Japan's Balance of Payments for 1999

I. Summary

A. Overall Trends[1]

In the balance of payments for 1999, the current account surplus registered ¥12.2 trillion, while the capital and financial account showed a net outflow of ¥5.6 trillion, down sharply from a net outflow of ¥17.3 trillion in 1998 which primarily reflected movements in the financial account. The net increase in reserve assets marked ¥8.8 trillion, the largest expansion ever.

B. The Current Account

The current account surplus declined for the first time since 1996, falling 22.7 percent from the previous year. This was largely due to the substantial decrease in the surpluses of the trade balance and the income balance (Table 1 and Chart 1).

The value of exports slipped 6.3 percent from the previous year, reflecting the yen's appreciation. Exports to Asia, however, rebounded and increased slightly due to the growth in exports of capital goods and parts related to electronics and information technology (IT).

The value of imports also declined by 3.5 percent year on year. However, the volume of imports, in particular those from Asia, surged 9.6 percent from the previous year. This reflected (1) higher domestic production and sales of IT-related products, and (2) a greater penetration of imported goods in the domestic markets facilitated by Japanese manufacturers' shifting of production bases overseas.

The income surplus shrank for the first time since 1994. This was partly due to (1) the decrease in the surplus in direct investment income prompted by the worsening profits of the overseas subsidiaries and branches of Japanese corporations, and (2) the narrowed surplus in portfolio investment income resulting from erosion of income value by the yen's appreciation, as well as the deficit registered in interest rate swaps.

C. The Capital and Financial Account

Investment in Japanese equities by nonresidents registered net purchases of ¥11.4 trillion, while inward direct investment by foreign corporations showed a net inflow of ¥1.4 trillion, both marking a record

Table 1
Current Account

bil. yen

	1999	Changes from a year earlier	98
Current account	12,197.2	–3,587.4	15,784.6
Goods and services	7,871.9	–1,657.9	9,529.9
Trade balance	14,054.0	–1,930.4	15,984.4
Exports	45,768.8	–3,097.7	48,866.5
Imports	31,714.8	–1,167.3	32,882.0
Services	–6,182.1	+272.5	–6,454.6
Transportation	–875.3	+58.3	–933.6
Travel	–3,325.8	–51.9	–3,273.9
Other services	–1,981.0	+266.1	–2,247.1
Income	5,709.4	–1,691.6	7,401.1
Direct investment income	433.8	–864.0	1,297.8
Portfolio investment income	4,065.0	–1,468.0	5,533.0
Other investment income	1,206.1	+638.3	567.8
Current transfers	–1,384.2	–2,387.9	–1,146.3

1. Figures in this article are preliminary. For a key to the symbols and abbreviations used in this article, see page 177.

high. The former was buoyed by such favorable factors as expectations of economic recovery in Japan, as well as rising stock prices in the United States and Europe. The boost in inward direct investment reflected the global industrial reorganization.

Other investment recorded a net inflow of ¥2.8 trillion; this compares with a ¥7.0 trillion outflow registered in 1998. The inflow mainly reflected repayment of funds that had been lent to Japanese banks' overseas branches through interoffice accounts. The funds were transferred to Japanese banks' domestic offices against the background of banks' efforts to reduce their overseas assets and improvements in overseas branches' foreign-currency funding conditions.

II. The Current Account

A. Overview

In 1999, the current account surplus generally followed a downward trend (Chart 2). Specifically, between January and April, it shrank as a result of a

Chart 1
Current Account, and Goods and Services

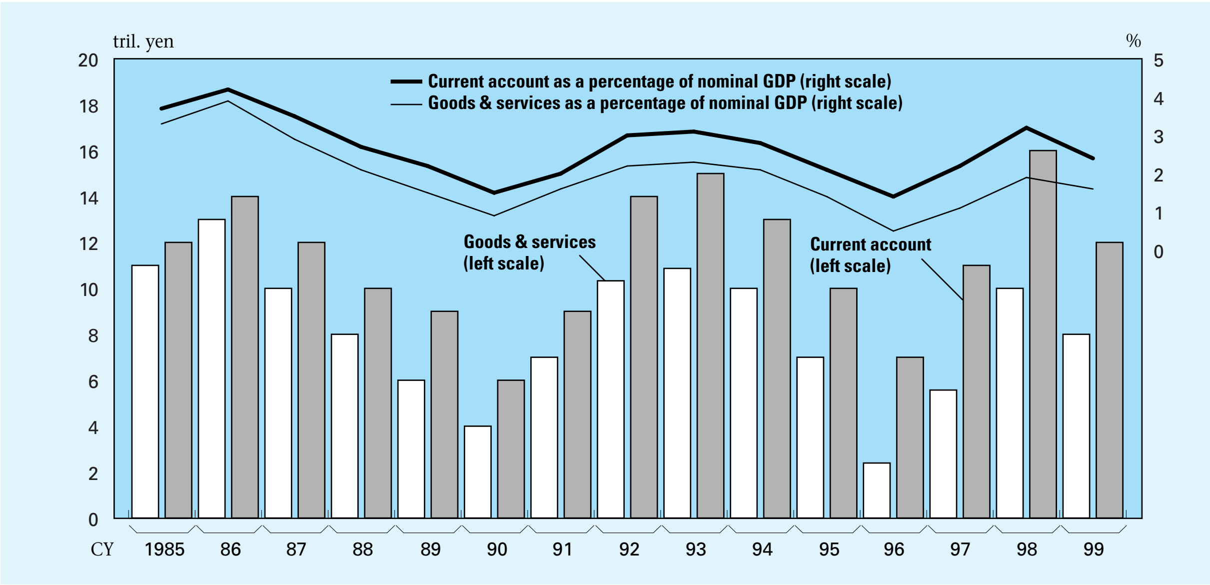
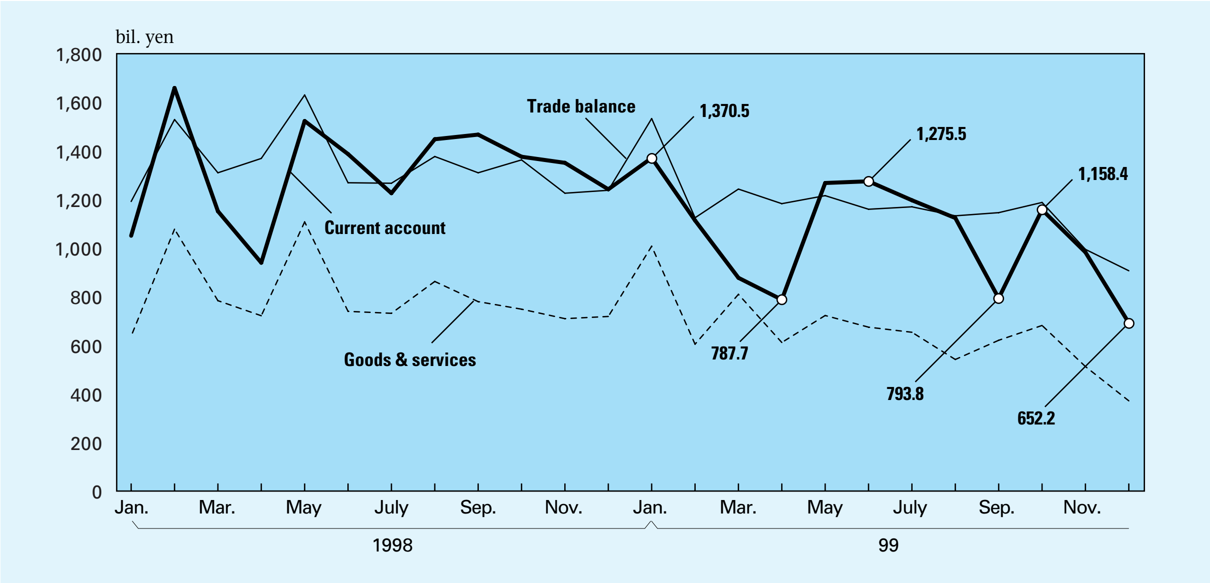


Chart 2
Current Account (Seasonally Adjusted)



reduction of an income surplus and an expansion of the current transfer deficit. In May and June, elimination of the above-mentioned causes allowed the current account surplus to grow. And between July and December, it declined again as surpluses of trade and income were squeezed.

B. Trade Balance

The trade balance surplus decreased for the first time in three years, falling to the sixth-lowest level in history (Table 2). The decline in import value was smaller than that in exports as the annual expansion in import volume of 9.6 percent (customs-clearance basis) far exceeded that of 2.1 percent in export volume. Both exports and imports grew in volume, this growth being mainly in those to and from Asia, but declined in value reflecting a fall in export and import prices as a result of the appreciation of the yen.[2]

1. Exports

a. Overview

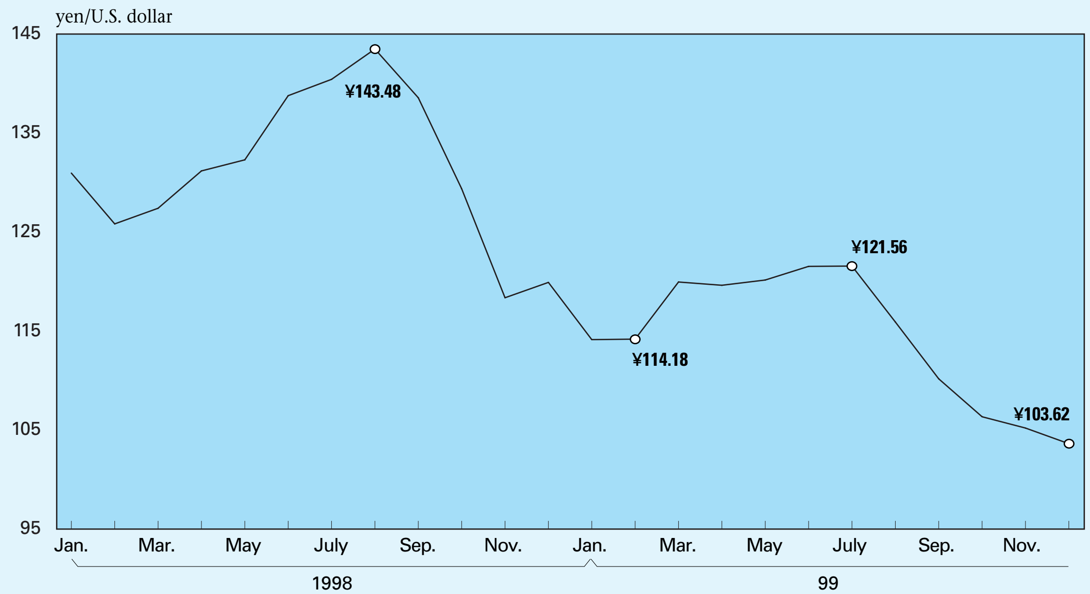
The value of exports fell 6.3 percent from the previous year, declining for two consecutive years reflecting the decline in export prices as a result of

Table 2
Trade Balance

	1999 (bil. yen)	Changes from a year earlier (bil. yen)	Changes from a year earlier (%)
Net balance	14,054.0	–1,930.4	–12.1
Exports	45,768.8	–3,097.7	–6.3
Imports	31,714.8	–1,167.3	–3.5

2. The exchange rate of the yen against the U.S. dollar officially announced by the chief customs inspector (used in the calculation of trade statistics): ¥114.37 in 1999 against ¥131.42 in 1998 (a year-on-year appreciation of 13 percent; see chart below).

Chart for Footnote 2
The Exchange Rate[1]



Note: *1.* The exchange rate officially announced by the chief customs inspector.

the appreciation of the yen (Chart 3). This was the third-highest level in history. The volume of exports, however, showed an increase for the first time in two years due to a recovery in demand in Asia from early 1999 and continued strong demand in the United States.

On a customs-clearance basis, export value decreased 6.1 percent year on year, while export volume increased 2.1 percent (Chart 4). Export prices declined by 8.1 percent.

Chart 3
Exports and Imports (Seasonally Adjusted)

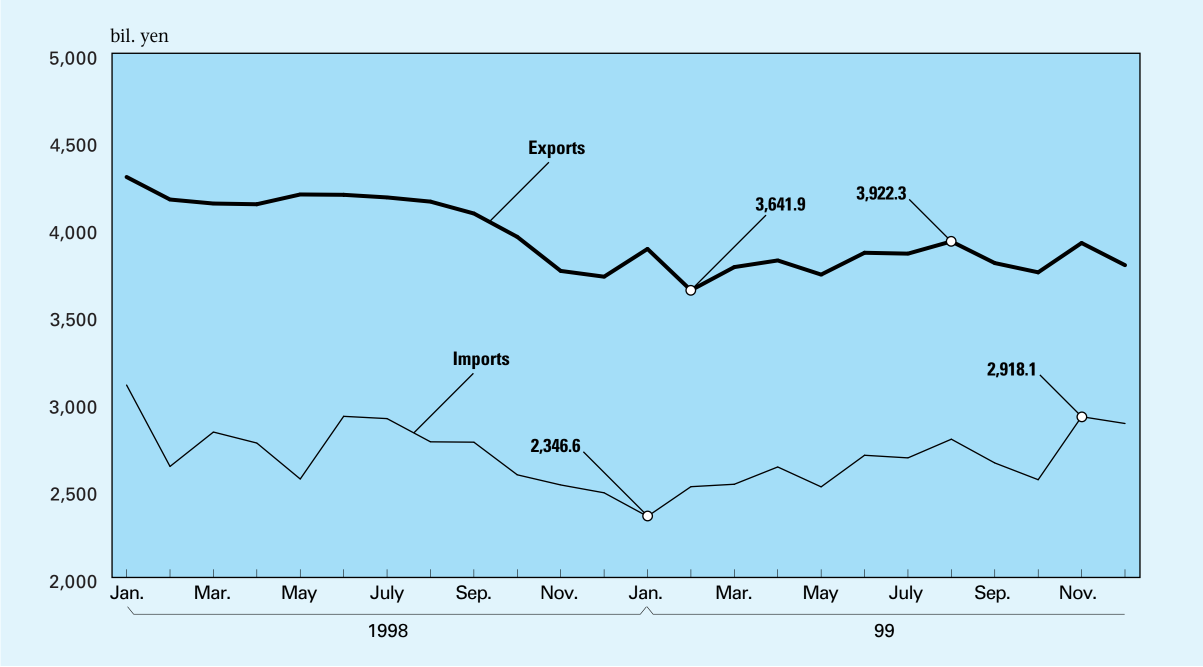
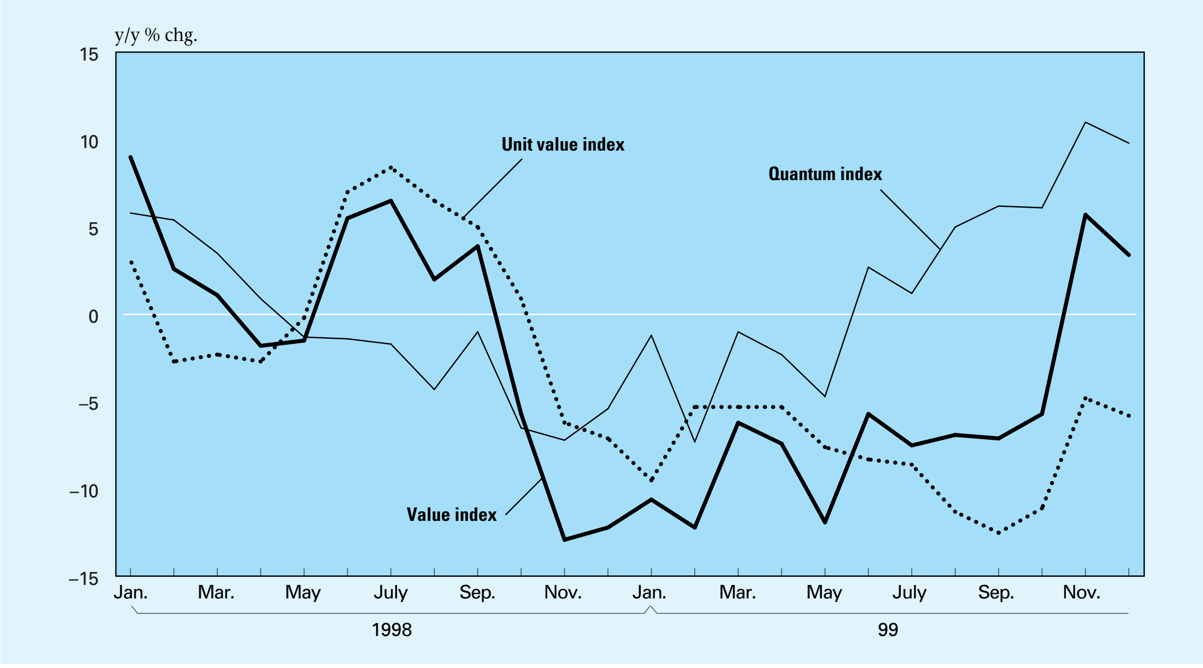


Chart 4
Export Indexes (Customs-Clearance Basis)



b. Principal items

With the yen's rise pushing export prices down, exports showing a year-on-year increase in terms of value were limited to such items as IT-related capital goods and parts (Table 3).

(1) Factors contributing positively to overall export growth: increased exports of capital goods and parts to Asia

Capital goods and parts destined for Asia accounted for the majority of the increase in exports in 1999 (Chart 5). This was mainly for the following reasons.

First, overseas Japanese-owned assembly facilities boosted their production and thus procurement of parts from Japan. This reflected (1) strong demand for IT- and electronics-related products in countries such as the United States, Japan, and Europe, and (2) Japanese firms' shifting of production bases overseas. Strong growth in exports was seen in electronic components such as semiconductors and other electronic devices; scientific, medical, and optical instruments such as liquid-crystal devices; parts for office machinery; and audiovisual apparatus.

Second, locally operating chipmakers in Korea, Taiwan, and Singapore increased their business fixed investment prompted by a broader global demand for IT-related products: scientific, medical, and optical instruments, such as semiconductor lithography instruments; electrical measuring and controlling instruments such as semiconductor test equipment; and metalworking machinery such as semiconductor etching machines.

And third, exports of motor vehicle parts, especially those destined for ASEAN countries, and of assembled motor vehicles were brisk. This reflected a recovery of automotive sales in Asia, as well as expanding exports by Japanese manufacturers and others in Asia to third countries such as Australia and Europe (Box 1).

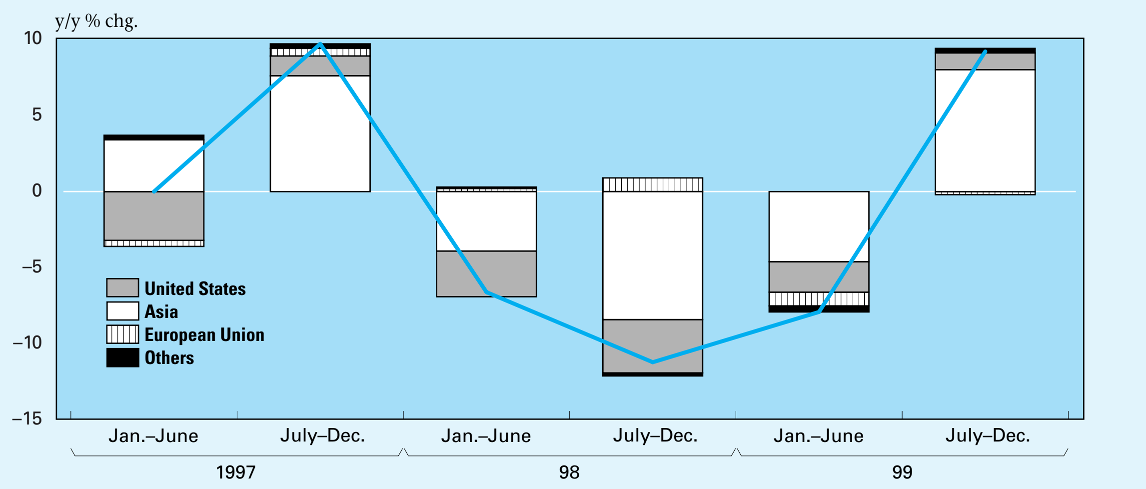
Table 3

Contribution to Overall Export Growth by Item in 1999 (Customs-Clearance Basis)

	Commodity (degree of contribution)
Items making a positive contribution	IT-related capital goods and parts (semiconductors and other electronic devices <+0.0%>, electrical measuring & controlling instruments <+0.0%>, scientific, medical, and optical instruments [liquid-crystal devices and semiconductor lithography instruments, etc.] <+0.2%>), parts of audiovisual apparatus (+0.1%), VTRs (+0.2%), parts of motor vehicles (+0.0%)
Items making a negative contribution	Motor vehicles (–1.4%), office machinery (–1.2%), iron & steel products (–0.8%), vessels (–0.5%), power generating machinery (–0.3%), metalworking machinery (–0.3%), mechanical handling equipment (–0.2%), chemicals (–0.1%)

Chart 5

Contribution of Semiconductors and Other Electronic Devices to Overall Export Growth by Area (Customs-Clearance Basis)



Box 1 Influence of IT and Electronics Industry Growth in Asia on Trade with Japan

Trade activities between Japan and the rest of Asia in 1999 reveal that, while trade with such partners as Korea, Taiwan, Malaysia, and the Philippines expanded, trade with other partners, including Hong Kong and Indonesia, shrank or stayed at the previous year's level (Chart for Box 1 and Table for Box 1). This disparity is closely related to the level of development attained by the IT- and electronics-related industries in each country. Despite the damage caused by the Asian currency crisis, countries with a high concentration of these industries have swiftly moved toward an export-led recovery by capitalizing on worldwide demand for IT- and electronics-related products.

More items, such as semiconductors, components for personal computers (PCs) and peripheral equipment, and parts of audiovisual apparatus, are being exported to local manufacturers in Korea and Taiwan, as well as to plants established by Japanese manufacturers in other areas of Asia, such as Malaysia. In these plants, exported items are assembled into finished products, such as PCs and domestic electrical equipment, and then reexported to such destinations as Japan, Europe, and the United States.

U.S. manufacturers are also shifting production bases to Malaysia, the Philippines, and other parts of Asia. Imports to Japan of semiconductors and PCs made at these U.S. production bases, as well as at local manufacturers in Korea and Taiwan, are increasing. These imports include products outsourced by Japanese manufacturers to the local manufacturers.

Asian economies, including Korea, Taiwan, Malaysia, and the Philippines, whose recovery has been achieved through the strength of high-tech industries, have gradually become pivotal production bases for Japanese and U.S. companies making IT and electronics products exported to countries outside Asia. This situation has changed the structure of Japan's trade.

Chart for Box 1 Exports to Asia (Contribution to Overall Export Growth by Item; Customs-Clearance Basis)

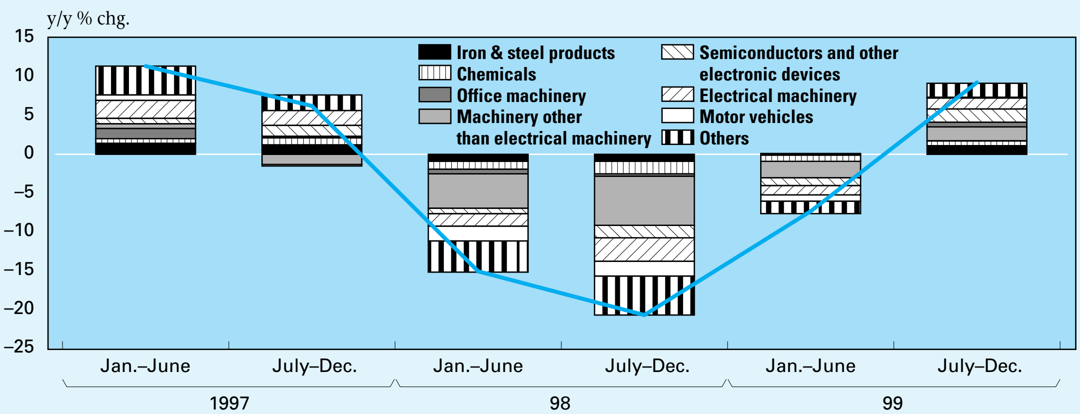


Table for Box 1 Japanese Trade with Asia (Customs-Clearance Basis)

y/y % chg.

	Exports from Japan			Imports into Japan		
	1997	98	99	97	98	99
Asia	+8.6	–17.9	+0.8	+6.6	–10.4	+2.8
Korea	–1.2	–36.4	+30.0	+1.6	–10.5	+15.7
Taiwan	+18.1	+0.2	–1.9	–7.2	–11.6	+8.9
Malaysia	+5.2	–30.7	+4.0	+7.6	–17.6	+9.5
Philippines	+14.9	–9.8	+5.1	+23.3	–4.6	+4.3
China	+10.4	–0.4	+1.4	+15.0	–4.3	+ 0.6
Singapore	+8.4	–21.2	–3.9	–10.9	–13.2	+0.3
Thailand	–11.2	–30.7	+5.1	+4.2	–7.7	–5.6
Hong Kong	+19.5	–10.6	–15.0	–2.8	–16.9	–10.2
Indonesia	+24.8	–54.5	–1.6	+7.0	–20.0	+ 0.9

(2) Factors contributing negatively to overall export growth

(a) Reduction in motor vehicle exports to the European Union (EU) and the Middle East

The contribution of automobiles to the growth in overall exports was –1.4 percent, while exports of automobiles fell in value by 9.0 percent from the previous year. Exports to the EU plunged in the second half of 1999 as a high-yen/low-euro situation undermined the price-competitiveness of Japanese automakers (Table 4). The introduction of new models by local automakers in Europe also contributed to this plunge. The poor performance of shipments to the EU (contribution to the growth in overall exports: –0.3 percent; value, down 10.7 percent) overshadowed favorable exports to the United States (contribution to the growth in overall exports: +0.3 percent; value, up 4.2 percent), primarily that of sports utility vehicles (SUVs). Furthermore, exports to the Middle East (contribution to the growth in overall exports: –0.4 percent; value, down 30.4 percent) were hurt by the strong yen that caused yen-denominated spot exports to plummet in the second half of 1999. Exports to Asia grew 7.0 percent in volume from the previous year but fell 14.8 percent in value (contribution to the growth in overall exports: –0.1 percent), owing to the impact of the rise in the yen. It should be noted, however, that the export value showed an increase in the second half of 1999 due to a considerable improvement in export volume.

(b) Production shift to Asia by Japanese manufacturers

The contribution of office machinery to the growth in overall exports was –1.2 percent, while the value fell 16.3 percent from the previous year (Chart 6). A decline was observed for exports to the United States (contribution to the growth in overall exports: –0.8 percent; value, down 24.4 percent) and exports to the EU (contribution to the growth in overall exports: –0.4 percent; value, down 19.8 percent). This reflected moves by Japanese manufacturers to transfer their production bases for export-oriented equipment to other parts of Asia, as well as reduced export capabilities of Japanese manufacturers due to an expansion in PC sales in Japan. Exports to Asia, however, fared better (contribution to the growth in overall exports: +0.1 percent; value, up 8.1 percent), boosted by procurement of parts by local production bases of Japanese manufacturers.

c. Regional trends

Contribution by region to the growth in overall exports, which declined 6.1 percent from the previous year on a customs-clearance basis, showed that Asia was the sole trade region that contributed positively to export growth, while exports to the United States, the EU, and the Middle East made a negative contribution (tables 5 and 6, Table 7 on page 150, and charts 7 and 8 on page 151). Exports to Asia showed an increase in the second half of 1999. A breakdown of Asian destinations for Japanese-made products showed that ASEAN countries, the newly industrializing economies (NIEs), and China increased their procurement from Japan.

The sectoral share of Asia-bound exports, calculated as a percentage of overall exports on a customs-clearance basis, increased from 34.7 percent in 1998 to 37.2 percent in 1999.

Table 4

Contribution of Motor Vehicles to Overall Export Growth by Area (Customs-Clearance Basis)

y/y % chg.

		Total	United States	European Union	Asia	Middle East
1997	Jan.–June	+32.5	+13.0	+6.0	+2.7	+2.5
	July–Dec.	+25.9	+6.6	+5.9	–0.6	+2.7
98	Jan.–June	+14.3	+7.5	+4.6	–5.8	+1.9
	July–Dec.	+5.3	+6.3	+2.8	–5.7	+2.8
99	Jan.–June	–7.6	+2.7	–1.0	–1.9	–1.8
	July–Dec.	–10.4	+0.8	–3.2	+0.2	–3.2

Chart 6
Contribution of Office Machinery to Overall Export Growth by Area (Customs-Clearance Basis)

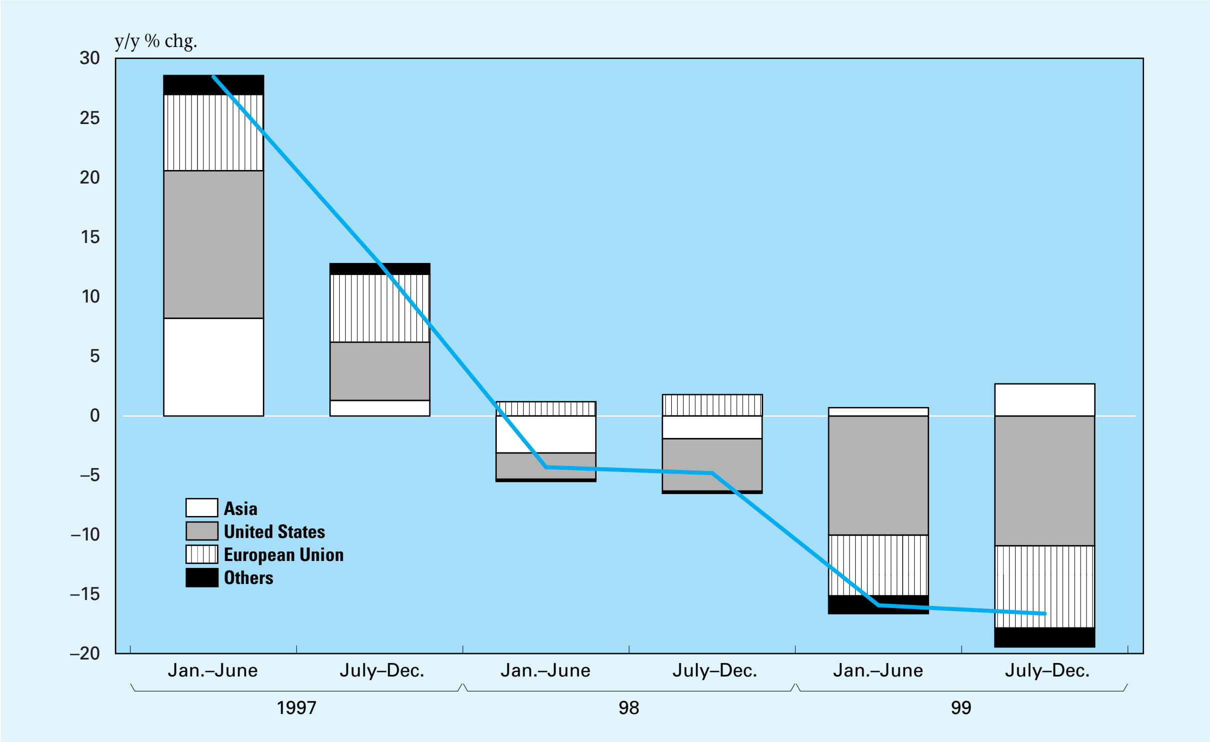


Table 5
Contribution to Overall Export Growth by Area (Customs-Clearance Basis)

	Exports	United States	European Union	Asia	NIEs	ASEAN	China	Middle East
Contribution (percent changes from a year earlier)	–6.1	–1.7	–1.7	+0.3	+0.0	+0.2	+0.1	–1.0
Share (percent)	100.0	30.7	17.8	37.2	21.5	13.0	5.6	2.3

Table 6
Indexes of Exports by Area (Customs-Clearance Basis)

y/y % chg.

	Total	United States	European Union	Asia	NIEs	ASEAN	China
Value index	–6.1	–5.6	–9.2	+0.8	+0.2	+1.3	+1.4
Unit value index	–8.1	–9.5	–7.9	–8.1	–7.5	–10.9	–10.6
Quantum index	+2.1	+4.3	–1.4	+9.7	+8.4	+13.7	+13.5

Table 7

Analysis of Contribution to Overall Export Growth by Area and by Item in 1999 (Customs-Clearance Basis)

y/y % chg.

Area		Item	Contribution to overall growth	Main factors
Asia +0.8	Items making a positive contribution	Scientific, medical, and optical instruments	+0.7	Increases in the export of semiconductor lithography instruments and liquid-crystal devices
		Chemicals	+0.5	Increase in the export of synthetic resin and ethylene
		Semiconductors and other electronic devices	+0.4	Increase in exports to Japanese-owned production bases in Asia
		Office machinery	+0.4	Increase in the export of parts of PCs
		Parts of motor vehicles	+0.3	Increase in the production of motor vehicles in ASEAN countries
	Items making a negative contribution	Vessels	–0.7	Intensification of competition with Korean manufacturers as a result of the yen's appreciation
		Motor vehicles	–0.4	Decline in prices as a result of the yen's appreciation despite an increase in export volume
		Power generating machinery	–0.4	Decline in fixed investment and a decrease in the number of projects involving electric power generators
		Heating or cooling equipment	–0.4	Decline in fixed investment
		Electric power machinery	–0.3	Decline in fixed investment and a decrease in the number of projects involving electric power generators
United States –5.6	Items making a positive contribution	Motor vehicles	+0.9	Continued strong demand in the United States, especially for SUVs
		Telecommunications apparatus	+0.6	Increase in demand for switching and transmission apparatus due to an expansion in the volume of telecommunications
		VTRs	+0.5	Launch of new products on the U.S. market
		Motorcycles	+0.2	Continued strong demand in the United States
		Electric power machinery	+0.2	Increase in precautionary demand for small, all-purpose backup electric power generators associated with the Y2K problem
	Items making a negative contribution	Office machinery	–2.5	Shifting of Japanese manufacturers' production bases to Asia
		Iron & steel products	–1.6	Filing of a suit by U.S. manufacturers against Japanese manufacturers
		Metalworking machinery	–0.7	Adjustment of distribution stock
		Chemicals	–0.4	Decline in Japanese manufacturers' capacity to export to the United States due to an increase in exports to Asia
		Construction machinery	–0.2	Adjustment of distribution stock
European Union –9.2	Items making a positive contribution	VTRs	+0.4	Launch of new products on the EU market
		Copying apparatus	+0.2	Growing replacement investment in digital copying apparatus
		Construction machinery	+0.2	Increase in demand for construction
		Parts of audiovisual apparatus	+0.1	Increase in production in the EU
	Items making a negative contribution	Office machinery	–2.4	Shifting of Japanese manufacturers' production bases to Asia
		Motor vehicles	–1.7	Weakened price-competitiveness of Japanese products as a result of the yen's appreciation
		Chemicals	–0.7	Decline in Japanese manufacturers' capacity to export to the EU due to an increase in exports to Asia
		Metalworking machinery	–0.4	Adjustment of distribution stock

2. Imports

a. Overview

Japan's import value declined for the second consecutive year, ranking nevertheless at the fourth-highest level in history (Chart 9 on page 152). This reflected the downward pressure on import prices from the rise in the yen. Import volume, however, increased for the first time in two years. A sizable increase in imports from Asia, chiefly petroleum- and IT-related products, in the second half of the year, offset a narrow year-on-year decrease in imports from the EU and the United States.

Chart 7
Contribution to Overall Export Growth by Area (Customs-Clearance Basis)

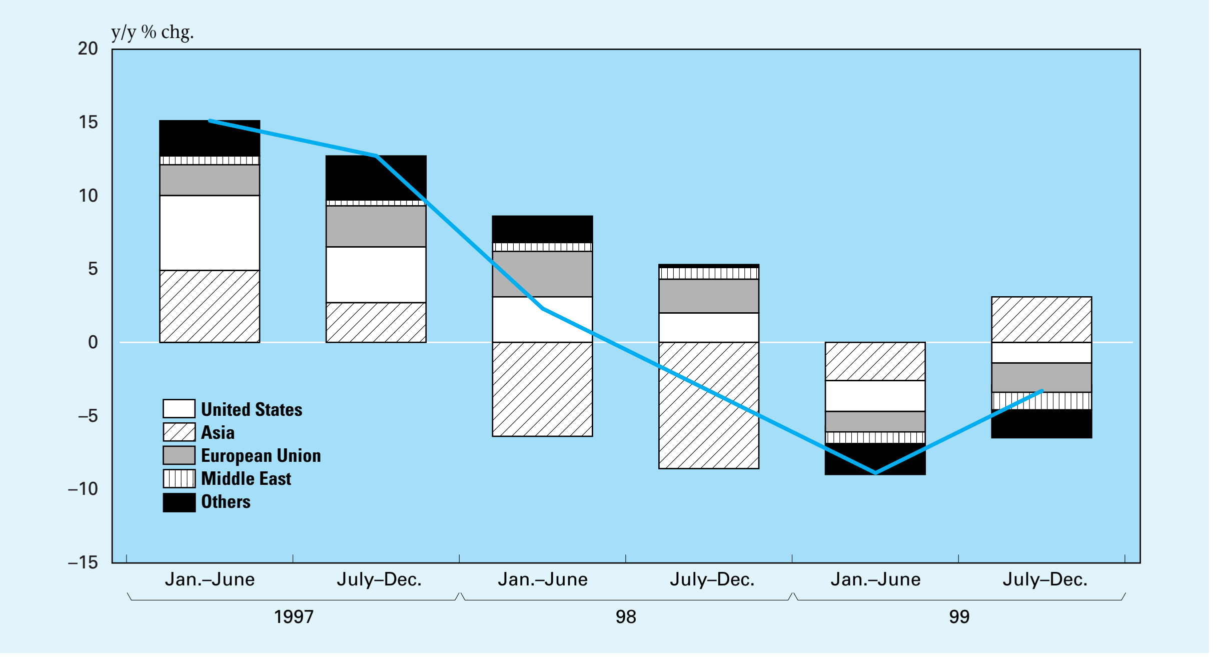
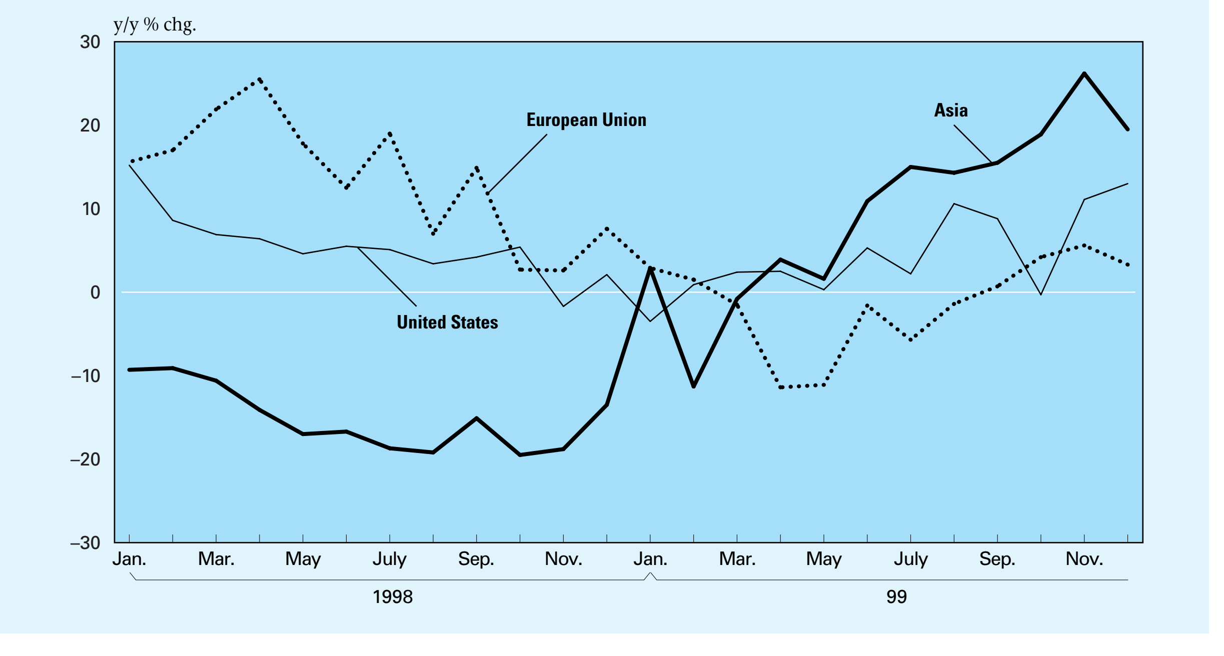


Chart 8
Indexes of Export Quantum by Area (Customs-Clearance Basis)



On a customs-clearance basis, import value decreased 3.8 percent year on year, while import volume jumped 9.6 percent and marked the highest expansion since the 11.7 percent recorded in 1995. Import prices fell 12.2 percent.

b. Changes by commodity

Imports of some commodities increased despite the effect of the rise in the yen (Chart 10). These included plastics, mineral fuels, audiovisual apparatus, housing-related products, and IT-related products, including office machinery and electronic devices such as semiconductors. Imports of finished products also rose, but manufactured items as a proportion of overall imports[3] edged up, from 62.1 percent in 1998 to 62.5 percent in 1999. This reflected a rise in the prices of mineral fuels

Chart 9
Indexes of Imports (Customs-Clearance Basis)

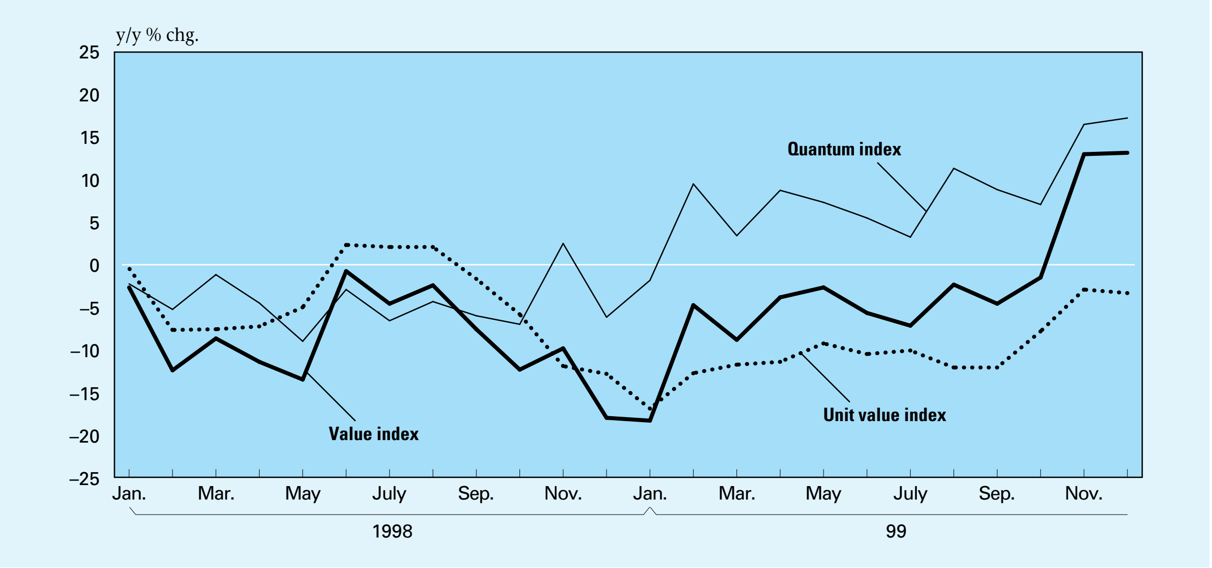
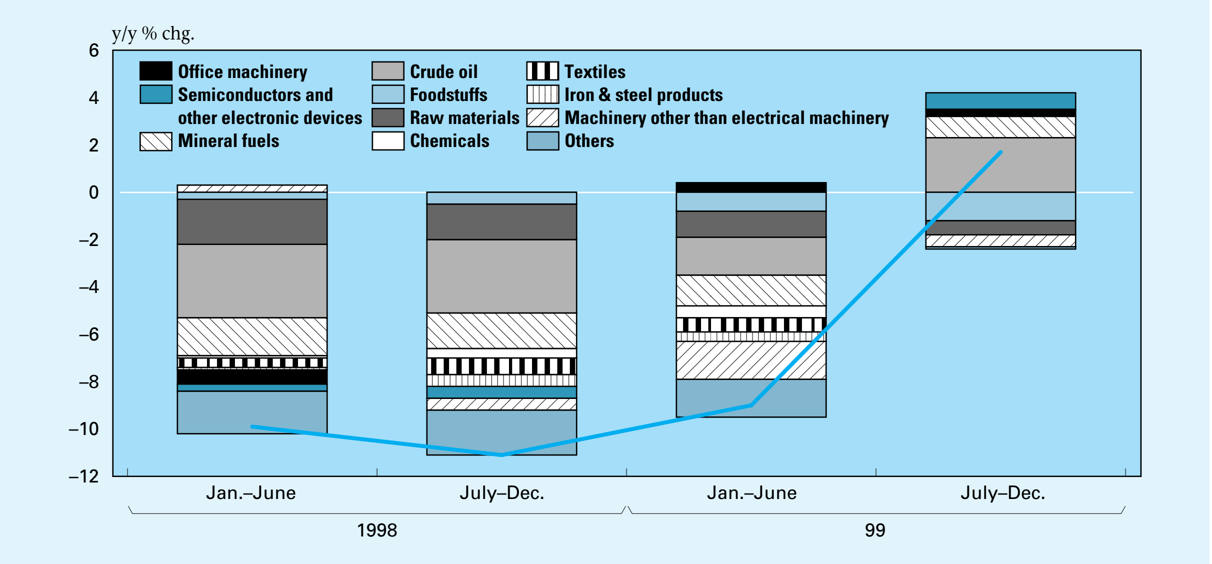


Chart 10
Contribution to Overall Import Growth by Item (Customs-Clearance Basis)



3. Ratio of manufactured items to aggregate imports (in percent) = [aggregate imports – (foodstuffs + raw materials + mineral fuels)]/overall imports × 100.

that enlarged the share of mineral fuels in total imports.

(1) Factors contributing positively to overall import growth

(a) Expansion in domestic production and sales

Office machinery contributed 0.3 percent to the growth in overall imports, while it increased in value by 5.8 percent year on year (Table 8 and Chart 11). Imports originating in Asia jumped (contribution to the growth in overall imports: +0.8 percent; value, up 23.9 percent). This was due firstly to U.S. manufacturers' shifting to Asia of production bases of PCs intended for export, and secondly to a heightened demand for low-priced PCs and components made by Korean and Taiwanese manufacturers that reflected increased PC production and sales in Japan. On the other hand, imports originating in the United States tumbled (contribution to the growth in overall imports: –0.4 percent; value, down 23.2 percent).

Table 8

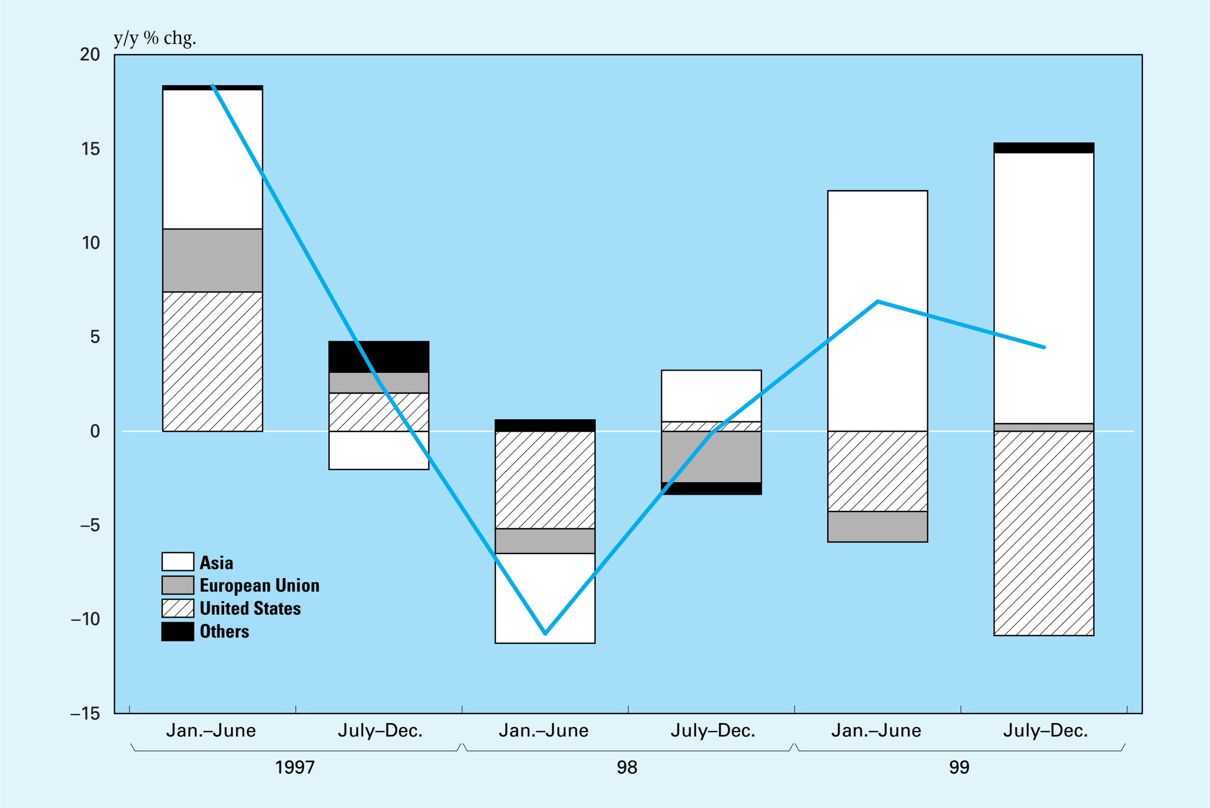
Increased Domestic Production and Sales

%

Products		Contribution to overall import growth
IT-related products	Office machinery	+0.3
	Electronic devices	+0.3
Housing-related products	Wood	+0.1
	Wood manufactures	+0.0

Chart 11

Contribution of Office Machinery to Overall Import Growth by Area (Customs-Clearance Basis)



Electronic devices such as semiconductors contributed +0.3 percent to the growth in overall imports, while the value of these imports jumped 8.9 percent year on year (Chart 12). Imports originating in Asia climbed (contribution to the growth in imports: +0.6 percent; value, up 32.7 percent), owing to increased imports of Korean-made dynamic random access memory chips (DRAMs) and greater outsourcing by Japanese corporations to manufacturers in Taiwan and Singapore in a bid to meet higher PC production and sales demand in Japan. In comparison, imports originating in the United States fell (contribution to the growth in overall imports: –0.3 percent; value, down 15.8 percent), reflecting a decline in prices of microprocessor units (MPUs).

(b) Rising overseas procurement ratio

Importers and some manufacturers buoyed procurement from Asia, including reverse imports (Table 9 and Chart 13). Amid the intensifying price competition in the domestic market, they took advantage of the strengthened price-competitiveness of low-priced imports that reflected the appreciation of the yen. Japan increased imports of televisions and other audiovisual apparatus from China and Malaysia, plastics from Korea, Thailand, and Malaysia, and meat, including pork from Denmark and chicken from Brazil.

(c) Rise in imports of petroleum-related commodities

Crude oil contributed +0.3 percent to the growth in overall imports, while its value increased 3.7 percent year on year (Table 10), mainly imports from the

Chart 12

Contribution of Semiconductors and Other Electronic Devices to Overall Import Growth by Area (Customs-Clearance Basis)

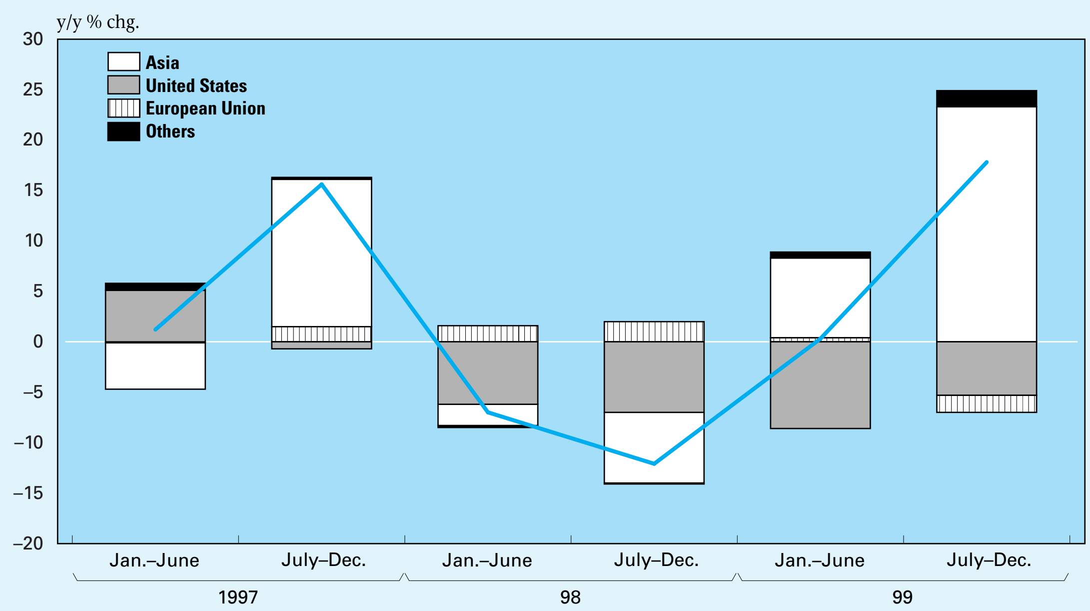


Table 9

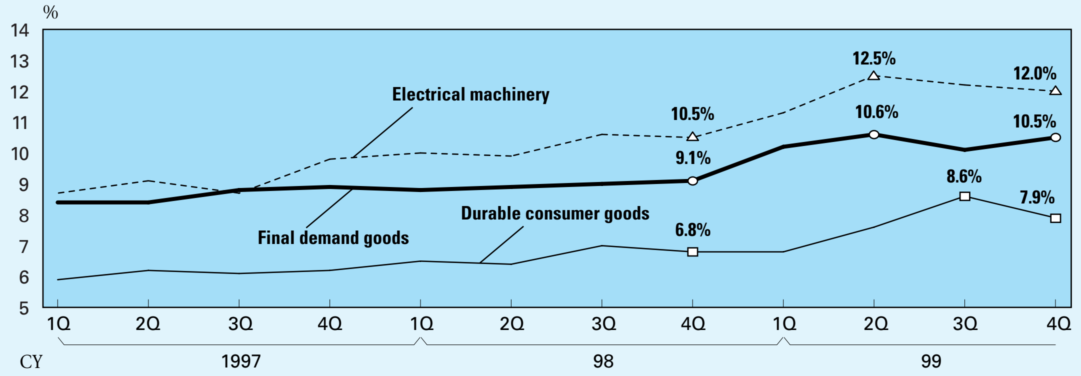
Increased Procurement from Overseas

%

Products	Contribution to overall import growth	Changes in volume from a year earlier
Plastics	+0.0	+25.1
Audiovisual apparatus	+0.1	—
Meats	+0.0	+9.1

Middle East (contribution to the growth in overall imports: +0.3 percent; value, up 4.0 percent). The import value jumped mainly due to an increase in crude oil prices.[4]

Chart 13
Rate of Import Penetration



Note: Import penetration rate = (import index × weighted imports)/(aggregate supply index × weighted aggregate supply).
Final demand goods = capital equipment + consumer goods + production goods.
Source: Ministry of International Trade and Industry, "Indices of Industrial Production."

Table 10
Increased Imports of Petroleum-Related Commodities

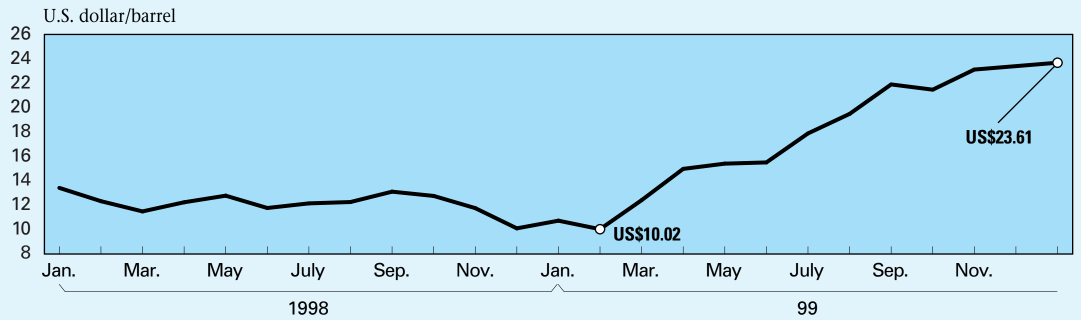
%

Commodities	Contribution to overall import growth	Changes in volume from a year earlier
Crude oil	+0.3	–1.8
Petroleum products	+0.3	—
Liquefied petroleum gas	+0.1	+0.9

4. Crude oil prices fell significantly from the end of 1998 to early 1999, with the Dubai spot price reaching a low of US$9.75 per barrel on February 9, 1999—the lowest since 1989 (see chart below). Prices, however, rallied on March 23, in response to an announcement of concerted action by OPEC members to curb production. Prices rose into the second half of the year due to factors such as the Year 2000 problem and a recovery in Asian demand. Affected by the price declines at the start of the year, the average price of crude oil, based on the unit prices of crude oil on a customs-clearance basis, was US$16.85 in 1999 against US$13.89 in 1998—an increase of US$2.96 per barrel. High crude oil prices continued into 2000, soaring to US$25.00 per barrel on February 14, the highest level since the US$35.15 recorded in September 1990 amid the Gulf Crisis.

Petroleum Statistics (preliminary) showed that Japan acquired 85.2 percent of crude oil from the Middle East (25.2 percent from the United Arab Emirates and 18.8 percent from Saudi Arabia, excluding the "neutral zone" that encompasses such areas as the Khafji oil fields and contributes 3.0 percent to imports); and 11.4 percent from Asia (9.0 percent from Southeast Asia, for example Indonesia, Malaysia, Brunei, and Vietnam; and 2.4 percent from China). Imports from the Middle East dipped for the first time in 12 years (85.6 percent in 1998 to 85.2 percent in 1999), reducing Japan's reliance on oil supplies from the area. This was attributable to cuts in crude oil supply by OPEC members. It was also attributable to increased spot procurement from such producers as Mexico, the United States (Alaska), Norway, and Africa (Sudan), in a bid by importers to acquire crude oil at prices lower than those asked by the Middle East.

Chart for Footnote 4 **Oil Prices (Dubai Spot Price; Monthly Average)**



Petroleum products contributed +0.3 percent to the growth of total imports, while the value of imports jumped 22.9 percent year on year. The increase was largely attributable to a rise in prices, as well as increased imports of naphtha and residual fuel oils, especially from Korea and other NIEs (contribution to the growth in overall imports: +0.2 percent; value, up 49.4 percent), prompted by the wholesalers' restriction on the amount of crude oil processed.

(2) Factors contributing negatively to overall import growth

(a) Drop in exports of agricultural products, nonferrous metals, and other international commodities

The value of nonferrous metals (contribution to the growth in overall imports: –0.1 percent; value, down 5.9 percent and volume, up 1.7 percent) and aluminum and aluminum alloys (contribution to the growth in overall imports: –0.2 percent; value, down 16. 3 percent and volume, up 3.7 percent) dropped significantly despite an increase in import volume (Table 11). This was because price declines which continued until the middle of 1999 pushed the average annual price below that of the previous year.

The import value of liquefied natural gas (LNG; contribution to the growth in overall imports: –0.2 percent; value, down 6.3 percent and volume, up 5.3 percent) slipped below that of the previous year. Imports of LNG are mostly tied to long-term contracts, and price revisions usually lag about six months behind those of crude oil prices. Consequently, the rise in crude oil prices from March 1999 was not fully reflected in these prices.

The import value of coal (contribution to the growth in overall imports: –0.5 percent; value, down 22.6 percent and volume, up 4.1 percent) retreated from the previous year's level. This was because a drop in spot prices of coal reflecting increased output in producer nations such as Canada, Australia, China, and Indonesia outweighed an increase in import volume which reflected an increase in crude steel production.

(b) Decline in unit prices of imports

Imports of textiles in value (contribution to the growth in overall imports: –0.3 percent; value, down 4.4 percent) declined from the previous year because of a drop in unit prices (Table 12 and Chart 14). Customers' preference for lower-priced apparel brought about a large drop in the value of apparel imports from the EU (value of textile imports, down 23.1 percent; volume of apparel imports down 11.3 percent, and value down 23.9 percent), especially in high-quality apparel. Meanwhile, low-priced textiles from Asia (value, down 0.3 percent) soared in volume, with a notable increase in imports from China (value, up 3.3 percent; volume of apparel imports up 26.5 percent and value, up 4.0 percent) and Korea (value, down 1.2 percent; volume of apparel imports, up 5.6 percent, and value down 3.6 percent). This increase in imports of low-priced textiles from Asia reduced the market share of domestically produced textiles, meaning an increase in import penetration for textile goods.

Table 11
Decreased Imports of Agricultural Products, Nonferrous Metals, and Mineral Fuels

%

Commodities		Contribution to overall import growth
Agricultural products	Corn	–0.1
	Soybeans	–0.1
	Wheat	–0.1
Nonferrous metals	Nonferrous ores	–0.1
	Aluminum and aluminum alloys	–0.2
Mineral fuels	Coal	–0.5
	Liquefied natural gas	–0.2

The rate of import penetration for textiles rose from 19.4 percent in the fourth quarter of 1998 to 22.2 percent in the third quarter of 1999. With regard to apparel, the import penetration rate reached nearly 70 percent in 1999, according to the Japan Textiles Importers' Association (this rate expanded from 64.2 percent in 1997 to 66.6 percent in 1998).

c. Regional trends

The United States, the EU, and Oceania (including Australia) made a negative contribution to overall imports in 1999 (down 3.8 percent on a custom-clearance basis), while Asia and the Middle East made a positive contribution (tables 13 and 14, Table 15 on page 158, and charts 15 and 16 on page 159).

Table 12
Decreased Imports of Textiles, etc.

%

Product	Contribution to overall import growth
Textiles, etc.	–0.3

Chart 14
Contribution of Textiles to Overall Import Growth by Area (Customs-Clearance Basis)

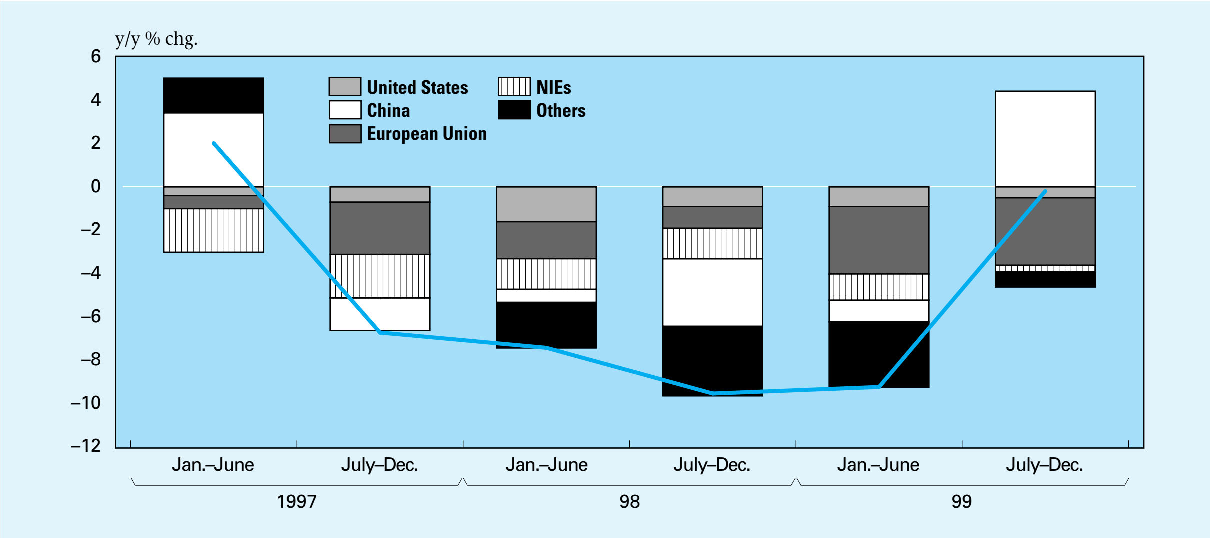


Table 13
Contribution to Overall Import Growth by Area (Customs-Clearance Basis)

	Total	United States	European Union	Asia	NIEs	ASEAN	China	Oceania	Middle East
Contribution (percent changes from a year earlier)	–3.8	–3.1	–0.6	+1.0	+0.9	+0.2	+0.1	–0.8	+0.3
Share (percent)	100.0	21.7	13.8	39.6	11.6	14.9	13.8	5.0	9.8

Table 14
Indexes of Imports by Area (Customs-Clearance Basis)

y/y % chg.

	Total	United States	European Union	Asia	NIEs	ASEAN	China
Value index	–3.8	–13.0	–4.6	+2.8	+9.2	+1.3	+0.6
Unit value index	–12.2	–12.5	–1.4	–11.2	–6.5	–9.1	–13.8
Quantum index	+9.6	–0.5	–3.3	+15.8	+16.7	+11.4	+16.7

Table 15

Contribution to Overall Import Growth by Area and Item in 1999 (Customs-Clearance Basis)

y/y % chg.

Area		Item	Contribution to overall growth	Main factors
Asia +2.8	Items making a positive contribution	Office machinery	+2.1	Increase in imports of low-priced PCs, increase in Japanese manufacturers' commission to Asian manufacturers to produce office machinery, and shifting of U.S. manufacturers' production bases to Asia
		Semiconductors and other electronic devices	+1.6	Tightening of domestic market conditions and an increase in Japanese manufacturers' commission to Asian manufacturers
		Petroleum products	+0.6	Rise in oil prices and the wholesalers' restriction on the amount of crude oil processed
		Wood manufactures	+0.4	Increase in imports of plywood made from Southeast Asian wood
		Scientific, medical, and optical instruments	+0.3	Increase in imports of various parts of scientific, medical, and optical instruments
	Items making a negative contribution	Fish & shellfish	–0.4	Fall in prices as a result of the yen's appreciation despite an increase in import volume
		Iron & steel products	–0.3	Decline in Asian (including Korean and Taiwanese) manufacturers' capacity to export to Japan
		Coal	–0.2	Fall in the prices of international commodities mainly due to an increase in production
		Liquefied natural gas	–0.2	Fall in prices of international commodities that followed a decline in prices of crude oil with some time lag
		Aluminum and aluminum alloys	–0.2	Fall in prices and a decline in Asian manufacturers' capacity to export to Japan
United States –13.0	Items making a positive contribution	Crude oil	+0.2	Increase in spot procurement of Alaskan crude oil
		Fish & shellfish	–0.4	Large catches of salmon and a rise in the prices of crab due to an increase in U.S. demand
	Items making a negative contribution	Office machinery	–1.8	Shifting of U.S. manufacturers' production bases to Asia
		Semiconductors and other electronic devices	–1.1	Fall in prices of MPUs
		Chemicals	–1.0	Decrease in U.S. manufacturers' capacity to export to Japan
		Aircraft	–0.5	Decline in the number of large aircraft imports
		Soybeans	–0.4	Fall in market prices
		Maize	–0.3	Fall in market prices
		Wheat	–0.1	Fall in market prices
European Union –4.6	Items making a positive contribution	Medical products	+0.7	German manufacturers' exports of promising new medicines to Japan
		Telecommunications apparatus	+0.7	Swedish manufacturers' supply of new cellular phones to Japan
		Meat	+0.6	Increase in imports of Danish pork products as a result of the yen's appreciation
		Fish & shellfish	+0.2	Increase in precautionary demand for canned mackerel associated with the Y2K problem and reopening of smelt fishing
	Items making a negative contribution	Textiles	–1.5	Decline in the sales of high-quality apparel, mainly those from Italy
		Alcoholic beverages	–1.1	Adjustment of distribution stock of wine
		Office machinery	–0.2	Intensification of competition with Asian products
		Semiconductors and other electronic devices	–0.2	Intensification of competition with Asian products
		Electrical measuring & controlling instruments	–0.2	Restriction of fixed investment by Japanese semiconductor manufacturers

The negative contribution made by Oceania was largely due to a year-on-year decline in international commodity prices such as coal, nonferrous ores (particularly bauxite), and aluminum and aluminum alloys.

Imports from Asia captured a larger share of aggregate imports, rising from 37.1 percent in 1998 to 39.6 percent in 1999. Manufactured items as a proportion of overall imports also increased, from 71.4 percent in 1998 to 73.3 percent in 1999. Notably, imports of IT- and electronics-related products from Asia hit ¥3.3 trillion, contributing to the growth in overall imports (down 3.8 percent from the previous year) by +1.6 percent.

Manufactured items as a proportion of overall imports reached 62.5 percent in 1999. The proportion was comparatively high for the United States (72.7 percent), the EU (85.9 percent), and Asia

Chart 15
Contribution to Overall Import Growth by Area (Customs-Clearance Basis)

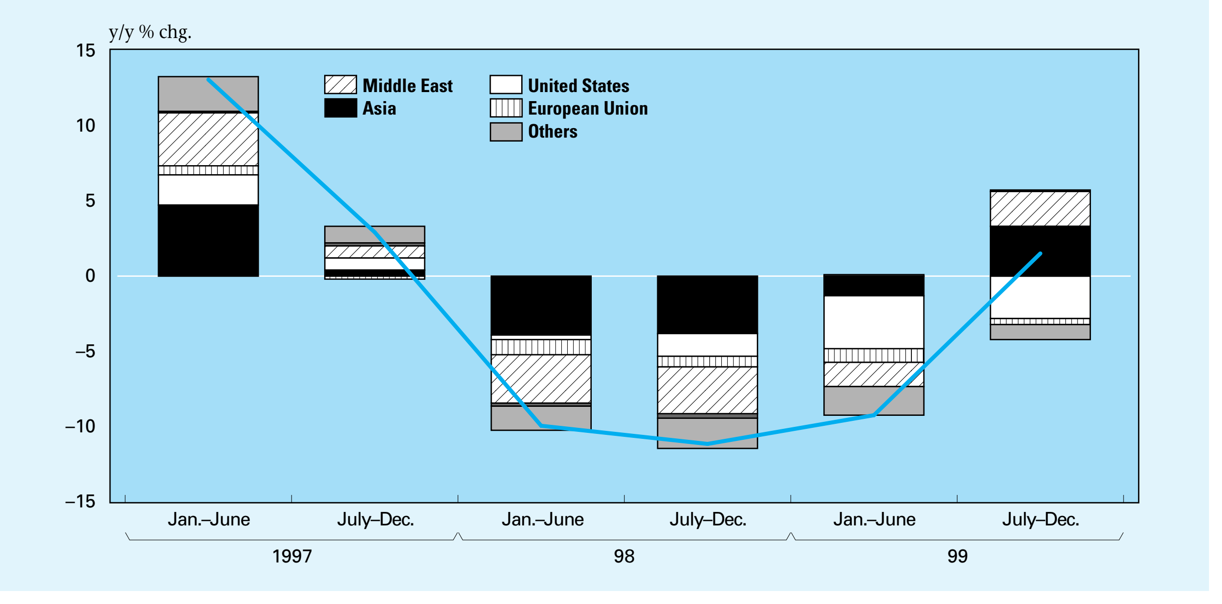
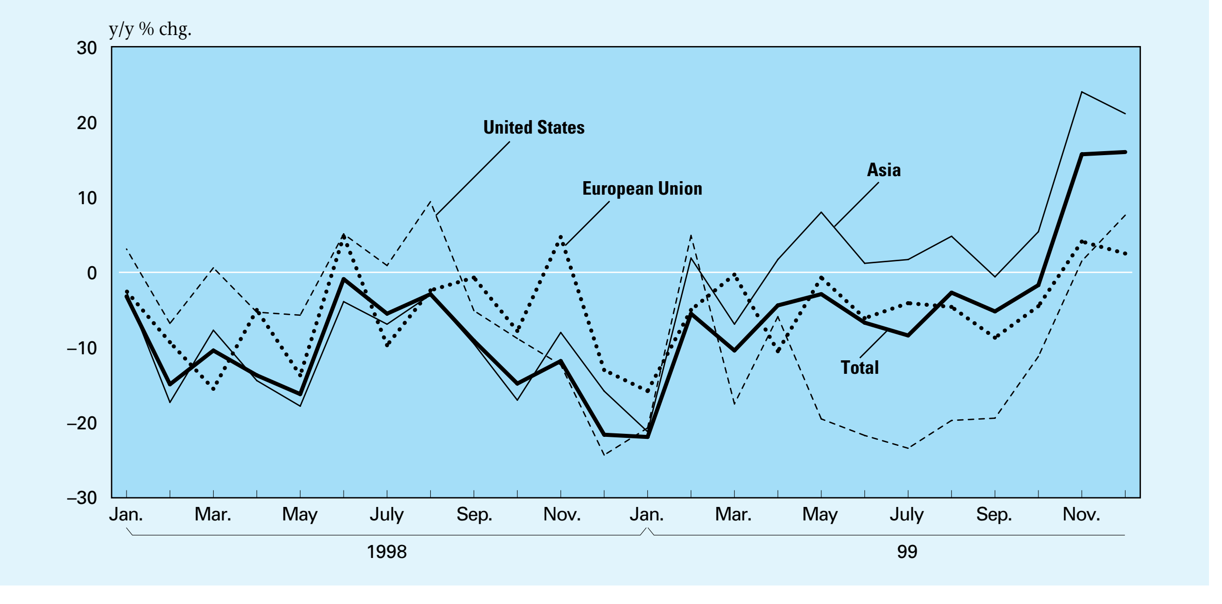


Chart 16
Value of Imports (Customs-Clearance Basis)



(73.3 percent for Asia overall, 82.8 percent for NIEs, 61.4 percent for ASEAN countries, and 81.6 percent for China). Meanwhile, the proportion was lower for such trading partners as the Middle East (4.7 percent), Australia (19.2 percent), Canada (26.6 percent), Brazil (33.1 percent), and Russia (44.5 percent).

C. Services

The deficit in the net balance of services shrank for three consecutive years to become the fifth-highest level in history (deficit of ¥6,182.1 billion for 1999, down ¥272.5 billion or 4.2 percent year on year; Chart 17). This was because the deficits in transportation and other services accounts shrank at a faster pace than the expanding deficit in travel account. Changes by category are given below.

1. Transportation

The deficit in the transportation account shrank for three consecutive years (deficit of ¥875.3 billion, up ¥58.3 billion year on year; Table 16). This was due to a considerable decline in sea transport deficit (down ¥188.9 billion) that offset a ¥132.7 billion

Chart 17
Services

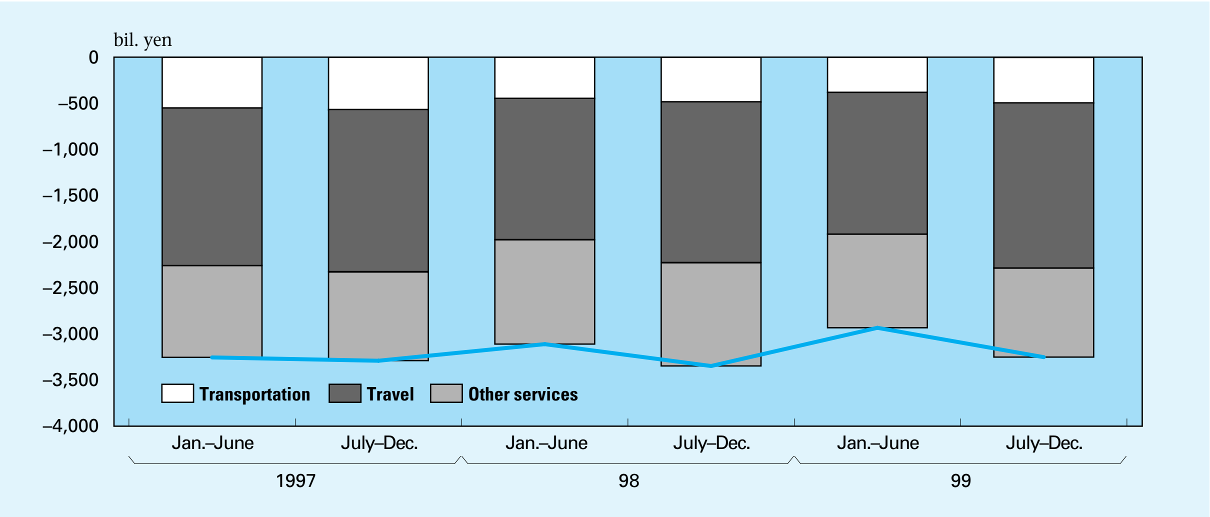


Table 16
Transportation

bil. yen

	1999	Changes from a year earlier	98
Transportation	–875.3	+58.3	–933.6
Sea transport	–529.8	+188.9	–718.6
Credit	1,702.1	–160.9	1,863.0
Debit	2,231.9	–349.8	2,581.7
Air transport	–340.3	–132.7	–207.6
Passenger	–692.7	–88.6	–604.1
Credit	258.1	+9.1	249.0
Debit	950.8	+97.7	853.1
Freight	85.4	+3.6	81.8
Credit	262.1	+29.9	232.2
Debit	176.7	+26.3	150.4

expansion in air transport deficit. A drop in sea transport debit was prompted by slimmer freight and other sea transport debits as a result of the appreciation of the yen. The rise in air transport debit stemmed from an increase in passenger fare debit that paralleled a rise in the number of people traveling from Japan.

2. Travel

The deficit in the travel account expanded for the first time since 1996 (deficit of ¥3,325.8 billion, down ¥51.9 billion year on year; Table 17). A decline of 20.3 percent in travel credits outweighed a 1.3 percent reduction in debits.

3. Other services

The deficit of other services declined for the first time since 1994 (deficit of ¥1,981.0 billion, up ¥266.1 billion year on year; Table 18, and Chart 18 on page 162). A narrowing of surplus in construction services (down ¥129.5 billion) offset the contraction in the deficit in other business services (down ¥262.0 billion).

Table 17
Travel

bil. yen

	1999	Changes from a year earlier	98
Travel	–3,325.8	–51.9	–3,273.9
Credit	390.9	–99.6	490.5
Debit	3,716.7	–47.7	3,764.4

Table 18
Other Services

bil. yen

	1999	Changes from a year earlier	98
Other services	–1,981.0	+266.1	–2,247.1
Construction services	161.3	–129.5	290.9
Credit	636.7	–377.8	1,014.5
Debit	475.4	–248.2	723.6
Financial services	–77.2	–8.3	–68.9
Credit	231.6	+21.0	210.6
Debit	308.8	+29.4	279.4
Royalties and license fees	–209.9	–5.2	–204.7
Credit	910.1	–55.8	965.9
Debit	1,120.1	–50.5	1,170.6
Other business services	–1,177.4	+262.0	–1,439.4
Credit	1,779.3	–453.1	2,232.4
Debit	2,956.7	–715.1	3,671.8

The deficit of other business services account dropped significantly. This reflected the decline in debits of the miscellaneous business, professional, and technical services account, which includes such items as office expenses and R&D expenditures (mostly U.S. dollar-denominated) incurred by Japanese companies' subsidiaries and branches overseas. These debits fell from ¥2,478.7 billion in 1998 to ¥2,064.8 billion in 1999, owing to the appreciation of the yen.

D. Income

Income surplus contracted for the first time since 1994 to mark the fourth-highest level in history (surplus of ¥5,709.4 billion, down ¥691.6 billion or 22.9 percent year on year; Table 19 and Chart 19). This was because a decline in the surplus of direct investment income and portfolio investment income offset an increase in surplus of other investment income.

Chart 18
Other Services

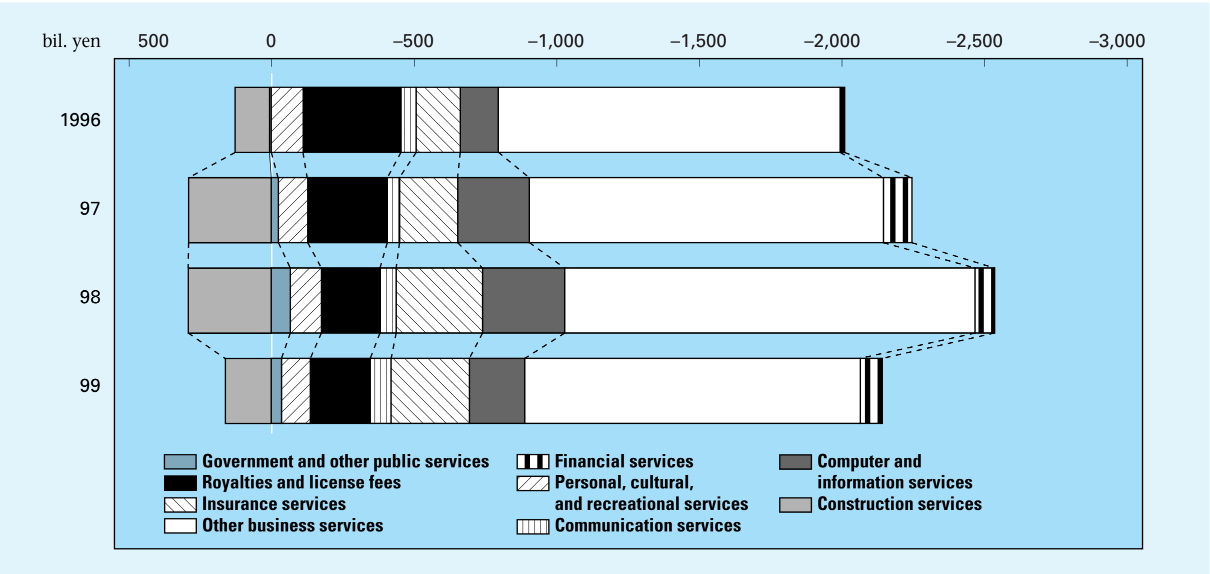


Table 19
Income

bil. yen

	1999	Changes from a year earlier	98
Income	5,709.4	–1,691.6	7,401.1
Direct investment income	433.8	–864.0	1,297.8
Dividends and distributed branch profits	134.2	–652.6	786.8
Credit	492.6	–572.5	1,065.1
Debit	358.4	+80.1	278.3
Reinvested earnings	199.6	–196.9	396.5
Credit	79.7	–291.7	371.4
Debit	–119.9	–94.8	–25.1
Portfolio investment income	4,065.0	–1,468.0	5,533.0
Bonds and notes	3,968.5	–301.1	4,269.6
Credit	5,101.3	–621.9	5,723.2
Debit	1,132.8	–320.8	1,453.6
Money market instruments and financial derivatives	–499.2	–1,233.7	734.5
Credit	11,364.1	–3,396.9	14,761.0
Debit	11,863.3	–2,163.3	14,026.6
Other investment income	1,206.1	+638.3	567.8
Interest on loans	912.7	+336.0	576.7
Interest on deposits	–49.6	+332.0	–381.6

1. Direct investment income

The surplus of direct investment income declined for two consecutive years (surplus of ¥433.8 billion, down ¥864.0 billion year on year; Chart 20). This reflected reduced surpluses in dividends and distributed branch profits, as well as reinvested earnings, all of which were affected by the deterioration in the business performances of Japanese companies' subsidiaries and branches overseas as seen in their financial statements for fiscal 1998, prompted mainly by the Asian currency crisis.

Dividends and distributed branch profits[5] ran a deficit in the first half of 1999, the first deficit recorded since the statistics were initiated in the first half of 1991. This owed to dwindling credits, as well as expanding loss-compensation debits to support the activities of overseas subsidiaries and to offset losses recorded by overseas branches.

Chart 19
Income

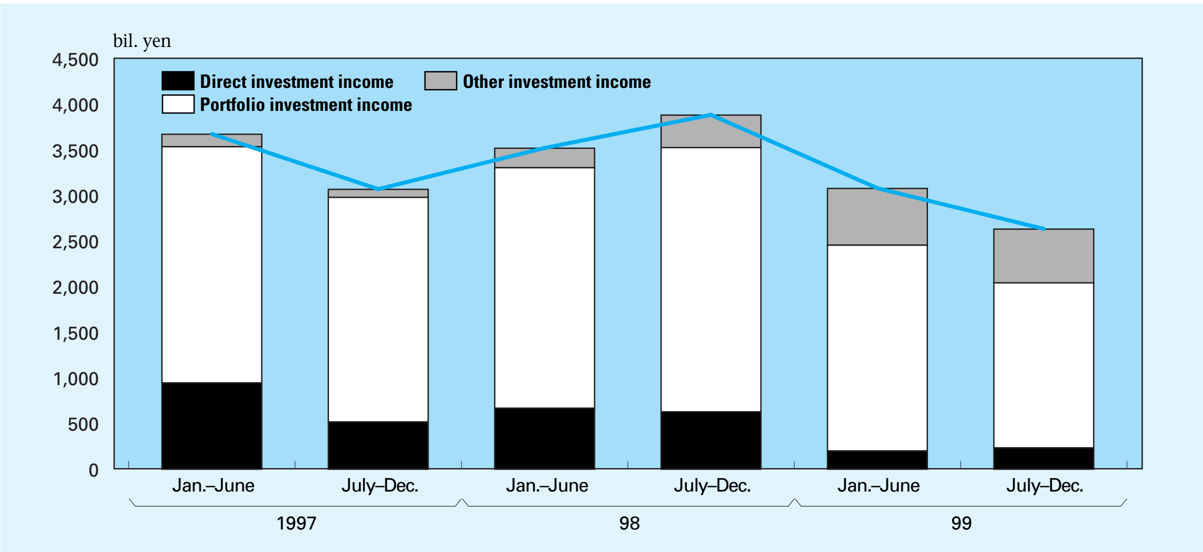
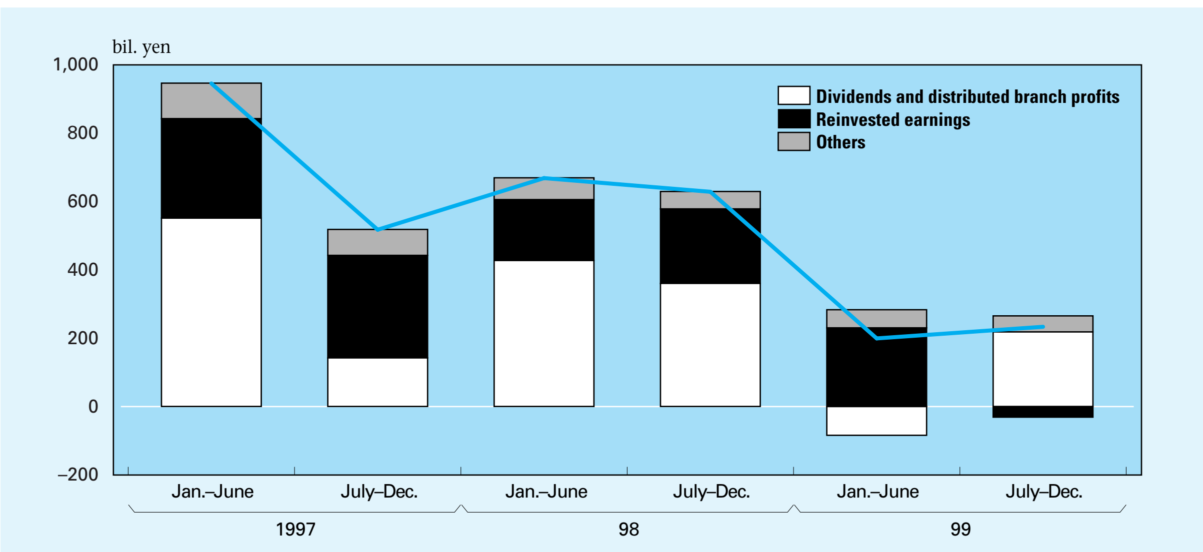


Chart 20
Direct Investment Income



5. Dividends from overseas subsidiaries and the income from overseas branches actually remitted to the parent company or the head office.

Reinvested earnings[6] registered a loss of ¥30.7 billion in the second half of 1999, the highest deficit in history, while being the first deficit recorded since the ¥15.2 billion deficit in the first half of 1996. This was due to worsened profits of overseas subsidiaries, in addition to a decrease in the value of internal reserves on a yen basis that resulted from the rise in the yen.

2. Portfolio investment income

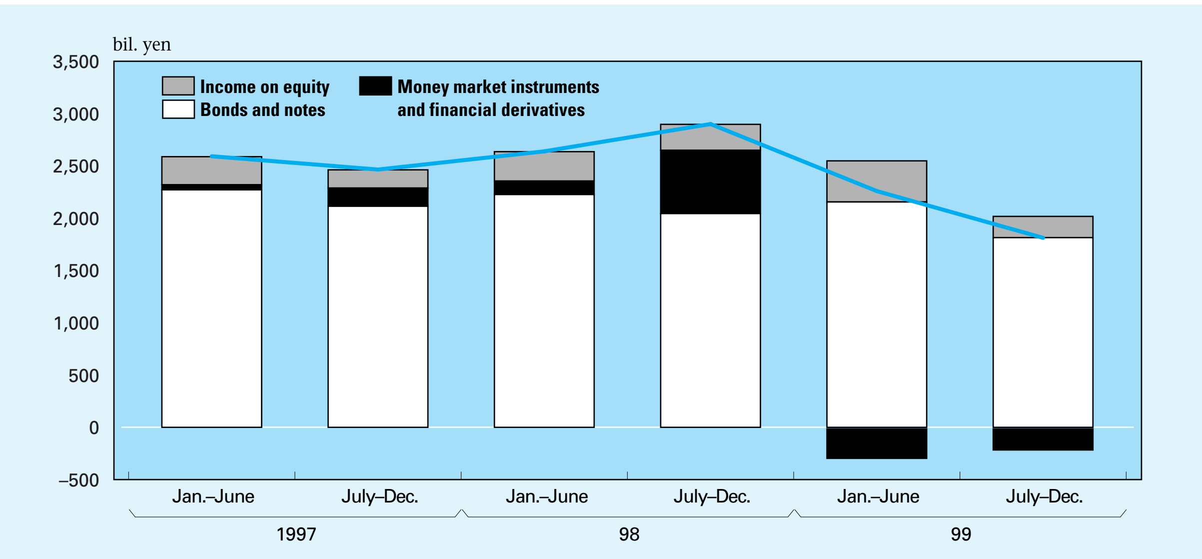
The portfolio investment income surplus shrank for the first time since 1994 (surplus of ¥4,065.0 billion, down ¥1,468.0 billion year on year; Chart 21). This owed to the continued decrease in the bonds and notes surplus that reflected erosion by the strong yen of the value of U.S. dollar-denominated credit arising from interest on U.S. Treasury bonds and notes. It also reflected the fact that the balance of money market instruments and financial derivatives turned negative and went down from a surplus of ¥734.5 billion in 1998 to a deficit of ¥499.2 billion in 1999.

A look at the developments in money market and financial derivatives revealed that the surplus increased in the second half of 1998. This occurred as an unrealized gain actualized when the ratings of Japanese banks were downgraded and foreign banks were prompted to cancel interest rate swap contracts (U.S. dollar-fixed credits minus U.S. dollar-variable debits) with the dealing divisions of Japanese banks before maturity. However, from early 1999, the surplus turned into a deficit as credits decreased. This was a result of Japanese banks having to increase the share of swap transactions (fixed debits minus variable credits) through their banking divisions accompanying a decline of transactions through their dealing divisions. Consequently, fewer credits were received reflecting a drop in interest rates.

3. Other investment income

The surplus of other investment income expanded significantly for the second consecutive year, surpassing the previous high in 1998 (surplus of ¥1,206.1 billion, up ¥638.3 billion year on year; Chart 22). Both credits and debits decreased, owing firstly to the cut in assets and liabilities following the contraction of overseas business by Japanese banks, and secondly because of the erosion of investment value owing to the appreciation of the yen. However,

Chart 21
Portfolio Investment Income



6. In balance of payments statistics, the increase in accumulated reserves of a foreign subsidiary in each settlement period is recorded in direct investment income. This is based on a fiction that the dividends, which are to be received by a parent company, are reinvested in the subsidiary by the parent company in Japan.

Reinvested earnings, the year-on-year change in accumulated reserves, are revised at the end of each settlement period. If entered into the books as a lump sum, the earnings would only be recognized as one-time data for the month of settlement. To average out the amount, the change in reserves is divided into twelve equal portions and recorded as monthly reinvestment income based on a report by each company. Therefore, a foreign subsidiary's worsening profits are reflected in reinvested earnings of the balance of payment statistics in the next fiscal year.

the decrease in debits greatly exceeded that in credits, as a result of the reduced fund-raising rates reflecting narrowing of the "Japan premium."

The majority of credits on interest in loans is interest on funds arising from interoffice transactions of Japanese banks (funds transferred from head offices in Japan [residents] to overseas branches [nonresidents]). On the other hand, the major part of debits in interest on loans is interest on funds acquired by the head offices of Japanese banks, through their overseas branches, from foreign banks. Interest on deposits are chiefly interest on transactions between foreign banks and head offices of Japanese banks.

E. Current Transfers

Current transfers in 1999 showed a deficit for the seventh consecutive year, as the general government sector expanded its deficit considerably, up ¥335.9 billion from the previous year (deficit of ¥1,384.2 billion, down ¥237.9 billion or 20.8 percent increase year on year; Chart 23). This principally

Chart 22
Other Investment Income

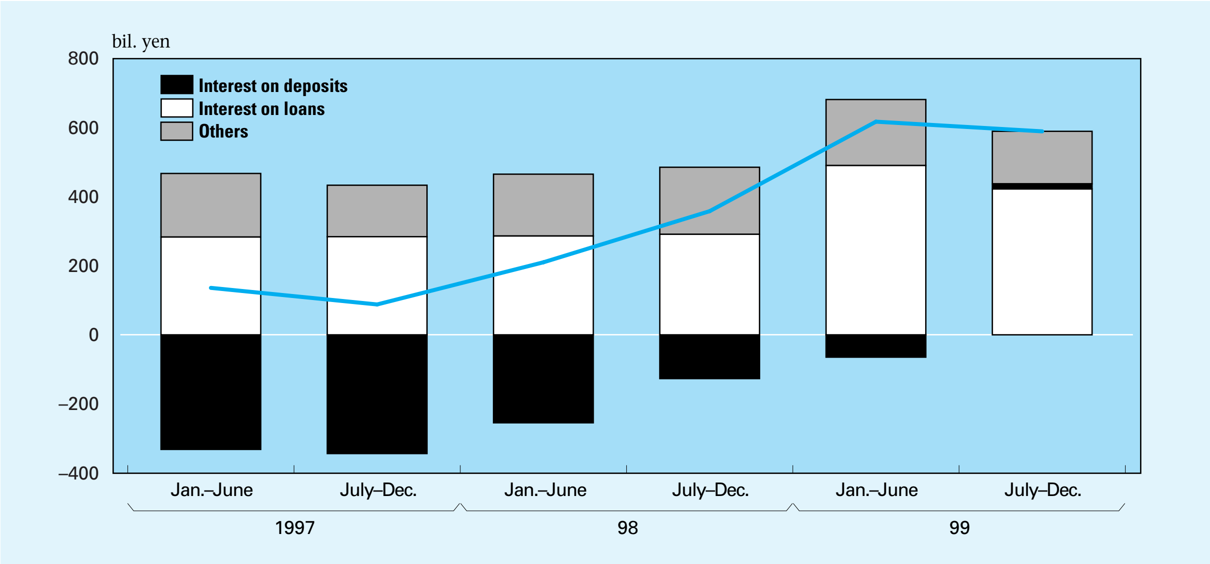
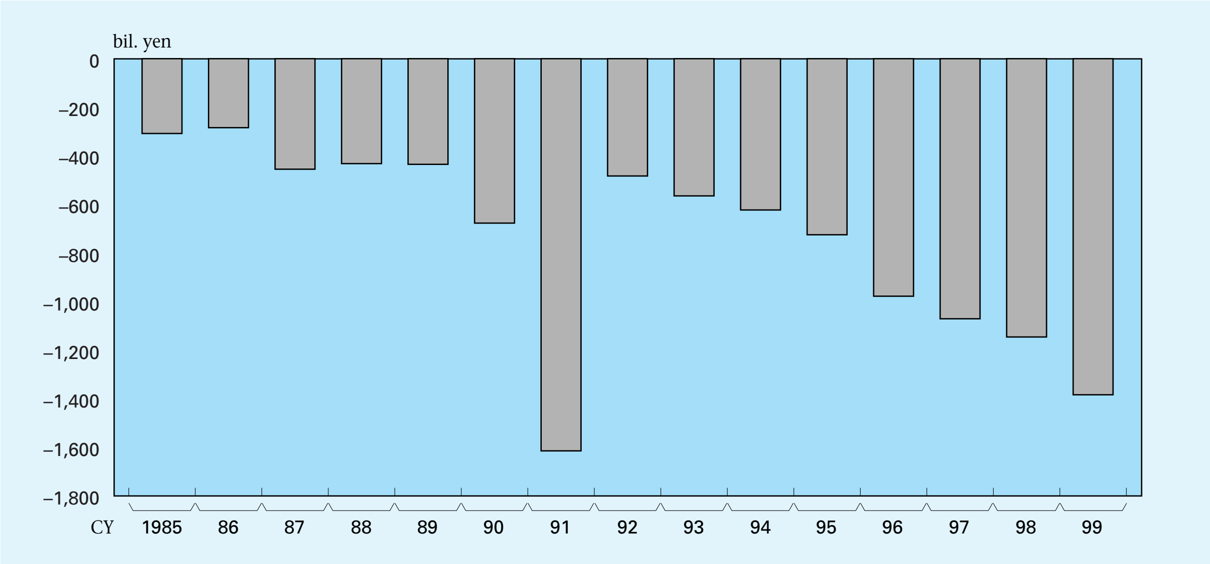


Chart 23
Current Transfers



owed to the contributions made to the Asian Currency Crisis Support Facility in the Asian Development Bank. This large deficit outweighed the ¥98.0 billion reduction in the deficit recorded in the private sector.

The current transfer deficit reached the second-highest level in history. The highest was the ¥1,615.0 billion recorded in 1991, when Japan contributed to the international effort to finance expenses to settle the Gulf War.

III. Capital and Financial Account (Excluding Securities Lending)[7]

A. Overview (Table 20)

Buoyed by favorable factors such as expectations of economic recovery in Japan and rising stock prices in the United States and Europe, investment in Japanese equities by nonresidents marked a new historical high. The pressure of global industrial reorganization boosted inward direct investment, which also recorded a new peak.

Against a backdrop of reduction in overseas assets and improved foreign-currency funding conditions, the collection of funds by Japanese banks from their overseas branches led "other investment" to shift to a net inflow.

The current account surplus reached ¥12.2 trillion, while the capital and financial account showed a net outflow of ¥5.6 trillion, down sharply from the previous year. Under the pressure of the yen appreciation, a large amount of foreign exchange intervention led the net increase in reserve assets to mark a new historical high.

Table 20
Changes in Capital and Financial Account[1]

bil. yen

	1999			98		
		Assets (outward investment)	Liabilities (inward investment)		Assets (outward investment)	Liabilities (inward investment)
Current account	12,197.2			15,784.6		
Capital and financial account	–5,614.8			–17,339.0		
Financial account	–3,705.9			–15,407.7		
Direct investment	–1,205.0	–2,605.2	1,400.2	–2,743.7	–3,161.6	417.9
Portfolio investment[2]	–5,324.7	–17,908.2	12,583.6	–5,525.6	–16,816.8	11,291.2
Equity securities	7,712.9	–3,665.6	11,378.5	74.8	–1,844.0	1,918.8
Bonds and notes	–10,184.0	–8,532.1	–1,652.0	–10,291.3	–9,728.2	–563.1
Money market instruments	–3,425.4	–4,257.1	831.7	4,844.3	–2,806.3	7,650.6
Other investment[2]	2,823.7	26,846.9	–24,023.2	–6,987.1	6,543.3	–13,530.4
Loans	9,434.7	25,583.2	–16,148.5	–7,535.1	–217.6	–7,317.5
Currency and deposits	–6,312.9	422.3	–6,735.2	584.4	7,977.6	–7,393.2
Capital account	–1,908.9			–1,931.3		
Changes in reserve assets	–8,796.3			998.6		
Errors and omissions	2,213.9			555.8		

Notes: *1.* Negative figures show capital outflow. Capital outflow of assets means an outward investment by residents and an increase in reserve assets, whereas capital outflow of liabilities means the withdrawal of inward investment by nonresidents.
2. Figures exclude securities lending.

7. Figures exclude securities lending since it may fluctuate considerably from month to month.

B. Changes by Type of Investment

1. Direct investment

While there was a net outflow of ¥2.6 trillion in outward direct investment centering on the United States and Europe, there was a net inflow of ¥1.4 trillion in inward direct investment, 3.4 times higher than the previous year's figure, marking a new peak for the third consecutive year. As a result, the ratio of inward direct investment to outward direct investment rose to 53.7 percent in 1999 (Chart 24 and Table 21).[8]

a. Outward direct investment (assets)

"Outward direct investment (assets)" showed a slight contraction in the net outflow. The main movements were as follows: (1) acquisition by a major tobacco manufacturer of the business division of an overseas company and capital participation by a major telecommunications company in an overseas telecommunications company, against a backdrop of global industrial reorganization; (2) investments by electrical machinery, automobile manufacturers, and leading financial institutions in the expansion of

Chart 24
Direct Investment

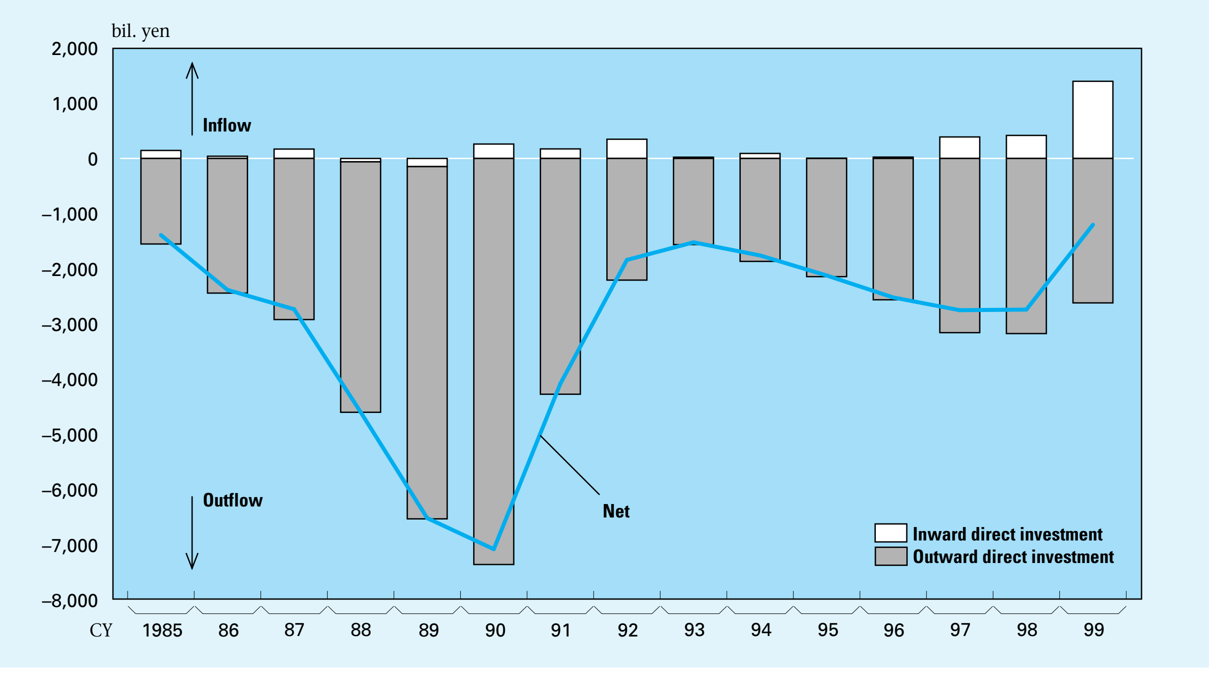


Table 21
The Ratio of Inward Direct Investment to Outward Direct Investment

	1985	90	95	96	97	98	99
Outward investment (bil. yen)	1,536.2	7,351.8	2,128.6	2,548.5	3,144.9	3,161.6	2,605.2
Inward investment (bil. yen)	145.2	261.5	3.9	24.8	390.1	417.9	1,400.2
Inward/outward (percent)	9.5	3.6	0.2	1.0	12.4	13.2	53.7

8. The ratios of inward to outward direct investment (inward direct investment outstanding/outward direct investment outstanding) among the major countries were as follows: France (92.0 percent), the United States (90.3 percent), the United Kingdom (75.1 percent), Germany (39.3 percent), and Japan (9.7 percent). Japan's ratio is notably low and significantly smaller than Germany's, the second lowest.

their overseas businesses; and (3) financial support by real estate, construction, and retail businesses to their overseas subsidiaries, for the purpose of improving financial conditions of the subsidiaries. There was also a move, mainly among financial institutions, to sell equities they held, and reduce capital of their overseas affiliates or liquidate these affiliates in order to improve financial conditions.

b. Inward direct investment (liabilities)

"Inward direct investment (liabilities)" showed a net inflow 3.4 times higher than the previous year's level, marking a new peak for the third consecutive year and exceeding ¥1 trillion for the first time. The reasons for this increase were (1) the current phase of global industrial reorganization; (2) an increase in the number of foreign companies anticipating expanded business opportunities in Japan as a result of deregulation and reduced business costs, such as falling land prices and lower corporate tax; and (3) Japanese corporations taking an aggressive stance toward the introduction of foreign capital in the process of their restructuring.

With regard to industry, there were noteworthy moves in transportation equipment (capital participation by French and U.S. automobile manufacturers in Japanese automobile manufacturers), telecommunications (capital participation by leading U.S. and British telecommunications companies in Japanese telecommunications companies), and financial services and insurance (acquisition by a leading Canadian life insurance company of the operating rights of a Japanese life insurance company and a capital increase in a subsidiary by a major U.S. securities firm).

2. Portfolio investment (excluding securities lending)

In "investment in foreign securities by residents (assets)," net purchases in investment in foreign equities by residents (outflow) surpassed the previous peak (an outflow of ¥3,665.6 billion in 1999 against that of ¥1,844.0 billion in 1998 [the previous peak was ¥2,468.0 billion in 1989]) as trust banks purchased U.S. and European equities with the inflow of pension fund money amid record-high share prices in those markets. Net purchases in investment in foreign money market instruments by residents (outflow) also increased sharply (an outflow of ¥4,257.1 billion in 1999 against that of ¥2,806.3 billion in 1998) as individuals and corporations purchased Euro-yen structured bonds. There was a continued high level of net purchases (outflow) in investment in foreign bonds and notes by residents (an outflow of ¥8,532.1 billion in 1999 against that of ¥9,728.2 billion in 1998) as trust banks purchased U.S. and European bonds with the inflow of pension fund money, and as individuals and corporations purchased Euro-yen bonds.

In "investment in Japanese securities by nonresidents (liabilities)," net purchases in investment in Japanese equities by nonresidents (inflow) surpassed the previous peak (an inflow of ¥11,378.5 billion in 1999 against that of ¥1,918.8 billion in 1998 [the previous peak was ¥6,265.2 billion in 1991]) as expectations of a recovery in the Japanese economy and rising share prices in the United States and Europe led to aggressive buying by foreign investors. On the other hand, investment in Japanese bonds and notes by nonresidents saw an increase in net sales (outflow) because of large-volume selling following the abolishment of the securities transaction tax in April 1999[9] and selling following the provisional report on January–March 1999 GDP released in June 1999 (an outflow of ¥1,652.0 billion in 1999 against that of ¥563.1 billion in 1998). Also, net purchases arising from investment in Japanese money market instruments by nonresidents (inflow) shrank considerably (an inflow of ¥831.7 billion in 1999 against that of ¥7,650.6 billion in 1998) as treasury bills (TBs) that had been purchased by foreign banks when the Japan premium increased in the autumn of 1998 matured in the January–March quarter, and there was little rollover (from maturing bills to new issues) of TBs and financing bills (FBs) maturing at year-end because of concerns over possible Year 2000 problems.

a. Investment in foreign bonds and notes by residents (assets)

In "investment in foreign bonds and notes by residents (assets),"[10] the overall net outflow fell (an outflow of ¥8,532.1 billion in 1999 against that of ¥9,728.2 billion in 1998). Although there was a decrease in net redemption (inflow) in issuance and

9. Securities firms held inventory positions at their overseas branches for clients in order to avoid the securities transaction tax. However, following the abolishment of this tax on April 1, inventory was transferred (sold) to offices in Japan.
10. "Investment in foreign bonds by residents (assets)" is the sum of "sales and purchases" and "issuance and redemption of bonds and notes issued in Japan by nonresidents."

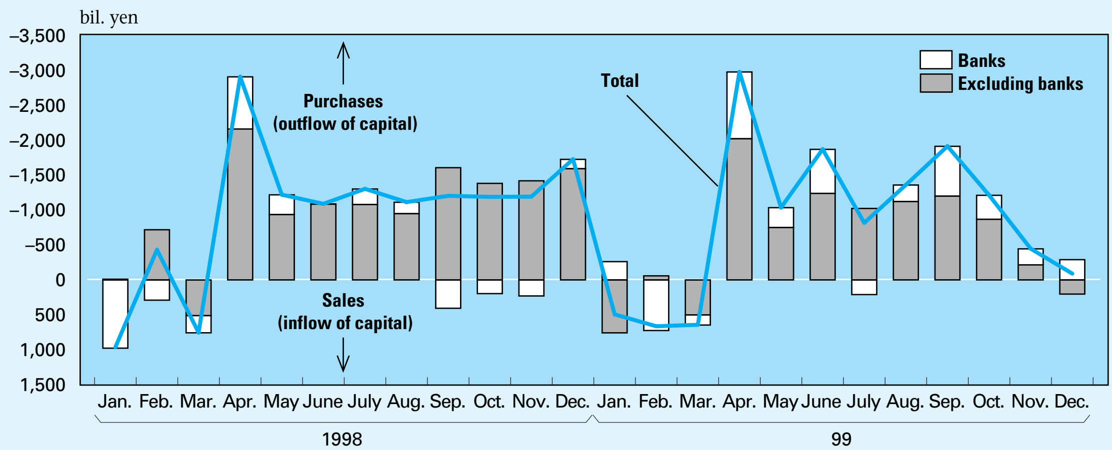
redemption of bonds and notes issued in Japan by nonresidents, net purchases (outflow) in investment in foreign bonds and notes by residents (sales and purchases) also shrank.

The level of net purchases (outflow) in investment in foreign bonds and notes by residents (sales and purchases) remained high on buying of U.S. and European bonds by trust banks following an inflow of pension fund money; buying of Euro-yen bonds mainly by individuals and corporations; and buying by banks that felt price levels were reasonable in a phase of rising interest rates in the United States and Europe (Chart 25). However, with concerns over appreciation of the yen and further rate hikes in the United States and Europe, life insurance companies became net sellers, mainly of U.S. bonds, and, as a result, net purchases (outflow) contracted (an outflow of ¥9,857.7 billion in 1999 against that of ¥11,584.0 billion in 1998).

Looking at geographical trends in 1999, with a stronger interest in index investing,[11] life insurance companies continued to shift from U.S. bonds to

Chart 25
Investment in Foreign Bonds and Notes by Residents (Sales and Purchases)

■ By Investors[1]



bil. yen

	1996	97	98	99	IIP[2] (end of 1998)
Total investment	–7,206.0	–3,752.8	–11,584.0	–9,857.7	94,278.3
Banks	–99.7	996.9	783.8	–2,855.2	21,613.7
Other sectors	–7,402.0	–5,020.5	–12,802.0	–7,537.7	64,100.6

[Reference]

bil. yen

	1996	97	98	99
Life insurance companies	–2,621.3	–1,211.5	–2,721.5	106.5
Trust banks	–604.9	760.9	–3,594.8	–3,813.1
Others	–4,164.3	–3,011.7	–3,786.1	–3,481.6

Notes: *1.* Negative figures show outflow of capital (an increase in assets).
2. International investment position (IIP) includes securities lending, issuance, and redemption of bonds and notes in Japan by nonresidents.
Source: Ministry of Finance, "Securities Investment at Home and Abroad."

11. A style of fund management wherein a fund tries to match the profit and risk profile of a particular index by linking the portfolio makeup to an index that shows, for example, a fixed geographical breakdown.

European bonds. As a result, the overall shift to European bonds, such as German and French bonds, continued while trading in U.S. bonds turned to net sales (Table 22).

In issuance and redemption of bonds and notes in Japan by nonresidents, a high level of redemption (inflow) continued due to the concentration of maturing yen-denominated foreign bonds (*samurai* bonds), and dual currency bonds[12] that were issued when the yen was weak in 1996. However, (1) economic recovery led to a favorable turnaround in the environment for bond issuance by government agencies of those emerging countries that had deteriorated after the Asian currency crisis in 1997; (2) U.S. and European companies aggressively raised funds for operating capital needed to expand their business in Japan; and (3) with a decrease in straight bond issuance by Japanese companies with high bond ratings, Japanese investors increased their appetite for yen-denominated foreign bonds issued by overseas companies with high bond ratings. As a result, overall net redemption (inflow) shrank (an inflow of ¥1,325.6 billion in 1999 against that of ¥1,855.8 billion in 1998).

b. Investment in foreign equities by residents (assets)

Net purchases (outflow) in "investment in foreign equities by residents (assets)" surpassed the previous peak (an outflow of ¥3,665.6 billion in 1999 against

Table 22
Investment in Foreign Bonds and Notes by Residents (By Area)[1]

bil. yen

	1996	97	98	99	IIP (end of 1998)
United States	–4,939.7	–2,471.5	–3,309.8	38.7	30,092.4
Europe[2]	–1,541.7	–2,796.6	–7,270.1	–5,406.4	30,732.8
Germany	–538.7	–546.9	–3,967.6	–2,074.5	10,636.4
France	344.1	28.6	–1,456.8	–1,424.2	3,618.8
United Kingdom	–982.1	–1,335.5	–853.5	–336.5	8,009.6
Asia[3]	n.a.	–57.1	69.9	74.6	1,691.8

Notes: *1.* Negative figures show outflow of capital (an increase in assets).
2. Europe consists of Germany, France, the United Kingdom, the Netherlands, Luxembourg, and Switzerland (international investment position [IIP] consists of the same countries and Belgium).
3. Asia consists of Hong Kong, Korea, Thailand, Malaysia, and Singapore (the same in IIP).
4. The criteria for distinguishing between "outward" and "inward" in *Balance of Payments* and *Securities Investment at Home and Abroad* are as follows:

	Balance of Payments	*Securities Investment at Home and Abroad*
Criteria	Issuer: residents/nonresidents	Denomination of securities: foreign currency/yen
Outward portfolio investment	Residents' sales and purchases of securities issued by nonresidents	Residents' sales and purchases of securities denominated in foreign currency (including Euro-yen)
Inward portfolio investment	Nonresidents' sales and purchases of securities issued by residents	Residents' sales and purchases of securities denominated in yen

Source: Ministry of Finance, "Securities Investment at Home and Abroad."

12. With a dual currency bond, the bond is issued and interest is paid in one currency, while the principal is repaid upon redemption in another currency.

that of ¥1,844.0 billion in 1998 [the previous peak was ¥2,468.0 billion in 1989]; Chart 26). With U.S. and European markets at record-high levels and with an inflow of pension fund money, trust banks (trust accounts) aggressively purchased U.S. and European equities after the start of the new fiscal year in April 1999.

Looking at geographical trends in 1999, with the vitality in U.S. equity markets, there was a sharp increase in investment in U.S. equities, in addition to a continuing high level of investment in European equities (Table 23). Even in Asia, the recovery in share prices led to a shift to net purchases after a period of net sales (inflow) following the Asian currency crisis in 1997.

c. Investment in foreign money market instruments by residents (assets)

Net purchases (outflow) in "investment in foreign money market instruments by residents (assets)" grew significantly (an outflow of ¥4,257.1 billion in

Chart 26
Investment in Foreign Equities by Residents

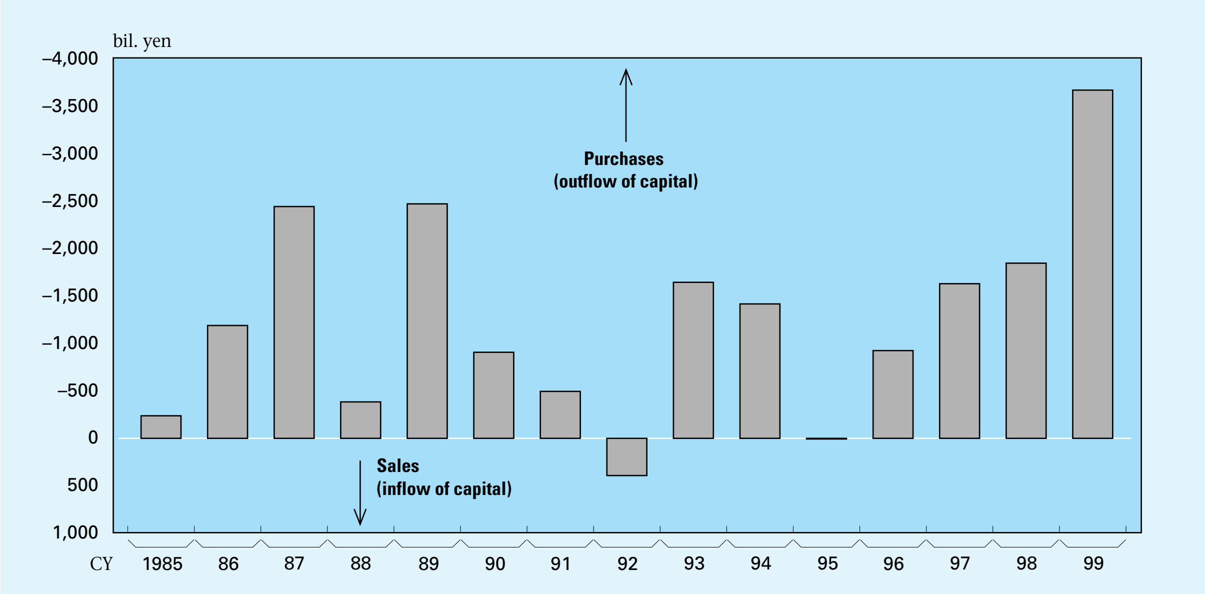


Table 23
Investment in Foreign Equities by Residents (By Area)[1]

bil. yen

	1996	97	98	99	IIP (end of 1998)
United States	–406.3	–1,310.1	–530.3	–1,462.1	12,285.9
Europe[2]	–471.9	–491.8	–836.4	–1,020.4	7,840.9
Germany	–159.0	88.2	–96.3	–154.5	1,306.3
France	–7.7	–87.7	–227.8	–246.8	1,286.6
United Kingdom	–117.5	–233.8	–137.5	–368.8	3,232.4
Asia[3]	n.a.	488.5	198.7	–218.9	668.7

Notes: *1.* Negative figures show outflow of capital (an increase in assets).
2. Europe consists of Germany, France, the United Kingdom, the Netherlands, Luxembourg, and Switzerland (international investment position [IIP] consists of the same countries and Belgium).
3. Asia consists of Hong Kong, Korea, Thailand, Malaysia, and Singapore (the same in IIP).
Source: Ministry of Finance, "Securities Investment at Home and Abroad."

1999 against that of ¥2,806.3 billion in 1998). Although there was a decline in the issuance of *samurai* commercial paper (CP) by overseas subsidiaries of Japanese financial institutions in order to liquidate the credits of the institutions, purchases mainly by individual investors of high-yield exchangeable bonds (EBs) and Nikkei Average linked bonds increased, and regional financial institutions and corporations purchased bonds exchangeable for U.S. bonds (Table 24).

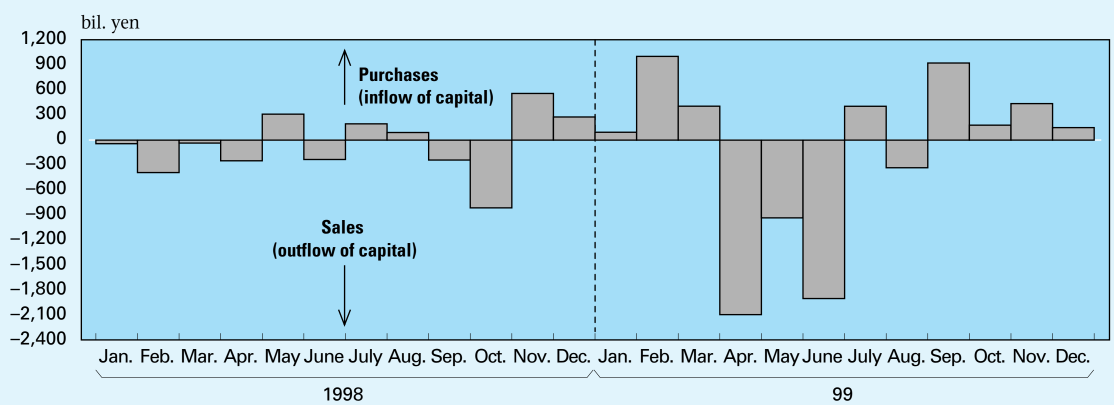
d. Investment in Japanese bonds and notes by nonresidents (liabilities)

In "investment in Japanese bonds and notes by nonresidents (liabilities),"[13] the overall net outflow increased (an outflow of ¥1,652.0 billion in 1999 against that of ¥563.1 billion in 1998; Chart 27). Although the net redemption (outflow) in issuance and redemption of bonds and notes issued overseas by residents shrank, there was a shift to net sales (outflow) in investment in Japanese

Table 24
Major Structured Bonds Denominated in Euro-Yen

Type of securities	Exchangeable bonds (EBs)	Knock-in type Nikkei Average-linked bonds	Bonds exchangeable for U.S. bonds
Yield	Mostly 10–15%	Mostly 4–5%	Mostly 3–4%
Main issuers	European financial institutions with high bond ratings	European financial institutions with high bond ratings	European governmental organizations and financial institutions with high bond ratings
Term	Mostly 3–4 months	Mostly 1 year, but ranging from 3–4 months to 2 years	Mostly 3–4 months
Features	If the underlying share price is below the set strike price on the conversion date, the bond is redeemed not in cash but in equities (even in this case, interest is paid in cash). Many of the equities are those of Japanese information technology or telecommunications companies.	During the period from the start of the investment until just before maturity, if the Nikkei Average is below the set "knock-in level," repayment of principal is linked to the Nikkei Average.	Since it is Euro-yen denominated, in the case of cash redemption, the purchaser does not bear the currency exchange risk. However, if the U.S. bond price is below the set strike price on the conversion date, the bond is redeemed not in cash but in U.S. bonds. In this case, there is a currency exchange risk.
Main purchasers	Individuals, corporations, and regional financial institutions	Individuals, corporations, and regional financial institutions	Regional financial institutions

Chart 27
Investment in Japanese Bonds and Notes by Nonresidents (Sales and Purchases)



13. "Investment in Japanese bonds and notes by nonresidents (liabilities)" is the sum of "sales and purchases" and "issuance and redemption of bonds and notes issued overseas by residents."

bonds and notes by nonresidents (sales and purchases).

Investment in Japanese bonds and notes by nonresidents (sales and purchases) saw a shift to net sales (outflow) (an outflow of ¥1,480.8 billion in 1999 against that of ¥2,180.9 billion in 1998). Despite index buying by foreign investors following the increased weighting of Japanese bonds in the global indices,[14] as well as buying in favorable reaction to the continued zero interest rate policy in the second half of the year, there was large-volume selling in April and May 1999 following the abolishment of the securities transaction tax and selling in June 1999 caused by the view that the zero interest rate policy would be reviewed following the preliminary release of a sharp improvement in Japan's GDP for January–March 1999.

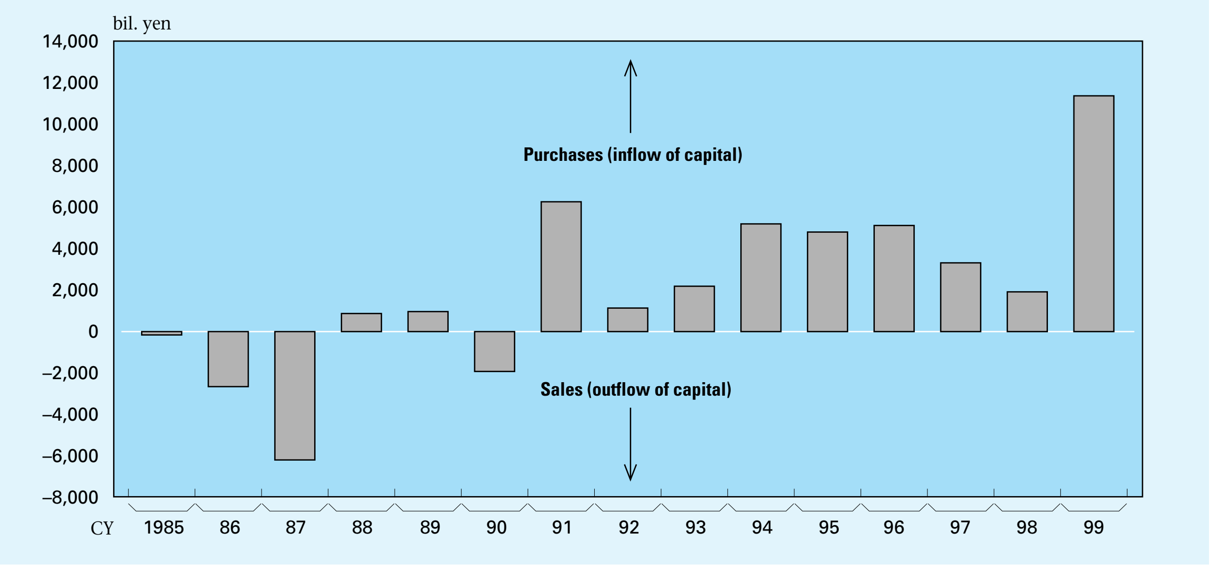
Net redemption (outflow) in issuance and redemption of bonds and notes issued overseas by residents declined (an outflow of ¥171.1 billion in 1999 against that of ¥2,744.0 billion in 1998). In addition to the increase in the issuance of straight bonds in order to structure collateralized bond obligations and of government guaranteed bonds, there was an increase in issues of convertible bonds due to the recovery in Japanese share prices. Furthermore, redemption (outflow) of mainly straight bonds declined.

e. Investment in Japanese equities by nonresidents (liabilities)

Net purchases (inflow) in "investment in Japanese equities by nonresidents (liabilities)" surpassed the previous peak (an inflow of ¥11,378.5 billion in 1999 against that of ¥1,918.8 billion in 1998 [the previous peak was ¥6,265.2 billion in 1991]) as a result of the high level of purchasing centering on information technology and telecommunications companies (Chart 28). This was brought about by the following factors: (1) recovery of confidence in the financial system following the injection of public funds into Japanese financial institutions in March 1999; (2) expectations that the Japanese economy would bottom out in view of the preliminary release of the January–March 1999 GDP; (3) the Bank of Japan's zero interest rate policy; (4) increased weighting of Japanese equities in global indices; (5) continuing bullish stock prices in the United States and Europe; and (6) expectations of industrial reorganizations.

Analyzing geographical trends in 1999, reflecting active U.S. and European stock markets, investment from the United States accounted for 66 percent of the total, while investment from

Chart 28
Investment in Japanese Equities by Nonresidents



14. While an improved fiscal balance has led to a declining trend in bond issues outstanding in Western industrialized nations, Japan's bond issues outstanding are increasing. Therefore, the weighting of Japanese bonds in indices used for investment by pension funds and other investors increased.

Europe and Asia also shifted to a net purchase (Chart 29).

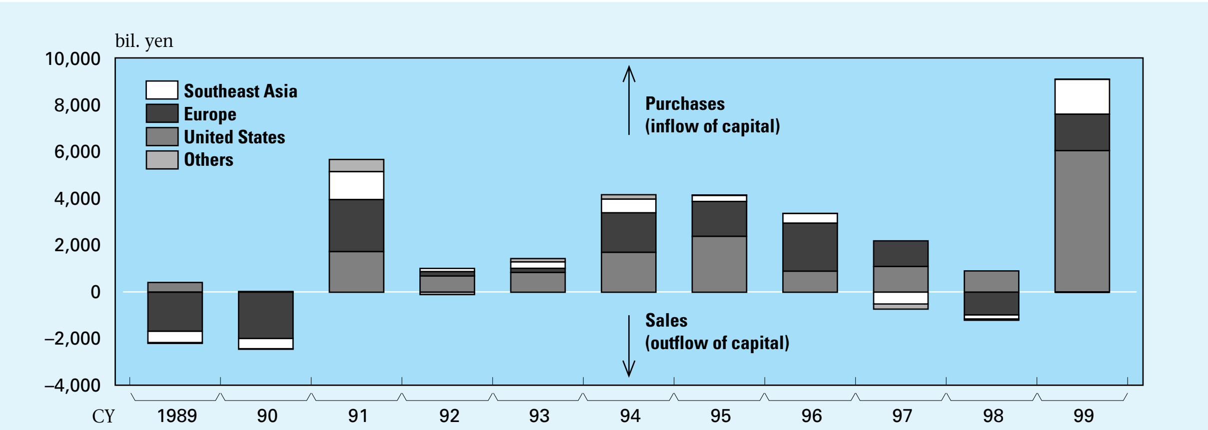
f. Investment in Japanese money market instruments by nonresidents (liabilities)

There was a considerable decline in net purchases (inflow) in "investment in Japanese money market instruments by nonresidents (liabilities)" (an inflow of ¥831.7 billion in 1999 against that of ¥7,650.6 billion in 1998). Although FBs began to be issued through public auctions from April 1999 and were aggressively purchased during a strong yen phase, the January–March quarter saw a redemption of TBs, which were purchased in large volume by foreign banks following a reduction in the yen funding costs as a result of the increase in the Japan premium in the autumn of 1998.[15] Moreover, there was also selling in November and December that seemed to be brought about by concerns over possible Year 2000 problems and year-end demand for funds.

3. Other investment (excluding securities lending)

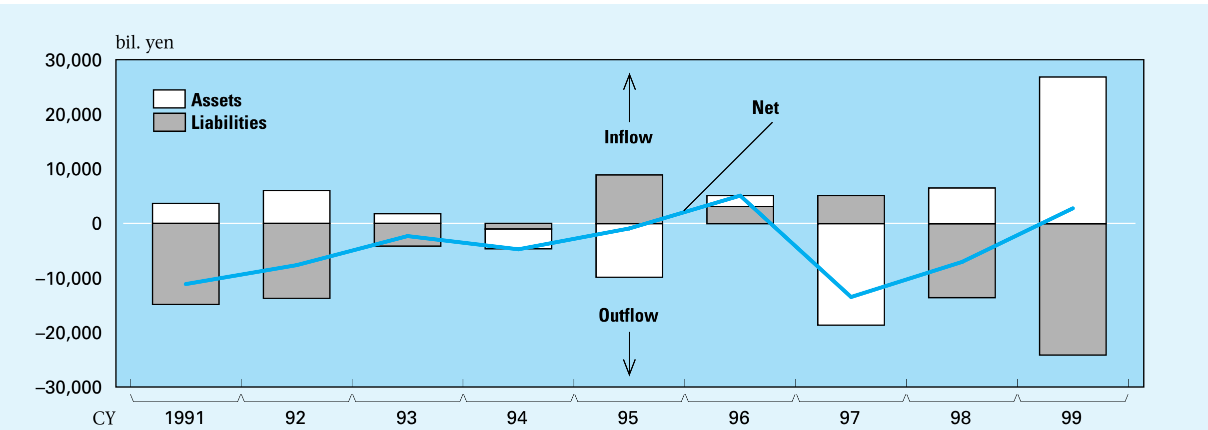
Looking at overall trends in "other investment," the account shifted to a net inflow (an inflow of ¥2,823.7 billion in 1999 against an outflow of ¥6,987.1 billion in 1998; Chart 30). The net inflow in "assets" (loans, bank deposits, etc.) increased (from ¥6,543.3 billion in 1998 to ¥26,846.9 billion in 1999) as funds that had been lent to Japanese banks' overseas branches

Chart 29
Investment in Japanese Equities by Nonresidents (by Area)



Source: Tokyo Stock Exchange.

Chart 30
Other Investment



15. In 1999, there was no noticeable trend toward low-cost yen funding and investment in TBs by foreign banks, as had been seen in 1998, following the reduction in the Japan premium.

through interoffice accounts were repaid, caused by a reduction in their overseas assets and improved conditions for foreign currency funding. In contrast, the net outflow in "liabilities" (loans payable, bank deposits received, etc.) increased (an outflow of ¥24,023.2 billion in 1999 against that of ¥13,530.4 billion in 1998) as Japanese branches of foreign banks repaid yen funds through interoffice accounts in the first half of 1999 that had been invested mainly in Japanese TBs.

a. Loans and loans payable

(1) Loans (assets [lending by residents to nonresidents])

In "loans," there was a shift to a considerable net inflow, mainly due to activities in interoffice accounts (an inflow of ¥25,583.2 billion in 1999 [loan withdrawal surplus] against an outflow of ¥217.6 billion in 1998 [loan surplus]).

Looking at interoffice accounts (loans by Japan-based offices to overseas offices), there was a notable increase in net inflow at Japanese banks, mainly because of (1) repayments through May 1999 of large-volume loans made to overseas branches when the Japan premium increased in the autumn of 1998 (Box 2);[16] (2) continued reduction in overseas assets (including overseas branch closures); and (3) continued withdrawal of funds that had been lent to overseas branches for Euro-yen impact loans (Box 3 on page 176).[17] Also, since foreign banks shifted to a net inflow through the withdrawal of yen funds lent to overseas offices, the overall capital flow shifted to a significant net inflow.

(2) Loans payable (liabilities [borrowing by residents from nonresidents])

In "loans payable," the overall net outflow increased (an outflow of ¥16,148.5 billion in 1999 [net loan repayment] against that of ¥7,317.5 billion in 1998). Although repayments (outflow) in Euro-yen impact loans declined, interoffice accounts shifted to a considerable net outflow.

Box 2 **Flow of Funds with the Increase in the Japan Premium**

When the Japan premium rose toward the end of 1997 and 1998 because of lack of confidence in Japanese financial institutions, Japanese banks sent large amounts of funds through interoffice accounts in order to support overseas branches that had difficulty in raising funds. Also, since the Japanese banks' demand for foreign currency increased, the cost of yen funding for foreign banks fell sharply through the foreign currency swap transactions with Japanese banks, and there was a notable increase in foreign banks' investment mainly in Japanese TBs.

In the balance of payments, funds transferred to overseas branches by Japanese banks through interoffice accounts are recorded in "loans" under "other investment (assets)." Investment in Japanese TBs by foreign banks appears as "money market instruments" under "portfolio investment (liabilities)" if purchased directly from overseas and as "loans payable"[1] under "other investment (liabilities)" if purchased through branches in Japan.

In 1999, with an improvement in the funding environment for foreign currency due to a recovery in the level of confidence and reduction of overseas assets, Japanese banks withdrew large amounts of lending to overseas branches through interoffice accounts. Also, foreign banks' yen funds flowed overseas in the first half of 1999 with a large volume of redemption of the TBs in which the foreign banks had invested.

In the current account, interest received and paid in relation to loans is listed as "interest on loans" under "other investment income" in "investment income." Looking at trends in 1999, interest received fell mainly because of the withdrawal of funds from overseas branches by Japanese banks. Interest paid also declined as foreign banks' offices in Japan paid off loans from overseas offices.

1. The funds transferred from foreign banks' overseas offices to Japanese offices through interoffice accounts are included in the balance of payments that records cross-border capital flows.

16. Despite concerns over possible Year 2000 problems, 1999 saw improved funding conditions for foreign currency following a recovery in the level of confidence in Japanese banks, and thus, there was no large-volume lending to support overseas branches toward year-end as there had been in 1998.
17. Yen-denominated loans by nonresidents to residents, chiefly by overseas branches of Japanese banks to companies in Japan.

Looking at interoffice accounts (borrowing by Japan-based offices from overseas offices), there was a shift to a net outflow of capital. There was a shift by foreign banks to a considerable net outflow, mainly because (1) yen funds borrowed from overseas offices and invested mainly in Japanese TBs in the autumn of 1998, when the increased Japan premium lowered yen funding costs, were repaid in the first half of 1999, and (2) as low interest rates made investing difficult, capital borrowed from foreign offices for investment purposes was repaid[18] in the second half of 1999. Japanese banks also repaid loans[19] from overseas branches mainly in the first half of 1999.

In the case of Euro-yen impact loans, major banks' overseas branches continued to withdraw loans (repayments by corporations in Japan) in order to reduce their assets, but with a decline in loans outstanding, net repayment (outflow) fell compared with the previous year.

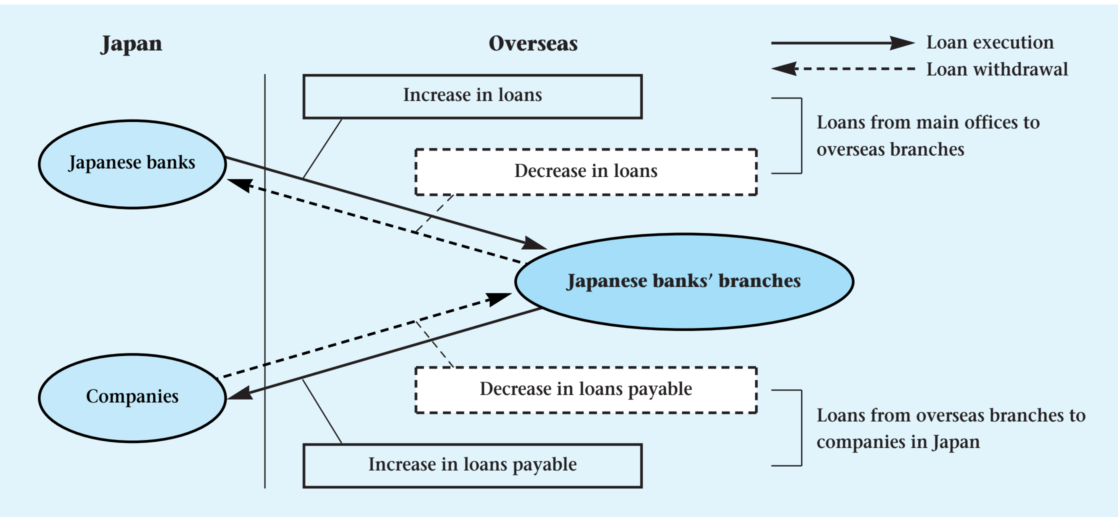
Loans payable other than those on interoffice accounts and Euro-yen impact loans, including borrowing by Japanese banks from overseas special purpose companies (SPCs) and "*gensaki* (sell/buy-back)" transactions by securities firms, remained a net inflow.

Box 3 Flow of Funds in Euro-Yen Impact Loans

Euro-yen impact loans are yen-denominated loans by nonresidents to residents. They are mainly lent by Japanese banks' overseas branches to companies in Japan, and in many cases the funds for the loans are transferred from main offices in Japan through interoffice accounts. They are recorded in the balance of payments' "other investment," as indicated below.

Withdrawal of Euro-yen impact loans (repayments by residents) has continued in recent years, mainly mirroring asset reductions in Japanese banks' overseas branches. This movement is shown in the balance of payments as an increase in repayments of "loans payable (other sectors)," and in withdrawal of "loans (funds for the loans transferred to Japanese banks' overseas branches through interoffice accounts) (banks)" under "other investment."

Chart for Box 3 **Euro-Yen Impact Loans: Flow of Funds**



18. However, some foreign banks borrowed large volumes of yen funds from their overseas offices and invested them in, for example, Japanese FBs.

19. When the Japan premium increased in the autumn of 1998, the assets of interoffice accounts (loans from Japanese main offices to overseas branches) as well as the liabilities (loans payable by Japanese main offices from overseas branches) increased, because (1) Japanese banks transferred yen mainly to London and Singapore branches, converting it to U.S. dollars, and transferred the U.S. dollars to other overseas branches as a way of supporting their foreign currency needs, and (2) excess funds at overseas branches resulting in the transfers of abundant funds from main offices were transferred back to main offices.

b. Currency and deposits

(1) Assets (deposits by residents to nonresidents)

In "currency and deposits (assets)," the overall net inflow fell considerably (an inflow of ¥422.3 billion in 1999 [net withdrawal] against that of ¥7,977.6 billion in 1998). There was a continued net inflow in collateral deposits[20] in securities borrowing transactions of securities firms. However, banks' deposits (deposits by banks in Japan to nonresidents) shifted to a net outflow because Japanese banks did not reduce overseas deposits as they had done the previous year, due to improved funding conditions for foreign currency, and foreign currency funds raised in preparation for possible Year 2000 problems were invested in overseas deposits.[21]

(2) Liabilities (deposits received by residents from nonresidents)

In "currency and deposits (liabilities)," a high level of net outflow continued (an outflow of ¥6,735.2 billion in 1999 [net repayment] against that of ¥7,393.2 billion in 1998), chiefly because of an outflow in banks' deposits received (deposits received by banks in Japan from nonresidents). Japanese banks continued to reduce deposits received in line with asset reduction. Foreign banks also increased their net repayment, since low interest rates in Japan made investing difficult.

Symbols and Abbreviations Used in This Article

CY	Calendar year	y/y % chg.	Percentage changes from the previous year
Q	Calendar quarter	bil.	Billions
n.a.	Not available	tril.	Trillions
%	Percent		

20. Receipt and payment of collateral deposits related to securities borrowing transactions by residents from nonresidents is included in "currency and deposits" (repayment of collateral deposits indicates a reduction in collateral-backed securities borrowings by residents from nonresidents).
21. In many cases, investments through bank deposits of the surplus funds were not withdrawn at 1999 year-end, but rather rolled over.