

Japan's Balance of Payments for 2003

May 2004

**International Department
Bank of Japan**

(The Japanese original was released on March 5, 2004)

I. Summary¹

A. Overview

Japan's balance of payments (BOP) in 2003 shows that the current account recorded a surplus of 15.8 trillion yen, increased from a surplus of 14.1 trillion yen in 2002; the capital and financial account turned to a net inflow of 8.1 trillion yen from a net outflow of 8.5 trillion yen, caused mainly by a significant net inflow in the financial account; reserve assets increased by 21.5 trillion yen, which was much larger than the increase in 2002 (5.8 trillion yen);² and errors and omissions recorded a debit of 2.4 trillion yen.

B. Highlights of Japan's BOP for 2003

1. An increase in surplus in the balance of goods

The surplus in the balance of goods increased due to strong exports to Asia. Two background factors to the strength can be pointed out. First, Asian economies, especially China, kept their strength throughout 2003, except for a period when severe acute respiratory syndrome (SARS) broke out in the region. Second, an economic recovery in the United States and the expansion of global demand for digital appliances caused increases in production in Asia. Exports of a wide range of items of goods increased; these included IT-related machine parts, machine tools, construction machinery, and material handling machines. The increase of the latter two reflected an expansion of demand for infrastructure building in China in preparation for the coming Beijing Olympic Games and Shanghai World Exposition, etc. Meanwhile, exports to the United States decreased because of the expansion of production by local production bases of Japan's manufacturers such as automobile makers.

2. A decrease in deficit in all major items in services

The deficit in the balance of services decreased, reflecting a decrease in deficits in the balance of all major items, i.e., travel, transportation, and other services. The deficits in the balance of travel and passengers for air transport, a sub-component of transportation, decreased significantly because the number of Japanese travelers overseas plunged mainly due to the effects of SARS. The balance of royalties and license fees, a sub-component of

¹ Data for 2003, including charts, are provisional unless otherwise stated. Annual, semiannual, and quarterly data in this report, including charts, are on a calendar-year basis unless otherwise stated.

² An increase in reserve assets means a capital outflow in the BOP.

other services, turned to a surplus for the first time, reflecting increases in receipts of royalties from overseas subsidiaries of Japanese manufacturers such as automobile companies.

3. A record-high net outflow (purchases) of outward investment (assets) in bonds and notes

Net outflow of outward investment (assets) in bonds and notes, a sub-component of portfolio investment, recorded a historical peak of 18.4 trillion yen, far exceeding the previous peak of 11.3 trillion yen in 2001. This was mainly because investors, who usually raised foreign currency for outward investment by converting their yen, purchased foreign bonds very actively. Specifically, (1) life insurance companies increased their position in foreign bonds with hedging currency risk, (2) securities companies underwrote a large amount of foreign bonds for retail sales, and (3) investment trusts increased investment in foreign bonds reflecting steady sales of monthly-distribution-type funds that mainly invested in foreign bonds. Meanwhile, net purchases (outflow) at banks, which ordinarily invested by borrowing foreign currency, remained almost unchanged from the previous year.

4. A significant net inflow (purchases) of inward investment (liabilities) in equities

Net inflow of inward investment (liabilities) in equities, a sub-component of portfolio investment, recorded significant net purchases of 9.8 trillion yen in 2003 from net sales (outflow) in 2002. This was the second historical high as a net inflow, behind only that of 11.4 trillion yen in 1999. Two background factors can be pointed out for the significant net purchases. First, pension funds and investment trusts in the United States and Europe actively invested in Japanese equities that were adopted in the stock indices. These attitudes reflected the expectation that the Japanese economy would recover and, consequently, Japanese stock prices would rise as a whole. Second, hedge funds invested in equities of banks and high-tech related companies reflecting appreciation in values of equities held by banks. Appreciation in prices of U.S. semiconductor-related companies also stimulated hedge funds' appetite for equities of Japanese IT-related companies.

5. A turn to a net inflow from a net outflow in the capital and financial account

The capital and financial account recorded a net inflow for the first time since 1985, when Japan's BOP statistics based on the fifth edition of the *Balance of Payments Manual* (BPM5) became available. The inflows were recorded under other investment and

portfolio investment, mainly due to investment by nonresidents using surplus funds resulting from an increase in reserve assets.³

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

Current account surplus increased for the second consecutive year and marked a new record-high of 15.8 trillion yen in 2003.⁴ The balance of goods, services, and income contributed to the increase. The surplus was 3.2 percent of nominal GDP in 2003,⁵ the highest under current statistics based on the BPM5.⁶ The following are the major highlights of the current account.

- (1) The deficits in travel and passengers for air transport shrank by 708.1 billion yen from 2002, because the number of Japanese travelers abroad decreased at the highest rate ever mainly due to the effect of SARS.⁷
- (2) The surplus in the balance of goods increased by 521.8 billion yen from 2002 mainly due to the increase in exports to Asia.
- (3) The balance of royalties and license fees recorded a surplus for the first time from 1996, up 224.5 billion yen year on year, mainly due to an increase in credits in royalties from overseas subsidiaries of Japanese manufacturers.

³ “Capital and financial account,” a standard component in the BPM5, includes reserve assets as a component. Thus, a relationship between the current account, and the capital and financial account, based on the definitions in the BPM5, is shown in the following equation.

$$\text{Current account} + \text{capital and financial account} + \text{errors and omissions} = 0 \dots (a).$$

The scope of Japan’s “capital and financial account” is different from that in the BPM5 because it does not include reserve assets as its component. Changes in reserve assets are recorded independently from the capital and financial account in Japan’s BOP.

Therefore, the above equation must be modified for Japan’s BOP as follows.

$$\begin{aligned} &\text{Current account} + \text{capital and financial account} + \text{changes in reserve assets} \\ &+ \text{errors and omissions} = 0 \dots (b). \end{aligned}$$

In Japan’s BOP for 2003, “capital and financial account + changes in reserve assets” recorded a deficit of 13 trillion yen. On the other hand, “current account + errors and omissions” marked a surplus of the same amount. Thus, equation (a) holds true.

⁴ The previous peak was 15.5 trillion yen recorded in 1998.

⁵ The average of Quick Estimation (QE) for the first through fourth quarters (annualized and seasonally adjusted basis of 2003) is used as a substitute for the GDP for 2003.

⁶ Statistics based on the fifth edition of the International Monetary Fund’s *Balance of Payments Manual* are available from figures for 1996. Therefore, strictly speaking, there is no continuity of data between figures up to 1995 and 1996 onward. For example, reinvested earnings have been added to income in the current account since 1996.

⁷ In 2003, the number of Japanese travelers overseas decreased by 19.5 percent year on year. This was larger than the 9.0 percent year-on-year decrease in 2001 when there were

The surplus in the balance of goods and services increased for the second consecutive year because (1) the deficit in the balance of travel decreased, (2) the credits in goods (exports) and royalties and license fees marked a new record. As a result, the net aggregate of goods and services exceeded the surplus in the balance of income for the first time in three years.

A. Goods (Chart 4)

Exports increased by 2,446.7 billion yen (4.9 percent) from 2002, increasing for the second consecutive year. Export prices declined due to a 7.3 percent appreciation of the yen from 2002.⁸ The positive impact of an increase in the volume of exports exceeded the negative impact of a decline in export prices (Chart 5). The increase in the volume of exports came from strong demand for capital goods and parts in Asia

Imports increased by 1,924.9 billion yen (5.1 percent) from 2002. This reflected increases in the volume of imports of mineral fuels and raw materials.

The surplus in the balance of goods increased for the second consecutive year, because the increase in exports exceeded the increase in imports.

(1) The background to the increase in exports: robust economic growth in Asia and a worldwide recovery in demand for semiconductors

Exports to Asia grew throughout 2003 particularly in those of capital goods and parts for the reasons below. First, in the first half of the year, the Asian economies, especially China, kept their economic boom, except for a temporary stagnation caused by SARS in the April-June period. Second, in the second half of the year, production in Asia increased because of an economic recovery in the United States, a recovery in worldwide demand for IT-related goods, and an increase in the worldwide demand for digital appliances. Third, exports of construction machinery and mechanical handling equipment to China also grew. This reflected active demand for new factories and office buildings, and the need to improve infrastructure for the Beijing Olympic Games and the Shanghai World Exposition.

(2) The background to the increase in imports: a rise in the price of crude oil and an

terrorist attacks in the United States.

⁸ The exchange rate officially announced by the chief customs inspector is 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.

increase in demand for mineral fuels to replace nuclear power

Overall imports turned to an increase year-on-year, mainly reflecting a high growth in imports of mineral fuels. This was caused by the following: (1) the price of crude oil stayed high because of uncertainty over the situation in Iraq and (2) growing demand for mineral fuels for thermal power generation resulting from a suspension in operations of nuclear power plants. Imports of raw materials also increased due to a rise in prices and a recovery in production in Japan.

1. Exports⁹

On a customs-clearance basis year-on-year, exports increased by 4.7 percent. The volume of exports increased 5.1 percent. Export prices decreased by 0.4 percent.

a. Regional trends (charts 6, 7, and 8)

Exports to Asia continued their significant contribution to an increase in exports to the rest of the world. Exports to the European Union (EU) contributed positively from a negative contribution in 2002. Exports to the United States made a large negative contribution, reflecting sluggish demand for IT-related goods in the first half of 2003 and an expansion of local production by Japanese automobile companies.

(1) Exports to Asia

Exports to Asia recorded a double-digit growth for the second consecutive year, given increases in both volume and prices. The volume of exports increased significantly, especially for semiconductors and other electronic parts, visual apparatus, and transport equipment, reflecting strong domestic demand (a cyclical factor) and a shift of production bases overseas (a structural factor). Export prices, which had declined in 2002, increased due to a rise in the prices of raw materials. This was because the positive impact of robust production in Asia against prices exceeded the negative impact of an appreciation of the yen.

⁹ 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 (credit in goods) are recorded in the BOP based on the change of ownership principle, in which an export takes place when there is a transfer of the ownership of goods 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 51.

Chart 9 gives major items contributing to the growth in exports to Asia.

(2) Exports to the EU

Exports to the EU increased for the first time in five years, with increases in both volume and prices. The volume of exports turned to an increase for the reasons below. First, the sales of Japanese motor vehicles were brisk in the EU. Second, exports for visual apparatus and their parts were firm. Export prices rose for the third consecutive year because of a depreciation of the yen against the euro.

Chart 10 gives major items contributing to the growth in exports to EU.

(3) Exports to the United States

Exports to the United States turned to a decrease, with decreases in both volume and prices. The volume of exports decreased due to a plunge in exports of assembled motor vehicles caused by the expansion of local production by Japanese automobile companies, and a decrease in exports of office machines caused by a shift of production bases of Japanese manufacturers to China. Export prices decreased mainly due to an appreciation of the yen.

Chart 11 gives major items contributing to the growth in exports to the United States.

b. Principal items (charts 12 and 13)

The large increase in exports of “other machinery” contributed significantly to an increase in overall exports. “Other machinery” includes scientific, medical, and optical instruments, construction and mining machinery, and metalworking machinery. Raw materials and other electrical machinery such as parts for audiovisual apparatus and visual apparatus also increased. Meanwhile, IT-related goods such as office machines decreased, reflecting a shift of production bases of Japanese manufacturers to China.

2. Imports

On a customs-clearance basis year-on-year, imports increased 5.0 percent. The volume of imports increased 7.1 percent. Meanwhile, import prices declined by 2.0 percent.

a. Regional trends (charts 14, 15, and 16)

Imports from Asia, particularly those from China, contributed positively to an increase in imports from the rest of the world. Imports from the Middle East, which contributed negatively in 2002, made a positive contribution. Imports from the EU also contributed

positively albeit marginally. Meanwhile, imports from the United States made a negative contribution.

(1) Imports from Asia

Imports from Asia increased for the fifth consecutive year, because the positive impact of an increase in volume exceeded the negative impact of a decline in prices. The volume of imports also increased for the fifth consecutive year for the reasons below. First, imports of mineral fuels from ASEAN increased because of growing demand for thermal power generation resulting from a suspension in operations of nuclear power plants. Second, imports of office machines, mainly made in China, grew throughout the year. Import prices declined for the second consecutive year, because the negative impact of an appreciation of the yen exceeded the positive impact of a rise in the prices of crude oil and raw materials.

Chart 17 gives major items contributing to the growth in imports from Asia.

(2) Imports from the EU

Imports from the EU increased for the fourth consecutive year, because the positive impact of a rise in import prices exceeded the negative impact of a decrease in volume. Imports of motor vehicles decreased on an annual basis, but turned to an increase on a monthly basis from September onward, partly because Japanese manufacturers increased imports of motor vehicles produced at their production bases in Europe, especially in the United Kingdom. The volume of imports decreased for the second consecutive year, mainly due to decreases in imports of motor vehicles and foodstuffs. Import prices rose for the third consecutive year, reflecting a depreciation of the yen against the euro and a rise in the price of pharmaceuticals.

Chart 18 gives major items contributing to the growth in imports from the EU.

(3) Imports from the United States

Imports from the United States decreased for the third consecutive year, because the negative impact of a decrease in the volume of imports exceeded the positive impact of a rise in prices. Despite the year-on-year increase in the imports of large aircraft, the volume of imports decreased as a whole, mainly due to decreases in imports of office machines and power generating machinery. Import prices rose for the fourth consecutive year, with an increase in meat prices reflecting the rise in tariffs, due to the imposition of

safeguard measures, in addition to the rise in prices of nonferrous metals and iron and steel.

Chart 19 gives major items contributing to the growth in imports from the United States.

b. Principal items (charts 20 and 21)

Imports of mineral fuels, which made a large contribution to the overall growth in imports, increased significantly in the first half of 2003. This reflected the two factors below. First, Japanese oil companies accelerated imports of crude oil before the military action against Iraq. Second, Japanese oil companies increased imports of crude oil for use in electricity generation in the summer, following the suspension of nuclear power plant operations in Japan. In the second half of 2003, however, imports of mineral fuels turned to an increase, reflecting the restart of operations at some nuclear power plants and the sluggish consumption of electricity. Afterward, imports of mineral fuels turned to a year-on-year increase in the October–December period.

B. Services (Charts 22 and 23)

The deficit in the balance of trade in services in 2003 decreased by 26 percent from 2002 to 3,889.0 billion yen, recording the smallest deficit. It is the first time that the annual deficit was smaller than 4 trillion yen. This was because of (1) a decline in deficit in travel and transportation as a result of the impact of SARS and (2) an increase in credits in other services, especially that of royalties and license fees, caused by an expansion in production by foreign subsidiaries of Japanese manufacturers.

As shown in Chart 23, the absolute amount of the deficit in trade-in-services accounted for about 30 percent vis-à-vis the surplus in trade-in-goods in 2003, dropping significantly from more than 70 percent in 1996.

1. Transportation (charts 24, 25, and 26)

The deficit in the balance of transportation decreased for the third consecutive year to 882.8 billion yen, decreasing by 51.5 billion yen or 5.5 percent from 2002. This was because the effect from the considerable decrease of the deficit in air transport exceeded that of the increase of the deficit in sea transport.

The deficit in sea transport increased because payments for freight shipment increased due to a growth of volume in imports and a rise in sea freight fares for both liners and trampers.

In Japan's sea transport, the debit in freight exceeds the credit in freight. Therefore, a rise in sea freight fares causes an increase in the deficit in sea transport. In December 2003, sea freight fares for trampers marked a new record-high for the first time under the corporate services price index based on the current benchmark (1995).

The deficit in air transport decreased considerably because the number of Japanese travelers abroad shrank significantly due to the negative effects of SARS and increases in export volume of visual apparatus and parts for audiovisual apparatus.

Freight credit in air transport posted the highest level since 1996, when Japan started to compile the BOP based on BPM5.

2. Travel¹⁰ (charts 27 and 28)

The deficit in the balance of travel decreased to 2,323.3 billion yen, by 564.6 billion yen or a 19.6 percent decrease from 2002. This reflected the number of Japanese travelers abroad dropped more severely than the number of foreign visitors due to the effect of SARS. The magnitude of decrease in the deficit far exceeded that of the 8.3 percent year-on-year decrease in 2001, when the deficit had decreased after the terrorist attacks in the United States.

a. The movements of Japanese travelers abroad and foreign visitors (Chart 29)

The number of Japanese travelers abroad and foreign visitors had tended to decrease from around October 2002 reflecting the terrorist bombing in Bali and the destabilization over the situation in Iraq. When the war occurred in Iraq and SARS broke out in March 2003, both dropped sharply. However, the decrease in the number of foreign visitors recovered relatively quickly and their annual record in 2003 was 5.23 million, a decrease of only 0.2 percent year-on-year from the record-high level of 2002. In contrast, the recovery in the decreased number of Japanese travelers abroad was slow. It recorded 13.3 million in 2003 and it was the first time since 1994 that the number of Japanese travelers abroad was less than 15.0 million. The magnitude of the decrease was 19.5 percent year-on-year, the

¹⁰ From January 2003, the Bank of Japan started to compile Travel based on a new method that accounts for the amount of yen brought into Japan by foreign visitors, and brought out and spent abroad by Japanese travelers abroad (see Reference for details). As a result, the amount of gross debit and credit in 2003 increased significantly from 2002. The net balance, however, did not differ much because the increases in debit and credit resulting from the new method were offset to a large extent.

largest scale exceeding that of 9.0 percent in 2001.

b. Regional trend (charts 30 and 31)

The number of Japanese travelers abroad: After the terrorist attacks in the United States, there had been a tendency among Japanese travelers abroad to shift their destinations to Asia¹¹. As a result, however, the number of Japanese travelers abroad decreased sharply when SARS spread in Asia.

The number of foreign visitors: After the terrorist attacks in the United States, the number of foreign visitors increased on the strength of visitors from Asia, especially from South Korea.¹² Under the circumstances that the income situation in the East Asian countries was relatively favorable, the effect of SARS was limited and the decrease in the number of foreign visitors was only temporary as SARS did not spread to Japan.

3. Other services (charts 32, 33, 34, and 35)

In 2003 the deficits in other services shrank considerably to 682.9 billion yen, dropping as much as 52.6 percent from 2002.

The net balance of other services had remained in a deficit since 1996, when statistics based on BPM5 started to be compiled. In 2003, however, a surplus was recorded for the first time on a monthly basis (58.1 billion yen, 22.0 billion yen, and 22.7 billion yen in March, May, and November 2003, respectively).

The balance of royalties and license fees recorded a surplus in 2003 for the first time as an annual figure. This was mainly due to the increase in royalties which Japanese manufacturers received from their overseas subsidiaries (see Box 4 for details). The proportion of gross royalties and license fees against gross total other services in 2003 accounted for 29 percent in credits and 23 percent in debits,¹³ and each increased from 27

¹¹ Travelers by air to North America decreased by 5.0 percent in 2002 from the previous year, and those to Hawaii and Guam areas also decreased by 6.6 percent year on year. On the other hand, those to Asia increased by 5.3 percent (*Provisional Statistical Report on Air Transport* released by the Ministry of Land, Infrastructure and Transport).

¹² South Korean travelers abroad had increased for 16 consecutive months from November 2001 to February 2003. That means that the increase had started just after the terrorist attacks in the United States and ended by the time of the outbreak of SARS. Regarding the increase of South Koreans visiting Japan, it could be considered that the gradual lifting of the ban on Japanese culture within South Korea has led to a growing interest in Japan.

¹³ The proportion of gross royalties and license fees against gross overall services

percent and 22 percent respectively in 2002.

The deficit in insurance services narrowed in 2003 due to an increase in credit. The increase was caused by the fact that there were no sizable reinsurance claims in the year (see Chart 34). Sizable reinsurance repayments had taken place in the previous year, which were caused by the terrorist attacks in the United States in 2001.¹⁴

The surplus in financial services narrowed due to an increase in debit, while credit mildly increased (see Chart 35). The increase in debit was due to sizable commission fees paid to foreign securities companies, which underwrote the shares newly issued by Japanese banks aimed at strengthening their capital bases.

C. Income (Charts 36 and 37)

The balance of income recorded a surplus of 8,285.8 billion yen, increasing by 19.4 billion yen or 0.2 percent from 2002. The surplus in the balance of direct investment income decreased due to a decline in credits in reinvested earnings.¹⁵ Meanwhile, the surplus in the balance of portfolio investment income and other investment income increased, due to increases in credits of interest on bonds and notes, and decreases in debits of interest on loans, respectively.

1. Direct investment income (Charts 38 and 39)

The surplus in the balance of direct investment income decreased for the second consecutive year to 944.9 billion yen, down 499.1 billion yen or 34.6 percent from 2002. This was because credit in reinvested earnings was almost halved to 529.1 billion yen in 2003 from 1,031.3 billion yen in 2002.

The background to the decrease in the credit in reinvested earnings is given below. First, the retained earnings of foreign subsidiaries of Japanese companies decreased in 2002. The decrease was caused by deterioration in the business performance of electrical machinery

accounted for 16 percent in credits and 10 percent in debits in 2003.

¹⁴ Credit in insurance services is calculated by deducting insurance claims paid to nonresidents from insurance premiums received from them. Reinsurance claims paid to nonresidents are thus recorded as negative figures in credit in insurance services.

¹⁵ In the BOP statistics, an increase in retained earnings of overseas subsidiaries in each accounting period is recorded under both credits in income and assets in direct investment. This is based on the premise that the dividends, which are to be received by the parent company in Japan, are fictitiously reinvested in the subsidiary by the parent company.

firms, banks, and securities companies based on the global IT recession and the economic slowdown in the United States. As a result, the monthly average of credit was about 59.0 billion yen for companies closing accounts at end-March 2002 (recorded over the twelve months from September 2002 to August 2003),¹⁶ down significantly from about 120.0 billion yen for companies closing accounts at end-March 2001 (recorded over the twelve months from September 2001 to August 2002). Second, the reinvested earnings of companies closing accounts at end-March 2003 (recorded over the twelve months from September 2003 to August 2004) were relatively small. The monthly average of credit was about 42.0 billion yen. This was partly because an appreciation of the yen reduced the outstanding amount of earnings.¹⁷

2. Portfolio investment income (Chart 40)

The surplus in the balance of portfolio investment income increased for the fourth consecutive year to 6,821.3 billion yen, increasing by 475.8 billion yen or 7.5 percent from 2002. Credit from money market instruments decreased reflecting a decline in interest rates in the United States and Europe. Credit of interest in bonds and notes increased despite the fall in interest rates and the depreciation of credit due to an appreciation of the yen. This was because the positive effects caused by (1) the increase in outstanding amount of outward investment, and (2) the decrease in debit due to an increase in the redemption of bonds issued by residents, exceeded those negative effects. Credit of dividends increased reflecting an increase in the amount outstanding of investment in foreign equities by residents.

3. Other investment income (Charts 41 and 42)

The surplus in the balance of other investment income increased for the first time in four years to 533.6 billion yen, increasing by 46.1 billion yen or 9.5 percent from 2002. This was because the decrease in credit of interest on loans and deposits was smaller than that in debit, reflecting the recording of a sizable amount of credits in interest on loans related to

¹⁶ Reinvested earnings, the year-on-year change in the outstanding amount of retained earnings, 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-end of the accounting period, which is usually March for most Japanese companies. Meanwhile, BPM5 requires to account for reinvested earnings on an accrual basis. Therefore, the change in reserves is divided for convenience into twelve equal portions and recorded as monthly reinvestment income from six months after the end of the accounting period, based on the report submitted by each company.

¹⁷ The exchange rate of the yen against the U.S. dollar was 132.71 yen and 119.02 yen at end-March 2002 and end-March 2003, respectively.

debt rescheduling.¹⁸ Both credit and debit of interest on loans and deposits decreased for the fifth consecutive year, reflecting the contraction of assets and liabilities by Japanese banks' streamlining of their business operations overseas.

D. Current Transfers (Charts 43 and 44)

The deficit in the balance of current transfers increased for the first time in four years to 866.7 billion yen, increasing by 270.9 billion yen or 45.5 percent from 2002. This growth was mainly brought about by the considerable increase of the deficit in the official sector which exceeded that of the decrease of the deficit in other sectors.

The deficit in the official sector increased mainly due to the falloff in a receipt from the Asian Development Bank (ADB) in March 2002.¹⁹ Also the deficit increased because the Japanese government's payments of salaries to Japanese employees working for "U.S. Forces, Japan"²⁰ started to be recorded as a debit in the official sector.

The deficit in other sectors decreased because payments for workers' remittances²¹ shrank.

III. Capital and Financial Account (Chart 45)

In 2003, the capital and financial account recorded a net inflow of 8.1 trillion yen, mainly due to developments in the financial account.

Outward direct investment decreased for the second consecutive year mainly due to the effects of SARS and a falloff of large-scale investment that boosted up the figure in 2002. Inward direct investment decreased by about 40 percent from 2002 as issued shares of

¹⁸ Amounts corresponding to loan repayments and interest payments are registered in the statistics on the assumption that these payments have been collected before rescheduling loans.

¹⁹ In March 1999, the Japanese government provided the ADB's Asian Currency Crisis Support Facility with noninterest-bearing and nonnegotiable government notes amounting to about 360.0 billion yen to support the guarantee for 3 years. All of these funds were returned to the Japanese government in March 2002 without default of matter guaranteed.

²⁰ See Reference 2 for details.

²¹ There is no statistical continuity between figures for workers' remittances before and after April 2003 because of the following reasons. First, the figures of workers' remittances started to be compiled based on a new survey at major banks. Second, estimation on worker's remittances and other transfers were abolished. See Reference 2 for details.

Japanese subsidiaries such as pharmaceuticals were sold by nonresident direct investors, despite sizable investments into the Japanese financial industry.

Net purchases (outflow) of outward investment in foreign equities shrank considerably due to a decrease in purchases by public pension funds through trust banks, and sales of assets by corporate pension funds due to the change in some employees' pension fund schemes. Net outflow of outward investments in bonds and notes, recorded a historical peak of 18.4 trillion yen, far exceeding the previous peak of 11.3 trillion yen in 2001. This was mainly because life insurance companies and investment trusts, who usually obtain foreign currency for outward investments by converting their yen, purchased foreign bonds and notes very actively.

Net inflow of inward investment in Japanese equities recorded significant net purchases (inflow) from net sales (outflow) in 2002, mainly due to active investment by pension funds, investment trusts, and hedge funds in the United States and Europe, reflecting the expectation that the Japanese economy would recover. Inward investment in bonds and notes continued to record net sales (outflow) due to large sales by some overseas institutional investors and sales by hedge funds and banks that closed out arbitrage positions taken on in the past.

Financial derivatives continued to record a net inflow. This was because resident banks that had entered into yen-dollar swap arrangements on the yen-payments side received supplementary principal in U.S. dollars as a result of the appreciation of the yen against the dollar.

Net inflow expanded in other investment. This was because, reflecting the negative cost of funding yen in exchange for the U.S. dollar, foreign banks obtained yen by converting their dollars in the overseas markets and employed the funds through repurchase agreements with Japanese securities companies.

A. Direct Investment (Chart 46)

Outward direct investment²² recorded a net outflow of 3.3 trillion yen, mainly due to investment in the United States and Europe, decreasing for the second consecutive year. Inward direct investment²³ registered a net inflow of 752.5 billion yen, decreasing by about 40 percent from 2002, mainly due to the falloff of large-scale investments in the pharmaceuticals and automobile industries that boosted up the figure in 2002. As a result, the ratio of inward direct investment to outward direct investment was 22.5 percent in 2003, down from 28.6 percent in 2002.

Outward direct investment increased against 2002 on the basis of excluding transactions such as funds extended by parent companies in Japan for the purpose of financial assistance to their overseas subsidiaries, which primarily pushed up outward direct investment in 2001 and 2002, as shown in the shaded bars in Chart 46.

Developments in the first and the second half of 2003 are as follows. In the first half of 2003, both outward and inward direct investment decreased from 2002 mainly due to (1) the falloff of sizable investment by carmakers to add to their cross shareholdings that boosted up the figure in 2002, and (2) the negative effects of SARS (outward direct investment). In the second half of 2003, outward direct investment increased year-on-year reflecting large-scale investments by Japanese pharmaceuticals and carmakers planning to expand their business overseas. On the other hand, inward direct investment continued to record a year-on-year decrease mainly due to sales of issued shares of a Japanese subsidiary by an U.S. financial institution.

1. Outward direct investment (assets)

²² Outward direct investment refers to direct investment by a resident in an economy into a resident in another economy (a nonresident), and is recorded under assets in the BOP 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.

²³ Inward direct investment refers to direct investment by a resident in another economy (a nonresident) into a resident, and is recorded under liabilities in the BOP 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.

Outward direct investment in 2003 included the following expansion investments: (1) purchasing of new shares of overseas subsidiaries by carmakers, manufacturers of parts for motor vehicles, ceramics manufacturers, pharmaceuticals, and financial institutions aimed at expanding business overseas; and (2) capital participation in the energy-related and electrical machinery industries in line with industrial reorganization and intensifying competition worldwide. Financial assistance by parent companies in Japan to overseas subsidiaries such as telecommunications firms was also implemented, but this type of investment decreased considerably against 2002. In the capital inflow to Japan, the withdrawals of overseas investment by Japanese financial institutions were observed, as they reviewed their overseas business strategies and sold off or liquidated overseas subsidiaries.

The following developments were observed in outward direct investment by region in the first half of 2003 (Chart 47). Investment in the United States remained at a high level as carmakers and manufacturers of parts for motor vehicles injected capital into their overseas subsidiaries to expand production bases. Investment in Western Europe continued to be firm primarily as financial institutions purchased new shares of subsidiaries to expand business in Europe. Investment in Asia decreased from 2002 due to the negative effects of SARS. However, investments by carmakers and electrical machinery industries were observed, mainly in China with its growing market, especially those aimed to establish new production bases and to expand existing ones.

2. Inward direct investment (liabilities)

Net inflow in inward direct investment recorded 752.5 billion yen in 2003. Several sizable investments by foreign firms were made primarily in financial institutions to expand business in Japan. However, net inflow decreased by about 40 percent from 2002 since large-scale investments in the automobile and pharmaceuticals industries seen in 2002 fell off, and a nonresident withdrew from investment by selling issued shares of a Japanese pharmaceutical company.

The following developments were observed in inward direct investment by region in the first half of 2003 (Chart 48). Net inflow of investment from Western Europe remained

high mainly as (1) a U.S. financial institution purchased a part of sizable new shares of its subsidiary in Japan through a holding company in Europe, and (2) a German carmaker purchased new shares of a Japanese carmaker to strengthen its business in Asia. On the other hand, net inflow of investment from the United States remained low primarily because a U.S. pharmaceuticals firm sold issued shares of its subsidiary in Japan to reorganize its affiliates in Japan.

B. Portfolio Investment (Excluding Securities Lending)

Net outflow of portfolio investment declined to 8.8 trillion yen from 18.6 trillion yen in 2002. This was because, although net purchases (outflow) expanded in outward portfolio investment, inward portfolio investment turned to net purchases (inflow) from net sales in 2002.

1. Outward portfolio investment (assets)

Net purchases (outflow) of outward portfolio investment increased significantly to 18,384.5 billion yen in 2003 from 13,330.7 billion yen in 2002. Net outflow recorded more than 10 trillion yen for the sixth consecutive year. This was mainly due to active purchases of foreign bonds and notes by residents that usually obtain foreign currency for outward investment by converting their yen. For example, life insurance companies increased their positions on foreign bonds and notes with hedging currency risk, and securities companies underwrote a large amount of foreign bonds for retail sales.

a. Outward investment in equities (assets; Chart 49)

Net purchases of outward investment in equities narrowed sharply to 686.1 billion yen in 2003 from 4,735.5 billion yen in 2002, mainly reflecting transactions by trust banks (trust accounts). Specifically, purchases of equities by public pension funds²⁴ to rebalance their portfolios were less than in 2002 given the rise in stock prices in the United States and Europe (Chart 50).²⁵ In addition, corporate pension funds sold equities (1) to raise cash

²⁴ The majority of the outward portfolio investment by public pension funds is made by entrusting funds to investment firms and trust banks, thus recorded as transactions under trust banks (trust accounts).

²⁵ Public and corporate pension funds usually decide the percentage of each asset to total assets prior to investment, and for assets whose percentage share to total assets has

reflecting the change in some employees' pension fund schemes and (2) to rebalance their portfolios due to the rise in U.S. and European stock prices.

Net purchases by trust banks (trust accounts), the largest investor category for investment in foreign equities, dropped significantly in 2003 due to the following factors (Chart 51). First, purchases by public pension funds to rebalance their portfolios were less than in 2002 when U.S. and European stock prices declined, since U.S. and European stock prices started to increase from the early spring of 2003. Second, corporate pension funds sold equities to raise cash reflecting the change in some employees' pension fund schemes and to rebalance their portfolios given the rise in U.S. and European stock prices.

Net purchases by investment trusts decreased from 2002. This was mainly because there was a large amount of sales reflecting repurchases of private placement investment trusts from corporate pension funds when stock prices weakened at the beginning of 2003, although funds flowed into some additional-type equity funds reflecting the rise in U.S. and European stock prices since spring.

Banks shifted to net purchases from net sales in 2002 (Chart 51), largely contributed by purchases of corporation type investment trusts organized by foreign investment trust firms.

Life insurance companies continued to record net sales, because they sold foreign equities and shifted funds to less volatile foreign bonds and notes, following a policy to reduce a portion of the high risk instruments in their portfolios.

Under investment by other sector, there was a turn to net purchases from net sales, mainly because some securities firms increased purchases of equities for retail sales.

The following developments were observed by region in 2003 (Chart 52). Net purchases in investment in U.S. equities decreased substantially from 2002 while investment in European equities turned to net sales from net purchases. These developments mainly

declined/increased due to changes in prices or exchange rates, they purchase/sell to rebalance the portfolio to maintain the decided targeted percentage.

reflected sales of equities held by corporate pension funds, with the change in some employees' pension fund schemes. Net purchases decreased slightly in investment in Asian equities mainly because several firms sold stocks in early spring to strengthen their financial condition while investment trust companies continued to invest in Asia, mainly in China, reflecting cash flows into their funds. Investment in other regions continued to record net purchases because Japanese non-financial firms purchased preferred securities issued by special-purpose entities (SPEs) located in the Cayman Islands.²⁶ These SPEs were established by Japanese banks to obtain funds to boost their net worth.

b. Outward investment in bonds and notes (assets; Chart 53)²⁷

Net purchases (outflow) of outward investment in foreign bonds and notes recorded a historical peak of 18,391.1 billion yen in 2003 from 9,291.2 billion yen in 2002, far exceeding the previous peak of 11,130.0 billion yen in 2001.

Net purchases of sales and purchases by residents increased to 18,807.0 billion yen in 2003 from 9,902.7 billion yen in 2002. This was mainly because investors, who usually obtain foreign currency for outward investments by converting their yen, purchased foreign bonds very actively. Specifically, (1) life insurance companies increased their positions on foreign bonds with hedging currency risk, (2) securities companies underwrote a large amount of foreign bonds for retail sales, and (3) investment trusts increased investments in foreign bonds reflecting steady sales of monthly-distribution-type funds that mainly invested in foreign bonds. Meanwhile, net purchases (outflow) of banks, which are ordinarily invested by borrowing foreign currency, remained almost unchanged from the previous year. In the first half of 2003, banks purchased foreign bonds and notes actively to earn capital gains. However they closed out long positions as U.S. and European interest rates started to rise reflecting the brighter economic indicators and the improved economic outlook (Chart 54) in the second half of 2003.

²⁶ Purchases of a stake of less than 10 percent are recorded under portfolio investment. Purchases of a stake of 10 percent or more are recorded under direct investment.

²⁷ Investment in foreign bonds and notes by residents (assets) is the sum of sales and purchases by residents, and of issuance and redemption of bonds and notes issued in Japan by nonresidents.

Net redemption (inflow) continued in issuance and redemption of bonds and notes issued in Japan by nonresidents, recording 415.8 billion yen in 2003 against 611.6 billion yen in 2002. This was because the issuance amount of *samurai* bonds remained sluggish for the third consecutive year (Chart 55).

Sales and purchases of foreign bonds and notes by sector were characterized by the following developments (Chart 56). Life insurance companies actively purchased U.S. and European government bonds and notes with hedging currency risk, instead of investing in yen-denominated assets given the low long-term interest rates in Japan.

Net purchases by banks remained almost unchanged from 2002. In the first half of 2003, banks actively purchased foreign bonds and notes to earn capital gains on the expectation U.S. and European interest rates would decline. They, however, increased sales to close out the long positions in the second half of 2003 due to the upturn in interest rates in the United States and Europe reflecting the brighter economic indicators. There were some purchases when employment statistics and other economic indicators in the United States turned out to be weaker than expected, but the effect of these purchases to the annual total was limited.

Net purchases by investment trusts increased substantially. This was because there was a massive inflow of money from retail investors to monthly-distribution-type funds investing in foreign bonds. Thus, investment trusts actively purchased U.S. and European government bonds throughout 2003.

Investment by the public sector recorded net sales. This reflected continuous selling of U.S. and European government bonds and notes, or, refrain from reinvesting the redeemed funds to these securities by one institution. The institution held a plan to squeeze its foreign bond position before institutional reorganization.

Trust banks (trust accounts) turned to net sales from net purchases in 2002, reflecting the repurchase of a large-scale fund investing in foreign bonds despite continuous purchases

with funds newly allocated by public pension funds.

Large net purchases were recorded in other sectors mainly due to strong investment by retail investors into foreign bonds and notes denominated in high-yield foreign currencies such as the Australian dollar and the Canadian dollar (see Box 6 for details).

By region, net purchases expanded substantially under investment in U.S. bonds and notes (Chart 57). This was because (1) life insurance companies increased purchases of foreign bonds with hedging currency risk and (2) banks increased purchases on the expectation that medium- and long-term interest rates would decline in the United States. Investment in European bonds and notes also recorded a considerable increase in net purchases due to purchases by life insurance companies as in the case of U.S. bonds and notes and by banks in the latter half of 2003 to earn capital gains. Net purchases under investment in bonds and notes issued in other regions remained high, because (1) some financial institutions actively purchased investment trust beneficiary certificates mainly issued in the Cayman Islands in the same way as 2002 and (2) securities companies increased underwriting of bonds issued by international organizations²⁸ for retail sales.

c. Outward investment in money market instruments (assets; Chart 58)

Outward investment in money market instruments recorded net sales (inflow) for the third consecutive year, registering 692.7 billion yen in 2003 against 696.0 billion yen in 2002. In the summer when long-term interest rates in the U.S. and Europe started increasing, banks shifted their funds from treasury bonds to treasury bills in order to reduce risk exposure. However, sales of, or refrain from reinvesting into, Euro-yen CP and *samurai* CP were more throughout 2003 reflecting investors' deep-rooted anxiety about credit risks of firms overseas after the bankruptcy of Enron in the United States.

2. Inward portfolio investment (liabilities)

Inward portfolio investment turned to large net purchases (inflow), recording 9,541.1 billion

²⁸ In this report, international organizations such as the International Bank for Reconstruction and Development (IBRD) are categorized under "other regions." In the BOP statistics, regional classification is not applied to international organizations.

yen in 2003 against 5,045.6 billion yen in 2002. This was mainly due to sizable net purchases of inward investment in equities given vigorous buying by pension funds, investment trusts, and hedge funds in the United States and Europe. Meanwhile, inward investment in bonds and notes recorded net sales (outflow) due to (1) large sales of Japanese government bonds (JGBs) by some foreign institutional investors and (2) sales by hedge funds and banks to close out arbitrage positions taken in the past.

a. Inward investment in equities (liabilities; Chart 59)

Inward investment in equities turned to significant net purchases of 9,831.9 billion yen in 2003 from net sales (outflow) in 2002. This was the second historical high as a net inflow, only slightly behind the historical high of 11.4 trillion yen in 1999. Two backgrounds can be pointed out for these significant net purchases. First, pension funds and investment trusts in the United States and Europe actively invested in Japanese equities that were adopted in the stock indices. Those attitudes reflected the expectation that the Japanese economy would recover and, consequently, Japanese stock prices would rise as a whole (Chart 60). Second, hedge funds invested in equities of banks and high-tech related companies reflecting an appreciation in the value of equities held by banks. Appreciation in the prices of U.S. semiconductor-related companies also stimulated hedge funds' appetite for equities of Japanese IT-related companies.

By region, U.S. and European investors both showed large net purchases in 2003 (Chart 61). U.S. investors started to make large scale purchases from the July-September quarter of 2003, while European investors substantially increased their Japanese equity positions from the April-June quarter to the July-September quarter of 2003.

By industry, Japanese equities that had a high weight in the stock indices such as electrical machinery, transportation equipment (motor vehicles), and chemicals were actively purchased by pension funds and investment trusts in the United States and Europe (Chart 62). Bank equities were also actively purchased by hedge funds, reflecting an appreciation in the value of equities held by banks.

b. Inward investment in bonds and notes (liabilities; Chart 63)²⁹

Inward investment in bonds and notes recorded sizable net sales (outflow) for the second consecutive year, marking 1,631.0 billion yen in 2003 from 4,183.4 billion yen in 2002. This was caused by the continued sizable net outflow of sales and purchases. Issuance and redemption of bonds and notes issued overseas by residents turned to net issuance (inflow) in 2003 from net redemption (outflow) in 2002.

Sales and purchases registered large net sales (outflow) for the second consecutive year, recording 2,312.3 billion yen in 2003 against 3,278.9 billion yen in 2002. This mainly reflected the following factors. First, some overseas institutional investors sold JGBs given (1) the deteriorating profitability as the yen depreciated against the euro in the first half of 2003 (Chart 64), and (2) the increasing demand for yen cash. Second, hedge funds and foreign banks sold bonds and notes in line with the closing out of arbitrage positions taken on in the past. Specifically, they closed out the positions combining cash bond purchases and yen-yen interest rate swap agreements on the fixed rate payments side given the widening of swap spreads, or the positions combining cash bond purchases and bond futures sales when cash bonds became relatively more expensive compared to bond futures. And third, hedge funds and banks carried out so-called box trade transactions from end-June to October and caused a temporary increase in net sales. In box trades, sales of cash bonds with medium-term maturity and yen-yen interest rate swap agreements on the fixed rate receipts side were combined with purchases of cash bonds with long-term maturity and the swap agreements on the fixed rate payments side. Investors had to sell more bonds with medium-term maturity than buy bonds with long-term maturity in order to cover the difference of duration (see BOX 7 for details).

Issuance and redemption of bonds and notes issued overseas by residents changed to net issuance (inflow) of 681.3 billion yen in 2003 from net redemption (outflow) of 904.6 billion yen in 2002, mainly due to a large amount of issuance of U.S. dollar denominated perpetual subordinate bonds by some Japanese banks.

By region, European and U.S. investors recorded net sales (outflow; Chart 65). This

²⁹ Inward investment in bonds and notes (liabilities) is the sum of sales and purchases by nonresidents, and issuance and redemption of bonds and notes issued overseas by residents.

reflected sales of JGBs by some overseas institutional investors given the deteriorating profitability, and sales of cash bonds by hedge funds and banks due to the closing out of the arbitrage positions. In addition, net sales associated with the box trades as mentioned above expanded in the July-September quarter. Asian investors also recorded net sales as Japanese bonds and notes were sold in response to the temporary demand for yen cash by some foreign institutional investors.

c. Inward investment in money market instruments (liabilities; Chart 66)

Inward investment in money market instruments recorded net purchases (inflow) for the second consecutive year, registering 1,340.1 billion yen in 2003 from 814.8 billion yen in 2002. This was mainly because some foreign institutional investors overseas purchased financing bills (FBs) and TBs in the first half of 2003 given the appreciation of the yen against the U.S. dollar since the end of 2002.

C. Financial Derivatives (Chart 67)

Financial derivatives continued to record a net inflow, marking 604.4 billion yen in 2003 against 263.0 billion yen in 2002. This was because resident banks that had entered into yen-dollar swap arrangements on the yen-payments side received supplementary principal in US dollars as a result of the appreciation of the yen against the dollar toward the end of 2003.

Meanwhile, a sizable net outflow was recorded in September 2003. Overseas investors closed out long positions on the Nikkei 225 futures and TOPIX futures, and short positions on the JGB futures, to settle stock index futures and JGB futures whose contract month was September 2003. These positions gave profits to the overseas investors, and as a result, large payments on the net profits were made by resident securities companies, which were intermediaries in the futures transactions.

D. Other Investment (Excluding Securities Lending; Charts 68 and 69)

Net inflow was recorded in other investment for the third consecutive year, reaching 19,377.8 billion yen in 2003 from 12,726.6 billion yen in 2002. This was mainly because foreign banks' surplus yen funds flowed into Japan through transactions under repurchase

agreements with Japanese securities companies, given the negative cost of funding yen in exchange for the U.S. dollar.

By item, transactions under repurchase agreements, especially sales by residents, increased considerably from 2002, as interoffice account transactions of Japanese banks shrank in both assets (net inflow) and liabilities (net outflow) . This reflected the following factors. First, more Japanese banks engaged in transactions under repurchase agreements with their overseas subsidiaries for raising foreign currency instead of interoffice account transactions with overseas branches. Second, Japanese banks diversified their methods of funding foreign currency for investment in foreign bonds and notes, for example, by borrowing from Japanese securities companies who obtained foreign currency through repurchase agreements with nonresidents. Third, foreign banks' demand for investing in yen funds became stronger as mentioned above.

Box 1: Analysis of Changes in the Production Structure of Technology-Intensive Industries Based on Movement of the Trade Specialization Coefficient

From the medium-term point of view, Japan's trade with China has been increasing in both exports and imports. The growth rate of Japan's trade with China has been greatly exceeding that with other countries for several years. This results in an increase in the share of trade with China. In 2002 and 2003, China was Japan's second largest trading partner in exports and the largest trading partner in imports (Chart 1 for Box 1). The United States retained its position as Japan's largest trading partner in exports, but fell to second place behind China for imports in 2002.

By type of goods, trade with China has the following characteristics (Chart 2 for Box 1). First, as for exports, significant growth was observed in general machinery (including office machines) and electrical machinery (including audio and visual apparatus and semiconductors and other electronic parts). Second, as for imports, growth accelerated in IT-related goods (e.g. office machines, and semiconductors, and other electronic parts and telecommunications equipment) and machinery (including electrical appliances). On the other hand, imports of textile products by Japanese manufacturers peaked out.

The increase in trade with China and changes in the weight of goods traded have been widely recognized as a result of changes in the relative competitiveness between Japan and China. These changes can be described below by using the trade specialization coefficient, which is one of the indicators to gauge competitiveness (Chart 3 for Box 1). The trade specialization coefficient for major items decreased in the latter half of the 1990s, but some remarkable reversals were observed in recent years. These developments seemingly imply a recovery in Japan's export competitiveness.

Detailed analysis, however, reveals that the increase in the trade specialization coefficient resulted from a growth in exports of intermediate goods and parts that exceeded imports of finished goods (Chart 4 for Box 1). Thus, it does not mean an improvement of Japan's export competitiveness. In other words, the "division of production processes" and the "vertical labor specialization" have come about (importing finished goods from China and

exporting parts from Japan) in the same category of products. This strategy was taken in addition to traditional “inter-industry trade”, i.e. the exchange of labor-intensive goods and capital-intensive ones. This new production structure reflects the global business strategies of technology-intensive firms in recent years. They segment production processes and assign each process to specific production bases among all the bases extended worldwide, considering wage differentials, infrastructure, and the situations of the local market. Under the strategies, electrical machinery manufacturers are increasing production of newly-introduced finished goods (e.g. DVD players and liquid crystal display monitors) in China. It indicates that the lifecycle of products is becoming shorter (Chart 5 for Box 1).

Box 2: Increase of Credit in Freight from Cross Trade in 2003¹

In 2003 credit in freight from cross trade increased by 19.5 percent from 2002, and posted the highest level since 1996, when Japan started to compile the BOP based on the BPM5. This increase also brought a new high for credit in transportation, contributing to the decrease of the deficit in the balance of transportation on the whole (charts 1 and 2 for Box 2).

There are two factors for the background to the increase of credit in freight from cross trade. First, Japanese shipping companies increased cross trade actively because the growth of bilateral trade had been sluggish compared with the growth of world trade (Chart 3 for Box 2). Second, the supply-demand balance for shipping space tightened further both for liners and trampers due to economic cyclical factors (Chart 4 for Box 2).

By shipping route for liners, the increase of credit in freight from the Asia-North America route made the largest contribution to the increase of total credit in freight from liners (Chart 5 for Box 2). This increase was mainly because sea freight fares for liners on this route rose by just 20 percent from 2002, the year when an increase in sea freight fares was held off² (Chart 6 for Box 2).

Cargo movements by liners from Asia to the United States increased largely due to a growth of volume of household furnishings, mainly furniture, exported from China to the United States (Chart 7 for Box 2). These cargo movements reflected the brisk housing investment in the U.S. (Chart 8 for Box 2)

¹ Credit in freight from cross trade refers to the fares paid for transportation of cargo loaded and unloaded overseas by Japanese shipping companies. Although cross trade takes place in both sea and air transportation, in this report, it refers to sea transportation, unless otherwise stated.

² In principle, negotiations regarding freight fares between shipping companies and cargo holders start from the beginning of every calendar year, and fares are revised during April and May. In 2002, freight fares were unchanged because the supply of shipping space exceeded the demand at the beginning of the year. The actual cargo movement, however, became brisk after April when the negotiations were completed.

The increase of credit in freight from trampers was mainly due to the transportation of iron ore and coal (Chart 9 for Box 2). This increase was brought about by a considerable rise in sea freight fares for trampers in all kinds of cargo, which reflected the increase of cargo movements of iron ore and coal for China. In China, demand for steel increased because of the rapid urban developments in preparation for the Olympic Games in Beijing in 2008 and the Shanghai World Exposition in 2010. Against this background, China rapidly expanded the production of crude steel, and increased the volume of imports for iron ore and coal (Chart 10 for Box 2).

Box 3: Effects of SARS on Travel and Transportation

The deficits in the balance of travel and transportation, sub-components of services, decreased in 2003 reflecting the decrease in the number of Japanese travelers abroad due to the effects of SARS. The negative effects of SARS were more serious than those of the September 11 terrorist attacks in the United States in 2001 (see section II.B.2 for details).

The deficit in the balance of transportation sharply decreased in 2003 and recorded the second lowest level under the current statistics based on the BPM5. This decrease was caused by a substantial decrease in the deficit of passengers for air transport (see Chart 1 in section II). This item reflects the number of Japanese travelers abroad (passengers debit) and foreign travelers visiting Japan (passengers credit). In 2003, due to a decrease in the number of Japanese travelers abroad caused by SARS, the deficit in passengers for air transport decreased significantly.

Chart 1 for Box 3 shows movements in the aggregate of the balance of travel and passengers for air transport.¹ The deficits were stable before the terrorist attacks in the United States. The deficits decreased substantially in the October–December quarter of 2001 and the April–June quarter of 2003 when the debits both in travel and passengers for air transport decreased due to the effects of the terrorist attacks in the United States and SARS. The impact of SARS that spread mainly in the Asian countries was more significant than that of the terrorist attacks because the number of Japanese travelers visiting Asia was greater than that of the United States. They accounted for about 50 percent (Asia) and 30 percent (the USA) respectively.²

A. The Number of Japanese Travelers Abroad

A feature can be pointed out in the recovery of the number of Japanese travelers going abroad from a decrease caused by SARS, although the whole recovery pattern looks similar

¹ In order to realize the movement of travel in a broad sense, it is appropriate to read data on the net aggregate of travel and passengers for air transport.

² The numbers of Japanese travelers visiting Asia and the United States are estimated by Balance of Payments Division, International Department, Bank of Japan, using data from Japan National Tourist Organization (JNTO) and *Provisional Statistical Report on Air Transport* released by the Ministry of Land, Infrastructure and Transport. The figures are calculated by the cumulative total from January 2001 through September 2003.

to that from a decrease caused by the September 11 terrorist attacks (Chart 2 for Box 3). That is the decrease in the number of travelers of 60 years old and above after the outbreak of SARS exceeded that after the terrorist attacks in the United States and its recovery pace was much slower. This could reflect on the sensitivity of the elderly to epidemics (Chart 3 for Box 3).

In addition, according to the data on Japanese travelers abroad during the recent year-end and New Year holidays, the negative effects of SARS remained as the number of Japanese travelers visiting China and East Asia, where there was a concern about a recurrence of SARS, stayed below that of the previous year.

B. The Number of Foreign Visitors to Japan (Chart 4 for Box 3)

The number of foreign visitors to Japan was slightly more affected by SARS than the terrorist attacks in the United States³ because the proportion of visitors from Asia was much larger than that of other areas.⁴ However, after July 2003, when the World Health Organization (WHO) officially announced that all known chains of person-to-person transmission of the SARS virus were broken, the number of foreign visitors increased rapidly. In August, five months after the outbreak of SARS, the number recorded the highest level since 1996, when the seasonally adjusted data became available, due to the following factors. First, SARS did not spread to Japan. Second, the number of travelers going abroad was increasing in Asia reflecting a relatively favorable income environment. Third, Japan was becoming more popular as a traveling destination because Japan pushed

³ In the face of the outbreak of SARS, the Chinese government imposed restrictions on the overseas package tours for its citizens through regulations. Though no such formal restrictions were imposed by the governments in Hong Kong and Taiwan, a majority of people refrained from traveling abroad due to the spread of SARS. Meanwhile, the number of foreign visitors surged in March 2003, the initial month of the outbreak of SARS, because travelers temporarily concentrated to Japan, where no case of SARS was reported, as an alternative destination for China or Hong Kong.

⁴ Travelers from Asia, North America, and Europe accounted for 66 percent, 17 percent, and 13 percent respectively of total foreign visitors from January 2001 through October 2003, based on data on the number of foreign visitors by nationality, released by the JNTO.

forward with various “Visit Japan” tourism campaigns.⁵

⁵ Helped by the continued introduction of new charter flights from abroad in several prefectures, hot springs and golf tours in Japan in particular are becoming more popular among foreign visitors mainly from South Korea and Taiwan. The Japanese government set out the “Visit Japan Campaign” in 2003, which aims to increase the number of foreign visitors up to 10 million by 2010. At a local level, various promotion activities are becoming active beyond the prefectures.

Box 4: Royalties and License Fees

For many years, the balance of royalties and license fees in Japan had remained in a substantial deficit. However, the deficit gradually diminished from around 1990 (Chart 1 for Box 4). Thereafter, a surplus was recorded for the first time as an annual figure in 2003.

Since 1996 royalties and license fees can be divided into the two components of fees for industrial property rights etc. (Chart 2 for Box 4) and fees for copyrights (Chart 3 for Box 4).

Chart 2 for Box 4 shows a significant increase in credit in fees for industrial property rights, etc. resulting in an overall surplus in royalties and license fees. An industrial breakdown of credit in fees for industrial property rights etc. (Chart 4 for Box 4)¹ in turn reveals that the royalties received by Japanese automotive firms for trademark rights and technical assistance have consistently made a positive contribution to the balance.

Japanese manufacturers have been expanding their overseas production to (1) avoid trade friction, (2) avert deterioration in cost competitiveness caused by a yen appreciation, and (3) take advantage of decreasing market-entry costs pursuant to expanding WTO membership. Among such industries, the transportation equipment industry took the lead in transferring its production overseas.²

The surplus in the balance of Japan's royalties and license fees in 2003 is the consequence of the overseas shift of Japanese manufacturing facilities rather than of licensing intellectual property rights to nonresident third parties. Meanwhile, Japanese residents received only a small amount of fees for copyrights including computer software. Thus, it may be too early to say that the competitive position of Japanese companies in the area of intellectual property has improved significantly.

¹ The data of industrial breakdown are obtained by picking up and tallying large payments exceeding one billion yen. Therefore, it should be noted that there is a difference in coverage between data of industrial breakdown and that of published the BOP statistics.

² The ratio of overseas production to total production is highest at 31.1 percent for transportation equipment industry, exceeding the average of 13.4 percent for all manufacturers, according to *Basic (Trend) Survey of Overseas Business Activities* by the Ministry of Economy, Trade and Industry.

Box 5: Outward Direct Investment in Central and Eastern Europe

Japanese companies are increasing direct investment in Central and Eastern Europe in view of the joining of ten countries, mainly in Central and Eastern Europe, as new members in the European Union (EU) in May 2004 (Chart 1 for Box 5).¹ Outward direct investment by industry in Central and Eastern Europe in the past few years shows that manufacturers of transportation equipment, electrical and general machinery account for about 80 to 90 percent of the total. This indicates that more Japanese manufacturers are increasing investment in these areas as one of the measures to expand their production and sales in Europe (Chart 2 for Box 5).

Factors encouraging direct investment in Central and Eastern European by Japanese manufacturers include the following: (1) low labor cost and easy accessibility to highly skilled human resources, (2) availability of well established infrastructure including electricity, telecommunications, and road systems, (3) geographical advantage by being close to the Western European market, and (4) the expected changes to the legal system and economic policy in line with the EU standards, such as abolition of tariffs and elimination of nontariff barriers.

Certain conditions are required to be met when a country joins the EU. One of them is to accept and adopt the legal system and common policies established within the EU, based on 31 qualifying criteria including free cross-border transfer of goods. Therefore, the Union of Industrial and Employers' Confederations of Europe (UNICE), a business group comprising firms in Europe, expressed its view in *Ensuring EU Enlargement A Success: UNICE Position* released in May 2002 that the investment environment would be improved and investment to Central and Eastern European countries would increase if those countries' domestic laws could be changed in accordance with those of the EU, in fields of antimonopoly, intellectual property rights,

¹ The ten countries are the Czech Republic, Hungary, Poland, Slovakia, Slovenia, Estonia, Latvia, Lithuania, Cyprus, and Malta.

In the regional classification of the BOP statistics, Central and Eastern Europe includes the following 21 countries: Azerbaijan, Armenia, Uzbekistan, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Georgia, Poland, Hungary, Albania, Romania, Bulgaria, Estonia, Latvia, Lithuania, Ukraine, Belarus, Moldova, Czech Republic, and Slovakia.

standards of production and certification, corporate law, and accounting system.

It seems Japanese manufacturers will be increasing direct investment steadily in Central and Eastern Europe into the future, considering (1) manufacturers have to develop cost cutting given the intensifying global competition, (2) Central and Eastern European countries plan to promote incentives to attract foreign direct investment mainly by improving the business environment.

Box 6: Outward Investment in Foreign Bonds by Retail Investors

Outward portfolio investment¹ shows that investment by those categorized under “others,”² including mainly securities companies, individuals, and nonfinancial corporations, remains high from spring 2002 (4.8 trillion yen in 2003 and 3.8 trillion yen in 2002; Chart 1 for Box 6).³ Most of the investment in this category is accounted by underwriting through securities companies who sell the securities to retail investors such as individuals and small- and medium-sized nonfinancial corporations.

Public offerings of foreign bonds for retail sales in the past one to two years showed the following features. First, the majority of issuers were international organizations and foreign government-affiliated institutions with high credit ratings. Second, bonds issued were denominated in high-yield currencies such as the Australian dollar and the Canadian dollar (charts 2 and 3 for Box 6).

Factors that contribute to increasing the investment in foreign bonds by retail investors are as follows: (1) the interest rate differential between yen denominated bonds and foreign currency denominated bonds continued to be in the range of 2.0 to 5.5 percent, that is, the expected income of yen denominated bonds was too small, (2) some foreign currencies including the Australian dollar appreciated against the yen, and (3) the credit risk of bonds issued by international organizations and others is minimal (charts 4 and 5 for Box 6).

In addition, securities companies also intended to underwrite foreign bonds actively. This was because (1) they could not make enough profit from equity brokerage business due to the deregulation of brokerage fees and the sluggish domestic stock market until the first half of 2003; on the other hand (2) foreign-bond business remained rather profitable, with underwriting and offering fees earned from issuers, and remittance fees

¹ Data are taken from *Securities Investment at Home and Abroad* released by the Ministry of Finance.

² Figures in “others” are calculated by excluding entrusted transactions by banks (including trust banks), life insurance companies, and investment trusts, from data on foreign securities transactions reported mainly by securities companies.

³ See “Outward Investment in bonds and notes (assets).”

from investors.

Box 7: The Effect of “Box Trades” on Inward Investment in Bonds and Notes

In the end-June to end-September period, foreign investors actively sold JGBs with medium-term maturity and purchased JGBs with long-term maturity. On the other hand, the opposite transactions occurred in the end-September to end-December period (Chart 1 for Box 7). In the former period, when the medium-term swap spread, that is, the fixed rate in yen-yen interest rate swap minus the yield of JGB of the same maturity, was widening compared to long-term swap spreads, hedge funds and banks took arbitrage positions combining sales of medium-term JGBs and interest rate swap agreements on the fixed rate receipts side. At the same time, as for long-term JGBs, cash bond purchases and swap agreements on the fixed rate payments side were carried out. Then, the arbitrage positions were closed out from end-September to end-December. These transactions are so-called “box trades.”

Hedge funds and banks engaged in the above transactions took more medium-term positions than long-term ones to maintain a certain average of duration in their portfolios. Therefore, taking box trade positions contributed largely to net sales in inward investment in bonds and notes, while closing out these positions contributed largely to net purchases. Although the impact of box trade transactions on sales and purchases throughout 2003 was negligible, these transactions caused wider fluctuations for inward investment in bonds and notes in the second half of 2003.

Changes in term structure of swap spreads of different maturity are shown in Chart 2 for Box 7. The spreads expanded significantly for the medium-term relative to the long-term from end-June to end-September, and that means there were opportunities to gain profits by taking arbitrage positions such as box trades. However, such opportunities were scarce from end-September to end-December, when swap spreads for both medium- and long-term maturity narrowed and the disparity between the two contracted.

Reference to Box 7

A so-called “box trade” is a technical investment combining two arbitrage positions, that is, purchases of cash bonds with a certain remaining maturity and interest rate swap agreements on the fixed rate payments side, and sales of cash bonds with a different remaining maturity and swap agreements on the fixed rate receipts side. Profits are gained by taking advantage of arbitrage opportunities from the distortions of the term structure of swap spreads. An outline of a box trade can be explained as follows.

A. Cash Bond Sales and Interest Rate Swap Agreements on Fixed Rate Receipts Side

Hedge funds and banks often combine sales of JGBs obtained through transactions under repurchase agreements with interest rate swap agreements on the fixed rate receipts side (Chart 3 for Box 7). The arbitrage positions taken by these transactions neutralize the interest rate risk by canceling out payments and receipts of fixed and floating rates.

However, the risk from fluctuations in swap spreads remains in the positions. This is because the difference in the fixed rates (swap spreads) between taking and closing out the arbitrage positions generates capital gains or losses. For example, a combination of cash bond sales and interest rate swap agreements on the fixed rate receipts side will generate profits if the position is closed out when swap spreads are narrowing, but will result in losses in the opposite case (Chart 4 for Box 7).

B. Cash Bond Purchases and Interest Rate Swap Agreements on Fixed Rate Payments Side (Asset Swaps)

Hedge funds and banks also often combine purchases of JGBs, investing yen funds funded in the Euroyen market with interest rate swap agreements on the fixed rate payments side (Chart 5 for Box 7). As explained above, the interest rate risk is neutralized because combined transactions cancel out payments and receipts of fixed and floating rates, but the risk from fluctuations in the swap spreads remains. Contrary to the case above, this arbitrage position generates profits if the position is closed out when swap spreads are widening (Chart 6 for Box 7).

C. Box Trades

In box trades, the risk of fluctuations in swap spreads can be hedged by combining arbitrage positions as explained in A and B above. However, this box trade bears risks from changes in the term structure of the swap spread (difference in rates of fluctuation between different maturities). In other words, when the term structure of a swap spread changes, the difference between profits or losses arising from an arbitrage position in cash bond sales and interest rate swap agreements on the fixed rate receipts side, and, losses or profits arising from an arbitrage position in cash bond purchases and the swap agreements on the fixed rate payments side, generates the profits or losses resulting from the box trade overall.

Therefore, capital gains will be realized in a box trade in the following two cases. The first case is when the narrowing of swap spreads in maturity of X years with the position of cash bond sales and the swap agreements on the fixed rate receipts side exceeds that for a remaining maturity of Y years with the position of cash bond purchases and the swap agreements on the fixed rate payments side. The second case is when the expansion of swap spreads for a maturity of Y years exceeds that for a maturity of X years (Chart 7 for Box 7). In other words, the widening difference between swap spreads for a maturity of X years and Y years generates capital gains in a box trade as a whole (see Chart 1 for Box 7).

Reference: Revisions and Changes to the Method of Recording the BOP Statistics in 2003

In compiling statistics, it is necessary to constantly search for better data sources and revise recording methods to reflect the continually changing economic situation more accurately. From this viewpoint, the method of compiling Japan's BOP statistics is constantly reviewed by statisticians in Japan, cooperating with the International Monetary Fund (IMF)¹ and related parties in other major countries. Revisions and changes introduced in 2003 are listed below.

	Category in BOP	Revisions and changes	Release date of revised data
Yen brought into Japan by visitors from abroad	Travel	Introduction of new supplementary data	From January 2003
Compensation received by locally-hired staff working at the Japanese embassies and consulates overseas	Income	Changes in classification	From April 2003
Compensation received by Japanese workers at U.S. military bases in Japan	Other services and current transfer	Introduction of new items	From April 2003
Workers' remittances (to family members remaining in home countries)	Current transfer	Introduction of new supplementary data	From April 2003
Abolition of estimation for workers' remittances and other transfers	Current transfer	Change in the compilation methodology	From April 2003

A. Yen Brought into Japan by Visitors from Abroad

More and more cases are observed recently, where (1) yen held in foreign countries is

¹ The IMF formulates an international guideline in compiling the BOP statistics in the *Balance of Payments Manual* from the perspective of improving the international comparability and increasing the accuracy of the statistics. The fifth edition (BPM5) released in 1993 is the most recent version. The IMF BOP Committee holds regular meetings, at which the IMF, other international organizations, and representatives from major countries discuss various system issues related to the BOP statistics.

brought into Japan by visitors, especially from Asia, and (2) yen cash is withdrawn by visitors from cash dispensers (CDs) or automated teller machines (ATMs) located in Japan. Previously, the flow of these funds was not reflected under credit in the travel category, but since January 2003, these figures have been compiled using data from a survey conducted in 2002 on visitors from abroad concerning the amount of yen they brought into Japan. This data was partly reflected under debit in the travel category, as it is considered that yen brought into Japan was originally carried abroad by Japanese travelers. For details of the estimation, see “Revision of Compilation Methodology for Balance of Payments Statistics on Travel in Japan” available on the Bank’s web site (<http://www.boj.or.jp/en/ronbun/03/data/ron0307a.pdf>).

B. Compensation Received by Locally-Hired Staff Working at Japanese Embassies and Consulates Overseas

The BPM5 states that “because embassies and consulates are considered extraterritorial to the economies in which they are located, the compensation received by locally-hired (host country) staff of these institutional entities is classified as that paid to resident entities by nonresident entities” (Paragraph 269). In Japan’s BOP, however, such compensation has been recorded together with other expenses at embassies and consulates in “other public services” under the category of other services in the services account.² To respond to a request from BOP statisticians, the Ministry of Foreign Affairs and some Japanese embassies and consulates started to submit data for estimating (1) compensation received by locally-hired staff working at Japanese embassies and consulates overseas, and (2) compensation received by foreign staff working at embassies and consulates in Japan. Estimates are reflected from April 2003 figures. Specifically, figures in (1) above were transferred to debit under compensation of employees in income from debit in other public services and those in (2) above were transferred to credit under compensation of employees from credit in other public services.

² Previously, data on compensation received by locally-hired staff was collected from reports on payments, which recorded compensation and other expenses together, without giving details of the breakdown.

C. Compensation Received by Japanese Workers at U.S. Military Bases in Japan

Japanese workers (resident) at U.S. military bases in Japan (nonresident) are employed based on contracts with the Japanese government and receive a large proportion of their salaries from the Japanese government. This may be understood as exports of labor services to a nonresident and, therefore, should be recorded as credit under services. The portion of compensation the U.S. Military does not bear but is paid by the Japanese government should be recorded in debit under current transfers as money granted by the Japanese government to the U.S. military. Currently, necessary documents are collected from related ministries and (1) compensation paid by the U.S. military is recorded as credit under other official services in other services and (2) compensation paid by the Japanese government is recorded as debit under the official sector in others.

D. Workers' Remittances (To Family Members Remaining in Home Countries)

The minimum threshold of workers' remittances to family members remaining in home countries, subject to stating in the reports on payments, was raised to 30 million yen from 5 million yen in transactions from April 1, 2003 to reduce the reporting burden on related parties. This change left many transactions unreported, especially workers' remittances categorized under current transfers, which are mostly small transactions. In order to fill this void, from April necessary data are now collected from major banks through surveys, which will be used to compile the BOP figures. The new survey covers major banks reporting on transactions which are more than 2 million yen and 30 million yen or less, and data on those over 30 million yen is collected through reports on payments as in the past.

E. Abolition of Estimation for Workers' Remittances and Other Transfers

Workers' remittances and other transfers were previously calculated by multiplying a fixed rate to a certain portion of the total stated in the reports on payments. However, there was the possibility that a large disparity might have existed between actual transactions and the estimations, because a revision of the fixed rate was impossible as there were no benchmark data. Therefore, when the minimum threshold of transactions to be reported was raised, figures were started to be compiled based on data from the survey mentioned above, instead of using the fixed rate, having taken into

account the effect of the change in the estimation method.

Chart 1: Current Account

bil. yen

	2003 ¹		2002 ¹
		Changes from the previous year	
Current account	15,785.3	+1,645.6	14,139.7
Goods and services	8,366.1	+1,897.1	6,469.0
Goods	12,255.1	+521.8	11,733.3
Exports	51,926.3	+2,446.7	49,479.7
Imports	39,671.3	+1,924.9	37,746.4
Services	-3,889.0	+1,375.3	-5,264.3
Transportation	-882.8	+51.5	-934.2
Air transport, passengers	-570.3	+143.4	-713.7
Travel	-2,323.3	+564.7	-2,887.9
Other services	-682.9	+759.2	-1,442.1
Royalties and license fees	151.2	+224.5	-73.3
Income	8,285.8	+19.4	8,266.5
Current transfers	-866.7	-270.9	-595.8

Note: 1. Figures are preliminary.

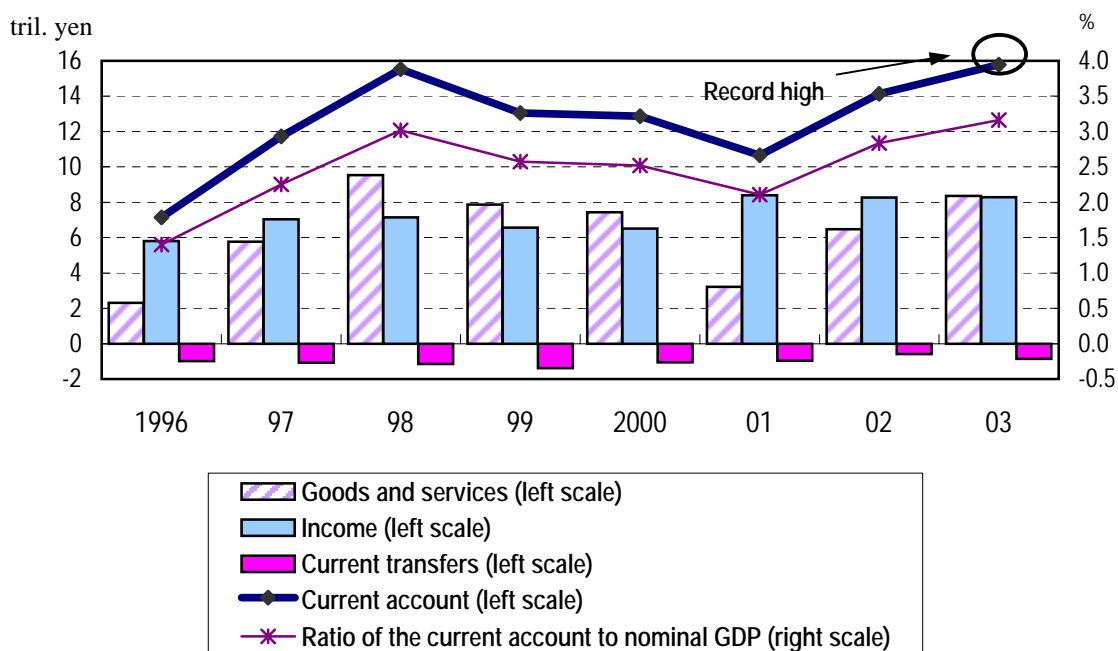
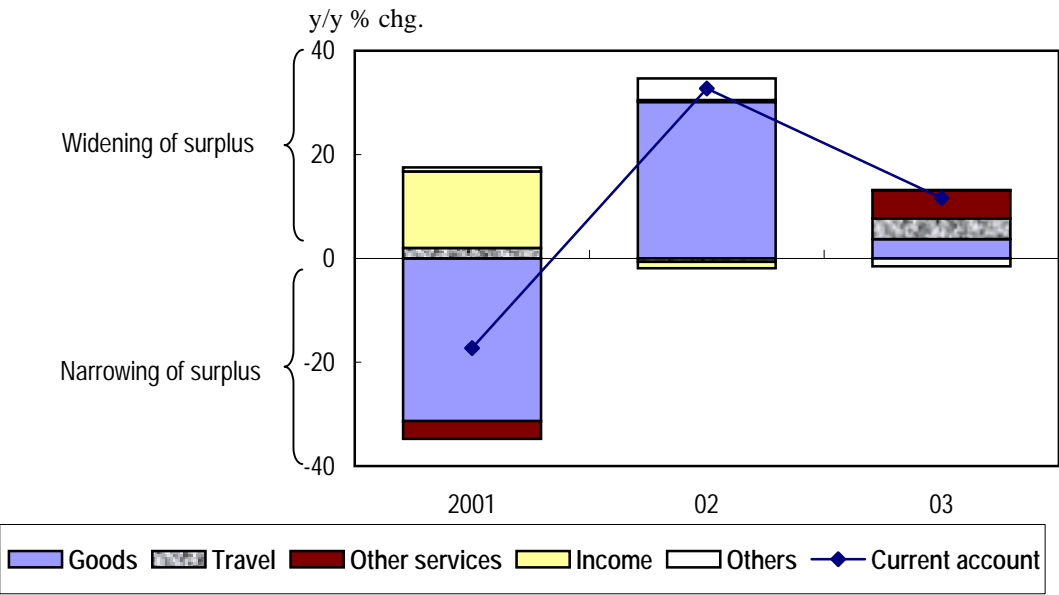
Chart 2: Development in Current Account

Chart 3: Contribution to Changes in Current Account¹



Note: 1. Narrowing of the deficit widens the surplus and vice versa for services (travel, transportation, others) and the current transfers, both of which continually record a deficit.

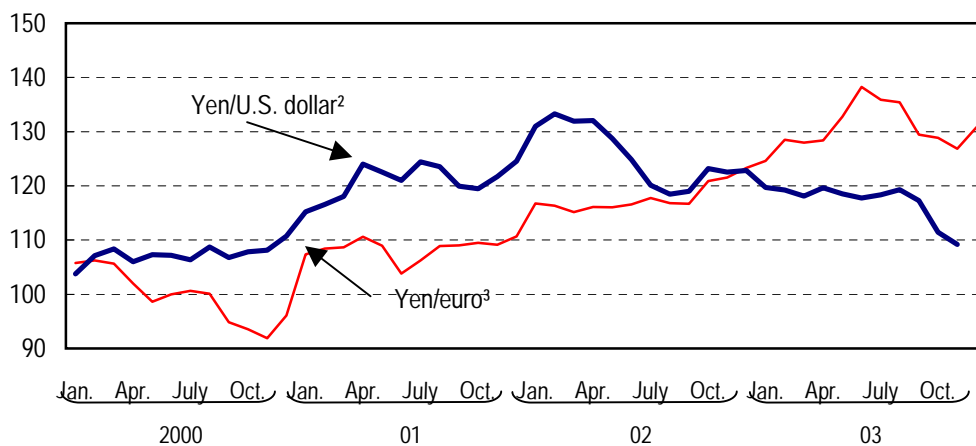
Chart 4: Goods

bil. yen; figures in parentheses are % chg. from the previous year

	2002		
		Changes from the previous year	
Net balance	12,255.1	521.8	(+4.4)
Exports	51,926.3	2,446.7	(+4.9)
Imports	39,671.3	1,924.9	(+5.1)

Chart 5: Exchange Rate¹

yen/U.S.dollar; yen/euro



- Notes: 1. The exchange rate officially announced by the chief customs inspector is 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.
2. The average rate of the yen against the U.S. dollar appreciated to 116.4 yen in 2003 from 125.61 yen in 2002.
3. The average rate of the yen against the euro depreciated to 130.66 yen in 2003 from 117.84 yen in 2002.

Chart 6: Contribution to Overall Export Growth by Region (Customs-Clearance Basis)
y/y % chg.

	Overall exports	United States	European Union	Asia				Middle East
					NIES ¹	ASEAN ¹	China	
2002	+6.4	+0.3	-0.3	+5.5	+2.4	+0.8	+2.5	+0.3
2003	+4.7	-2.9	+1.3	+5.4	+1.8	+0.2	+3.2	+0.1

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

	<i>Merchandise Trade Statistics²</i>	<i>Balance of Payments</i>
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 7: Contribution to Overall Export Growth by Region (Customs-Clearance Basis)

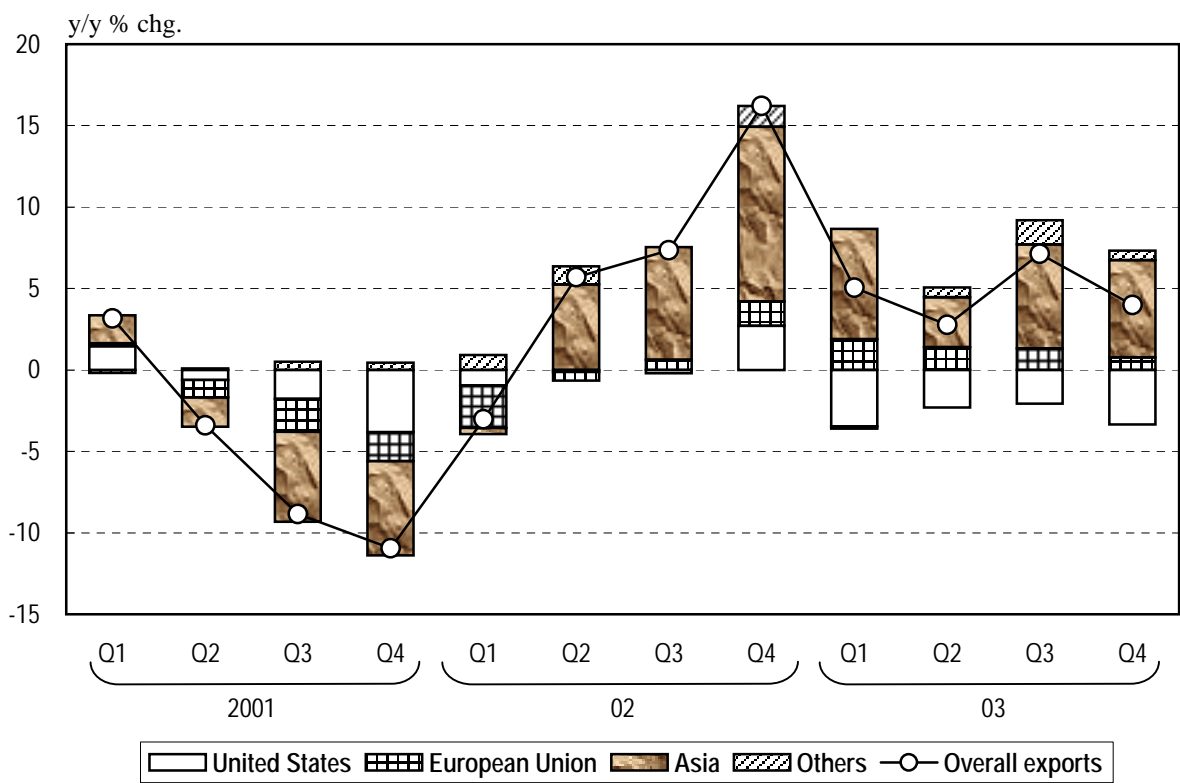


Chart 8: Exports to Asia, the European Union, and the United States (Customs-Clearance Basis)

y/y % chg.

	Value	Volume	Price
Asia	+12.9	+10.9	+1.8
European Union	+9.0	+5.9	+2.9
United States	-9.8	-5.7	-4.3

Chart 9: Major Items Contributing Positively or Negatively to the Growth in Exports to Asia

	Items	Contribution to overall growth (%)
Items making a positive contribution	Semiconductors and other electronic parts	+1.2
	Parts for audiovisual apparatus	+1.0
	Scientific, medical, and optical instruments	+0.8
	Parts for motor vehicles	+0.7
Items making a negative contribution	Ships	-0.1

Chart 10: Major Items Contributing Positively or Negatively to the Growth in Exports to the European Union

	Items	Contribution to overall growth (%)
Items making a positive contribution	Motor vehicles	+5.3
	Visual apparatus	+1.2
	Ships	+1.0
	Parts for audiovisual apparatus	+0.9
Items making a negative contribution	Office machines	-1.7
	Audio apparatus	-0.3

Chart 11: Major Items Contributing Positively or Negatively to the Growth in Exports to the United States

	Items	Contribution to overall growth (%)
Items making a positive contribution	Visual apparatus	+0.2
	Construction and mining machinery	+0.2
	Parts for motor vehicles	+0.1
Items making a negative contribution	Motor vehicles	-4.4
	Office machines	-1.5
	Power generating machinery	-0.6

Chart 12: Contribution to Overall Export Growth by Item
(Customs-Clearance Basis)

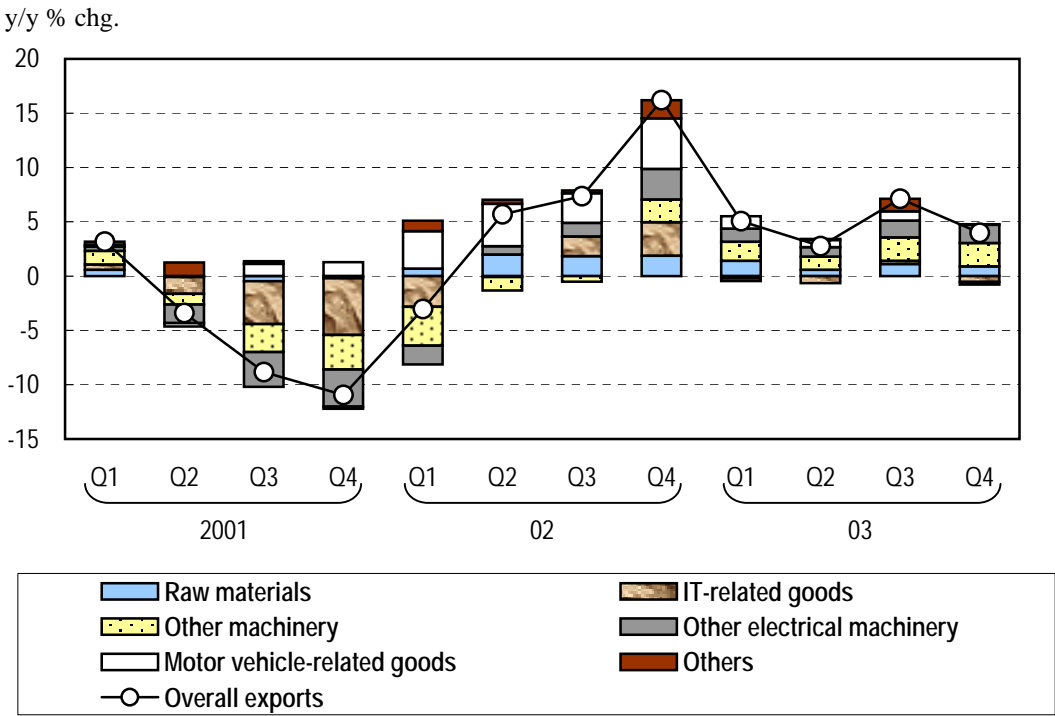


Chart 13: Contribution to Overall Export Growth by Item

y/y % chg.

	2002	2003	Major factors
Value of overall exports	+6.4	+4.7	—
Motor vehicle related goods	+3.7	+0.5	
Motor vehicles	+3.2	+0.2	Brisk sales in the European Union and Asia; decreased exports to the United States due to expanded production at local production bases
Parts for motor vehicles	+0.5	+0.4	Expanded the local production in Asia and the United States
Raw materials	+1.6	+0.9	
Chemicals	+0.9	+0.7	Expanded production in Asia
Iron and steel products	+0.6	+0.2	Rise in prices reflecting increased demands in Asia
IT-related goods	+0.4	-0.3	
Semiconductors and other electronic parts	+0.4	+0.4	Increase in demands for parts for digital appliances in China and the NIEs
Office machines	+0.4	-0.7	Shift of production bases for PCs to China
Telecommunications apparatus	-0.4	+0.1	Increase in demands for telecommunications apparatus for base stations in China
Other electrical machinery	+0.7	+1.3	
Visual apparatus	+0.5	+0.4	Increase in demands for flat-screen TVs and DVD players in the United States, the European Union, and Asia
Parts for audiovisual apparatus	+0.2	+0.6	Expanded production in Asia
Other machinery	-0.9	+1.7	
Scientific, medical, and optical instruments	-1.2	+0.3	Increase in demands for semiconductors reflecting expanded production of digital cameras and high technology-intensive mobile phones especially in Asia
Metalworking machinery	-0.2	+0.2	Increase in demands for semiconductor manufacturing equipment to Asia, and increase in the construction of factories, buildings, and infrastructure
Others	+0.8	+0.2	

Chart 14: Contribution to Overall Import Growth by Region (Customs-Clearance Basis)

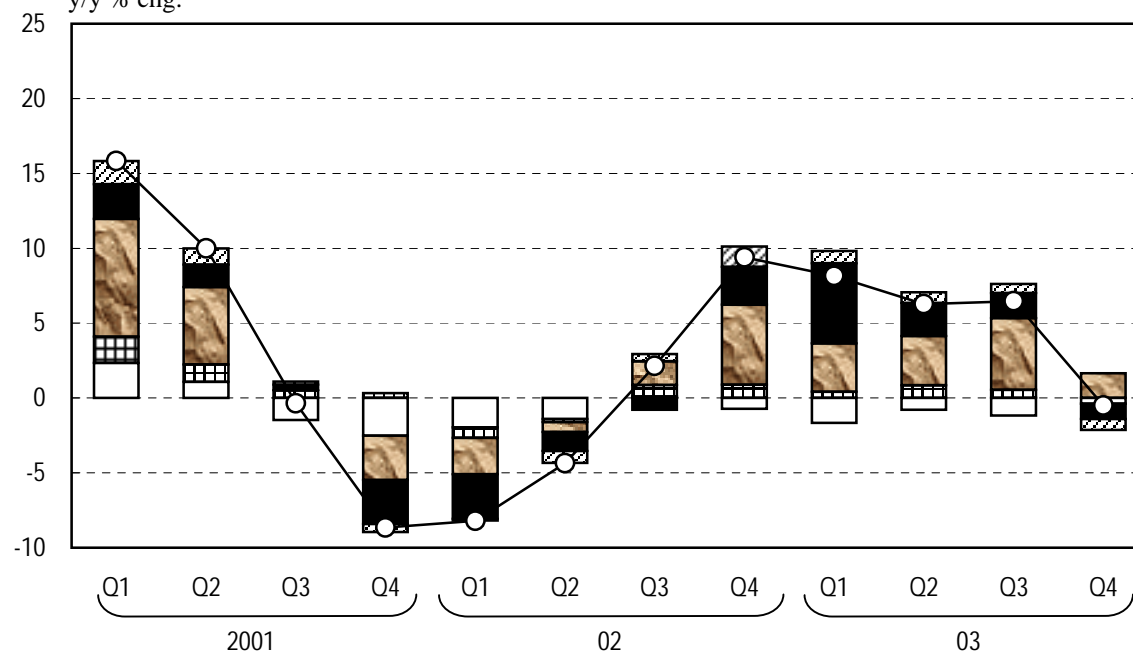
y/y % chg.

	Overall imports	Overall imports						Middle East
		United States	European Union	Asia	NIEs ¹	ASEAN ¹	China	
2002	-0.4	-1.0	+0.2	+0.9	-0.5	-0.3	+1.7	-0.7
03	+5.0	-1.0	+0.4	+3.2	+0.2	+0.7	+2.4	+2.0

Note: 1. Includes imports from Singapore.

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

y/y % chg.



United States European Union Asia Middle East Others Overall exports

Chart 16: Imports from Asia, the European Union, and the United States
(Customs-Clearance Basis)

y/y % chg.

	Value	Volume	Price
Asia	+7.4	+10.9	-3.2
European Union	+3.4	-2.2	+5.7
United States	-5.7	-11.2	+6.1

Chart 17: Major Items Contributing Positively or Negatively to the Growth in Imports from Asia

	Items	Contribution to overall growth (%)
Items making a positive contribution	Office machines	+1.0
	Semiconductors and other electronic parts	+0.8
	Liquefied natural gas	+0.7
	Petroleum products	+0.5
Items making a negative contribution	Fish products	-0.6

Chart 18: Major Items Contributing Positively or Negatively to the Growth in Imports from the European Union

	Items	Contribution to overall growth (%)
Items making a positive contribution	Organic chemicals	+0.4
	Electrical measuring and controlling instruments	+0.4
	Scientific, medical, and optical instruments	+0.3
Items making a negative contribution	Aircraft	-0.5
	Office machines	-0.4

Chart 19: Major Items Contributing Positively or Negatively to the Growth in Imports from the United States

	Items	Contribution to overall growth (%)
Items making a positive contribution	Aircraft	+0.9
	Meat	+0.6
Items making a negative contribution	Office machines	-1.2
	Power generating machinery	-0.9
	Semiconductors and other electronic parts	-0.6

Chart 20: Contribution to Overall Import Growth by Item
(Customs-Clearance Basis)

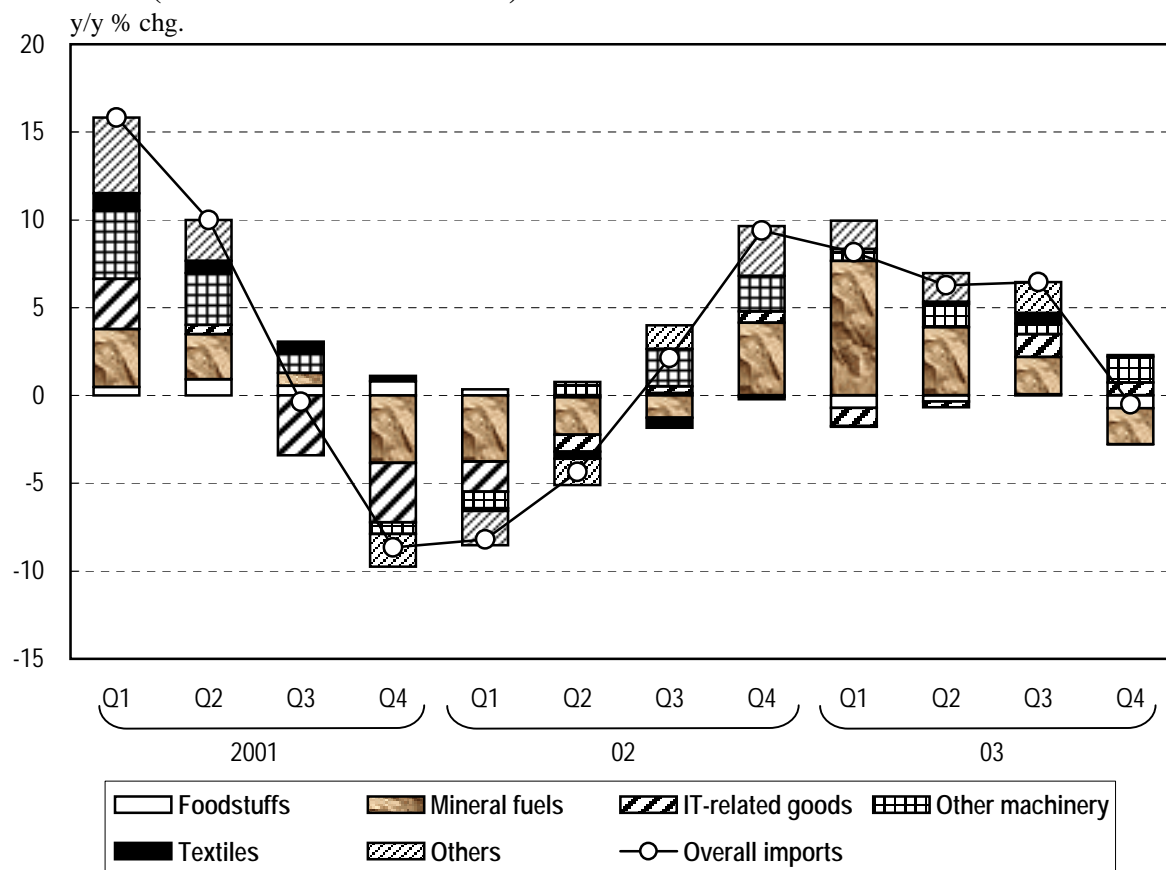


Chart 21: Contribution of Overall Import Growth by Item

y/y % chg.

Items	2002	2003	Major factors
Value of overall imports	-0.4	+5.0	—
Mineral fuels	-0.8	+2.8	—
Crude oil and partly refined oil	-0.3	+1.8	Rise in prices reflecting the situation in Iraq, and increase in demands for thermal power generation due to the suspension of the operation of nuclear power plants in Japan
Petroleum products	-0.2	+0.4	Same as above
Liquefied natural gas	-0.1	+0.5	Same as above
IT related goods	-0.4	+0.1	—
Semiconductors and other electronic parts	+0.0	+0.2	Recovery in the worldwide demands for semiconductors from the middle of the year
Office machines	-0.2	+0.1	Launch of operations at PC production bases in China
Telecommunications apparatus	-0.3	-0.2	—
Textiles	-0.3	+0.2	Rise in the prices of raw materials
Aircraft	+0.5	+0.1	Demands for renewal of aircraft
Chemicals	+0.3	+0.5	Recovery in production in Japan and rise in prices
Foodstuffs	+0.1	-0.4	Decrease in demands for fish products

Chart 22: Services

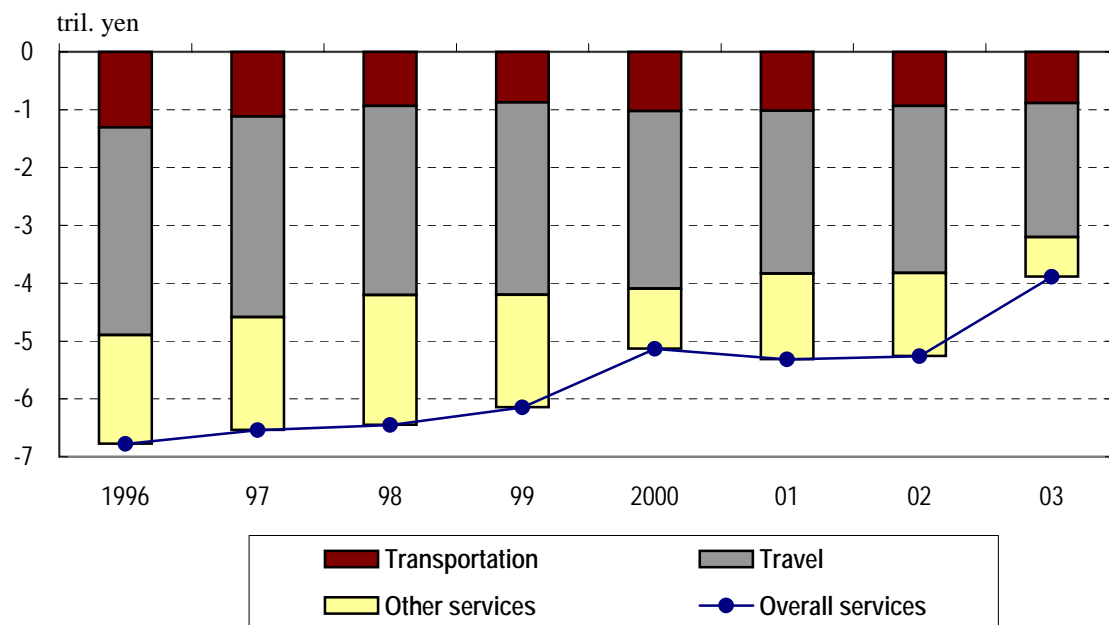


Chart 23: Goods and Services

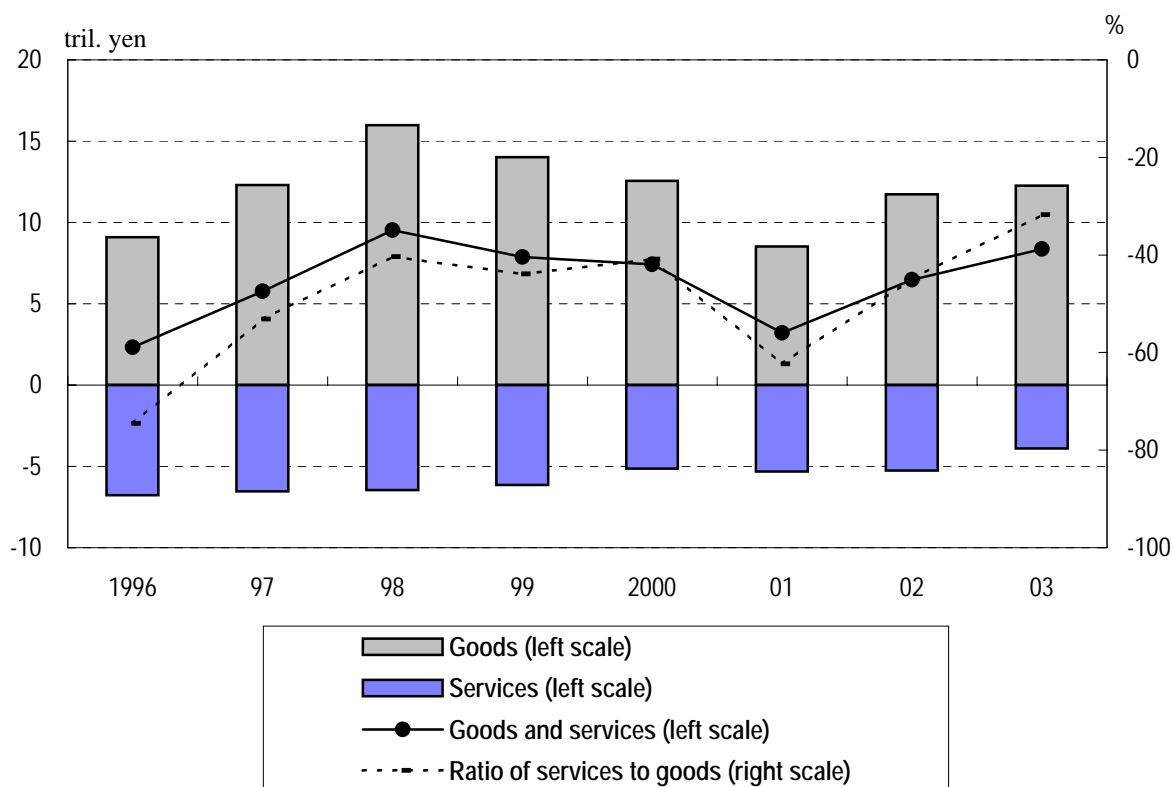
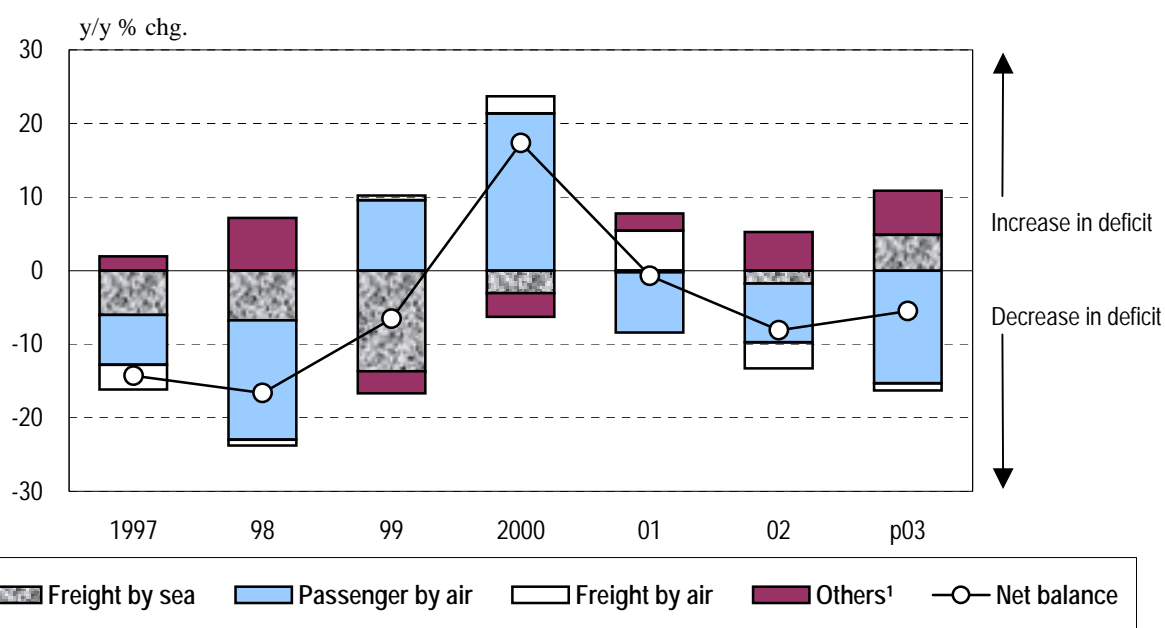


Chart 24: Transportation

bil. yen

		2003		2002
			Changes from the previous year	
Transportation		-882.8	+51.5	-934.2
	Sea transport	-588.1	-87.7	-500.3
	Credit	2,123.0	+102.2	2,020.8
	Debit	2,711.1	+190.0	2,521.1
	Air transport	-282.5	+138.9	-421.4
	Passenger	-570.3	+143.4	-713.7
	Credit	302.4	-17.4	319.9
	Debit	872.7	-160.8	1,033.5
	Freight	45.6	+9.4	36.1
	Credit	290.5	+5.1	285.4
	Debit	244.9	-4.4	249.3

Chart 25: Contribution to Overall Transportation by Item

Note: 1. Includes "passenger by sea," "other sea transport," "other air transport," and "other transport."

In 2003, "others" contributed to the increase of the deficit in transportation. This was because the number of Japanese travelers going abroad by air decreased due to effects from SARS and payments of incentives to Japanese airlines or agencies declined as a result.

Chart 26: Sea Freight Fares (Corporate Service Price Index)

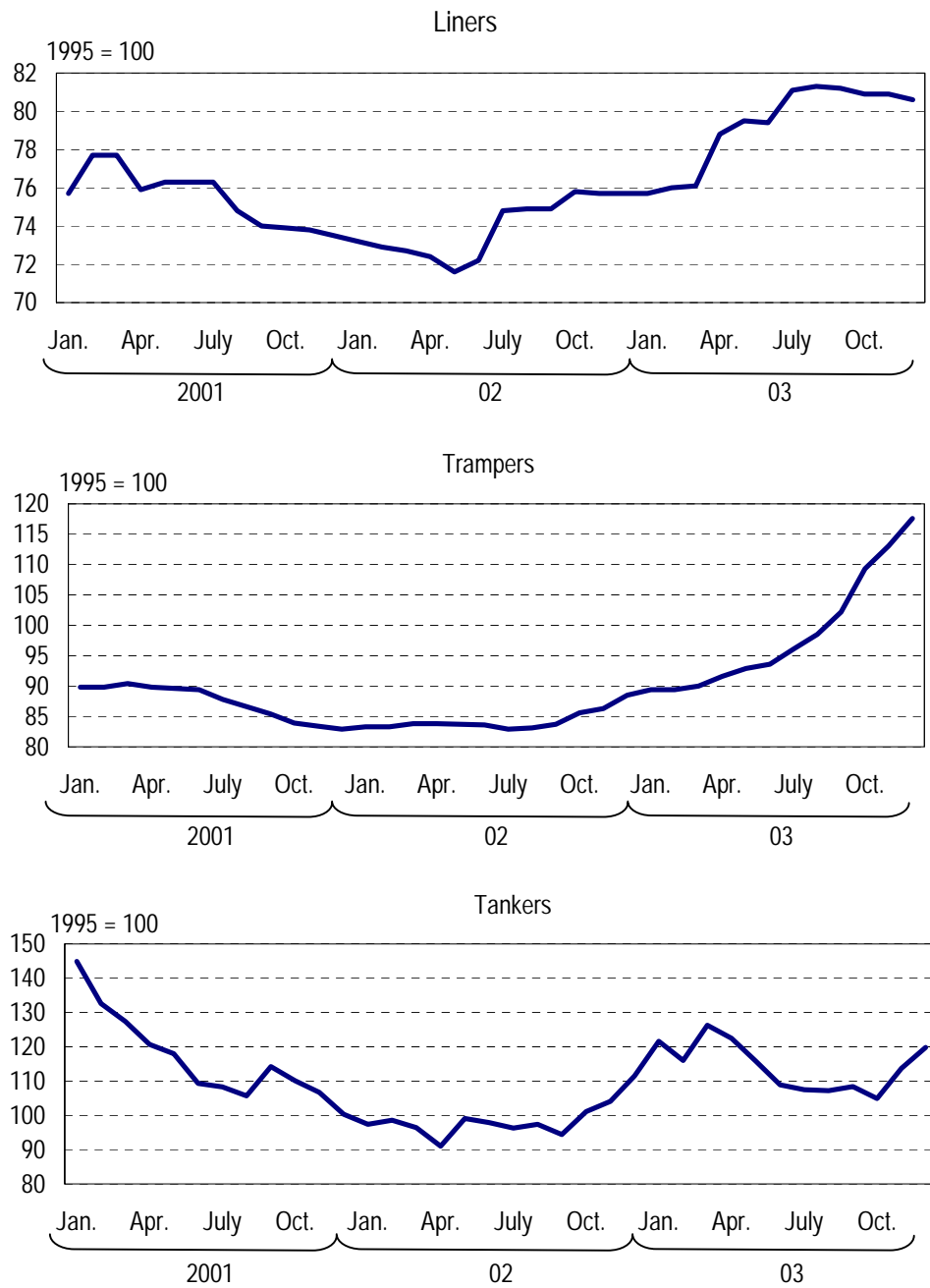


Chart 27: Travel

bil. yen

		2003		2002
			Changes from the previous year	
Travel		-2,323.3	+564.6	-2,887.9
	Credit	1,018.4	+580.3	438.1
	Debit	3,341.7	+15.7	3,326.0

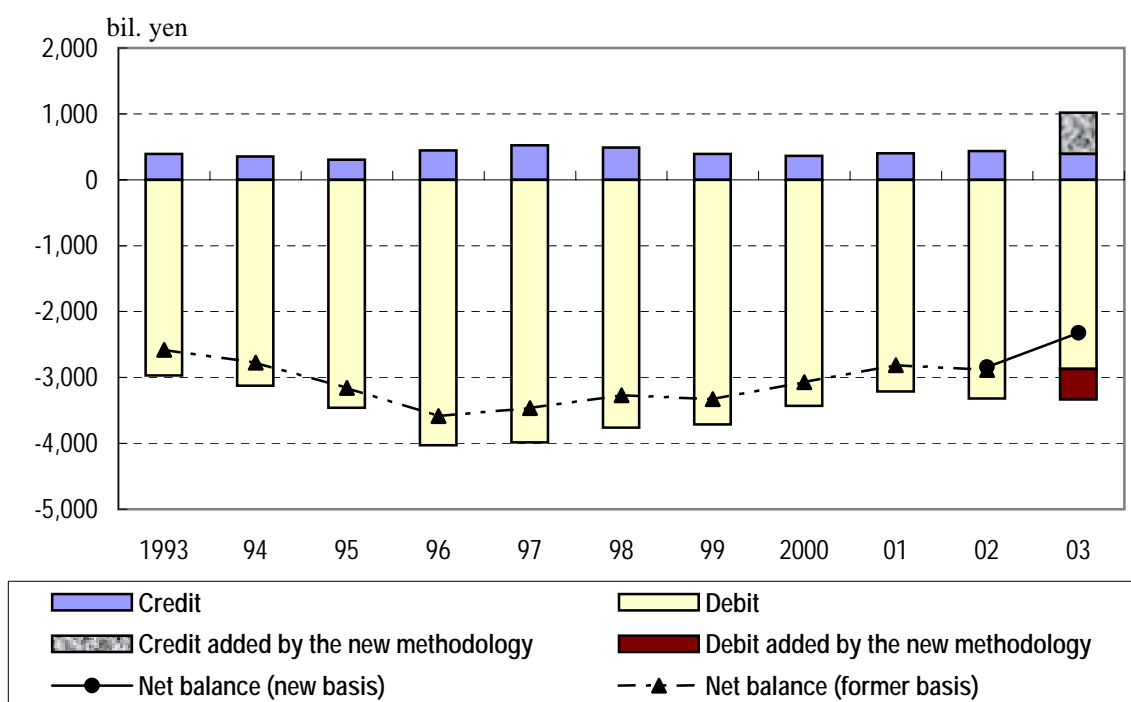
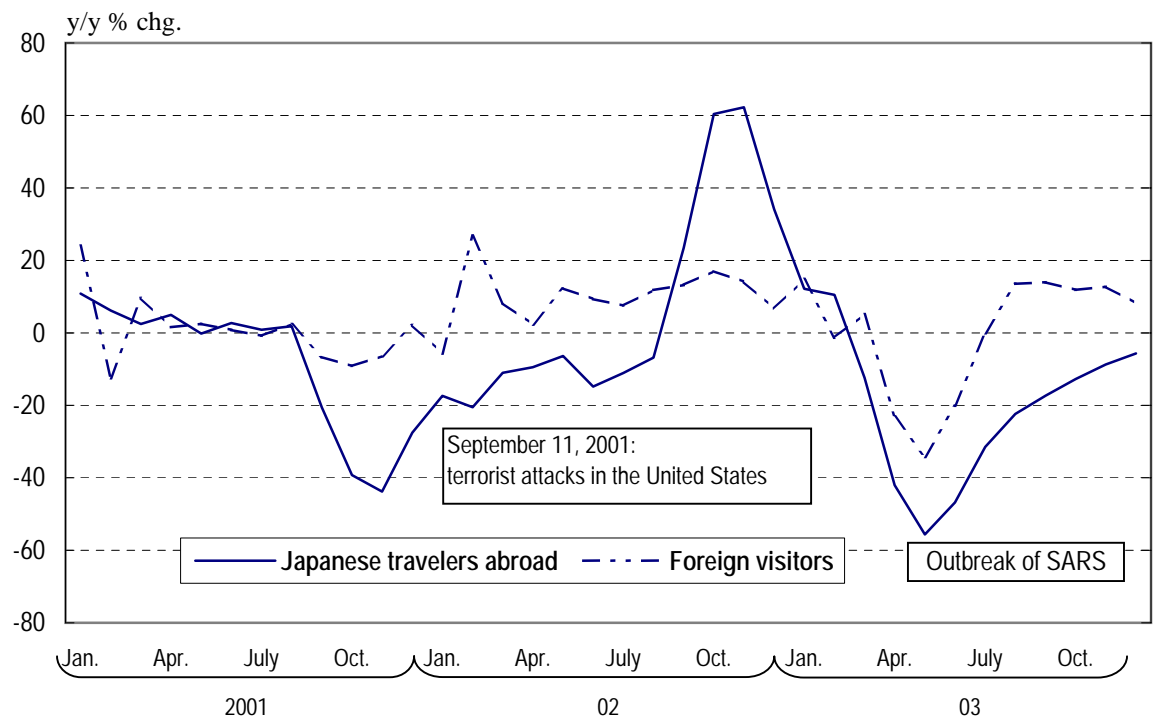
Chart 28: Travel

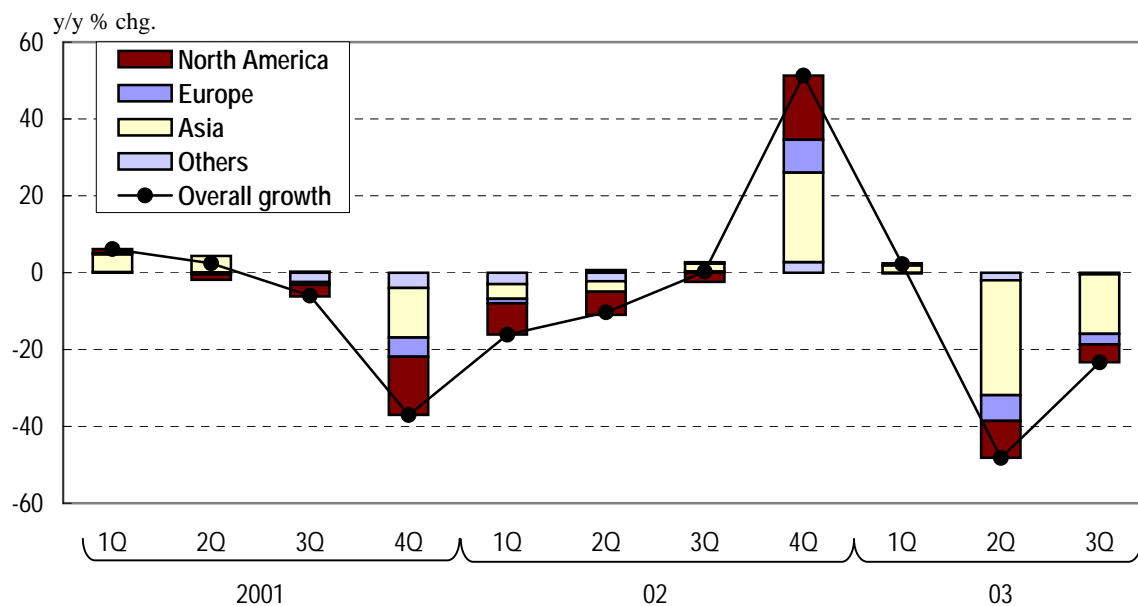
Chart 29: The Number of Japanese Travelers Abroad and Foreign Visitors



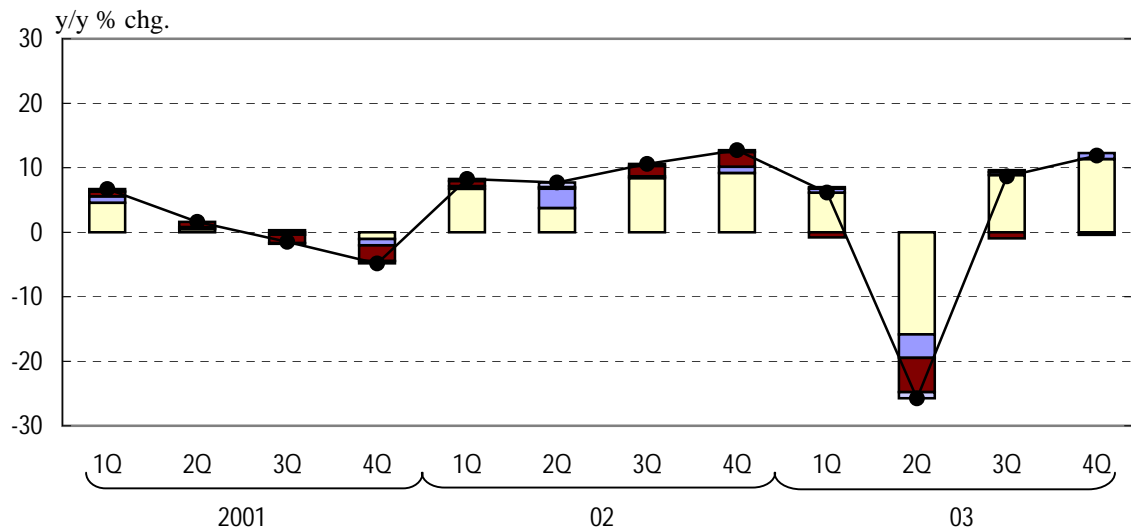
Source: Japan National Tourist Organization (JNTO).

Chart 30: Quarterly Changes and Regional Contribution to Overall Growth in the Number of Japanese Travelers Abroad and Foreign Visitors

(1) Japanese Travelers Abroad¹



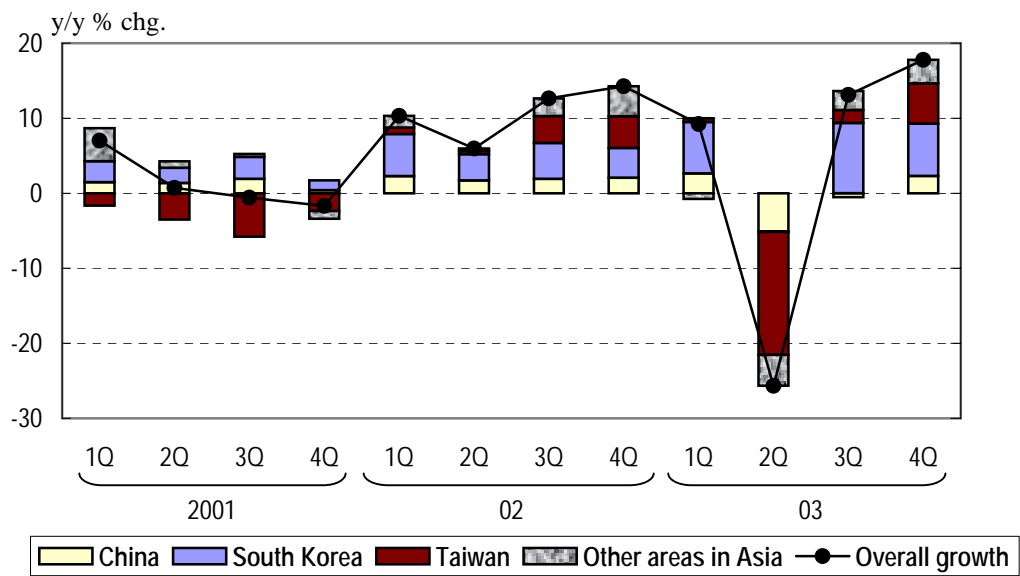
(2) Foreign Visitors²



Notes: 1. Estimated by Balance of Payments Division, International Department, Bank of Japan based on data released by the Japan National Tourist Organization (JNTO) and the Ministry of Land, Infrastructure and Transport "Provisional Statistical Report on Air Transport."

2. Source: Japan National Tourist Organization (JNTO); figures for the October-December quarter of 2003 are year-on-year percent changes for October due to data constraint.

Chart 31: Quarterly Changes in the Number of Visitors from Asian Countries and Their Contribution to Overall Growth¹



Note: 1. Figures for the October-December quarter of 2003 are year-on-year percentage changes for October due to data constraint.

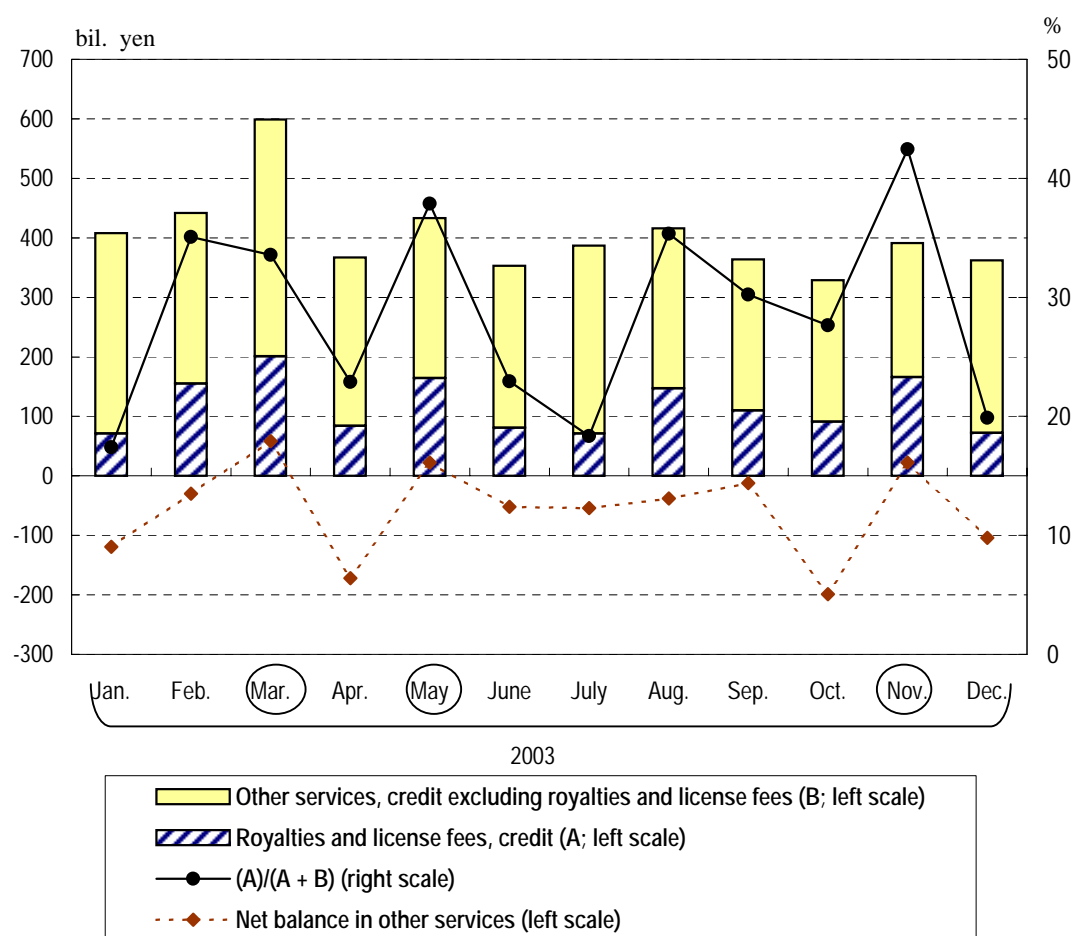
Chart 32: Other Services

bil. yen

		2003	Changes from the previous year	2002
Other services		-682.9	+759.2	-1,442.1
Royalties and license fees		151.2	+224.4	-73.3
	Credit	1,418.5	+112.0	1,306.5
	Debit	1,267.3	-112.4	1,379.7
Insurance services		-368.4	+79.9	-448.3
	Credit	41.5	+85.7	-44.2
	Debit	409.9	+5.8	404.1
Financial services		150.9	-37.3	188.1
	Credit	402.5	+10.1	392.5
	Debit	251.7	+47.3	204.3
Personal, cultural, and recreational services		-90.7	+19.7	-110.4
	Credit	16.4	-23.0	39.3
	Debit	107.1	-42.7	149.8
Construction services		135.1	+4.7	130.4
	Credit	487.2	-92.3	579.4
	Debit	352.0	-97.0	449.0
Other official services¹		47.2	+113.7	-66.5
	Credit	194.5	+94.2	100.2
	Debit	147.3	-19.5	166.7
Other business services		-574.6	+340.0	-914.6
Miscellaneous business, professional, and technical services		-1,042.2	+232.2	-1,274.4
	Credit	936.9	-90.6	1,027.4
	Debit	1,979.1	-322.7	2,301.8
Merchanting and other trade related services		380.2	+106.2	274.0
	Credit	1,046.4	+8.9	1,037.5
	Debit	666.3	-97.3	763.6

Note: 1. In 2003, other official services recorded a surplus, compared with a deficit in 2002. This was because compensation received by the Japanese staff at the U.S. military bases in Japan has been included in the statistics since April 2003. See Reference for details.

Chart 33: Monthly Credit of Royalties and License Fees and Its Share in Other Services in 2003¹



Note: 1. Other services recorded a surplus in the months marked with circles.

Chart 34: Insurance Services

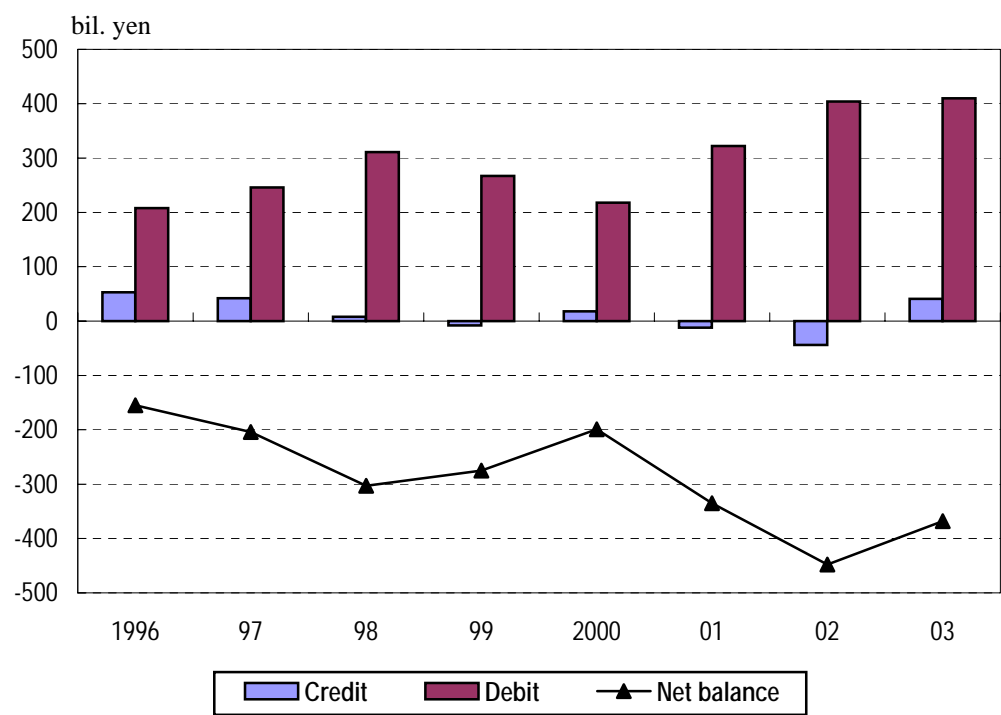


Chart 35: Financial Services

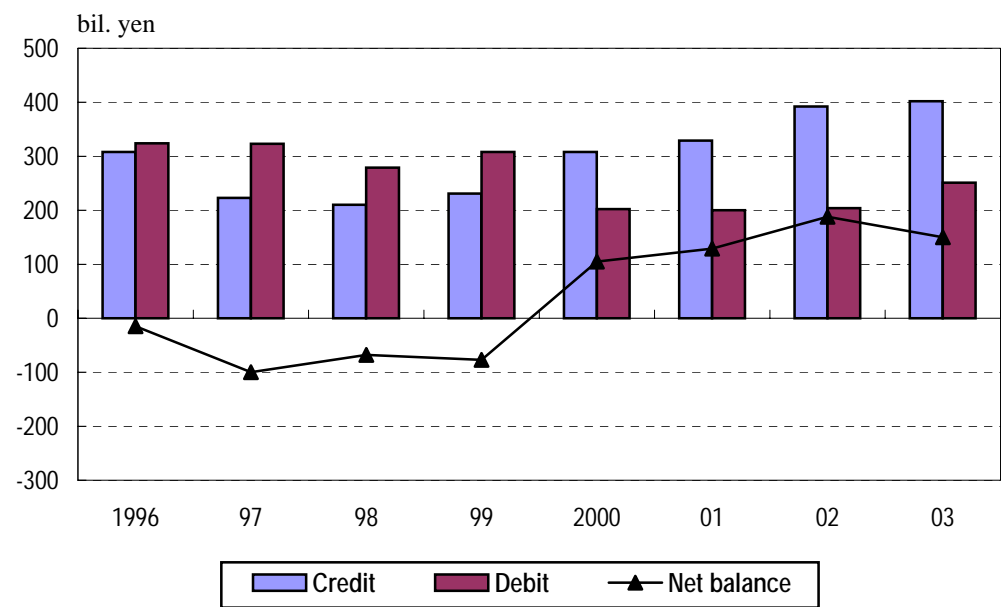


Chart 36: Income

bil. yen

	2003 ¹		2002 ²
		Changes from the previous year	
Income	8,285.8	+19.4	8,266.5
Direct investment income	944.9	-499.1	1,443.9
Dividends and distributed branch profits	547.7	+1.4	546.4
Credit	924.2	-44.0	968.2
Debit	376.4	-45.4	421.8
Reinvested earnings	366.3	-476.3	842.6
Credit	529.1	-502.2	1,031.3
Debit	162.8	-25.9	188.7
Portfolio investment income	6,821.3	+475.8	6,345.5
Bonds and notes	5,781.2	+502.9	5,278.2
Credit	6,553.7	+355.6	6,198.1
Debit	772.5	-147.4	919.9
Other investment income	533.6	+46.1	487.5
Interest on loans	528.1	+62.5	465.6
Credit	1,184.3	-148.1	1,332.4
Debit	656.2	-210.6	866.9
Interest on deposits	-10.5	+1.9	-12.4
Credit	243.4	-105.4	348.8
Debit	253.9	-107.3	361.1

Notes: 1. Figures are preliminary.
2. Figures are final.

Chart 37: Income

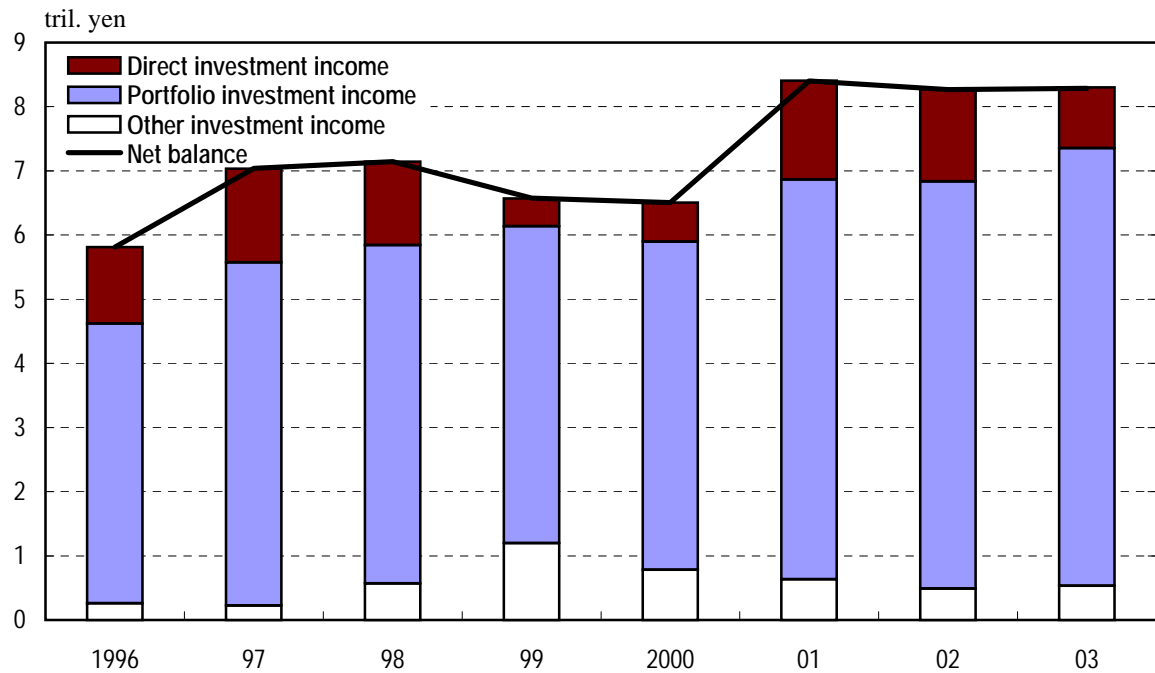


Chart 38: Direct Investment Income (Net)

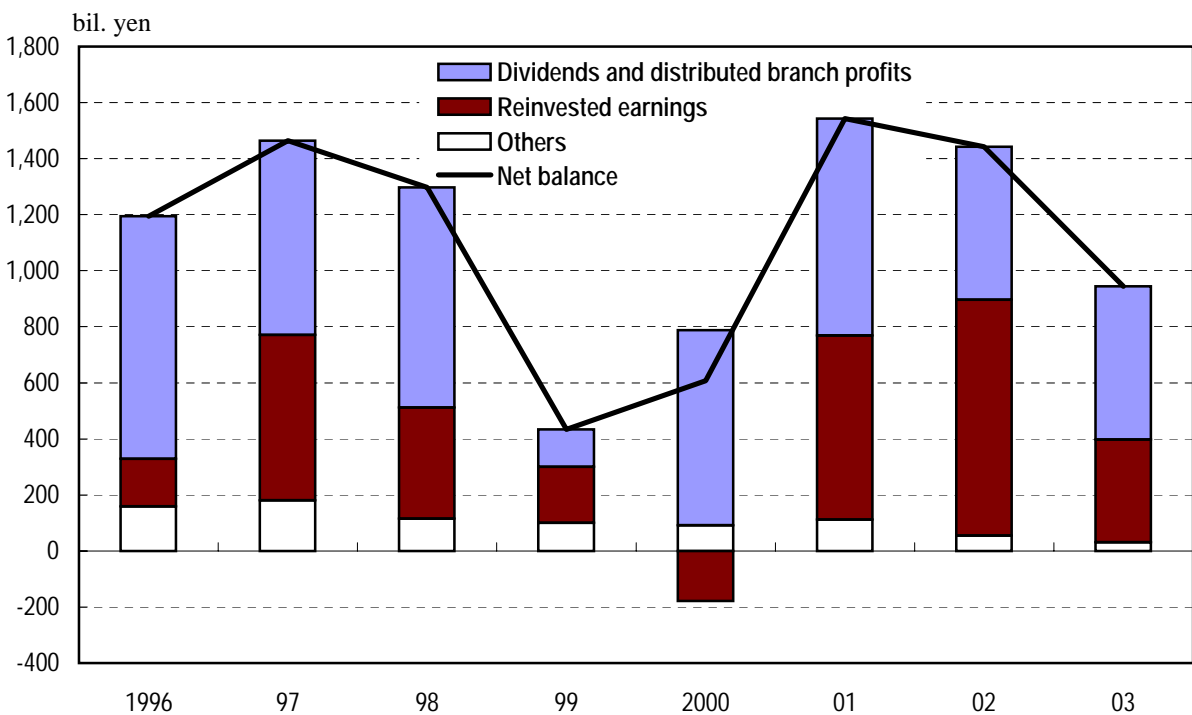


Chart 39: Credit in Reinvested Earnings

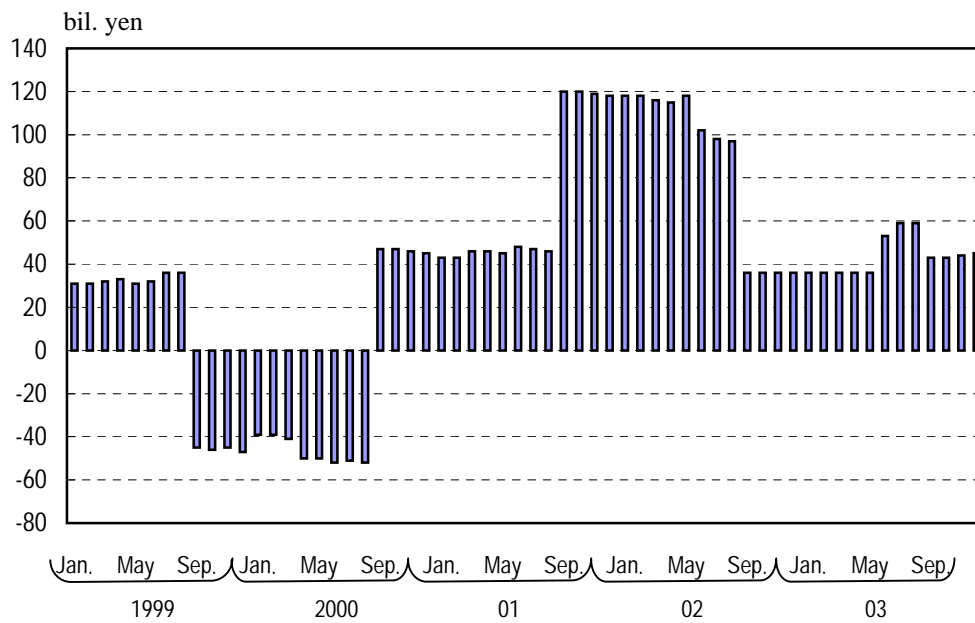


Chart 40: Portfolio Investment Income (Net)

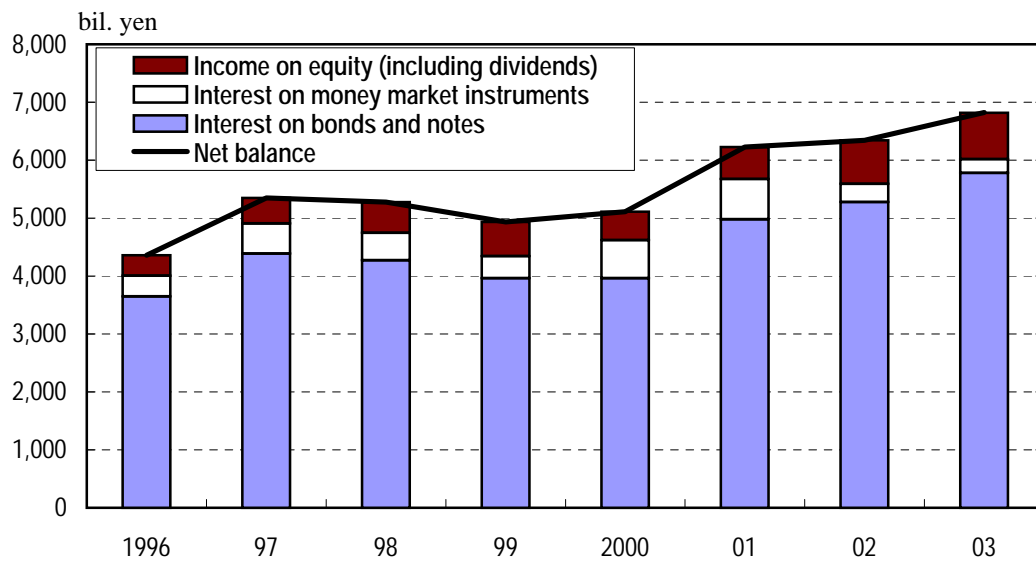


Chart 41: Other Investment Income (Net)

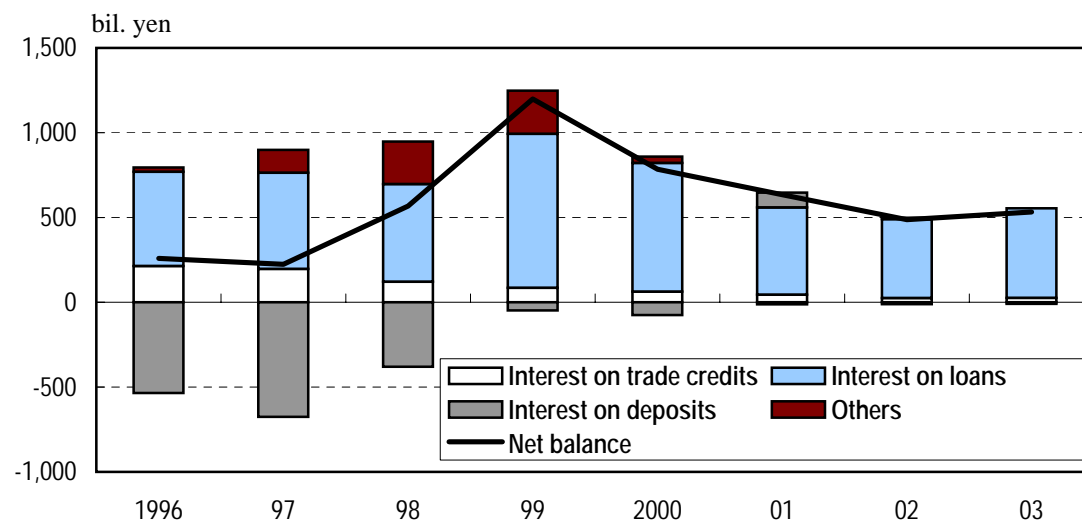


Chart 42: Other Investment Income (Gross)

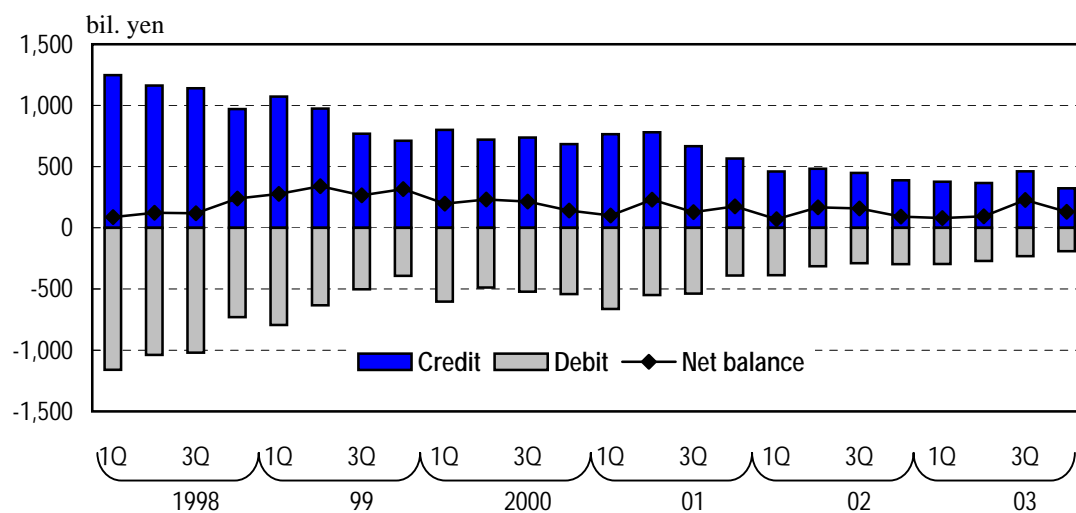


Chart 43: Current Transfers

bil. yen

	2003	Changes from the previous year	2002
Current transfers	-866.7	-270.9	-595.8
Official sector	-427.9	-452.9	25.0
Credit	22.2	-364.7	386.8
Debit	450.0	+88.2	361.8
Other sectors	-438.8	+182.0	-620.8
Credit	733.7	-158.1	891.8
Debit	1,172.6	-340.1	1,512.6

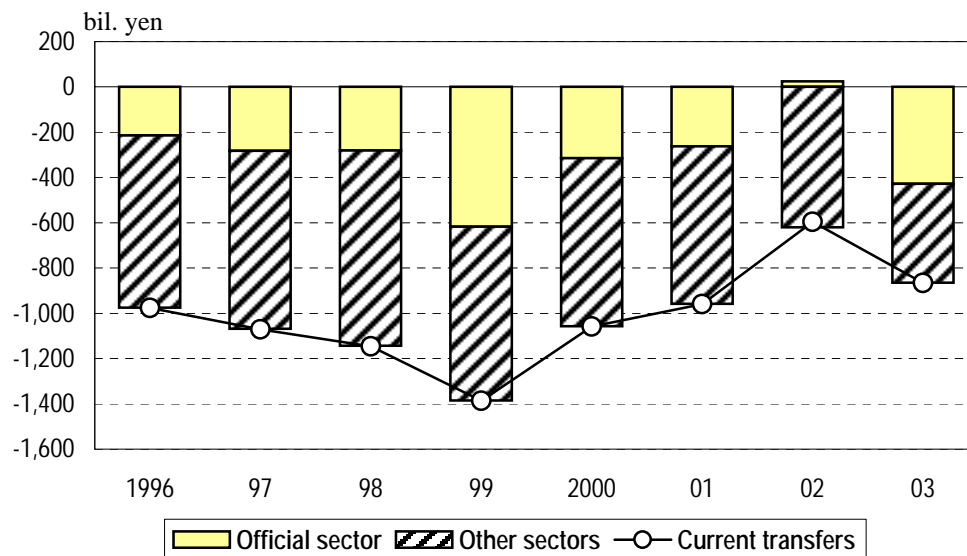
Chart 44: Developments in Current Transfers

Chart 45: Capital and Financial Account¹

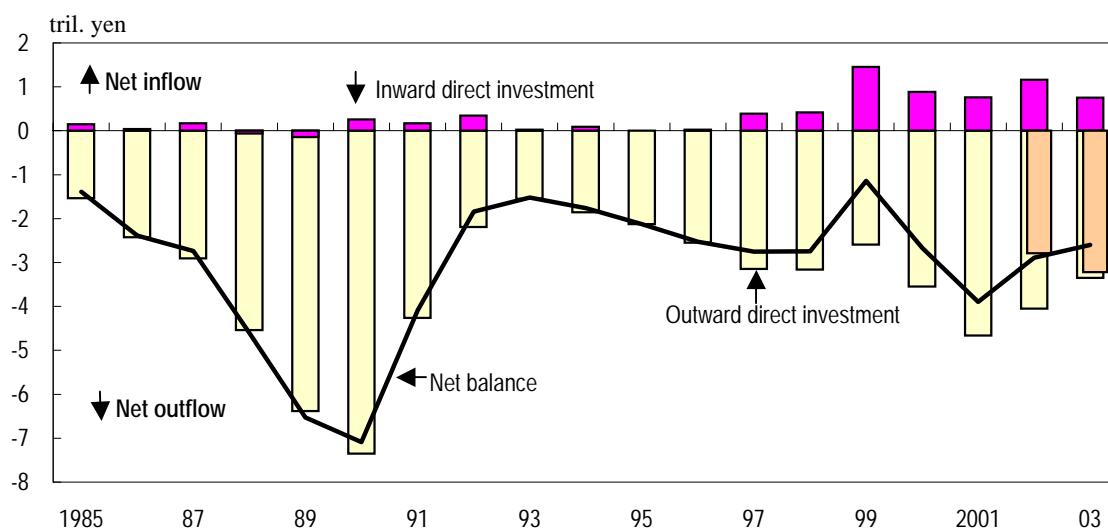
bil. yen

	2003 ²			2002		
Current account	15,785.3			14,139.7		
Capital and financial account	8,132.0	Assets (outward investment)	Liabilities (inward investment)	-8,477.5	Assets (outward investment)	Liabilities (inward investment)
Financial account	8,599.5			-8,055.8		
Direct investment	-2,595.8	-3,348.3	752.5	-2,889.1	-4,047.6	1,158.5
Portfolio investment ³	-8,843.5	-18,384.5	9,541.1	-18,576.3	-13,330.7	-5,245.6
Of which Equity securities	9,145.9	-686.1	9,831.9	-6,612.5	-4,735.5	-1,876.9
Bonds and notes	-20,022.1	-18,391.1	-1,631.0	-13,474.6	-9,291.2	-4,183.4
Money market instruments	2,032.8	692.7	1,340.1	1,510.8	696.0	814.8
Financial derivatives	604.4	7,528.2	-6,923.7	263.0	9,701.2	-9,438.3
Other investment ⁴	19,377.8	14,787.4	4,590.4	12,726.6	8,920.5	3,806.1
Of which Loans	10,553.7	7,247.8	3,306.0	3,618.2	-3,259.2	6,877.3
Currency and deposits	2,595.1	598.5	1,996.6	4,139.4	6,965.9	-2,826.6
Capital account	-467.6			-421.7		
Changes in reserve assets	-21,528.8			-5,796.9		
Errors and omissions	-2,388.4			134.8		

- Notes:
1. Negative figures show capital outflow. Capital outflow of assets means an outward investment by residents and an increase in reserve assets, whereas capital outflow of liabilities means the withdrawal of inward investment by nonresidents.
 2. Figures 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 46: Outward and Inward Direct Investment¹

	2001		02		03		03				Avg. in the 1990s
							Jan.—June		July—Dec.		
	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	-4,658.6	+37.0	-4,047.6	-13.1	-3,348.3	-17.3	-1,477.6	-37.4	-1,870.6	+10.9	-3,077.9
Inward direct investment	758.5	-15.4	1,158.5	+52.7	752.5	-35.0	466.0	-41.5	286.4	-20.7	318.6
Inward/outward (%)	16.3		28.6		22.5		31.5		15.3		10.4

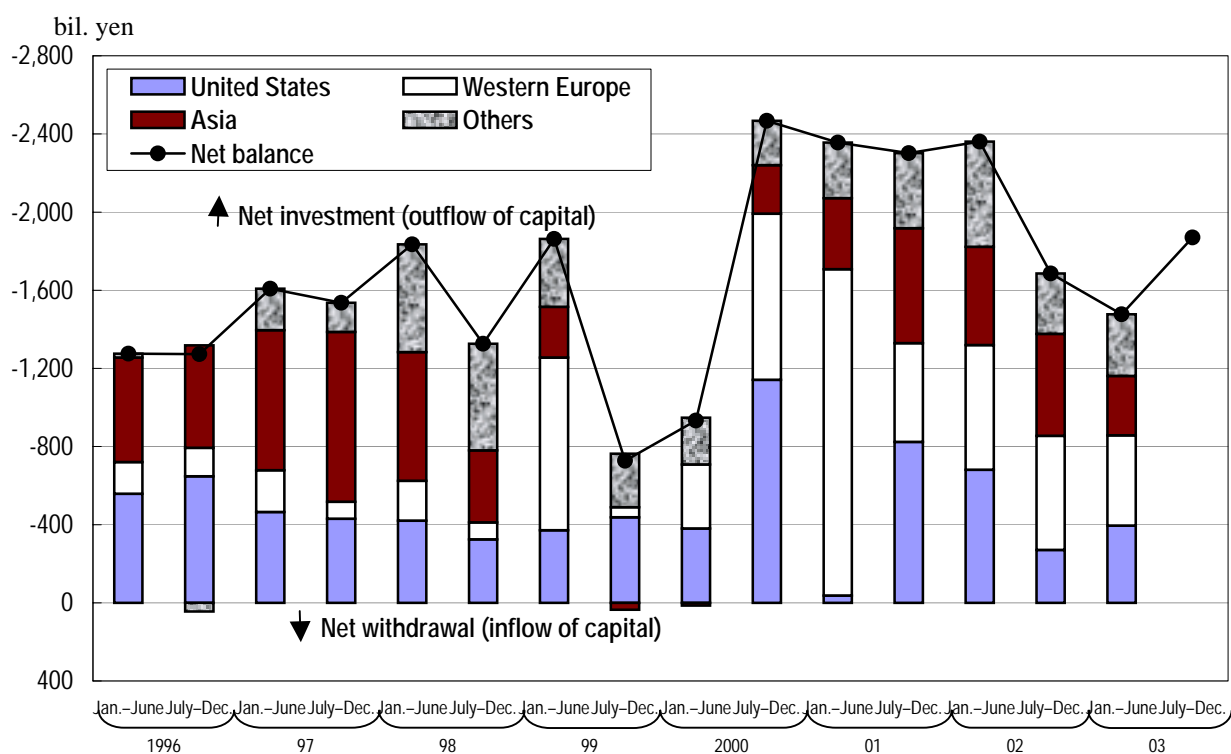


Note: 1. Shaded area shows outward direct investment on the basis, excluding financial assistance, etc., extended to subsidiaries overseas calculated by Balance of Payments Division, International Department, Bank of Japan.

Chart 47: Outward Direct Investment (By Region)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.	–270.2	–584.8	–521.7	–309.8	–1,686.5
03	Jan.–June	–395.1	–462.1	–304.0	–316.4	–1,477.6
	July–Dec.	n.a.	n.a.	n.a.	n.a.	–1,870.6



Note: 1. Negative figures show a net outflow of capital.

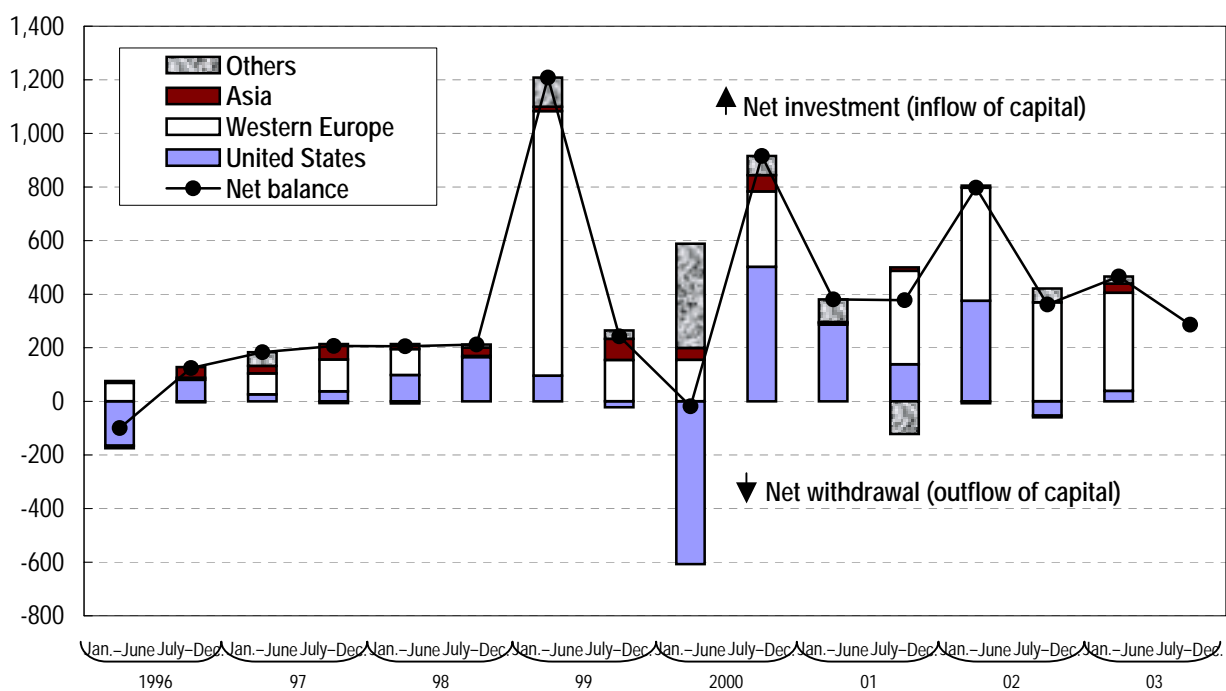
A breakdown of figures for the second half of 2003 is scheduled to be released in June 2004.

Chart 48: Inward Direct Investment (By Region)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.	–53.6	369.5	–6.9	52.3	361.3
03	Jan.–June	39.5	366.6	34.3	25.6	466.0
	July–Dec.	n.a.	n.a.	n.a.	n.a.	286.4

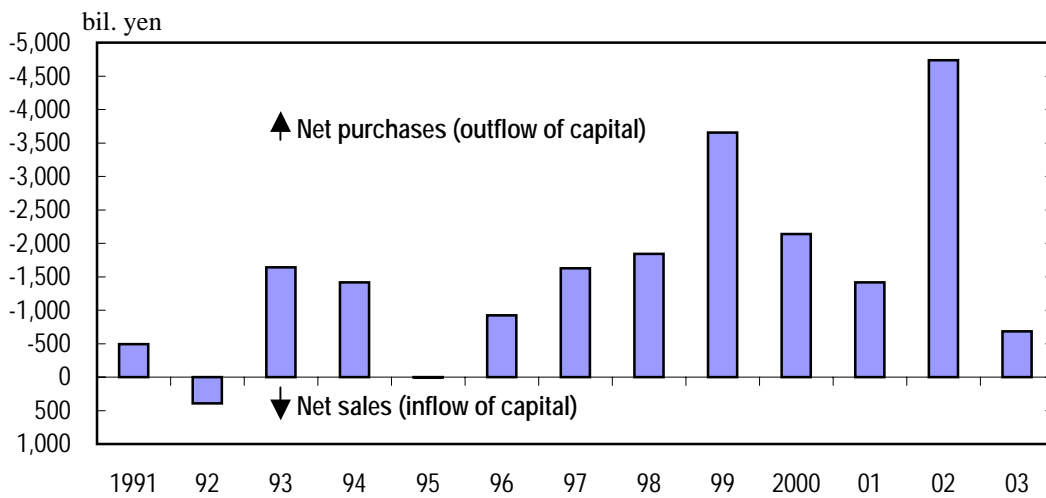
bil. yen



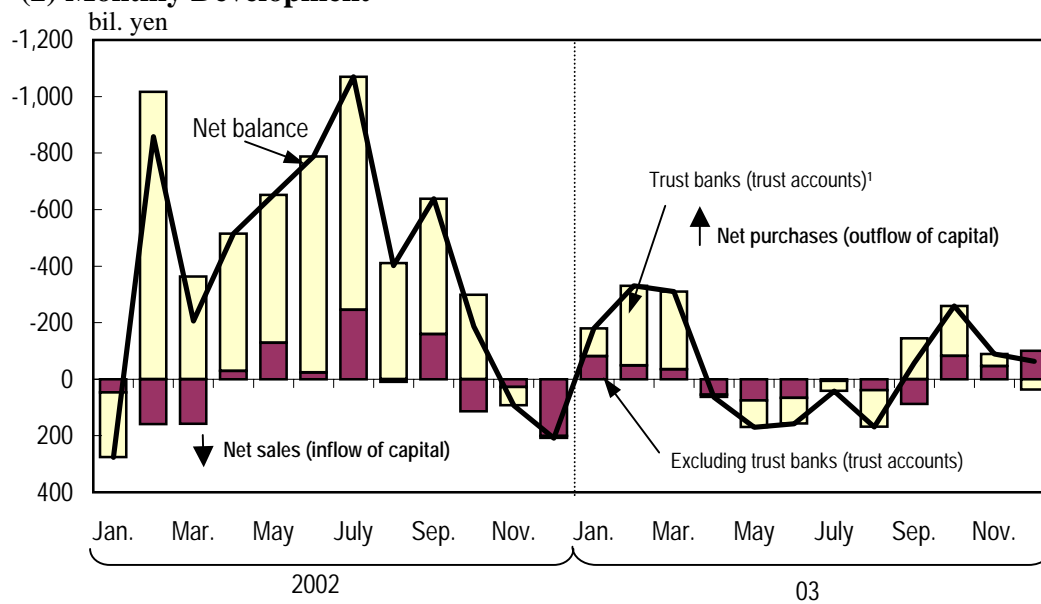
Note: 1. Negative figures show a net outflow of capital.

A breakdown of figures for the second half of 2003 is scheduled to be released in June 2004.

Chart 49: Outward Investment in Equities
(1) Annual Development



(2) Monthly Development



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 Ministry of Finance.

Chart 50: Stock Prices in Major Markets

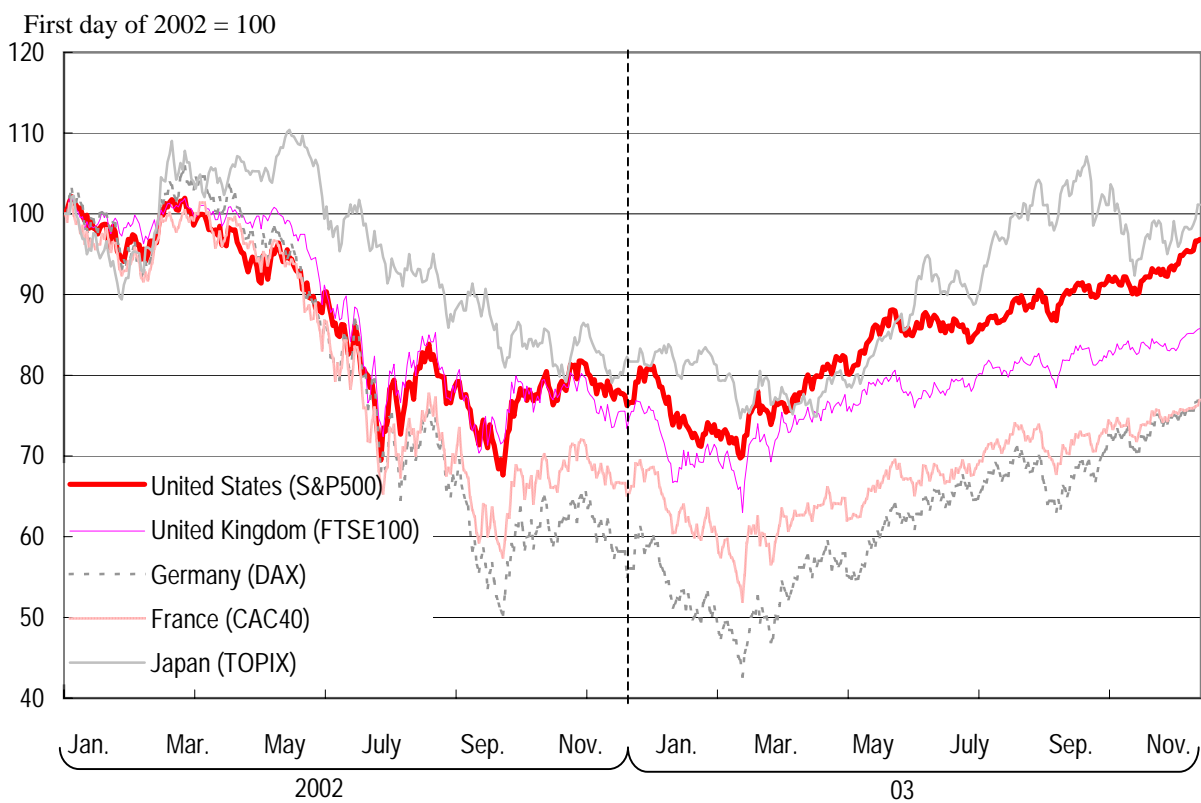


Chart 51: Outward Investment in Equities (By Sector)¹

bil. yen

	2000	01	02	03
Life insurance companies	93.1	519.8	397.2	309.5
Trust banks ²	-1,883.7	-1,369.1	-4,862.3	-619.1
Investment trusts	-282.5	-374.0	-391.1	-269.7
Banks ³	-100.5	37.3	140.4	-61.7
Others ⁴	-52.2	-295.2	218.2	-39.5

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.

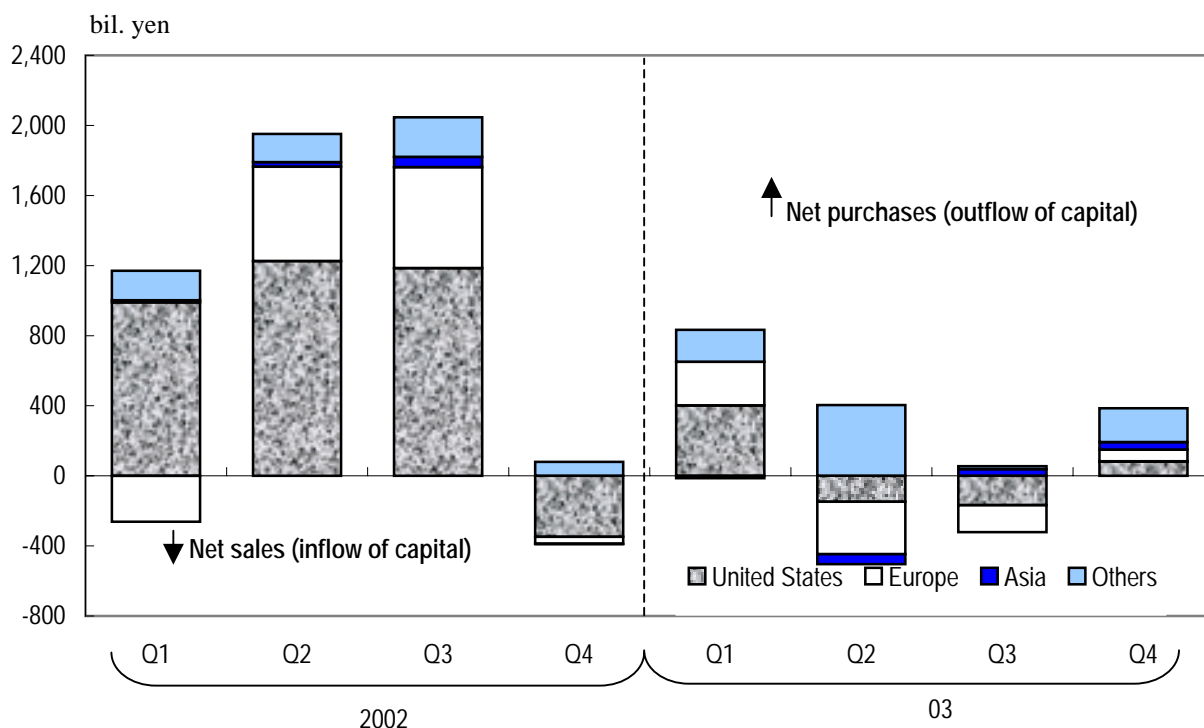
Source: Ministry of Finance, “Securities Investment at Home and Abroad (settlement basis).”

[Reference] Comparison of the Definitions in the Balance of Payments and Securities Investment at Home and Abroad¹

	<i>Balance of Payments</i>	<i>Securities Investment at Home and Abroad</i>
Criteria for determining inward/outward investment	<u>Issuer</u> : residents/nonresidents	<u>Denomination of securities</u> : foreign currency/yen
Outward portfolio investment	Residents’ sales and purchases of <u>securities issued by nonresidents</u>	Residents’ sales and purchases of <u>securities denominated in foreign currency (including Euroyen)</u>
Inward portfolio investment	Nonresidents’ sales and purchases of <u>securities issued by residents</u>	Nonresidents’ sales and purchases of <u>securities denominated in yen</u>

Note: 1. 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, if a nonresident purchases securities denominated in yen (*samurai* bonds) issued by a nonresident from a resident (in other words, a sale by a resident to a nonresident), the transaction is recorded under “outward portfolio investment” as a sale by a resident of securities issued by a nonresident in the *Balance of Payments*. 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.

Chart 52: Outward Investment in Equities (By Region)¹



bil. yen

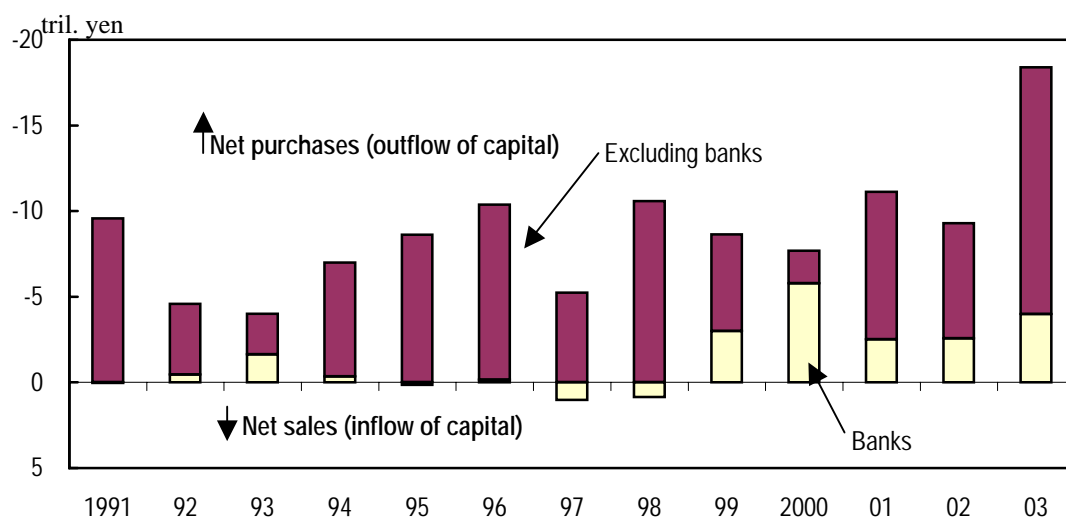
	2000	01	02	03	IIP ⁴ (end of 2002)
United States	-1,133.9	-1,499.8	-3,051.8	-168.9	13,014.8
Europe ²	-654.0	393.4	-846.3	138.3	8,236.7
Of which	95.8	174.8	-58.7	-54.3	590.2
Germany					
France	7.1	-228.8	-55.1	4.9	1,029.9
United Kingdom	-344.8	-131.8	-441.2	82.2	3,182.8
Asia ³	-156.0	29.4	-93.1	-8.8	622.6
Cayman Islands	-140.7	-250.5	-411.5	-324.1	1,988.3

- Notes:
1. Negative figures show a net outflow of capital.
 2. Figures are the total for the 15 member countries of the European Union 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 53: Outward Investment in Bonds and Notes (By Sector)¹

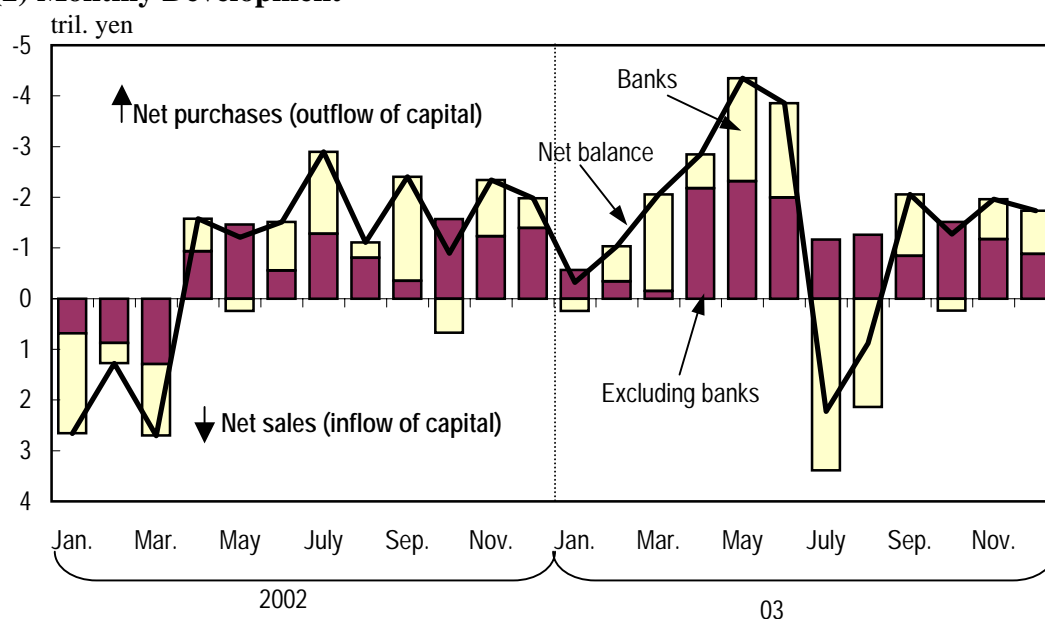
(1) Annual Development



bil. yen

	2000	01	02	03	IIP ³ (end of 2002)
Investment in foreign bonds and notes	-7,692.3	-11,130.0	-9,291.2	-18,807.0	136,149.0
Public sector ²	417.8	1,509.2	1,807.1	812.4	5,626.0
Banks ²	-5,783.2	-2,519.6	-2,568.2	-3,722.1	40,989.0
Other sectors ²	-2,326.9	-10,119.6	-8,530.0	-15,897.3	89,533.0

(2) Monthly Development



- Notes:
1. Negative figures show a net outflow of capital.
 2. 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 depository 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). IIP includes figures for issuance and redemption of bonds and notes issued in Japan by nonresidents.

Chart 54: Long-Term Interest Rates in Major Markets (10-Year Government Bonds)



Chart 55: Issuance and Redemption of Bonds and Notes Issued in Japan by Nonresidents

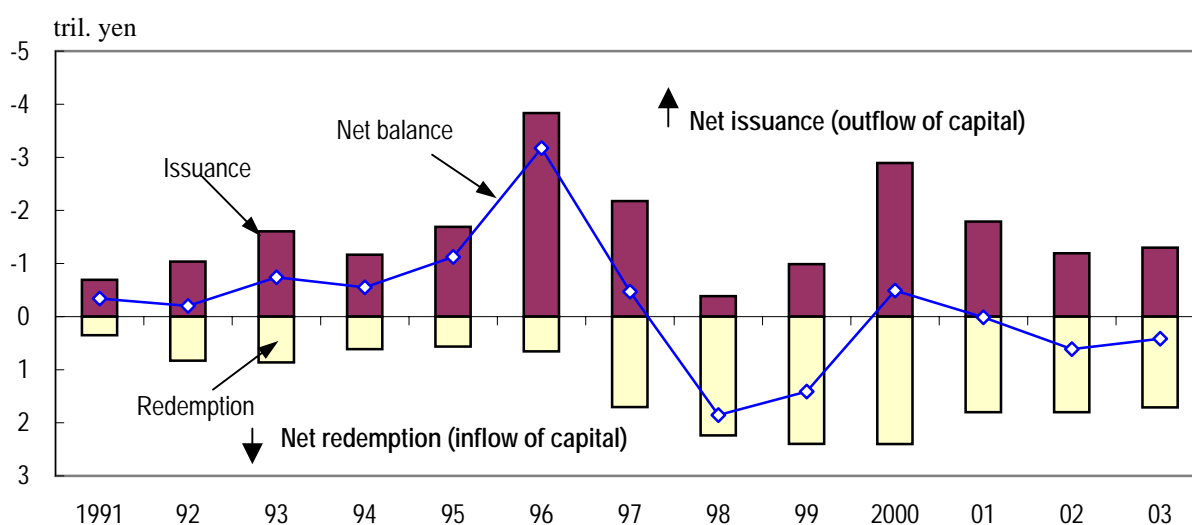


Chart 56: Outward Investment in Bonds and Notes (By Sector)¹

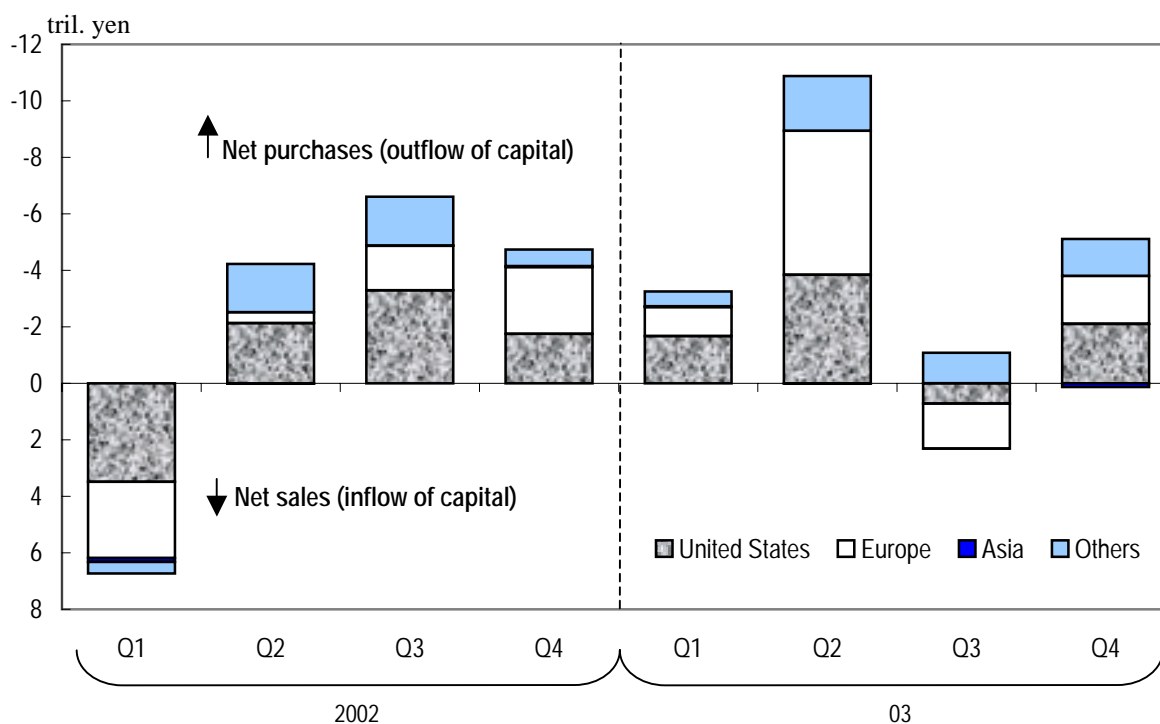
bil. yen

	2000	01	02	03
Life insurance companies	-48.0	-4,579.2	-1,082.8	-5,541.7
Trust banks ²	-919.3	-550.4	-11,367.9	34.7
Banks ³	-6,085.1	-4,568.6	-4,152.1	-4,651.6
Investment trusts	1,419.3	-1,340.6	-763.3	-3,195.5
Public sector ⁴	--	--	1,983.9	887.7
Others ⁵	33.1	-568.9	-3,824.4	-4,702.9

- 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 exclude management of reserve assets, and its large portion is that of governmental financial institutions.
 5. 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 57: Outward Investment in Bonds and Notes (By Region)¹



bil. yen

	2000	01	02	03	IIP ⁴ (end of 2002)
United States	-1,240.1	-4,395.3	-3,690.3	-6,901.9	45,008.5
Europe ²	-3,051.4	-2,371.6	-1,621.1	-6,227.4	54,542.1
Of which	-1,309.2	-122.7	1,295.9	-1,882.6	13,707.3
Germany					
France	-603.7	-1,363.6	-518.4	-897.2	6,799.8
United Kingdom	358.1	162.1	645.6	-576.8	7,599.7
Asia ³	58.3	62.8	106.6	129.0	1,143.6
Cayman Islands	-2,017.3	-2,177.0	-2,385.8	-2,005.3	17,114.2

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

2. Figures are the total for the 15 member countries of the European Union and Switzerland.

3. Figures are the total for Hong Kong, South Korea, Thailand, Malaysia, and Singapore.

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

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

Chart 58: Outward Investment in Money Market Instruments

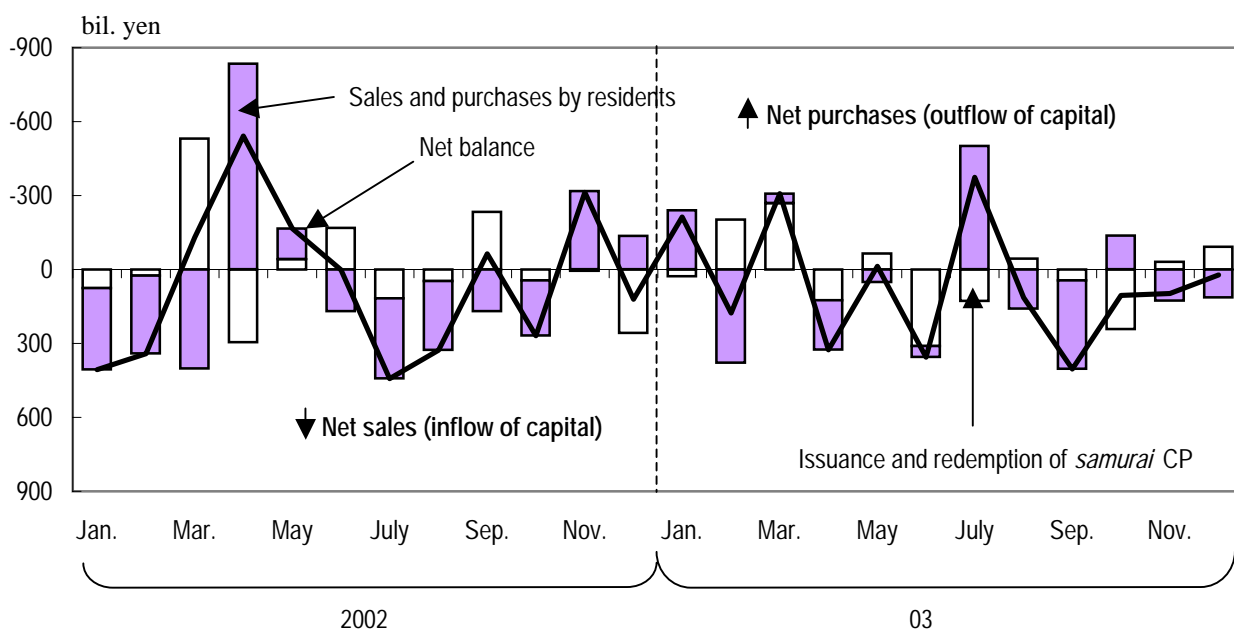
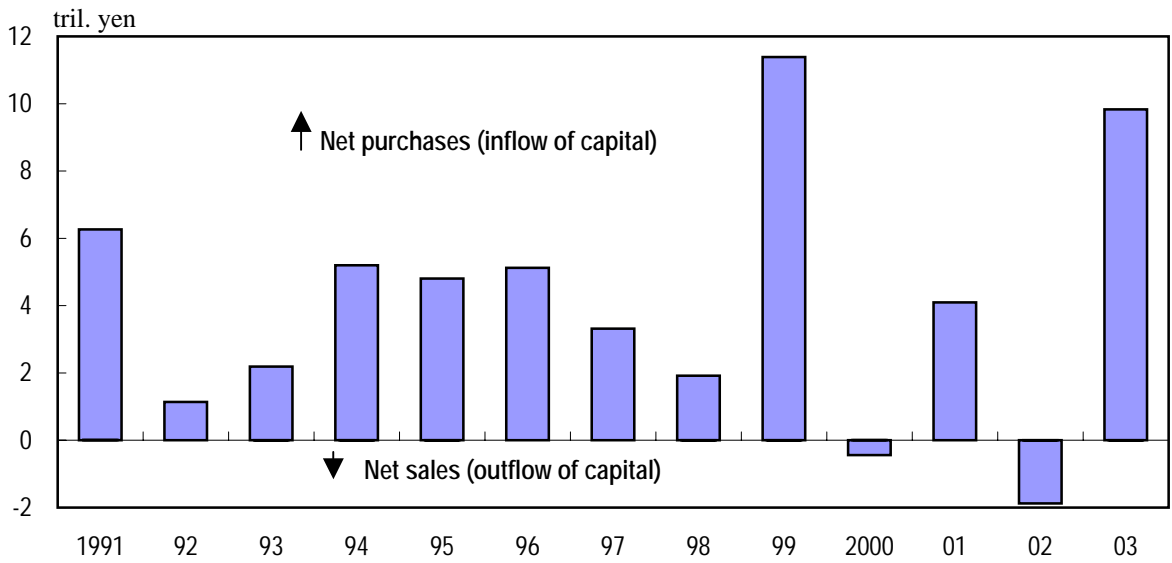


Chart 59: Inward Investment in Equities

(1) Annual Development



(2) Monthly Development

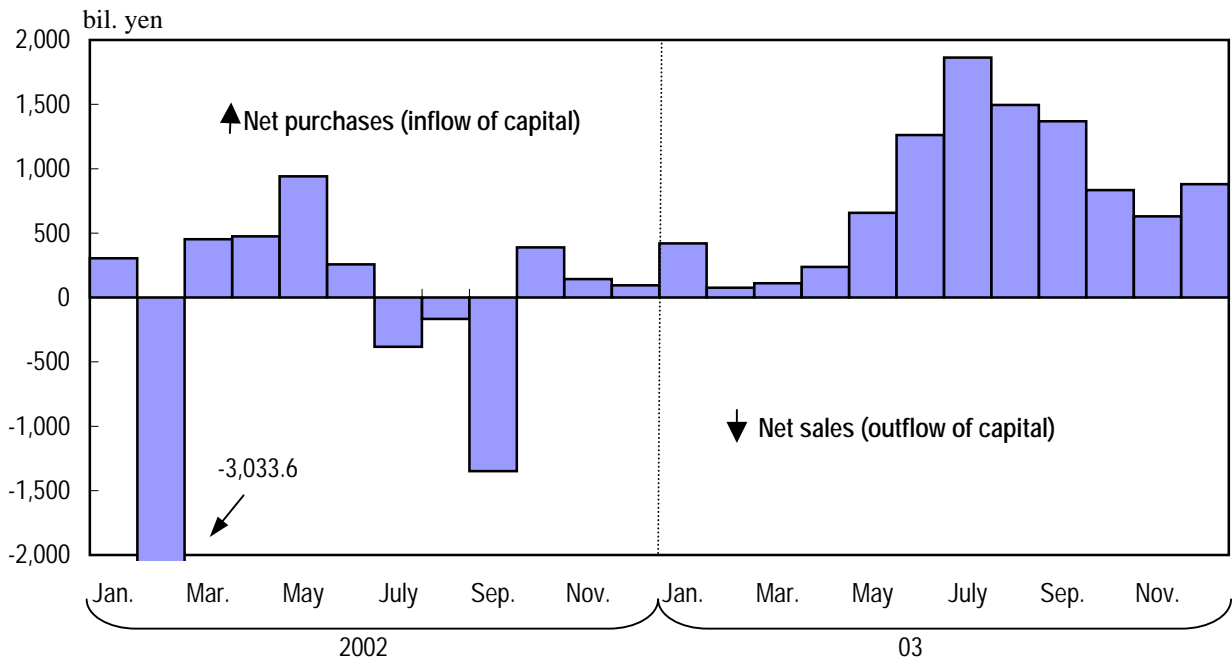
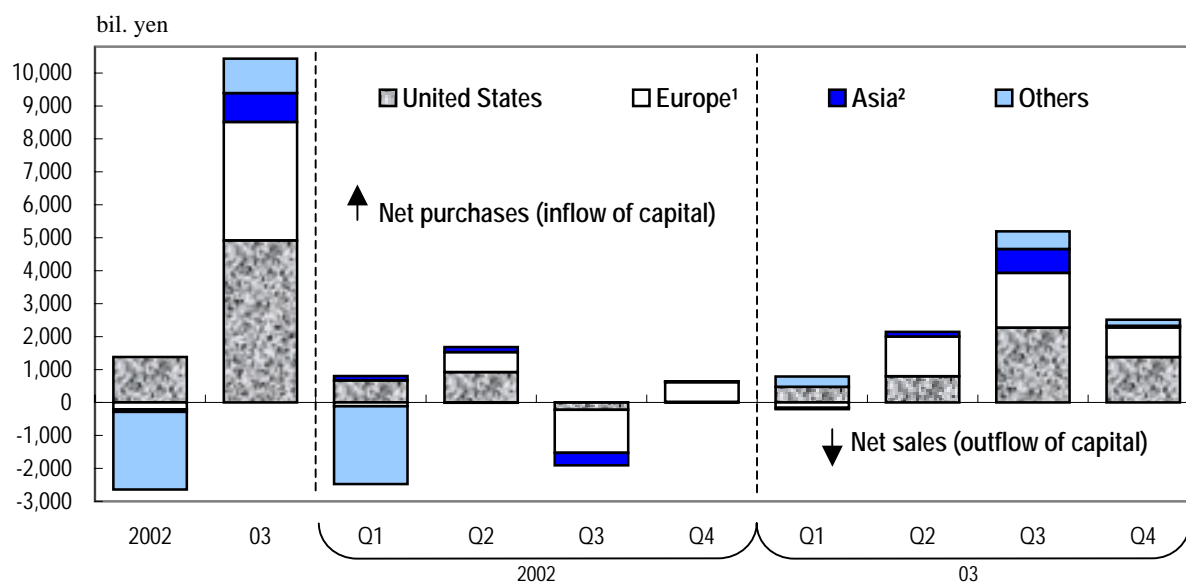


Chart 60: TOPIX (U.S. Dollar Basis)¹



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

Chart 61: Inward Investment in Equities (By Region)



Notes: 1. Figures are the total for the 15 member countries of the European Union 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: Inward Investment in Equities in 2003 (By Industry)

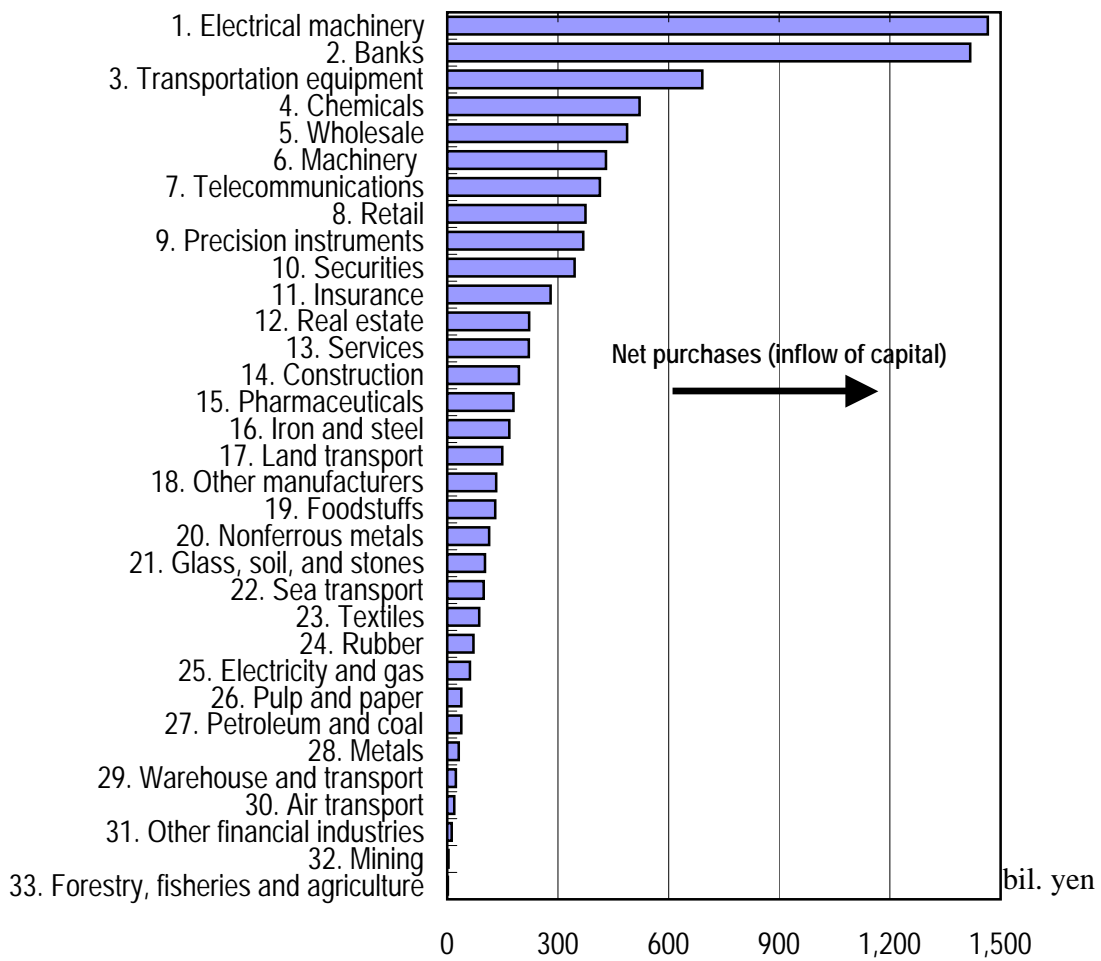
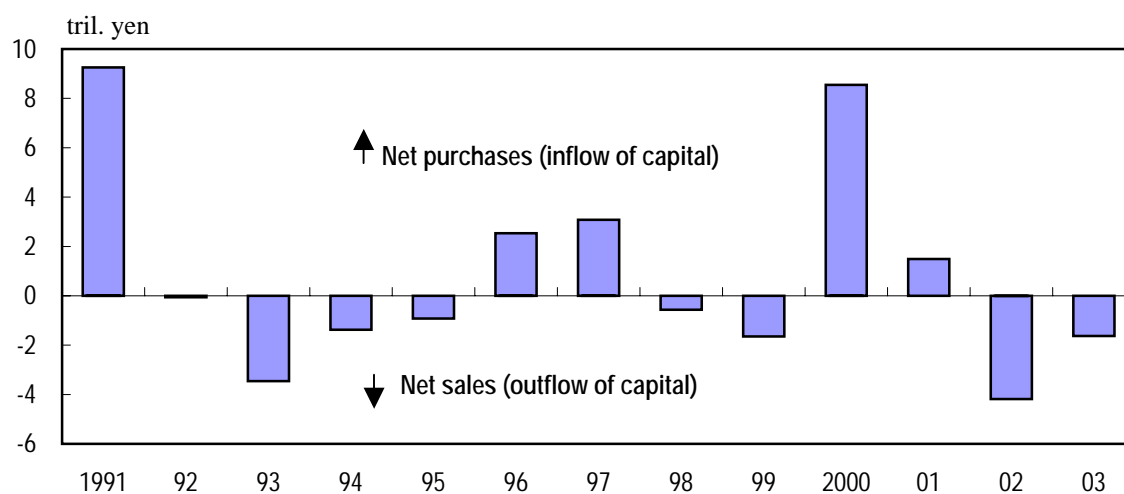


Chart 63: Inward Investment in Bonds and Notes

(1) Annual Development



(2) Monthly Development

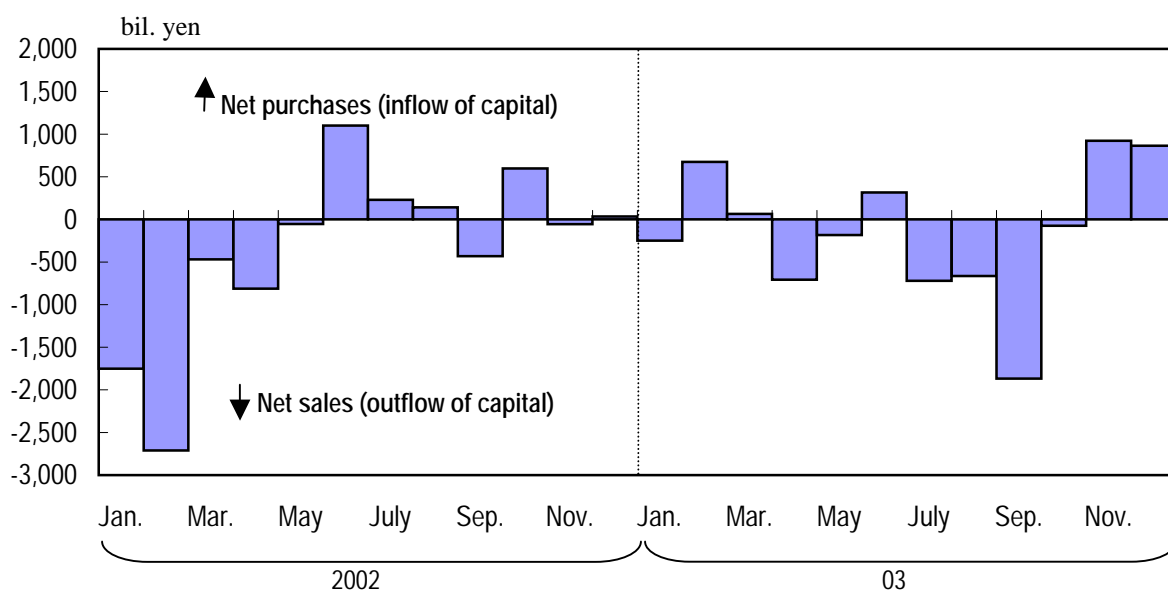
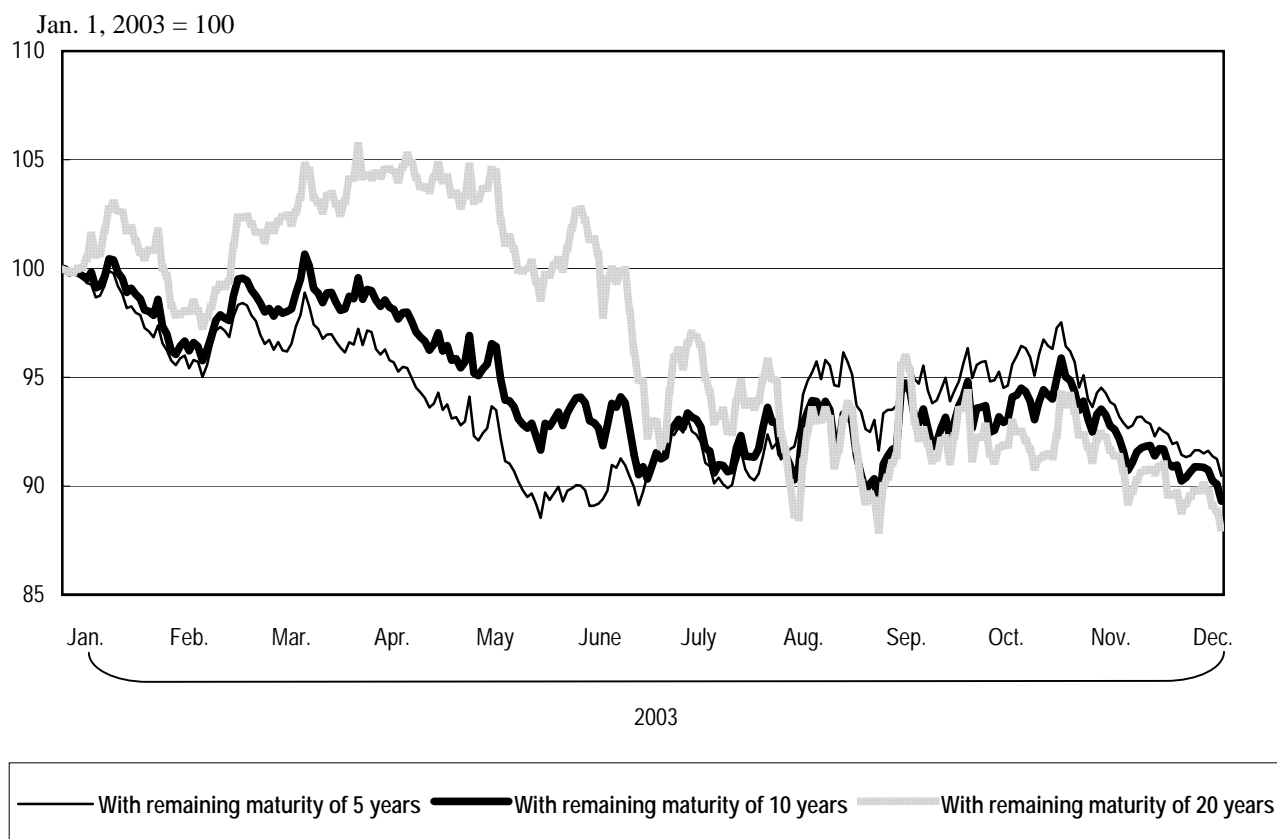


Chart 64: Performance of Japanese Government Bonds (Euro Basis)¹

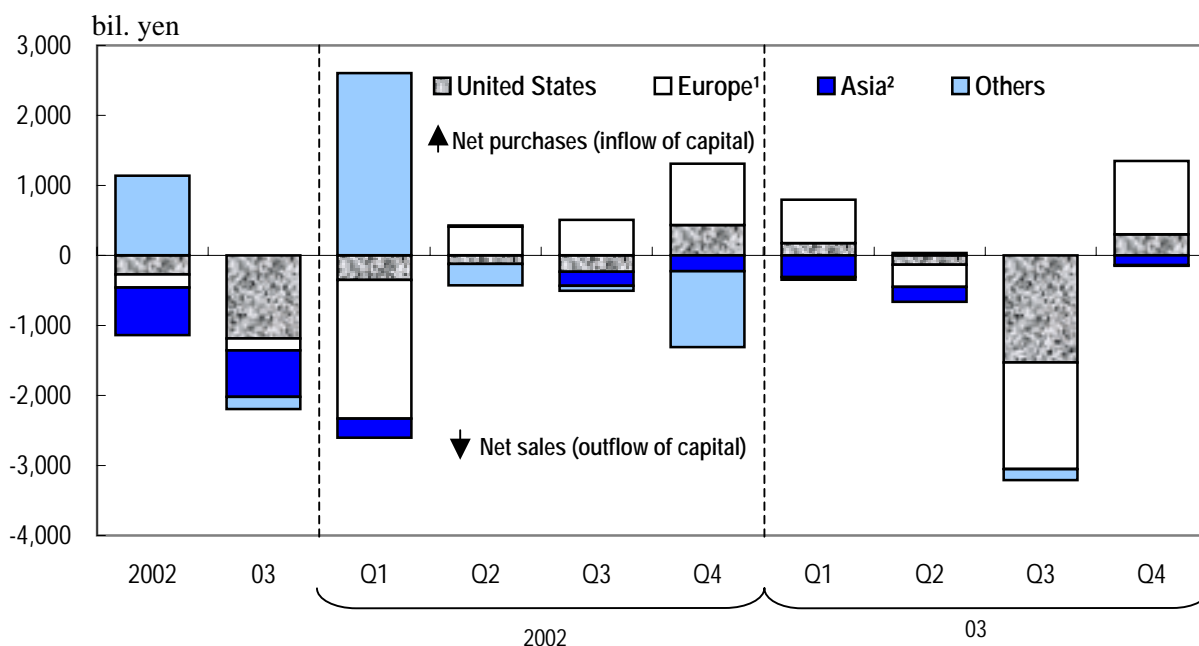


Note: 1. Performance is measured on the assumption that 100 euros were invested on January 1, 2003, excluding reinvestment of coupons.

Issues used in this chart are the 200th and 224th issues of 10-year government bonds, and the 59th issue of 20-year government bonds.

Source: Bloomberg.

Chart 65: Inward Investment in Bonds and Notes (By Region)



Notes: 1. Figures are the total for the 15 member countries of the European Union 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 66: Inward Investment in Money Market Instruments

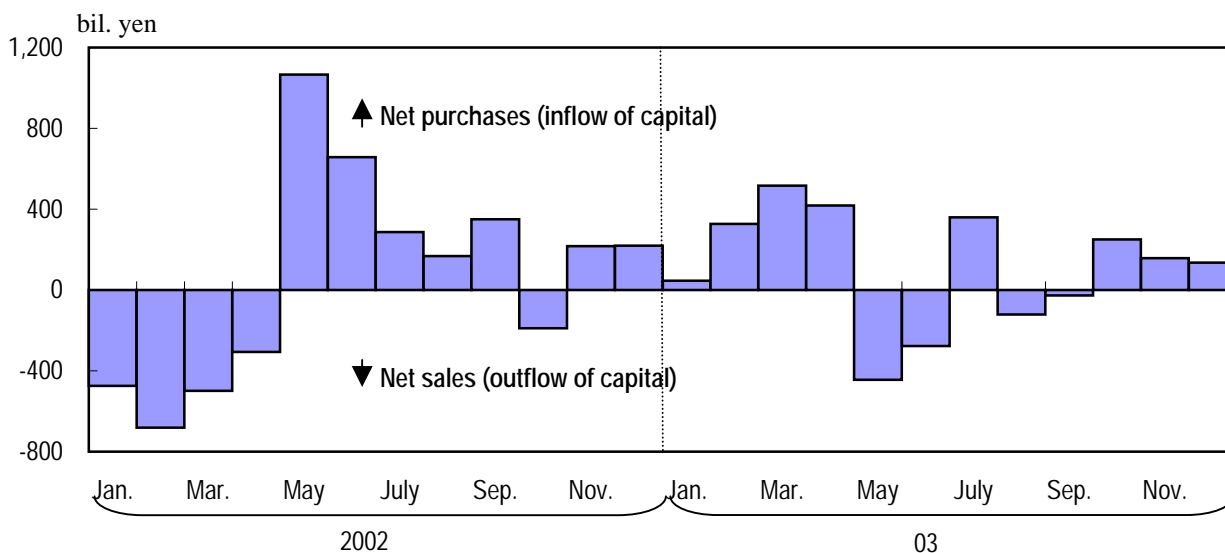


Chart 67: Financial Derivatives

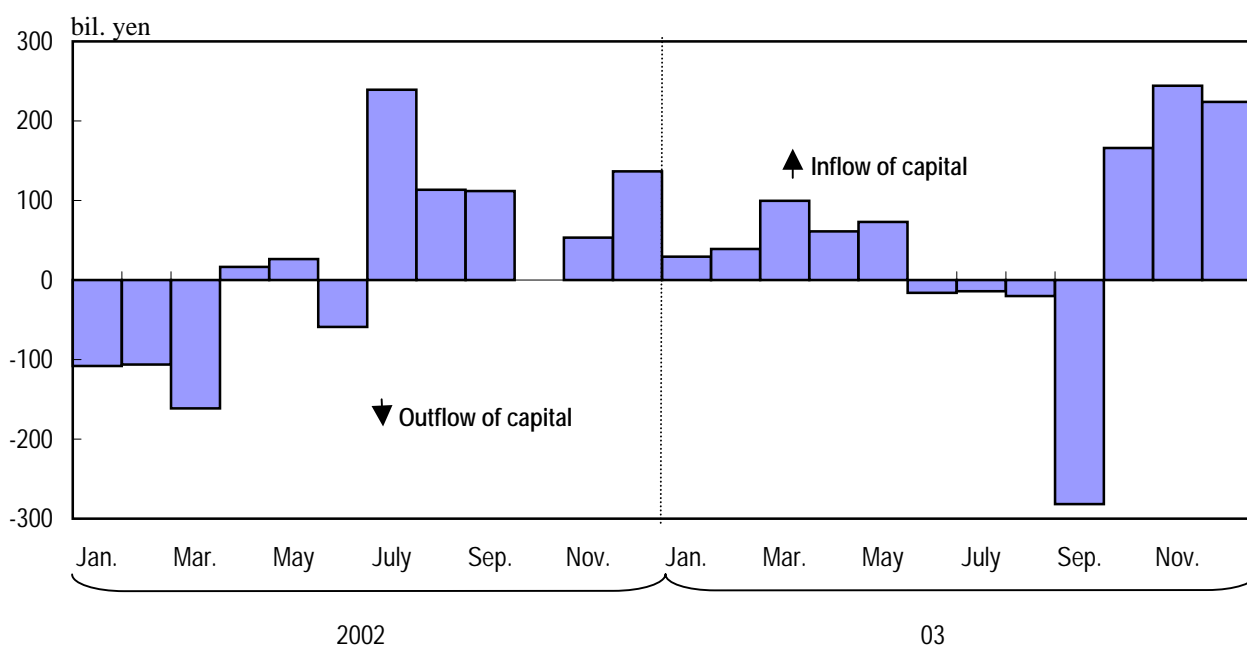


Chart 68: Other Investment (By Investor)

Monthly Development

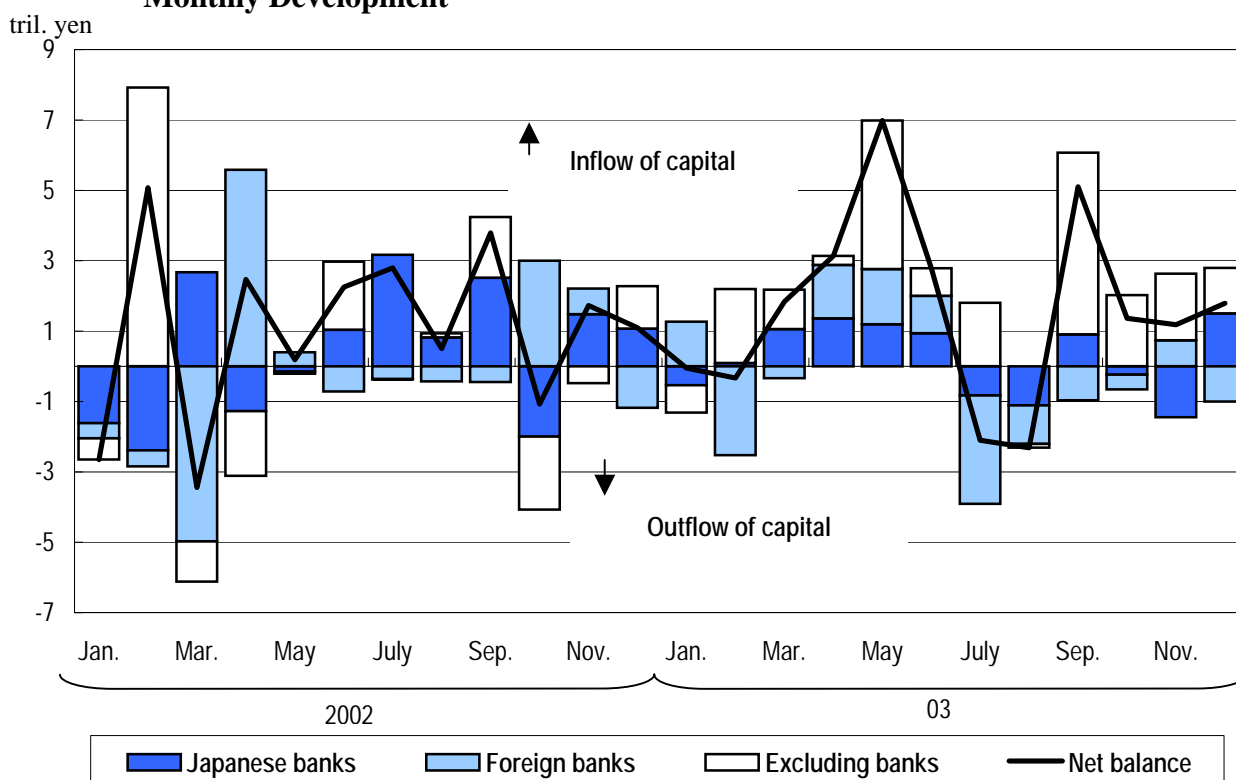


Chart 69: Other Investment (By Item)

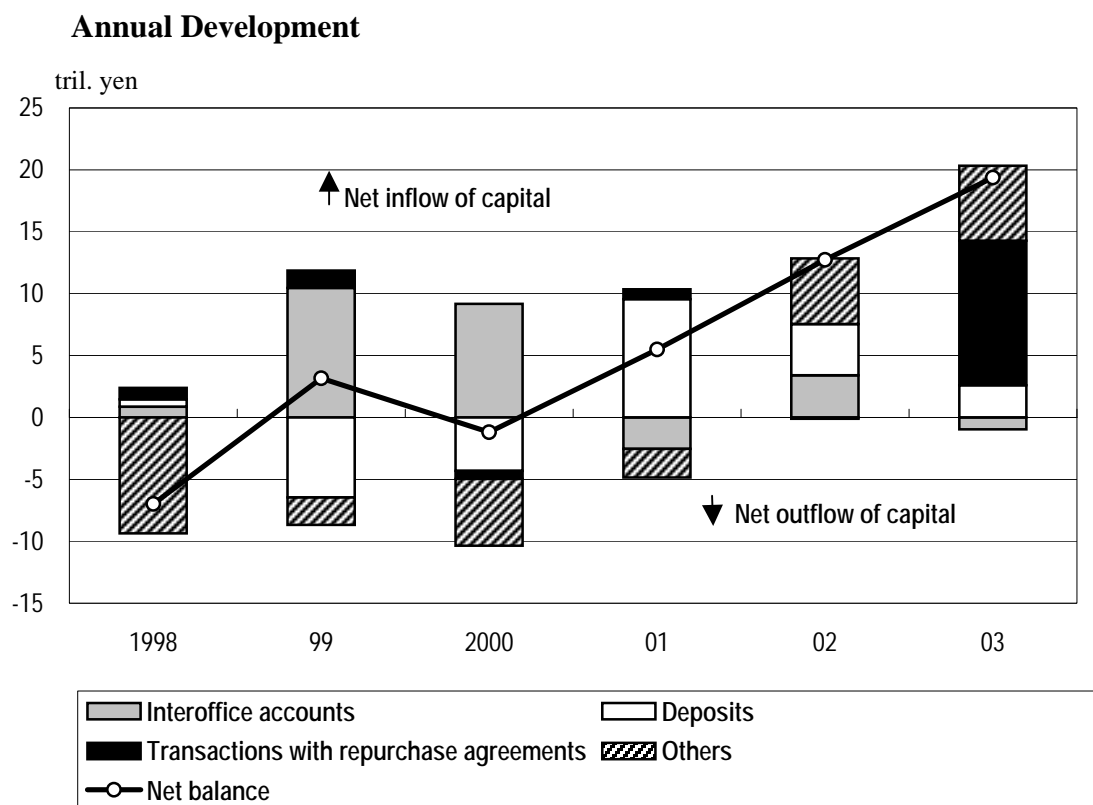


Chart 1 for Box 1

(1) Share in Overall Exports by Area

%

	1990	96	2002	03
Asia	31.1	44.0	43.1	46.4
China	2.1	5.3	9.6	12.2
Nies	19.7	24.7	22.7	23.5
ASEAN	11.5	17.8	13.4	13.0
United States	31.5	27.2	28.5	24.6
European Union	18.7	15.3	14.7	15.3
Oceania	3.1	2.4	2.5	2.6
Middle East	3.0	2.4	2.7	2.7
Others	12.6	8.7	8.5	8.4

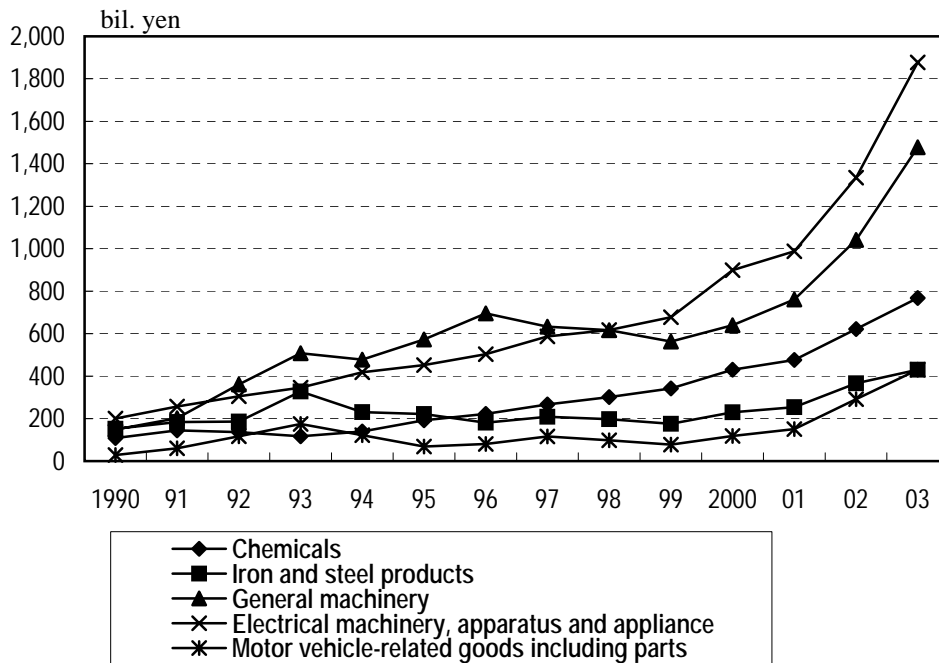
(2) Share in Overall Imports by Area

%

	1990	96	2002	03
Asia	28.7	37.4	43.5	44.5
China	5.1	11.6	18.3	19.7
NIEs	11.1	11.7	10.5	10.2
ASEAN	12.4	15.0	15.3	15.3
United States	22.4	22.7	17.1	15.4
European Union	15.0	14.1	13.0	12.8
Oceania	6.3	5.1	4.9	4.6
Middle East	13.1	10.1	12.1	13.4
Others	14.5	10.5	9.4	9.3

Chart 2 for Box 1

(1) Exports to China by Item



(2) Imports from China by Item

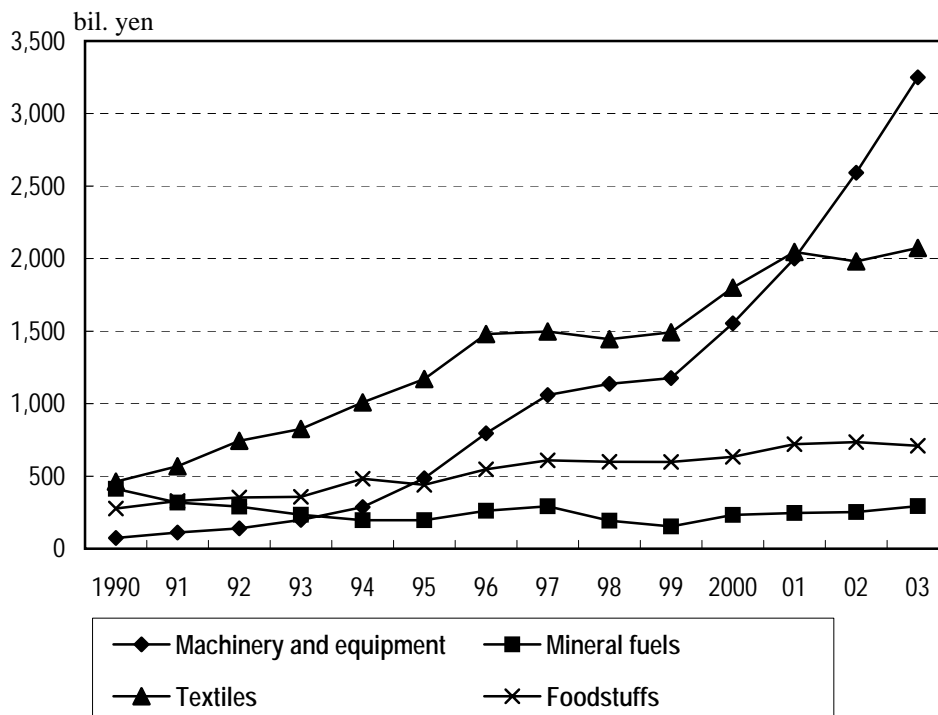
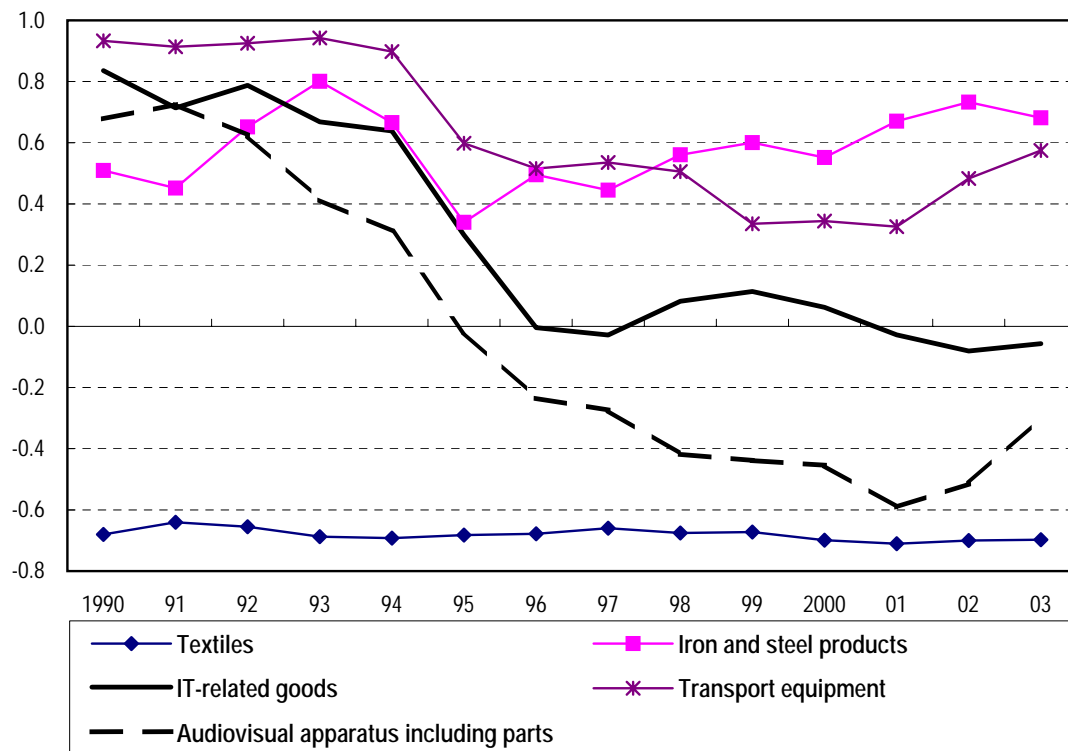


Chart 3 for Box 1: Trade Specialization Coefficient by Item in Trade with China¹



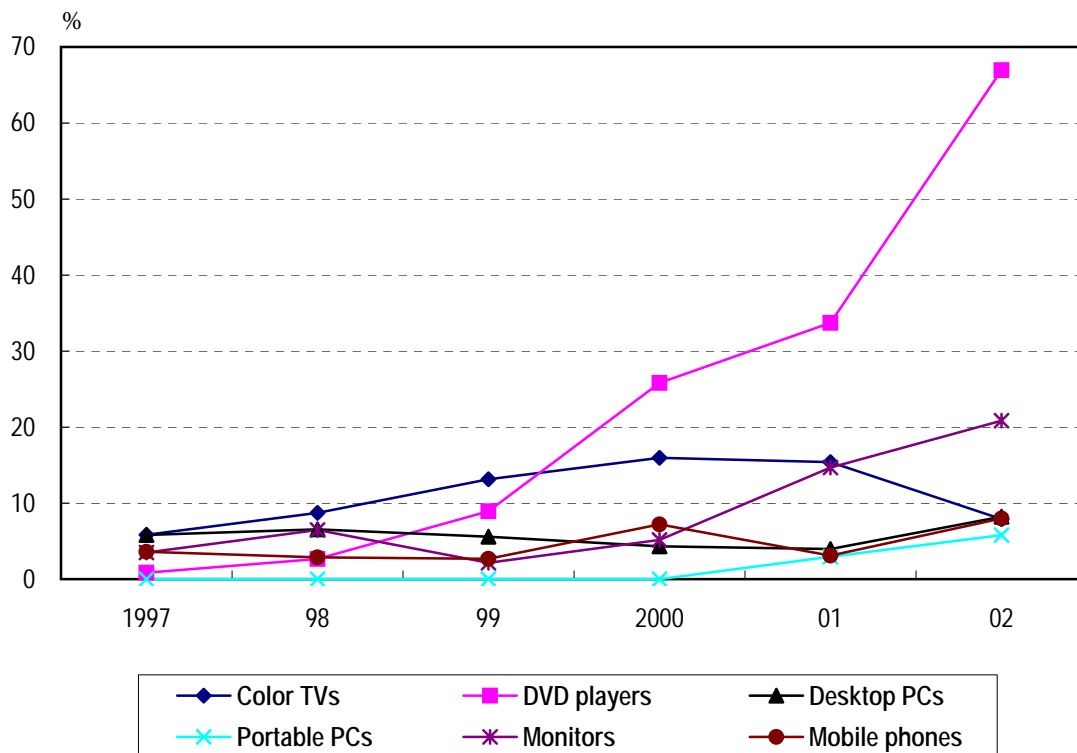
Note: 1. Trade specialization coefficient = (export value - import value)/(export value + import value) x 100.

Chart 4 for Box 1: Share of Major Items in Japan's Trade of Office Machines with China
(1) Exports to China **(2) Imports from China**

2003	Share (%)
Parts and accessories for PCs	74.1
Liquid crystal displays	8.3
Optical disk devices	6.8
Portable PCs	1.5
Magnetic disk units	1.1

2003	Share (%)
PCs (including portable PCs)	41.8
Parts and accessories for PCs	20.9
Liquid crystal displays	8.7
Printing units	8.1
Other devices for PCs	3.1

Chart 5 for Box 1: Share of Major Items Produced at Production Bases in China by Japanese Manufacturers¹



Note: 1. Figures are based on a world survey of the electronics market conducted by Fuji Chimera Research Institute, Inc. The chart indicates the share of production in China when total production worldwide is assumed to be 100.

Chart 1 for Box 2: Credit in Transportation

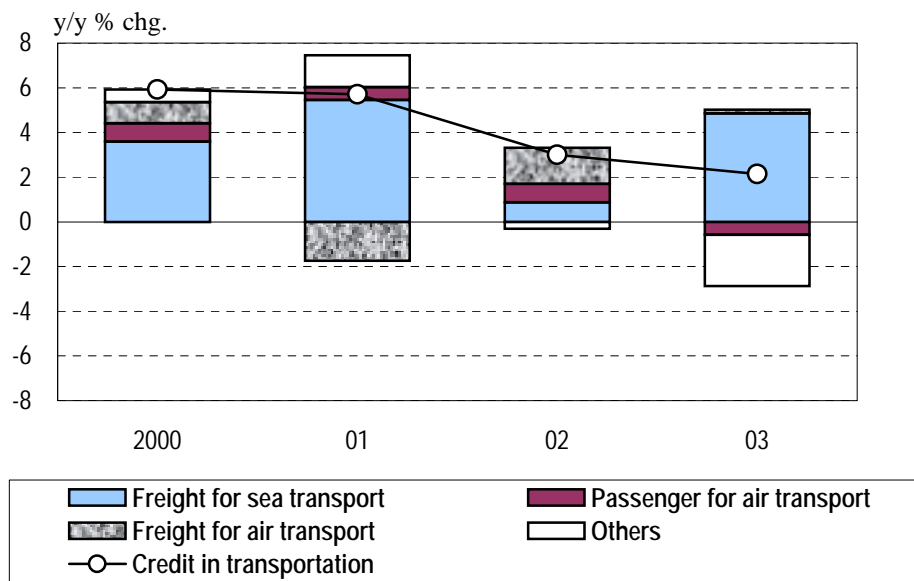
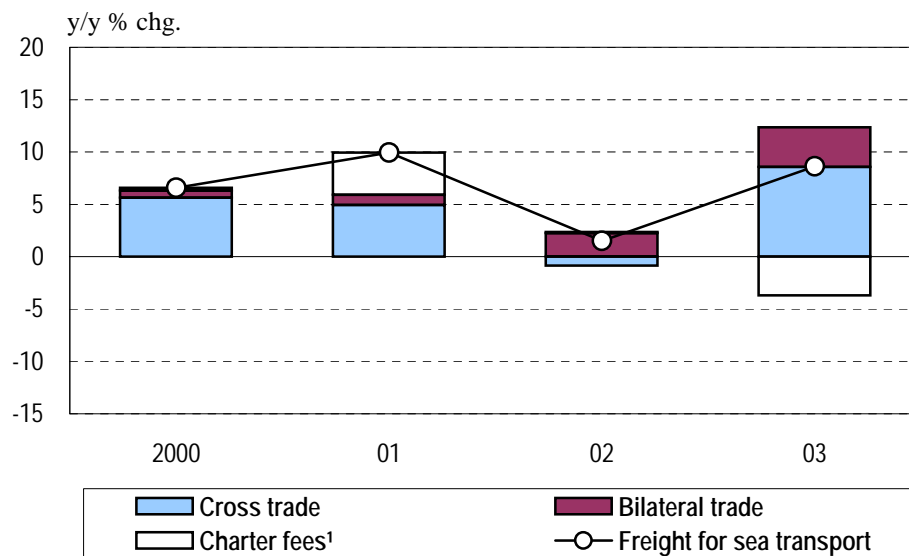
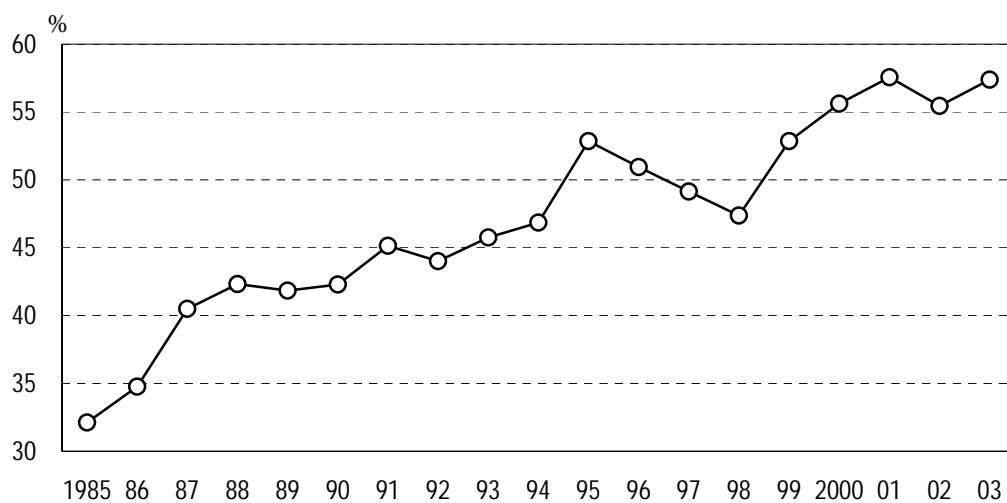


Chart 2 for Box 2: Freight Credit for Sea Transport



Note: 1. Charter fees are paid/received when a shipping company borrows/lends vessels from another company.

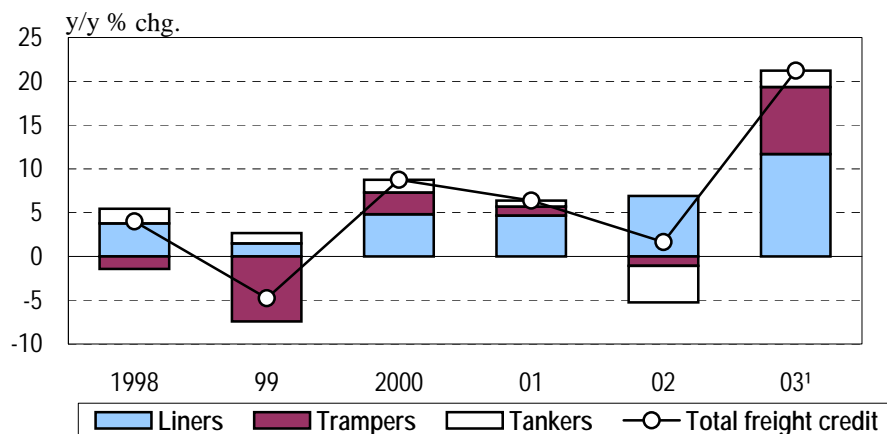
Chart 3 for Box 2: Share of Freight Credit from Cross Trade to Total Freight Credit for Sea Transport in Japan¹



Note: 1. Excluding charter fees.

Source: Ministry of Land, Infrastructure and Transport, "Report on Maritime Affairs."

Chart 4 for Box 2: Breakdown of Freight Credit from Cross Trade

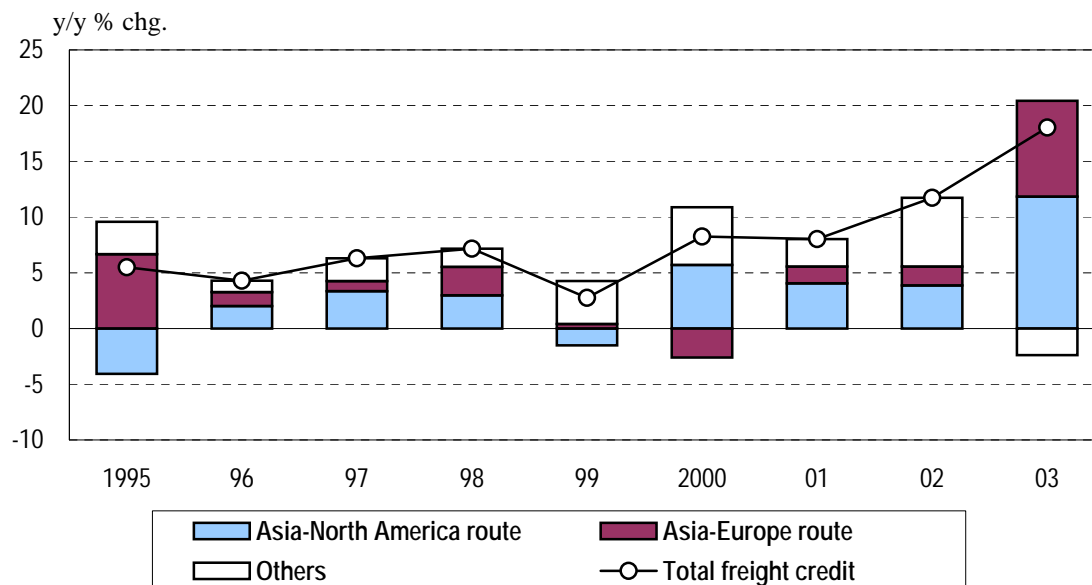


Note: 1. Figures are calculations by Balance of Payments Division, International Department, Bank of Japan.

Calculations are based on estimates of cargo movement of major shipping companies in 2003 and major indices.

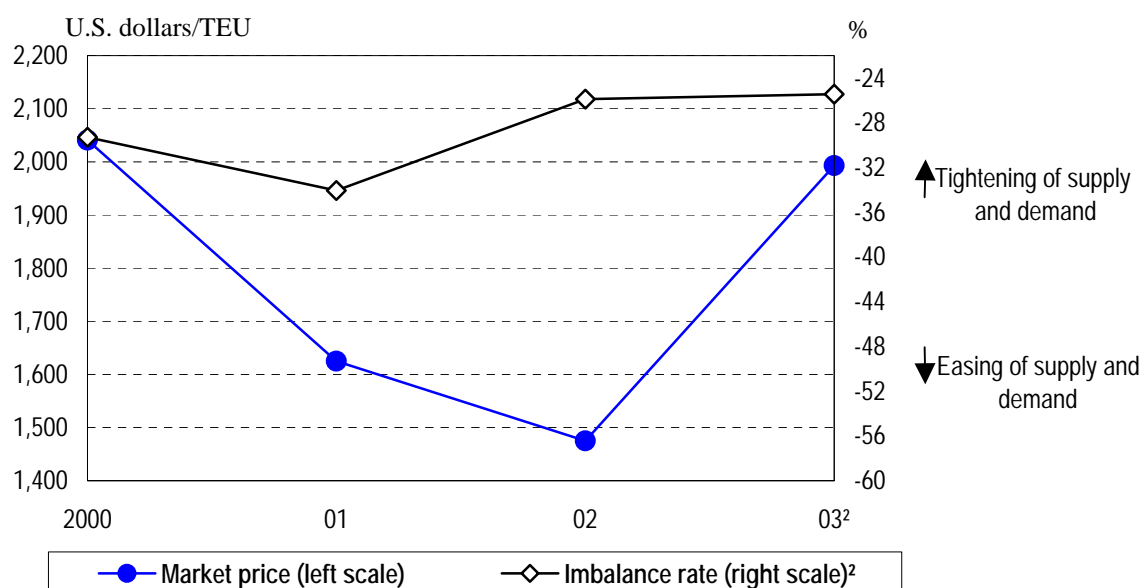
Source: Ministry of Land, Infrastructure and Transport, "Report on Maritime Affairs."

Chart 5 for Box 2: Freight Credit from Cross Trade Using Liners¹



Note: 1. Figures are calculations by Balance of Payments Division, International Department, Bank of Japan.
Calculations are based on estimates of cargo movement of major shipping companies and major indexes.

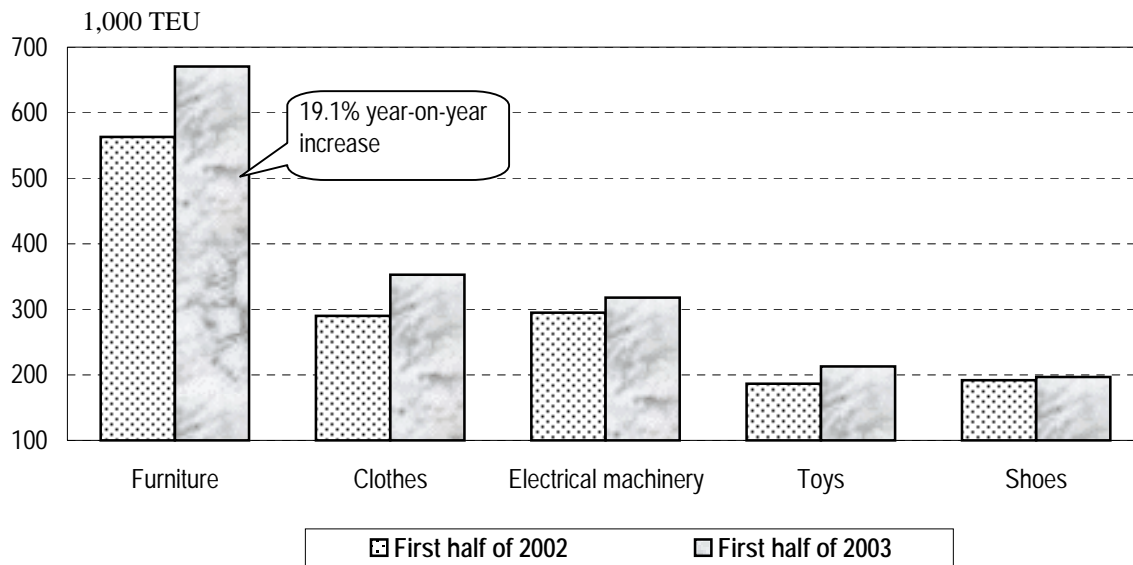
Chart 6 for Box 2: Freight Fares for Ships Bound for North America from Asia¹



Notes: 1. Figures are calculations by Balance of Payments Division, International Department, Bank of Japan.
Calculations are based on estimates of cargo movement of major shipping companies in 2003 and major indexes.
"TEU" denotes "twenty-foot equivalent units."
2. Calculated as (supply volume minus demand volume)/supply volume. Smaller figures show tightening of supply and demand.

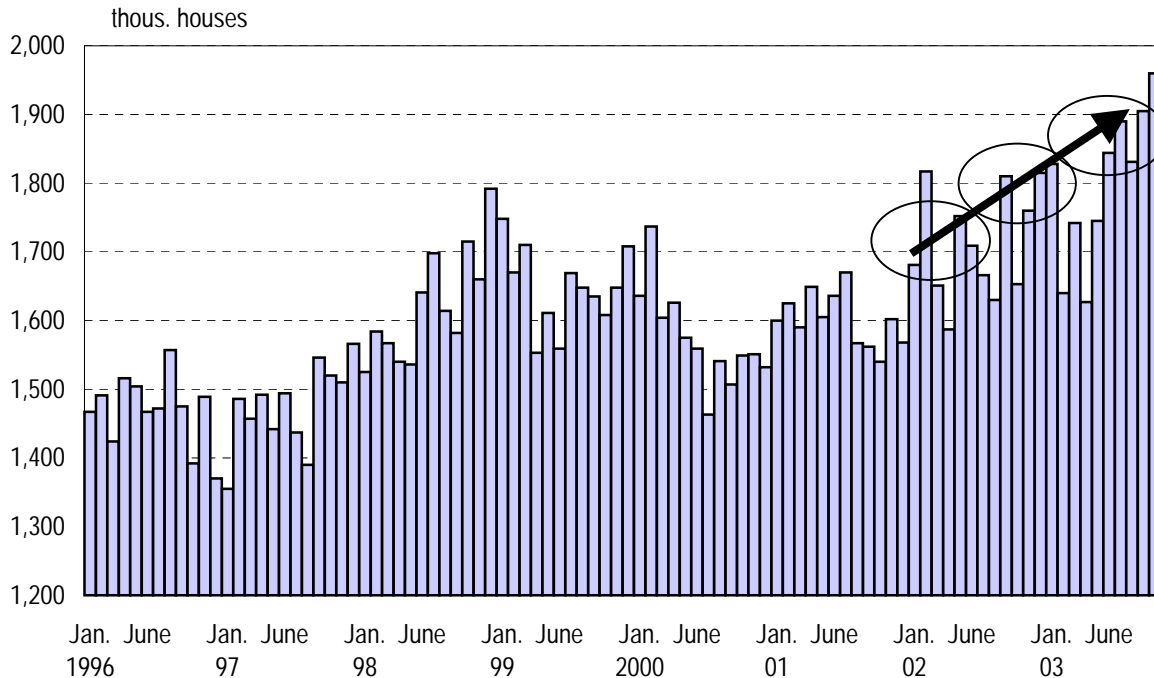
Source: Semiannual closing of accounts of Mitsui O.S.K. Lines, Ltd.

Chart 7 for Box 2: Cargo Movement of Liners Bound for North America from Asia by Goods



Source: Japan Maritime Research Institute.

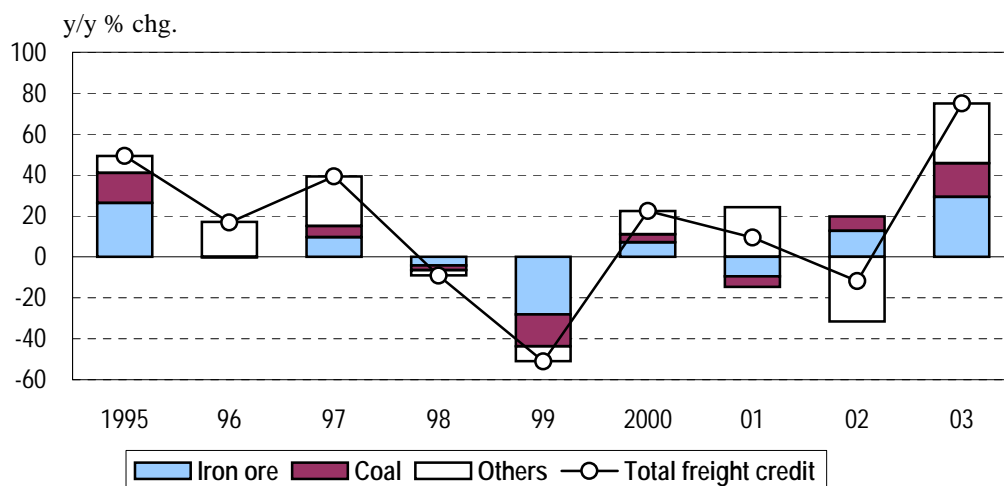
Chart 8 for Box 2: Housing Starts in the United States¹



Note: 1. Figures are on an annualized and seasonally adjusted basis.

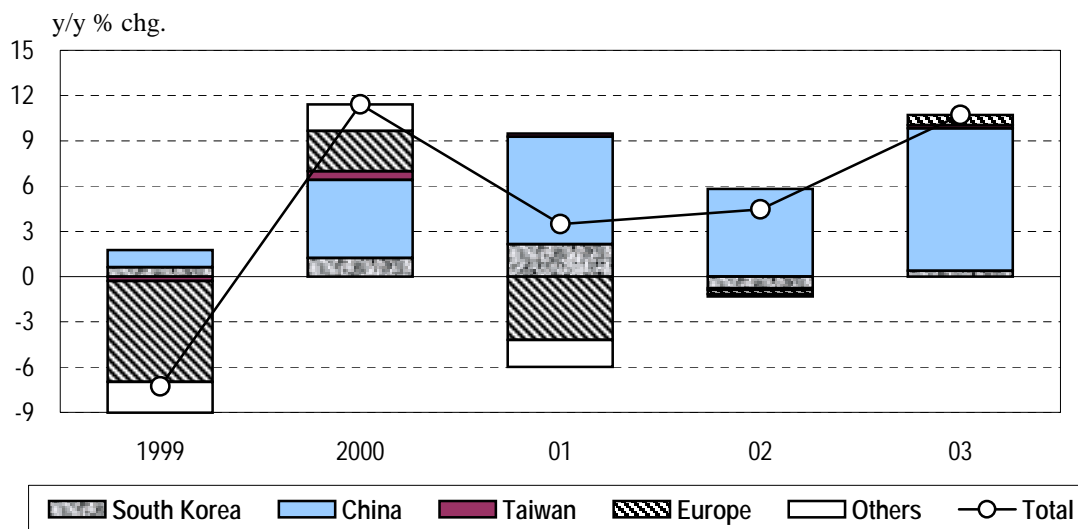
Source: U.S. Department of Commerce, "Housing Starts."

Chart 9 for Box 2: Freight Credit from Cross Trade Using Trampers¹



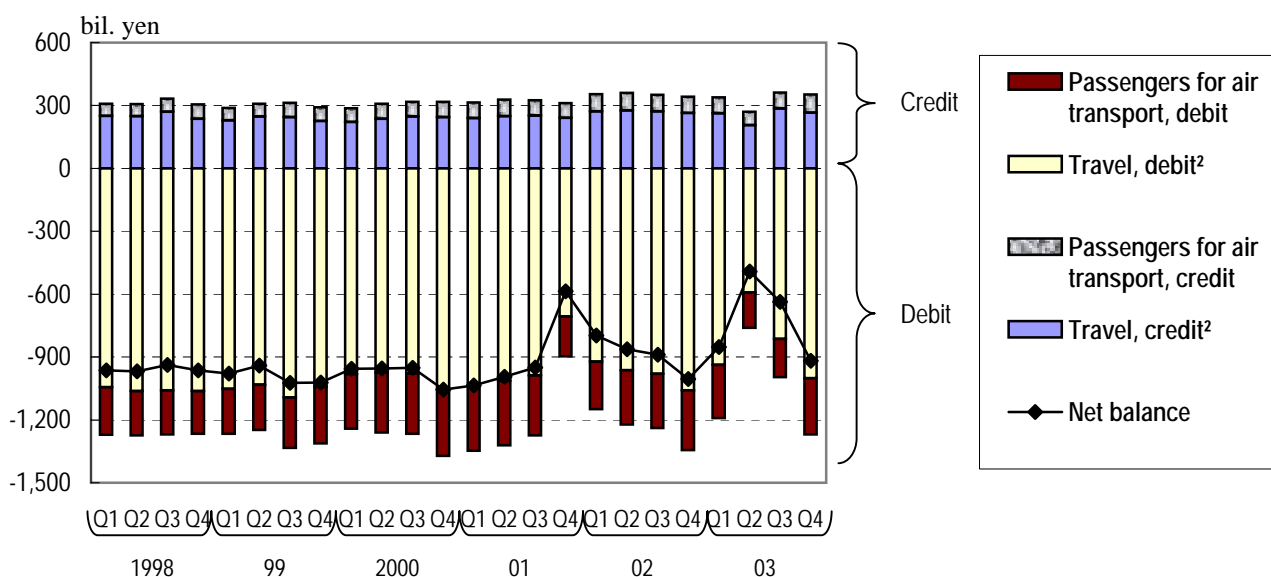
Note: 1. Figures are calculations by Balance of Payments Division, International Department, Bank of Japan.
Calculations are based on estimates of cargo movement of major shipping companies and major indices.

Chart 10 for Box 2: Cargo Movement of Iron Ore



Source: Clarkson, "Dry Bulk Trade Outlook."

Chart 1 for Box 3: Travel and Passengers for Air Transport¹



Notes: 1. Figures are on a seasonally adjusted basis.

2. Figures before 2003 are estimated taking into account expenditures of yen brought into and taken out of Japan, based on a survey conducted in 2002 and on data on the number of legal immigrants released by the Ministry of Justice.

[Reference] Key Events Affecting the Number of Departures from and Entries into Japan

(1) Events Related to the Terrorist Attacks in the United States

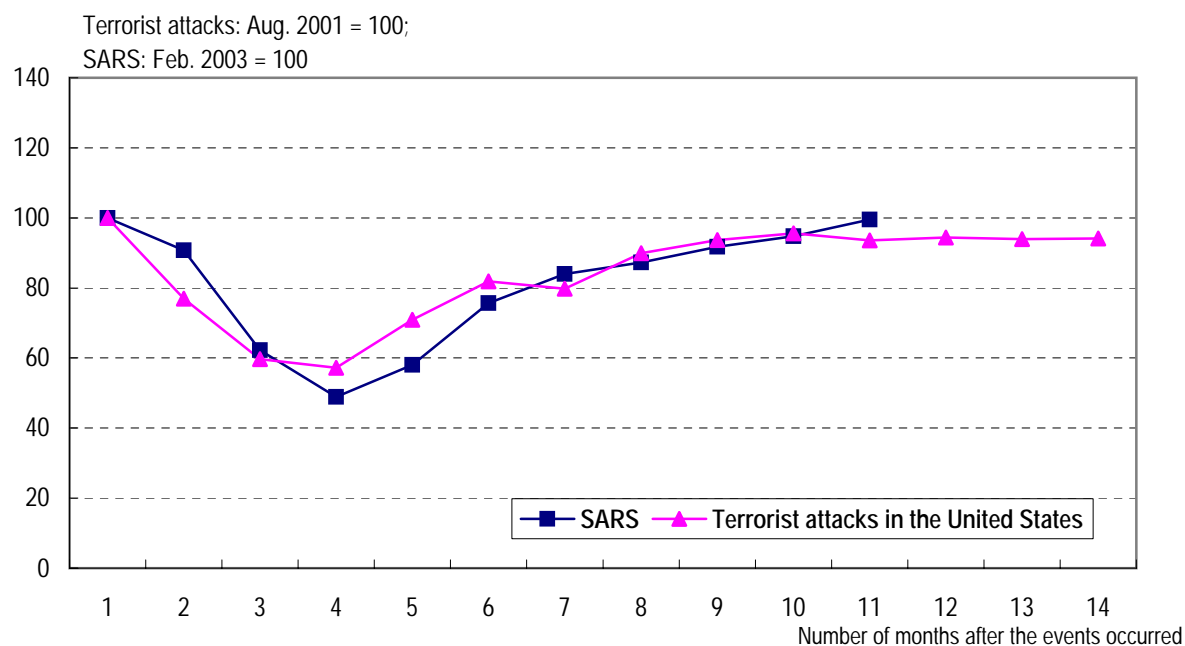
Date	Event
2001	
September 11	Terrorist attacks occur in the United States. All flights in the United States are canceled for two days.
October 8	The United States begins air strikes in Afghanistan.
November 13	The anti-Taliban alliance in northern Afghanistan takes control of Kabul, the capital of Afghanistan.
December 8	The Taliban surrenders.

(2) Events Related to SARS

Period	Event
2003	
March	SARS broke out in China and Hanoi, Vietnam.
April	The World Health Organization (WHO) issued recommendations that travelers should consider postponing all but essential travel to designated areas where the risk of exposure to SARS is considered high. Additional outbreak sites were identified. ¹
End-May to June	Number of infected persons decreases. Travel recommendations are canceled for all areas.
Early July	WHO removed all regions from the list of areas affected by SARS, with Taiwan removed last. WHO announces that the last known chain of human-to-human transmission of the SARS corona virus has been broken, bringing to an end the initial outbreak.

Note: 1. Outbreak sites include ten countries and regions, namely, China, Hong Kong, Taiwan, Hanoi, Singapore, Mongolia, the Philippines, Toronto, the United States, and London.

Chart 2 for Box 3: The Number of Japanese Travelers Abroad after the Terrorist Attacks in the United States and the Outbreak of SARS¹



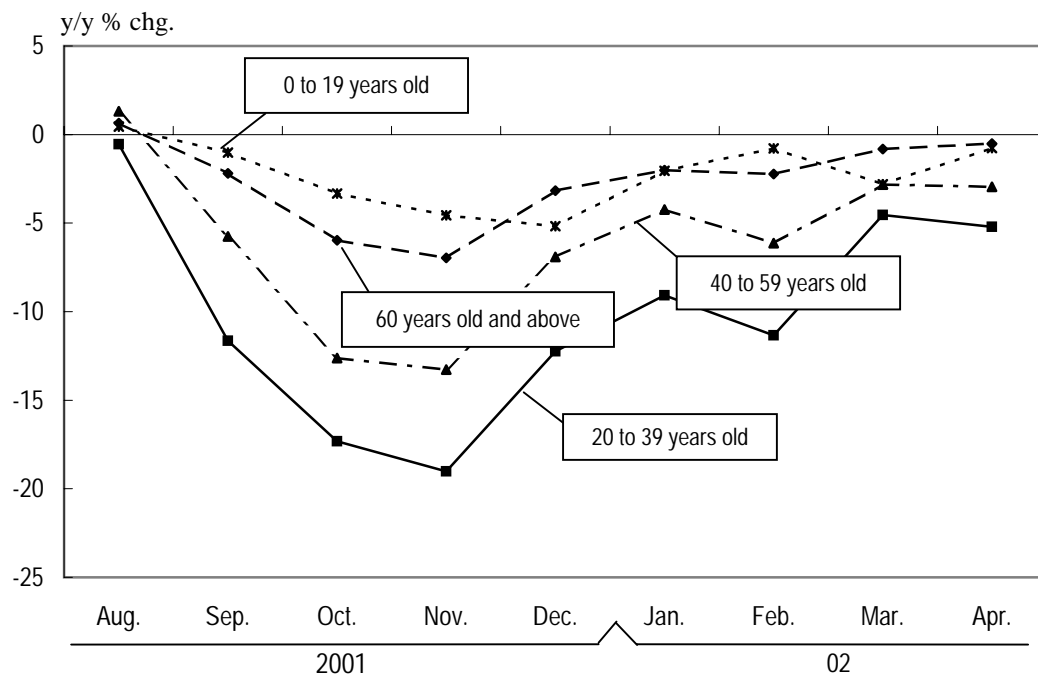
Note: 1. The number of Japanese travelers abroad in August 2001 and February 2003, one month before the terrorist attacks and the outbreak of SARS, respectively, as 100.

Figures are seasonally adjusted by Balance of Payments Division, International Department, Bank of Japan.

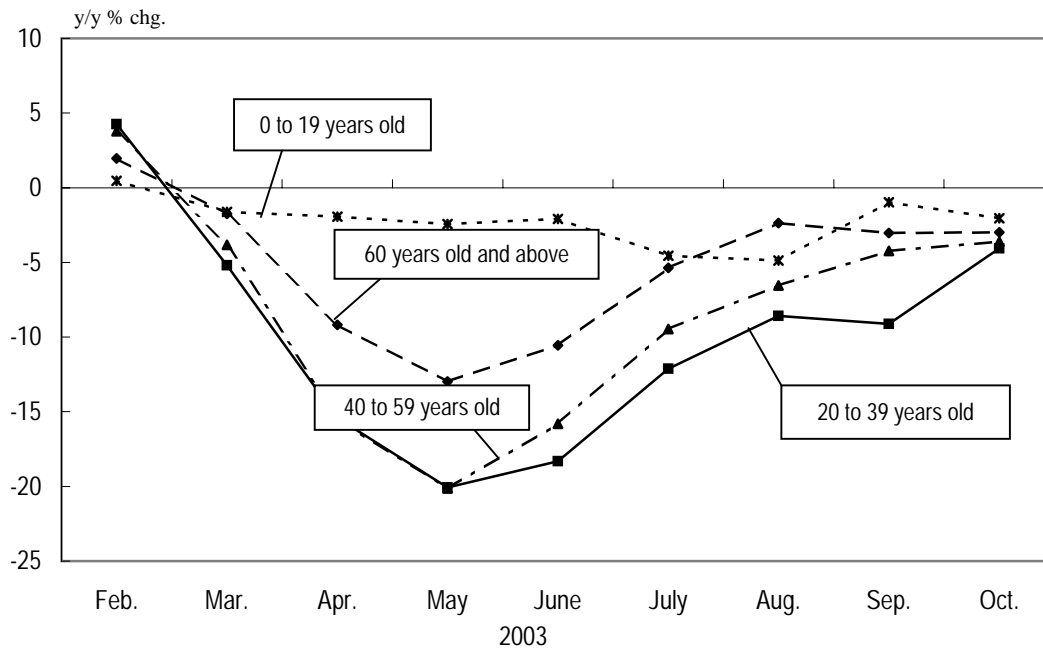
Source: Japan National Tourist Organization (JNTO).

Chart 3 for Box 3: Contribution to Changes in the Number of Japanese Travelers Abroad by Age Group

(1) Terrorist Attacks in the United States

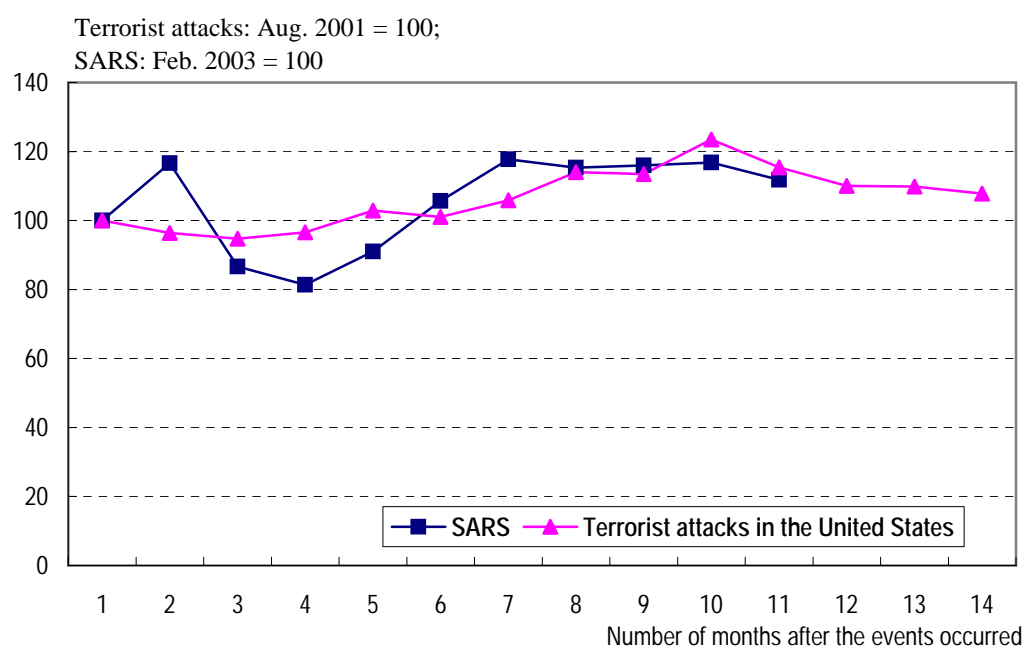


(2) SARS



Source: Japan National Tourist Organization (JNTO).

Chart 4 for Box 3: Changes in the Number of Foreign Visitors after the Terrorist Attacks in the United States and the Outbreak of SARS¹



Note: 1. The number of foreign visitors August 2001 and February 2003, one month before the terrorist attacks and the outbreak of SARS, respectively, as 100.

Figures are seasonally adjusted by Balance of Payments Division, International Department, Bank of Japan.

Source: Japan National Tourist Organization (JNTO).

Chart 1 for Box 4: Royalties and License Fees

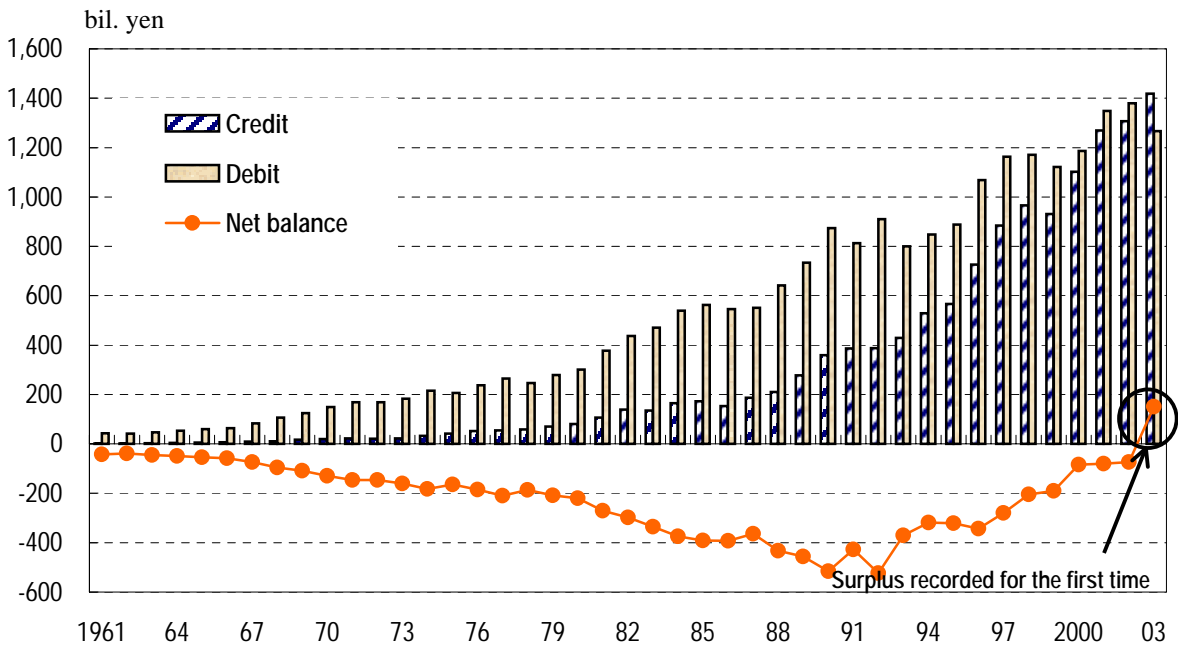
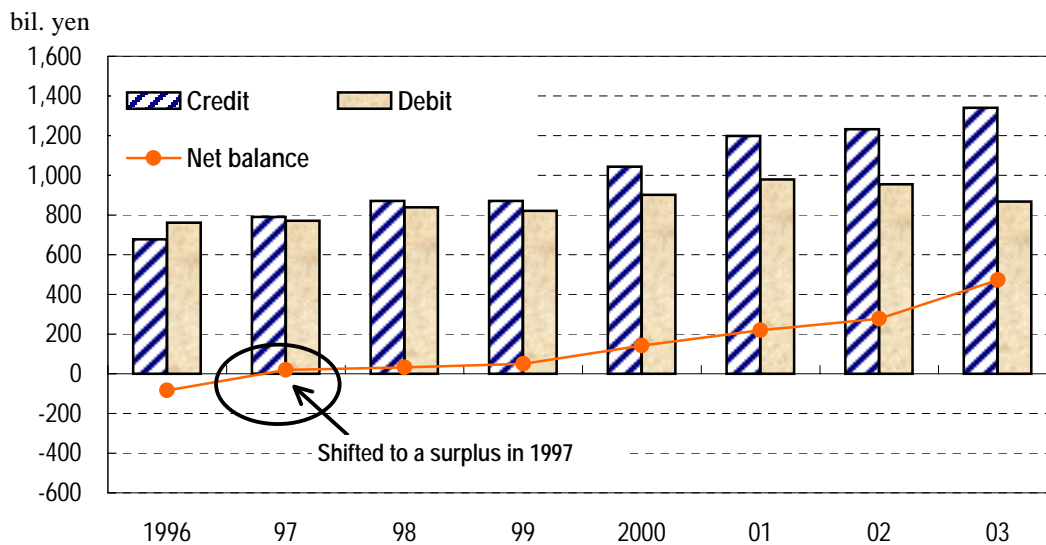


Chart 2 for Box 4: Fees for Industrial Property Rights, etc.¹



Note: 1. In figures published "Industrial Processes, Franchise, etc.," fees for industrial property rights accounted for the majority while those for mining rights including oil-drilling concession accounted for only a small portion. Industrial property rights include trademark, registered design, utility model, and patent rights.

Chart 3 for Box 4: Fees for Copyrights

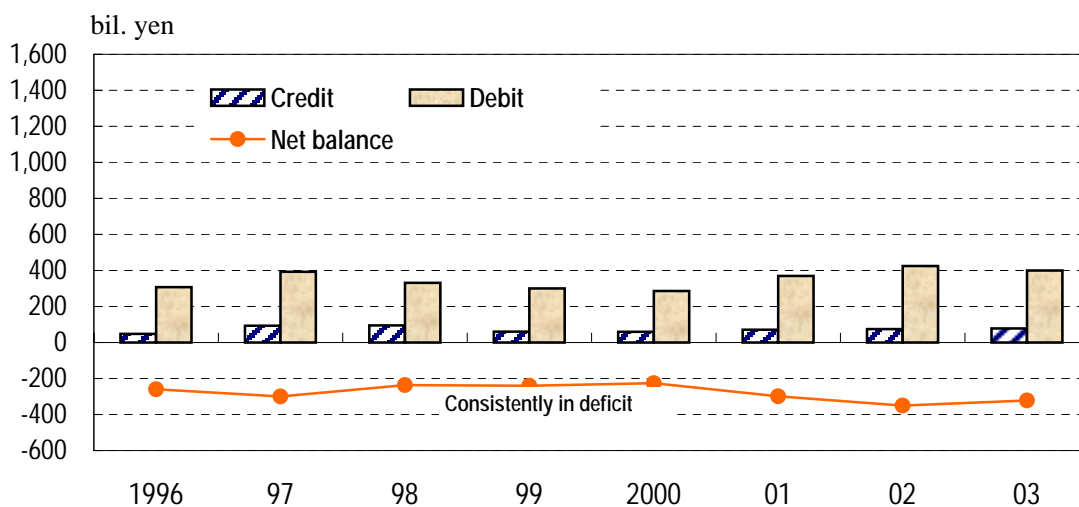
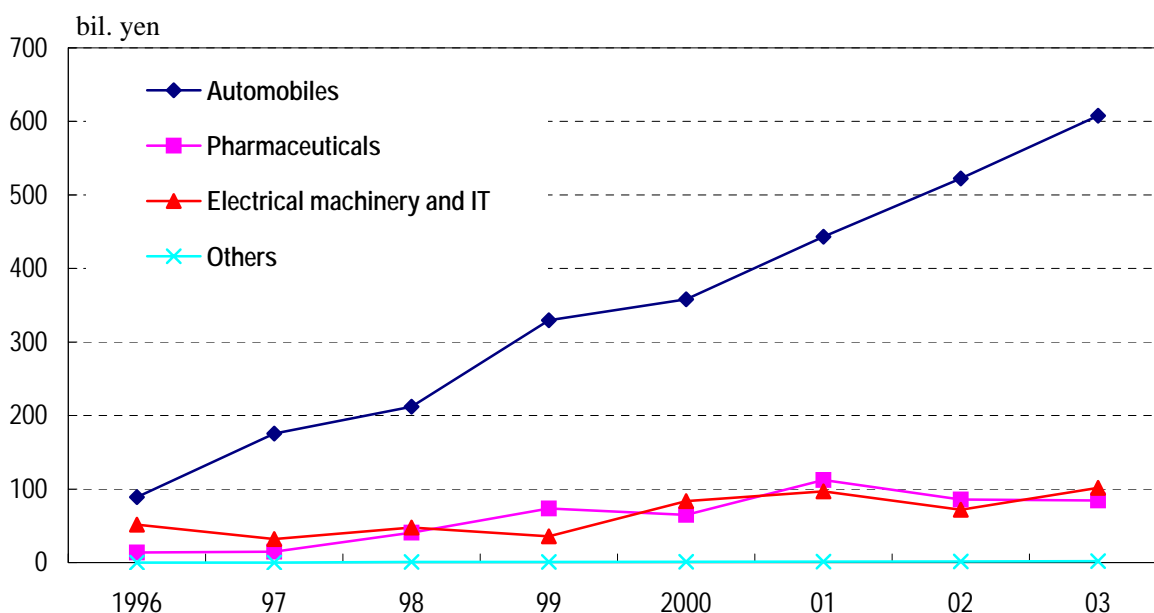


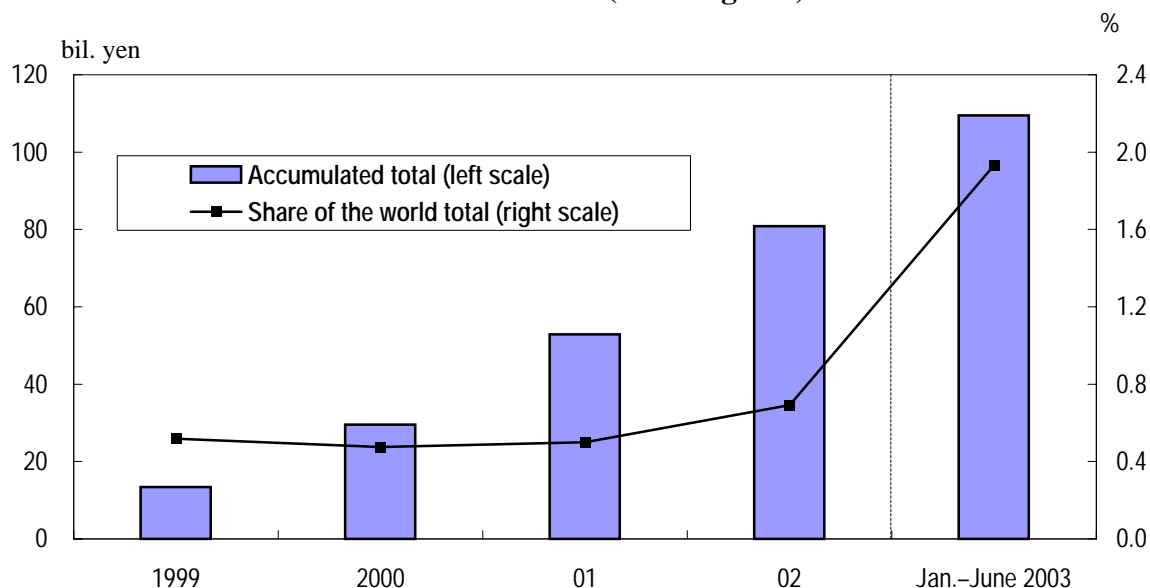
Chart 4 for Box 4: Industrial Breakdown of Fees Received for Industrial Property Rights, etc.¹



Note: 1. It should be noted that there is a difference in coverage between the data on industrial breakdown and those on the published total.

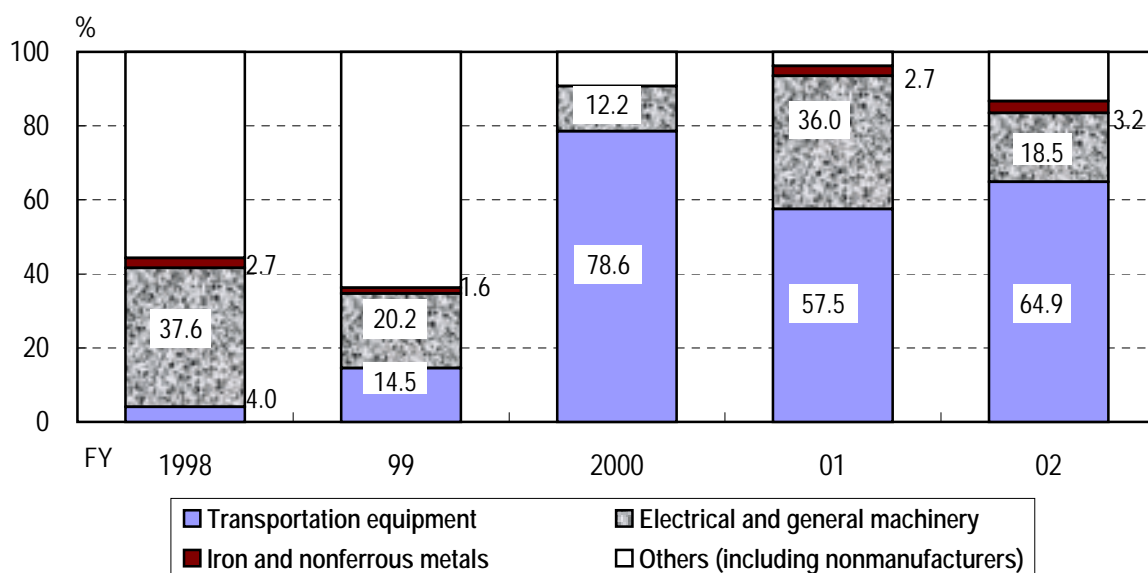
Figures for periods for which reports on large payments were unavailable (December 1996 and January 1997) were estimated using the growth rate of total receipts in royalties and license fees.

Chart 1 for Box 5: Share of Outward Direct Investment in Central and Eastern European to Total Direct Investment (Flow Figures)



Note: 1. Figures are accumulated total from early 1999. Figures do not reflect transfers of issued shares of subsidiaries (statistically withdrawal of investment) in Central and Eastern Europe to holding subsidiaries in Belgium, the Netherlands, and Luxembourg for the purpose of improvement of efficiency in group management, as it is not an actual withdrawal from business.

Chart 2 for Box 5: Outward Direct Investment in Central and Eastern Europe by Japanese Firms by Industry



Source: Ministry of Finance, "Foreign Direct Investment."

Chart 1 for Box 6: Outward Investment in Foreign Bonds in “Others”

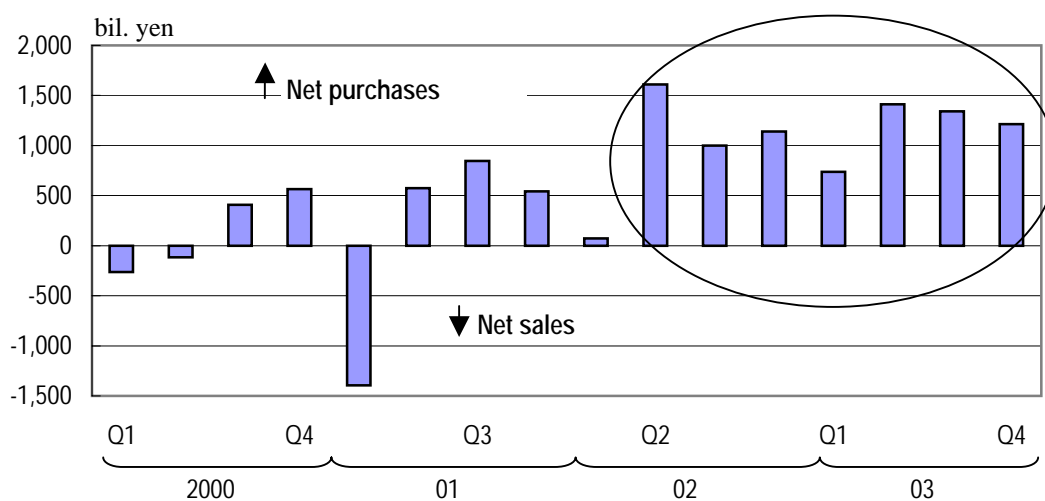
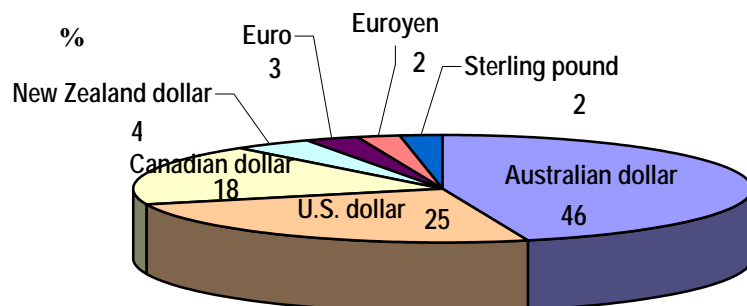


Chart 2 for Box 6: Bonds Offered by Major Issuers for Retail Sales in 2003

Issuer	Currency	Term (years)	Interest rate (%)
International Bank for Reconstruction and Development	Australian dollar	3 to 5	4.1 to 5.3
	Canadian dollar	4 to 7	3.8 to 4.1
	New Zealand dollar	3 to 4	5.2 to 5.4
Swedish Export Credit Corporation	Australian dollar	3 to 5	4.1 to 5.5
	Euro	4 to 10	2.5 to 3.7
Inter-American Development Bank ¹	U.S. dollar	5	0.5 to 1.0
Kreditanstalt für Wiederaufbau	Australian dollar	4	4.2 to 5.4

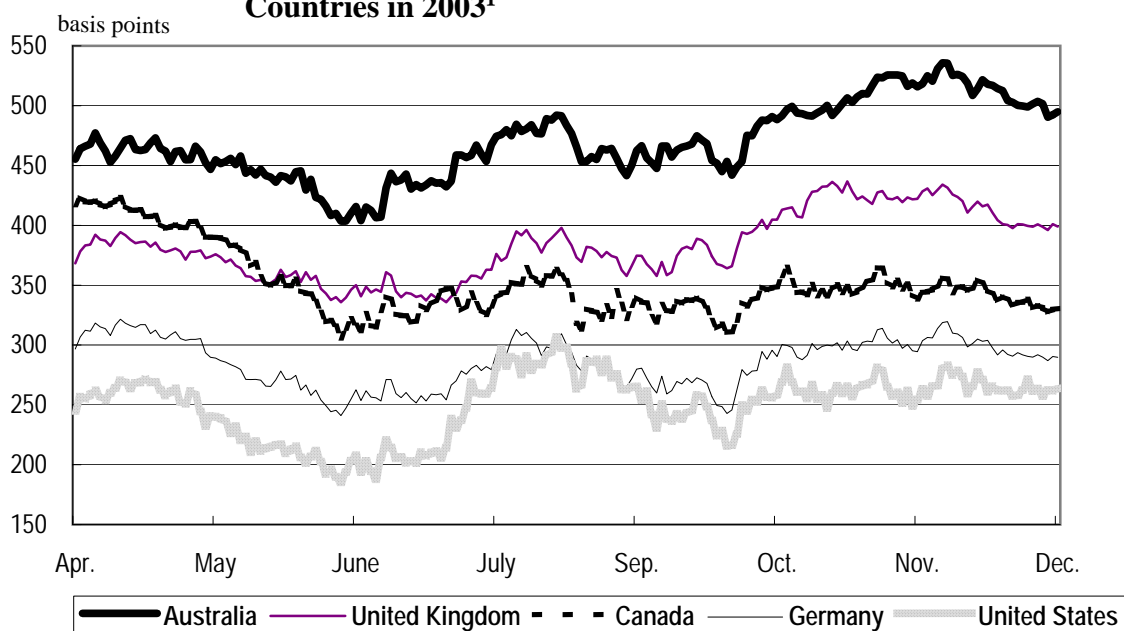
Note: 1. Deep-discounted bonds whose selling price is below the face value.

**Chart 3 for Box 6: Foreign Bonds Offered for Retail Sales in 2003
by Type of Currency¹**



Note: 1. Calculated using figures for large transactions (ten million U.S. dollars or more in face value for a single issue) taken from reports on foreign securities transactions submitted to the International Department, Bank of Japan.

Chart 4 for Box 6: Yield Spreads between JGBs and Government Bonds of Other Major Countries in 2003¹



Note: 1. Yields on 5-year government bonds.

Chart 5 for Box 6: Exchange Rates of Major Currencies against the Yen

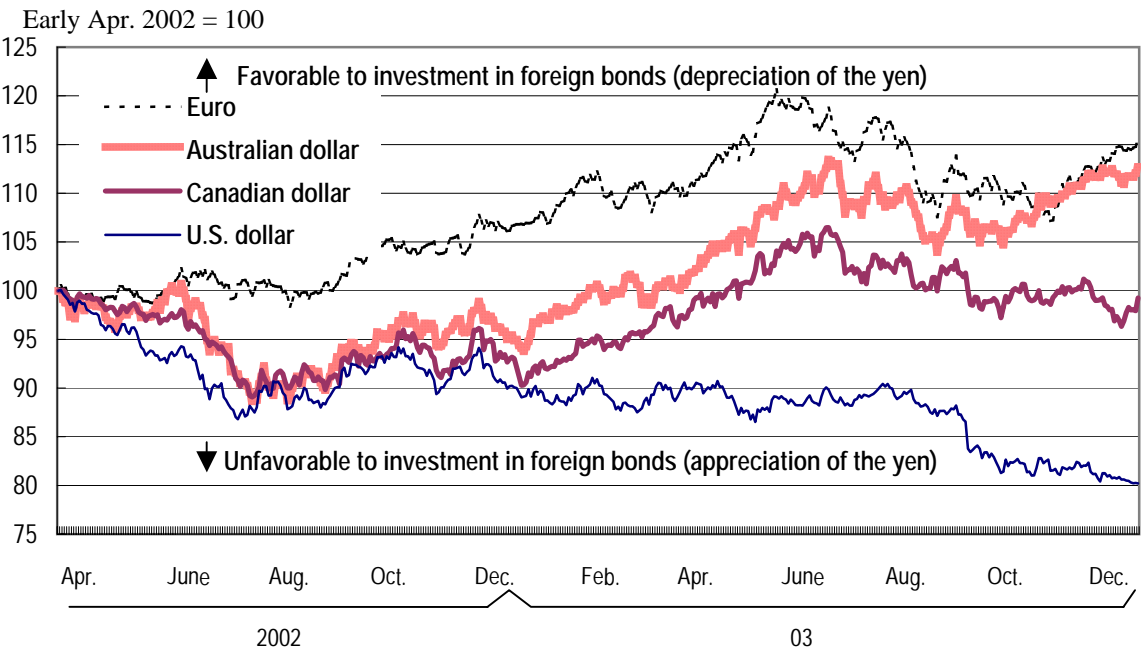
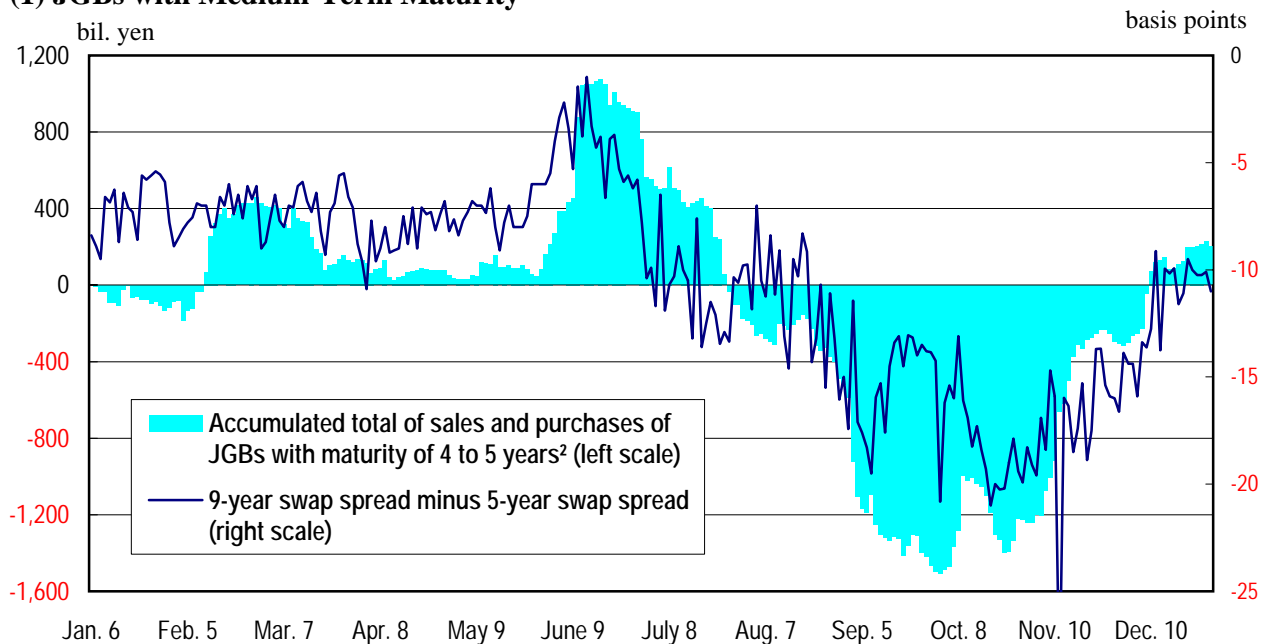
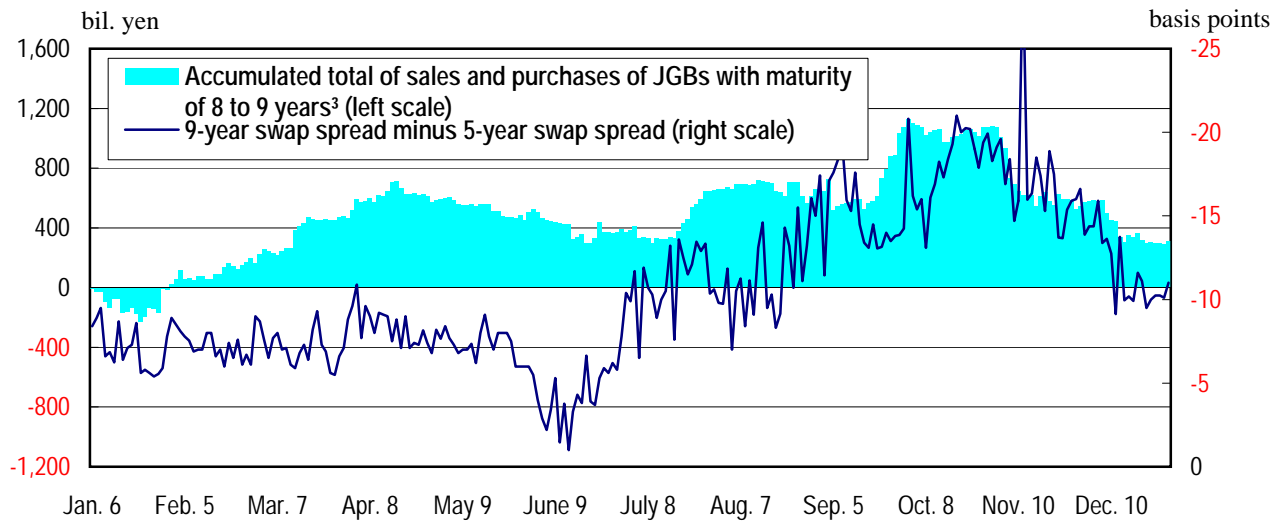


Chart 1 for Box 7: Accumulated Total of Sales and Purchases of JGBs by Overseas Investors, and Swap Spreads¹

(1) JGBs with Medium-Term Maturity



(2) JGBs with Long-Term Maturity



Notes: 1. Net accumulated total on contract basis in 2003.

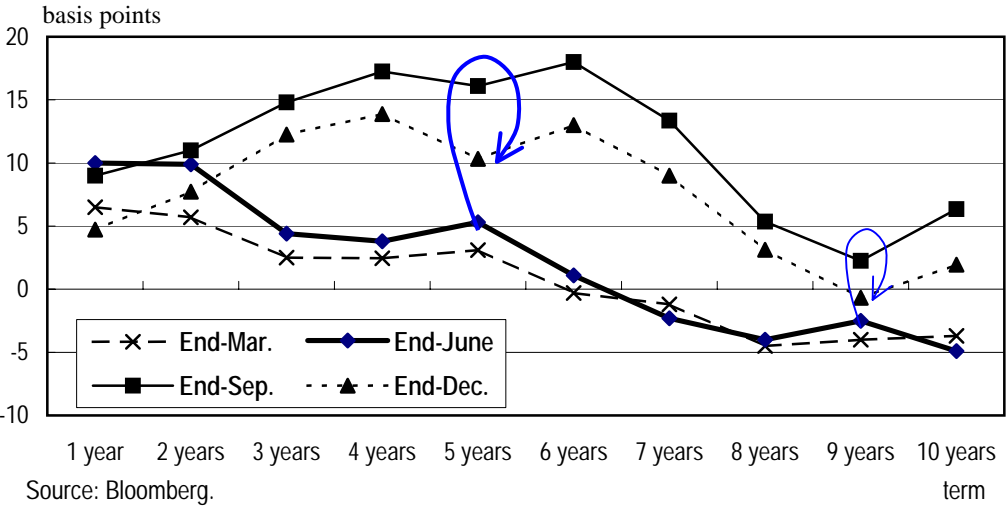
Total of transactions amounting to one billion yen or more. Data were selected for JGBs maturing in the end-June to end-September period, when position-making was active.

2. For 20th to 32nd issues of 5-year JGBs, 194th to 206th issues of 10-year JGBs, and 16th to 20th issues of 20-year JGBs.

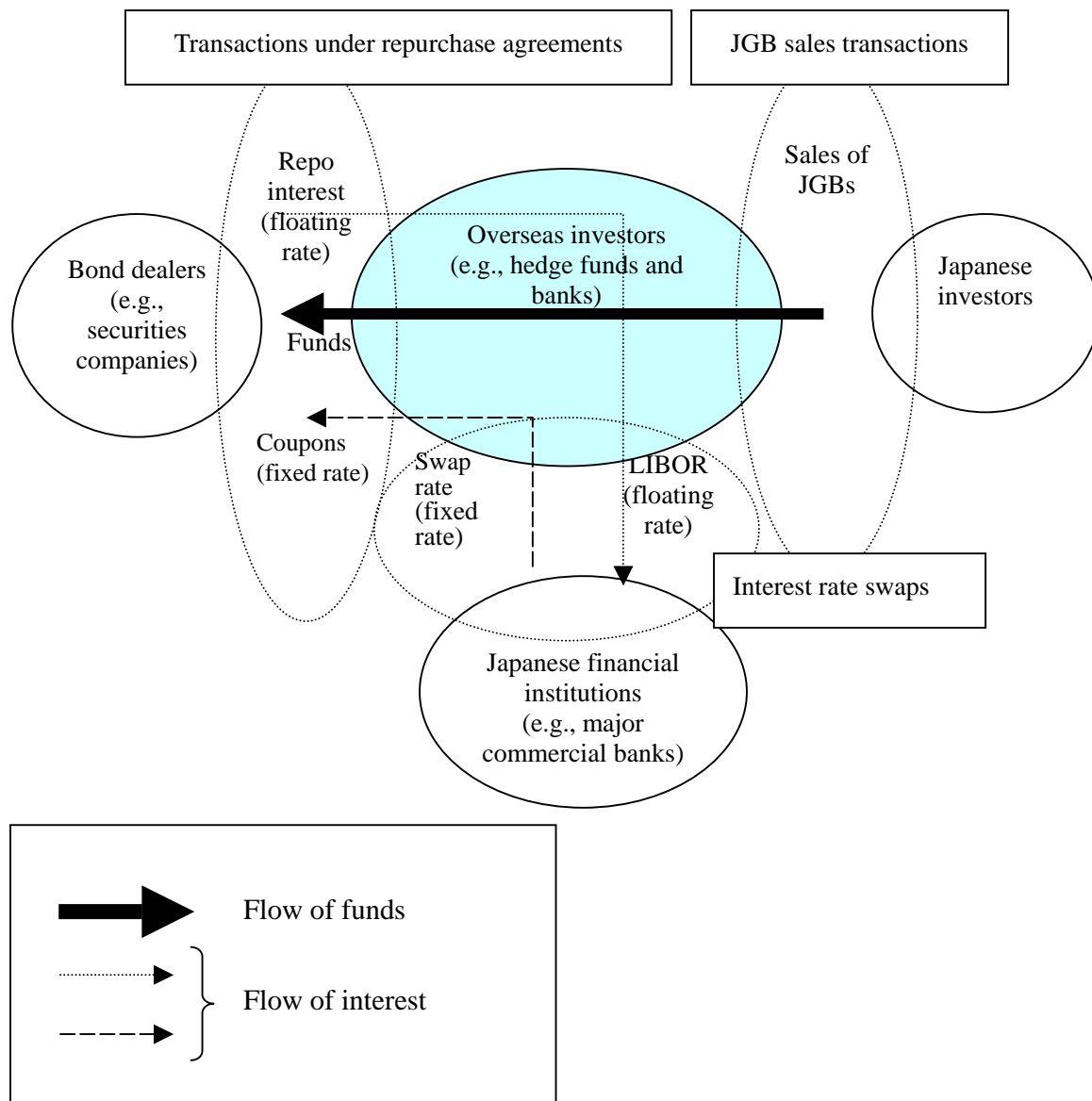
3. For 231st to 243rd issues of 10-year JGBs and 16th to 20th issues of 20-year JGBs.

Sources: Reports submitted under Foreign Exchange and Foreign Trade Law; Bloomberg.

Chart 2 for Box 7: Changes in the Term Structure of Swap Spreads



**Chart 3 for Box 7: Arbitrage Position Taken by Combining Sales of JGBs
and Interest Rate Swap Agreements on Fixed Rate Receipts Side**



Floating rate

(Repo interest – LIBOR)

Receipts from
bond dealers

Payments to
Japanese
financial
institutions

+

Fixed rate (swap spread)

(swap rate – yields on JGBs)

Receipts of
fixed rate
from Japanese
financial
institutions

Payments of
fixed rate
to bond dealers

Chart 4 for Box 7: Profits/Losses in Arbitrage Positions Combining Cash Bond Sales and Interest Rate Swap Agreements on Fixed Rate Receipts Side

(1) Expansion of Swap Spreads¹

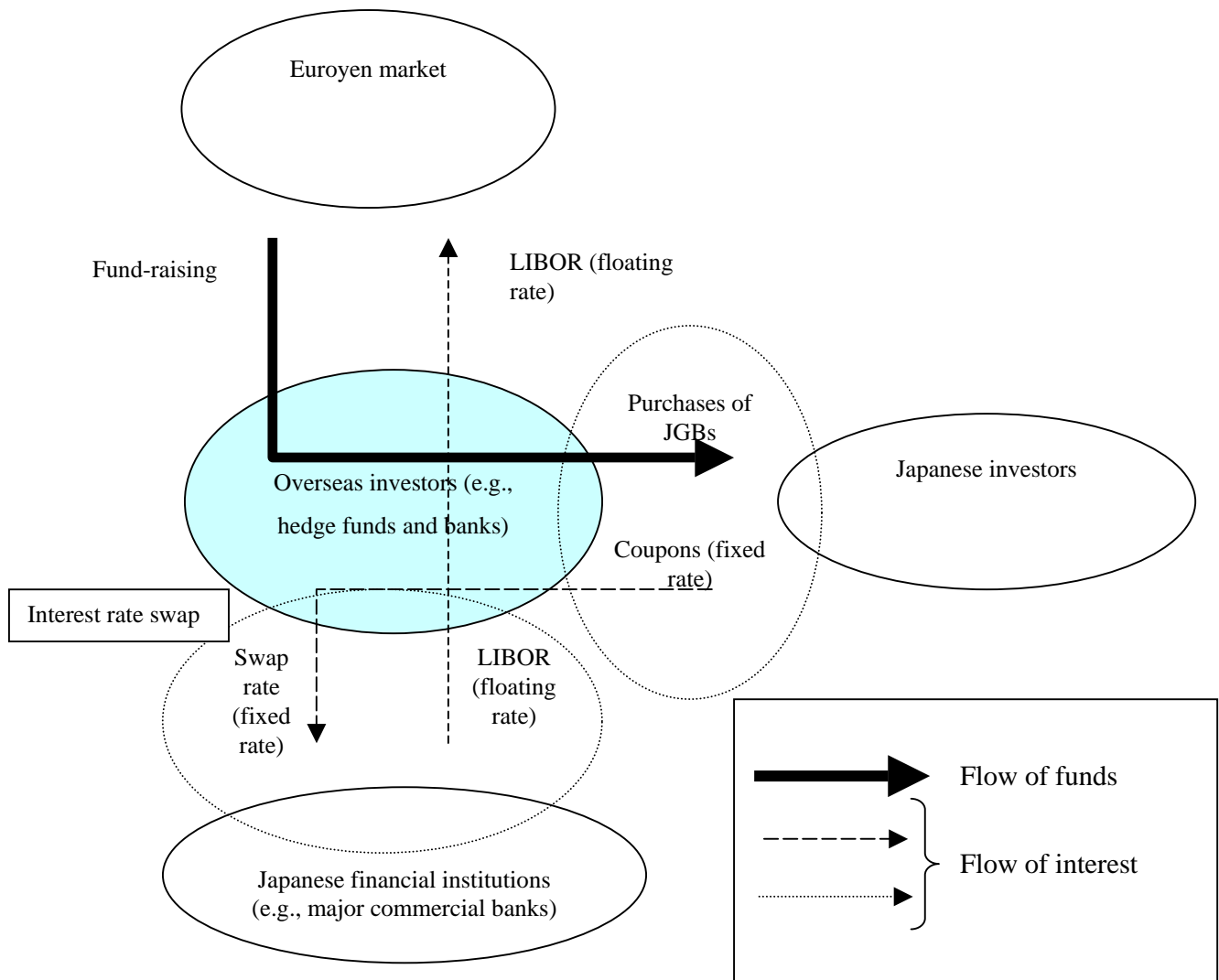
		Interest rate	
		Increase	Decrease
Profits/losses	JGBs	+	--
	Swaps	--	+
	Net balance	Capital loss	

(2) Narrowing of Swap Spreads²

		Interest rate	
		Increase	Decrease
Profits/losses	JGBs	++	-
	Swaps	-	++
	Net balance	Capital gain	

Notes: 1. Increase in interest rates: increase in swap rates > increase in yields on JGBs.
 Decrease in interest rates: decrease in swap rates < decrease in yields on JGBs.
 2. Increase in interest rates: increase in swap rates < increase in yields on JGBs.
 Decrease in interest rates: decrease in swap rates > decrease in yields on JGBs.

Chart 5 for Box 7: Arbitrage Position Taken by Combining Purchases of JGBs and Interest Rate Swap Agreements on Fixed Rate Payments Side



Floating rate		Fixed rate (swap spread)	
(LIBOR – LIBOR)		(swap rate – yields on JGBs)	
Receipts from Japanese financial institutions	Fund-raising cost	Payments of fixed rate to Japanese financial institutions	Receipts of fixed rate from JGBs

Chart 6 for Box 7: Profits/Losses in Arbitrage Positions Combining Cash Bond Purchases and Interest Rate Swap Agreements on Fixed Rate Payments Side

(1) Expansion of Swap Spreads¹

		Interest rate	
		Increase	Decrease
Profits/losses	JGBs	–	++
	Swaps	++	–
	Net balance	Capital gain	

(2) Narrowing of Swap Spreads²

		Interest rate	
		Increase	Decrease
Profits/losses	JGBs	– –	+
	Swaps	+	– –
	Net balance	Capital loss	

- Notes: 1. Increase in interest rates: increase in swap rates > increase in the yields on JGBs.
Decrease in interest rates: decrease in swap rates < decrease in the yields on JGBs.
2. Increase in interest rates: increase in swap rates < increase in the yields on JGBs.
Decrease in interest rates: decrease in swap rates > decrease in the yields on JGBs.

Chart 7 for Box 7: Profits/Losses in Box Trade

(1) Expansion of the Differences in Swap Spreads¹

		Swap spread	
		Increase	Decrease
Profits/losses	Cash bond sales and swap agreements on fixed rate receipts side (X-years maturity)	–	++
	Cash bond purchases and swap agreements on fixed rate payments side (Y-years maturity)	++	–
	Net balance	Capital gain	

(2) Narrowing of Differences in Swap Spreads²

		Swap spread	
		Increase	Decrease
Profits/losses	Cash bond sales and swap agreements on fixed rate receipts side (X-years maturity)	– –	+
	Cash bond purchases and swap agreements on fixed rate payments side (Y-years maturity)	+	– –
	Net balance	Capital loss	

- Notes: 1. Expansion of swap spreads: increase in swap spreads for swaps maturing in X years < increase in swap spreads for swaps maturing in Y years.
Narrowing of swap spreads: decrease in swap spreads for swaps maturing in X years > decrease in swap spreads for swaps maturing in Y years.
2. Expansion of swap spreads: increase in swap spreads for swaps maturing in X years > increase in swap spreads for swaps maturing in Y years.
Narrowing of swap spreads: decrease in swap spreads for swaps maturing in X years < decrease in swap spreads for swaps maturing in Y years.