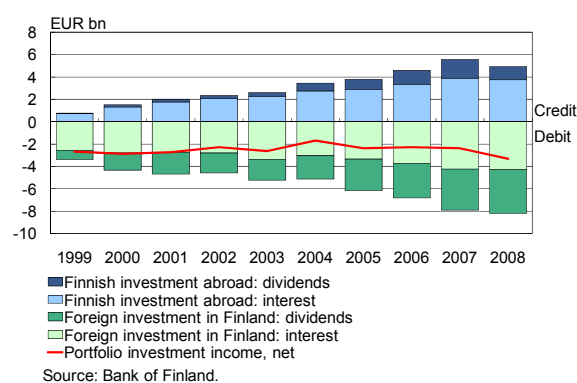
Income from other services totalled EUR 12.2 billion in 2008. This means a reduction of some 3% with respect to the previous year. Expenditure on other services declined by nearly 4% from the previous year. Other services were imported to the value of EUR 8.9 billion.

More than 80% of income from other services is composed of other business services and IT services. Other business services include, for example, merchandising and related services, leasing services and internal services within international groups. More than 90% of expenditure on other services is merely composed of other business services, IT services as well as royalties and licences.

² See footnote 1.

The income account posted a deficit of EUR 1.6 billion in 2008. Compared with the previous year, the deficit was about 1 billion larger. Dividends received from Finnish portfolio investment abroad declined by 28% from the year ago level. Interests received from portfolio investment decreased by less. In 2008, interest income paid to Finnish investors on portfolio investment abroad amounted to EUR 3.7 billion, which is however almost 4% less than a year earlier.

Chart 10. Interest and dividends on portfolio investment, 1999–2008

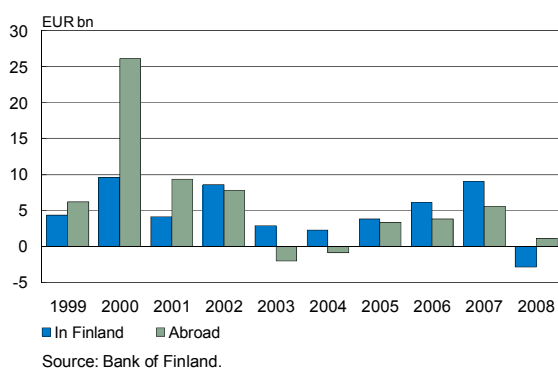


Interests and dividends paid to foreign investors on portfolio investment in Finland totalled EUR 8.2 billion in 2008. Outward dividend payments in 2008 amounted to EUR 3.9 billion, which is almost 7% more than the year earlier figure. Interest expenditure on portfolio investment increased more moderately, recording 1% growth. In 2008, foreign investors were paid EUR 4.3 billion worth of interest income on portfolio investment in Finland.

3 Direct investment

In 2008, there was a net outflow of EUR 4 billion in direct investment. Direct investment registered an outflow of EUR 1.1 billion, and foreign investors repatriated EUR 2.9 billion worth of capital invested in Finland.

Chart 11. Direct investment, net capital flows 1999–2008

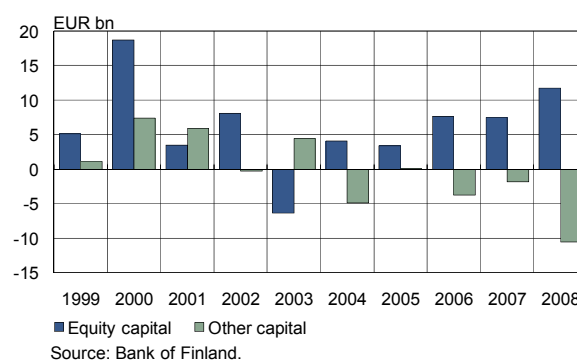


In 2008, capital repatriations abroad from direct investment in Finland amounted to EUR 2.9 billion. This does not, however, mean that foreign companies would have started major withdrawals of capital from Finnish investments. The repatriation of capital is explained by only a few individual foreign groups' internal ownership arrangements, where holdings were dissolved that had existed via Finnish subsidiaries in other foreign subsidiaries. These arrangements reduced both direct investment inflows and outflows in the corporate sector. If these ownership arrangements are excluded, foreign investors imported capital for Finnish investments, albeit clearly less than in the previous year, which saw capital inflows of EUR 9 billion. No major corporate acquisitions occurred in

2008 that would have increased capital inflows, as in 2007.

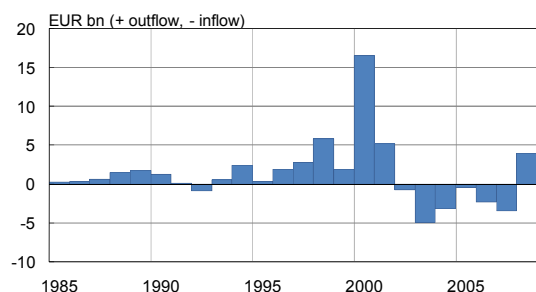
The direct investment outflow amounted to EUR 1.1 billion. In the absence of the above ownership arrangements, the outflow would have been slightly larger than in the previous year, when an outflow of EUR 5.6 billion was recorded. In 2008, equity and other capital flows were considerable and opposite in direction. Equity investments amounted to EUR 11.7 billion, whereas other capital investments were cut down by EUR 10.6 billion. Large foreign corporate acquisitions were financed by capital borrowed from foreign group enterprises. In addition, loans to foreign group enterprises were converted into equity.

Chart 12. Finnish direct investment abroad, outflow by type of capital, 1999–2008



International groups' financial arrangements between foreign and Finnish units are also reflected in equity and other capital flows in direct investment. Outward direct investment has recorded significant repatriations of other capital to Finland particularly since the early years of the present decade, when capital was channelled to Finland via intra-group foreign finance companies. In 2008, the inflow of other capital reached an all-time high.

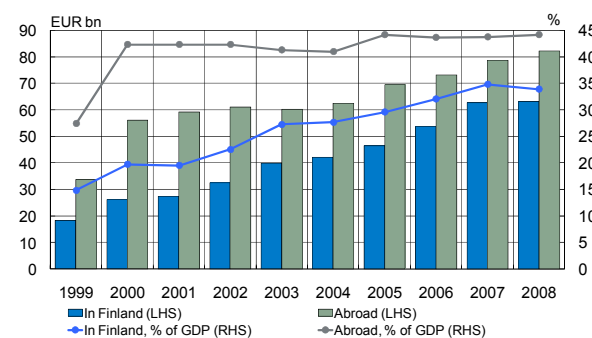
Chart 13. Capital movements in direct investment (investment abroad – investment in Finland) 1985–2008



Source: Bank of Finland.

An examination of the combined effect of inward and outward direct investment flows on foreign capital movements shows that there were outflows of capital in direct investment from the latter part of the 1970s until 2001. Finnish direct investment abroad outpaced foreign direct investment in Finland. In 2002–2007, there was an inflow of capital in direct investment. Foreign investors imported capital into Finland in connection with large corporate acquisitions, and service-sector companies increased their popularity as investments. Although Finnish companies continued to expand their foreign operations, outward direct investment was lower than inward direct investment. Direct financing by Finnish parent companies to foreign subsidiaries has decreased, and financing is increasingly being handled by groups' foreign funding centres and other foreign group enterprises, which is not reflected in Finnish direct investment figures. Capital movements again reversed in 2008, when there was a net outflow of capital in direct investment.

Chart 14. Direct investment, stock 1999–2008



Sources: Bank of Finland and Statistics Finland.

At the end of 2008, the value of the stock of inward and outward foreign direct investment totalled EUR 63 billion and EUR 82 billion respectively. The stock of inward investment accounted for 34% and that of outward investment 44% of GDP.

Income flows to Finnish investors on direct investment abroad have exceeded income paid to foreign investors on direct investment in Finland ever since the late 1990s. The current account direct investment income has therefore contributed to growth in the current account surplus. In 2008, the contribution of direct investment income on current account was approximately EUR 1.2 billion.

4 Portfolio investment

The stock of both outward and inward portfolio investment³ started to decline in the course of 2008. Finnish portfolio investment abroad totalled EUR 131 billion, and foreign portfolio investment in Finland, in turn, totalled EUR 174 billion. The collapse in the stocks mainly resulted from lower market values, although capital flows did fall considerably from 2007.

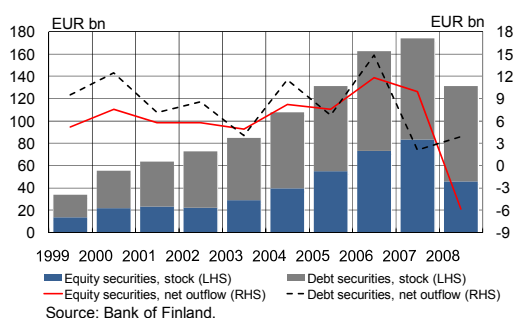
4.1 Finnish portfolio investment abroad

Finnish portfolio investment abroad declined by a quarter. The upward trend in the investment stock reversed, and the stock amounted to EUR 131 billion at the end of 2008 (Chart 15). The net outflow turned negative by a total of EUR 2.0 billion, ie repatriations of capital to Finland outpaced capital invested abroad during the year. Investment flows started to reverse particularly towards the end of the year.

The meltdown experienced in the international securities markets in 2008 was reflected in Finnish portfolio investment abroad. The retrenchment of the investment stock mainly stemmed from valuation changes rather than sales of invested assets (Table 3). The stock of equity investment halved from the end of 2007, staying at EUR 16.5 billion.

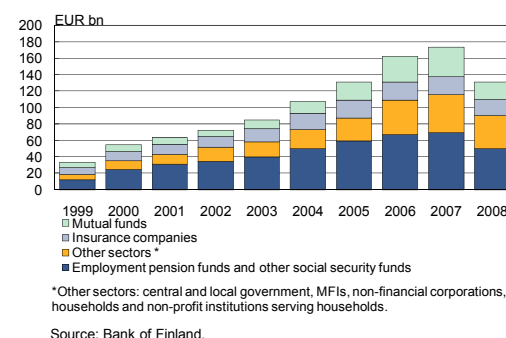
³ The statistical compilation of balance of payments portfolio investment data migrated to a security-by-security reporting system, starting from the December 2008 stock data. Therefore, the 2008 figures are not fully comparable with those of the previous years. Box 1 provides a more detailed overview of the statistical reform.

Chart 15. Finnish portfolio investment abroad, 1999–2008



More than half of outward portfolio investment is held in bonds and notes. The stock of bonds and notes remained almost at the year ago level, ie at EUR 80 billion, as particularly institutions investing pension assets added debt instruments into their portfolios. As the values of investments dropped, employment pension funds – under pressure from capital adequacy requirements – disposed of foreign equities in particular, and their foreign investment stock as a whole contracted by 28%, ie to EUR 50 billion (Chart 16). Of employment pension assets invested abroad, 10% were held in equities, 34% in mutual fund shares, 53% in bonds and notes, and 2% in money market instruments.

Chart 16. Finnish portfolio investment abroad by sector: stock 1999–2008



*Other sectors: central and local government, MFIs, non-financial corporations, households and non-profit institutions serving households.

Source: Bank of Finland.

Table 3. Portfolio investment abroad and in Finland by type of capital, 2008

EUR m

| | Investment stock 31 Dec 2007 | Net capital flows, 2008 | Exchange rate and other valuation changes, 2008 | Investment stock 31 Dec 2008 | Dividends and interest, 2008 |
|--|---------------------------------|----------------------------|--|---------------------------------|------------------------------------|
| Finnish portfolio investment abroad | | | | | |
| Equity securities | 41 355 | -5 095 | -19 728 | 16 532 | 875 |
| Mutual fund shares | 41 744 | -745 | -12 012 | 28 986 | 338 |
| Bonds and notes | 85 333 | 5 438 | -9 890 | 80 881 | 3 563 |
| Money market instruments | 5 484 | -1 598 | 532 | 4 417 | 130 |
| Total | 173 916 | -2 001 | -41 099 | 130 816 | 4 908 |
| Foreign portfolio investment in Finland | | | | | |
| Equity and mutual fund shares | 156 177 | -1 181 | -83 714 | 71 283 | 3 935 |
| Bonds and notes | 83 543 | 1 562 | -3 883 | 81 222 | 3 817 |
| Money market instruments | 18 167 | 2 557 | 300 | 21 023 | 465 |
| Total | 257 887 | 2 938 | -87 297 | 173 528 | 8 218 |

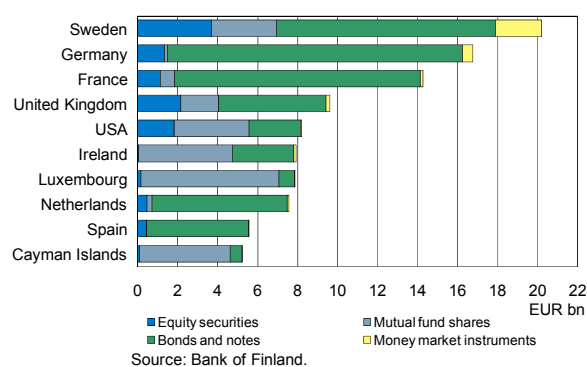
Source: Bank of Finland.

Employment pension funds accounted for 38% of Finland's foreign portfolio assets at the end of 2008. By contrast, the relative share of banks and insurance companies of the foreign investment stock grew slightly, following their new investments in bonds and notes in particular. Impairments caused households' foreign portfolio holdings to plunge to EUR 3.8 billion.

The geographical breakdown of Finnish portfolio investment abroad did not change significantly from the situation in 2007. Most Finnish investments were placed in Swedish, German and French securities (Chart 17). Holdings of Swedish bonds and notes amounted to EUR 10.9 billion. Finnish investors had their largest bond and note holdings in German and French assets, in the amount of EUR 14.7 billion and EUR 12.3 billion, respectively, while investments in these countries were mainly focused on government debt securities. Equity investments attracted to the UK, to the value of EUR 2.2 billion, were placed in equities issued by the corporate sector. The majority of mutual

fund shares held by households were in funds registered in Luxembourg, Sweden and Ireland.

Chart 17. Geographical breakdown of Finnish portfolio investment abroad: stock end-2008



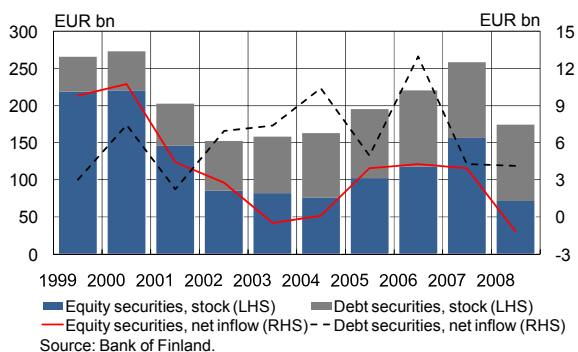
Source: Bank of Finland.

4.2 Foreign portfolio investment in Finland

At the end of 2008, foreign investors owned EUR 174 billion worth of Finnish securities, as measured in terms of market values. The stock of Finnish equities held by foreign investors was cut by half to EUR 71.3 billion, while the stock of debt securities remained

almost at the level of the previous year, EUR 102.2 billion. Following the collapse in equity values, the relative share of debt securities of Finnish portfolio liabilities expanded from 40% at the end of 2007 to approximately 60% (Chart 18).

Chart 18. Foreign portfolio investment in Finland, 1999–2008

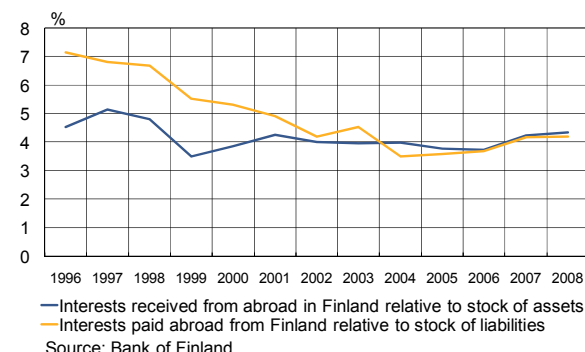


The net portfolio investment inflow totalled EUR 2.9 billion, ie foreign investors' purchases of Finnish securities exceeded their capital repatriations from Finland. Equity investment recorded a net outflow in capital repatriations, whereas capital was imported into Finland for investment in debt securities. The stock of liabilities held in money market instruments grew to EUR 21.0 billion, particularly as a result of capital inflows into MFI certificates of deposits and short-term treasury bills. By contrast, the stock of bonds and notes issued by non-financial corporations declined by 10%, as a result of capital repatriations abroad from long-term debt securities. Non-financial corporations' portfolio liabilities totalled EUR 12.5 billion at the end of 2008. Approximately half of Finland's foreign portfolio liabilities consist of government debt.

Income accruing to Finnish investors on portfolio investment abroad decreased to EUR 4.9 billion, while outflows of investment income were higher than in the previous year, totalling EUR 8.2 billion. Relative to the stock of liabilities, outward interest payments have historically been higher than inward interest payments, but in the present decade the imputed cost of debt for Finnish borrowers has come down to the same level as

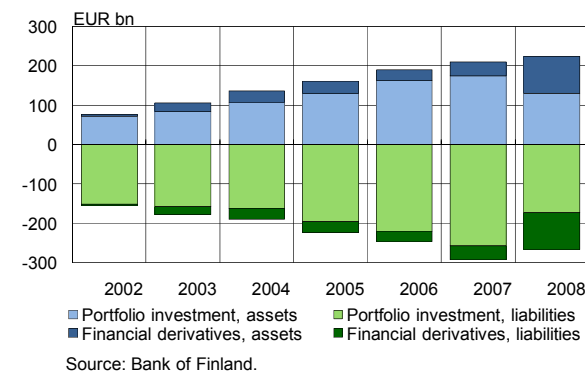
the expected rate of return on investment in debt securities (Chart 19). This is partly explained by the greater emphasis placed on both shorter maturities and lower-risk issuers in the stock of liabilities in recent years.

Chart 19. Implied interest rates in % of stock of liabilities, 1996–2008



Although portfolio investment stocks contracted in 2008, financial derivatives transactions concluded by Finnish investors with foreign counterparties and on foreign derivatives exchanges led to the combined investment position rising to the same level as in 2007 (Chart 20). The volume of financial derivatives has grown year after year, with the value of gross derivatives assets and liabilities reaching EUR 93.2 billion and EUR 93.0 billion, respectively, at the end of 2008. The net value thus remained at EUR 0.3 billion.

Chart 20. Portfolio investment and financial derivatives, 2002–2008



Box 1. New statistical methods for reporting portfolio investment

The turn of the year witnessed a change in data collection and statistical compilation methods applied to balance of payments and international investment position portfolio investment data. The aggregate-based approach to data collection, applied since the early 1990s, was abandoned and a changeover to a security-by-security reporting system was introduced. Data still continues to be collected from the same sources (eg institutional investors, book-entry registrars and securities issuers), but reporting agents no longer need to classify their data by instrument, country or sector. Instead of aggregated and categorised data, reporting agents currently report the volumes of all securities held in their portfolios, on a security-by-security basis, at the level of ISIN codes (ISIN= International Securities Identification Number, ISO standard 6166).

The new system means classification and aggregation of data on a centralised basis at central bank. An important tool in compiling statistics is the centralised securities database, developed by the European Central Bank (ECB), which contains classification details and market information on almost all securities that are actively traded worldwide. The database enables the Bank of Finland to enrich the security-specific data collected from reporting agents and to classify the investments by instrument, country and sector. In connection with the migration to the new data reporting system, the Bank of Finland also abandoned the direct collection of flow and income data from reporting agents. Going forward, investment flows and income will be calculated and aggregated on the basis of enriched security-specific data.

Underlying these changes to data collection and statistical compilation methods are the provisions contained in the ECB's Guideline concerning balance

of payments statistics. By harmonising the compilation methods for balance of payments portfolio investment data across euro area countries, the ECB seeks to improve the quality of statistics. Another aim of the security-by-security data reporting system has been to make it more flexible to introduce changes in statistical compilation. Detailed basic data at the level of ISIN codes, combined with a securities database of broad coverage, provides an opportunity of quickly responding to statistical requirements that may arise in the preparation of central bank policy. A third incentive to reforming the methods has been the endeavour to reduce the reporting burden placed on reporting agents. Although the volume of reported data increases in connection with the changeover from data aggregation to security-by-security data collection, the production of security-specific data is considerably easier and cheaper for reporting agents than aggregate-based reporting, which in most cases involves a lot of work in terms of calculation, classification and verification.

The methodological revision of portfolio investment data collection led to changes in the levels of Finland's international investment position; however, these are very small and key time series continue unbroken. By contrast, data broken down by instrument, sector or country does display minor shifts in classification.

The revised method for portfolio investment data reporting implemented at the turn of the year applied to all balance of payments reporting agents except for monetary financial institutions (MFIs). MFIs will implement a corresponding data collection reform in 2010 in the context of other changes to the reporting framework.

Appendix 1. Charts

Chart 21. Current account and trade account, 1960–2008

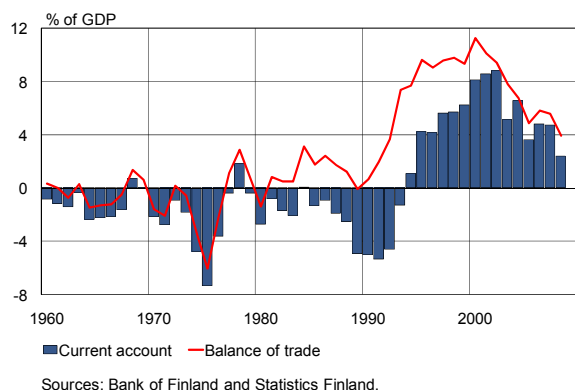


Chart 24. Expenditure on travel abroad, 2004–2008



Chart 22. Percentage share of 10 most important export countries in total goods exports value, 2007 and 2008



Chart 25. Export and import price indices, 1999–2008

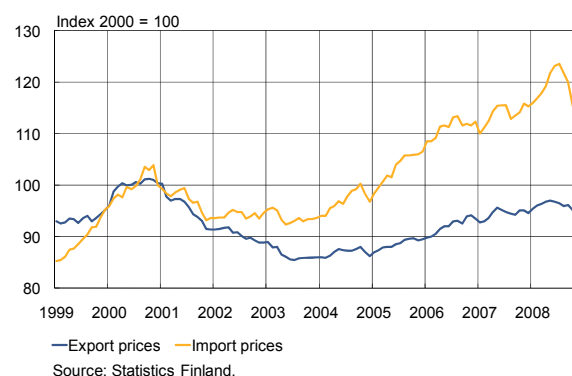


Chart 23. Income from travel to Finland, 2004–2008

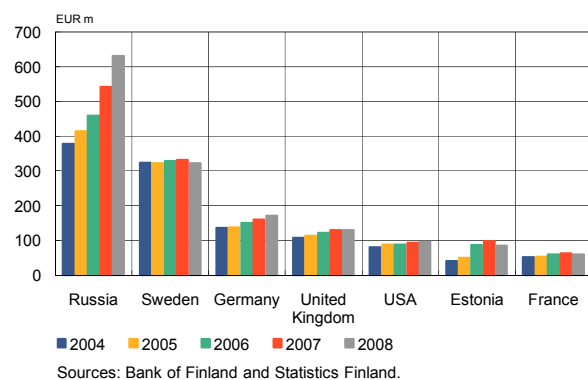
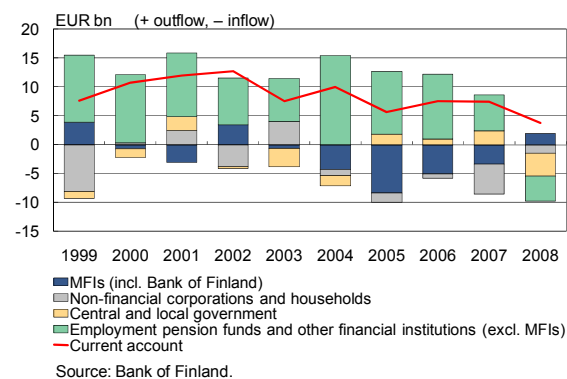


Chart 26. Capital movements by sector, 1999–2008



FINLAND'S BALANCE OF PAYMENTS

Chart 27. Direct investment, stock by type of capital 1999, 2003 and 2008

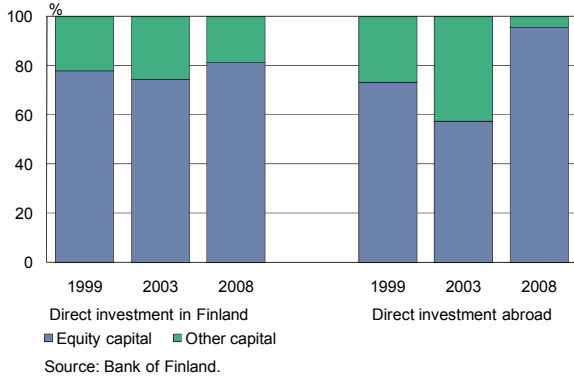


Chart 30. Foreign portfolio investment in Finland by sector: investment stock of debt securities, end-2008

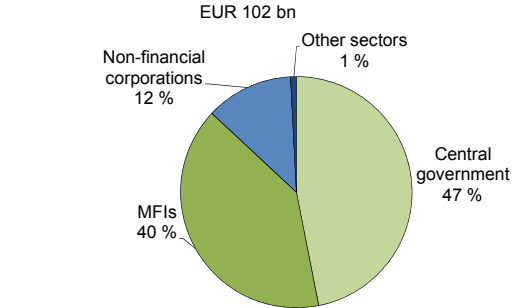


Chart 28. Direct investment income, 1999–2008

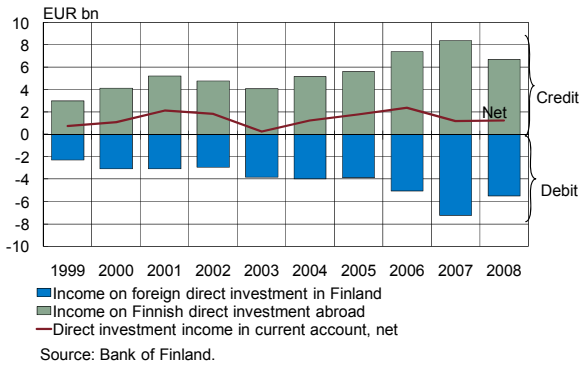


Chart 31. Portfolio investment, shares and mutual fund shares, stock and dividends 1999–2008

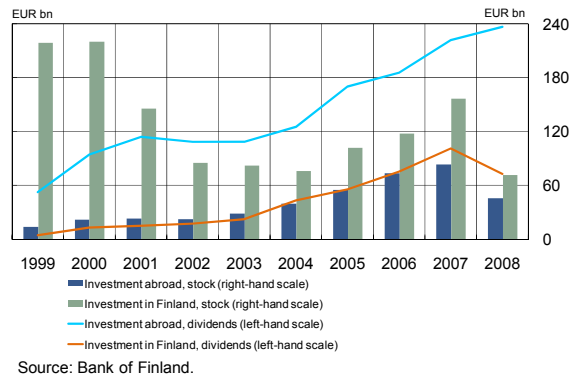


Chart 29. Finnish portfolio investment abroad by sector: investment stock, end-2008

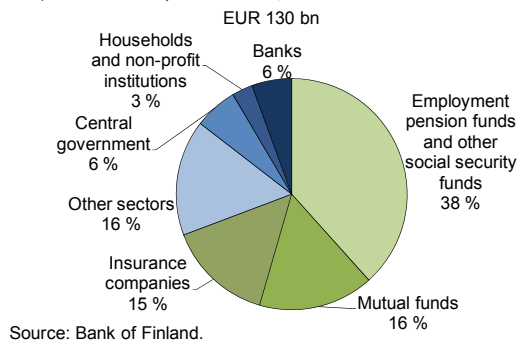


Chart 32. Portfolio investment, debt securities, stock and interest 1999–2008

