Japan's Balance of Payments for 2002

I. Summary[1]

A. Overall Trends[2]

In the balance of payments for 2002, the current account surplus registered 14.2 trillion yen, an increase from the surplus of 10.7 trillion yen in 2001. The capital and financial account recorded a net outflow of 8.0 trillion yen, widening from the net outflow of 6.2 trillion yen in 2001, an expansion primarily reflecting movements in the financial account. The year-on-year growth in reserve assets was 5.8 trillion yen, up from 4.9 trillion yen in 2001.

B. Major Developments in the Balance of Payments for 2002

1. A widening of the current account surplus due to structural factors (shift of production bases overseas and an increase in overseas production)

Structural factors contributed significantly to the widening of the current account surplus in 2002. Specifically, there was a surge in Japan's exports of capital goods and parts, as capacity at newly established Japanese production bases in Asia and especially in China became fully operational.

The trade surplus widened for the first time since 1998 primarily due to an expansion in exports. Exports increased as a result of (1) brisk sales of Japanese motor vehicles worldwide, (2) restocking of IT-related goods in the first half of 2002, and (3) a surge in demand for equipment, raw materials, and parts in the second half of 2002. The third factor reflected the influence of Japanese production bases abroad, as these became fully operational or began to increase production.

China replaced the United States as Japan's largest trading partner in terms of imports due to an increase in imports of manufactured goods from China. However, the trade deficit with China narrowed significantly in 2002 because the increase in exports of equipment, raw materials, and parts more than offset the increase in imports. When trade with Hong Kong is included, Japan recorded a small trade surplus with China.[3]

The deficit in the services account shrank because deficits narrowed in the transportation and other services accounts, contributing to the widening of the current account surplus. The deficit in the transportation account narrowed because air freight charges recorded a surplus in the second half of the year. This was in part because demand for semiconductors and other electronic parts increased as overseas production bases newly established by electrical machinery manufacturers became fully operational.

The deficit in other services also narrowed. This was partly attributable to an increase in royalty receipts due to an expansion in Japanese carmakers' production overseas. The deficit in royalties and license fees contracted for the sixth consecutive year, registering a record-low deficit.

2. A high level of outward and inward direct investment

Outward direct investment by residents recorded a substantial net outflow in 2002, despite a falling off in large-scale investments in telecommunications. This was because Japanese carmakers and electrical machinery manufacturers continued to invest actively in their subsidiaries in the United States and Europe. Inward direct investment by nonresidents marked the second highest net inflow on record, reflecting active investment in industries such as pharmaceuticals and chemicals, and the automobile industry.

3. A record-high investment in foreign equities by residents

Investment in foreign equities by residents recorded a record-high net outflow (purchases) due to purchases by trust banks (trust accounts). Public pension funds significantly increased purchases of U.S. and European equities using newly distributed funds. In addition, corporate pension funds actively invested in foreign equities toward the summer, expecting a rise in the stock prices, as an early recovery in the U.S. economy was anticipated.

4. Dissolution by a major Japanese investor of its overseas "LP" fund management scheme

A major Japanese investor dissolved a fund management scheme that made use of overseas limited partnerships (LPs). As a result, securities were transferred to Japanese trust banks (residents) from the LPs (nonresidents), considerably affecting the financial

1. This article is based on data available as of February 20, 2003.
2. Figures for 2002, including charts, are preliminary unless otherwise noted. For a key to the symbols and abbreviations used in this article, see page 144.
   Annual, semiannual, and quarterly figures in this article, including charts, are on a calendar-year basis unless otherwise noted.
3. In Japan's trade statistics, trade partners are defined as countries of origin for imports and as countries of destination for exports. Accordingly, Japan's exports to mainland China via Hong Kong are recorded as exports from Japan to Hong Kong in Japan's trade statistics, and as imports from Japan to mainland China in China's trade statistics.

account (outward and inward portfolio investment and other investment) at the time of the transfer.[4]

The transfer of securities held by the LPs was recorded in the balance of payments statistics as follows: (1) the transfer of Japanese equities and bonds issued by residents was recorded as sales (an outflow) by nonresidents in inward portfolio investment; (2) the transfer of foreign equities and bonds issued by nonresidents was recorded as purchases (an outflow) by residents in outward portfolio investment; and (3) the return of capital subscribed to the LPs was recorded as a collection (an inflow) in other assets in other investment.[5]

II. The Current Account (Charts 1, 2, and 3)

The current account surplus widened by 33.8 percent from the previous year, primarily reflecting a substantial widening of the surplus in goods and services, which doubled from the previous year's level. The surplus in income contracted slightly, narrowing by 1.5 percent from its record high in the previous year.

The trade surplus widened for the first time since 1998.

The income surplus narrowed slightly from the previous year, but exceeded the surplus in goods and services, and accounted for nearly 60 percent of the current account surplus.

A. Trade Balance (Chart 4)

The value of exports increased by 6.2 percent from the previous year, mainly due to an increase in the volume of exports to Asia. Export prices declined from the previous year, because a fall in U.S. dollar-denominated nominal prices, mainly for semiconductors and raw materials, more than offset the effect of the depreciation of the yen (Chart 5).

The value of imports declined by 0.8 percent from the previous year, primarily due to the decline in import prices. This decline was due to the fall in U.S. dollar-denominated prices of mineral fuels and others, which more than offset the effect of the depreciation of the yen. The volume of imports increased slightly year on year.

The trade surplus widened for the first time in four years, owing to the increase in exports and the decline in imports.

The widening of the trade surplus was due to the following developments in exports and imports. Exports increased against the following background: (1) a gradual recovery in production in the United States and Asia in the first half of the year, as restocking of IT-related goods started worldwide, the U.S. economy bottomed out, and domestic demand in China remained firm (cyclical factors); and (2) a shift of production overseas by Japanese companies, which led to an increase in demand for raw materials and parts in Asia, especially China, in the second half of the year (structural factors). The decline in imports was attributable both to the weak recovery in domestic production, which led to a decline in imports of mineral fuels, and to sluggish domestic demand, which led to a decline in imports of textiles.

(1) Cyclical factors: a gradual recovery in overseas economies and a recovery in demand for IT-related goods

In 2002, the increase in Japan's exports was due to the following three factors. First, there was a recovery in demand for IT-related goods such as semiconductors and other electronic parts, reflecting the restocking of inventory that began once the worldwide inventory adjustment that had continued from the beginning of 2001 until the first quarter of 2002 had run its course. Second, with the bottoming out of the U.S. economy, production began to recover gradually. And third, these two factors contributed to a gradual recovery in production in Asia, which is highly dependent on IT-related industry and the U.S. economy. Meanwhile, imports decreased slightly on the whole, despite demand for renewal of aircraft, with imports of mineral fuels and textiles declining as a result of sluggish domestic production and weak private consumption.

(2) Structural factors: the shift of production bases overseas

In the past few years, an increasing number of Japanese manufacturers have been shifting their production bases to Southeast Asia and China, where the cost of labor is low and the potential growth of the market is high. Such developments in Japan's direct investment have been changing its export/import structure, and this change became more apparent during 2002.

Specific changes observed were as follows (charts 6 and 7). In Japan's total exports, the share of

4. This transfer did not result in an actual flow of funds.
5. The net outflow in inward and outward portfolio investment and the net inflow in other assets in other investment balanced.

exports to China has been increasing reflecting the shift of production bases to China, while that of the United States has been decreasing. Looking at exports to Asia by type of goods, the share of capital goods and parts has been increasing while that of durable consumer goods, such as audiovisual apparatus and motor vehicles, has been decreasing. As for imports, (1) the share of imports has been increasing for Asia, and especially China; and (2) by type of goods, the share of finished products, especially machinery, has been increasing while that of primary products has been decreasing.

Recent developments in direct investment suggest that production bases for goods other than consumer goods will also shift overseas in the future and thereby lead to a narrowing of the trade surplus. Currently, however, the shifting of production bases overseas is contributing to an increase in both exports and imports, with exports of capital goods and parts growing at a faster pace than imports of consumer goods.

Trade with China expanded significantly in 2002. Specifically, exports to China grew considerably for raw materials and manufacturing equipment and parts, as an increasing number of firms' production bases in China became fully operational. Imports from China increased for highly technology-intensive finished products such as office machinery (see Box 1 on pages 129–131 for details on imports of high-value-added products from China).

In 2002, China replaced the United States for the first time to become Japan's largest trading partner in terms of annual imports.

Japan's export structure has become less dependent on the U.S. economy. The level of exports in Japan has moved almost in parallel with the level of U.S. production in the past (Chart 8). In 2002, however, Japan's exports surged despite a slow recovery in U.S. production due to an increase in exports of capital and other goods to Asia, where many Japanese firms with production bases became fully operational.

The structural changes can also be observed in the import penetration rate (Chart 9). An increase in the rate of import penetration for textiles was coming to a halt, while there were surges for machinery, particularly for general machinery (e.g., personal computers [PCs] and printers), that are relatively technology-intensive consumer goods. This change was also evident in the trade specialization coefficient, which showed that Japan's export competitiveness has weakened for machinery (Chart 10).

1. Exports[6]

On a customs-clearance basis, export value and volume both increased, by 6.4 percent and 8.3 percent year on year, respectively. Export prices decreased by 1.8 percent.

a. Regional trends (charts 11, 12, and 13)

Exports to Asia and the United States, both of which contributed negatively in the previous year, made positive contributions to overall export growth in 2002. Among Asian economies, China's contribution was fairly large, and taken together with those of NIEs accounted for a large part of growth in exports to Asia. Exports to the European Union (EU) contributed negatively but to a lesser degree than in the previous year.

(1) Exports to Asia

The value of exports increased from the previous year, with the increase in export volume more than offsetting the fall in export prices. After decreasing in 2001, the volume of imports increased, reflecting the cyclical and structural factors mentioned earlier. Specifically, the volume of exports for raw materials increased throughout the year, and growth in exports of IT-related goods and other machinery turned positive in the April–June quarter and increased further toward the year-end. Export prices declined on the whole. Depreciation of the yen contributed to push up export prices, but was more than offset by the fall in U.S. dollar-denominated nominal prices for raw materials (including iron and steel products, and plastics) as well as for semiconductors and other electronic parts, which together accounted for a large share of total exports.

Chart 14 gives major items contributing to growth in exports to Asia.

(2) Exports to the United States

The value of exports increased from the previous year, as the increase in export volume more than

6. Figures for exports and imports are on a customs-clearance basis. Figures for December are final figures for exports and provisional figures for imports. Three customs-clearance figures are released: estimated, provisional, and final figures.

Exports are recorded in the balance of payments based on the change of ownership principle, in which an export takes place when there is a transfer of the ownership of a good between residents and nonresidents. Specifically, figures are compiled by deducting the amount of reexports/reimports (the parts of a transaction that do not involve transfer of ownership) and other figures from customs-clearance figures (recorded when goods cross the customs frontier). Major differences between the two statistics are shown in the Reference to Chart 52.

offset the fall in prices. The volume of exports increased year on year. Export volume of motor vehicle-related goods registered an especially high growth throughout the year. The volume also increased for visual apparatus. Export volume of IT-related goods, such as semiconductors and telecommunications apparatus, recorded positive growth in the October–December quarter, following a slowing rate of year-on-year decline in the previous three quarters. Meanwhile, scientific, medical, and optical instruments recorded a larger year-on-year decline in export volume from the previous year. Export prices decreased for the first time in three years.

(3) Exports to the EU

The value of exports decreased for the fourth consecutive year, with the decline in volume more than offsetting the rise in prices. The volume of exports decreased on the whole. Exports of motor vehicle-related goods and audiovisual apparatus increased from the previous year and the pace of year-on-year decline slowed for IT-related goods (semiconductors and other electronic parts, and telecommunications apparatus) from the April–June quarter. These developments, however, were not strong enough to offset an expansion in the year-on-year decline recorded for scientific, medical, and optical instruments and metalworking machinery. Despite falls in market prices, export prices rose for the second consecutive year due to the appreciation of the euro.

b. Principal items (charts 15 and 16)

A major export item contributing to the increase in overall exports was motor vehicles. Exports of raw materials and visual apparatus also increased, and those of IT-related goods recovered, with the exception of telecommunications apparatus.

(1) An increase in exports of motor vehicles

There were increases in the value of motor vehicle exports destined for the United States, Europe, and Asia, with the United States accounting for the largest portion of these exports. Brisk sales, following successful sales promotion programs launched by Japanese carmakers such as the introduction of new models and offers of zero-interest car loans, contributed to the increase in exports to the United States. Meanwhile, the removal of a special tariff on motor vehicles in China following its accession to the World Trade Organization (WTO) resulted in a significant expansion of exports to China, which was the main factor behind the increase in exports to Asia.

(2) An increase in exports of raw materials, and capital goods and parts to Asia

Exports, especially those to Asia, increased for raw materials and capital goods and parts. This increase stemmed from a combination of the following cyclical and structural factors. Cyclical factors such as the completion of worldwide inventory adjustment for IT-related goods and the bottoming out of the U.S. economy led to a recovery in production in Asia, the world's exporting base for IT-related goods. At the same time, production facilities established in China and other parts of Asia were becoming fully operational, and this structural factor led to a surge in demand for raw materials and capital goods and parts in Asia.

2. Imports

On a customs-clearance basis, import value decreased by 0.6 percent year on year, while the volume of imports increased by 1.6 percent and prices fell by 2.1 percent. See Box 2 on pages 132–135 for recent developments in import prices.

a. Regional trends (charts 17, 18, and 19)

Imports from Asia contributed positively to the overall growth in imports owing to an increase in imports from China. Imports from the EU also contributed slightly to this growth, but contributions of other areas were all negative.

(1) Imports from the United States

The value of imports decreased for the second consecutive year, with the decline in the volume of imports more than offsetting the rise in import prices. In spite of imports of large aircraft in the April–September period, the volume of imports declined as a whole, mainly due to decreases in telecommunications apparatus and meat. Import prices rose for the third consecutive year, pushed up mainly by the depreciation of the yen.

See Chart 20 for major items contributing to the growth in imports from the United States.

(2) Imports from the EU

The value of imports increased for the third consecutive year, with a rise in prices more than offsetting a decline in import volume. The volume of imports decreased for the first time in three years mainly reflecting declines in imports of office machinery and iron and steel products. Import prices rose for the second consecutive year given the depreciation of the yen and the rising prices of pharmaceuticals.

See Chart 21 for major items contributing to the growth in imports from the EU.

(3) Imports from Asia

The value of imports from Asia increased for the fourth consecutive year with the rise in the import volume more than offsetting the fall in import prices. The volume of imports rose for the fourth consecutive year, reflecting a surge in the imports of coal and Chinese-made office machinery toward the year-end. Import prices fell for the first time in three years, mainly reflecting the fall in the prices of petroleum products.

See Chart 22 for major items contributing to the growth in imports from Asia.

b. Principal items (charts 23 and 24)

(1) A decline in imports of mineral fuels

The value of imports decreased for the majority of items categorized under mineral fuels due to sluggish demand for energy. The fall was especially significant for crude and partly refined petroleum, which declined by 4.0 percent year on year. The fall in the value of imports for liquefied natural gas owed much to a decline in prices, with the average unit price falling 9.4 percent year on year.

The volume of imports decreased on an annual basis, but registered an increase from September onward. This was because prices of mineral fuels rose amid growing political tension in the Middle East, a general strike in Venezuela, and an increase in imports of fuels to supplement the domestic energy supply after the suspended operation of nuclear power plants in Japan.

(2) An increase in imports of office machinery and a decline in imports of textiles from China

Imports of office machinery from China increased considerably, up 81.7 percent from the previous year, while imports from other major countries declined across the board. Imports from China increased primarily because production bases established in China by manufacturers from Japan and various other countries became fully operational.

Imports of textiles decreased as a whole from the previous year because those from China and other major countries decreased reflecting weak demand in Japan. The significant increase in imports of office machinery from China suggests that structural changes are in progress. Imports are growing for capital-intensive goods while decreasing for labor-intensive goods. Moreover, imports from China have become increasingly high-value-added even within the same product category.

(3) An increase in imports of aircraft

Imports of aircraft surged by 94.2 percent year on year and made the largest single contribution to the overall growth in the value of imports. This was because, after delaying the pace of aircraft renewal in the late 1990s due to the severe fund-raising environment, since 2000 Japanese airlines have begun large-scale purchases of aircraft with relatively short delivery schedules, and receipt of these was concentrated in 2002.

B. Services

After widening in 2001, the deficit in the services account shrank to 5,162.7 billion yen in 2002 to give a year-on-year decrease of 152.3 billion yen (down 2.9 percent). This was because the deficit in the transportation account and other services shrank, although the deficit in the travel account expanded.[7]

1. Transportation (Chart 25)

The deficit in the transportation account narrowed for the second consecutive year to 915.2 billion yen, decreasing by 101.5 billion yen from the previous year. This was because (1) the unit price paid for passenger fares decreased, reflecting the increased popularity of trips to Asia and other neighboring areas amid slow recovery in the number of Japanese travelers going abroad; and (2) receipts (credit) in air freight increased, reflecting the growth in exports of visual apparatus and semiconductors and other electronic parts.

2. Travel (Chart 26)

The deficit in the travel account expanded for the first time in three years to 2,855.2 billion yen, widening by 38.4 billion yen from the previous year. Receipts (credit) in the travel account increased, with a substantial increase in the number of flights between Japan and other Asian countries following the opening of Tokyo Narita Airport's temporary runway in April. This, however, was not adequate to offset an increase in payments (debit) following the plunge to an extremely low level after the terrorist attacks in the United States in September 2001.

7. Certain travel-related transactions conducted between residents and nonresidents are registered under the following items in the services account. Airfare payments are recorded under "passenger" for air transport in the transportation account. Expenditures on goods and services by nonresidents traveling in Japan and residents traveling abroad are entered in the travel account.

a. Consumption per traveler

Consumption per Japanese traveler going overseas increased slightly from the previous year to 201,000 yen, up 0.8 percent. The increase was due largely to the depreciation of the yen, as the annual average for the interbank exchange rate of the yen depreciated by 3.1 percent against the U.S. dollar to 125.31 yen in 2002 from 121.53 yen in 2001. Consumption per traveler in terms of the U.S. dollar was down 2.3 percent from the previous year. Consumption per traveler decreased because travel to Asia, where outlays for travel are relatively low compared to other regions, continued to be popular.

Consumption per traveler entering Japan remained almost unchanged from the previous year at 84,000 yen, up by only 0.1 percent from 2001. The amount in U.S. dollars, however, decreased by 3.1 percent in 2002.

b. Travelers departing from and entering Japan

(1) Number of Japanese travelers going overseas (Chart 27)

The number of travelers going abroad from Japan slightly exceeded the previous year's level, recording 16.51 million in 2002, up 1.8 percent year on year. This small increase was a response to the sharp decline in the number of travelers going overseas in 2001, after the terrorist attacks in the United States in September that year. The number of travelers in 2002 represented a 7.3 percent decline from its level of 17.82 million in 2000 (see Box 3 on pages 136–137 for details on the number of travelers departing from Japan after the terrorist attacks).

By destination, the number of travelers visiting China increased significantly, surpassing the number of people going to South Korea. The number of people visiting the United States, including Hawaii and Guam, dropped sharply from the previous year's level (Chart 28).

(2) Number of travelers entering Japan

The number of travelers entering Japan increased to 5.24 million in 2002 from the previous peak of 4.77 million in 2001. Despite a decline at the beginning of the year due to the lingering negative effects of the terrorist attacks in the United States, the number increased owing to steady growth thereafter.

There was an increase in travelers to Japan from Taiwan, South Korea, and China (charts 29 and 30). This was attributable to (1) the considerable increase in the number of flights between Japan and other Asian economies as a result of the use of the temporary runway at Tokyo Narita Airport; and (2) the relatively high economic growth in Asia compared to other areas.

3. Other services (Chart 31)

The deficit in other services shrank to 1,392.3 billion yen in 2002, declining by 89.3 billion yen from the previous year. This was because the surplus in merchanting and other trade-related services and financial services widened while the deficit in royalties and license fees and personal, cultural, and recreational services narrowed. These factors contributed to narrowing the deficit in other services by 297.5 billion yen from the previous year, more than compensating for the 282.3 billion yen widening in the deficit in miscellaneous business, professional, and technical services and insurance services.

(1) Items recording a widened surplus

The surplus in merchanting and other trade-related services was 2.5 times larger than that in the previous year. This was because the year-on-year increase of 20.9 percent in receipts due to active merchanting was larger than the 1.8 percent increase in payments.

The surplus in financial services widened for the second consecutive year since it turned to a surplus in 2000. Active investment banking in Japan by nonresidents led to an increase in receipts of 19.1 percent year on year, which was larger than the 1.9 percent increase in payments.

(2) Items recording a narrowed deficit

The deficit in royalties and license fees shrank for the sixth consecutive year and recorded 52.3 billion yen, a record-low deficit (Chart 32). This was due to an increase in income from royalties reflecting the expansion of production overseas by Japanese manufacturers, especially carmakers.

The deficit in personal, cultural, and recreational services narrowed for the first time in three years. This was because receipts (credit) in this account increased as much as 2.7 times their level of the previous year as a result of the World Cup soccer tournament (see Box 4 on page 138 for the effect of the World Cup Soccer tournament on the travel account).

(3) Items recording a widened deficit

The deficit in miscellaneous business, professional, and technical services widened for the second consecutive year. This was due to an increase in payments by 8.4 percent from the previous year given that research and development expenses increased for overseas operational bases of Japanese companies in the automobile and pharmaceuticals industries.

The deficit in insurance services expanded for the second consecutive year. This was due primarily to sizable reinsurance payments made as a result of the terrorist attacks in the United States.

C. Income (Charts 33 and 34)

The level of the income surplus remained high in 2002 at 8,278.4 billion yen, although narrowing slightly from the previous year's level, down 122.3 billion yen or 1.5 percent year on year. This was because the narrowing of the surplus in other investment income and direct investment income was larger than the widening of the surplus in portfolio investment income.

1. Direct investment income (Chart 35)

The surplus in direct investment income narrowed slightly for the first time in three years to 1,441.4 billion yen, down 101.9 billion yen or 6.6 percent from the previous year. Receipts (credit) from reinvested earnings[8] increased by 186.7 billion yen to 1,032.0 billion yen. This was because large profits were recorded by overseas subsidiaries and branches of Japanese companies and banks in their settlement of accounts for fiscal 2000, and these were reflected in the statistics until August 2002.[9] Payments (debit) in dividends and distributed branch profits[10] increased by 144.8 billion yen, partly because a foreign parent company increased its share of paid-in capital in a manufacturer in Japan, while receipts (credit) decreased by 84.8 billion yen reflecting the streamlining of business operations overseas by Japanese companies. See Box 5 on pages 139–142 for the analysis of the profitability of direct investment in China using balance of payments statistics.

2. Portfolio investment income (Chart 36)

The surplus in portfolio investment income widened for the third consecutive year to 6,347.8 billion yen, increasing by 120.9 billion yen or 1.9 percent from 2001, and recording a new high. Receipts (credit) from money market instruments declined reflecting a fall in the outstanding amount of investment and a decline in interest rates in the United States and Europe. Net receipts from investment in bonds and notes increased despite declining interest rates, mainly due to an increase in the outstanding amount of investment by residents and a decrease in investment in Japanese bonds and notes by nonresidents. See Box 6 on pages 143–144 for long-term trends in Japan's current account surplus with the United States.

3. Other investment income (Chart 37)

The surplus in other investment income narrowed for the third consecutive year to 499.6 billion yen, narrowing by 135.9 billion yen or 21.4 percent from a year earlier. This was due to a fall in income reflecting the streamlining of business operations overseas by Japanese financial institutions and a decline in the interest rate on loans in the United States and Europe.

D. Current Transfers (Charts 38 and 39)

The deficit in current transfers decreased for the third consecutive year to 595.2 billion yen, narrowing substantially by 365.2 billion yen or 38.0 percent from a year earlier. The official sector recorded a surplus for the first time in the current categorization of data available since 1991 due to a receipt of funds returned by the Asian Development Bank (ADB) in March 2002.[11] The deficit in other sectors narrowed due to large settlement payments of a lawsuit received in January and a decline in tax payments, contributions, and fines.

III. The Capital and Financial Account (Chart 40)

In 2002, the capital and financial account recorded a net outflow of 8.0 trillion yen, mainly due to developments in portfolio investment.

8. In the balance of payments statistics, an increase in accumulated reserves of an overseas subsidiary in each accounting period is recorded as reinvested earnings in direct investment income. This is based on the fiction that the dividends, which are to be received by the parent company in Japan, are reinvested in the subsidiary by the parent company.
9. Reinvested earnings, the year-on-year change in accumulated reserves, are revised at the end of each accounting period. If entered into the books as a lump sum, the earnings would only be recognized as one-time data for the month ending the accounting period, which is usually March for many Japanese companies. To average out the amount, the change in reserves is divided into twelve equal portions and recorded as monthly reinvestment income from six months after the end of the previous accounting period, based on a report submitted by each company. Therefore, the results of the accounting of overseas subsidiaries for fiscal 2000 greatly affected reinvested earnings for the twelve months covering September 2001 to August 2002.
10. Dividends and distributed branch profits are dividends from overseas subsidiaries and the income from overseas branches actually remitted to the parent company or the head office in Japan.
11. In March 1999, the Japanese government granted funds amounting to about 360.0 billion yen to the ADB's Asian Currency Crisis Support Facility.

Statistics compiled on the basis of the International Monetary Fund's *Balance of Payments Manual, Fifth Edition* introduced in 1996 can be obtained from 1991 and onward for the "official sector" and "other sectors."

Outward direct investment by residents continued to record a large net outflow primarily reflecting investment in the automobile and electrical machinery industries in the United States and Europe. However, outward direct investment decreased year on year due to a falloff in large-scale investments in telecommunications companies. Inward direct investment by nonresidents increased from the previous year, marking its second highest level on record, with the increase reflecting active investment in the pharmaceuticals, automobile, and financial services and insurance industries.

In investment in foreign equities by residents, net purchases (outflow) widened significantly and reached a new high mainly due to an increase in purchases by public pension funds through trust banks. Investment in foreign bonds and notes by residents continued to record large net purchases (outflow). This was mainly attributable to banks' active investment in U.S. and European government bonds, given a decline in long-term interest rates in the United States and Europe.

Investment in Japanese equities by nonresidents saw a shift to net sales (outflow). This was mainly because a major Japanese investor terminated its investments through LPs[12] overseas, collecting the Japanese equities held by the LPs. This was recorded as sales of Japanese equities by nonresidents. Investment in Japanese bonds and notes by nonresidents also marked a shift to net sales (outflow). In addition to the influence of the same one-off factor that affected investment in equities above, contributions to this shift were due to sales of Japanese government bonds (JGBs), as the rapid depreciation of the yen in early 2002 caused deterioration in the profitability of JGBs on a foreign currency basis.

Financial derivatives continued to record a net inflow. This was mainly due to two factors. First, a net inflow was recorded as residents that engaged in yen (payments)/U.S. dollar (receipts) currency swaps received U.S. dollars to compensate for depreciated U.S. dollar-denominated principal due to the appreciation of the yen toward the summer. Second, net receipts continued for Japanese banks engaged in interest rate swaps.

Net inflow expanded in other investment. This was due to (1) a shift to net inflow in banks' interoffice accounts reflecting Japanese banks' increasing need to raise foreign currency funds, and (2) return of the funds subscribed as capital to the LPs resulting from the cancellation by a major Japanese investor of its overseas LP fund management scheme.

A. Direct Investment (Chart 41)

Outward direct investment by residents[13] recorded another large net outflow in 2002, of 3.9 trillion yen, mainly due to investment in the United States and Europe. However, net outflow declined from 4.7 trillion yen recorded the previous year, due to a falloff in large-scale capital participation by telecommunications companies. Inward direct investment by nonresidents[14] registered a net inflow of 1.2 trillion yen, the second highest on record next to the 1.5 trillion yen in 1999, reflecting active investment in the automobile, financial services and insurance, and pharmaceuticals industries. As a result, the ratio of

---

12. Limited partnerships (LPs) are a form of investment partnership. In 2002, the financial account was greatly affected by the dissolution of a fund management scheme by a major Japanese investor, which had invested in LPs overseas through Japanese trust banks for its portfolio investment management. The dissolution of this arrangement caused increases in "outflow of capital" in portfolio investment and "inflow of capital" in other investment. As a result, net outflow in inward portfolio investment by nonresidents reached a new high in 2002.

The investor used this overseas LP fund management scheme to carry out portfolio investment in Japanese and foreign equities and bonds and notes. However, it dissolved the scheme in 2002. Cancellation of this fund management scheme led to a transfer of the securities held by the overseas LPs (nonresidents) to trust banks in Japan (residents), a transaction that had to be reflected in the balance of payments statistics.

Specifically, this transaction was recorded in the balance of payments statistics in the following manner. The transfer of Japanese equities and bonds and notes held by the LPs was treated as sales by nonresidents to residents of securities issued by residents, and was recorded as sales (outflow) in inward portfolio investment. The transfer of foreign equities and bonds and notes was treated as purchases by residents of securities issued by nonresidents, and was recorded as purchases (outflow) in outward portfolio investment. Collection of funds subscribed as capital to the LPs was registered as collection (inflow) in other assets in other investment. The net outflow in inward and outward portfolio investment and the net inflow in other assets in other investment balanced.

13. Outward direct investment by a resident refers to direct investment by a resident in an economy in a resident in another economy (a nonresident), and is recorded on the assets side in the balance of payments statistics. It includes investment by Japanese companies in their foreign subsidiaries (with paid-in capital of 10 percent or more) such as initial capitalization, capital increase, loan capital (excluding loans between financial companies), and reinvested earnings.

14. Inward direct investment by a nonresident refers to direct investment by a resident in another economy (a nonresident) in a resident, and is recorded on the liabilities side in the balance of payments statistics. It includes investment by nonresident companies in their Japanese subsidiaries (with paid-in capital of 10 percent or more) such as initial capitalization, capital increase, loan capital (excluding loans between financial companies), and reinvested earnings.

inward direct investment to outward direct investment was 29.6 percent in 2002, up from 16.3 percent in 2001.

In the first half of 2002, both outward and inward direct investment increased from the same period of the previous year due to the large-scale cross-holding of shares between a Japanese and a French carmaker. In the second half of 2002, however, both types of investment registered declines, because (1) cross-border M&A projects and other forms of direct investment decreased, reflecting the worldwide economic slowdown; and (2) firms refrained from active expansion of their businesses, concentrating on retrenching measures, such as corporate restructuring and business reorganization.

1. Outward direct investment by residents (assets)

Outward direct investment, which had plunged after the bursting of the bubble and bottomed out in 1993, continued to record a large net outflow, registering 3.9 trillion yen in 2002. Net outflow, however, decreased from the previous year, when telecommunications companies made large-scale investments. There was forward-looking investment such as (1) an increase in underwriting of capital at subsidiaries by carmakers and manufacturers of parts for motor vehicles planning to expand their overseas business; and (2) capital participation in companies in the food, ceramics, and electrical machinery industries following global industrial reorganization and intensifying competition. On the other hand, there were a number of cases in which funds were extended by parent companies in Japan for the purpose of financial assistance to their overseas subsidiaries in the telecommunications, rubber, and real estate industries. Capital flowed into Japan primarily as financial institutions reviewed their strategies on overseas business and sold off or liquidated their overseas subsidiaries.

Notable developments in outward direct investment in 2002 were as follows. A Japanese carmaker purchased shares of a French carmaker to strengthen tie-ups through cross-holding of shares. Japanese carmakers and manufacturers of parts for motor vehicles increased capital in their subsidiaries in Europe to increase production overseas. An electrical machinery manufacturer engaged in capital participation in a U.S. IT-related firm's subsidiaries in order to expand its business through consolidation. Telecommunications companies extended financial support to their overseas subsidiaries for the purpose of improving the financial condition of subsidiaries.[15] Companies in the financial services and insurance industries sold off or liquidated their overseas subsidiaries as they revised their overseas business strategies.

The following developments were observed in direct investment by area in the first half of 2002 (Chart 42). Investment in Asia remained firm, mainly due to (1) investment in the production bases for motor vehicles, parts for motor vehicles, electrical machinery, and other goods for export; and (2) investment in China, with its growing market, for the purpose of establishing or expanding production bases. Investment in Western Europe, which had been increasing noticeably since 1999, registered a net outflow virtually unchanged from the second half of 2001, as large-scale investments made by a telecommunications company through its U.K. subsidiaries had run their course. Investment in the United States recorded a net outflow, but Japanese companies, primarily financial institutions, continued to sell off or liquidate U.S. subsidiaries in line with their revised overseas business strategies.

2. Inward direct investment by nonresidents (liabilities)

The level of inward direct investment by nonresidents has been increasing since 1997 for the following reasons. First, global industrial reorganization has progressed and competition has intensified. Second, an increasing number of foreign firms have attempted to expand their business in Japan. And third, an increasing number of Japanese companies have begun to accept foreign capital to aid with business restructuring and to help improve their financial conditions. Investment remained active in 2002, especially in the automobile, financial services and insurance, and pharmaceuticals industries, registering a net inflow of 1,169.4 billion yen, its second highest level on record next to the 1,451.3 billion yen in 1999.

15. Companies in the mobile communications industry have bought and established equity ties with companies worldwide to benefit from economies of scale as they prepare for the introduction of next-generation mobile phone services. From the beginning of 2002, however, these companies have been restraining large-scale investment aimed at expanding overseas business and instead are increasing the financial support extended to their subsidiaries, in order to improve the subsidiaries' financial condition. This is due to the waning of demand for telecommunications products and large debts accumulated from past capital participation that have narrowed their ability to invest further.

In 2002, active investment was made in companies in the pharmaceuticals and chemicals, automobile, and financial services and insurance industries, while investment subsided in companies in telecommunications that had accounted for a large proportion of investment in recent years. Specifically, a Swiss pharmaceuticals company purchased capital in a Japanese pharmaceuticals company and a French carmaker increased its share in a Japanese carmaker to strengthen ties between them. In financial services and insurance, a U.S. securities company underwrote a capital increase in its Japanese subsidiary to strengthen its financial base, and a U.S. insurance company purchased capital in a Japanese nonlife insurance company to expand its business in Japan, where there was a need for financial restructuring by Japanese companies.

Inward direct investment by nonresidents by area was characterized by the following developments in the first half of 2002 (Chart 43). Net inflow of investment from Western Europe was large partly because a French carmaker increased its stake in a Japanese subsidiary and a Swiss pharmaceuticals company purchased capital in a Japanese pharmaceuticals company. Investment from the United States continued to be active, mainly because a U.S. firm purchased shares newly issued by a Japanese subsidiary as part of a financial support package, and a U.S. pharmaceuticals company purchased shares newly issued by a Japanese subsidiary for the purpose of expanding its business in Japan.

B. Portfolio Investment (Excluding Securities Lending)

In 2002, a record-high net outflow of 18.1 trillion yen was registered in portfolio investment. Net purchases (outflow) continued to be sizable in outward portfolio investment by residents. In addition, inward portfolio investment by nonresidents shifted to net sales (outflow) for the first time since 1993, reaching a record high.

1. Outward portfolio investment by residents (assets)

Net purchases (outflow) remained sizable in outward portfolio investment by residents, increasing to 13,164.4 billion yen in 2002 from 12,403.1 billion yen in 2001. Net purchases above 10 trillion yen were recorded for the fifth consecutive year. This was mainly because an increase in purchases by pension funds led to large net purchases in investment in equities. Foreign bonds and notes were also actively purchased given that there were not many attractive investment opportunities in Japan, and long-term interest rates in the United States and Europe declined reflecting the worldwide economic slowdown.

a. Investment in foreign equities by residents (assets; Chart 44)

Net purchases (outflow) in investment in foreign equities by residents expanded substantially and reached a new record of 4,565.9 billion yen in 2002 from 1,413.8 billion yen in 2001 (the previous peak was the 3,657.0 billion yen registered in 1999). This mainly reflected investment by trust banks (trust accounts) using corporate and public pension funds. Specifically, many pension funds increased investment in foreign equities looking for capital gains on the expectation of an early recovery of the U.S. economy around early spring. From the summer onward, when U.S. and European stock prices began to fall, public pension funds increased new investment in foreign equities to rebalance their portfolios (Chart 45).

Net purchases by trust banks (trust accounts), the largest investor in foreign equities, surged in 2002 (Chart 46). This reflected the following three factors. First, public pension funds increased their purchases using newly entrusted funds. They particularly increased purchases to rebalance their portfolios when U.S. and European stock prices declined and the yen appreciated further. Second, corporate pension funds increasingly shifted investment funds out of foreign bonds and into foreign equities in the January–March quarter of 2002, anticipating capital gains given that an early recovery in the U.S. economy was expected. And third, foreign equities held by nonresidents were transferred to residents when a major investor in Japan dissolved its overseas LP investment scheme and entrusted portfolio management to investment firms in Japan. This was recorded in the balance of payments statistics as purchases of foreign equities issued by nonresidents.

Investment trusts continued to record net purchases reflecting the establishment of new private placement investment funds for defined contribution annuity plans in Japan.

Life insurance companies continued to record net sales, because they sold their more volatile foreign equity holdings in order to shift funds to foreign bonds and notes as their risk-taking capacity had declined due to weak stock prices in Japan.

Investment by banks also recorded net sales because some financial institutions sold their holdings of shares to reduce the burden of portfolio management.

By area, net purchases in investment in U.S. equities doubled and investment in European equities saw a shift to net purchases (Chart 47). Excluding the transaction related to the dissolution of overseas LPs mentioned above, the share of investment by area in overall investment was about 60 percent for the United States and about 30 percent for Europe. This was more or less in line with the weight of U.S. and European stocks in global indices. This indicates that the share of investors who used global indices as their benchmark was high in net purchases in 2002. Investment in Asian equities shifted to small net purchases in 2002. This was mainly because (1) investment trusts purchased stocks using new funds received from the second half of 2001 to early 2002 as investment funds investing in Asian equities became popular, and (2) newly listed stocks of Chinese firms were sold to Japanese investors from the summer onward. Investment in other areas continued to record net purchases. This was mainly because (1) Japanese firms purchased preferred subscription certificates issued by Japanese banks to boost their capital base through special-purpose entities (SPEs) located in the Cayman Islands (purchases of a stake of less than 10 percent are recorded in portfolio investment), and (2) Japanese investors purchased corporate-type investment trusts.[16]

b. Investment in foreign bonds and notes by residents (assets; Chart 48)[17]

Net purchases (outflow) in investment in foreign bonds and notes by residents continued to be large, recording 9,294.5 billion yen in 2002 against 11,130.0 billion yen in 2001, mainly due to sales and purchases of foreign bonds and notes. Net purchases narrowed slightly from the previous year despite active purchases of foreign bonds and notes by banks, as investment by life insurance companies that invest by converting yen funds into foreign currency declined substantially. Net redemption (inflow) expanded in issuance and redemption of bonds and notes issued in Japan by nonresidents because the value of *samurai* bonds issued declined considerably for the second consecutive year.

Sales and purchases by residents continued to record net purchases (outflow), registering a net purchase of 9,902.3 billion yen in 2002, narrowing from 11,143.4 billion yen in 2001. This was because banks continued to actively purchase foreign bonds given deteriorating investment opportunities in Japan that resulted from low interest rates, and because long-term interest rates in the United States and Europe continued to fall reflecting concern about the economic outlook (Chart 49). Moreover, compared with the previous year, individuals substantially increased purchases of foreign currency-denominated bonds and notes, and also their investment in investment funds managing foreign bonds and notes. Net purchases, however, narrowed slightly year on year. This mainly reflected a large fall in net purchases by life insurance companies due to a decline in risk-taking capacity and anticipation of a rise in U.S. and European interest rates in the first half of 2002.

Net redemption (inflow) expanded for issuance and redemption of bonds and notes issued in Japan by nonresidents to 607.8 billion yen in 2002 from 13.4 billion yen in 2001 (Chart 50). This was because the value of *samurai* bonds issued continued to decline while the value redeemed remained at the previous year's level. There was a large-scale issuance of *samurai* bonds by some U.S. firms with high credit ratings. On the whole, however, the value of *samurai* bonds issued remained small reflecting (1) skepticism about firms' accounting information stemming from the window-dressing of books by overseas firms, and (2) heightened awareness of credit risk following a default on Argentine bonds. A number of Japanese firms used SPEs established overseas to issue asset-backed securities (ABS), in order to securitize their assets.

Sales and purchases of foreign bonds and notes by sector were characterized by the following developments (Chart 51). Banks, the largest purchaser, continued to record a high level of net purchases. They actively purchased U.S. and European government bonds in the second half of 2002 as long-term interest rates in the United States and Europe fell against the background of growing concern about the outlook for U.S. and European economies. Many banks increased purchases of European government

16. Closed-end and corporate-type open-end investment trusts are registered in investment in equities, while contract-type open-end investment trusts are registered in investment in bonds and notes.
17. Investment in foreign bonds and notes by residents (assets) is the sum of sales and purchases by residents and issuance and redemption of bonds and notes issued in Japan by nonresidents.

bonds, especially from the autumn, as concerns about an economic slowdown in the euro area induced expectation of an interest rate cut by the European Central Bank (ECB). Some financial institutions purchased foreign investment trusts that invested in mortgage bonds.

Net purchases narrowed for investment trusts. They purchased U.S. and European government bonds constantly throughout the year for their portfolios, as there was a massive inflow of money from individuals to monthly dividend-type funds investing in foreign bonds. This, however, was largely cancelled out by the sales of euro-yen bonds carried out in the first half of the year in order to have cash on hand for possible cancellation of contracts, following the fall below par of the prices of money management funds (MMFs) in the previous year.

Net purchases declined considerably for life insurance companies despite continued purchases of U.S. and European government bonds and U.S. agency securities combined with transactions to hedge exchange rate risks. This was mainly due to a decline in their risk-taking capacity. In addition, in the first half of 2002, some life insurance companies sold bonds purchased the previous year due to their cautious investment stance in light of expectation that long-term interest rates might rise given the anticipated early recovery in the U.S. economy.

Trust banks (trust accounts) recorded expanded net purchases. They purchased foreign bonds and notes using funds newly distributed by public pension funds, and some corporate pension funds shifted their assets to foreign bonds and notes that earn higher profits.

Large net purchases were recorded in other sectors because individuals increased investment in foreign bonds and notes. Purchases were mainly concentrated in highly rated foreign bonds such as those issued for individuals by the International Bank for Reconstruction and Development (IBRD) and the ADB. This reflected (1) individual investors' increasing interest in investment in foreign bonds and notes against the background of deteriorating investment opportunities in Japan; and (2) aggressive sales promotion by securities companies, which were eager to collect money from their clients and increase income from commission fees amid weak stock prices.

The public sector recorded net sales. This was because it continued to sell U.S. and European government bonds while refraining from reinvesting the redeemed funds so as to decrease holdings of foreign bonds.[18]

By area, investment in U.S. bonds continued to record large net purchases (Chart 52). Banks actively purchased U.S. government bonds and agency securities because U.S. long-term interest rates fell reflecting growing concern about the economic outlook. Investment in European bonds also continued to record net purchases. Banks purchased European government bonds, judging that long-term interest rates would decline as an interest rate cut by the ECB became likely in late 2002. Some financial institutions purchased investment trusts established and managed in Luxembourg. Banks also sold European government bonds in the first half of the year, expecting an early recovery in the world economy. This contributed to the narrowing of net purchases in 2002. Large net purchases were again recorded in investment in bonds and notes issued in other areas. As in the previous year, some financial institutions actively purchased investment trust beneficiary certificates issued mainly in the Cayman Islands, while securities companies increased their purchases of bonds issued for individuals by the IBRD and other international organizations.[19]

c. Investment in foreign money market instruments (assets; Chart 53)

Investment in foreign money market instruments recorded net sales (inflow) for the second consecutive year, reaching 696.0 billion yen in 2002 against 140.7 billion yen in 2001. This was mainly because investment trusts sold foreign securities such as Euro-yen CP and refrained from reinvesting redeemed funds in order to have cash on hand for possible cancellation of contracts following the fall below par in the prices of money market funds (MMFs) in late 2001. Meanwhile, overseas SPEs of Japanese financial institutions continued to issue *samurai* CP to securitize their loans, recording net issuance.

18. The public sector in the balance of payments statistics does not include transactions related to the management of reserve assets. It is registered as an increase/decrease in reserve assets.

19. In the balance of payments statistics, regional classification is not applied to international organizations such as the IBRD. They are registered as "international organizations." In this article, however, international organizations are categorized under "other areas" for convenience.

2. Inward portfolio investment by nonresidents (liabilities)

Inward portfolio investment by nonresidents shifted to net sales (outflow) in 2002 with record-high net sales of 4,964.5 billion yen, from a net purchase of 4,789.9 billion yen in 2001, mainly reflecting the dissolution by a major Japanese investor of its fund management scheme using overseas LPs. As a result of the dissolution, securities were transferred from the overseas LPs (nonresidents) to trust banks in Japan (residents) and investment in Japanese equities and bonds and notes saw large net sales (outflow). This was because the transfer was recorded in the balance of payments statistics as sales by nonresidents to residents of securities issued by residents.

When the above one-off factor is excluded, it seems that inward portfolio investment by nonresidents registered net purchases (inflow) mainly due to developments in investment in equities and money market instruments that cancelled out net sales in investment in bonds and notes.

a. Investment in Japanese equities by nonresidents (liabilities; Chart 54)

Investment in Japanese equities by nonresidents recorded sizable net sales (outflow) of 1,860.3 billion yen in 2002, the second largest net sales next to 1987, marking a turnaround from net purchases (inflow) of 4,097.3 billion yen in 2001. This was mainly because a major Japanese investor dissolved its overseas LP fund management scheme and received assets transferred from the LPs. Excluding this transaction, investment in Japanese equities by nonresidents recorded net purchases (inflow), although they were smaller in size than in the previous year. The first half of 2002 was marked by (1) hedge funds repurchasing stocks they had previously sold short as tighter regulations on short-selling were introduced in the spring of 2002 to the Japanese stock market, and (2) foreign investors such as pension funds temporarily raising the weight of Japanese stocks in their portfolios given steady developments in Japanese stock prices (Chart 55). In the second half of the year, however, investment funds and pension funds decreased the weight of stocks in their portfolios in response to falling stock prices worldwide reflecting concern over an economic slowdown.

Developments by area were mixed (Chart 56). Purchases by U.S. investors exceeded sales in 2002 mainly because they increased purchases after increasing the weight put on Japanese equities that had been lowered in the first half of the year. European investors recorded net sales in the January–March and July–September quarters, but purchases exceeded sales in the other two quarters. These were results of some investors' heavy selling of various stocks through negotiated transactions before the semiannual book-closing in March and September, followed by repurchase of the same issues. Sales by investors in other areas far exceeded purchases, as investment through the overseas LP fund management scheme mentioned above was mainly made in "other areas."

By industry, there was purchasing preference for shares issued by firms in retail, chemicals, and automobiles that recorded favorable business results in the fiscal 2001 book-closing. Meanwhile, shares of firms in electrical machinery, telecommunications, and other highly export-dependent industries were sold against the background of a slow recovery in overseas economies.

b. Investment in Japanese bonds and notes by nonresidents (liabilities; Chart 57)[20]

Investment in Japanese bonds and notes by nonresidents shifted to large net sales (outflow) of 4,138.5 billion yen in 2002 (a record high) from net purchases of 1,492.4 billion yen in the previous year. This was primarily due to large net sales (outflow) in sales and purchases of Japanese bonds and notes. Issuance and redemption of bonds and notes issued overseas by residents shifted to net redemption (outflow).

Sales and purchases shifted to large net sales (outflow) of 3,248.5 billion yen in 2002 (a record high) from a net inflow of 1,428.3 billion yen in 2001. As in the case of investment in Japanese equities by nonresidents, this mainly reflected transactions resulting from the dissolution of the fund management scheme using the overseas LPs. Even when this factor is excluded, however, net sales were still recorded. This was against the following background. First, some overseas institutional investors sold JGBs given the deteriorating profitability of JGBs on a foreign currency basis as the yen rapidly depreciated toward early 2002. And second, hedge funds and foreign banks undertook sales of bonds and notes as part of technical transactions involving

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

arbitrage position makings (sales of cash bonds and purchases of bond futures) and asset swap position closings (charts 58, 59, and 60).[21]

Issuance and redemption of bonds and notes issued overseas by residents shifted to a net redemption (outflow) of 890.0 billion yen in 2002 from a net issuance (inflow) of 64.1 billion yen in 2001. This was mainly due to the large-scale redemption of convertible bonds issued by a Japanese bank.

By area, European and U.S. investors recorded net sales (Chart 61). In investment from Europe, net sales were mainly due to large sales by some institutional investors (Chart 62). In investment from the United States, bonds and notes were sold as the profitability of yen-denominated bonds on a U.S. dollar basis deteriorated at the beginning of the year (Chart 63). Sizable net sales in other areas resulted from the withdrawal by a major Japanese investor of its investment through overseas LPs, which were mainly located in "other areas."

c. Investment in Japanese money market instruments by nonresidents (liabilities; Chart 64)

Investment in Japanese money market instruments by nonresidents recorded net purchases (inflow) for the first time in three years, registering net purchases of 1,034.4 billion yen in 2002 against net sales of 799.8 billion yen in 2001. Due to the low interest rate environment, purchases were not active. In the second half of the year, however, foreign banks invested their surplus funds in treasury bills (TBs) and financing bills (FBs), against the background of a relatively low rate of yen funding (Chart 65). Central banks and international organizations also saw a shift to net purchases in the second half of the year.

C. Financial Derivatives (Chart 66)

Net inflow continued in financial derivatives, recording 262.9 billion yen in 2002 against 185.3 billion yen in 2001. This could be attributed to the following developments. First, net inflow was recorded when principal exchanged in currency swaps (yen payments and U.S. dollar receipts for Japanese banks) was marked to market, because nonresidents made additional payments in U.S. dollars to compensate for the depreciated portion of the principal to residents against the background of the appreciation of the yen toward mid-2002 (Chart 67). And second, net receipts (inflow) were recorded in interest rate swaps by banks.

D. Other Investment (Excluding Securities Lending; Chart 68)[22]

Net inflow widened in other investment to 12,667.2 billion yen in 2002 from 5,492.2 billion yen in 2001. This was mainly because (1) interoffice accounts of banks shifted to a net inflow, and (2) funds subscribed as capital to the overseas LPs were collected after a major Japanese investor dissolved its overseas LP fund management scheme and this was recorded as an inflow in other sectors in other assets.

Excluding the one-off effects from the dissolution of the LP scheme, the size of the net inflow was virtually the same as in 2001.

1. Assets/liabilities

a. Assets

Net collection (inflow) in assets, such as loans including interoffice accounts, bank deposits, and others, expanded to 8,876.0 billion yen in 2002 from 5,082.9 billion yen in 2001. This was due mainly to the dissolution of the overseas LP fund management scheme that resulted in the return of the funds subscribed as capital to the LPs. This funds flow was recorded as an inflow in other sectors in other assets. Excluding this one-off factor, net collection (inflow) narrowed in spite of the inflow that occurred as Japanese banks were unable to roll over their deposits with other banks overseas when, as in the previous year, these matured given abundant yen funds in the overseas financial markets. The decline in net inflow was due mainly to developments in interoffice accounts and other assets. Specifically, in order to increase foreign currency assets, some Japanese financial institutions (1) actively raised foreign currency through yen investment overseas using their interoffice accounts, and (2) invested the foreign currency overseas in the form of money trusts (other assets).

b. Liabilities

In liabilities, such as borrowing by residents from nonresidents (including interoffice accounts and Euro-yen impact loans[23]) and bank deposits, net borrowings (inflow) expanded to 3,791.2 billion yen

21. A combination of JGB sales and interest rate swaps (fixed-rate interest receipts and floating-rate interest payments).
22. Excludes securities lending transactions but includes exchange of cash collateral associated with securities lending transactions as well as payment and receipt of funds when borrowed securities are sold and repaid in cash. These transactions are recorded under currency and deposits or other assets/liabilities in other investment.
23. Yen-denominated loans extended by nonresidents to residents.

in 2002 from 409.3 billion yen in 2001. This occurred against the following background. First, Japanese banks raised foreign currency (inflow) through their interoffice accounts, carrying out yen investment or repo transactions to increase investment in foreign bonds. Second, foreign banks raised funds (inflow) from their overseas offices through interoffice accounts when the cost of funding yen in exchange for U.S. dollars became negative. Third, foreign securities companies raised foreign currency through repo transactions in overseas markets to meet Japanese banks' demand for foreign currency. And fourth, net repayment by Japanese firms to overseas branches of Japanese banks narrowed further with a decline in the amount outstanding of Euro-yen impact loans.

2. By item

a. Interoffice accounts and currency and deposits

Japanese banks' interoffice accounts and currency and deposits shifted to a net inflow mainly due to developments in interoffice accounts. Currency and deposits were affected as Japanese banks, given abundant yen funds in overseas financial markets, were unable to roll over their deposits with other banks overseas and collected matured funds (inflow in assets). In interoffice accounts, the shift to net inflow occurred because banks actively raised funds through repo transactions at their overseas branches (inflow in liabilities), increasing investment in foreign bonds toward the second half of the year, on the expectation of a decline in long-term interest rates in the United States.

Net inflow narrowed for foreign banks mainly due to developments in interoffice accounts. Given an expansion in the negative cost of funding yen, Japanese offices of foreign banks continued (1) to raise foreign currency funds for conversion into yen (inflow in liabilities) from their overseas offices, and (2) to collect yen funds raised by overseas offices (inflow in liabilities). Net inflow, however, narrowed from the previous year as some Japanese offices repaid yen funds to their overseas offices (outflow in liabilities). Deposits accepted from banks overseas recorded net repayment (outflow in liabilities).

b. Accounts other than interoffice accounts and currency and deposits

Net inflow widened in accounts other than interoffice accounts and currency and deposits. This was because the funds subscribed as capital to the overseas LPs were collected after a Japanese major investor dissolved its overseas LP fund management scheme, and this was recorded as an inflow in other assets in other sectors. However, when this factor is excluded, net inflow narrowed from the previous year. This was because, in addition to their usual investment in foreign bonds, some financial institutions also invested in foreign mortgage bonds (in the form of money trusts) as part of an investment strategy to increase their foreign currency assets.

Chart 1

Current Account

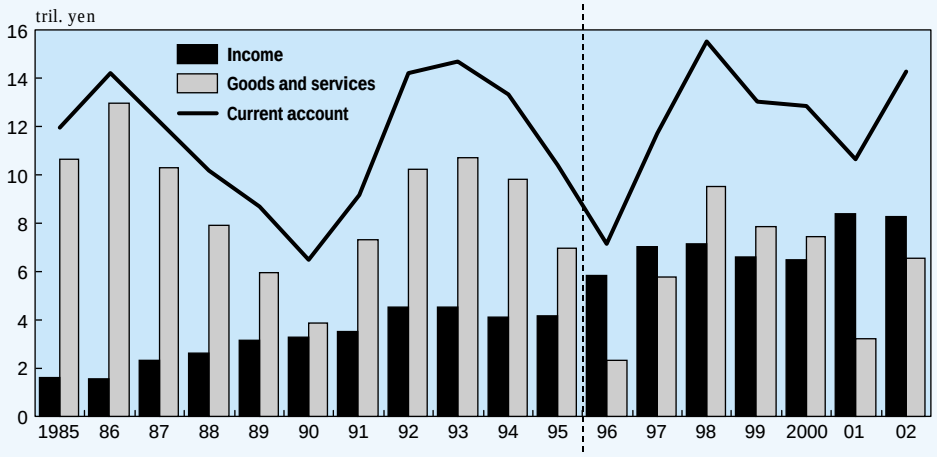
bil. yen

	2002[1]	Changes from a year earlier	2001
Current account	14,248.4	+3,596.1	10,652.3
Goods and services	6,565.3	+3,353.3	3,212.0
Trade balance	11,728.0	+3,200.9	8,527.0
Exports	**49,471.0**	**+2,887.6**	**46,583.5**
Imports	**37,743.1**	**–313.3**	**38,056.4**
Services	–5,162.7	+152.3	–5,315.0
Transportation	**–915.2**	**+101.5**	**–1,016.6**
Travel	**–2,855.2**	**–38.4**	**–2,816.8**
Other services	**–1,392.3**	**+89.3**	**–1,481.6**
Income	8,278.4	–122.3	8,400.7
Current transfers	–595.2	+365.2	–960.4

Note: *1*. Figures are preliminary.

Chart 2

Developments in the Current Account[1]



Note: *1*. Reinvested earnings and the majority of interest received on financial derivatives are not included in the income account before 1996. Accordingly, there is no statistical continuity between figures before 1996 and those from 1996 onward.

Chart 3
Goods and Services

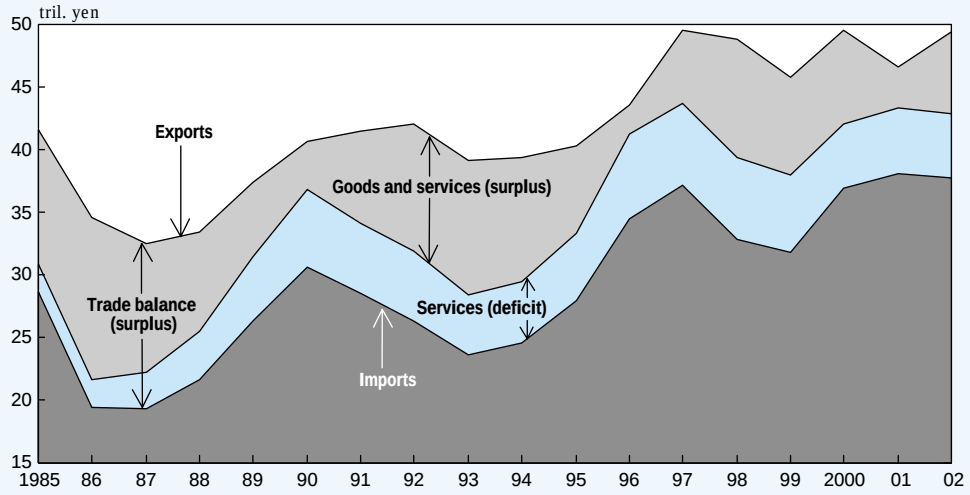
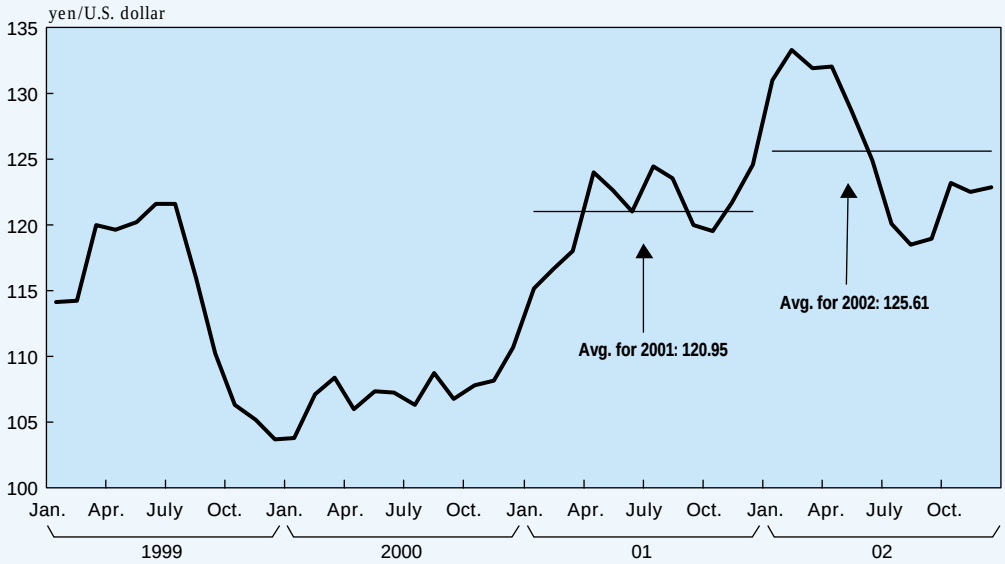


Chart 4
Trade Balance

bil. yen; figures in parentheses are % chg. from a year earlier

	2002		
		Changes from a year earlier	
Net balance	**11,728.0**	**+3,200.9**	**(+37.5)**
Exports	**49,471.0**	**+2,887.6**	**(+6.2)**
Imports	**37,743.1**	**–313.3**	**(–0.8)**

Chart 5
Exchange Rate[1]



Note: *1.* The exchange rate officially announced by the chief customs inspector used for customs-clearance documents. The rate applied is the weekly average of the most traded interbank rate on the Tokyo Foreign Exchange Market two weeks before.

Chart 6

Share in Overall Exports and Imports by Area

(1) Exports

%

	1990	95	2002
Asia	31.1	43.5	43.1
China	2.1	5.0	9.6
NIEs	19.7	25.0	22.7
ASEAN	11.5	17.4	13.4
United States	31.5	27.3	28.5
European Union	18.7	15.9	14.7
Oceania	3.1	2.4	2.5
Middle East	3.0	2.0	2.7
Others	12.6	9.0	8.5

(2) Imports

%

	1990	95	2002
Asia	28.7	36.7	43.5
China	5.1	10.7	18.3
NIEs	11.1	12.3	10.5
ASEAN	12.4	14.1	15.3
United States	22.4	22.4	17.1
European Union	15.0	14.5	13.0
Oceania	6.3	5.5	4.9
Middle East	13.1	9.4	12.1
Others	14.5	11.5	9.4

Chart 7

Share in Overall Exports and Imports by Item

(1) Exports

%

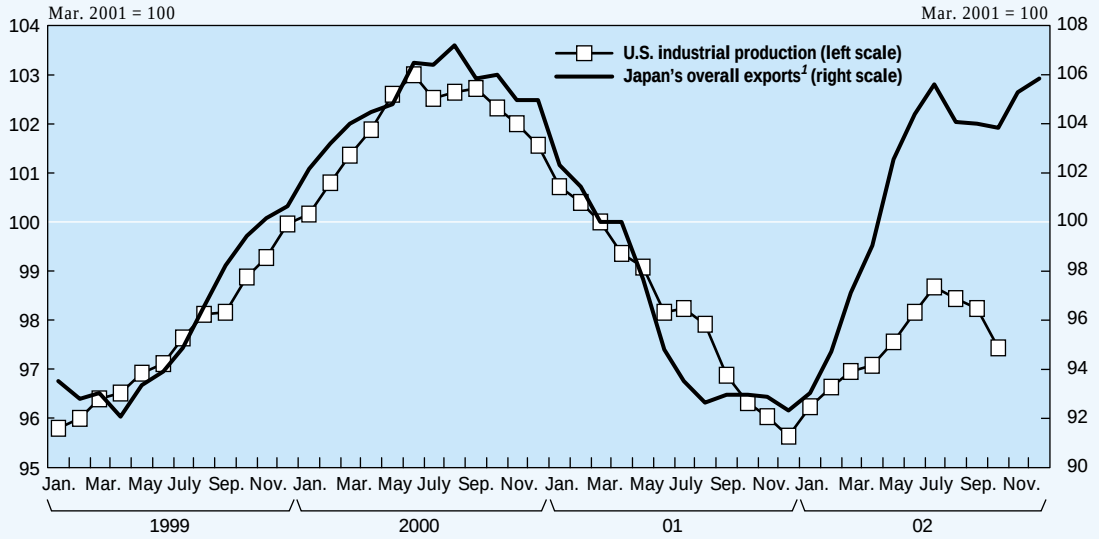
	1990	95	2002
Motor vehicles	4.9	3.7	3.1
Visual apparatus	3.1	1.7	1.3
Audio apparatus	1.0	0.6	0.2
Parts for audiovisual apparatus	1.6	1.6	1.8
Office machinery and its parts	3.0	3.2	4.3
Semiconductors and other electronic parts	7.7	12.9	13.8
Scientific, medical, and optical instruments	2.3	3.0	4.7
Chemicals	9.6	9.5	11.2
Metals and metal products	11.6	10.3	10.1

(2) Imports

%

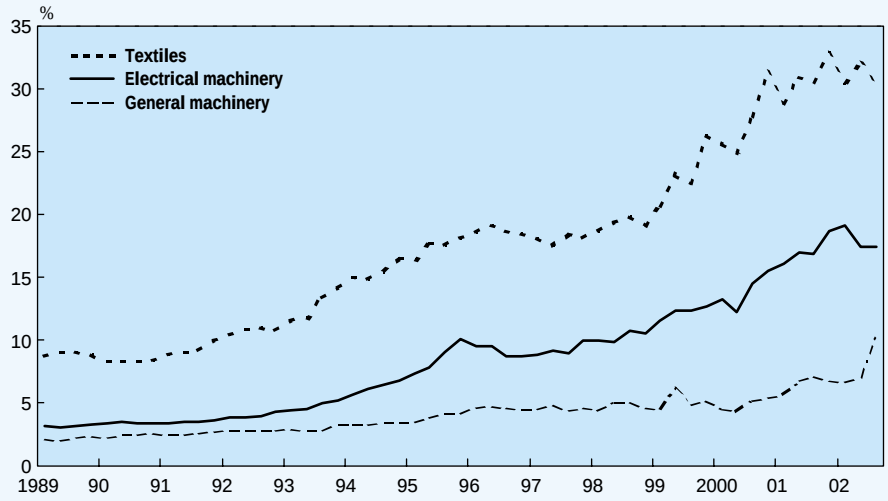
	1990	95	2002
Foodstuffs	13.9	13.3	9.5
Chemicals	3.6	3.4	4.0
Mineral fuels	25.4	11.7	11.0
Textiles	13.0	15.1	13.0
Office machinery	1.6	7.0	11.0
Audiovisual apparatus	1.9	4.1	5.0
Telecommunications apparatus	0.3	0.7	1.3
Semiconductors and other electronic parts	1.4	5.1	6.9
Scientific, medical, and optical instruments	0.5	1.3	2.2

Chart 8
U.S. Industrial Production and Japan's Overall Exports



Note: *1.* Figures are volume of exports (three-month moving average), seasonally adjusted.

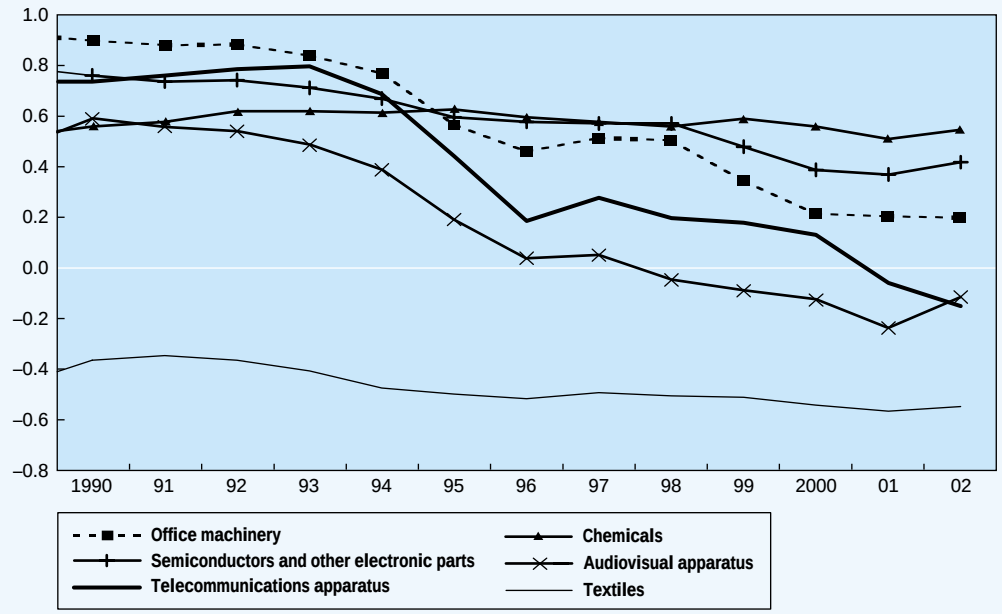
Chart 9
Rates of Import Penetration[1]



Note: *1.* Import penetration rate = (import index × weighted imports)/(aggregate supply index × weighted aggregate supply).
Source: Ministry of Economy, Trade and Industry, "Indices of Industrial Production."

Chart 10

Japan's Trade Specialization Coefficient against the Rest of Asia[1]



Note: *1.* Japan's trade specialization coefficient against the rest of Asia = (exports – imports)/(exports + imports). The distribution range of the trade specialization coefficient is between –1 and +1. Zero indicates that Japan's exports and imports are in equilibrium. Positive figures mean that exports exceed imports and thus indicate export competitiveness. Negative figures mean that imports exceed exports, and as the figures approach –1 export competitiveness weakens.

Chart 11

Contribution to Overall Export Growth in Value by Area (Customs-Clearance Basis)

y/y % chg.

	Overall exports	United States	European Union	Asia	NIEs[1]	ASEAN[1]	China	Middle East
2001	**–5.2**	**–1.2**	**–1.2**	**–2.9**	**–3.3**	**–1.5**	**+0.9**	**+0.4**
02	**+6.4**	**+0.3**	**–0.3**	**+5.5**	**+2.4**	**+0.8**	**+2.5**	**+0.3**

[Reference] Comparison of the Accounting Method for Merchandise Trade Statistics and for the Balance of Payments[2]

	Merchandise Trade Statistics	*Balance of Payments*
Price quoted[3]	**Exports: FOB** **Imports: CIF**	**Exports: FOB** **Imports: FOB**
Coverage	**Goods that have crossed the customs frontier of the reporting economy**	**Goods whose ownership has been transferred between residents and nonresidents**
Time of recording	**Exports: When the ship or the aircraft carrying the goods leaves the port** **Imports: When imported goods are officially recognized**	**When the ownership is transferred**

Notes: *1.* Includes exports to Singapore.
2. Merchandise Trade Statistics are trade statistics on a customs-clearance basis.
3. FOB stands for "free on board" and CIF for "cost, insurance, and freight." On an FOB basis, the price of goods at the exporting country is recorded. On a CIF basis, freight charges and insurance premiums in addition to the price of goods are recorded.

Chart 12
Contribution to Overall Export Growth in Value by Area (Customs-Clearance Basis)

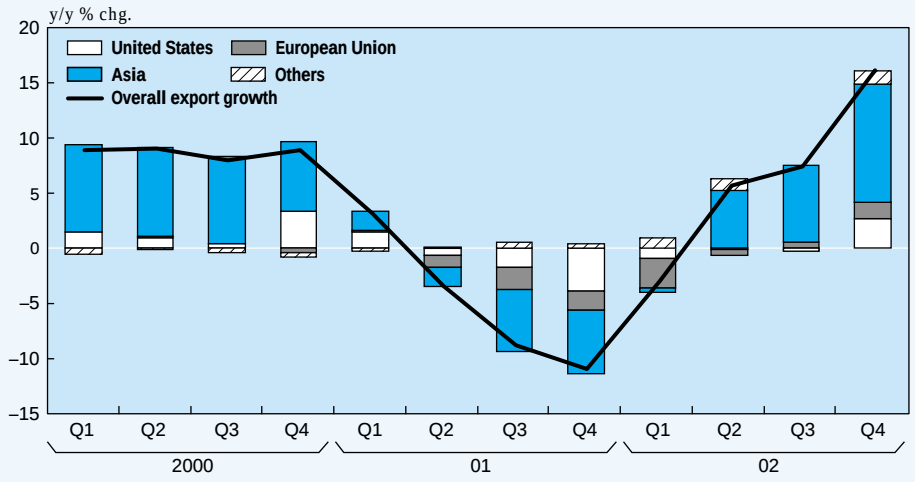


Chart 13
Exports to Asia, the United States, and the European Union (Customs-Clearance Basis)

y/y % chg.

	Value	Volume	Price
Asia	**+13.7**	**+17.9**	**–3.5**
United States	**+1.0**	**+2.8**	**–1.7**
European Union	**–2.0**	**–5.9**	**+4.2**

Chart 14
Contribution to Exports to Asia by Item

Items	Raw materials		IT-related products and audiovisual apparatus			Capital goods			Motor vehicle-related goods	
	Iron and steel products	Chemicals	Semi-conductors and other electronic parts	Office machinery	Parts for audio-visual apparatus	Scientific, medical, and optical instru-ments	Metal-working machinery	Mechanical handling equipment	Motor vehicles	Parts for motor vehicles
Contribution (percent)	**+1.8**	**+1.8**	**+2.2**	**+0.6**	**+0.4**	**+0.3**	**+0.3**	**+0.2**	**+1.0**	**+0.5**

Chart 15

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

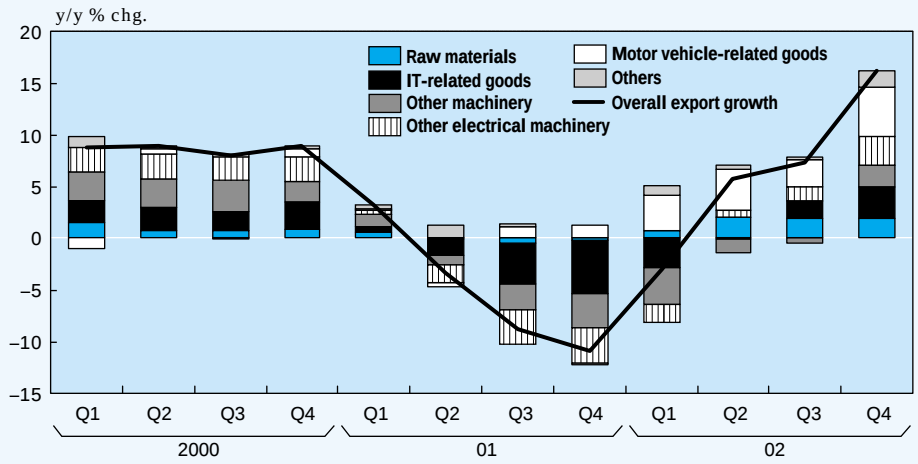


Chart 16

Contribution to Overall Export Growth by Item

y/y % chg.

Items	2001	2002	Major factors
Value of overall exports	–5.2	+6.4	—
Motor vehicle-related goods	+0.6	+3.7	—
Motor vehicles	**+0.5**	**+3.2**	**Brisk sales in the United States, Europe, and Asia**
Parts for motor vehicles	**+0.0**	**+0.5**	**Expanded production in Asia and the United States**
Raw materials	–0.1	+1.6	—
Chemicals	**–0.1**	**+0.9**	**Increase in demand due to expanded production in Asia**
Iron and steel products	**+0.1**	**+0.6**	**Expanded production in Asia**
IT-related goods	–2.6	+0.4	—
Semiconductors and other electronic parts	**–1.8**	**+0.5**	**Increase in demand for parts for PCs and telecommunications apparatus in China and NIEs**
Office machinery	**–0.5**	**+0.4**	**Increase in demand for parts for PCs and peripheral equipment**
Telecommunications apparatus	**–0.3**	**–0.4**	**Decrease in demand in the United States for telecommunications apparatus for base stations**
Other electrical machinery	–2.0	+0.7	—
Visual apparatus	**–0.1**	**+0.5**	**Brisk sales of digital cameras in the United States**
Parts for audiovisual apparatus	**–0.1**	**+0.2**	**Expanded production in Asia**
Other machinery	–1.4	–0.9	—
Scientific, medical, and optical instruments	**–0.2**	**–1.2**	**Decrease in demand for photocopiers and semiconductor manufacturing equipment in the United States and Europe**
Metalworking machinery	**–0.2**	**–0.2**	**Decrease in demand for semiconductor manufacturing equipment in the United States and Europe**
Others	+0.4	+0.8	—

Chart 17
Contribution to Overall Import Growth in Value by Area (Customs-Clearance Basis)
y/y % chg.

	Overall imports	United States	European Union	Asia	NIEs[1]	ASEAN[1]	China	Oceania	Middle East
2001	**+3.6**	**–0.3**	**+0.9**	**+2.3**	**–0.9**	**+0.4**	**+2.7**	**+0.4**	**+0.2**
02	**–0.6**	**–1.1**	**+0.2**	**+0.8**	**–0.5**	**–0.3**	**+1.6**	**–0.0**	**–0.7**

Note: *1.* Includes imports from Singapore.

Chart 18
Contribution to Overall Import Growth in Value by Area (Customs-Clearance Basis)

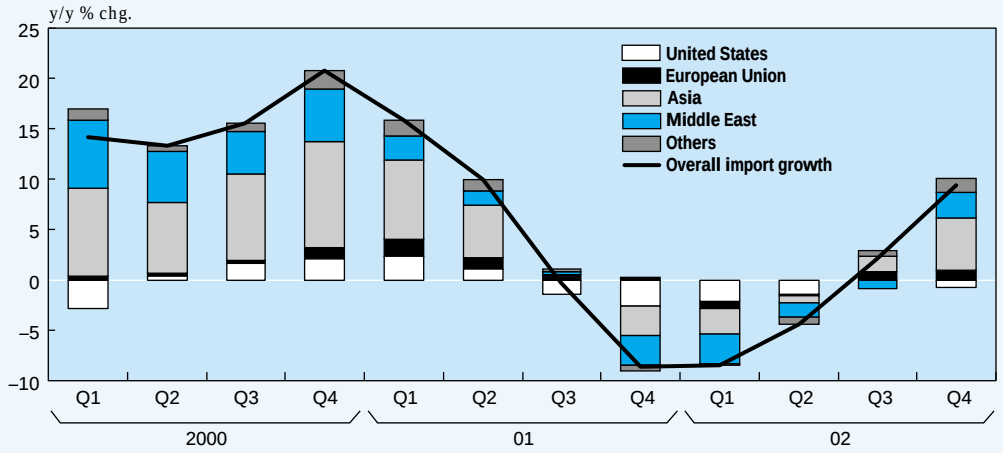


Chart 19
Imports from the United States, the European Union, and Asia (Customs-Clearance Basis)
y/y % chg.

	Value	Volume	Price
United States	**–5.9**	**–9.1**	**+3.5**
European Union	**+1.2**	**–1.9**	**+3.2**
Asia	**+2.0**	**+4.2**	**–2.1**

Chart 20

Major Items Contributing Positively or Negatively to the Growth in Imports from the United States

	Items	Contribution to overall growth (percent)
Items making a positive contribution	**Aircraft**	**+2.3**
	Power generating machinery	**+0.5**
Items making a negative contribution	**Telecommunications apparatus**	**–1.6**
	Office machinery	**–1.6**
	Meat	**–1.3**

Chart 21

Major Items Contributing Positively or Negatively to the Growth in Imports from the European Union

	Items	Contribution to overall growth (percent)
Items making a positive contribution	**Aircraft**	**+0.8**
	Pharmaceuticals	**+0.7**
	Meat	**+0.4**
Items making a negative contribution	**Office machinery**	**–1.4**

Chart 22

Major Items Contributing Positively or Negatively to the Growth in Imports from Asia

	Items	Contribution to overall growth (percent)
Items making a positive contribution	**Office machinery**	**+0.8**
	Semiconductors and other electronic parts	**+0.3**
Items making a negative contribution	**Textiles**	**–0.7**
	Petroleum products	**–0.6**
	Crude oil and partly refined oil	**–0.3**

Chart 23

Contribution to Overall Import Growth in Value by Item (Customs-Clearance Basis)

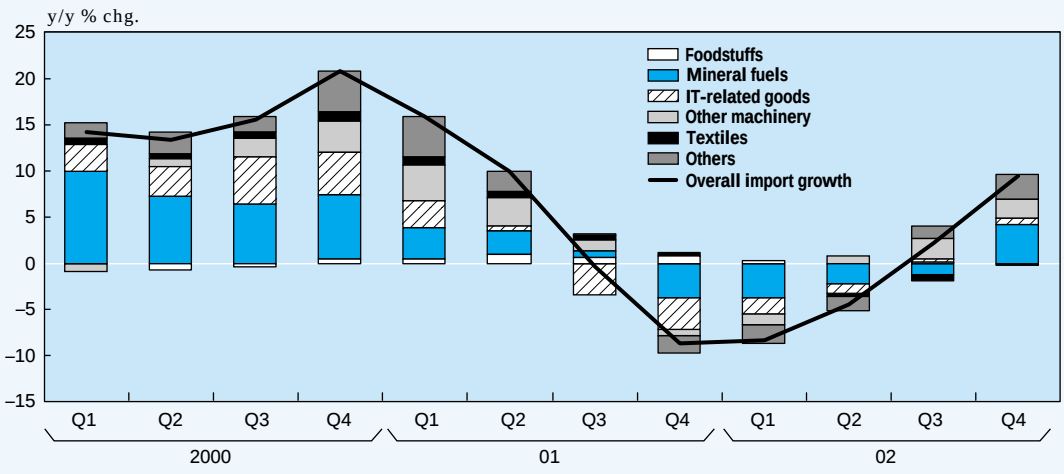


Chart 24

Contribution to Overall Import Growth by Item

y/y % chg.

Items	2001	2002	Major factors
Value of overall imports	+3.6	−0.6	—
Mineral fuels	+0.5	−0.8	—
Crude oil and partly refined oil	−0.2	−0.4	Decrease in the volume of imports in the January–June period, but both prices and volume increased from September
Petroleum products	−0.1	−0.2	Weak demand in Japan
Liquefied natural gas	+0.5	−0.2	Weak demand in Japan, but volume increased from September
IT-related goods	−1.0	−0.4	—
Telecommunications apparatus	−0.1	−0.3	Weak demand in Japan, but imports from China increased
Office machinery	−0.3	−0.2	Weak demand in Japan, but imports from China increased
Semiconductors and other electronic parts	−0.6	+0.0	Increase in volume and decline in unit prices
Textiles	+0.6	−0.3	Weak demand in Japan
Aircraft	−0.2	+0.5	Demand in the United States and the European Union for renewal of aircraft
Pharmaceuticals	+0.2	+0.2	Increase in the average unit price
Foodstuffs	+0.7	+0.0	Decrease in demand for beef due to bovine spongiform encephalopathy (BSE), and an increase in prices of fish products

Chart 25

Transportation

bil. yen

	2002	Changes from a year earlier	2001
Transportation	−915.2	+101.5	−1,016.6
Sea transport	−503.7	−18.0	−485.7
Credit	2,017.4	+22.5	1,994.9
Debit	2,521.1	+40.5	2,480.6
Air transport	−399.0	+124.2	−523.2
Passenger	−710.2	+85.2	−795.4
Credit	319.9	+24.5	295.4
Debit	1,030.1	−60.7	1,090.8
Freight	53.4	+53.6	−0.2
Credit	285.4	+47.2	238.2
Debit	232.0	−6.4	238.4

Chart 26

Travel

bil. yen

	2002	Changes from a year earlier	2001
Travel	**–2,855.2**	**–38.4**	**–2,816.8**
Credit	**440.8**	**+38.8**	**402.0**
Debit	**3,296.0**	**+77.2**	**3,218.8**

Chart 27

Travelers Departing from and Entering Japan[1]

thous. people; figures in parentheses are % chg. from the same period of the previous year; figures in brackets are % chg. from the previous quarter on a seasonally adjusted basis[2]

	2002				2002[3]
	Jan.–Mar.	Apr.–June	July–Sep.	Oct.–Dec.[3]	
Departure	**3,753 (–16.1) <+29.3>**	**3,764 (–10.3) <+8.4>**	**4,733 (+0.3) <+3.4>**	**4,264 (+51.0) <+3.0>**	**16,514 (+1.8)**
Entry	**1,227 (+8.3)**	**1,340 (+7.7)**	**1,402 (+10.6)**	**1,272 (+12.9)**	**5,241 (+9.8)**

Notes: *1*. Based on statistics on the number of foreign travelers visiting Japan compiled by the Japan National Tourist Organization (JNTO).
2. Calculated by the Balance of Payments Division, the International Department of the Bank of Japan.
3. Figures are preliminary.

Chart 28

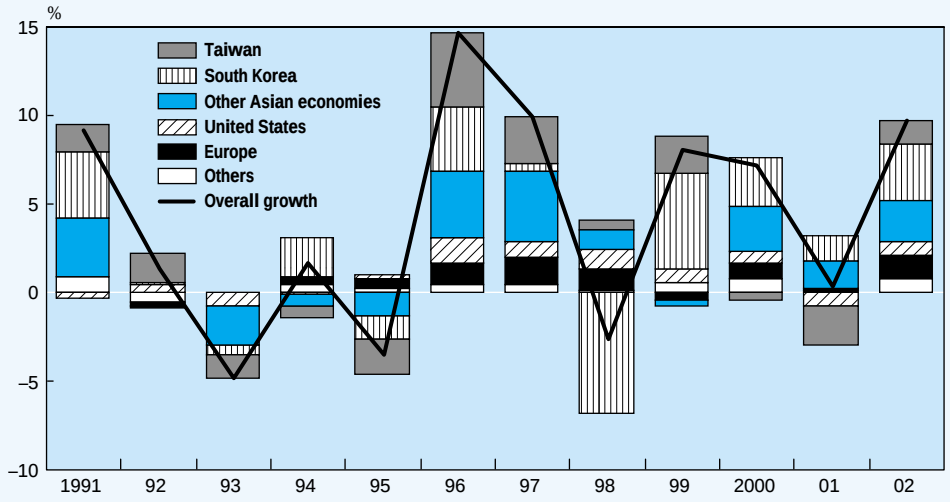
Number of Japanese Travelers Going Abroad by Destination[1]

thous. people; figures in parentheses are % chg. from the same period of the previous year

	2002				2002
	Jan.–Mar.	Apr.–June	July–Sep.	Oct.–Dec.	
South Korea	**538 (–9.4)**	**487 (–23.6)**	**665 (+0.8)**	**630 (+29.6)**	**2,321 (–2.4)**
China	**613 (+9.4)**	**695 (+15.3)**	**837 (+31.2)**	**842 (+44.3)**	**2,987 (+25.3)**
Hong Kong	**333 (–8.1)**	**331 (–0.7)**	**362 (+4.2)**	**369 (+25.7)**	**1,395 (+4.4)**
United States	**318 (–37.8)**	**352 (–26.6)**	**477 (–9.4)**	**n.a.**	**n.a.**
Hawaii	**339 (–24.2)**	**342 (–15.0)**	**399 (–8.1)**	**405 (+78.4)**	**1,485 (–1.7)**
Guam	**210 (–28.3)**	**181 (–21.0)**	**235 (–7.6)**	**153 (+22.4)**	**779 (–13.6)**

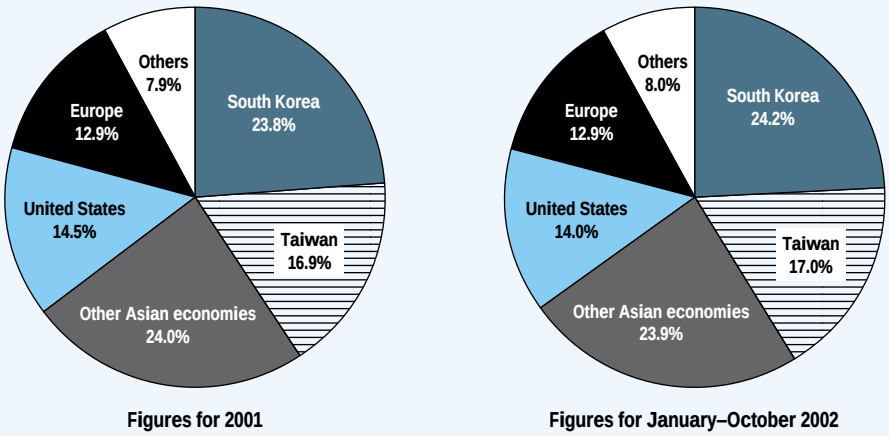
Note: *1*. Based on data released by the Japan Tourism Marketing Co.
Sources: South Korea: Statistics on the number of people entering South Korea by nationality compiled by the Korea National Tourism Organization.
China: Statistics on the number of people entering mainland China by nationality compiled by the China National Tourism Administration.
Hong Kong: Statistics on the number of people entering Hong Kong by residence compiled by the Hong Kong Tourism Board.
United States: Statistics on the number of people entering the United States by residence compiled by the Office of Travel and Tourism Industries of the International Trade Administration (ITA). Data exclude Hawaii and Guam.
Hawaii: Statistics on the number of people entering Hawaii by nationality compiled by the Hawaii State Department of Business, Economic Development & Tourism.
Guam: Statistics on the number of people entering Guam by residence compiled by the Guam Visitors Bureau.

Chart 29
Year-on-Year Changes in the Number of Visitors to Japan and Contribution to Overall Change by Nationality[1]



Note: *1*. Figures for 2002 are year-on-year percentage changes for January–October.

Chart 30
Nationality of Visitors to Japan



Source: Japan National Tourist Organization (JNTO).

Chart 31

Other Services[1]

bil. yen

	2002	Changes from a year earlier	2001
Other services	–1,392.3	+89.3	–1,481.6
Other business services	–908.9	+12.4	–921.3
Miscellaneous business, professional, and technical services	–1,274.6	–185.7	–1,088.9
Credit (21.4)	**1,019.4**	**–8.4**	**1,027.8**
Debit <37.3>	**2,294.0**	**+177.3**	**2,116.7**
Merchanting and other trade-related services	279.7	+166.3	113.4
Credit (21.8)	**1,039.6**	**+179.6**	**860.0**
Debit <12.3>	**759.8**	**+13.3**	**746.6**
Insurance services[2]	–431.8	–96.5	–335.3
Credit (–0.9)	**–44.7**	**–32.1**	**–12.6**
Debit <6.3>	**387.1**	**+64.4**	**322.7**
Royalties and license fees	–52.3	+27.7	–80.0
Credit (27.3)	**1,301.6**	**+32.6**	**1,268.9**
Debit <22.0>	**1,353.9**	**+4.9**	**1,349.0**
Financial services	188.6	+59.2	129.3
Credit (8.2)	**392.4**	**+62.9**	**329.5**
Debit <3.3>	**203.8**	**+3.7**	**200.1**
Personal, cultural, and recreational services	–110.4	+44.3	–154.7
Credit (0.8)	**39.3**	**+25.0**	**14.3**
Debit <2.4>	**149.8**	**–19.2**	**169.0**
Construction services	133.1	+15.3	117.8
Credit (11.7)	**558.9**	**–22.7**	**581.6**
Debit <6.9>	**425.7**	**–38.0**	**463.8**
Computer and information services	–124.4	+24.6	–149.0
Credit (3.0)	**143.0**	**–28.4**	**171.4**
Debit <4.3>	**267.4**	**–53.0**	**320.4**

Notes: *1.* Figures in parentheses are percentage share in gross credit in other services. Figures in brackets are percentage share in gross debit in other services.
2. Credit in insurance services is negative because it is calculated by deducting insurance claims from insurance premiums.

Chart 32
Royalties and License Fees

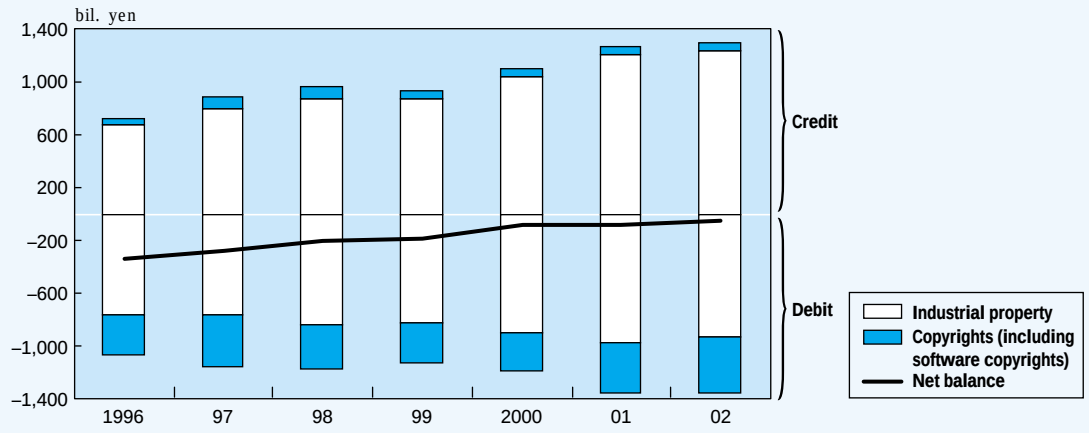


Chart 33
Income

bil. yen

	2002	Changes from a year earlier	2001
Income	8,278.4	–122.3	8,400.7
Direct investment income	1,441.4	–101.9	1,543.3
Dividends and distributed branch profits	**545.1**	**–229.6**	**774.7**
Credit	**965.7**	**–84.8**	**1,050.5**
Debit	**420.6**	**+144.8**	**275.8**
Reinvested earnings	**843.3**	**+186.0**	**657.3**
Credit	**1,032.0**	**+186.7**	**845.3**
Debit	**188.7**	**+0.7**	**188.0**
Portfolio investment income	6,347.8	+120.9	6,226.9
Bonds and notes	**5,280.6**	**+304.5**	**4,976.1**
Credit	**6,198.1**	**+111.4**	**6,086.7**
Debit	**917.5**	**–193.1**	**1,110.6**
Money market instruments and financial derivatives	**311.3**	**–387.7**	**699.0**
Credit	**311.6**	**–388.0**	**699.6**
Debit	**0.4**	**–0.3**	**0.7**
Other investment income	499.6	–135.9	635.5
Interest on loans	**465.6**	**–49.1**	**514.6**
Credit	**1,332.4**	**–673.1**	**2,005.5**
Debit	**866.9**	**–624.0**	**1,490.9**
Interest on deposits	**–2.4**	**–91.2**	**88.7**
Credit	**348.8**	**–310.2**	**659.0**
Debit	**351.2**	**–219.1**	**570.3**

Chart 34
Income

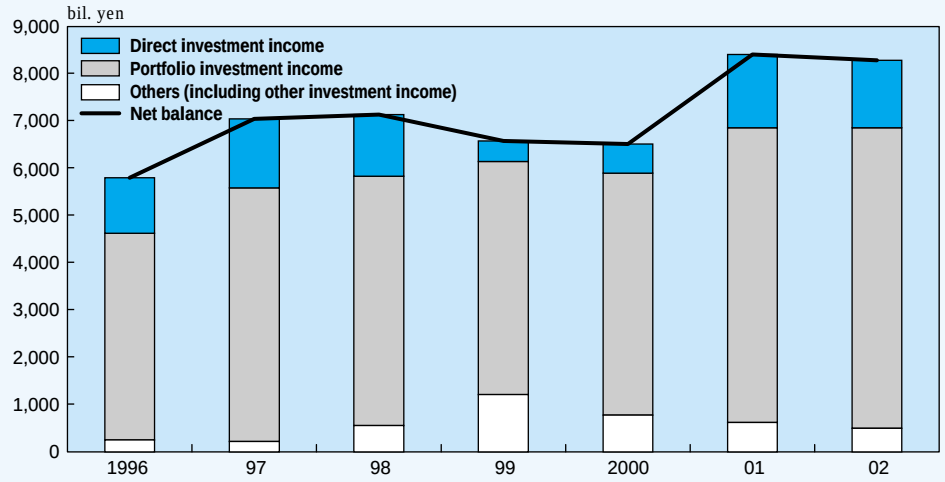


Chart 35
Direct Investment Income

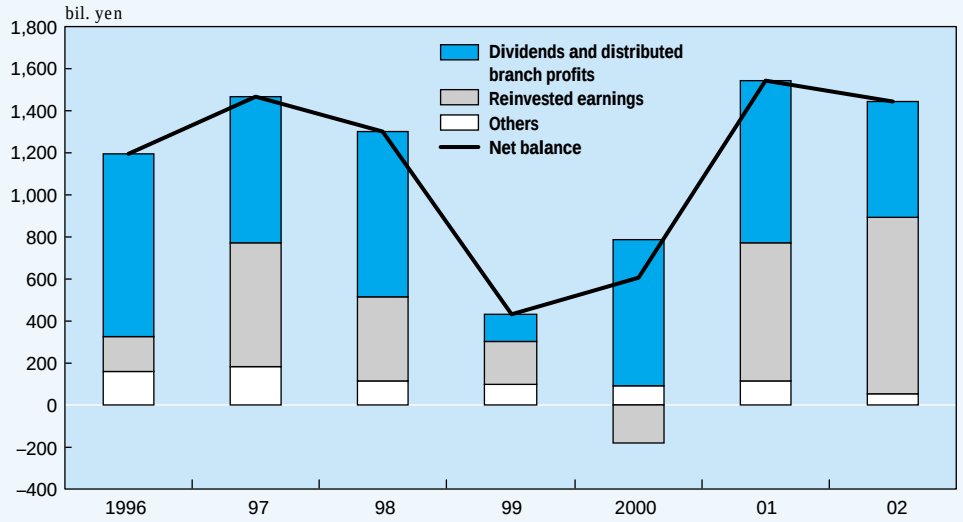


Chart 36
Portfolio Investment Income

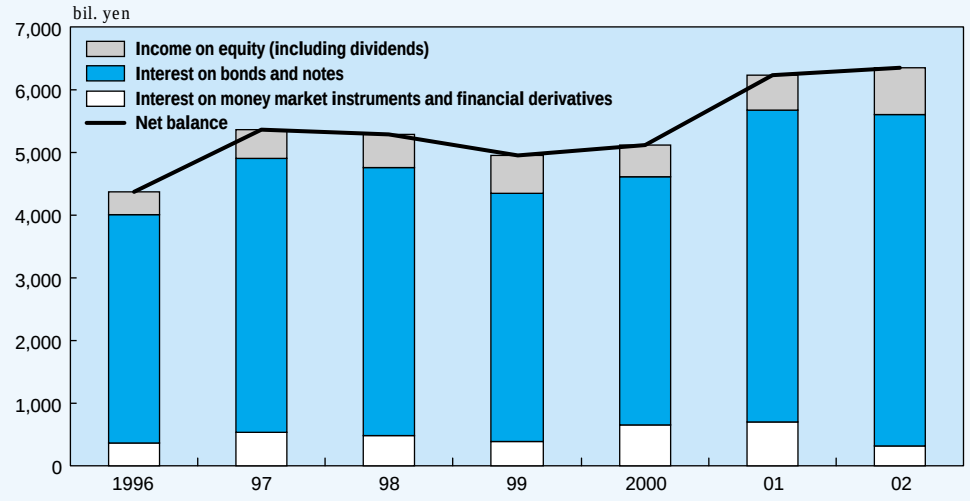


Chart 37
Other Investment Income

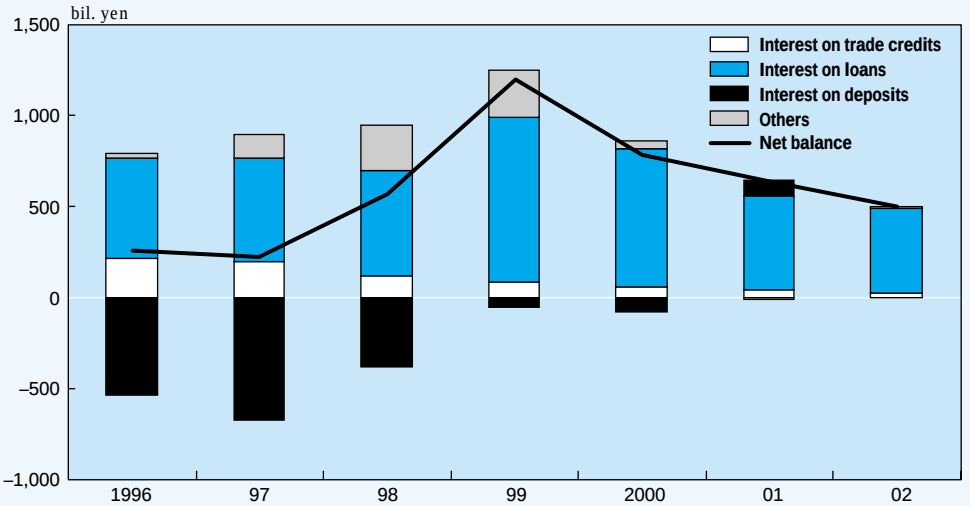
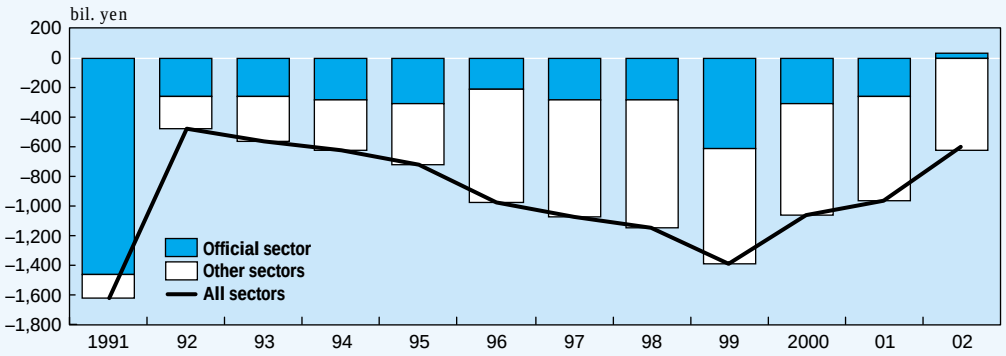


Chart 38
Current Transfers

bil. yen

	2002	Changes from a year earlier	2001
Current transfers	**–595.2**	**+365.2**	**–960.4**
Official sector	**25.0**	**+287.3**	**–262.3**
Credit	**386.8**	**+366.9**	**19.9**
Debit	**361.8**	**+79.6**	**282.2**
Other sectors	**–620.3**	**+77.9**	**–698.1**
Credit	**891.6**	**+164.3**	**727.3**
Debit	**1,511.9**	**–86.4**	**1,425.4**

Chart 39
Developments in Current Transfers[1]



Note: *1.* Current transfers on a net basis.

Chart 40

Capital and Financial Account[1]

bil. yen

	2002[2]			2001		
Current account	14,248.4			10,652.3		
Capital and financial account	–7,978.4	Assets (outward investment)	Liabilities (inward investment)	–6,172.6	Assets (outward investment)	Liabilities (inward investment)
Financial account	–7,556.7			–5,826.4		
Direct investment	–2,778.0	–3,947.4	1,169.4	–3,900.0	–4,658.6	758.5
Portfolio investment[3]	–18,128.9	–13,164.4	–4,964.5	–7,613.3	–12,403.1	4,789.9
Of which Equity securities	–6,426.2	–4,565.9	–1,860.3	2,683.5	–1,413.8	4,097.3
Bonds and notes	–13,433.0	–9,294.5	–4,138.5	–9,637.7	–11,130.0	1,492.4
Money market instruments	1,730.3	696.0	1,034.4	–659.1	140.7	–799.8
Financial derivatives	262.9	9,701.2	–9,438.3	185.3	12,455.6	–12,270.4
Other investment[3]	12,667.2	8,876.0	3,791.2	5,492.2	5,082.9	409.3
Of which Loans	4,021.4	–3,409.3	7,430.8	–5,125.2	–3,705.0	–1,420.1
Currency and deposits	3,994.1	6,873.0	–2,878.9	9,549.6	7,598.1	1,951.5
Capital account	–421.7			–346.2		
Changes in reserve assets	–5,796.9			–4,936.4		
Errors and omissions	–473.1			456.7		

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 are preliminary.
3. Figures exclude securities lending transactions. Figures for securities lending transactions are not included in the analysis in this article unless otherwise noted. This is because they are large and volatile, and therefore could hinder accurate understanding of securities transactions and loans if they are included in portfolio investment and other investment in the capital and financial account.

Chart 41

Outward and Inward Direct Investment

	2000		01		02		02 Jan.–June		02 July–Dec.		Avg. in the 1990s
	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)
Outward direct investment	**–3,400.8**	**+31.3**	**–4,658.6**	**+37.0**	**–3,947.4**	**–15.3**	**–2,361.1**	**+0.2**	**–1,586.3**	**–31.1**	**–3,077.9**
Inward direct investment	**896.9**	**–38.2**	**758.5**	**–15.4**	**1,169.4**	**+54.2**	**797.2**	**2.1 times**	**372.2**	**–1.5**	**318.6**
Inward/outward (percent)	**26.4**		**16.3**		**29.6**		**33.8**		**23.5**		**10.4**

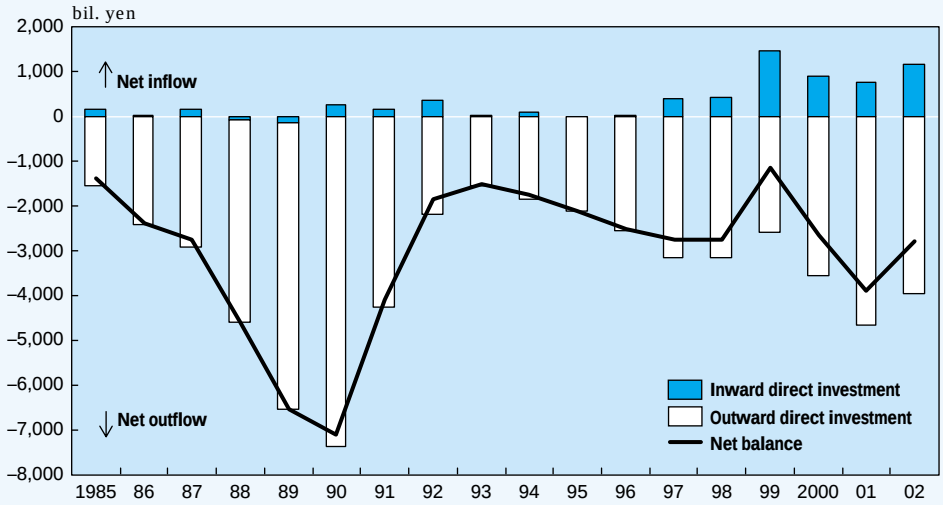
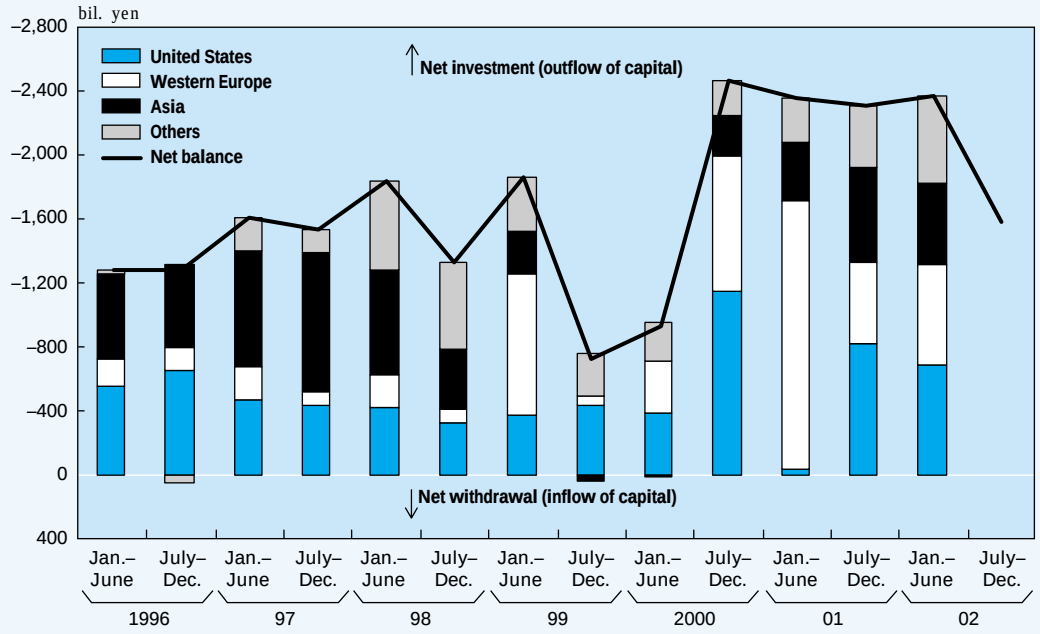


Chart 42

Outward Direct Investment by Residents (By Area)[1]

bil. yen

		United States	Western Europe	Asia	Others	Overall outward direct investment
1996	Jan.–June	–558.7	–162.1	–535.1	–19.5	–1,275.3
	July–Dec.	–647.7	–146.4	–524.8	45.8	–1,273.1
97	Jan.–June	–464.4	–214.7	–716.9	–212.6	–1,608.7
	July–Dec.	–430.0	–86.9	–869.7	–149.6	–1,536.2
98	Jan.–June	–420.1	–204.2	–659.3	–551.4	–1,835.0
	July–Dec.	–323.9	–87.1	–369.6	–546.1	–1,326.6
99	Jan.–June	–370.9	–883.8	–260.2	–348.5	–1,863.4
	July–Dec.	–437.2	–52.1	36.8	–274.7	–727.2
2000	Jan.–June	–380.0	–328.6	15.5	–239.9	–933.0
	July–Dec.	–1,140.9	–850.5	–249.7	–226.7	–2,467.8
01	Jan.–June	–36.9	–1,670.4	–363.9	–285.0	–2,356.2
	July–Dec.	–823.5	–506.4	–588.4	–384.0	–2,302.3
02	Jan.–June	–681.1	–638.6	–502.8	–538.6	–2,361.1
	July–Dec.	n.a.	n.a.	n.a.	n.a.	–1,586.3



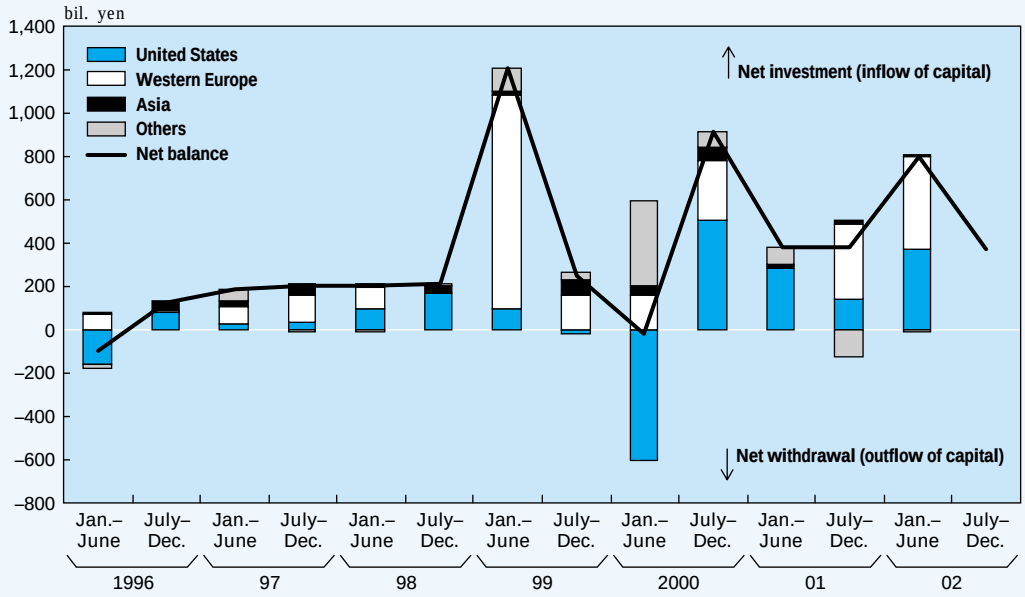
Note: *1.* A breakdown of figures for the second half of 2002 is scheduled to be released in June 2003.
Negative figures show a net outflow of capital.

Chart 43

Inward Direct Investment by Nonresidents (By Area)[1]

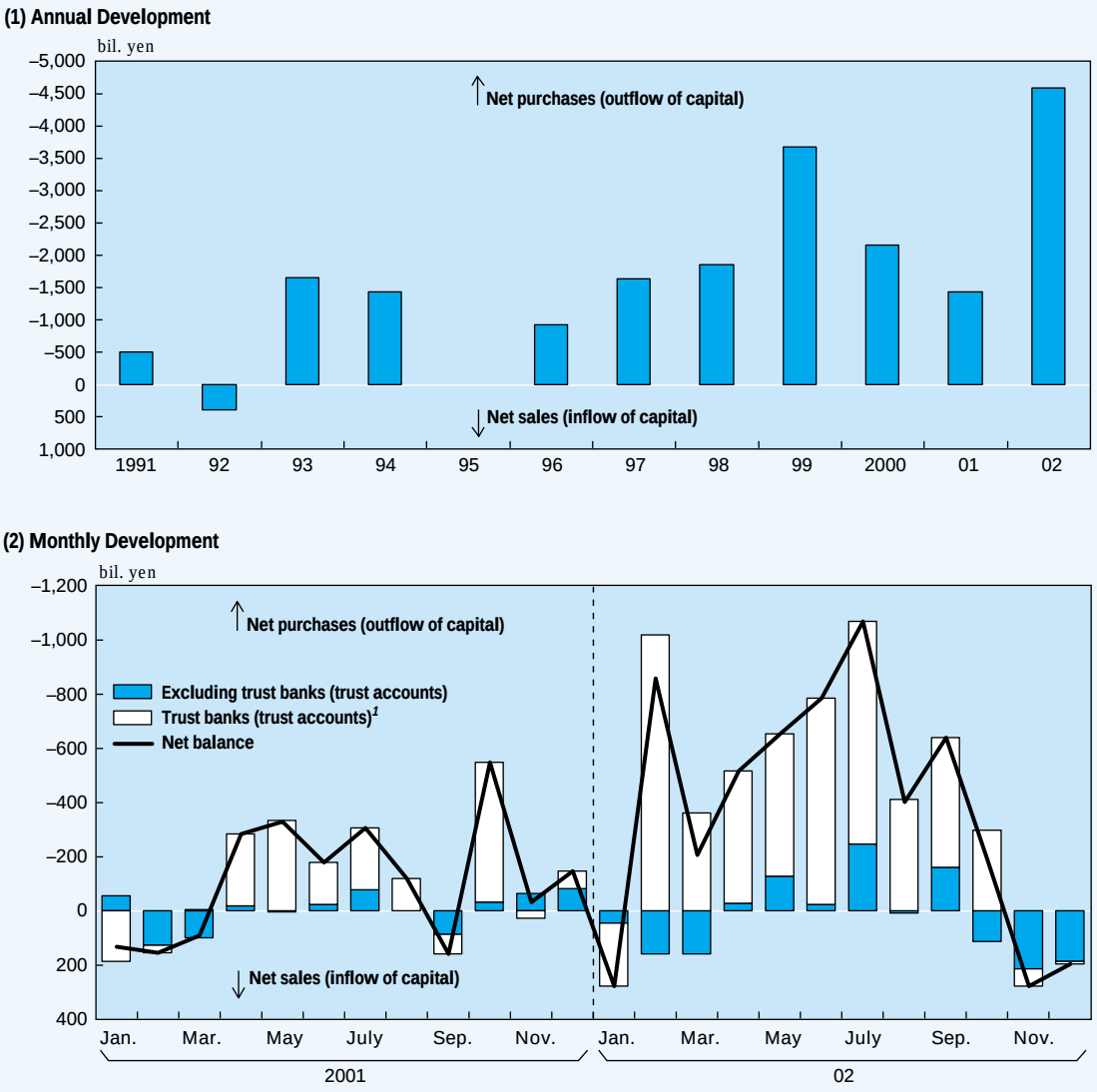
bil. yen

		United States	Western Europe	Asia	Others	Overall inward direct investment
1996	Jan.–June	–165.7	69.4	7.8	–10.9	–99.4
	July–Dec.	80.7	8.3	40.4	–5.1	124.3
97	Jan.–June	25.9	78.8	28.6	50.0	183.3
	July–Dec.	37.5	119.2	58.5	–8.4	206.8
98	Jan.–June	98.1	97.6	19.1	–9.2	205.6
	July–Dec.	164.9	4.5	31.4	11.5	212.3
99	Jan.–June	96.7	987.9	16.2	107.8	1,208.6
	July–Dec.	–21.9	154.0	79.3	31.3	242.7
2000	Jan.–June	–607.5	155.4	44.6	389.0	–18.5
	July–Dec.	502.3	280.9	61.7	70.5	915.4
01	Jan.–June	286.6	6.7	2.8	84.5	380.6
	July–Dec.	138.0	349.0	13.0	–122.1	377.9
02	Jan.–June	374.9	422.0	8.4	–8.1	797.2
	July–Dec.	n.a.	n.a.	n.a.	n.a.	372.2



Note: *1.* A breakdown of figures for the second half of 2002 is scheduled to be released in June 2003.
Negative figures show a net outflow of capital.

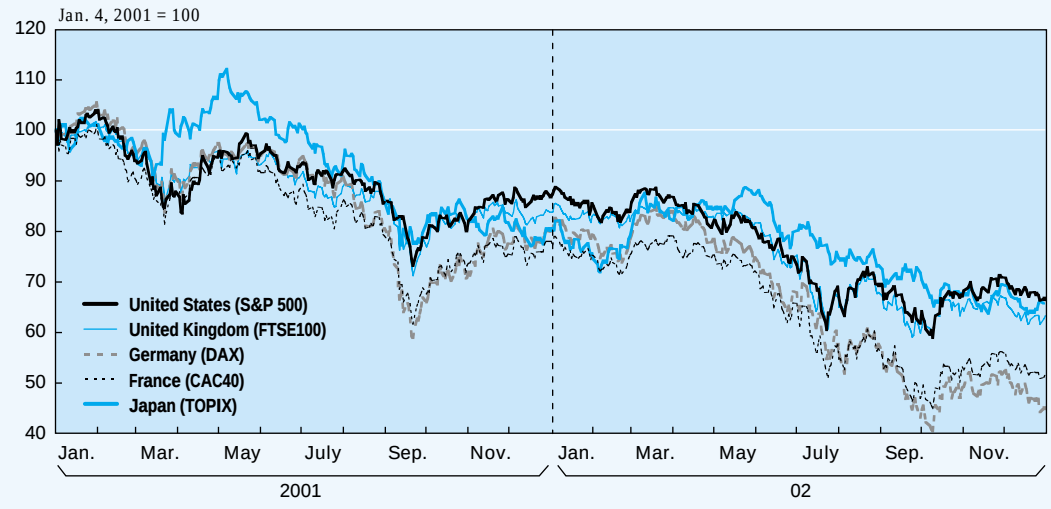
Chart 44
Investment in Foreign Equities by Residents



Note: *1.* Figures are based on "Securities Investment at Home and Abroad (compiled based on the value of transactions settled, hereafter settlement basis)," released by the Ministry of Finance.

Chart 45

Stock Prices in Major Industrial Countries



Source: Bloomberg.

Chart 46

Investment in Foreign Equities by Residents (By Sector)[1]

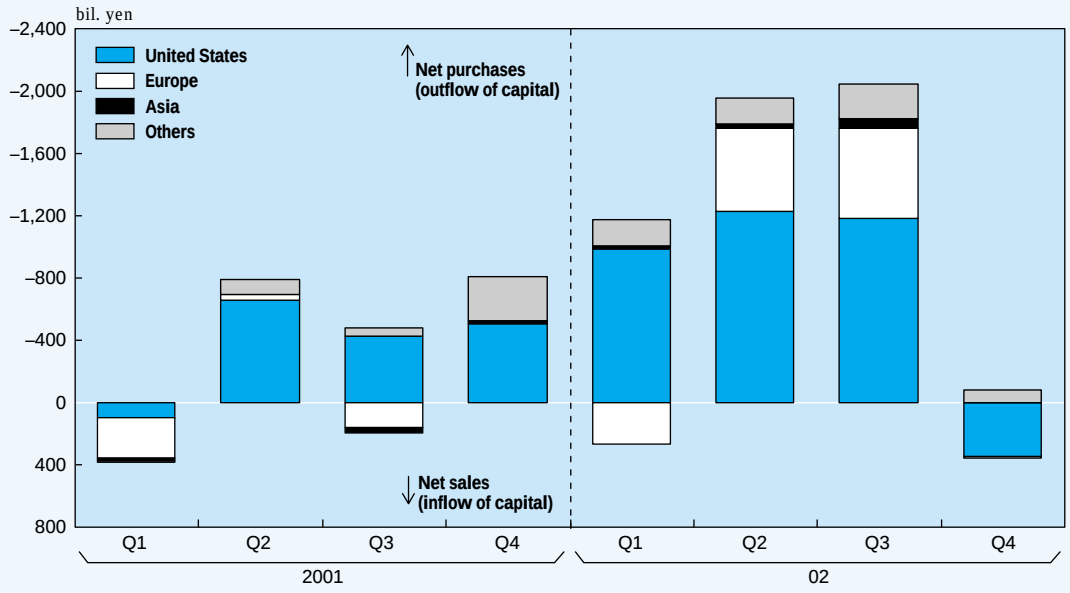
bil. yen

	1999	2000	01	02
Life insurance companies	**−353.9**	**93.1**	**519.8**	**397.2**
Trust banks[2]	**−3,050.6**	**−1,883.7**	**−1,369.1**	**−4,862.3**
Investment trusts	**9.6**	**−282.5**	**−374.0**	**−391.1**
Banks[3]	**84.5**	**−100.5**	**37.3**	**140.4**
Others[4]	**−334.2**	**−52.2**	**−295.2**	**218.2**

Notes: *1.* Negative figures show a net outflow of capital.
2. Figures are for trust accounts of trust banks.
3. Figures include bank accounts of trust banks.
4. Includes securities companies, individuals, and nonfinancial corporations.
Source: Ministry of Finance, "Securities Investment at Home and Abroad (settlement basis)."

Chart 47

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



bil. yen

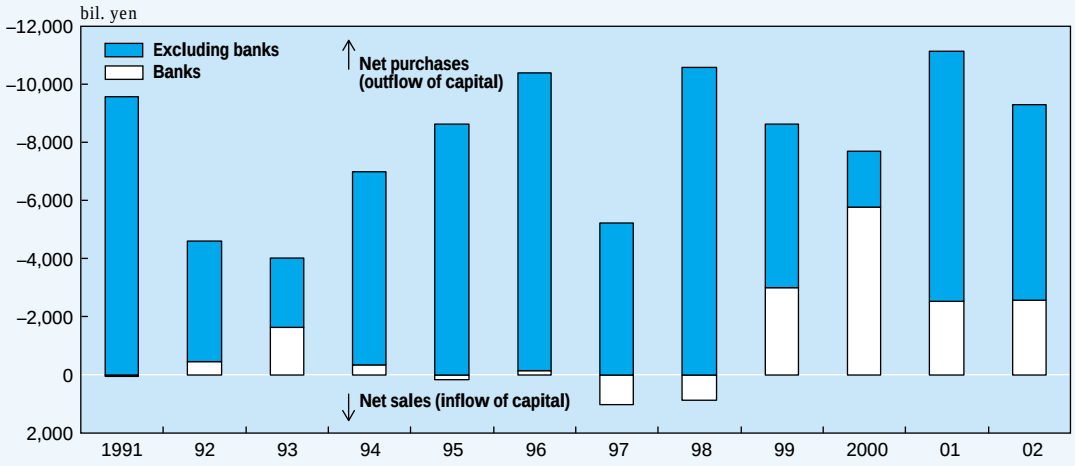
	1999	2000	01	02	IIP[4] (end of 2001)
United States	**–1,462.2**	**–1,133.9**	**–1,499.7**	**–3,051.8**	**16,278.8**
Europe[2]	**–1,227.6**	**–654.1**	**393.6**	**–846.4**	**10,090.7**
Of which Germany	**–154.5**	**95.8**	**174.6**	**–58.5**	**896.3**
France	**–246.8**	**–7.1**	**228.7**	**–55.3**	**1,351.8**
United Kingdom	**–368.7**	**–344.8**	**–131.8**	**–441.1**	**3,885.4**
Asia[3]	**–218.7**	**–156.0**	**29.2**	**–92.5**	**893.8**
Cayman Islands	**–477.7**	**–140.7**	**–250.7**	**–411.5**	**1,319.2**

Notes: *1.* Negative figures show a net outflow of capital.
2. Figures are the total for the 15 member countries of the European Union (EU) and Switzerland.
3. Figures are the total for Hong Kong, South Korea, Thailand, Malaysia, and Singapore.
4. International investment position.
Source: Ministry of Finance, "Securities Investment at Home and Abroad (settlement basis)."

Chart 48

Investment in Foreign Bonds and Notes by Residents[1]

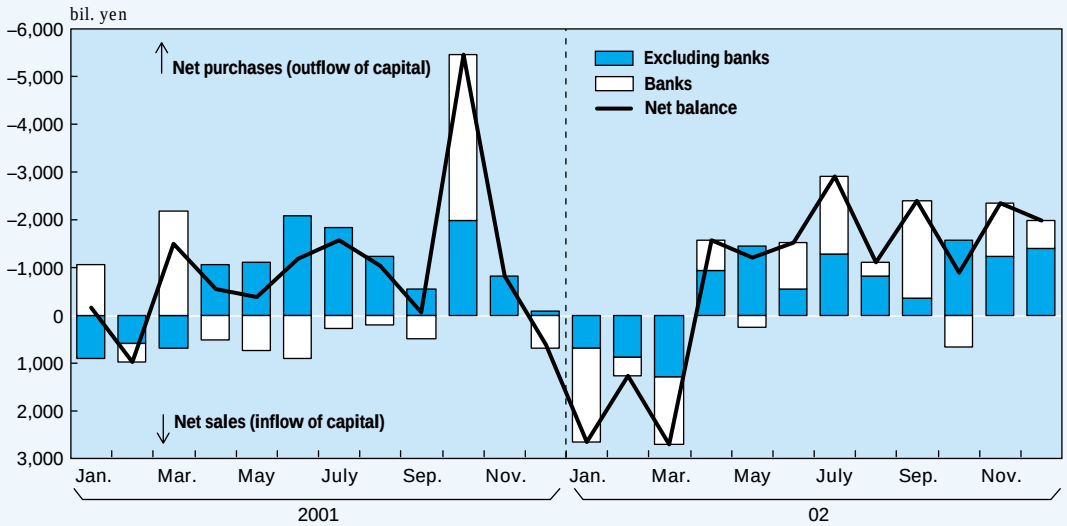
(1) Annual Development



bil. yen

	1999	2000	01	02	IIP[3] (end of 2001)
Investment in foreign bonds and notes	**–8,648.2**	**–7,692.3**	**–11,130.0**	**–9,294.5**	**132,443.0**
Public sector[2]	**535.2**	**417.8**	**1,509.2**	**1,805.4**	**6,948.0**
Banks[2]	**–2,995.2**	**–5,783.2**	**–2,519.6**	**–2,577.4**	**40,098.0**
Other sectors[2]	**–6,188.2**	**–2,326.9**	**–10,119.6**	**–8,524.2**	**85,396.0**

(2) Monthly Development



Notes: *1.* Negative figures show a net outflow of capital.

2. In accordance with the fifth edition of the International Monetary Fund's *Balance of Payments Manual*, investors are categorized into three sectors, "public sector," "banks," and "other sectors." "Public sector" includes general government, monetary authorities, and governmental financial institutions. "Banks" includes banks and other deposit-taking financial institutions such as cooperative-type financial institutions. "Other sectors" includes trust accounts of trust banks, life and nonlife insurance companies, securities companies, nonfinancial corporations, and individuals.

3. International investment position (IIP) includes figures for issuance and redemption of bonds and notes issued in Japan by nonresidents.

Chart 49
Long-Term Interest Rates in Major Industrial Countries (10-Year Government Bonds)

Source: Bloomberg.

Chart 50
Issuance and Redemption of Bonds and Notes Issued in Japan by Nonresidents

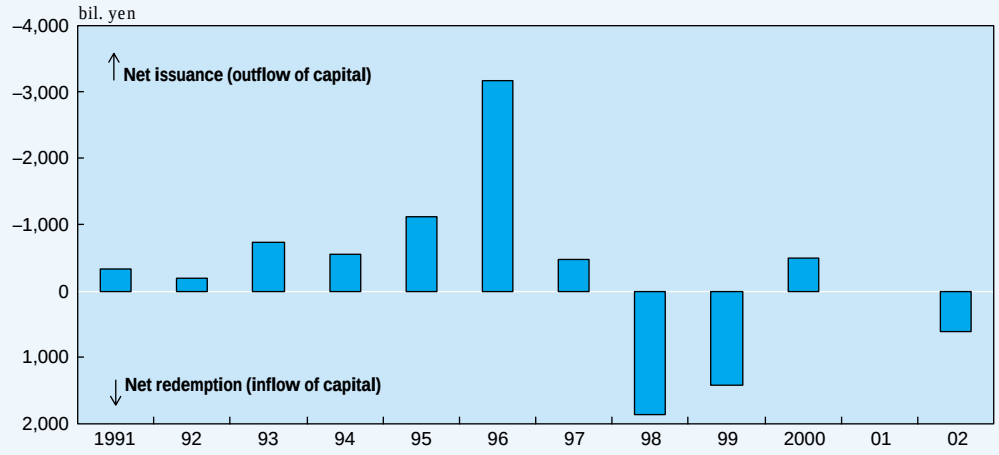


Chart 51
Investment in Foreign Bonds and Notes by Residents (By Sector)[1]

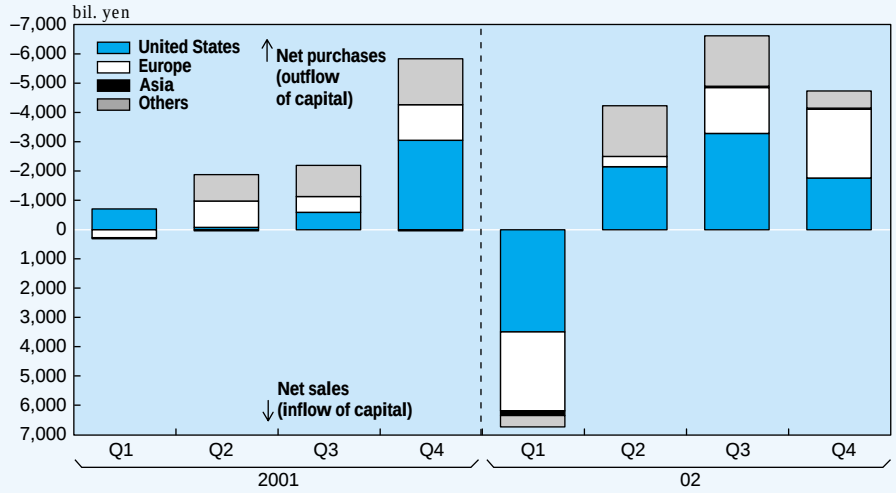
bil. yen

	1999	2000	01	02
Life insurance companies	**106.5**	**–48.0**	**–4,579.2**	**–1,082.8**
Trust banks[2]	**–3,095.7**	**–919.3**	**–550.4**	**–1,167.9**
Investment trusts	**856.7**	**1,419.3**	**–1,340.6**	**–763.3**
Banks[3]	**–3,314.3**	**–6,085.1**	**–4,568.6**	**–4,152.1**
Public sector	**—**	**—**	**—**	**1,983.9**
Others[4]	**–3,481.6**	**33.1**	**–568.9**	**–3,824.4**

Notes: *1.* Negative figures show a net outflow of capital.
2. Figures are for trust accounts of trust banks.
3. Figures include bank accounts of trust banks.
4. Figures include public institutions (until 2001), securities companies, nonfinancial corporations, and individuals.
Source: Ministry of Finance, "Securities Investment at Home and Abroad (settlement basis)."

Chart 52

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



bil. yen

	1999	2000	01	02	IIP[2] (end of 2001)
United States	**38.5**	**–1,240.1**	**–4,395.3**	**–3,690.3**	**45,756.7**
Europe[3]	**–6,238.1**	**–3,051.4**	**–2,371.6**	**–1,621.1**	**53,035.8**
Of which Germany	**–2,074.4**	**–1,309.2**	**–122.7**	**1,295.9**	**13,332.4**
France	**–1,424.1**	**–603.7**	**–1,363.6**	**–518.4**	**6,854.8**
United Kingdom	**–336.5**	**358.1**	**162.1**	**645.6**	**9,312.3**
Asia[4]	**74.7**	**58.3**	**62.8**	**106.6**	**1,392.1**
Cayman Islands	**–2,219.2**	**–2,017.3**	**–2,177.0**	**–2,385.8**	**15,132.4**

[Reference] Comparison of the Definitions in the Balance of Payments and Securities Investment at Home and Abroad[5]

	Balance of Payments	*Securities Investment at Home and Abroad*
Criteria for determining inward/outward investment	**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**	**Nonresidents' sales and purchases of securities denominated in yen**

Notes: *1.* Negative figures show a net outflow of capital.
2. International investment position (IIP) includes figures for issuance and redemption of bonds and notes issued in Japan by nonresidents.
3. Figures are the total for the 15 member countries of the EU and Switzerland.
4. Figures are the total for Hong Kong, South Korea, Thailand, Malaysia, and Singapore.
5. Outward and inward portfolio investment is classified by the nationality of the issuer of securities in the *Balance of Payments*, and by the denominated currency in *Securities Investment at Home and Abroad*. For example, in the *Balance of Payments*, a purchase from a resident by a nonresident of securities denominated in yen (*samurai* bonds) issued by a nonresident (in other words, a sale by a resident to a nonresident) is recorded under "outward portfolio investment" as a sale by a resident of securities issued by a nonresident. In *Securities Investment at Home and Abroad*, the same transaction is recorded under "inward portfolio investment" as a purchase by a nonresident of securities denominated in yen.

Source: Ministry of Finance, "Securities Investment at Home and Abroad (settlement basis)."

Chart 53
Investment in Foreign Money Market Instruments by Residents

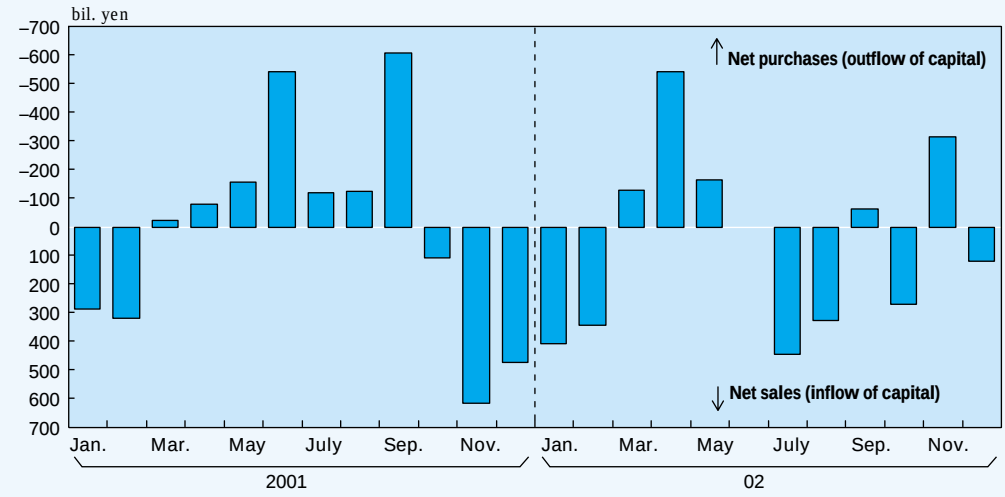


Chart 54
Investment in Japanese Equities by Nonresidents

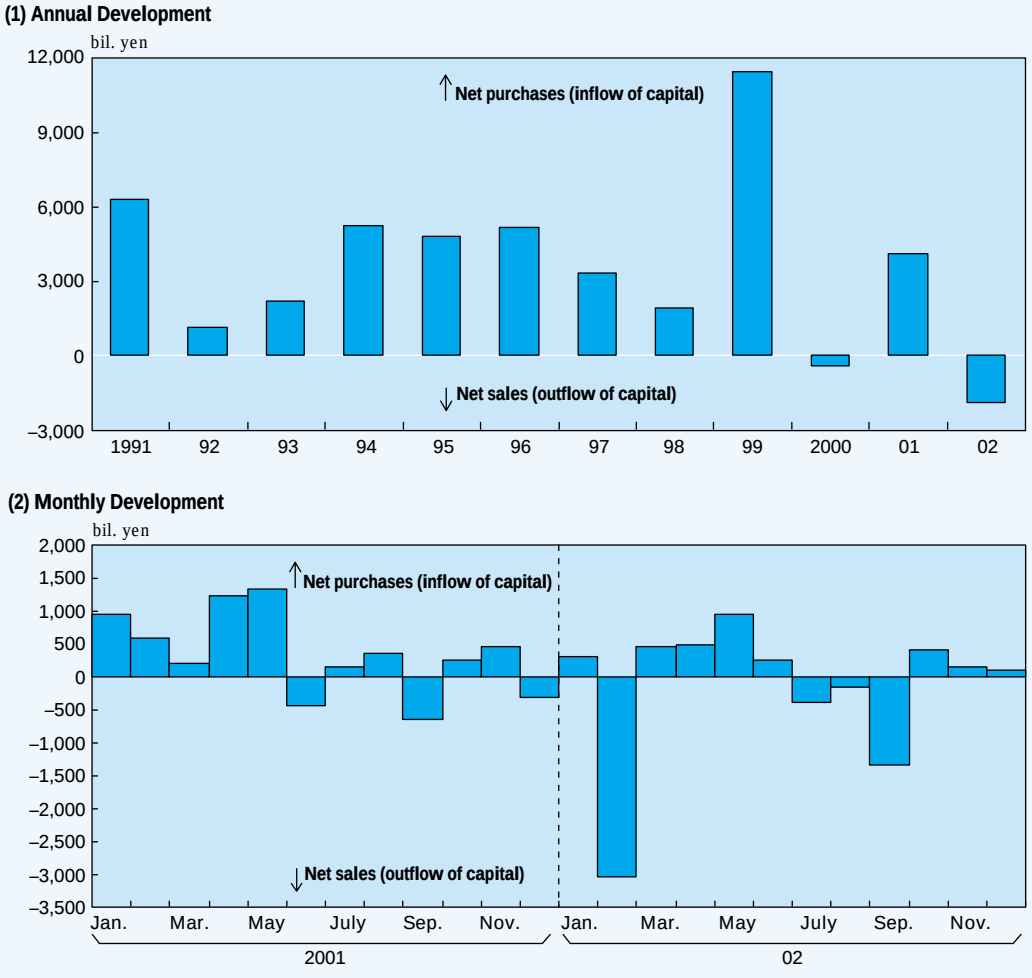
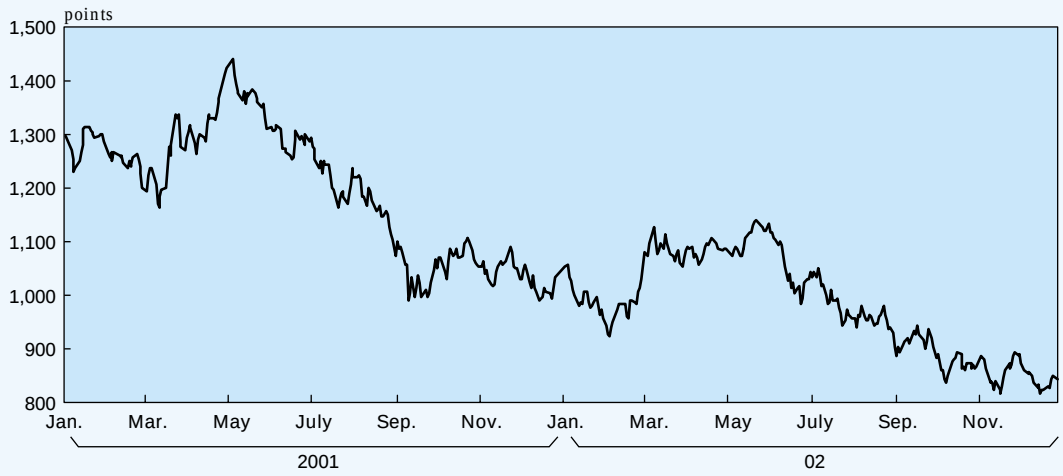
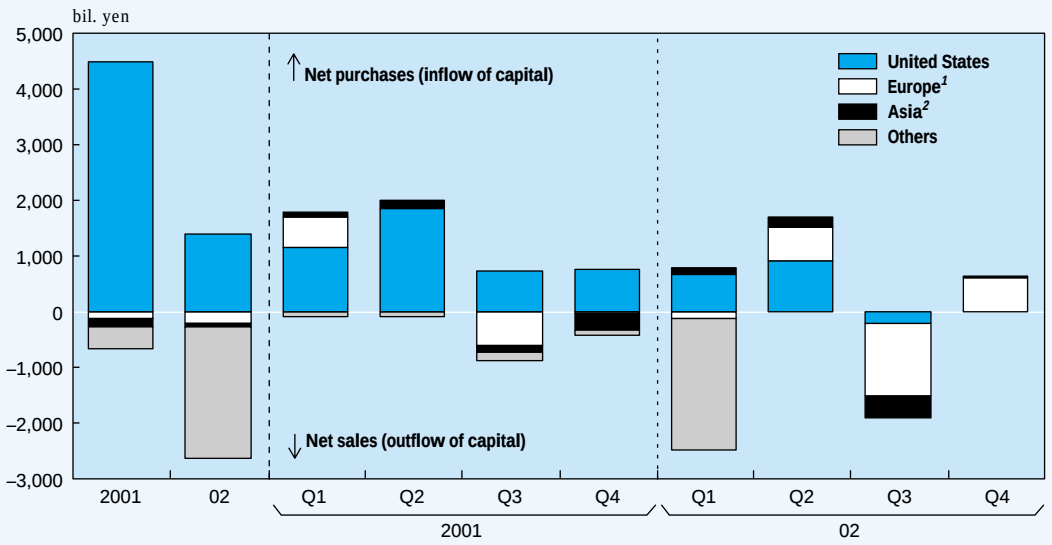


Chart 55
TOPIX[1]



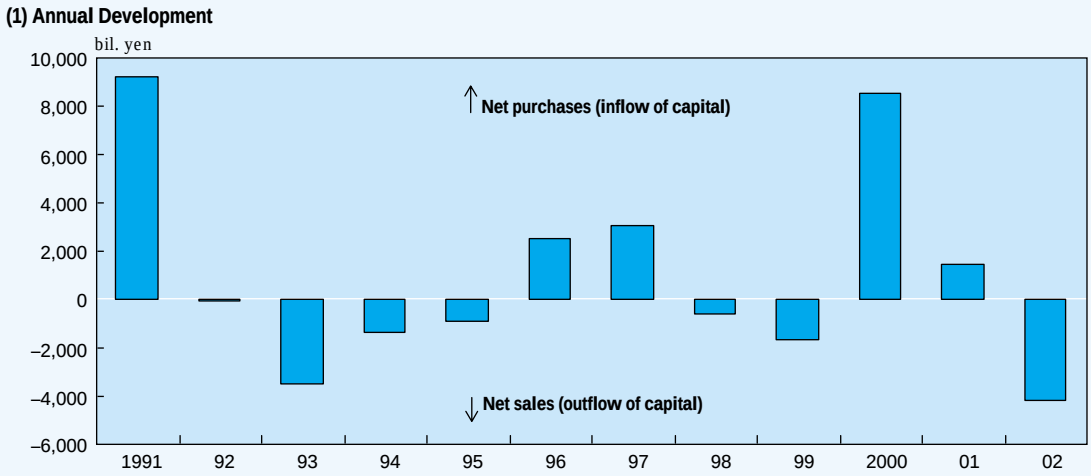
Note: *1.* TOPIX denotes the Tokyo Stock Exchange Stock Price Index.

Chart 56
Investment in Japanese Equities by Nonresidents (By Area)



Notes: *1.* Figures are the total for the 15 member countries of the EU and Switzerland.
2. Figures are the total for Hong Kong, South Korea, Singapore, and Thailand.
Source: Ministry of Finance, "Securities Investment at Home and Abroad (settlement basis)."

Chart 57
Investment in Japanese Bonds and Notes by Nonresidents



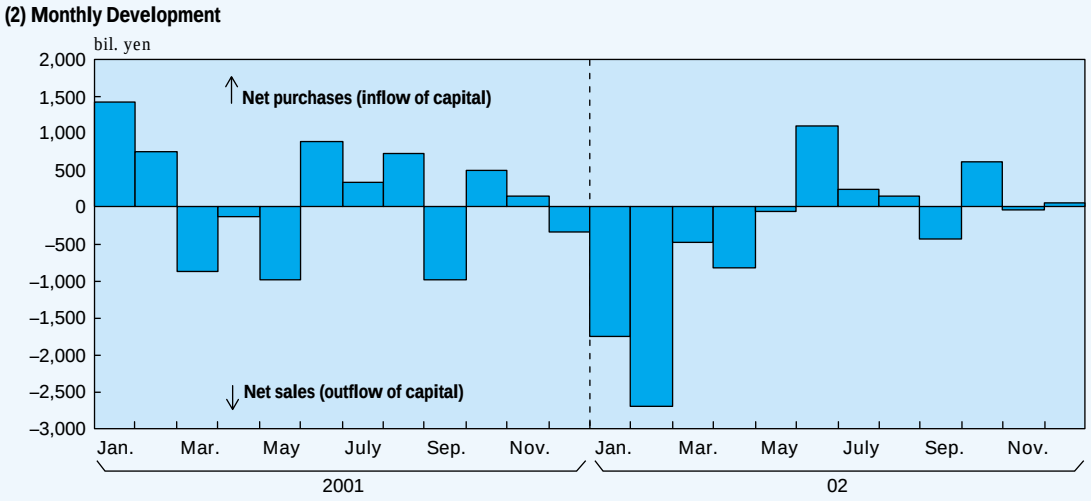
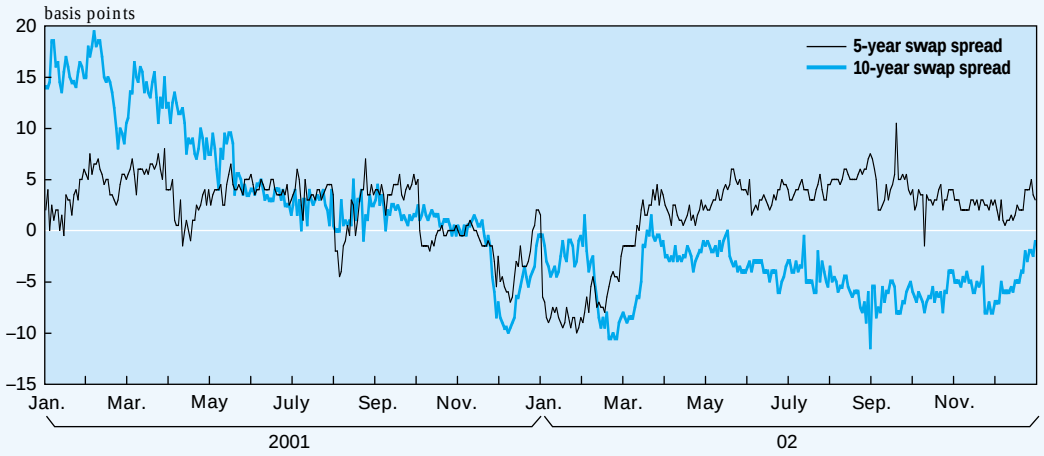


Chart 58
Yield on 10-Year Japanese Government Bonds

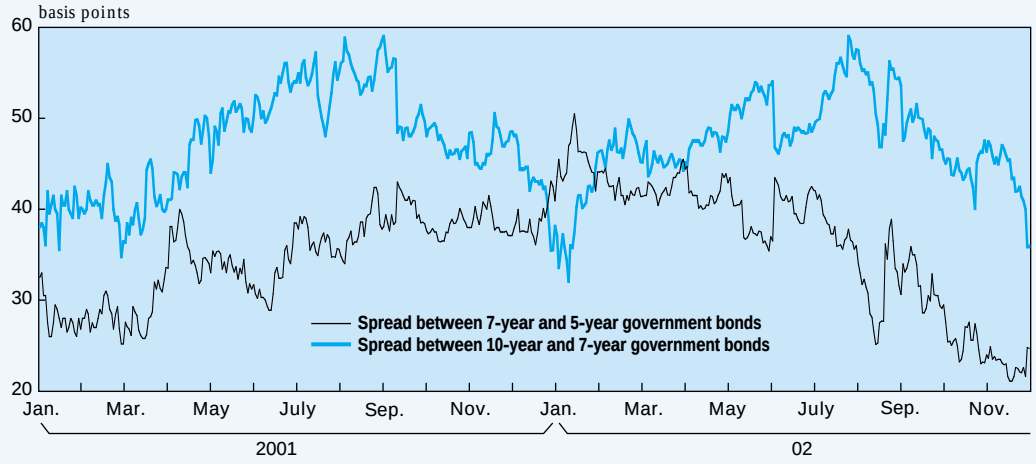
Source: Bloomberg.

Chart 59
Swap Spreads[1]



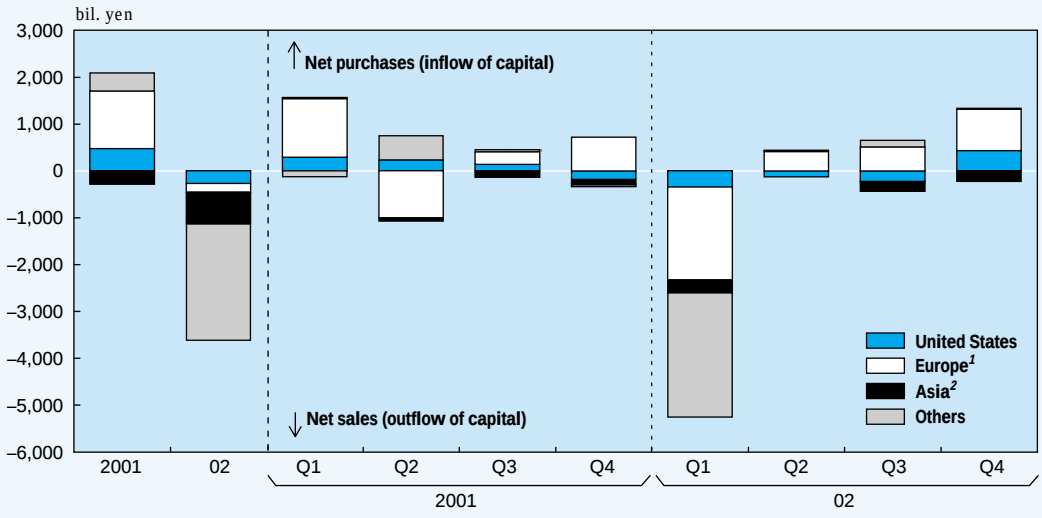
Note: *1*. Swap spread = swap rate – yield on government bonds.
Source: Bloomberg.

Chart 60
Yield Spreads



Source: Bloomberg.

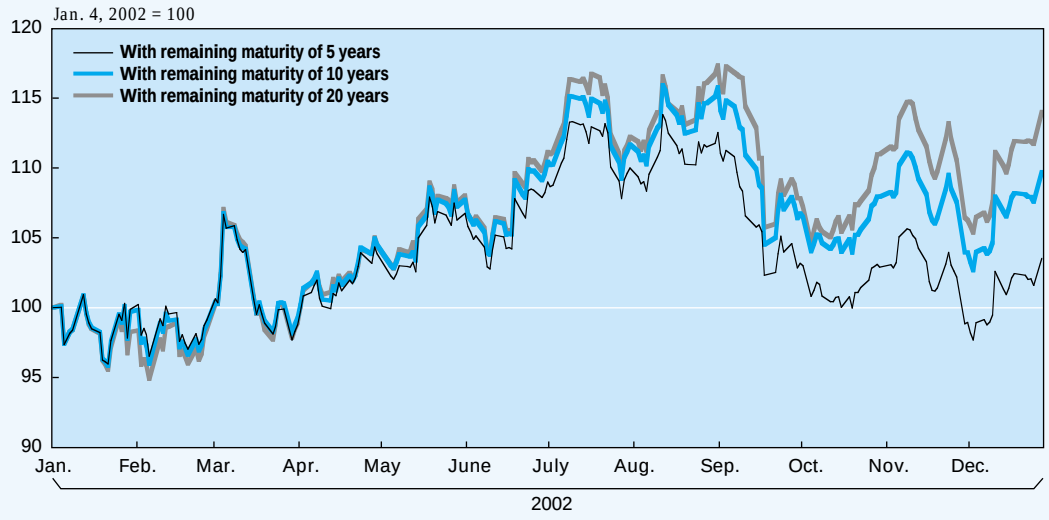
Chart 61
Investment in Japanese Bonds and Notes by Nonresidents (By Area)



Notes: *1*. Figures are the total for the 15 member countries of the EU and Switzerland.
2. Figures are the total for Hong Kong, South Korea, Singapore, and Thailand.
Source: Ministry of Finance, "Securities Investment at Home and Abroad (settlement basis)."

Chart 62

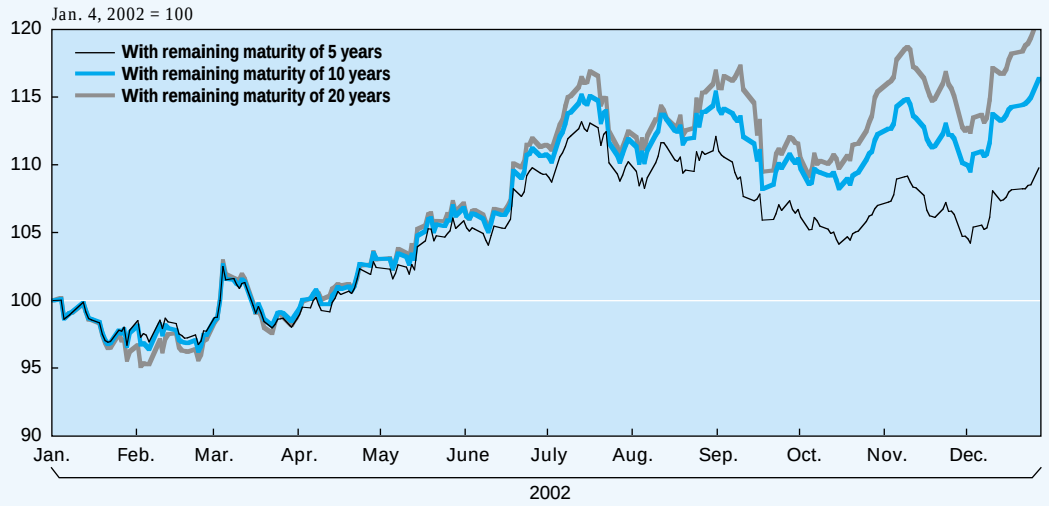
Performance of Japanese Government Bonds (Euro Basis)[1]



Note: *1*. Performance is measured on the assumption that 100 euros were invested on January 4, 2002, excluding reinvestment of coupons. Issues used in this chart are the 191st and 235th issues of 10-year government bonds, and the 53rd issue of 20-year government bonds.
Source: Bloomberg.

Chart 63

Performance of Japanese Government Bonds (U.S. Dollar Basis)[1]



Note: *1*. Performance is measured on the assumption that 100 U.S. dollars were invested on January 4, 2002, excluding reinvestment of coupons. Issues used in this chart are the 191st and 235th issues of 10-year government bonds, and the 53rd issue of 20-year government bonds.
Source: Bloomberg.

Chart 64
Investment in Japanese Money Market Instruments by Nonresidents

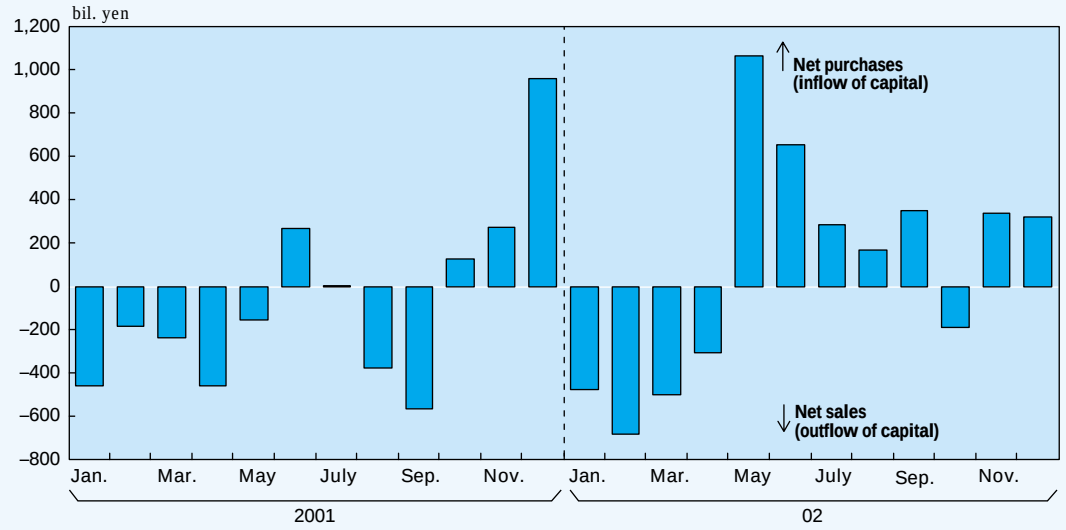
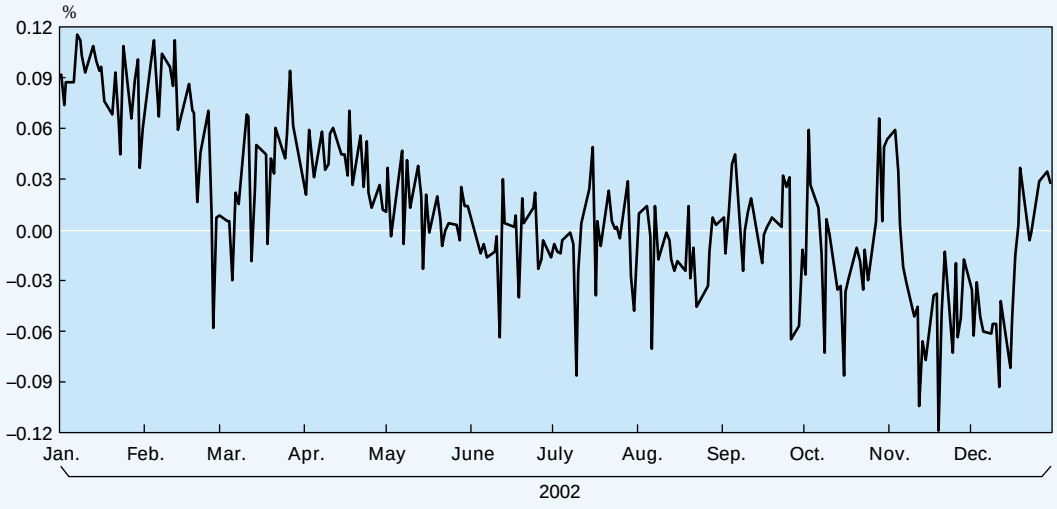


Chart 65
Yen Funding Rate (3-Month)



Source: Bloomberg.

Chart 66
Financial Derivatives

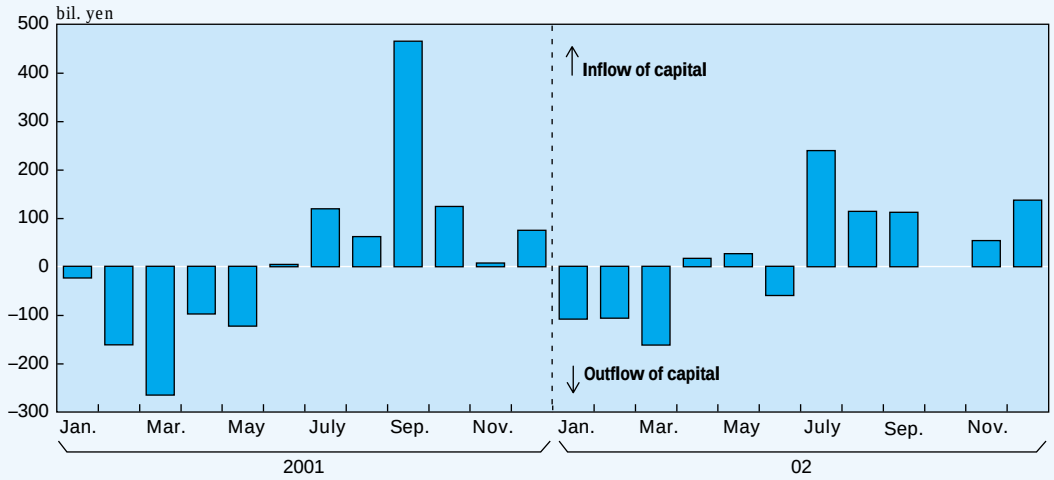
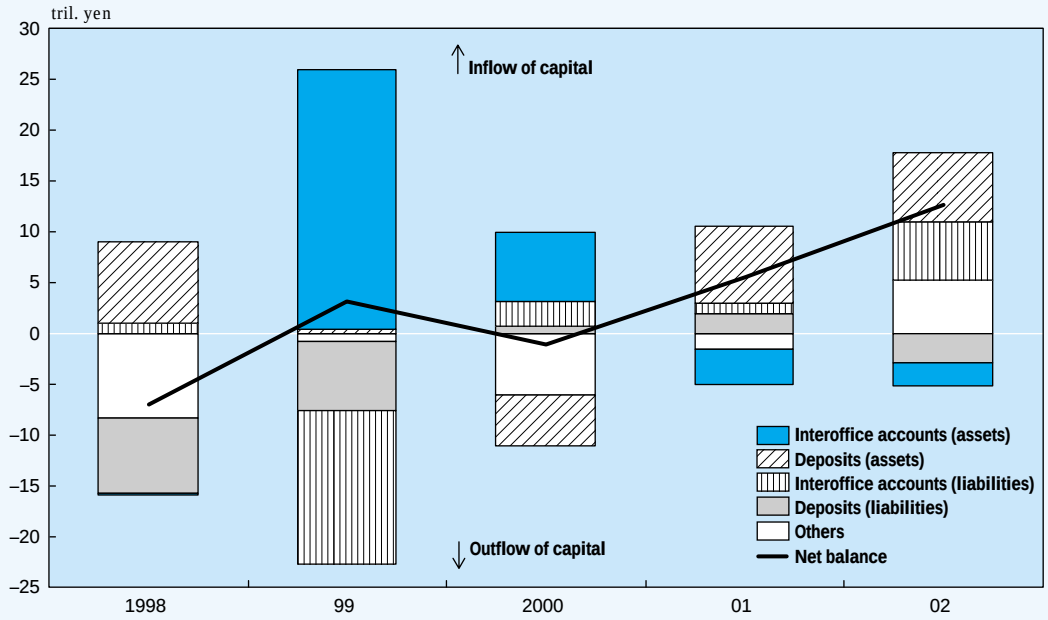


Chart 67
Exchange Rate

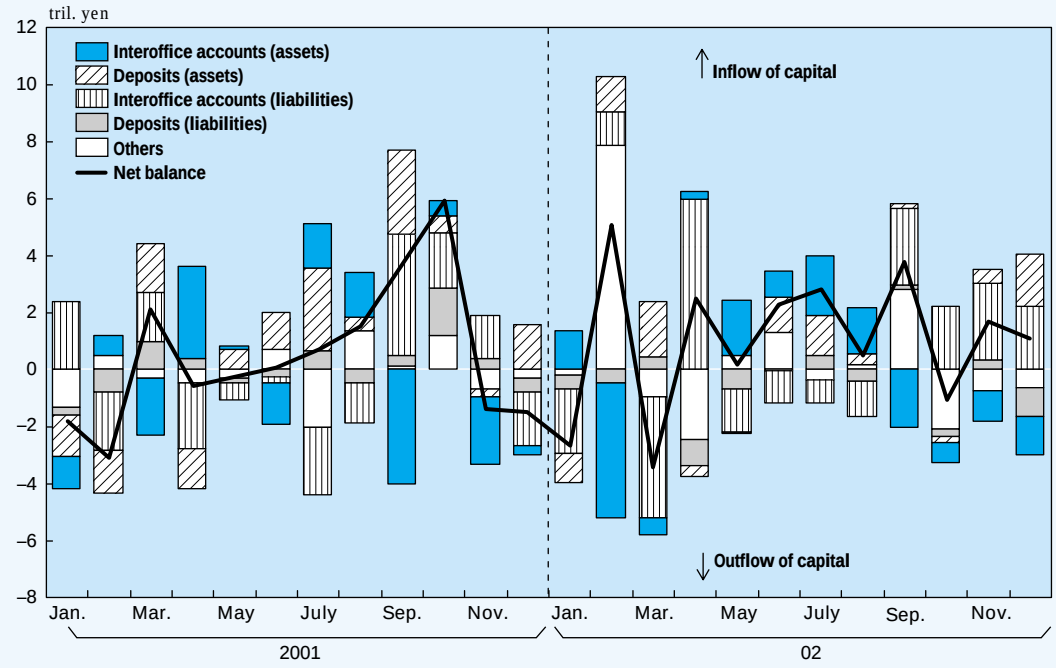
Source: Bloomberg.

Chart 68
Other Investment

(1) Annual Development



(2) Monthly Development



Box 1 Imports of High-Value-Added Products from China

The share of high-value-added products in overall imports from China has increased significantly in the past decade. The share of manufactured goods, such as textiles and machinery, increased to almost 60 percent in 2002 from about 35 percent in 1991 (Chart 1 for Box 1). The contribution of capital-intensive products was especially notable in the growing share of manufactured goods. For example, the share of machinery surged to 33.5 percent in 2002 from 5.8 percent in 1991.

A closer study of the balance of payments statistics shows that a shift to imports of high-value-added products has occurred not only among different import commodity categories but also among goods within the same category. In imports of machinery, for example, the share of personal computers (PCs) and other office machinery has been increasing while that of audio apparatus has been decreasing. In addition, within the increasingly high-value-added category of office machinery, the share of imports has been increasing for the higher-value-added or finished products such as PCs, liquid crystal displays, and notebook PCs, while decreasing for relatively low-value-added products, such as parts and calculators (Chart 2 for Box 1).

The above developments seem to reflect changes in the relative export competitiveness of Japan and China in each product category. This may also be roughly seen in the changes over the years in the trade specialization coefficients, which show the degree of imbalance between exports and imports. For example, the trade specialization coefficient calculated for machinery in general, a major trade commodity, clearly shows a decline in Japan's competitiveness over the past decade (Chart 3 for Box 1). Such a decline is especially notable in general machinery, audiovisual apparatus, and transportation equipment (excluding motor vehicles), which showed extremely strong competitiveness ten years ago.

The trade specialization coefficients for selected items within each product category are as follows.

(1) General machinery

Japan's competitiveness for general machinery weakened substantially as shown by the fall in the trade specialization coefficient to near zero, at 0.06 in 2002 from 0.84 in 1991. There has been a substantial decline in competitiveness for finished products such as office machinery, although competitiveness remains high for capital goods such as power generating machinery and metalworking machinery. The above analysis suggests that China is increasing exports of high-value-added products to Japan, while depending on imports of capital goods from Japan to produce them.

(2) Electrical machinery

Competitiveness in electrical machinery is roughly the same for Japan and China, although Japan had a comparative advantage over China in 1991. Japan's trade specialization coefficient for electrical machinery was 0.00 in 2002 against 0.54 in 1991. By item, Japan's competitiveness against China in audiovisual apparatus has declined, becoming significantly weak in its competitiveness, while the two countries have roughly equal levels of competitiveness in exports of telecommunications apparatus. Japan remains highly competitive in semiconductors.

(3) Transportation equipment

Overall, the level of Japan's advantage over China is gradually declining for transportation equipment, standing at 0.48 in 2002 against 0.91 in 1991. Although Japan remains formidably competitive in motor vehicles, this is partly cancelled out by the sharp fall in the competitiveness of ships and other transportation equipment.

The fields of industry within which China is competitive are expanding to include the electronics as well as the textiles industry. This trend is likely to continue for the following reasons. First, a high level of direct investment from overseas continues in China and technology and expertise continue to spread across a wider range of industries. Second, not only is an abundant supply of low-cost labor continuing, but the quality of the labor force is improving due to better educational opportunities. Third, active government assistance is attracting foreign capital and encouraging the growth of high-tech industry. And fourth, the introduction of modularization, in which a number of parts are pre-assembled,

Box 1 (continued)

has enabled the electronics industry to carry out production under the cell method.

Developments in the trade specialization coefficients by item show that China is increasing imports of intermediate goods and producer goods from Japan as it increased exports of high-value-added products to Japan. China still depends on imports from Japan and other countries for high technology-intensive products, namely, capital goods such as metalworking machinery and producer goods such as semiconductors. In this sense, the trading relationship between Japan and China is to some extent complementary.

Chart 1 for Box 1 Share of the Major Items in Japan's Imports from China

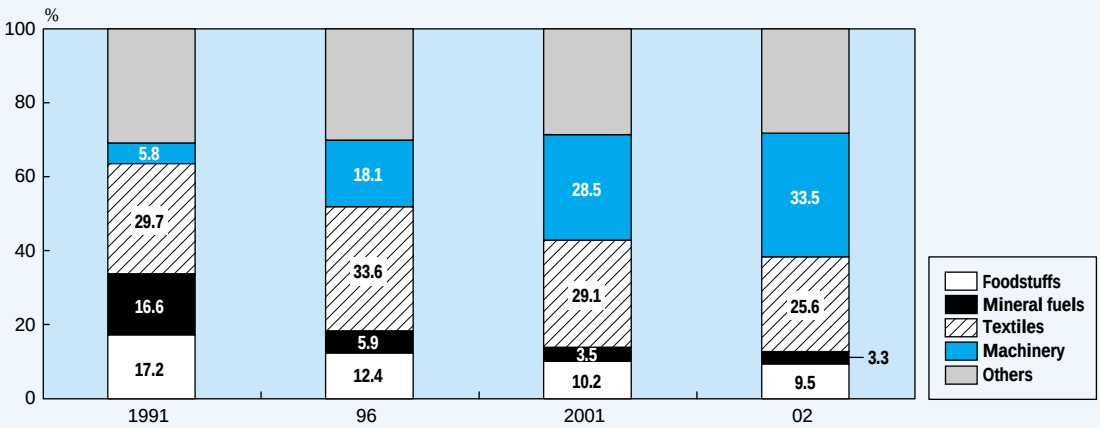


Chart 2 for Box 1 Share of Major Items in Japan's Imports of Office Machinery from China

%

1998	Share	99	Share	2000	Share	01	Share	02	Share
Parts and accessories for PCs	50.3	Parts and accessories for PCs	42.4	Parts and accessories for PCs	46.9	Parts and accessories for PCs	33.4	Parts and accessories for PCs	24.9
Input/output devices	11.1	Input/output devices	13.3	Input/output devices	14.9	Input/output devices	20.4	PCs	15.6
Displays excluding liquid crystal displays	10.4	Displays excluding liquid crystal displays	11.1	Displays excluding liquid crystal displays	10.8	PCs	12.1	Notebook PCs	15.3
Parts and accessories for word processors and typewriters	5.6	Parts and accessories for word processors and typewriters	6.0	PCs	5.9	Displays excluding liquid crystal displays	5.7	Printing units	11.6
Electronic calculating machines	5.4	Electronic calculating machines	5.8	Parts and accessories excluding those for PCs	4.5	Notebook PCs	5.1	Liquid crystal displays	8.1
Magnetic disk units	4.3	Parts and accessories excluding those for PCs	4.0	Electronic calculating machines	2.9	Parts and accessories excluding those for PCs	3.0	Input/output devices	4.1

Chart 3 for Box 1 Share of Items under Machinery in Japan's Exports and Imports and the Trade Specialization Coefficients against China[1]

	1991 (a)			2002 (b)			(b) – (a)
	Share in overall exports	Share in overall imports	Trade speciali-zation coefficients	Share in overall exports	Share in overall imports	Trade speciali-zation coefficients	Changes in the trade specialization coefficients[1]
General machinery	17.4%	0.9%	0.84	20.9%	11.9%	0.06	–0.78
Power generating machinery	**2.1%**	**0.0%**	**0.95**	**1.5%**	**0.1%**	**0.75**	**–0.20**
Office machinery	**1.7%**	**0.4%**	**0.45**	**3.2%**	**9.2%**	**–0.63**	**–1.08**
Of which: PCs and peripheral equipment	**0.0%**	**0.4%**	**–0.86**	**3.2%**	**9.0%**	**–0.63**	**0.23**
Metalworking machinery	**1.1%**	**0.1%**	**0.80**	**2.0%**	**0.1%**	**0.87**	**0.07**
Electrical machinery	22.2%	4.0%	0.54	26.8%	17.1%	0.00	–0.53
Audiovisual apparatus	**11.3%**	**0.9%**	**0.76**	**2.8%**	**5.6%**	**–0.51**	**–1.28**
Telecommunications apparatus	**1.5%**	**0.2%**	**0.57**	**1.5%**	**1.3%**	**–0.14**	**–0.71**
Semiconductors and other electronic parts	**2.4%**	**0.2%**	**0.79**	**10.5%**	**1.1%**	**0.72**	**–0.06**
Electrical measuring and controlling instruments	**0.8%**	**0.0%**	**1.00**	**1.5%**	**0.2%**	**0.67**	**–0.33**
Transportation equipment	6.4%	0.2%	0.91	6.1%	1.4%	0.48	–0.43
Motor vehicles	**4.0%**	**0.0%**	**1.00**	**3.7%**	**0.0%**	**1.00**	**–0.00**
Ships	**0.2%**	**0.0%**	**0.55**	**0.0%**	**0.0%**	**–0.52**	**–1.07**
Scientific, medical, and optical instruments	1.5%	0.2%	0.61	4.0%	2.5%	0.01	–0.60

Note: *1.* Shaded items are those for which Japan's competitiveness has declined in the past decade.

Box 2 Recent Developments in Import Prices: Factor Decomposition of the Import Unit Value Index

Import prices, which are sensitive to exchange rates and the commodities market, are also influenced by changes in the quality of commodities and the commodity structure of imports. In what follows, this point is examined by analyzing developments in Japan's import prices since 1998 (Chart 1 for Box 2).

Changes in import prices are analyzed by examining changes in the Fisher import unit value index compiled by the Ministry of Finance. Price changes are decomposed into the following factors: (1) exchange rate changes; (2) market price changes (fluctuations in prices); (3) quality changes (changes in the quality of goods within the same commodity category); and (4) weight changes (changes in the weight of import commodity structure).[1] The analysis of these factors is conducted using two import unit value indexes, both compiled by the Ministry of Finance (one using the Laspeyres formula, the other the Paasche formula), and two import price indexes, both compiled by the Bank of Japan using the Laspeyres formula (one constructed on a yen basis and the other on a contract currency basis).

By type of good, prices of raw materials are considerably affected by market price changes, while manufactured goods, such as textiles and machinery, are especially affected by quality and weight changes. Analysis of prices for machinery, a major component of manufactured goods, reveals that the quality changes factor pushed up prices until 2001 but that the market price and weight changes factors pushed down prices from early 2001 (Chart 1 [2] for Box 2). During this period, the quality of IT-related goods improved significantly, while prices of semiconductors and other electronic parts declined due to accumulation of inventories. At the same time, there was a general decrease in prices reflecting acceleration in the global shift of production bases to overseas countries where production costs were low.

In line with the above analysis, the share of machinery imported from China increased to 18.7 percent in 2001 from 9.3 percent in 1998 as it did also for imports from other Asian economies, to 32.2 percent in 2001 from 27.2 percent in 1998, while there was a decrease in the share of machinery imported from both the United States (to 27.2 percent in 2001 from 41.1 percent in 1998) and the EU (to 16.6 percent in 2001 from 18.3 percent in 1998). This increase in the share of imports from countries with lower production costs coincides with the rise in the import penetration rate of machinery (see Chart 9 on page 96). Given this, it seems that the fall in import prices of machinery is exerting downward pressure on the domestic prices of competing Japanese products.

Analysis of the weight changes factor shows that prices are declining in all countries and areas (Chart 2 for Box 2). The pace of decline is much faster for the EU than for China and other Asian economies, suggesting that the decline in import prices in recent years is mainly attributable to products imported from the EU. This is evident in the decline in weight of luxury cars and the increase in the weight of small and low-priced cars in imports of motor vehicles, which account for about 30 percent of overall imports of machinery from the EU.

In sum, the recent decline in prices stems from a combination of the following two factors. First, imports of lower-priced manufactured goods from China increased reflecting the shift of production bases to the country. And second, consumer preference changed in favor of popular lines and lower-priced goods, as seen in the case of motor vehicles.

1. For details, see Reference for Box 2.

[Reference for Box 2] Details and Points to Note Regarding the Factor Decomposition of the Import Unit Value Index (Fisher Formula)

A. Factor Decomposition of Import Unit Value Index

The following factor decomposition identifies four factors behind fluctuations in import prices.

$M(F)$ = import unit value index (Ministry of Finance; *Merchandise Trade Statistics*; compiled using the Fisher formula; yen basis; base year = 1995).

$M(L)$ = import unit value index (Ministry of Finance; *Merchandise Trade Statistics*; compiled using the Laspeyres formula; yen basis; base year = 1995).

$M(P)$ = import unit value index (Ministry of Finance; *Merchandise Trade Statistics*; compiled using the Paasche formula; yen basis; base year = 1995).

$B(L)$ = import price index (Bank of Japan; *Economic Statistics Annual*; compiled using the Laspeyres formula; yen basis; adjusted for quality differences; base year = 1995).

$Bf(L)$ = import price index (Bank of Japan; *Economic Statistics Annual*; compiled using the Laspeyres formula; contract-currency basis; adjusted for quality differences; base year = 1995).

$$
\begin{aligned}
M(F) &= (M(L))^{0.5} \times (M(P))^{0.5} \\
&= M(L)/(M(L))^{0.5} \times (M(P))^{0.5} \\
&= M(L) \times \{(M(P))/(M(L))\}^{0.5} \\
M(F) &= M(L)/B(L) \times (M(P)/M(L))^{0.5} \\
&\quad \times B(L)/Bf(L) \times Bf(L) \\
\Delta M(F) &= \Delta(M(L)/B(L)) \quad \leftarrow \text{Quality changes factor} \\
&\quad + \Delta(M(P)/M(L))^{0.5} \leftarrow \text{Weight changes factor} \\
&\quad + \Delta(B(L)/Bf(L)) \quad \leftarrow \text{Exchange rate changes factor} \\
&\quad + \Delta Bf(L) \quad \leftarrow \text{Market price changes factor}
\end{aligned}
$$

B. Details of Individual Factors

The "market price changes factor" refers to changes in import prices that result purely from price fluctuations in the market. Effects of exchange rate fluctuations and changes in product quality are excluded.

The "exchange rate changes factor" refers to changes in import prices that result purely from fluctuations in the exchange rate. Effects of changes in product quality are excluded.

The "quality changes factor" is calculated by dividing the import unit value index (L) by the import price index (L) to adjust it for quality differences. In this way, the effect of quality adjustment for products within the same import category can be identified.

The "weight changes factor" identifies changes from the base year, at which prices are fixed, in the relative import shares of items composing the unit value index.

C. Notes

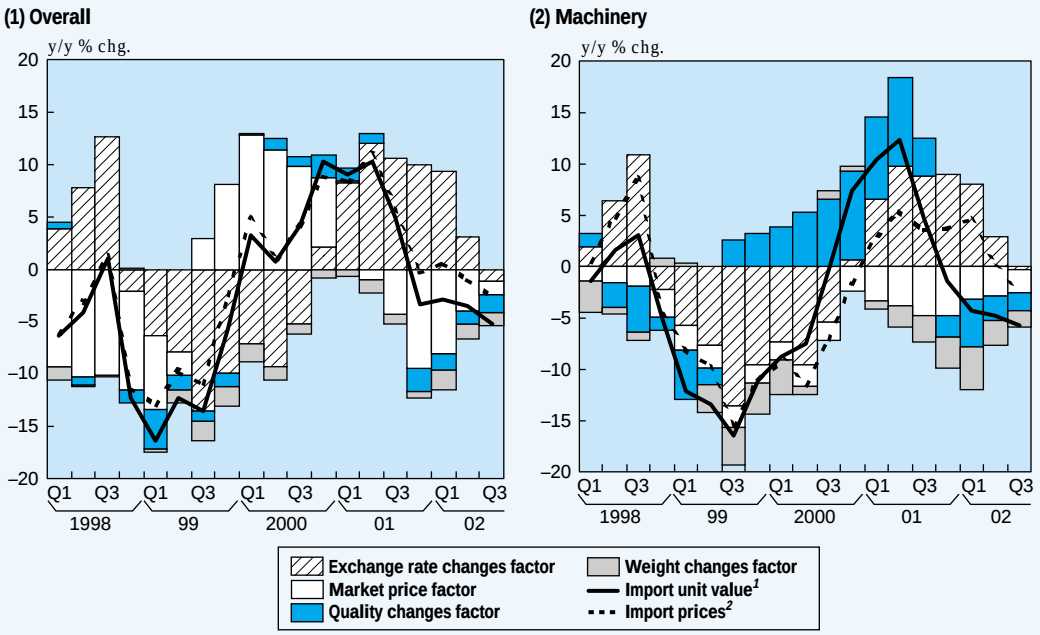
The following two points should be noted in relation to the "quality changes factor" and "weight changes factor."

(1) Sample items for both import unit value and import price indexes are selected with regard to the degree to which they influenced total imports in 1995. Items that have considerably expanded their shares in total imports or items newly included in the import category since 1995 are not, therefore, adequately reflected in the indexes. These items are often high-value-added goods particularly remarkable for recent technological innovation. There is, therefore, a degree of downward bias in the indexes. The degree of bias increases with the length of time that elapses from the index base year.

(2) The number of sample items selected for the unit value index compiled by the Ministry of Finance is 2,684, while that for the import price index compiled by the Bank of Japan is only 247. Therefore, there exists some bias regarding the selection of items between the indexes compiled by the Ministry of Finance and the Bank of Japan. Moreover, due to this vast difference in sample sizes, the effect of quality adjustment cannot be accurately calculated.

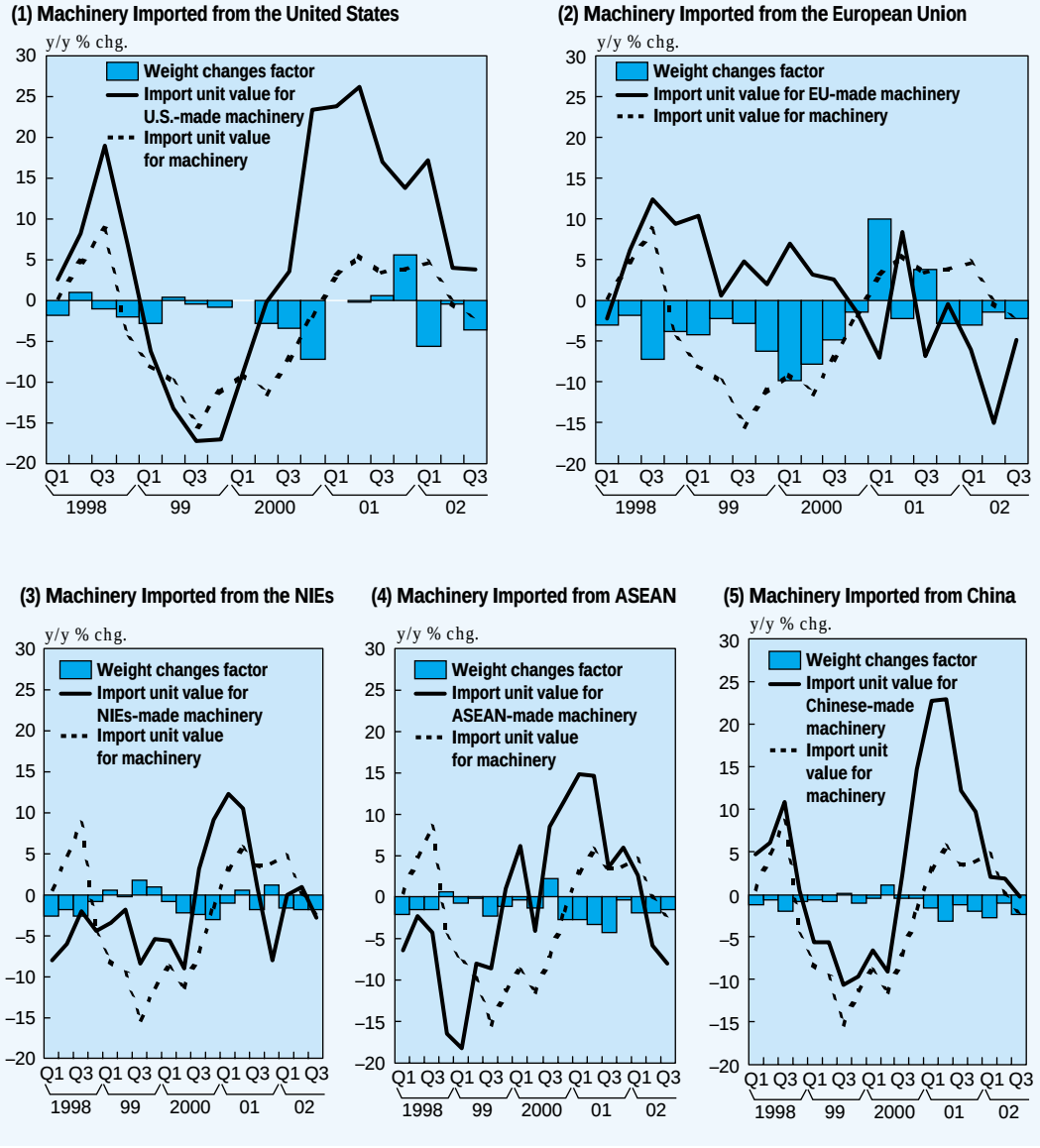
Box 2 (continued)

Chart 1 for Box 2 Import Prices



Notes: *1.* Import price index compiled by the Ministry of Finance using the Fisher method.
2. Import price index compiled by the Bank of Japan using the Laspeyres method. Figures are adjusted for changes in product quality.

Chart 2 for Box 2 Weight Changes Factor in Machinery



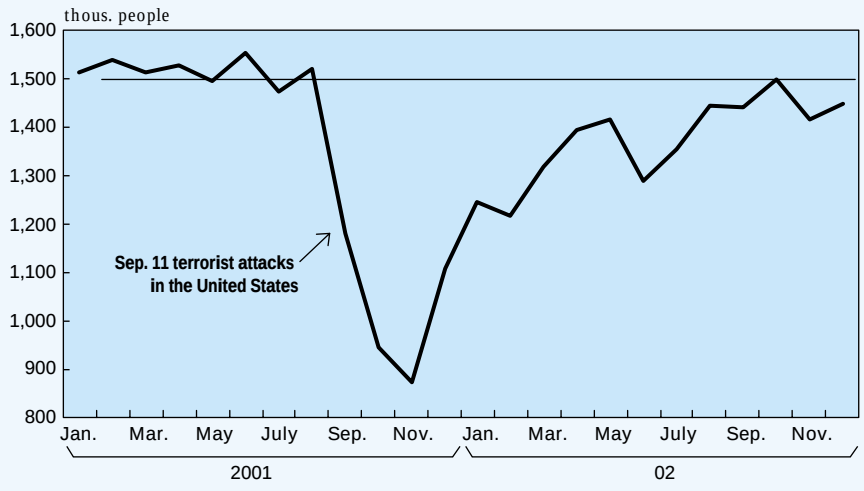
Box 3 Number of Travelers Departing from Japan after the Terrorist Attacks in the United States

In 2002, monthly figures for the number of travelers going overseas on a seasonally adjusted basis remained below the level before the terrorist attacks in the United States in 2001 overall (Chart 1 for Box 3). The number of Japanese travelers going abroad dropped sharply after the terrorist attacks, hitting bottom in November 2001 then following a recovery trend until May 2002. There was another decline in June, however, when people stayed in Japan for the World Cup soccer tournament that was co-hosted by Japan and South Korea. The number increased slightly in July and August, but its pace has been slow and it has yet to recover to its pre-September 2001 level.

The following are the possible factors behind the slow recovery in the number of travelers from Japan. Recovery in the number of travelers going to more distant countries or areas such as the United States, Canada, and Europe has been slow, although an increasing number of travelers were visiting neighboring countries or areas such as China and Oceania. Travelers to these countries or areas increased year on year from early 2002, surpassing the high levels marked before the terrorist attacks (Chart 2 for Box 3).

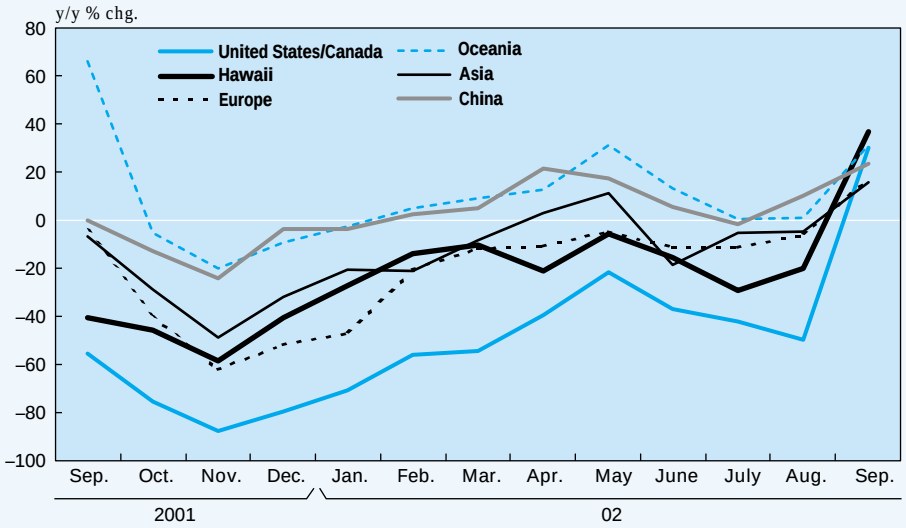
Another factor behind the slow recovery was a drop in the number of female travelers in their 20s (Chart 3 for Box 3). Developments by age group show an across-the-board year-on-year decline in the number of travelers going overseas after the terrorist attacks. The decline was especially notable for women in their 20s, which has been the core age group for travelers from Japan. The consumption trend of women in this age group is fairly sensitive to business cycles. Thus, cyclical factors may also underlie the slow recovery in the number of travelers departing from Japan.

Chart 1 for Box 3 Number of Japanese Travelers Going Overseas[1]



Note: *1.* Figures are seasonally adjusted. Calculated by the Balance of Payments Division, International Department of the Bank of Japan.
Source: Japan National Tourist Organization (JNTO).

Chart 2 for Box 3 Overseas Package Tours by Destination[1]



Note: *1*. The year-on-year average of the number of people who purchased overseas package tours based on figures by five major traveling agencies in Japan.
The sharp year-on-year increase in September 2002 is attributable to a large decrease in the same period of the previous year.
Source: Japan Association of Travel Agents (JATA).

Chart 3 for Box 3 Number of Japanese Travelers Going Overseas by Age Group and Sex

persons; %

	Jan.–Aug. 2001	Jan.–Aug. 2002	Changes from the previous year	Contribution
Total	**12,060,472**	**10,606,561**	**–12.1**	**–12.1**
Males	**6,498,379**	**5,864,403**	**–9.8**	**–5.3**
10–19	**288,634**	**246,121**	**–14.7**	**–0.4**
20–29	**971,513**	**819,941**	**–15.6**	**–1.3**
30–39	**1,419,767**	**1,295,706**	**–8.7**	**–1.0**
40–49	**1,288,768**	**1,178,870**	**–8.5**	**–0.9**
50–59	**1,346,966**	**1,237,483**	**–8.1**	**–0.9**
60–69	**739,865**	**685,659**	**–7.3**	**–0.4**
70–	**237,827**	**222,133**	**–6.6**	**–0.1**
Females	**5,562,093**	**4,742,158**	**–14.7**	**–6.8**
10–19	**384,890**	**318,641**	**–17.2**	**–0.5**
20–29	**1,628,998**	**1,315,868**	**–19.2**	**–2.6**
30–39	**1,042,577**	**942,974**	**–9.6**	**–0.8**
40–49	**626,628**	**537,003**	**–14.3**	**–0.7**
50–59	**884,917**	**753,292**	**–14.9**	**–1.1**
60–69	**601,896**	**529,025**	**–12.1**	**–0.6**
70–	**190,208**	**171,296**	**–9.9**	**–0.2**

Source: Japan National Tourist Organization (JNTO).

Box 4 Effect of the 2002 FIFA World Cup on the Travel Account

The deficit in the travel account narrowed in June 2002 on a seasonally adjusted basis, because payments (debit) in the travel account decreased with the co-hosting by Japan and South Korea of the 2002 Federation International Football Association (FIFA) World Cup from May 31 to June 30, 2002. Contrary to the initial forecast, the number of travelers entering Japan in June was only 441 thousand, an increase of only 38 thousand people year on year. Meanwhile, the number of Japanese travelers going overseas decreased considerably to 1,244 thousand, a decline of 216 thousand people year on year.

A comparison between the actual figures for June and the estimated figures excluding the effects of the World Cup soccer tournament reveals a decrease of more than 10 billion yen in the travel account deficit due to the World Cup soccer tournament (Chart for Box 4).

A decrease in the number of travelers to South Korea, one of the most popular overseas destinations for Japanese travelers during off-seasons, was the largest factor behind the fall in the number of travelers departing from Japan in June.[1] This was against the following background. First, fewer people visited South Korea to watch games than were discouraged from visiting by higher accommodation fees, air fares, and other expenses of traveling during the World Cup soccer tournament. And second, the number of travelers going overseas decreased in general because people were more interested in watching the World Cup soccer tournament in Japan.

Chart for Box 4 Travel Account and the Number of Travelers Departing from and Entering Japan in June 2002[1]

bil. yen; thous. people

	Travel (bil. yen)	Debit	Credit	Number of travelers departing from Japan	Number of travelers entering Japan[2]
Actual figures (A)	**–228.7**	**267.4**	**38.6**	**1,244**	**441**
Estimated figures excluding the effects of the World Cup (B)[3]	**–239.0**	**272.8**	**33.9**	**1,367**	**403**
(A) – (B)	**10.2**	**–5.5**	**4.7**	**–123**	**38**

Notes: *1.* Figures for travel account are seasonally adjusted. Numbers of travelers departing from and entering Japan are raw figures.
2. Based on data released by the JNTO that are compiled using figures on the number of people entering Japan released by the Ministry of Justice.
3. Calculated by the Bank of Japan. The following figures were used in the calculations: (1) the year-on-year change in the number of Japanese traveling overseas in May 2002 (a decline of 6.4 percent); (2) the number of people entering Japan in June 2001; and (3) consumption per traveler in June 2001 (credit is calculated on a yen basis, and debit is calculated on a U.S. dollar basis).

1. Off-seasons in Japan refer to periods other than the spring, summer, and winter vacation periods (March, July–August, and end-of-December/early January, respectively).

Box 5 Analysis of the Profitability of Direct Investment in China Using Balance of Payments Statistics

After a slight pause in the late 1990s, Japanese direct investment in China began once again to increase from 2000, with firms focused on access to Chinese markets (Chart 1 for Box 5).

The rate of return on Japan's direct investment in China started to increase in 2001 due to a recovery in the profitability of manufacturers of parts.[1] The level, however, remains low compared to the rate of return on U.S. direct investment in China and Japanese direct investment in the newly industrialized economies (NIEs) and the four countries that comprise the Association of South East Asian Nations (ASEAN4; see charts 2 and 3 for Box 5).[2]

The low rate of return on Japanese direct investment in China relative to that of the United States is mainly attributable to two factors. First, there are differences between the United States and Japan in the type of industry investing in China (charts 4 and 5 for Box 5). Compared to the United States, textile and other industries exposed to severe global competition take up a relatively large share of Japanese investment in China. And second, regarding electrical machinery, which accounts for a large share of investment by Japan and the United States, the type of products put on the Chinese market by Japanese and U.S. manufacturers differs. Japanese-affiliated firms in the electrical machinery industry operating in China concentrate on the production of household electrical appliances, a market where price competition is fierce in China (Chart 6 for Box 5). On the other hand, U.S.-affiliated firms concentrate on the production of high-tech products, and this enables them to retain market dominance and the concomitant profits (Chart 7 for Box 5).

The low rate of return on Japanese direct investment in China relative to its investment in the NIEs or the ASEAN4 is mainly attributable to the following three factors (Chart 8 for Box 5). First, competition with local firms for home electrical appliances (final products) is more severe in China. Second, additional costs are often incurred in China, where the legal and institutional frameworks have not yet been fully established. And third, Japanese-affiliated firms are still recording initial losses in China since they started their business in China later compared with their operations in the NIEs or the ASEAN4.

It may seem contradictory that Japanese direct investment in China is increasing despite low rates of return. Close studies on profitability of Japanese-affiliated firms in the late 1990s reveal, however, that not all firms are recording low rates of return. Rather, there is a polarization between highly profitable firms and unprofitable or loss-recording firms (Chart 9 for Box 5). Examples of highly successful operations in China, in addition to the country's importance as a world production base and the potential of the Chinese market, are considered to be factors attracting more Japanese investment in China.

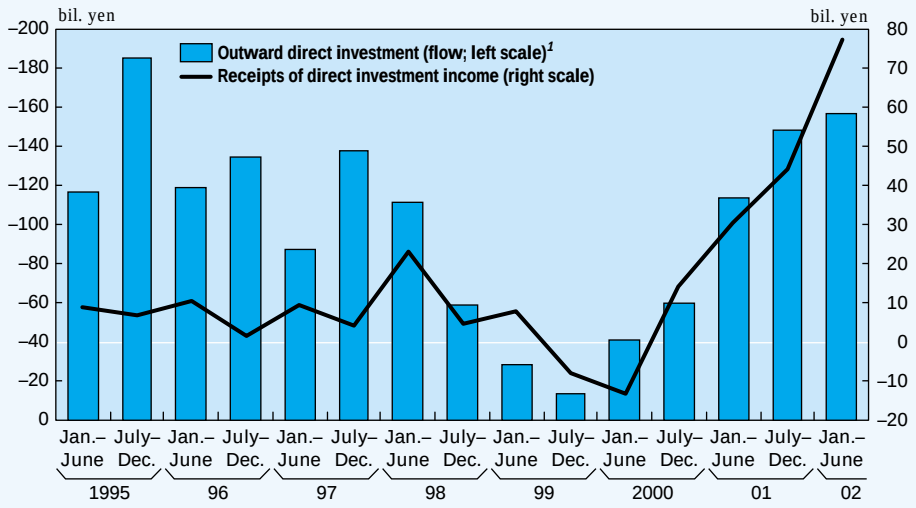
---

1. The rate of return on direct investment in China is calculated using balance of payments and international investment position statistics.

2. The NIEs comprise South Korea, Taiwan, Hong Kong, and Singapore. ASEAN4 comprises Thailand, Malaysia, Indonesia, and the Philippines.

Box 5 (continued)

Chart 1 for Box 5 Japan's Direct Investment in China and Profits



Note: *1.* Net balance of Japan's direct investment in China. Negative figures show an increase in net asset position.

Chart 2 for Box 5 Rate of Return on Japanese and U.S. Direct Investment in China[1]

%

	1997	98	99	2000	01
Japan	**0.7**	**1.2**	**–0.0**	**0.1**	**6.5**
United States[2]	**17.8**	**5.8**	**11.6**	**15.8**	**12.8**

Chart 3 for Box 5 Rate of Return on Japan's Outward Direct Investment by Area[1]

%

	1997	98	99	2000	01
NIEs	**18.8**	**9.9**	**–4.5**	**–5.1**	**10.6**
ASEAN4	**5.4**	**3.6**	**–8.4**	**–0.9**	**8.4**
China	**0.7**	**1.2**	**–0.0**	**0.1**	**6.5**

Notes: *1.* The rate of return is calculated by dividing annual receipts of direct investment income by the outstanding amount of direct investment (average of the amount outstanding of direct investment as of the end of the year concerned and that of the previous year).
2. Figures are based on U.S. direct investment abroad (USDIA) statistics.

Chart 4 for Box 5 Share of and Return on U.S. Direct Investment in China by Industry[1]

%

	Petroleum	Manufacturing							Non-manufacturing
		Transportation equipment	Electrical machinery	Industrial machinery and equipment	Chemicals and allied products	Metals	Food and kindred products	Others	
Share	**12.4**	**4.0**	**35.0**	**11.1**	**5.7**	**2.0**	**2.2**	**7.0**	**20.7**
Rate of return[2]	**2.8**	***–35.8***	***23.7***	***40.2***	**6.3**	**8.2**	**0.1**	***–3.8***	**n.a.**

Notes: *1.* Calculated based on amount outstanding of direct investment in USDIA statistics for 2001.
2. Figures are the average rate of return for the eight years from 1994 to 2001 except for those in italics. Figures for electrical machinery, and industrial machinery and equipment are the average for the five years from 1997 to 2001, and those for transportation equipment and others are the average for the four years from 1998 to 2001.

Chart 5 for Box 5 Share of and Return on Japan's Direct Investment in China by Industry[1]

%

	Manufacturing								Non-manufacturing
	Transportation equipment	Electrical machinery	Machinery[2]	Chemicals	Metals	Foodstuffs	Others	Textiles	
Share	**8.0**	**20.2**	**9.1**	**5.3**	**6.3**	**4.2**	**20.6**	**8.9**	**24.0**
Rate of return[2]	***5.7***	**2.9**	**7.2**	**2.1**	***–3.0***	**–5.3**	***3.1***	**2.7**	**n.a.**

Notes: *1.* The amount outstanding of Japan's direct investment in China is the accumulated total of direct investment in each industry (flow figures; reported statistics) for the 13 years from 1989 to 2001. The rate of return is calculated by dividing after-tax profits by capital, using data from the Ministry of International Trade and Industry's (MITI's) *Basic (Trend) Survey of Overseas Business Activities*, which provides data on overseas affiliates by country and by industry. Figures are the average of the rate of return in fiscal 1997, 1998, and 1999, except for those in italics that are data for fiscal 1999.
2. Includes precision instruments and apparatus.

Chart 6 for Box 5 Share of Electrical Appliances by Brand in the Chinese Market[1]

	No. 1	No. 2	No. 3
Refrigerators	**Haier (33)**	**Kelong (12)**	**Xinfei (9)**
Color TVs	**Changhong (19)**	**Konka (19)**	**TCL (10)**
Air conditioners	**Haier (19)**	**Midea (14)**	**Gree (13)**
Washing machines	**Haier (24)**	**Little Swan (22)**	**Yongshida (8)**
Microwave ovens	**Galanz (67)**	**LG* (12)**	**Matsushita* (5)**
Telephones	**Bubugao (23)**	**TCL (16)**	**Wandecai (3)**
DVDs/VCDs	**Shinco (18)**	**Bubugao (13)**	**Wanlida (8)**

Note: *1.* Figures in parentheses are the percentage share in the market.
Shaded area indicates a Japanese brand. Asterisks indicate non-Chinese brands.
Sources: Maruya, Toyojiro, *et al.*, "Made in China no Shougeki: Ajia 12 Kakoku, Chiiki karano Kinkyu Report (The Impact of 'Made in China' Brand on the World Economy: Reports from 12 Asian Countries and Regions)"; joint survey by Huawen Asatsu Advertising Co. and China Central Television.

Chart 7 for Box 5 Share of IT-Related Consumer Goods in the Chinese Market[1]

%

	No. 1	No. 2	No. 3	Source
Mobile phones	**Motorola (33)**	**Nokia (30)**	**Ericsson (10)**	**A[2]**
Notebook personal computers	**Legend (23)**	**IBM (17)**	**Toshiba (15)**	**B[3]**

Notes: *1.* Shaded areas indicate U.S. companies. Figures in parentheses show percentage share in the Chinese market.
2. Based on fiscal 2000 data released by the Ministry of Information Industry of China.
3. Based on 2000 data released by the IDC.
Sources: Ministry of Information Industry of China; IDC; Ministry of Finance's Study Group on China, "Chugoku ni Okeru Denshi Sangyo no Genjo to Kongo no Tenkai (China's Electronics Industry and Its Future Development)" by Shun'ichiro Aoki.

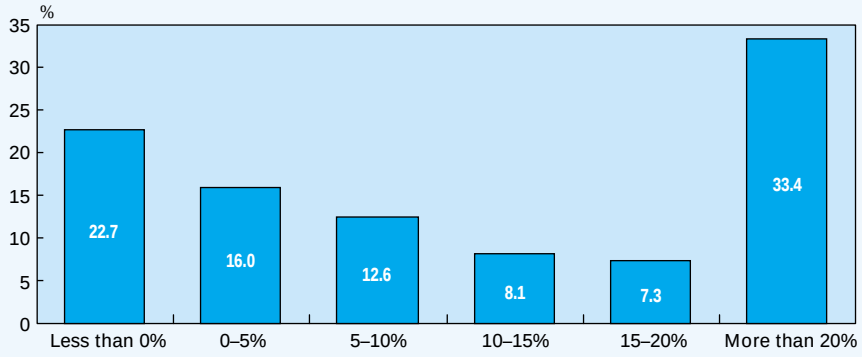
Box 5 (continued)

Chart 8 for Box 5 Reasons for the Low Level of Satisfaction with Returns on Direct Investment by Region[1]

	China	NIEs	ASEAN4
Not yet fully operational as the company was set up recently	**22.8**	**8.8**	**7.4**
Difficulty in obtaining customers due to intense competition	**43.9**	**46.2**	**36.9**
Shrinking market due to economic downturn	**11.4**	**46.2**	**51.3**
Customers' demand for discount sales	**22.8**	**11.0**	**21.0**
Unfavorable response by the investing country	**16.7**	**3.3**	**3.3**

Note: *1.* Reasons given for answering "somewhat unsatisfactory" or "unsatisfactory" in the survey. Figures indicate the rate of the answers relative to total respondents. Multiple answers could be chosen.
Source: Japan Bank for International Cooperation, "JBIC FY 2001 Survey: The Outlook for Japanese Foreign Direct Investment (13th Annual Survey)."

Chart 9 for Box 5 Distribution of the Ratio of Japanese-Affiliated Firms' Current Profits to Capital[1]



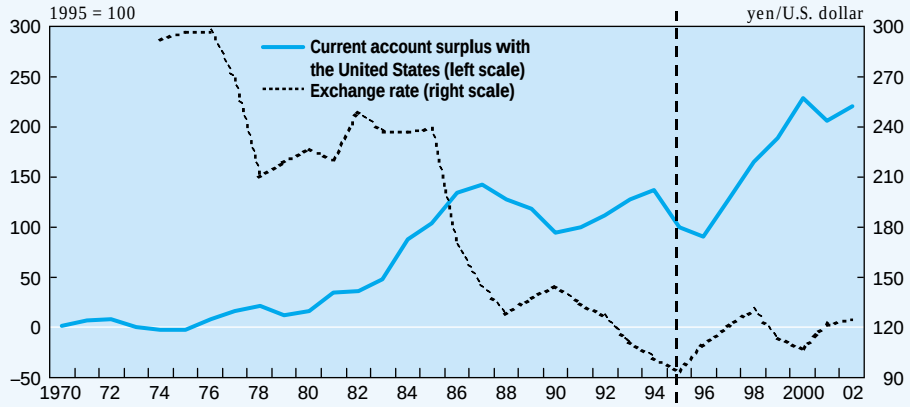
Note: *1.* The horizontal axis shows the ratio of current profits to capital (simple average of figures from 1996 to 1999). The vertical axis shows the percentage of firms to the total respondents. Firms surveyed have been operating in China for more than two years.
Source: Japan-China Investment Promotion Organization, "Dai Nanaji Nikkei Kigyou Ankeito Chousa (The Seventh Survey on Japanese-Affiliated Firms in China)."

Box 6 Long-Term Trends in Japan's Current Account Surplus with the United States

Japan's current account surplus with the United States has been gradually widening since 1976, when it shifted from deficit to surplus, with some fluctuations (Chart 1 for Box 6). However, the breakdown of components contributing to the surplus has changed considerably.

Until the first half of the 1980s, the surplus in goods and services, especially the trade surplus, accounted for most of the current account surplus with the United States (Chart 2 for Box 6). However, the contribution of the income surplus has increased, reaching over 40 percent in recent years. This is because the U.S. market has been the preferred site for investment in foreign currency-denominated assets, in spite of the relative decline in the status of the United States as a trading counterparty for Japan as Japan's trade with Asian economies has increased (charts 3 and 4 for Box 6).

Chart 1 for Box 6 Current Account Surplus with the United States[1]



Note: *1.* Data are on a U.S. dollar basis. Data from 1996 onward are compiled based on the fifth edition of the IMF's *Balance of Payments Manual*, and those before 1996 are compiled based on the fourth edition of the *Balance of Payments Manual.* There is no statistical continuity between figures before and after 1996.

The current account for 2002 is calculated by multiplying the current account for 2001 by the rate of year-on-year change for the first half of 2002.

Chart 2 for Box 6 Breakdown of Current Account Surplus: Share of Its Component[1]

%

	1981–85	1986–90	1991–95	1996–2000	2001–June 2002
Goods and services	**94**	**81**	**70**	**58**	**57**
Trade balance	**107**	**104**	**115**	**87**	**74**
Income[2]	**6**	**21**	**33**	**45**	**45**

Notes: *1.* Figures are the share of surplus in each account relative to current account surplus, and are calculated based on the sum of data for five years except for 2001–June 2002, for which data are one and a half years. Data for each account are on the same basis as for those used in Chart 1 for Box 6. For details, see Note 1 to Chart 1 for Box 6.

2. Figures for income before 1996 are investment income.

Box 6 (continued)

Chart 3 for Box 6 Exports from Japan by Area (Customs-Clearance Basis)

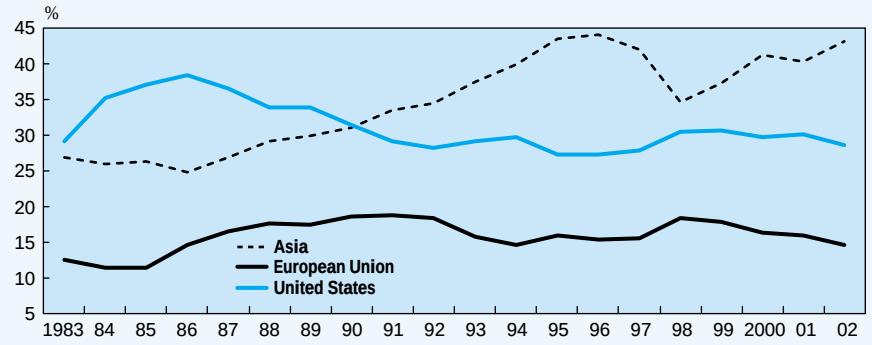
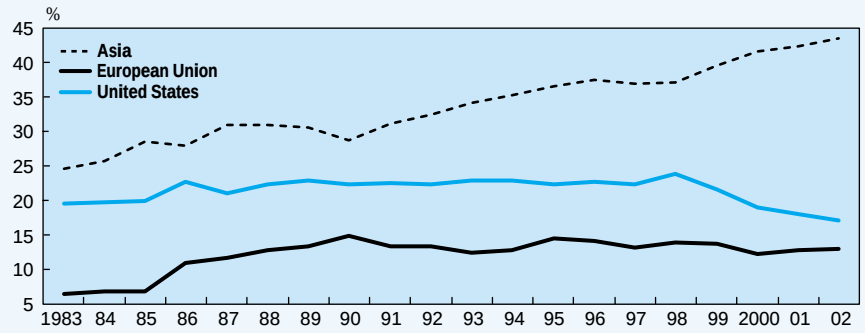


Chart 4 for Box 6 Imports to Japan by Area (Customs-Clearance Basis)



Symbols and Abbreviations Used in This Article

FY	Fiscal year	% chg.	Percentage changes
Q	Calendar quarter	y/y % chg.	Percentage changes from the previous year
%	Percent		
thous.	Thousands		
bil.	Billions	avg.	Average
tril.	Trillions	n.a.	Not available