

# **Japan's Balance of Payments for 2004**

**June 2005**

**International Department  
Bank of Japan**

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## **I. Summary<sup>1</sup>**

### **A. Overview**

Japan's balance of payments (BOP) in 2004 recorded a current account surplus of 18.6 trillion yen, increased from a surplus of 15.8 trillion yen in 2003. This represents a new record high for the second consecutive year. The capital and financial account recorded a net inflow of 1.5 trillion yen, decreased from a net inflow of 7.7 trillion yen in 2003; reserve assets increased by 17.3 trillion yen, which was smaller than the increase recorded in 2003 (21.5 trillion yen);<sup>2</sup> and errors and omissions recorded a debit of 2.8 trillion yen.

### **B. Highlights of Japan's BOP for 2004**

#### **1. A sharp increase in surplus in the balance of goods (Summary Chart 1)**

The surplus in the balance of goods increased sharply from the previous year, and marked a new record high for the second consecutive year as growth of exports exceeded that of imports. Exports recorded double-digit year-on-year growth due to buoyant Asian demand for a wide range of export items, as well as to the growth of machinery other than electric exports to the United States and that of motor vehicle-related goods exports to the European Union (EU). Imports also registered double-digit year-on-year growth due to the conspicuous increase of mineral fuels (petroleum, coal, etc.), reflecting their higher market prices, and the increase of finished goods, such as machinery from Asian countries.

However, the year-on-year increase in the surplus in the balance of goods began to shrink in the second half of the year. This is explained by a slowdown in exports with the continued strength in imports.

#### **2. An increase in the deficit in the overall balance of services, and a sharp decrease in the deficit in the balance of other services**

The deficit in the balance of other services shrank sharply. In the balance of merchanting and other trade-related services, the receipts of merchanting fees increased as a result of the growth of merchanting trade in audio-visual apparatus, precision instruments, and computer game equipment. In the balance of royalties and license fees, the receipts of fees for industrial property rights, etc., continued to increase, especially for the motor vehicle-related industry. Meanwhile, deficits in the balances of travel and transportation increased. This was due particularly to the increase in the number of Japanese travelers overseas and the higher level of cross-border movement of goods.

#### **3. Larger surplus in the balance of income**

The surplus in the balance of income increased and reached a new record high. Credits of direct investment income increased against the background of the sustained strong performance recorded by the foreign subsidiaries of Japanese companies. Credits of portfolio investment income increased reflecting the accumulation of the outstanding amount of outward portfolio investment. At the same time, debits of direct investment income and portfolio investment income also increased reflecting the buoyant performance of Japanese companies.

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<sup>1</sup> Data for 2004, including charts, are preliminary unless otherwise stated. Annual, semiannual, and quarterly data in this report, including charts, are on a calendar-year basis unless otherwise stated.

<sup>2</sup> An increase in assets in the capital and financial account denotes a capital outflow (increase in assets) in the BOP.

#### **4. An increase in inward portfolio investment**

Inward investments in bonds and notes showed a significant net inflow. This is attributed to the fact that foreign hedge funds and foreign banks purchased a large amount of Japanese government bonds (JGBs) to create arbitrage positions, a combination of spot buying and forward selling, while several foreign institutional investors engaged in the outright purchase of JGBs. Inward investment in equities also registered a large net inflow, as in the previous year. This could be attributed to active purchases by foreign investors, due to their sustained preference for Japanese equities supported by the relatively good performance of Japanese companies, and their expectations of a rise in Japanese stock prices following the rise in the overseas stock prices.

Outward investments in bonds and notes registered a slightly lower level of net outflow, compared to the previous year, as investments by “life insurance companies” and “others” declined. Contributing factors included a narrowed spread between domestic and foreign interest rates, and higher foreign exchange hedging costs following the rise in short-term U.S. interest rates. Meanwhile, outward investments in equities recorded a sharp increase in net outflow. This expansion reflected the purchase of foreign equities, following a good performance on overseas stock markets, and, the increased popularity of overseas funds, such as “fund of funds” and real estate investment trusts (REITs).

#### **5. A continued net inflow in the capital and financial account<sup>3</sup>**

The capital and financial account recorded a net inflow for the second consecutive year. This was mainly due to the inflow of nonresident funds in the form of portfolios, such as stocks and bonds, and other investments. The sustained net inflow in the capital and financial account for two consecutive years was noted for the first time in 40 years, the previous occasion being in 1963 and 1964. On a quarterly basis, a high net inflow was recorded only in the first quarter, and net outflows were recorded in the remaining quarters (Summary Chart 2).

## **II. Current Account (charts 1, 2, and 3)**

### **A. Summary**

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<sup>3</sup> “Capital and financial account,” a standard component of the fifth edition of the International Monetary Fund’s (IMF’s) *Balance of Payments Manual* (BPM5), includes reserve assets as its sub-component. Thus, the relationship between the current account, and the capital and financial account, based on the definitions in the BPM5, is shown in the following identity.

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

The scope of Japan’s “capital and financial account” is different from that of the BPM5, in that it does not include reserve assets as its sub-component. Changes in reserve assets are recorded separately from the capital and financial account in Japan’s BOP. Therefore, the above identity has been modified for Japan’s BOP as follows.

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

In Japan’s BOP for 2004, “capital and financial account” + “changes in reserve assets” in identity (b), which corresponds to “capital and financial account” in identity (a), recorded a deficit equivalent to the deficit of “current account” + “errors and omissions.” Thus, identity (a) holds true.

The current account surplus increased for the third consecutive year in 2004. While the deficit in the balance of services grew, this was more than offset by stronger surpluses in the balance of goods and income, and improvement in the balance of current transfers. Overall, the current account surplus reached 18.6 trillion yen in 2004, marking the second consecutive year of record-setting levels. The surplus amounted to 3.7 percent of the nominal GDP<sup>4</sup> in 2004, the highest level reached since 1996 when the current statistics based on the BPM5 were adopted.<sup>5</sup> The following are the three major features of the current account.

- (1) The surplus in the balance of goods increased sharply, rising by 2,051.1 billion yen from 2003. This was mainly due to the impact of the growth in exports to Asia.
- (2) The surplus in the balance of income increased by 992.1 billion yen from the previous year, marking a new high. This reflects the strong performances of foreign subsidiaries of Japanese companies and the growth in the outstanding positions of outward portfolio investment.
- (3) The deficit in the balance of services increased from 2003, as the combined deficits of the travel and transportation accounts increased by 840.2 billion yen. This is attributed to a rise in the number of Japanese overseas travelers and a higher level of cross-border movement of goods.

The balance of goods and services increased for the third consecutive year, reflecting the impact of the increase in the surplus in the balance of goods.

## **B. Developments in the Main Components**

### **1. Goods (Chart 4)**

Exports increased in value by 12.3 percent from 2003, increasing for the third consecutive year due to the positive impact of the recovery in the U.S. economy and China's high-speed economic growth. Export prices were firm, reflecting the sharp rise in raw materials prices.

Imports increased substantially in value by 10.9 percent from 2003. Volume of imports increased for a broad range of items such as machinery. Import prices were affected by the 7.0 percent appreciation of the yen against the U.S. dollar,<sup>6</sup> but prices were also impacted by the sharp increase in market prices for mineral fuels and materials (Chart 5).

The surplus in the balance of goods increased for the third consecutive year, because the growth of exports exceeded that of imports.

- (1) The background to the increase in exports: recovery in the U.S. economy, China's high-speed economic growth, and a sharp rise in materials prices  
Exports recorded double-digit growth in all four quarters of 2004. This was due to the recovery in the U.S. economy, China's high-speed economic growth, and the sharp rise in materials prices. Exports to the NIEs, China, and other Asian economies were buoyant

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<sup>4</sup> The average of Quick Estimation (QE) for the first through fourth quarters (annualized and seasonally adjusted basis of 2004) is used as a substitute for the GDP for 2004.

<sup>5</sup> Statistics based on the IMF's BPM5 are available from 1996 figures. Therefore, strictly speaking, there is no continuity of series between figures up to 1995 and 1996 onward. For example, reinvested earnings have been added to income in the current account since 1996.

<sup>6</sup> 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.

for a broad range of items. Exports to the United States turned upward from the previous year, primarily owing to robust exports of general machinery. Thus, exports to all major regions registered positive growth from 2003. However, the overall growth in exports began to sag in the second half of the year, under the pressure of inventory adjustment in electronic components for the Asian region.

(2) The background to the increase in imports: an increase in machinery imports from Asia and a sharp rise in materials prices

Imports registered a significant increase from the previous year. Machinery imports from Asia advanced strongly as a result of the recovery in the Japanese economy and continued progress in trade cooperation between Japanese companies and the Asian region. Another contributing factor was the sharp rise in prices of mineral fuels (crude oil, coal, etc.), which also impacted the prices of chemical products.

### **a. Exports<sup>7</sup>**

On a customs-clearance basis year on year, exports increased 12.2 percent. The volume of exports increased by 10.6 percent, and export prices rose by 1.4 percent.

#### **(1) Regional trends (charts 6 and 7)**

Exports to Asia continued to contribute significantly to the increase in overall exports. Exports to the EU also contributed positively. Exports to the United States made a slightly positive contribution.

A more detailed review of exports in 2004 highlights the following regional trends.

#### **(a) Exports to Asia**

Exports to Asia increased for the third consecutive year and recorded double-digit growth, given increases in both volume and prices. The volume of exports increased significantly, especially for semiconductors and other electronic parts, general machinery, and scientific, medical, and optical instruments. This reflected relatively firm domestic demand in Asian economies, robust capital investment-related demand, and the shift to overseas production bases by Japanese electric equipment manufacturers and others. Export prices were also up from the previous year as the positive impact of higher materials prices exceeded the negative impact of the appreciation of the yen.

Chart 8 gives major items contributing to the growth of exports to Asia.

#### **(b) Exports to the EU**

Exports to the EU increased for the second consecutive year, with increases in both volume and prices. The volume of exports increased for the second consecutive year for the following reasons. First, exports of assembled motor vehicles surged as sales of Japanese motor vehicles were brisk in the EU. Second, the export of electronic

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<sup>7</sup> Figures for exports and imports are on a customs-clearance basis. Three customs-clearance series are released every month: estimated, provisional, and final figures. Figures for December are final figures for exports and provisional figures for imports.

Exports (credit in goods) are recorded in the BOP based on the change of ownership principle, whereby export occurs at the transfer of ownership of goods between residents and nonresidents. Specifically, figures are compiled by deducting the amount of reexports/imports (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 6.

components to local factories in Europe (in central and eastern Europe) was firm. Export prices rose for the fourth consecutive year because of the depreciation of the yen against the euro.

Chart 9 gives major items contributing to the growth of exports to the EU.

### **(c) Exports to the United States**

Exports to the United States turned to an increase as growth in volume exceeded the decline in export prices. The volume of exports turned to an increase for the following reasons. First, while exports of assembled motor vehicles decreased due to the expansion of local production by Japanese automobile companies, exports of parts for motor vehicles increased. Second, exports of general machinery and electronic parts were buoyant. Export prices declined for the first time in five years primarily due to the appreciation of the yen against the U.S. dollar.

Chart 10 gives major items contributing to the growth of exports to the United States.

### **(2) Principal items (charts 11 and 12)**

A wide range of items recorded growth in exports compared to the previous year. These included raw materials (iron and steel, and chemical products), other machinery (scientific, medical, and optical instruments, construction and mining machinery, metalworking machinery), other electrical machinery (parts for audio-visual apparatus, audiovisual apparatus), and IT-related goods (semiconductors and other electronic parts).

The following developments were observed during 2004. Exports of raw materials registered larger year-on-year gains in the second half as compared to the first half of the year. This was due to the continued rise in market prices for raw materials. On the other hand, exports of other electrical machinery and IT-related goods registered smaller year-on-year gains in the second half as compared to the first half of the year. This reflected inventory adjustment and a decline in prices.

### **b. Imports**

On a customs-clearance basis year on year, imports increased 10.9 percent. The volume of imports increased by 7.0 percent, and import prices increased by 3.6 percent.

### **(1) Regional trends (chart 13 and 14)**

Imports from Asia, particularly those from China, contributed positively to an increase in imports. Imports from the Middle East also contributed positively as a result of higher crude oil prices. Imports from the EU also contributed positively. Meanwhile, imports from the United States continued to make a negative contribution.

A more detailed review of imports in 2004 highlights the following regional trends.

### **(a) Imports from Asia**

Imports from Asia increased for the sixth consecutive year as both volume and prices rose. The volume of imports also registered the sixth consecutive year of increase as imports of machinery and a broad range of other items grew. This was primarily due to the recovery in the Japanese economy and continued progress in trade specialization between Japanese companies and the NIEs and China. Import prices turned to a rise for the first time in three years. This was mainly due to higher raw materials prices (crude oil, coal, iron and steel, and chemical products).

Chart 15 gives major items contributing to the growth of imports from Asia.

### **(b) Imports from the EU**

Imports from the EU increased for the fifth consecutive year as both volume and prices rose. The volume of imports increased for the first time in three years for the following reasons. First, imports of motor vehicles increased, partly because Japanese manufacturers increased imports of motor vehicles produced at their production bases in the United Kingdom. Second, imports of meat increased as pork from Denmark was substituted for beef, imported from the United States. Import prices rose for the fourth consecutive year, reflecting the depreciation of the yen against the euro.

Chart 16 gives major items contributing to the growth of imports from the EU.

### **(c) Imports from the United States**

Imports from the United States decreased for the fourth consecutive year, because the negative impact of a decreased volume exceeded the positive impact of a rise in prices. The volume of imports decreased significantly. The suspension of imported U.S. beef, which was caused by the outbreak of bovine spongiform encephalopathy (BSE), had a major impact on this. Notwithstanding the appreciation of the yen against the U.S. dollar, import prices rose for the fifth consecutive year. This was primarily due to the rise in the prices of coal, organic chemicals, and gold.

Chart 17 gives major items contributing to the growth of imports from the United States.

## **(2) Principal items (charts 18 and 19)**

Imports of mineral fuels, such as crude oil and coal, made a large contribution to the overall growth in imports. Both items registered large increases because of the following factors. First, crude oil prices rose sharply on international markets (and set new record high levels). Second, imports of coal increased, for electric power generation, while coal prices jumped sharply in response to tight international supply and demand conditions.

## **2. Services (charts 20 and 21)**

The deficit in the balance of trade in services in 2004 increased for the first time in three years to 4,154.2 billion yen, increasing by 249.9 billion yen or 6.4 percent from 2003. The deficit in the balance of other services decreased, but this was exceeded by the sharp increase in the deficit in travel and transportation. This reflected a rise in the number of Japanese overseas travelers and a higher level of cross-border cargo movement.

In gross terms, credit and debit in transportation, and credit in other services marked new record high.

Salient developments in the balance of transportation, the balance of travel, and the balance of other services for 2004 are described below.

### **a. Transportation (charts 22 to 26)**

The deficit in the balance of transportation increased for the first time in two years to 1,130.6 billion yen, increasing by 241.9 billion yen or 27.2 percent from 2003. This was due to widening the deficits in both sea and air transport.

The deficit in sea transport increased because the payments for sea freight fares by Japanese importers to foreign shipping companies increased. This is explained by the

following three factors. First, imports of audiovisual apparatus (digital cameras, DVD recorders, etc.) and raw materials (iron and steel, coal, etc.) were buoyant. Second, sea freight fares rose sharply, especially for trampers.<sup>8</sup> Third, the payments of terminal charge, registered as other sea transport, also increased owing to the greater overseas cargo movement. As a result, the deficit in the balance of other sea transport increased by 87.6 billion yen from 2003.

The deficit in sea transport increased in 2004 because the increase in debit (freight fares for import goods) exceeded the increase in credit (freight fares for export goods). This reflected the sharp growth in tramper freight fares, which more directly affected the increase in debit than in credit because cargo by tramper occupies more weight in import goods than export goods.

In 2004, credit in freight from cross trade<sup>9</sup> increased for the second consecutive year, increasing by 20.8 percent from the record high set in 2003. This was due to the rise in sea freight fares reflecting the increase in the cargo movement to and from China.

In 2004, the cargo movement by liners<sup>10</sup> is estimated to have registered year-on-year double-digit growth for both outbound and inbound liners servicing the North American route (Asia-North America) and the European route (Asia-Europe).<sup>11</sup> This reflected the increase in the cargo movement to and from China.

The deficit in air transport increased because passenger debit entries under air transport increased for the following two reasons. First, the number of Japanese overseas travelers recovered from the negative effects of severe acute respiratory syndrome (SARS) in 2003. Second, foreign airline companies introduced surcharges due to higher fuel prices.

Freight credit in air transport reached a new record high in 2004. This reflected firm exports of semiconductor and other electronic parts, and electrical measuring and controlling instruments.

Credit in other air transport also increased mainly because the payments of incentives by foreign airline companies to Japanese travel agencies increased (up 59.9 billion yen from 2003). This reflected the increase in the number of Japanese overseas travelers.

## **b. Travel (charts 27 and 28)**

The deficit in the balance of travel increased to 2,917.1 billion yen. This represented a 598.2 billion yen or 25.8 percent increase from 2003.

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<sup>8</sup> According to the corporate services index, the average of ocean freight transport in 2004 rose for all types of ships on a year-on-year basis (liners: +7.1 percent; trampers: +31.1 percent; tankers: +7.8 percent).

<sup>9</sup> Credit in freight from cross trade refers to the fares paid for transportation of cargo loaded and unloaded overseas by Japanese shipping companies.

<sup>10</sup> Accounts for 64 percent of credits in freight from cross trade (Ministry of Land, Infrastructure and Transport, "Report on Maritime Affairs: 2003").

<sup>11</sup> The publication "Liner Freight Fares" (Mitsui O.S.K. Lines) estimates that the two routes account for 34 percent of global liner cargo movement (North American route: 20 percent; European route: 14 percent).



The deficit in the balance of travel<sup>12</sup> for 2004 increased by 25.8 percent from 2003.<sup>13</sup> This reflected the recovery in the number of Japanese overseas travelers from the decline in 2003 resulting from SARS.

### **(1) The movements of Japanese overseas travelers and foreign visitors (Chart 29)**

The number of Japanese overseas travelers and foreign visitors dropped sharply in 2003 as a result of SARS. The number of Japanese overseas travelers was especially slow to recover, recording negative year-on-year growth for twelve consecutive months from March 2003. However, the number of Japanese overseas travelers started to recover in March 2004 and its annual record in 2004 was 16.8 million, an increase of 26.6 percent year on year from 2003. This was the second largest number on record, following the 17.8 million in 2000. The number of foreign visitors hit a record high of 6.1 million in 2004. This reflected the impact of “Visit Japan” tourism campaigns by the Japanese government as well as some deregulation of visa acquisition for foreign visitors from several East Asian countries.

#### **(a) Regional trend (charts 30, 31, and 32)**

The number of Japanese overseas travelers recovered significantly in 2004 from the negative impact of SARS experienced in 2003. The recovery began in the second quarter of 2004 and was particularly conspicuous for travelers to the Asian region. This reflected the recovery in tourists to China<sup>14</sup> and also the surge in the number of tourists to South Korea due to the growing interest in Korean pop culture among Japanese.

The number of foreign visitors increased mainly on the strength of visitors from East Asia (China, South Korea, Hong Kong, and Taiwan). This reflected the recovery from the SARS-related decline in 2003 and the efforts to attract foreign visitors to Japan, such as various “Visit Japan” tourism campaigns and some deregulation of visa acquisition to enter Japan. In particular, the number of foreign visitors from Taiwan, which in 2003 had recorded the sharpest decline due to the impact of SARS, significantly recovered.

#### **c. Other services (charts 33 to 36)**

In 2004, the deficits in other services declined sharply to 106.5 billion yen, dropping by 590.2 billion yen or 84.7 percent.

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<sup>12</sup> From January 2003, Japan started to compile travel based on a new method for estimating the amount of yen brought into Japan by foreign visitors, and brought out and spent abroad by Japanese overseas travelers. As a result, the amount of gross debit and credit in 2003 increased significantly from 2002. The net balance, however, did not differ significantly because the increases in debit and credit resulting from the new method were offset to a large extent.

<sup>13</sup> This significantly exceeded the 2.5 percent increase in the deficit in 2002, the year following the terrorist attacks in the United States. For reference, the deficit recorded a 19.7 percent year-on-year decrease in 2003 as a result of SARS, compared to an 8.3 percent year-on-year decrease in 2001, when the deficit had decreased after the terrorist attacks. The impact of SARS exceeded the impact of the terrorist attacks mainly because the number of Japanese travelers visiting Asia exceeds that of the United States. They accounted for about 50 percent (Asia) and 30 percent (the United States), respectively. These figures are estimated by International Department, Bank of Japan, using data since 2002, from the Japan National Tourist Organization (JNTO) and “Provisional Statistical Report on Air Transport” released by the Ministry of Land, Infrastructure and Transport.

<sup>14</sup> Since September 1, 2003, Japanese travelers to China staying for a period of 15 days or less are exempted from visa acquisition. Moreover, during 2004, some new air routes to China were established besides additional flights added to existing routes.

In 2004, the net balance of other services decreased for the third consecutive year. This was because increases in credit (up 835.8 billion yen from 2003) exceeded increases in debit (up 245.6 billion yen from 2003) for the following sub-components: merchanting and other trade-related services, royalties and license fees, construction services, financial services, insurance services, and government services n.i.e. (The increase in credit for government services n.i.e. reflects the dispatch of the Japan Self-Defense Forces to Iraq and other factors.)

Developments in the sub-components of other services are as follows.

**(1) Merchanting and other trade-related services**

The surplus in the balance of merchanting and other trade-related services increased due to an increase in credit (up 213.4 billion yen from 2003). This represented the fifth consecutive year of increases in credit. The increase in credit mainly reflected the increase in merchanting commissions received due to brisk merchanting (transaction of goods not passing through Japanese customs) of audiovisual apparatus, precision machinery, and computer game equipment.

**(2) Royalties and license fees (Chart 37)**

The surplus in the balance of royalties and license fees increased. Debit increased by 119.1 billion yen from 2003, due to the increased debit for telecommunications-related copyrights and license fees. However, this was exceeded by the continued increase in credit. This reflected a 255.5 billion yen increase in credit in fees for industrial property rights, led by the royalty payments received by Japanese automobile manufacturers.

**(3) Construction services (Chart 38)**

The surplus in the balance of construction services increased in 2004, increasing by 74.8 billion yen from 2003. Credit increased for the first time in six years, reflecting the restart of Southeast Asian construction projects suspended during the Asian currency crisis and a new construction order from the Middle East.

**(4) Financial services (Chart 39)**

In 2004, the surplus in financial services rebounded due to a considerable increase in credit, which registered a new high. The significant increase in credits exceeded the increase in debits due to a surge in the issuance and transactions of securities in Japan by nonresidents.

**(5) Insurance services (Chart 40)**

The deficit in insurance services narrowed in 2004 for the second consecutive year due to an increase in credit and a decrease in debit. The increase in credit was due to a decrease in payments of reinsurance claims<sup>15</sup> by Japanese insurance companies, which are treated as deductions from credit.

**3. Income (charts 41 and 42)**

The balance of income recorded a surplus of 9,273.3 billion yen, increasing by 992.1 billion yen or 12.0 percent from 2003. This reflected the following factors. The direct

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<sup>15</sup> 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.

investment income increased due to an increase in credit of dividends and distributed branch profits and that of portfolio investment income increased due to an increase in credit of interest on bonds and notes. On the other hand, other investment income decreased primarily due to a falloff in large credits recorded in 2003.

**a. Direct investment income (Chart 43)**

The surplus in the balance of direct investment income increased for the first time in three years to reach 1,368.7 billion yen, increasing by 425.6 billion yen or 45.1 percent from 2003. This reflected the increase in credit of dividends and distributed branch profits (up 408.1 billion yen to 1,331.8 billion yen) and reinvested earnings<sup>16</sup> (up 115.7 billion yen to 645.3 billion yen), as the result of the strong performance of the foreign subsidiaries of Japanese companies.

Debits of both dividends and distributed branch profits and reinvested earnings also increased due to the strong performance of Japanese companies.

**b. Portfolio investment income (Chart 44)**

The surplus in the balance of portfolio investment income increased to 7,430.8 billion yen, increasing by 610.0 billion yen or 8.9 percent. This represented the fourth consecutive year of record highs. This was due to the following two factors. First, credit of interest in bonds and notes, the main sub-component, increased reflecting the accumulation in outstanding amount of outward portfolio investment. This exceeded the negative impact caused by the declining interest rates and the appreciation of the yen against the U.S. dollar. Second, debits decreased due to the downward trend in domestic interest rates.

**c. Other investment income (charts 45 and 46)**

The surplus in the balance of other investment income decreased for the first time in two years to 485.7 billion yen, decreasing by 45.3 billion yen or 8.5 percent from 2003. This was because the decrease in credit of interest on loans was larger than the decrease in debit. The decrease in credit reflected the falloff in sizeable amounts of credits in interest on loans related to debt rescheduling.<sup>17</sup>

Both credit and debit of other investment income decreased in 2004, reflecting the contraction of assets and liabilities of Japanese banks' streamlining of their business operations overseas. However, there are signs that this downward trend is coming to an end as streamlining has passed its peak and banks are adopting a more positive stance in their business operations overseas.

**4. Current transfers (charts 47 and 48)**

The deficit in the balance of current transfers decreased for the first time in two years to 839.0 billion yen, decreasing by 30.7 billion yen or 3.5 percent. While the deficit in the official sector increased substantially, this was exceeded by the decrease in the deficit in other sectors.

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<sup>16</sup> In the BOP statistics, the 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 assumption that the dividends, which are to be received by the parent company in Japan, are assumed to be reinvested in the subsidiary by the parent company.

<sup>17</sup> 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, in accordance with the recommendation of the BPM5.

The increase in the deficit in the official sector is attributed to the following two factors. First, payments<sup>18</sup> for grants in aid to the reconstruction assistance in Iraq increased. Second, expenditures for the dispatch of the Japan Self-Defense Forces to Iraq were recorded as current transfers.<sup>19</sup>

The deficit in other sectors<sup>20</sup> decreased because of the following two factors. First, the falloff in the effects of large-scale payments for settlement money and penalties that were registered in 2003. Second, the payments relating to religious groups.

### **III. Capital and Financial Account (Chart 49)<sup>21</sup>**

#### **A. Summary**

In 2004, the capital and financial account recorded a net inflow for the second consecutive year. The net inflow of 1.5 trillion yen for 2004 was substantially smaller (down by 6.2 trillion yen) than the net inflow for 2003, which was the year that recorded the first net inflow after 1985. The capital and financial account in 2004 reflected mainly the developments in the financial accounts.

Net inflow of other investment dropped sharply from the previous year, decreasing by 16.7 trillion yen. This is attributed to the decrease of funds inflow from foreign banks' head offices and overseas branches through interoffice account transactions.

Portfolio investment evidenced a net inflow in 2004, after the net outflow in the previous year, with a total change of 10.8 trillion yen. This is mainly explained by purchases of JGBs by foreign investors.

Net outflow of direct investment shrank by 116.5 billion yen from previous year, reflecting active inward direct investment in telecommunications and other industries.

#### **B. Developments in Principal Components**

##### **1. Direct investment (Chart 50)**

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<sup>18</sup> At the International Donors Conference for the Reconstruction of Iraq (Madrid Conference) held in October 2003, Japan pledged 1.5 billion U.S. dollars as “grants for immediate needs.”

<sup>19</sup> The dispatch of the Japan Self-Defense Forces to Iraq is treated as a provision of government services from Japan to Iraq, and expenditures related to the dispatch are recorded as credit in government services n.i.e. (a sub-component of “other services” under services). At the same time, dispatch expenditures are assumed to represent counter value and are recorded in current transfers as a debit in the official sector (beginning with revised statistics for the January–March quarter of 2004).

<sup>20</sup> The methodology of other sectors was changed in April 2003. Therefore, there is no continuity of data between figures for 2003 and 2004. The following specific changes were made. The minimum threshold of workers' remittances, subject to the reporting statement in “report on payments and receipts,” was raised from 5 million yen to 30 million yen in transactions from April 1, 2003. This change left many smaller transactions unreported. A new survey on workers' remittances to family members remaining in home countries was introduced at the same time with a minimum reporting threshold of 2 million yen, bridging this gap in source data.

<sup>21</sup> This account includes outward investment and loans by residents, withdrawal of inward investment and loans by nonresidents, and changes in reserve assets.

Outward direct investment by residents<sup>22</sup> increased for the first time in three years. Led by direct investments in Asia, the net outflow grew by 0.2 percent to reach 3.3 trillion yen. Inward direct investment<sup>23</sup> by nonresidents increased due to active investment in Japan's telecommunications sector and in other industries. With a 16.7 percent growth, the net inflow increased substantially from the previous year and posted a 855.6 billion yen balance. As a result, the ratio of inward to outward direct investment was 25.6 percent, up from 22.0 percent in 2003.

Developments in the first and second half of 2004 were as follows. In the first half of 2004, outward direct investment decreased slightly from the previous year. This was mainly due to the falloff in sizable investments by a financial institution to its subsidiary in Europe in the previous year. For its part, inward direct investment increased from the previous year. The growth is primarily explained by a large-scale capital equity transaction, involving Japanese subsidiaries of a European telecommunications company. In the second half of 2004, outward direct investment increased from the previous year, in connection with active investment transactions by Japanese operators mainly in financial services and insurance companies, and in automobile and motor vehicle manufacturers, seeking to expand their existing overseas businesses. For their part, large-scale investments in Japanese telecommunications firms explain the expansion of inward direct investment.

#### **a. Outward direct investment (assets)**

In 2004, outward direct investment posted a net outflow of 3.3 trillion yen, up 0.2 percent from the previous year. This reflected an improvement in the financial conditions of Japanese companies as a result of a recovery in the domestic economy. The following factors explain the increase in the net outflow: investments engaged in 2004 were mainly pro-cyclical measures, participating in an overall growth strategy, including (1) capital injection in subsidiaries in carmakers and manufacturers of parts for motor vehicles, financial services and insurance, and energy-related industries to prepare for the expansion of overseas businesses; and (2) capital participation in companies in the beverage and Internet business industries. However, several transactions were motivated by (3) assistance by Japanese parent companies to their overseas subsidiaries in carmakers and other industries in the form of financial assistance. In addition, other forms of investment included (4) purchases of corporate-type investment trusts<sup>24</sup> by Japanese financial institutions as an investment vehicle. Regarding capital flows into Japan, some financial institutions reduced the capital of overseas subsidiaries (withdrawal of outward direct investment by Japanese investors) following revision of strategies for overseas businesses.

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<sup>22</sup> Outward direct investment refers to direct investment by a resident in an economy into a resident in another economy (a nonresident), and is recorded as a change in assets in the BOP statistics. It includes investment by Japanese companies in their foreign subsidiaries (with a paid-in capital ratio of 10 percent or more), such as initial capitalization, capital increase, loan capital (excluding loans between financial companies), and reinvested earnings.

<sup>23</sup> 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 a paid-in equity ratio of 10 percent or more), such as initial capitalization, capital increase, loan capital (excluding loans between financial companies), and reinvested earnings.

<sup>24</sup> Investments in corporate-type investment trusts are recorded as direct investment in the BOP statistics when the equity ratio is 10 percent or more.

### **(1) Regional breakdown (Chart 51)**

The following developments were observed in outward direct investment by region in the first half of 2004. Investment in Asia surged, increasing by 64.3 percent over the previous year. This reflects active investment by carmakers and manufacturers of parts for motor vehicles and other industries to establish new production and to expand existing ones to bolster local production and marketing capabilities mainly in China. Investment in the United States increased by 19.1 percent from the previous year primarily reflecting large-scale loans extended by a Japanese carmaker to its U.S. subsidiary to support downsizing of the existing operations. Investment in the EU decreased substantially, declining by 44.6 percent from the previous year. In the financial sector, a large-scale capital injection in a Dutch subsidiary holding company was observed to supply investment funds aimed at Southeast Asian affiliate companies. However, the overall net outflow to the EU declined due to an absence of other sizeable investments.

Developments observed in investment in other regions included (1) investments made in subsidiaries in Australia and the Cayman Islands aimed at supplying raw materials and goods to the Chinese market, and (2) purchases of corporate-type investment trusts in the Cayman Islands.

### **b. Inward direct investment (liabilities)**

In 2004, inward direct investment posted a net inflow of 855.6 billion yen, representing a significant increase of 16.7 percent from the previous year. The growth subsumes large-scale investments in the telecommunications and financial services and insurance industries aimed at expanding business in Japan. These transactions largely compensated for the substantial sales of shares in Japanese subsidiaries by overseas investment funds (withdrawal of inward direct investment by nonresidents).

### **(1) Regional breakdown (Chart 52)**

The following developments were observed in inward direct investment by region in the first half of 2004. The net inflow of investment from the United States expanded dramatically, increasing by 2.5 times from the previous year, mainly because U.S. investment funds underwrote capital of a special-purpose entity (SPE) established in Japan for corporate rehabilitation. The net inflow of investment from Asia also increased substantially, by 2.1 times compared to the previous year. This is attributable to the following: a South Korean electric machinery manufacturer injected capital into its joint-venture subsidiary in Japan as part of business reorganization; and a real estate investment firm in Singapore invested in an SPE to securitize real estate in Japan. The net inflow of investment from the EU decreased by 13.0 percent from the previous year, reflecting mainly several outstanding operations: a Dutch holding company of a U.K.-based mobile communications company acquired substantial additional shares in its Japanese subsidiaries to expand its basis in the Japanese market. At the same time, a U.S. investment fund, acting through its Dutch subsidiary holding company, withdrew from investment by selling issued shares of a Japanese bank.

Regarding investment from other regions, a U.S. financial company (located in the Cayman Islands) invested in its Japanese branch to expand its asset securitization business in Japan.

### **2. Portfolio investment (excluding securities lending)**

In 2004, portfolio investment registered a net inflow of 1.9 trillion yen as compared to a net outflow of 8.9 trillion yen in 2003. This was the first net inflow to be registered in

seven years since 1997. This was because, although net purchases (outflow) expanded in outward portfolio investment, the increase in net purchases (inflow) in inward portfolio investment exceeded this.

#### **a. Outward portfolio investment (assets)**

Net purchases (outflow) of outward portfolio investment continued to increase in 2004 to reach 20.0 trillion yen from 18.4 trillion yen in 2003. This represented the seventh consecutive year in which net purchases exceeded 10 trillion yen and the first time they exceeded 20 trillion yen. Contributing factors included active purchases of foreign bonds and notes by residents, and the increase in net purchases of foreign equities.

#### **(1) Outward investment in equities (assets; charts 53 and 54)**

Net purchases (outflow) of outward investment in equities increased significantly to 3.3 billion yen in 2004 from 0.7 billion yen in 2003. This was mainly due to the purchase of foreign equities and foreign funds by investment trusts and banks' trust accounts.

#### **(a) Developments by investor category (Chart 55)**

In 2004, investment trusts were the largest investor for foreign equities. In particular, foreign REITs and Chinese equities were massively purchased, evidence of the soaring popularity of REIT funds and China equity investment funds. A large number of REIT funds were sold during 2004 following the liberalization of self-regulating rules concerning their investments.<sup>25</sup> Furthermore, purchases of U.S. and European equities increased toward the end of the year. This followed the rise in U.S. and European stock prices and the heightened flow of funds into global equity funds.

Net purchases by banks' trust accounts, which are used as investment contracts,<sup>26</sup> increased from 2003. This was mainly due to the steady flow of newly allocated funds from public pension funds throughout the year. Besides public pension funds, corporate pension funds also allocated their new funds to U.S. equities around mid-year. This was explained by the recovery of the U.S. economy and expectations for further increases in U.S. stock prices.

Banks furthered their net purchases as compared to 2003. This subsumes transactions bearing on purchases of corporate-type investment trusts with an aim to secure relatively higher levels of returns.

Life insurance companies recorded net sales as they continued to reduce their risks in their portfolios. On the other hand, special accounts for management of corporate pension funds were net purchasers. As a result, net sales narrowed from the previous year.

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<sup>25</sup> Self-regulating rules of the Investment Trusts Association of Japan concerning investment restrictions were liberalized in July 2003. Specifically, restrictions on investment in other investment trusts (fund of funds) were deregulated, so that it became possible for REITs to invest all their assets in fund of funds (including REITs). See Box 4 for details.

<sup>26</sup> The majority of outward portfolio investment by public pension funds is made by entrusting funds to investment management companies and banks' trust accounts. Thus, these are recorded as transactions under banks' trust accounts. The same holds true for corporate pension funds. However, in the case of corporate pension funds, some funds are entrusted to life insurance companies.

Under investment by other sector, net purchases increased from 2003. This was mainly because some securities firms increased purchases of equities for retail sales.

### **(b) Regional breakdown (Chart 56)**

In 2004, the following developments were observed in outward investment in equities by region. Net purchases in investment in U.S. equities increased. This was primarily due to the creation of REIT funds in Japan for investment in U.S. REITs. Investment in European equities posted net purchases as the result of active acquisition of corporate-type investment trusts established in Luxembourg and Ireland. Net purchases increased significantly in investment in Asian equities. This was due to the popularity of Chinese equity funds in the first half of the year in response to China's accelerated economic growth. Investment in other regions increased significantly. This reflected an increase in purchases of preferred shares and corporate-type investment trusts issued by SPEs located in the Cayman Islands and other tax havens. Specifically, Japanese nonfinancial firms purchased preferred shares<sup>27</sup> issued by Japanese banks to obtain funds to boost their net worth, and investors aiming for higher rates of return continued to purchase corporate-type investment funds.<sup>28</sup>

### **(2) Outward investment in bonds and notes (assets; charts 57 and 58)<sup>29</sup>**

Net purchases (outflow) of outward investment in foreign bonds and notes decreased slightly to 17.4 trillion yen from 18.4 trillion yen in the previous year, under the influence of the following factors: while the issuance and redemption of bonds and notes (outflow) evidenced a clear increase in transactions, this was largely exceeded by the decrease in the purchase (outflow) of transactions in bonds and notes, which account for a large proportion of this item.

#### **(a) Developments by investor category (Chart 59)**

In 2004, the following developments were seen in outward investment in bonds and notes by sector. Net purchases by banks increased significantly. This reflected the following. Investors with a strong preference for higher yields actively invested in government-sponsored enterprise (GSE) bonds<sup>30</sup> and asset-backed securities. Investors increased their purchases of U.S. government bonds in the second half of the year (Chart 60).

A more detailed review of the purchase of U.S. government bonds reveals the following. Investment was withheld in the first half of the year as the outlook for bond prices weakened. Beginning in the summer, economic indicators performed below those expected by the markets. Thereafter, investment in U.S. government bonds increased with expectations of higher bond prices.

Net purchases by investment trusts remained at approximately the same high levels as in 2003. This was due to the active purchase of investment trusts by household sector to

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<sup>27</sup> 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.

<sup>28</sup> Corporate-type investment trust securities and close-ended contract-type investment trust securities are included under "equities." Open-ended contract-type investment trust securities are classified under "bonds and notes."

<sup>29</sup> 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.

<sup>30</sup> Bonds issued by U.S. government-sponsored enterprises, such as the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (Freddie Mac).



monthly-distribution-income type investment funds, which mainly invest in foreign government bonds.

Net purchases by life insurance companies decreased from the previous year. Investment in foreign bonds and notes corresponding to sales of foreign-currency denominated insurance products remained firm. However, purchases of U.S. government bonds slowed down as investment in exchange-risk-hedged foreign bonds and notes became less attractive.

Life insurance companies continued to purchase exchange-risk-hedged U.S. and European government bonds as alternative investment tools to counter low domestic interest rates. However, at the time when domestic interest rates rose at mid-year in 2004, life insurance companies shifted their positions from hedged foreign bonds and notes to Japanese government bonds. Furthermore, higher currency hedging costs, which resulted from the rise in short-term U.S. interest rates, dampened new purchases while existing positions were reduced in some cases.

Net purchases by banks' trust accounts turned to net purchases from net sales in 2003. While purchases of foreign bonds for corporate pension funds decreased, this was exceeded by purchases of foreign bonds with funds newly allocated by public pension funds.

Net purchases by other sectors decreased reflecting the slowdown in the underwriting of bonds and notes for retail sales (see Box 5 for details).

Investment by the public sector<sup>31</sup> continued to record net sales. This reflected continuous withholding from reinvesting the redeemed funds in U.S. and European government bonds and notes.

### **(b) Regional breakdown (Chart 61)**

By region, net purchases remained at high levels for investment in the United States, reflecting the following developments. Although net purchase of exchange-risk-hedged foreign bonds and notes by life insurance companies decreased, banks actively purchased U.S. bonds and notes. Investment in Europe recorded a decrease in net purchases as investors liquidated their positions to earn capital gains when market prices rose toward the end of 2004. Net purchases under investment in other regions increased significantly, reflecting the following developments. Securities companies reduced their underwriting of bonds for retail sales issued by international organizations such as the International Bank for Reconstruction and Development (IBRD).<sup>32</sup> However, some financial institutions actively purchased securitized products mainly issued in the Cayman Islands.

### **(3) Outward investment in money market instruments (assets; Chart 62)**

Outward investment in money market instruments recorded net sales (inflow) for the fourth consecutive year, registering 647.2 billion yen in 2004 against 683.2 billion yen in 2003. Due to the downturn in asset securitization, the issuance of *samurai* CP through overseas SPEs decreased. This resulted in a decline in purchases by resident investors.

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<sup>31</sup> "Public sector" includes government financial institutions but excludes reserve assets (recorded in the BOP statistics as change in foreign reserves).

<sup>32</sup> In this report, international organizations, such as the IBRD, are categorized under "other regions." In the BOP statistics, regional classification is not applied to international organizations.

## **b. Inward portfolio investment (liabilities)**

Inward portfolio investment posted large net purchases (inflow), increasing to 22.0 trillion yen in 2004 from 9.5 trillion yen in 2003. Contributing factors included the shift of investment in bonds and notes to substantial net purchases (inflow) and continued sizable net purchases of inward investment in equities (inflow) from 2003.

### **(1) Inward investment in equities (liabilities; Chart 63)**

Inward investment in equities continued to register large net purchases (inflow), increasing to 10.6 trillion yen in 2004 from 9.8 trillion yen in 2003. This represented the highest level of inward portfolio investment recorded since 1999. This was mainly due to continued purchase of Japanese equities by nonresident investors in response to the relative improvement in Japan's economic indicators and corporate performances.

A more detailed review of inward portfolio investment in 2004 reveals the following. A broad range of stocks including those of export-related companies, banks and domestic-demand-related stocks were actively purchased from January through April 2004. The purchase, fueled by the depreciation of the yen and by Japan's improved economic indicators, was focused on export-related companies, banks and domestic-demand-related stocks. Against this background, Japanese stock prices rose ahead of foreign stock markets. However, a major sell-off of stocks of electrical machinery and telecommunications firms occurred in September. This was triggered by the bleaker economic outlook for the United States, concerns over a possible hard landing in the Chinese economy, and sagging prices for U.S. high-tech stocks. Over this period, foreign investors increased their positions in the stocks of banks, which had reported substantial progress in the disposal of nonperforming loans, and in domestic-demand-related stocks. Foreign investors also continued to purchase individual stocks with strong valuation indicators such as price-earnings ratios. However, net purchases fell below the pace that was maintained through April. Sizeable net purchases were again recorded beginning in October. The purchase reflected expectations of higher prices on the lagging Japanese stock markets and was centered on Japan's international blue chips and banks (**Chart 64**).

### **(a) Regional breakdown (Chart 65)**

Net purchases by U.S. investors decreased to 4.1 trillion yen in 2004 from 4.9 trillion yen in 2003. This reflected the slowdown in purchasing in the April–June and July–September quarters of 2004. For their part, net purchases by European investors increased to 5.4 trillion yen in 2004 from 3.7 trillion yen in 2003. As a result, net purchases (inflow) by European investors exceeded those of U.S. investors in 2004. By quarter, as in the case of U.S. investors, net purchases by European investors decreased in the April–June and July–September quarters. However, substantial increases in net purchases were registered in the January–March and October–December quarters.

### **(b) Industrial breakdown (Chart 66)**

By industry, equities were actively purchased in the following industries: (1) banks reporting good progress in the disposal of nonperforming loans and registering improved profits; (2) industries reporting relatively good performances, such as electrical machinery and transport equipment (motor vehicles); and (3) domestic-demand-related stocks (pharmaceuticals, foodstuffs, retail, etc.) bolstered by improvement in Japan's economic indicators.

## **(2) Inward investment in bonds and notes (liabilities; Chart 67)<sup>33</sup>**

Inward investment in bonds and notes turned to sizeable net purchases (inflow) of 6.5 trillion yen from net sales (outflow) of 1.6 trillion yen in 2003. This mainly reflected the following developments. First, sales and purchases of securities posted sizeable net purchases (inflow) of 5.1 trillion yen in 2004 from net sales of 2.3 trillion yen in 2003. Second, issuance and redemption of bonds and notes issued overseas by residents recorded a significant increase in net issuance (inflow).

A thorough review of sales and purchases of securities highlights several outstanding facts: hedge funds and foreign banks actively combined cash bond purchases and bond futures sales as rising bond prices rendered bond futures relatively expensive in comparison to cash bonds. When swap spreads narrowed, hedge funds and foreign banks took on new arbitrage positions combining cash bond purchases and swap payments, or closed out arbitrage positions taken on in the past involving cash bond sales and swap receipts. In addition to arbitrage transactions combining futures and asset swaps, outright purchases of bonds and notes by some Asian and other foreign institutional investors increased toward the end of the year. This was mainly due to the continued appreciation of the yen and firmness in the bond market.

Regarding the issuance and redemption of bonds and notes issued overseas by residents, data indicate large-scale issuance of subordinate bonds by several Japanese banks and an increase in the issuance of convertible bonds. In the latter case, the move manifests strong investment demand from foreign investors who anticipated the conversion of corporate bonds to shares as Japanese stock prices rose.

### **(a) Regional breakdown (Chart 68)**

U.S. investors recorded net sales (outflow). This reflected a surge in net sales in the April–June quarter when lower bond prices rendered bond futures relatively less expensive compared to cash bonds, encouraging investors to take on new arbitrage positions combining cash bond sales and bond futures purchases. European investors were also net sellers in the April–June quarter. However, in the last two quarters of 2004, European investors actively purchased cash bonds in arbitrage transactions combining bond futures and asset swaps. As a result, for the entire year, European investors reported sizeable net purchases (inflow). For their part, Asian investors also posted net purchases (inflow). This was mainly due to outright purchases undertaken by some foreign institutional investors.

## **(3) Inward investment in money market instruments (liabilities; Chart 69)**

Inward investment in money market instruments continued to record sizeable net purchases (inflow), reaching 4.9 trillion yen in 2004 from 1.3 trillion yen in 2003. This reflected heightened demand for investment of yen funds.

A more detailed review of inward investment in money market instruments emphasizes several outstanding elements. At the beginning of the year, some banks reported growing outstanding amounts of excess yen funds on hand as a result of increased intervention on foreign exchange markets (yen sale and U.S. dollar purchase). These yen funds were invested in low-risk financing bills (FBs) and treasury bills (TBs). When foreign

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<sup>33</sup> 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.

exchange market interventions stopped in April, investors maintained their assets in yen financed at low cost in the form of FBs and TBs, giving rise to sizeable net purchases (inflow) in certain months.

### **3. Financial derivatives (Chart 70)**

Financial derivatives recorded a decrease in net inflow, falling to 261.1 billion yen in 2004 from 607.4 billion yen in 2003. While credits were recorded for both option premiums and interest rate swaps, these were exceeded by debits related to stock futures.

During 2004, credits in premiums were generated as Japanese banks sold currency options to create positions anticipating stable foreign exchange markets. At the term when domestic and major foreign interest rates declined in the second half of the year, interest rate swap transactions contracted between Japanese banks or trust banks and nonresidents generated fixed interest rate net credits (inflow). In March 2004, foreign investors unwound long positions on Nikkei 225 futures and TOPIX futures to realize capital gains. This resulted in sizeable net payment (outflow) to foreign investors by resident counterparties, mainly securities companies.

### **4. Other investment (excluding securities lending; charts 71 and 72)**

Net inflow was recorded in other investment for the fourth consecutive year. However, the amount of net inflow fell sharply to 2.3 trillion yen in 2004 from 19.0 trillion yen in 2003. This was mainly due to the decrease in the inflow of funds from overseas head offices and branches of foreign banks through interoffice account transactions.

In 2004, both Japanese and foreign banks registered a net inflow (primarily liabilities) in their interoffice accounts. Some Japanese banks used interoffice accounts for fund-raising in foreign currencies in order to pursue portfolio investment in foreign bonds and notes. Given the negative cost of funding in yen in exchange for the U.S. dollar throughout 2004, foreign banks recorded both an inflow of funds in yen, which was traded in overseas markets, and an inflow of foreign currencies for conversion to yen in the Japanese market. However, because the negative cost of funding yen narrowed in comparison to 2003, funds that reached maturity were redeemed. As a result, the net inflow decreased.

### **Box 1: Japan's BOP from the Perspective of the "Balance of Payments Development Stage Theory"**

According to Crowther's "balance of payments development stage theory," a country's BOP undergoes certain long-term patterns of change. The theory explains that the balance between domestic investment and savings (IS balance) in any national economy will pass through certain stages in the process of economic development (as defined, for example, by the increase in per capita national income), and that in its relation to the rest of the world, the economy will advance from a debtor to a creditor country and finally to one that liquidates its overseas assets (Chart 1 for Box 1).<sup>34</sup>

#### **(a) Stage I: Immature Debtor Countries**

A country in the first stage of development is an importer of capital due to a shortage of domestic savings and difficulty in procurement of development funds. Hence, the capital and financial account registers a surplus (the current account registers a deficit). In this stage, the balance of goods and services is also in deficit due to underdeveloped domestic export industries. Finally, because it is a debtor country, the balance of income also shows a deficit.

#### **(b) Stage II: Mature Debtor Countries**

Imported capital promotes the development of export industries, and eventually the balance of goods and services turns to surplus. However, due to continued payment of interest on past debt, the current account remains in deficit.

#### **(c) Stage III: Debt Repayment Countries**

As the process of stage II advances, the surplus in the balance of goods and services comes to exceed the deficit in the balance of income. At this point, the current account turns to surplus (and on the reverse side, the capital and financial account turns to deficit). At this stage, the country remains a debtor country in stock terms but is repaying its debt in flow terms.

#### **(d) Stage IV: Immature Creditor Countries**

As the process of stage III advances, repayment of past debt is completed. As the surplus in the balance of goods and services supports a current account surplus, the country becomes a creditor country in stock terms. As a result, the balance of income also turns to surplus.

#### **(e) Stage V: Mature Creditor Countries**

The balance of goods and services turns to deficit as domestic export industries lose their international competitiveness due to high labor cost and other factors. At this point, the country is deemed to have entered the stage of a mature creditor. The current account remains in surplus due to the surplus in income balance reflecting past investment.

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<sup>34</sup> According to the fiscal 1984 *White Paper on the Economy*, the following countries have undergone changes in the structure of their BOP in general conformity to the development stage theory: the United Kingdom after the Industrial Revolution, the United States during the 20th century, and Japan in the postwar period. On the other hand, various cases have been cited in which countries have not followed the pattern of the development stage theory due to (1) destruction of their economic foundation through war and turmoil (such as Japan before and after World War II), and (2) changes in economic structure caused by exogenous factors (such as the United Kingdom upon discovery of North Sea oil).

#### **(f) Stage VI: Credit Disposing Countries**

As the process of stage V advances, the deficit in the balance of goods and services comes to exceed the surplus in the balance of income (at which point the current account turns to deficit), and the capital and financial account turns to surplus. This denotes the liquidation of the overseas assets that the country has accumulated in the past.

Using this framework, the BOP of various countries can be compared as follows (Chart 2 for Box 1).

- (1) Developing countries, such as Mongolia and Cambodia, can be identified as immature debtor countries (stage I) characterized by “a deficit in the balance of goods and services, and a deficit in the balance of income.”
- (2) Brazil was an immature debtor country (stage I) until the 1990s, but is now a mature debtor country (stage II). This is because its balance of goods and services has turned to surplus, reflecting the improved competitive position of its export industries.
- (3) China and Canada can be identified as stage III debt repayment countries characterized by “a surplus in the balance of goods and services exceeding the deficit in the balance of income.”

The BOP structure of Germany was affected by the reunification of East and West Germany in 1990.

- (4) France, Japan, and Switzerland can be identified as immature creditor countries (stage IV) characterized by “a surplus in the balance of goods and services, and a surplus in the balance of income.” South Korea has also joined this group recently.
- (5) The United States and the United Kingdom are registering current account deficits. From this, they can be identified as credit disposing countries (stage VI) characterized by “a deficit in the balance of goods and services exceeding the surplus in the balance of income.”

The surplus in the balance of income of the United States is approaching zero. From this, it can be argued that the United States may again become an immature debtor country (stage I) in the future. But the United States would be unlike the immature debtor country assumed by Crowther. For this reason, a different approach will be needed to classify the future BOP structure of the United States. For this purpose, it is notable that stages in economic development can be clearly identified using the balance of current transfers as a gauge. That is, it is highly likely for developing countries to register surpluses in their balance of current transfers due to the inflow of “economic aid” from developed countries and international organizations, and the inflow of “workers’ remittances” from family members working in developed countries. On the other hand, it is highly likely for developed countries to register deficits in their balance of current transfers due to the outflow of “economic aid” to developing countries and international organizations, and the outflow of “workers’ remittances” by foreign workers employed domestically. As a matter of fact, developed countries (countries in stages IV, V, and VI) generally register deficits in their balance of current transfers, while developing countries (countries in stages I, II, and III) generally register surpluses in their balance of current transfers.

A review of the BOP of Japan from a long-run perspective reveals the following. During the past 20 years or so, Japan has been an immature creditor country (stage IV) characterized by “a growing surplus in the balance of income, and growing external assets (a deficit in the capital and financial account)” (Chart 3 for Box 1). In terms of its balance of goods and services, Japan experienced a shrinking of its surplus between 1986 and 2000. However, this shrinkage in the balance of goods and services has been halted (2001–04), and it appears that Japan has moved back from the process of becoming a mature creditor country (stage V).

## **Box 2: Profitability of Direct Investment Enterprises in China**

While direct investment in China continues at a high level, changes have been observed in the profitability of direct investment enterprises in recent years. The profit rate of direct investment enterprises in China derived from BOP statistics remained very close to zero until 2000, and was clearly lower than the global average profit rate for direct investment enterprises. However, the profit rate of direct investment enterprises in China has risen to around the 5 percent mark since 2001 and has outperformed the global average (Chart 1 for Box 2).

An analysis of the improvement in the profit rate of direct investment in China since 2001 reveals the following factors.

### **1. China's Booming Economy**

A review of economic trends in China points to a period of economic slowdown through 1999, followed by the steady expansion beginning in 2000. As the Chinese economy grew steadily, sales of direct investment enterprises in China increased and profits increased accordingly (Chart 2 for Box 2).

### **2. Growth and Deepening of Japan-China Trade**

The main source of profit for Japanese-affiliated direct investment enterprises in China is said to be international trade whose pivot is Japan. The weight of Japan in the total value of sales and procurements by Japanese-affiliated direct investment enterprises (manufacturing) in China began to increase around 2001 (Chart 3 for Box 2). Moreover, a review of trends in trade with China (combined amount of exports and imports, including Hong Kong: customs-clearance basis<sup>35</sup>) indicates that both exports and imports have been steadily growing<sup>36</sup> since 2000. This growth in trade has contributed to the increase in profits of Japanese-affiliated direct investment enterprises in China (Chart 4 for Box 2).

### **3. Growing Weight of Higher-Value-Added Industries**

The ratio of recurring profits to revenues of Japanese-affiliated direct investment enterprises in China can be derived using the Ministry of Economy, Trade and Industry's "Basic (Trend) Survey of Overseas Business Activities." Computations indicate a major upward shift beginning in 2000. The shift is particularly conspicuous in the manufacturing sector (Chart 5 for Box 2). A breakdown of manufacturing industries indicates a relatively high ratio of recurring profits to revenues in transport equipment (primarily motor vehicle related) (Chart 6 for Box 2). The growing weight of transport equipment (Chart 7 for Box 2) can be seen to have raised the ratio for the entire manufacturing sector. Over the past few years, there has been a marked increase in direct investment projects in China undertaken by Japanese-affiliated carmakers and related parts manufacturers. Likewise, there has been an increase in joint ventures and alliances with local companies in these fields. Increased local production and sales in these

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<sup>35</sup> Customs-clearance statistics are subject to "country of origin principle" of the importing country. For example, goods produced in China and imported into Japan through Hong Kong are treated as imports from China. In the case of exports, the shipping destination is considered to be the country to which the goods are exported. Hence, goods exported to China through Hong Kong are treated as exports to Hong Kong. Therefore, it is appropriate to include Hong Kong in gross basis statistics of trade with China.

<sup>36</sup> In 2004, Japan's trade with China (gross basis trade, including Hong Kong) exceeded trade with the United States for the first time.



industries have contributed to improving the profitability of Japanese-affiliated direct investment enterprises in China as a whole.

#### **4. Outgrowing “Start-Up Losses”**

Japanese-affiliated direct investment enterprises in China tend to be considerably younger than counterparts in the United States and Europe, as well as counterparts in the NIEs and ASEAN regions (Chart 8 for Box 2). Generally, newly established enterprises tend to suffer from “start-up losses” (Chart 9 for Box 2). It appears that many Japanese-affiliated direct investment enterprises in China were registering “start-up losses” prior to 2000. However, as they gradually matured, Japanese-affiliated direct investment enterprises in China began to outgrow their “start-up losses” after 2000 and are now enjoying improved profitability.

#### **5. Improvement in China’s “Infrastructure”**

It is frequently commented that manufacturing and business activities in China face infrastructure bottlenecks. These include “hardware” bottlenecks, such as power supply and telecommunications, and “software” bottlenecks, such as issues related to the legal and tax systems. While these bottlenecks have not been totally removed, there are indications that infrastructure problems are being diminished and resolved (Chart 10 for Box 2). The reduction of such forms of “risk” has also contributed to improving the profitability of Japanese-affiliated direct investment enterprises in China.

### **Box 3: Travel Expenditure Per Capita and Debit in Travel**

In 2004, the deficit in the balance of travel increased because the debit increased owing to the recovery of number of Japanese overseas travelers from the negative effects of SARS in 2003.<sup>37</sup> The debit amounted to 3,416.7 billion yen (based on the former compilation method of 2002 and before), which was equivalent to only 85 percent of the peak level (4,032.8 billion yen) registered in 1996 (based on the BPM5 since 1996) (Chart 1 for Box 3). On the other hand, the number of Japanese overseas travelers in 2004 recovered nearly to the level marked in 1996 (approximately 17 million). This indicates that a decrease in travel expenditure per capita is suppressing the increase in the deficit in the balance of travel.

The decrease in travel expenditure per capita in recent years is widely recognized in the travel industry (Chart 2 for Box 3). This has been attributed to the following factors: (1) the share of Asia, which is a low-cost destination in total travel, has increased; and (2) the share of male travelers in the 30–59 age group, whose travel expenditure per capita is low, has increased.

#### **(1) Increased Share of Asian Countries**

Destinations of Japanese overseas travelers are shown in Chart 3 for Box 3. The shares of travelers to Asia and the United States were roughly equal in the past. However, beginning in 1999, Asia has consistently outperformed the United States as the leading destination for Japanese overseas travelers. The growing popularity of Asian destinations can be attributed to the following: (1) overseas travelers have shown a preference for “inexpensive, nearby, and short”<sup>38</sup> trips under the unfavorable income environment; (2) the traditional cultures of Asian countries have come to be widely recognized as tourist resources; and (3) compared to other regions, travel in Asian countries offers a higher grade of travel at relatively lower prices.

#### **(2) Increased Share of Male Travelers in 30–59 Age Group**

A breakdown of Japanese overseas travelers by sex and age group is shown in Chart 4 for Box 3. In the past, the largest group consisted of women in their 20s. However, the share of this group has decreased sharply since 1998. The slack has been taken up by the share of men in the 30–59 age group. The latest available figures indicate that men in their 30s now constitute the leading group of Japanese overseas travelers.

The decreasing share of women in their 20s reflects the unfavorable income environment<sup>39</sup> beginning in the second half of the 1990s (Chart 5 for Box 3). The

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<sup>37</sup> A new compilation method for travel was introduced in 2003 (for details, see “Reference” in Japan’s Balance of Payments for 2003). Under the new method, figures have shifted upward compared to figures compiled by the former method for 2002 and before.

<sup>38</sup> According to the surveys of Japan Tourism Marketing Co. (JTM), travel expenditure per capita of travelers to Asian countries is less than 50 percent of travel expenditure per capita of travelers to the United States, and less than 75 percent of travel expenditure per capita of travelers to Guam and Saipan (2003). Regarding duration of travel, in the past, trips of four days or less accounted for approximately 10 percent of all travel. This ratio surpassed 20 percent for the first time in 2000 and increased to roughly 25 percent in 2003. The number of trips per year has remained steady at around 1.7.

<sup>39</sup> Results of a public opinion poll conducted by the Cabinet Office (“Survey on Leisure Time and Tourism” conducted in 2003) depict women in their 20s cutting back on overseas travel for economic reasons. According to this survey, the ratio of people opting for domestic travel for

increasing share of men in the 30–59 age group can be attributed to the increase in business travel and extended interest in overseas travel within the context of “inexpensive, nearby, and short” trips (Chart 6 for Box 3).

Travel expenditure per capita by sex and age group is shown in Chart 7 for Box 3. Travel expenditure per capita of men in the 30–59 age group is significantly lower than that of women in their 20s. In the travel industry, this is frequently attributed to the following. The primary purpose of overseas travel by men in the 30–59 age group is interaction with foreign cultures, such as visits to historical sites. In comparison, women in their 20s have a greater interest in activities such as shopping and dining at restaurants.

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economic reasons was highest among women in their 20s (28 percent), while the ratio of people indicating that they were not interested in overseas travel was lowest among women in their 20s (4.4 percent).

#### **Box 4: Outward Portfolio Investment by Investment Trusts in 2004**

Establishment of investment trusts in Japan slowed down after the end of 2001 due to the Enron bankruptcy.<sup>40</sup> However, net increases in investment trusts were registered from the beginning of 2004 (Chart 1 for Box 4).

It is remarkable that, during 2004, investment in foreign equities by investment trust companies increased significantly (Chart 2 for Box 4). To analyze the trends in recent investment trusts, new funds sold during 2003 and 2004 are classified into six categories according to each investment fund portfolio (Chart 3 for Box 4). Funds are classified into the following six groups: investment funds that mainly invested in (1) foreign equities other than Chinese equities, (2) Chinese equities, (3) foreign REITs, (4) Euroyen bonds issued by nonresidents, (5) foreign bonds, and (6) domestic securities (bonds and equities). A comparison of the results for the two consecutive years shows highlights as the following:

- (1) While the total amount of new funds sold increased to 2.0 trillion yen in 2004 from 1.6 trillion in 2003, the percentage of funds invested in domestic securities declined (to 25.4 percent in 2004 from 36.5 percent in 2003). On the other hand, the percentage of funds whose composition reflects an increased weight of foreign securities rose to 74.6 percent from 63.5 percent.
- (2) Among all foreign securities, the weight of Chinese equity funds increased to 12.6 percent from 2.6 percent. REIT funds also became popular,<sup>41, 42</sup> increasing the proportion of REITs from 0.4 percent to 4.6 percent. These developments contributed to the increased share of investment in foreign equities in outward portfolio investment.
- (3) Among outward bond investment, significant flows were recorded in funds that invested in Euroyen bonds issued by nonresidents, increasing the weight to 37.9

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<sup>40</sup> Enron Corporation filed for bankruptcy in December 2002; as a consequence, MMFs investing in Enron corporate bonds suffered a substantial loss of principal.

<sup>41</sup> REIT funds are open-end-type investment trusts with high liquidity. For this reason, additional cash inflows were seen even after the second half of 2004 when the new funds sales peaked out. If additional cash inflows to REIT funds are included, the real percentage of REIT funds should be higher than the percentage (4.6 percent) shown in the chart. Investments in corporate-type investment trusts are recorded as equity investment in the BOP statistics. For this reason, investments in foreign REITs by domestic REIT funds are treated as equity investment in the BOP statistics.

<sup>42</sup> Self-regulating rules of the Investment Trusts Association of Japan, "Matters Pertaining to Investment," were partially revised in July 2003. They raised the maximum allowable limit while allowing the inclusion of REITs in fund of funds. Following this revision, investment trust companies started to increase their offer of REIT funds from September 2003. Specifically, under the new rules, a publicly offered fund of funds can invest up to 30 percent of its net assets in a REIT when the following conditions are met: the fund of funds can be sold at any time, it can be valued on a mark-to-market basis, and information on management of funds at settlement is disclosed and available. Furthermore, if the publicly offered fund of funds aims to achieve a return on investment linked to a specified real estate index, it can invest in each REIT to create an index portfolio in its own funds.

percent from 29.4 percent. These types of investment funds are designed to link to Japanese stock prices, where those profits and losses are limited.<sup>43</sup>

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<sup>43</sup> Investment funds linked to Japanese stock prices are based on Euroyen-denominated structured bonds issued by nonresidents. Funds are structured to be redeemed prior to maturity, with payment of principal and dividends, when stock prices rise above a previously specified level. On the other hand, when stock prices fall below a previously specified level (normally set at 70–90 percent of the stock price at issue), the fund can be redeemed at a price linked to the ratio between the initial and final stock prices. As such, this type of fund limits risk while ensuring a certain level of return. As Euroyen bonds invested by the funds are structured with option contracts, dividends are set higher to include option premiums.

## **Box 5: Investment in Foreign Bonds by Individual Investors in 2004**

Japanese securities companies have actively underwritten foreign bonds for retail sales. This development has contributed to the increase in net purchases (outflow) of foreign bonds and notes in recent years. However, underwriting of foreign bonds for retail sales in 2004 fell sharply below the underwriting levels in 2002 and 2003, at roughly 30 percent of the previous year (Chart 1 for Box 5).

Underwriting of foreign bonds by securities companies for retail sales is directly influenced by changes in the investment environment, such as changes in yield spreads between Japanese and foreign bonds and foreign exchange rates. Underwriting is also affected by marketing strategies for retail sales by securities companies. Viewed from this perspective, the developments in 2004 can be characterized as follows.

### **1. Impact of the Foreign Exchange Rate**

Between 2002 and 2003, the yen depreciated against almost all other major currencies, creating an environment favorable to investment in foreign bonds (Chart 2 for Box 5). However, the yen stopped depreciating in early 2004 and began to appreciate around May. Given this unfavorable environment for investment in foreign bonds, underwriting of foreign bonds for retail sales declined (area “a” in Chart 1 for Box 5). Underwriting again increased later in the year when the yen underwent a mild depreciation, which created a supportive environment for investment in foreign bonds (area “b” in Chart 1 for Box 5).

### **2. Difference in the Domestic and Foreign Interest Rate (Chart 3 for Box 5)**

Individual investors tend to prefer high-yield products for investment, and during 2004 there was a marked preference for high-interest-rate currencies (Chart 4 for Box 5). In 2004, the weight of Oceanian currency denominated bonds, which are denominated in the high-interest-rate currencies of the Australian and New Zealand dollars, increased to roughly 70 percent. In particular, underwriting of bonds denominated in New Zealand dollars increased in the second half of the year when the official discount rate was raised from 6 percent to 6.25 percent in September 2004. On the other hand, underwriting of bonds denominated in Canadian dollars decreased sharply as the spread between the U.S. dollar and Canadian dollar narrowed.

Underwriting of bonds denominated in the South African rand was a trend observed in the second half of the year. Against the background of low interest rates for the major currencies, this development reflected efforts to find alternative currencies for investment.

### **3. Competition with JGBs for Individual Investors**

Retail marketing of foreign bonds is significantly influenced by the management strategies of securities companies. In 2004, JGBs issued for individual investors became popular due to the rise in long-term domestic interest rates and were set in competition with retail foreign bonds (Chart 5 for Box 5). Some securities companies that concentrated on marketing JGBs for individual investors suspended the underwriting of foreign bonds during the subscription period of JGBs. During JGB subscription periods, investment in foreign bonds by “other sectors,” which includes securities companies, also slowed down (area “c” in Chart 1 for Box 5).

## **Box 6: Features of Investment in Bonds and Notes by Foreign Investors in 2004**

Inward investment in bonds and notes (Chart 1 for Box 6) registered significant net outflows (2.0 trillion yen) in June 2004. However, large net inflows were reported from August to October (August: 1.7 trillion yen; September: 1.5 trillion yen; October: 1.4 trillion yen). These swings in net inflows and outflows were significantly larger than those observed in the past. One of the reasons for these swings was active arbitrage trading by foreign investors. The arbitrage trading is designed to take advantage of arbitrage opportunities created by changes of relative values between cash and futures bonds in periods of bond market fluctuation. Because spreads on such arbitrage trading are normally limited to a few basis points, investors are forced to undertake very large transactions in order to generate a significant amount of profits. In this section, investment behavior is analyzed for periods of rising interest rates and falling interest rates.

Inward investment in bonds and notes in 2004 by length of residual maturity is shown in Chart 2 for Box 6. During periods of rising interest rates (March–April, June), foreign investors increased their net sale of bonds and notes, centered on five- and ten-year bonds. On the other hand, during periods of falling interest rates (May, July–December), foreign investors were net buyers of bonds and notes.

The transactions described above are closely related to movements in the butterfly spread, which is used as an indicator in butterfly trades.<sup>44</sup> Five-year, seven-year, and ten-year butterfly spreads are shown in Chart 3 for Box 6.<sup>45</sup> This gives a picture of the relative values between futures and five- and ten-year bonds, which were comparatively cheaper and heavily purchased in relation to futures. During periods of rising interest rates (March–April, June), the butterfly spread widened in a positive direction as futures were sold (futures were relatively cheap in comparison to cash bonds). On the other hand, during periods of falling interest rates (May, July–December), the butterfly spread widened in a negative direction (futures were relatively expensive). Opportunities for arbitrage transactions tend to arise when the butterfly spread is widening in either direction.

In addition to arbitrage transactions involving futures, inward investment in bonds and notes was also partly influenced by arbitrage transactions based on changes in swap spreads (the spread between swap rates and JGB yields). For example, the spread for five-year bonds narrowed somewhat in June (cash bonds became cheaper in comparison

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<sup>44</sup> In a butterfly trade, investors focus on price highs and lows that occur among different maturities. The investors buy two units of bonds with different maturities that are relatively low in price, and simultaneously sell a relatively expensive bond of intermediate maturity. The butterfly spread refers to the interest rate spreads among various maturities and is used to observe the relative values of cash and future bonds of intermediate maturity.

<sup>45</sup> Futures transactions in long-term JGBs can be settled as follows: (1) reverse transaction and exchange of price differential prior to settlement date; or (2) delivery of eligible bonds (ten-year coupon bond with residual maturity of more than seven and less than eleven years) and exchange of cash. In the latter case, the seller of the futures has the right to choose the bonds to be delivered. Hence, normally, the seller delivers the cheapest bond. For this reason, there is a strong price linkage between the cheapest bonds and the futures prices. Currently, the cheapest bond consists of ten-year bonds with residual maturity of seven years. Therefore, the analysis is based on the assumption that the futures yield is equivalent to the yield on JGBs with residual maturity of seven years.

to swap rates) (Chart 4 for Box 6). During this period, arbitrage positions were developed involving purchase of cash bonds and swap payment. For this reason, five-year bonds registered net purchases, notwithstanding the fact that cash bonds became relatively expensive in comparison to futures.



## Reference: Revisions and Changes to the Recording Methods of the BOP Statistics in 2004

In compiling BOP statistics, it is necessary to constantly search for better data sources and to update estimation or data adjustment methods to reflect the continually changing economic situation more accurately. From this viewpoint, the method of compiling Japan's BOP statistics is constantly reviewed in cooperation with the International Monetary Fund (IMF)<sup>46</sup> and related parties in other major countries. The revisions and changes introduced in 2004 are listed below.

### Chart for Reference: Revisions and Changes to the Recording Methods of the BOP Statistics in 2004

	Category in BOP	Revisions and changes	Release date of revised data
<b>1</b> Expenses of the Japan Self-Defense Forces' humanitarian and reconstruction assistance activities in Iraq	Other services and current transfers	Inclusion in the statistics	From January 2004
<b>2</b> Resumption of the dissemination of business and personal data under travel account	Travel	Resumption of compilation and release	From April 2004

#### 1. Expenses of the Japan Self-Defense Forces' Humanitarian and Reconstruction Assistance Activities in Iraq

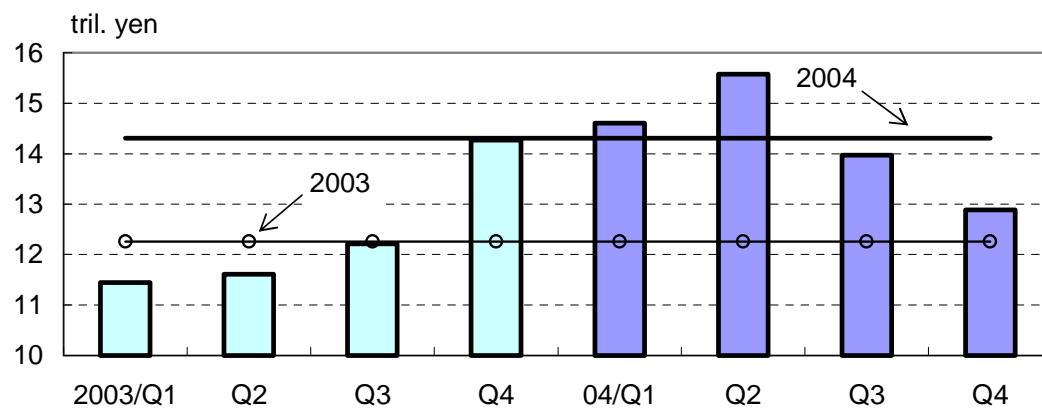
The government of Japan has dispatched the Japan Self-Defense Forces to Iraq, based on the Law Concerning the Special Measures on Humanitarian and Reconstruction Assistance in Iraq enacted in July 2003. Humanitarian and reconstruction assistance activities (medical care, water supply, transportation, infrastructure construction, etc.) started in January 2004. These assistance activities are recorded as current transfers from Japan to Iraq in the BOP statistics, because they imply grants from the Japanese government. Meanwhile, assistance activities can also be regarded as a provision of services by Japan to Iraq, and equivalent payments from Iraq to Japan are recorded as a credit in the "government services, n.i.e." Thus, the BOP statistics are based on an imputation whereby the grants provided by Japan to Iraq are returned from Iraq to Japan as payments for the provided services. The payments for the services cannot be evaluated, for example, at market value. Therefore, in accordance with the recommendations of the BPM5, the explicit cost, which is total expenditure of the Japan Self-Defense Forces in the course of humanitarian and reconstruction assistance activities in Iraq, is recorded in the BOP statistics. This method has been applied since the publication of revised BOP statistics for January 2004.

#### 2. Resumption of the Dissemination of Business and Personal Data under Travel Account

<sup>46</sup> The IMF formulates an international guideline in compiling the BOP statistics in the *Balance of Payments Manual* from the perspective of improving 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 structural issues related to BOP statistics.

The BPM5 recommends compiling data for business and personal travel separately, as a breakdown of travel by purpose. In line with the BPM5, Japan started to compile and release monthly data on business and personal travel in 1996. In July 2001, however, the “Embarkation Card and Disembarkation Card” (the so-called “ED card”) for Japanese overseas travelers, a principal data source for estimation, was abolished and became unavailable. This led to the suspension of the compilation and release of statistics on business and personal travel thereafter. While the Bank of Japan and the Ministry of Finance sought alternative data sources to the ED card, an appropriate data source for estimating business and personal travel was identified in the “Factual Survey of the Overseas Travel Situation” (released by Japan Tourism Marketing Co.), leading to the resumption of the compilation and release of data on business and personal travel from April 2004.

Summary Chart 1: Quarterly Balance of Goods in 2004 (Seasonally Adjusted, Annualized)



Summary Chart 2: Capital and Financial Account in 2004 (Quarterly)

bil. yen

	Q1	Q2	Q3	Q4
Capital and financial account	11,426.2	-3,823.5	-4,035.5	-2,075.7

Chart 1: Current Account

bil. yen

	2004		2003
		Changes from the previous year	
<b>Current account</b>	<b>18,590.8</b>	<b>+2,824.0</b>	<b>15,766.8</b>
<b>Goods and services</b>	<b>10,156.5</b>	<b>+1,801.2</b>	<b>8,355.3</b>
<b>Goods</b>	<b>14,310.8</b>	<b>(1) +2,051.1</b>	<b>12,259.6</b>
Exports	58,306.0	+6,371.7	51,934.2
Imports	43,995.2	+4,320.6	39,674.6
<b>Services</b>	<b>-4,154.2</b>	<b>-249.9</b>	<b>-3,904.3</b>
Transportation	-1,130.6	-241.9	-888.7
Travel	-2,917.1	(3) -598.2	-2,319.0
Other services	-106.5	+590.2	-696.6
<b>Income</b>	<b>9,273.3</b>	<b>(2) +992.1</b>	<b>8,281.2</b>
<b>Current transfers</b>	<b>-839.0</b>	<b>+30.7</b>	<b>-869.7</b>

Chart 2: Developments in Current Account Components

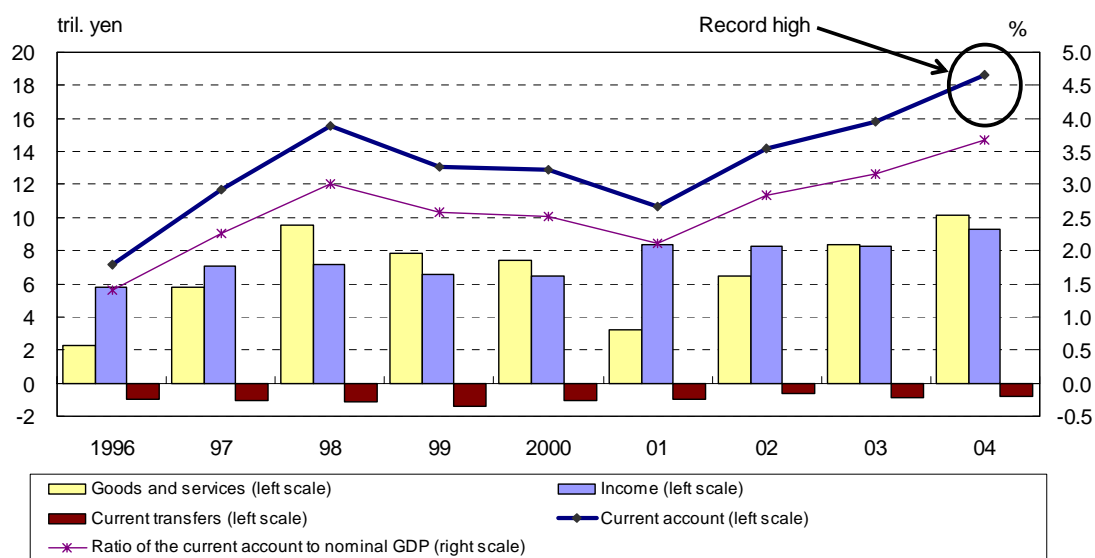
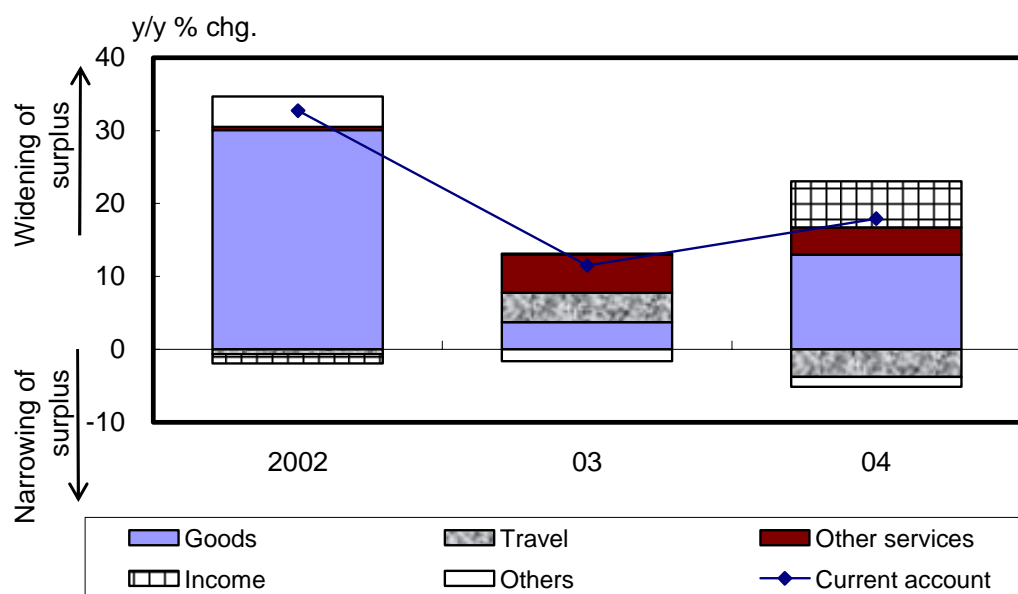


Chart 3: Contribution to Changes in Current Account<sup>1</sup>



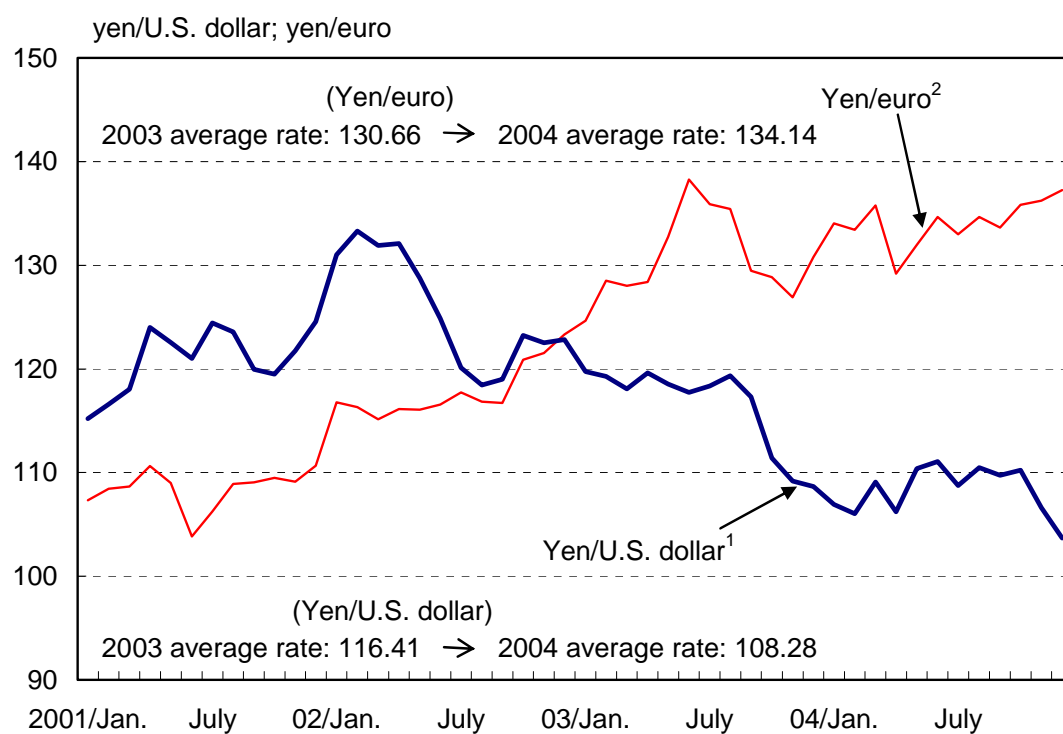
Note: 1. Narrowing of the deficit widens the overall surplus and vice versa for services (travel, transportation, other services) and current transfers, both of which consistently record a deficit.

Chart 4: Goods

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

	2004		
		Changes from the previous year	
Net balance	14,310.8	+2,051.1	(+16.7)
Exports	58,306.0	+6,371.7	(+12.3)
Imports	43,995.2	+4,320.6	(+10.9)

Chart 5: Exchange Rate



Notes: 1. The annual average rate of the yen against the U.S. dollar appreciated to 108.28 yen in 2004 from 116.41 yen in 2003.

2. The average rate of the yen against the euro depreciated to 134.14 yen in 2004 from 130.66 yen in 2003.

Chart 6: Contribution to Overall Export Growth by Region (Customs-Clearance Basis)<sup>1, 2</sup>

y/y % chg.

	Overall exports	United States	European Union	Asia	NIEs	ASEAN	China	Middle East
2003	+4.7	-2.8	+1.4	+5.5	+1.9	+0.2	+3.2	+0.1
2004	+12.2	+0.6	+1.7	+7.9	+4.2	+1.5	+2.5	+0.1

Notes: 1. Singapore is included in both NIEs and ASEAN.

2. EU membership was expanded in May 2004 (from 15 to 25 countries). The year-on-year figures for the EU are based on the expanded (25-country) EU membership. The new EU member countries are Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia.

[Reference] Comparison of the Accounting Method for Merchandise Trade Statistics and for Balance of Payments<sup>1,2</sup>

	Merchandise Trade Statistics	Balance of Payments Statistics
Price quoted	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. Merchandise trade statistics are trade statistics on a customs-clearance basis.

2. FOB stands for “free on board” and CIF for “cost, insurance and freight.” On an FOB basis, the price of goods at the border of the exporting country is recorded. On a CIF basis, freight charges and insurance premiums are recorded in addition to the price of goods.

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

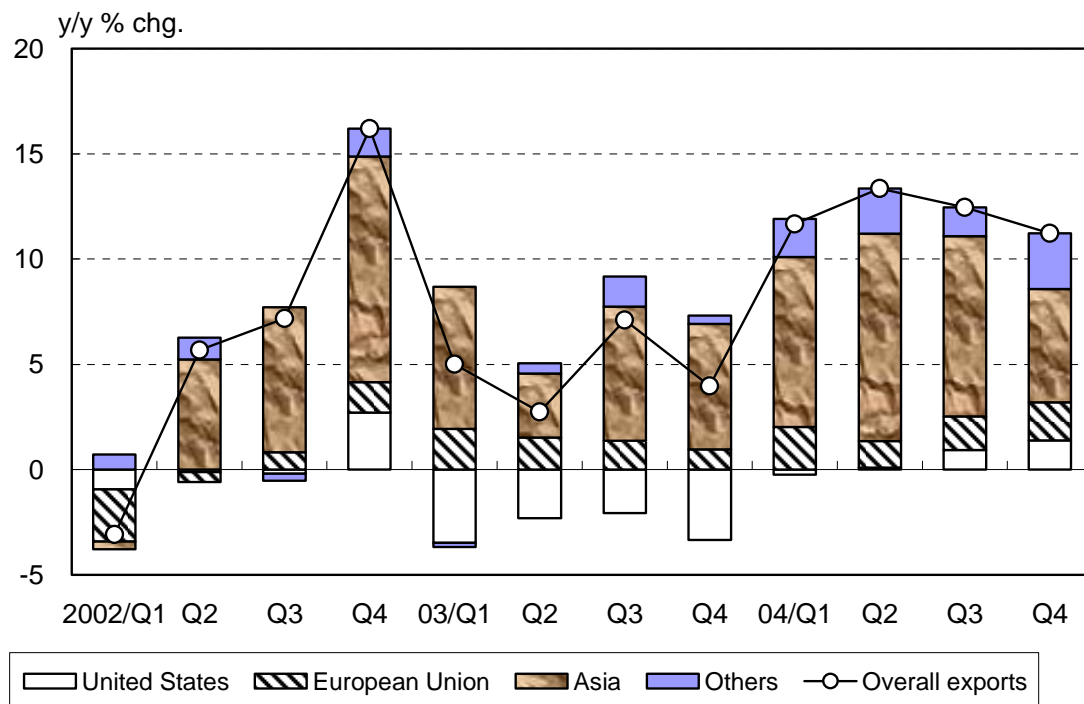


Chart 8: Major Items Contributing Positively or Negatively to the Growth in Exports to Asia

	Items	Contribution to the growth (%)
Items making a positive contribution	Scientific, medical, and optical instruments	+1.5
	Steel	+1.5
	Semiconductors and other electronic parts	+0.9
	Organic chemicals	+0.9
Items making a negative contribution	Office machines	-0.2
	Telecommunications apparatus	-0.2





Chart 12: Contribution to Overall Export Growth by Item

y/y % chg.

	2003	2004	Major factors
<b>Value of overall exports</b>	<b>+4.7</b>	<b>+12.2</b>	—
<b>Motor vehicle-related goods</b>	<b>+0.6</b>	<b>+1.1</b>	—
Motor vehicles	+0.2	+0.6	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	+0.4	+0.5	Expanded local production in Asia and the United States
<b>Raw materials</b>	<b>+1.0</b>	<b>+2.5</b>	—
Chemicals	+0.7	+1.3	Increased demand in Asia and pass-through of higher crude oil prices
Iron and steel products	+0.2	+0.8	Increased demand in Asia and pass-through of higher coal prices
<b>IT-related goods</b>	<b>-0.3</b>	<b>+0.5</b>	—
Semiconductors and other electronic parts	+0.4	+0.6	Increased demand for parts for digital appliances in China and NIEs
Office machines	-0.7	-0.0	Shift of production bases for PCs to China
Telecommunications apparatus	+0.1	-0.0	Shift of production bases to NIEs and other countries
<b>Other electrical machinery</b>	<b>+1.3</b>	<b>+2.2</b>	—
Audiovisual apparatus	+0.4	+0.2	Increased demand for flat-screen TVs and DVD players
Parts for audiovisual apparatus	+0.6	+0.5	Expanded production in Asia
<b>Other machinery</b>	<b>+1.8</b>	<b>+3.8</b>	—
Scientific, medical, and optical instruments	+0.3	+0.8	Increased demand for semiconductor manufacturing equipment reflecting expanded production of digital cameras and high technology-intensive mobile phones, especially in Asia
Metalworking machinery	+0.2	+0.3	Increased demand for semiconductor manufacturing equipment in Asia
<b>Other exports</b>	<b>+0.3</b>	<b>+2.1</b>	—

Chart 13: Contribution to Overall Import Growth by Region (Customs-Clearance Basis)<sup>1,2</sup>

y/y % chg.

	Overall imports	United States	European Union	Asia	NIEs	ASEAN	China	Middle East
2003	+5.1	-1.0	+0.4	+3.2	+0.2	+0.7	+2.4	+2.0
2004	+10.9	-0.1	+1.1	+5.6	+1.2	+1.1	+3.3	+1.9

Notes: 1. Singapore is included in both NIEs and ASEAN.

2. EU membership was expanded in May 2004 (from 15 to 25 countries). The year-on-year figures for the EU are based on the expanded (25-country) EU membership. The new EU member countries are Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia.

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

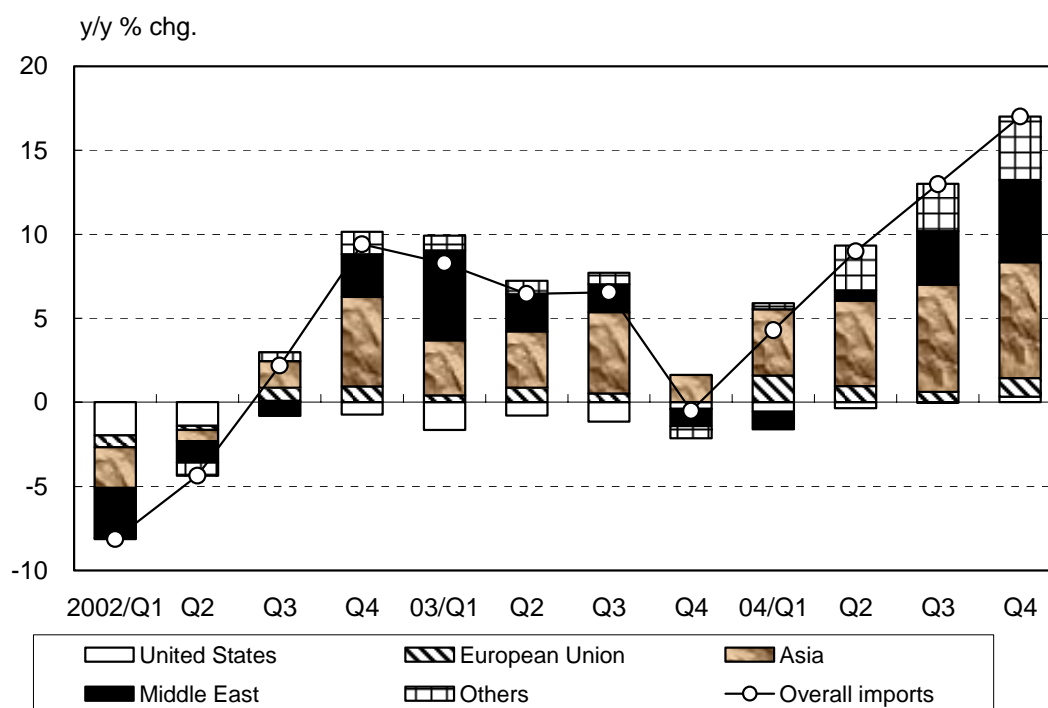


Chart 15: Major Items Contributing Positively or Negatively to the Growth of Imports from Asia

	Items	Contribution to the growth (%)
Items making a positive contribution	Semiconductors and other electronic parts	+1.4
	Audiovisual apparatus	+1.2
	Office machines	+0.9
	Iron and steel	+0.8
Items making a negative contribution	Crude oil and partly refined oil	-0.4
	Meat	-0.2

Chart 16: Major Items Contributing Positively or Negatively to the Growth of Imports from the European Union

	Items	Contribution to the growth (%)
Items making a positive contribution	Motor vehicles	+1.9
	Meat	+0.7
	Pharmaceuticals	+0.7
Items making a negative contribution	Aircraft	-0.4
	Telecommunications apparatus	-0.3

Chart 17: Major Items Contributing Positively or Negatively to the Growth of Imports from the United States

	Items	Contribution to the growth (%)
Items making a positive contribution	Coal	+1.0
	Gold	+0.2
	Electrical measuring and controlling instruments	+0.2
Items making a negative contribution	Meat	-2.7
	Aircraft	-0.4
	Office machines	-0.4

Chart 18: Contribution to Overall Import Growth by Item (Customs-Clearance Basis)

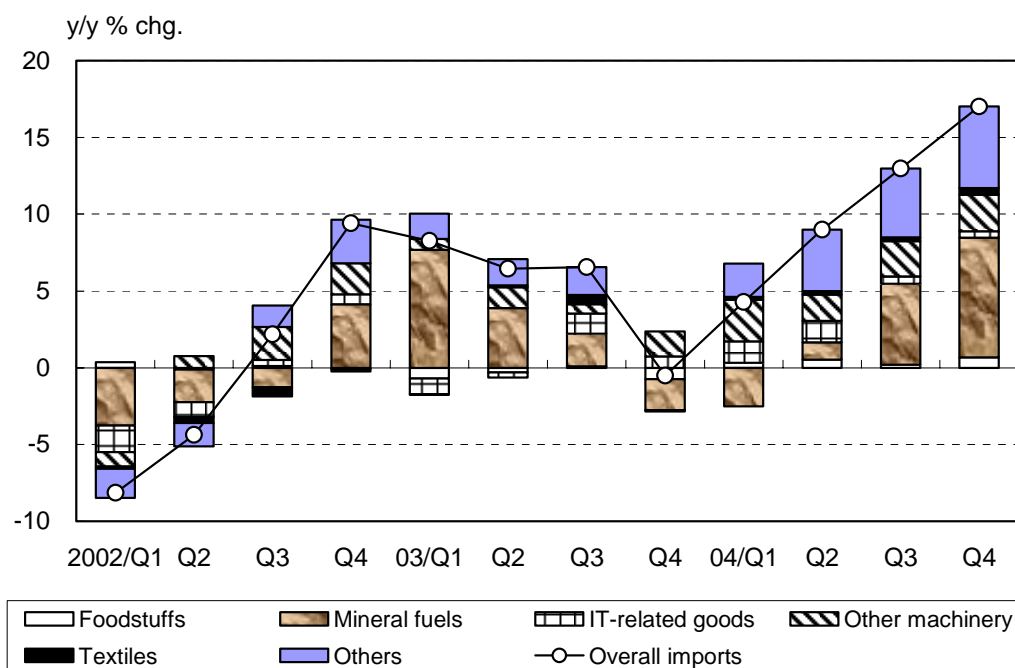


Chart 19: Contribution of Overall Import Growth by Item

	y/y % chg.		
	2003	2004	Major factors
<b>Value of overall imports</b>	<b>+5.1</b>	<b>+10.9</b>	—
<b>Mineral fuels</b>	<b>+2.8</b>	<b>+3.0</b>	—
Crude oil and partly refined oil	+1.8	+1.7	Rise in prices of crude oil
Petroleum products	+0.4	+0.4	Same as above
Coal	-0.1	+0.8	Rise in volume and sharp increase in price
<b>IT-related goods</b>	<b>+0.2</b>	<b>+0.9</b>	—
Semiconductors and other electronic parts	+0.3	+0.6	Increased demand for semiconductors in the first half of the year
Office machines	+0.1	+0.3	Launch of PC production bases in China
Telecommunications apparatus	-0.2	+0.0	—
<b>Textiles</b>	<b>+0.2</b>	<b>+0.3</b>	Rise in prices of raw materials
<b>Aircraft</b>	<b>+0.1</b>	<b>-0.1</b>	Slowdown in the demand for renewal of aircraft
<b>Chemicals</b>	<b>+0.5</b>	<b>+0.8</b>	Recovery in production in Japan and rise in prices
<b>Foodstuffs</b>	<b>-0.4</b>	<b>+0.4</b>	Sharp increase in imports of vegetables due to unfavorable weather

Chart 20: Services

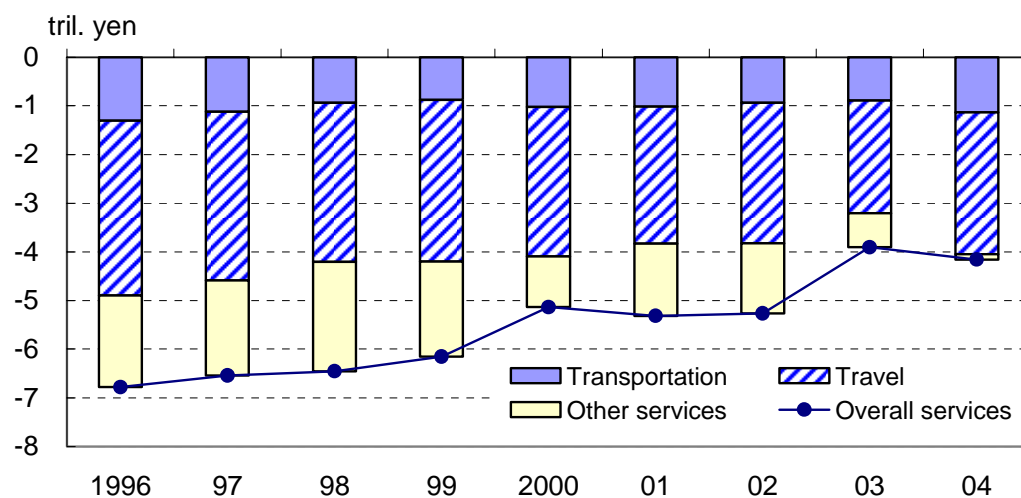


Chart 21: Balance of Trade in Services

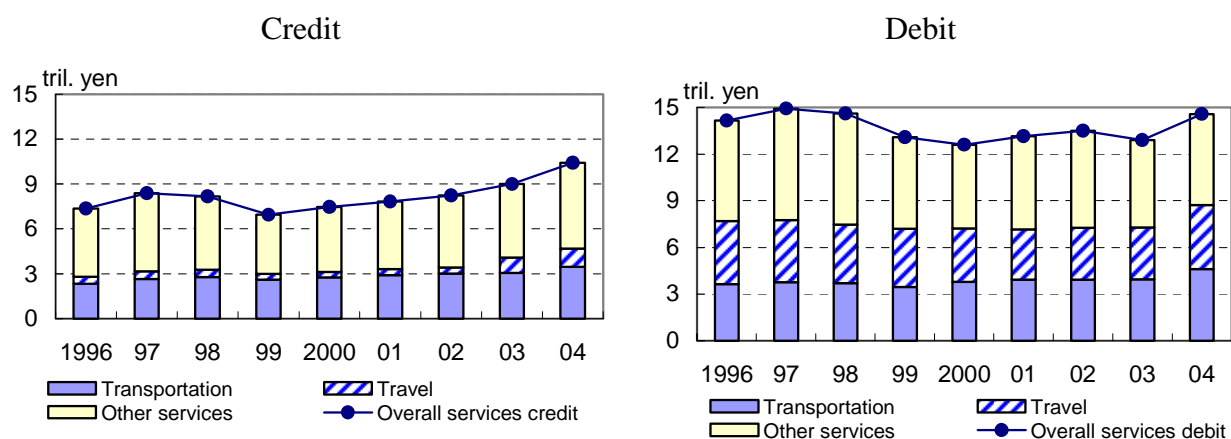
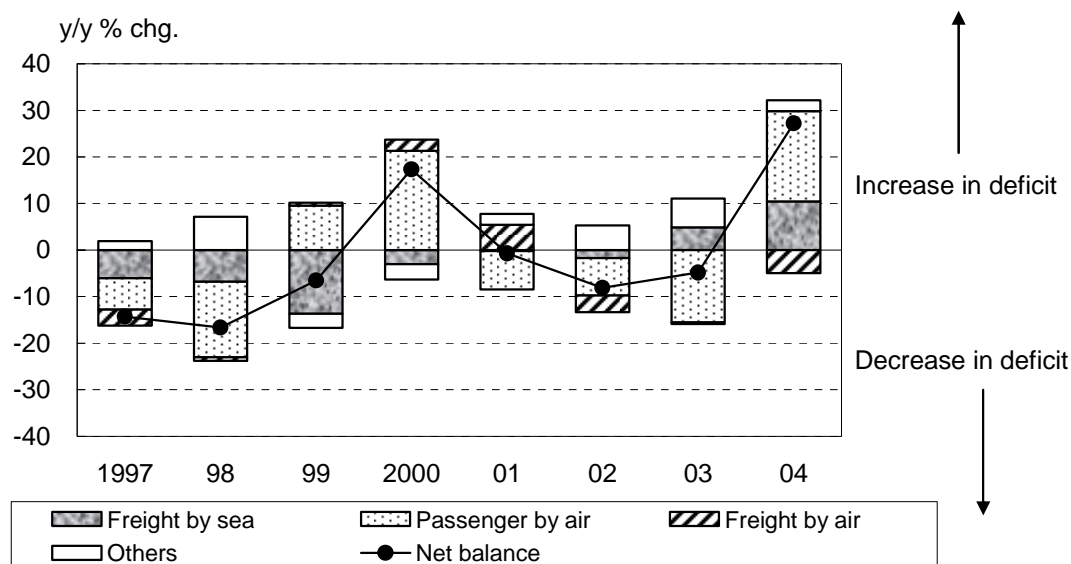


Chart 22: Transportation

bil. yen

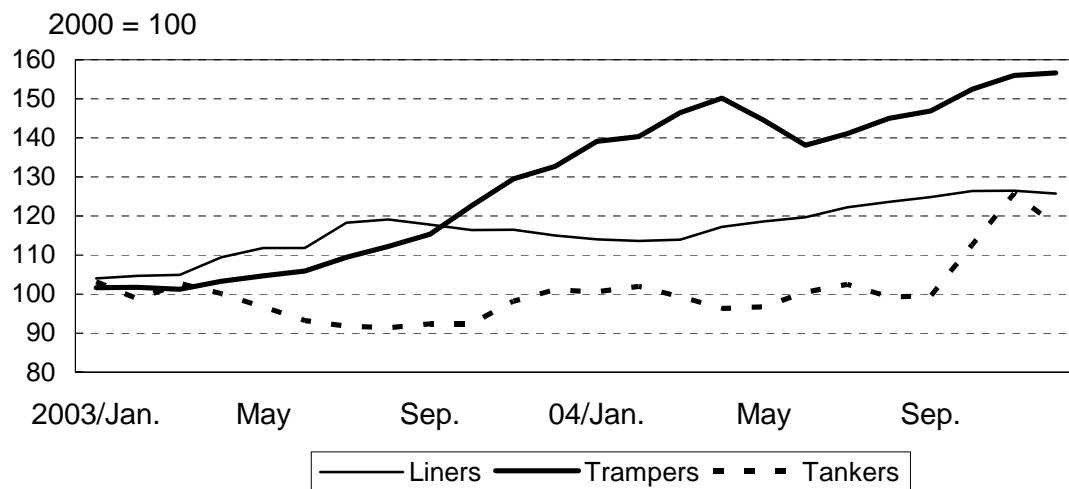
		2004	Changes from the previous year	2003
<b>Transportation</b>		<b>-1,130.6</b>	<b>-241.9</b>	<b>-888.7</b>
Sea transport		-767.7	-180.6	-587.2
	Passenger	0.4	-0.4	0.8
	Credit	0.9	-0.3	1.2
	Debit	0.5	+0.1	0.4
	Freight	-313.1	-92.5	-220.6
	Credit	2,102.1	+266.7	1,835.4
	Debit	2,415.2	+359.2	2,055.9
Air transport		-358.0	-68.6	-289.4
	Passenger	-740.5	-172.5	-568.0
	Credit	332.1	+29.7	302.4
	Debit	1,072.6	+202.2	870.4
	Freight	82.8	+44.0	38.8
	Credit	332.9	+42.4	290.5
	Debit	250.1	-1.6	251.7

Chart 23: Contribution to Overall Transportation by Item



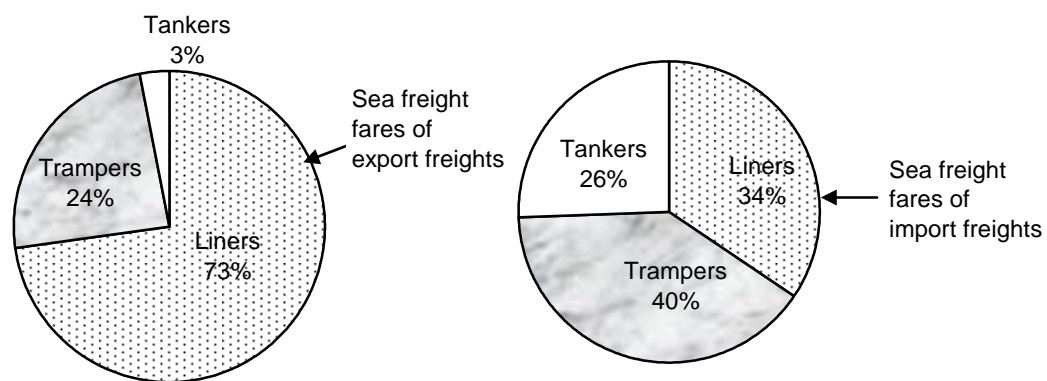
Note: 1. "Others" includes "passenger by sea," "other sea transport," "other air transport," and "other transport."

Chart 24: Sea Freight Fares (Corporate Service Price Index)<sup>1</sup>



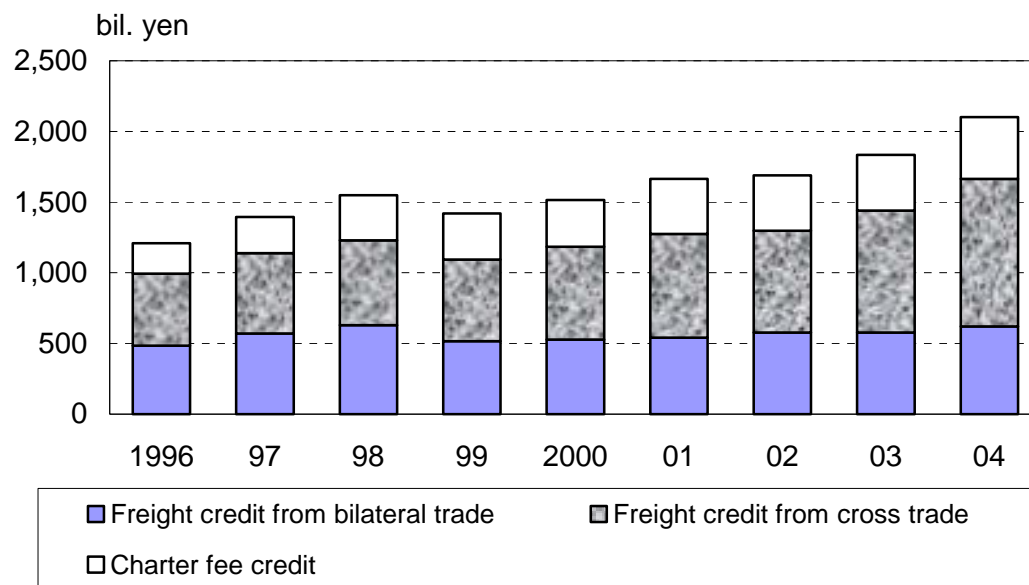
Note: 1. All indices are on a contract currency basis.

Chart 25: Breakdown of Sea Freight Fares for Export and Import Goods<sup>1</sup>



Note: 1. Estimations are made by the International Department, Bank of Japan based on the figures in the Ministry of Land, Infrastructure and Transport's "Report on Maritime Affairs: 2004."

Chart 26: Freight Credit for Sea Transport<sup>1</sup>



Note: 1. Credit in freight from bilateral trade is obtained by subtracting the sum of credit in freight from cross trade and credit from charter fees from total credit from freight.

Chart 27: Travel

bil. yen

		2004		2003
			Changes from the previous year	
Travel		-2,917.1	-598.2	-2,319.0
	Credit	1,208.7	+186.5	1,022.1
	Debit	4,125.8	+784.7	3,341.1



Chart 28: Travel

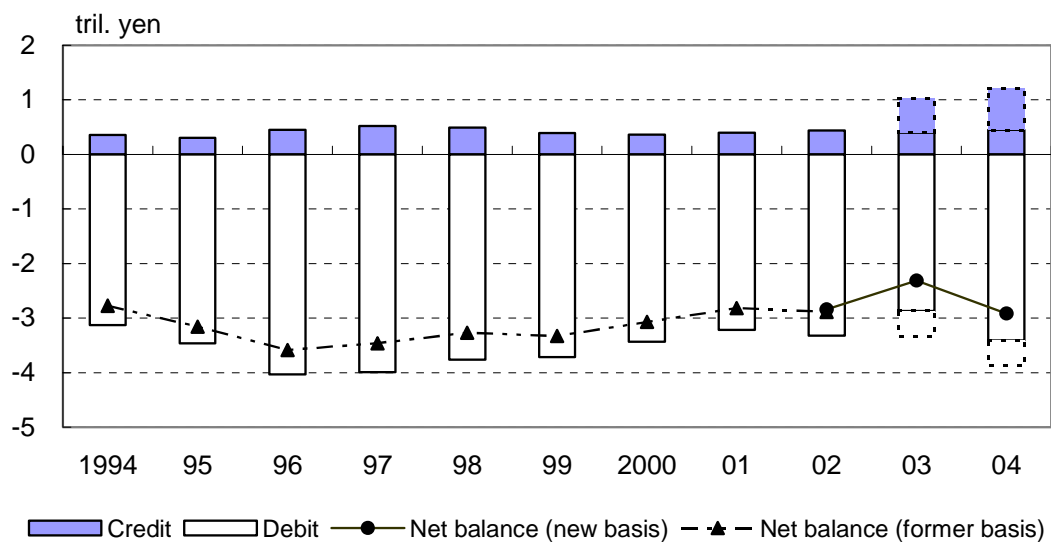
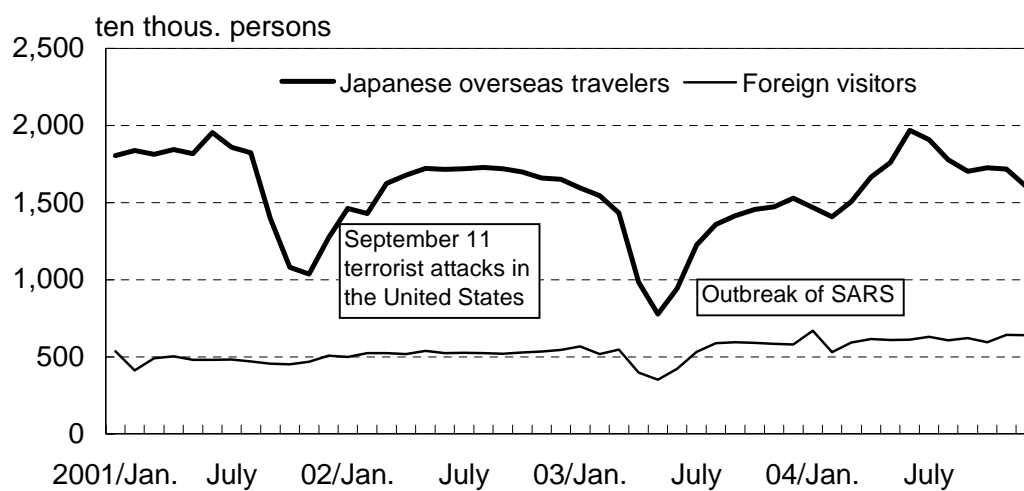
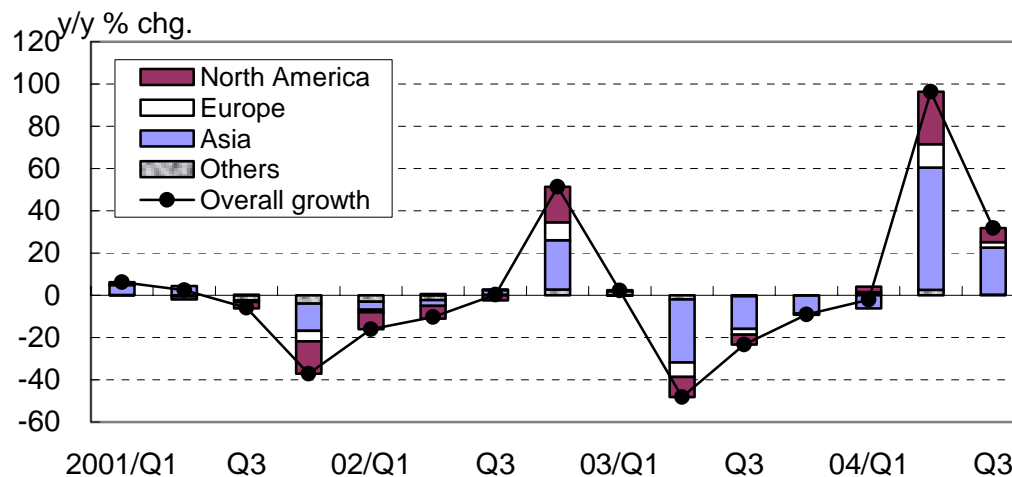


Chart 29: Number of Japanese Overseas Travelers and Foreign Visitors



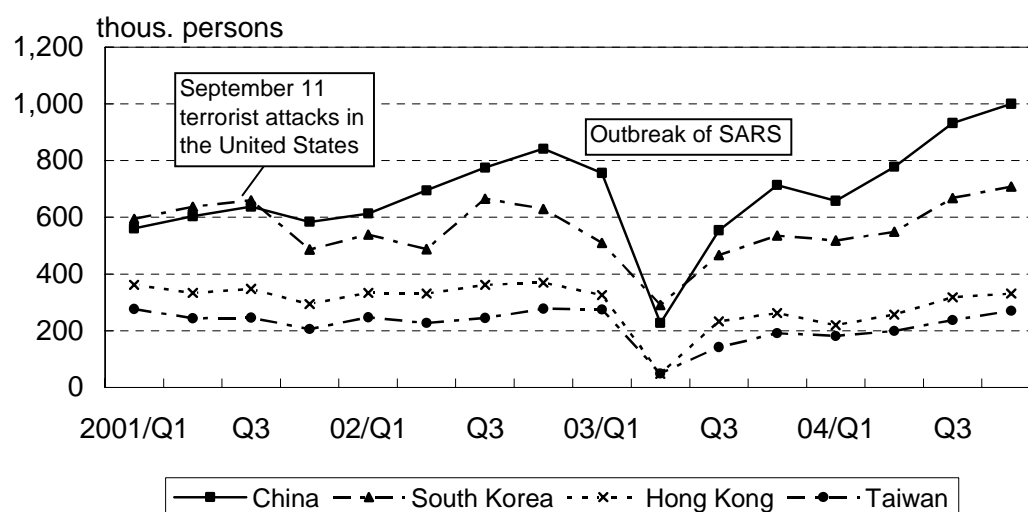
Source: Figures are seasonally adjusted by the International Department, Bank of Japan based on data from the Japan National Tourist Organization (JNTO).

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



Source: Figures are estimated by the International Department, Bank of Japan based on data from the Japan National Tourist Organization (JNTO) and the Ministry of Land, Infrastructure and Transport's "Provisional Statistical Report on Air Transport."

Chart 31: Number of Japanese Travelers to Asian Countries



Source: Japan Tourism Marketing Co. (JTM). Data sources and their definitions for individual countries are as follows:

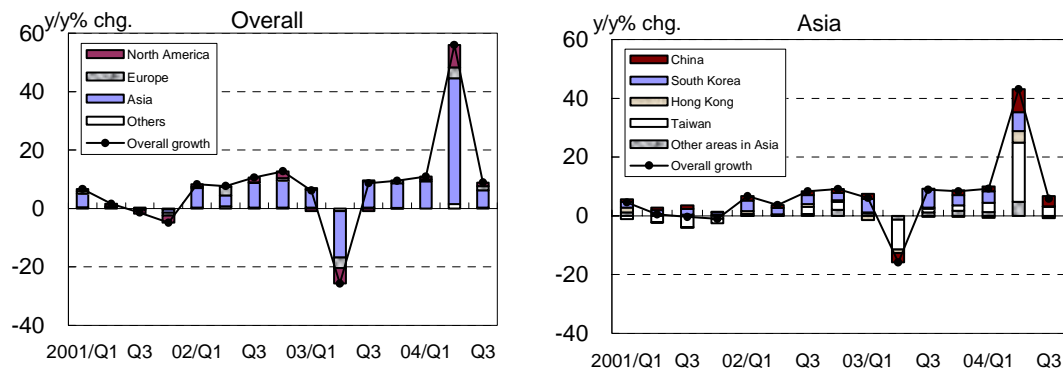
China: China National Tourism Administration (people of Japanese nationality). The figure for the fourth quarter is estimated from data in October and November due to data constraint.

South Korea: Korea National Tourism Organization (people of Japanese nationality).

Hong Kong: Hong Kong Tourism Board (people resident in Japan).

Taiwan: Tourism Bureau, Ministry of Transportation and Communications (persons resident in Japan).

Chart 32: Quarterly Changes and Regional Contribution to Overall Growth in the Number of Foreign Visitors



Source: Japan National Tourist Organization (JNTO).

[Reference]

The deregulation of visa acquisition for foreign visitors executed in 2004

South Korea: Visitors on school excursions exempted from visa acquisition: adopted March 1.

Hong Kong: Temporary visitors staying in Japan for no more than 90 days exempted from visa acquisition: adopted April 1.

Taiwan: Visitors on school excursions exempted from individual visa application and visa issuance fee: adopted September 1.

China: Visitors on school excursions exempted from visa acquisition: adopted September 1.

One city (Tianjin) and four provinces (Jiangsu, Zhejiang, Shandong, Liaoning) added to regions eligible for issuance of group tourist visas: adopted September 15.

Chart 33: Other Services

bil. yen

		2004		2003
			Changes from the previous year	
<b>Other services</b>		<b>-106.5</b>	<b>+590.2</b>	<b>-696.6</b>
	Credit	5,739.2	+835.8	4,903.5
	Debit	5,845.7	+245.6	5,600.1
<b>Royalties and license fees</b>		<b>232.4</b>	<b>+83.3</b>	<b>149.1</b>
	Credit	1,695.5	+272.5	1,423.0
	Debit	1,463.1	+189.2	1,273.8
<b>Insurance services</b>		<b>-271.9</b>	<b>+95.0</b>	<b>-366.9</b>
	Credit	110.7	+66.8	43.9
	Debit	382.6	-28.1	410.7
<b>Financial services</b>		<b>186.2</b>	<b>+35.3</b>	<b>150.8</b>
	Credit	472.3	+69.5	402.8
	Debit	286.2	+34.2	252.0
<b>Personal, cultural, and recreational services</b>		<b>-109.0</b>	<b>-16.0</b>	<b>-93.0</b>
	Credit	7.8	-8.5	16.4
	Debit	116.9	+7.5	109.4
<b>Construction services</b>		<b>211.7</b>	<b>+74.8</b>	<b>136.9</b>
	Credit	677.6	+149.7	527.9
	Debit	465.9	+74.9	391.0
<b>Government services n.i.e.</b>		<b>121.1</b>	<b>+73.8</b>	<b>47.3</b>
	Credit	283.9	+89.3	194.6
	Debit	162.8	+15.5	147.3
<b>Other business services</b>		<b>-336.1</b>	<b>+250.6</b>	<b>-586.7</b>
	<b>Miscellaneous business, professional, and technical services</b>	<b>-1,070.7</b>	<b>-27.4</b>	<b>-1,043.3</b>
	Credit	964.8	+20.6	944.2
	Debit	2,035.5	+48.0	1,987.5
	<b>Merchanting and other trade-related services</b>	<b>644.6</b>	<b>+275.6</b>	<b>369.0</b>
	Credit	1,252.6	+213.4	1,039.1
	Debit	608.0	-62.1	670.1

Chart 34: Other Services

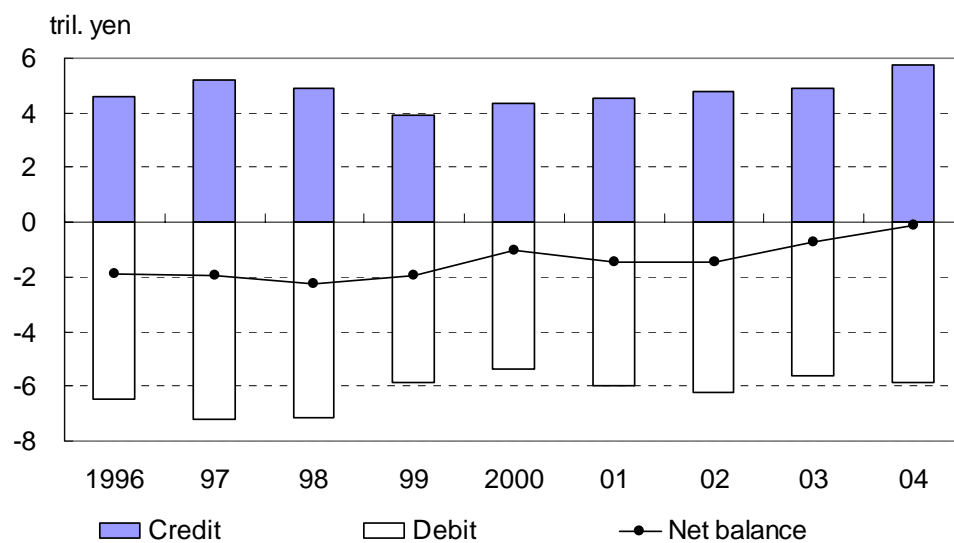


Chart 35: Year-on-Year Increase in Credit of Other Services

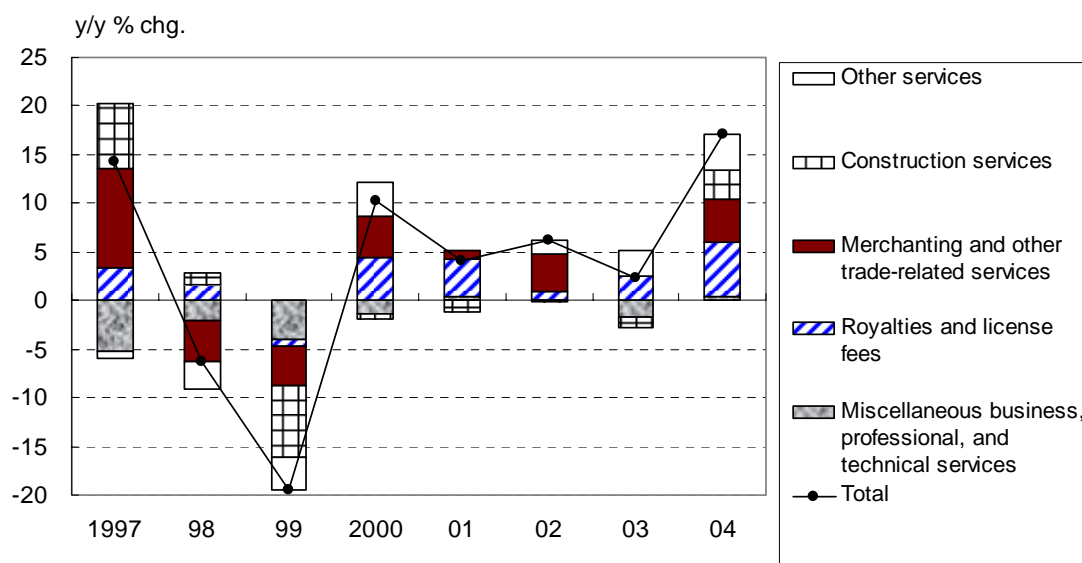


Chart 36: Year-on-Year Increase in Debit of Other Services

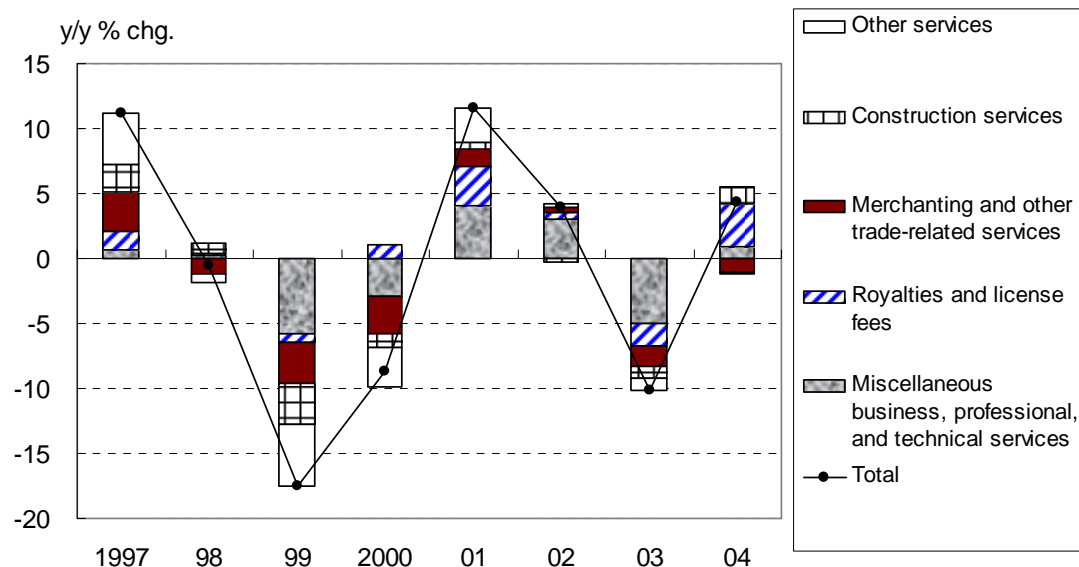


Chart 37: Royalties and License Fees

Fees for Industrial Property Rights

Fees for Copyrights

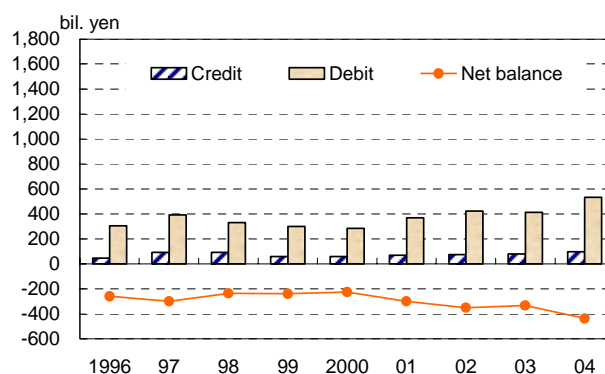
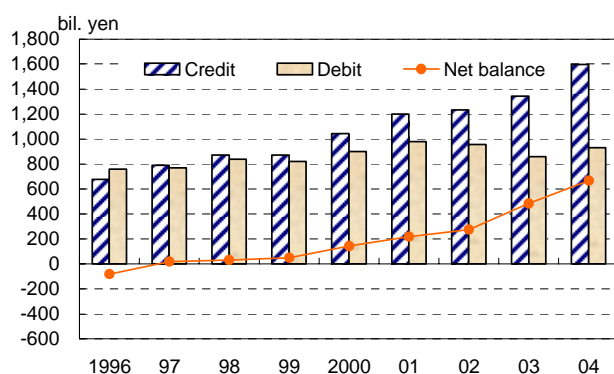
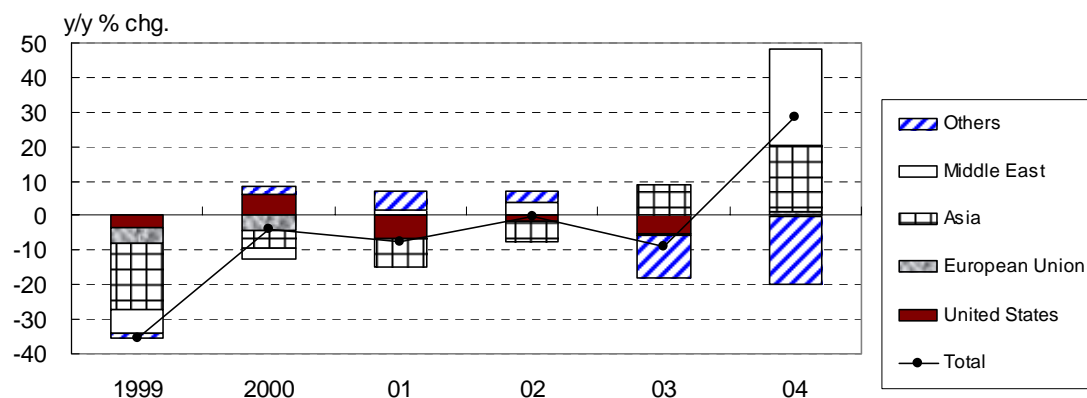


Chart 38: Regional Contribution to Credit in Construction Services<sup>1</sup>



Note: 1. Figures for 2004 are estimated by the International Department, Bank of Japan.

Chart 39: Financial Services

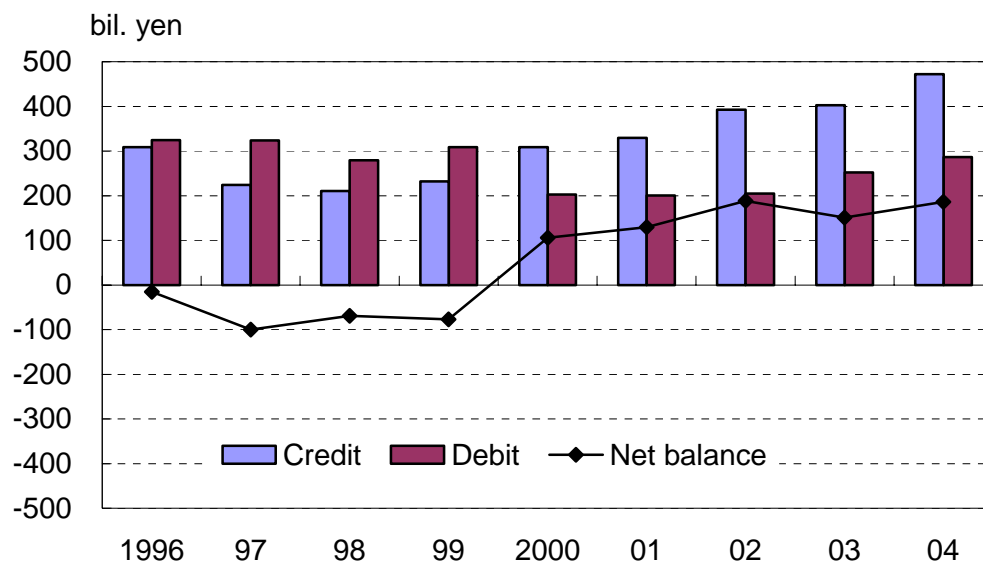


Chart 40: Insurance Services

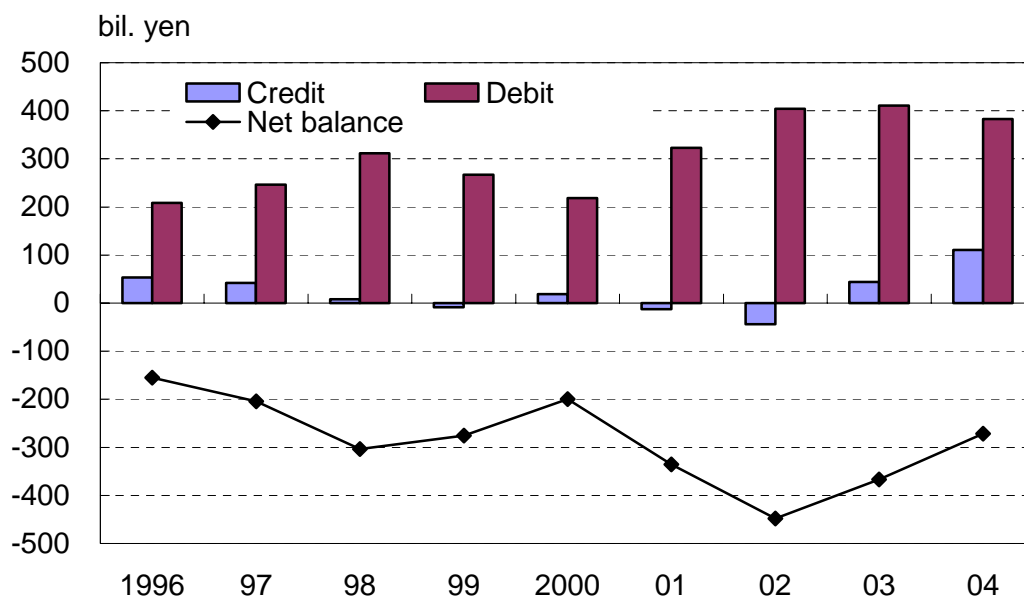


Chart 41: Balance of Income for 2004

bil. yen

	2004	Changes from the previous year	2003
<b>Income</b>	<b>9,273.3</b>	<b>+992.1</b>	<b>8,281.2</b>
<b>Direct investment income</b>	<b>1,368.7</b>	<b>+425.6</b>	<b>943.1</b>
Dividends and distributed branch profits	899.7	+354.2	545.5
Credit	1,331.8	+408.1	923.7
Debit	432.1	+53.8	378.3
Reinvested earnings	435.0	+68.1	366.9
Credit	645.3	+115.7	529.6
Debit	210.3	+47.5	162.7
<b>Portfolio investment income</b>	<b>7,430.8</b>	<b>+610.0</b>	<b>6,820.9</b>
Bonds and notes	6,411.9	+629.7	5,782.1
Credit	7,125.6	+570.8	6,554.8
Debit	713.8	-58.9	772.7
<b>Other investment income</b>	<b>485.7</b>	<b>-45.3</b>	<b>531.0</b>
Credit	1,389.6	-138.4	1,528.0
Debit	903.9	-93.1	996.9

Chart 42: Income

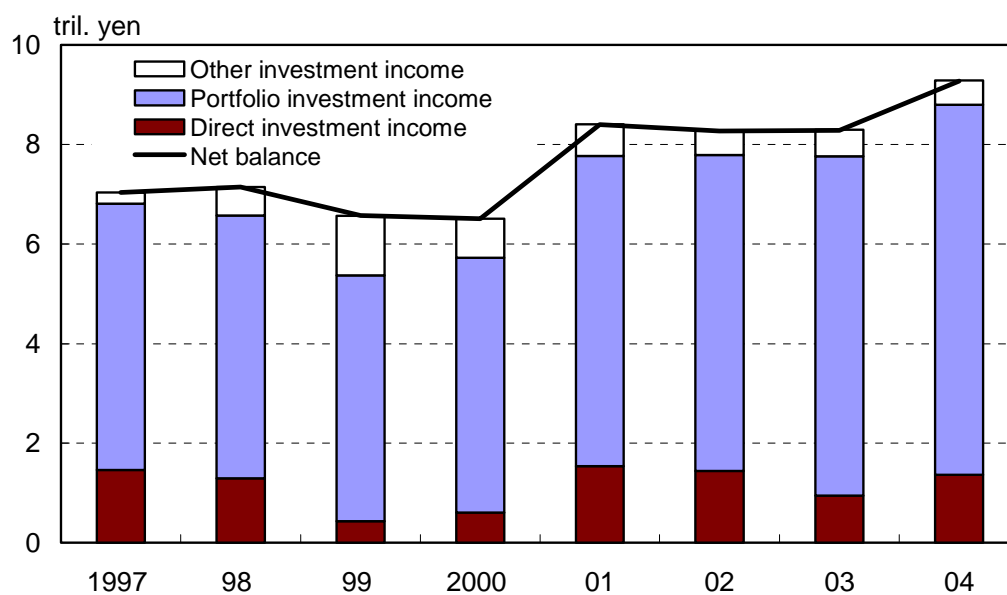




Chart 43: Direct Investment Income (Net)

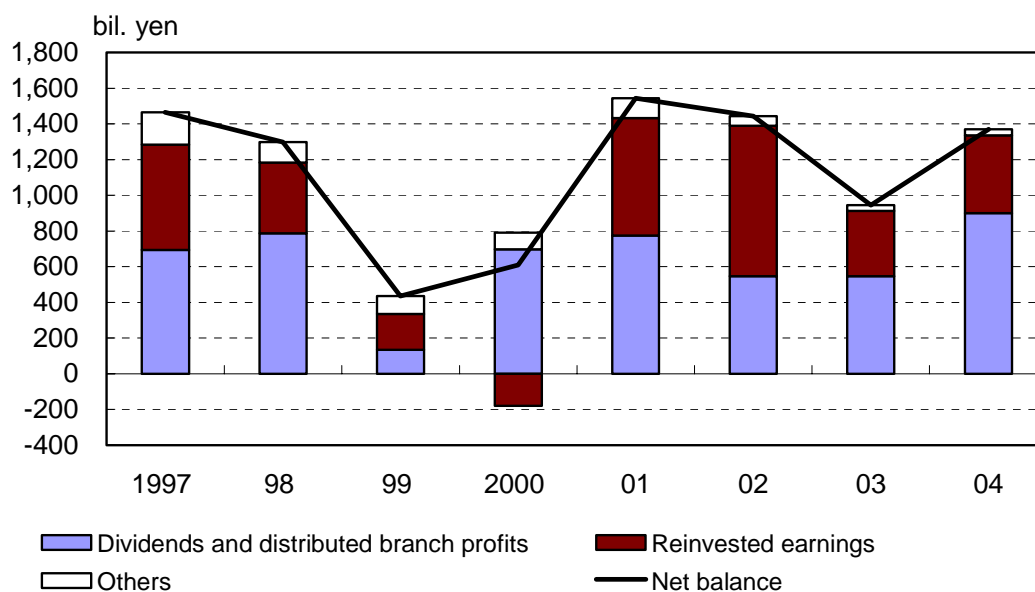


Chart 44: Portfolio Investment Income (Net)

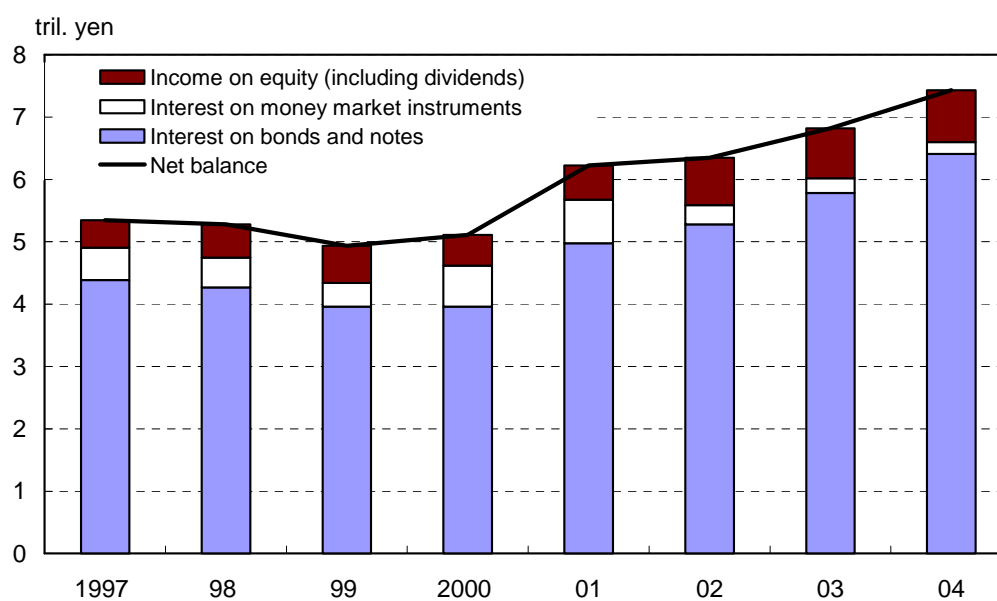


Chart 45: Other Investment Income (Net)

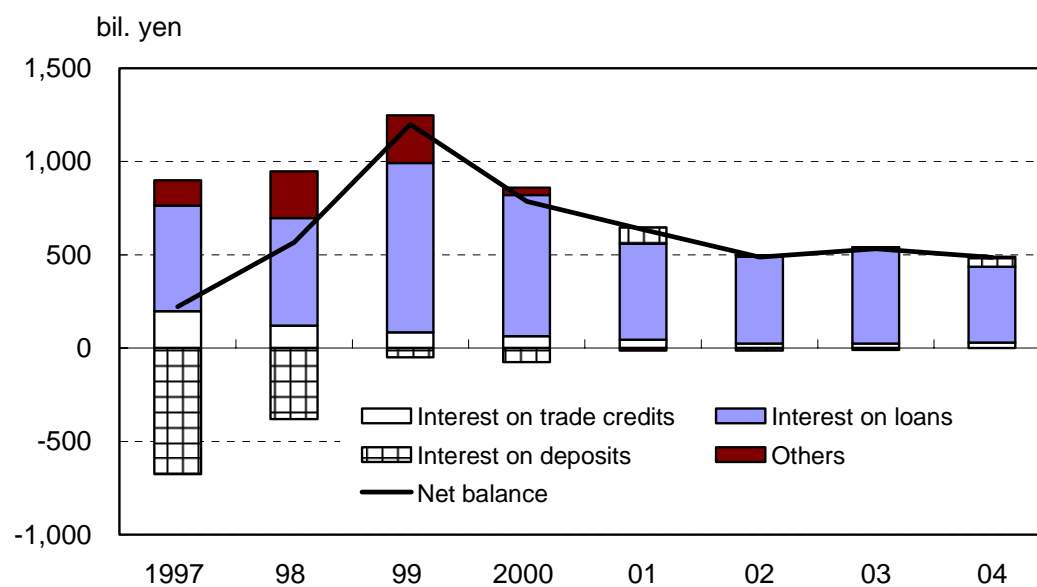


Chart 46: Other Investment Income (Gross)

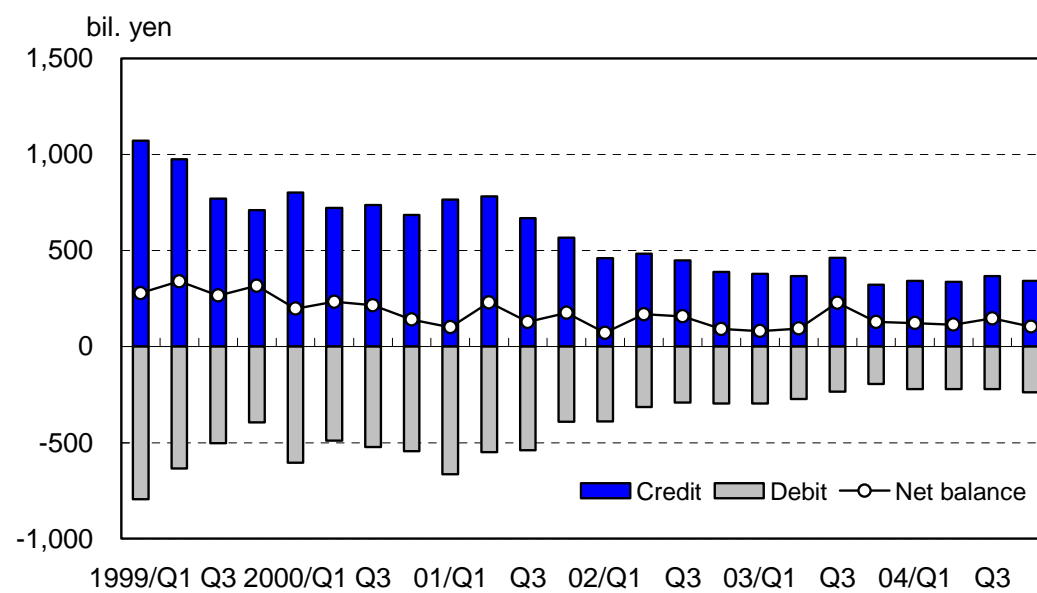


Chart 47: Current Transfers

bil. yen

		2004		2003
			Changes from the previous year	
<b>Current transfers</b>		<b>-839.0</b>	<b>+30.7</b>	<b>-869.7</b>
	Official sector	-580.0	-152.3	-427.7
	Credit	19.1	-3.3	22.4
	Debit	599.1	+149.0	450.0
	Other sectors	-259.1	+183.0	-442.0
	Credit	725.8	-7.7	733.6
	Debit	984.9	-190.7	1,175.6

Chart 48: Current Transfers

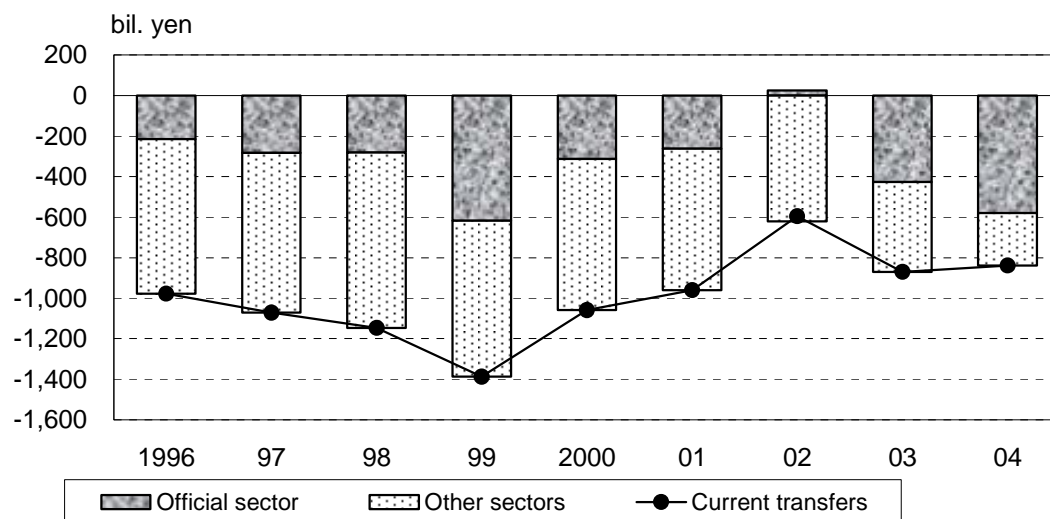


Chart 49: Capital and Financial Account<sup>1</sup>

bil. yen

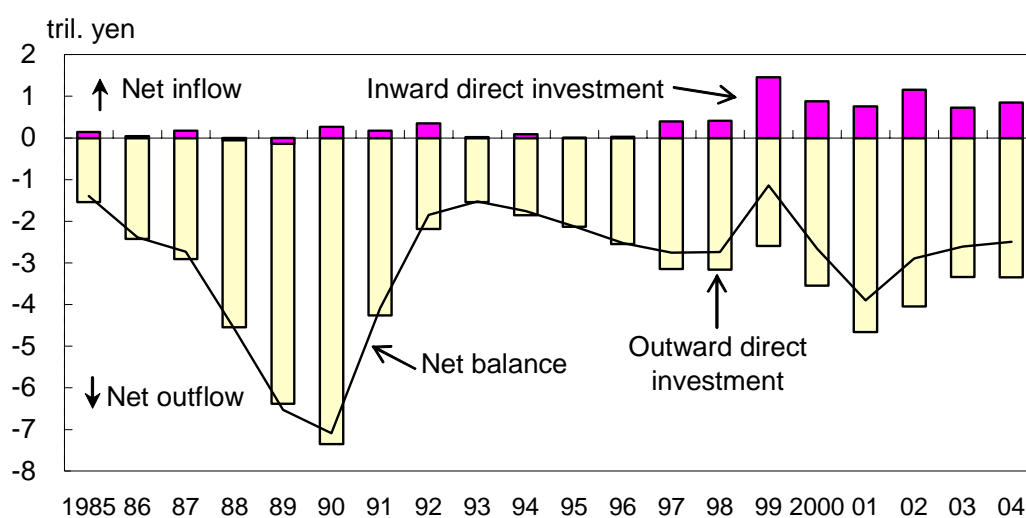
	2004			2003		
Current account	18,590.8			15,766.8		
Capital and financial account	1,491.5	Assets (outward investment)	Liabilities (inward investment)	7,734.1	Assets (outward investment)	Liabilities (inward investment)
Financial account	1,988.2			8,201.4		
Direct investment	-2,489.3	-3,344.9	855.6	-2,605.8	-3,338.9	733.2
Portfolio investment <sup>3</sup>	1,911.8	-20,046.9	21,958.6	-8,863.2	-18,396.1	9,532.9
Of which Equity securities	7,308.8	-3,289.7	10,598.5	9,152.1	-686.6	9,838.6
Bonds and notes	-10,938.7	-17,404.4	6,465.7	-20,038.5	-18,392.7	-1,645.8
Money market instruments	5,541.6	647.2	4,894.4	2,023.2	683.2	1,340.1
Financial derivatives	261.1	6,103.7	-5,842.6	607.4	7,526.0	-6,918.5
Other investment <sup>2</sup>	2,338.6	-3,727.7	6,066.3	19,006.3	14,530.9	4,475.4
Of which Loans	4,957.7	-2,653.6	7,611.3	10,396.3	7,229.9	3,166.4
Currency and deposits	-1,963.9	-1,519.5	-444.4	2,574.9	578.3	1,996.6
Capital account	-496.8			-467.2		
Changes in reserve assets	-17,267.5			-21,528.8		
Errors and omissions	-2,814.8			-1,972.2		

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

2. Figures exclude securities lending 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 50: Outward and Inward Direct Investment<sup>1</sup>

	2002		03		04		04 Jan.–June		04 July–Dec.		Avg. in the 1990s
	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)	Percent changes from a year earlier	Value (bil. yen)
Outward direct investment	–4,047.6	–13.1	–3,338.9	–17.5	–3,344.9	+0.2	–1,436.9	–2.8	–1,908.0	+2.5	–3,077.9
Inward direct investment	1,158.5	+52.7	733.2	–36.7	855.6	+16.7	565.5	+21.4	290.0	+8.6	318.6
Inward/outward (%)	28.6		22.0		25.6		39.4		15.2		10.4

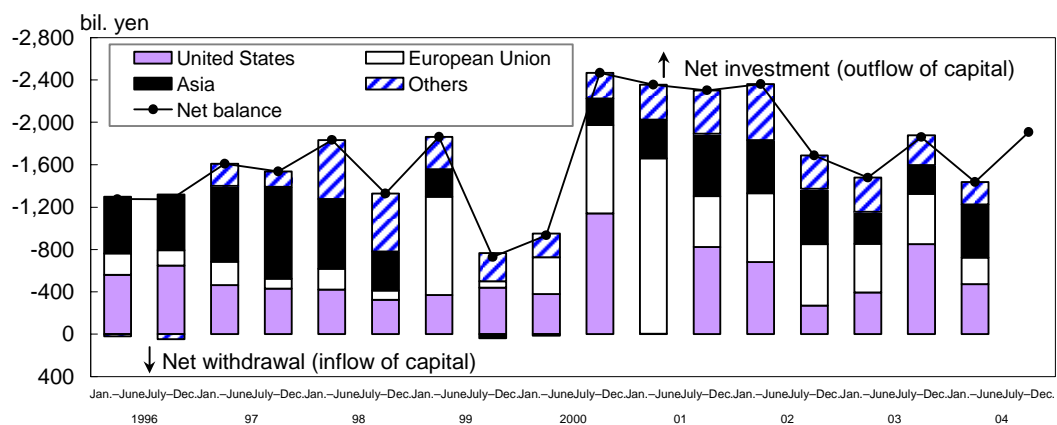


Note: 1. Shaded area shows outward direct investment on the basis, excluding financial assistance, etc., extended to subsidiaries overseas calculated by the International Department, Bank of Japan.

Chart 51: Outward Direct Investment (By Region)<sup>1</sup>

bil. yen

		Asia		United States	European Union	Others	Overall outward direct investment
			China				
1996	Jan.–June	–535.1	–118.6	–558.7	–203.8	22.2	–1,275.3
	July–Dec.	–524.8	–134.3	–647.7	–146.6	46.0	–1,273.1
97	Jan.–June	–716.9	–87.3	–464.4	–218.5	–208.8	–1,608.7
	July–Dec.	–869.7	–137.8	–430.0	–92.9	–143.6	–1,536.2
98	Jan.–June	–659.3	–111.9	–420.1	–197.8	–557.7	–1,835.0
	July–Dec.	–369.6	–59.6	–323.9	–87.4	–545.8	–1,326.6
99	Jan.–June	–260.2	–28.1	–370.9	–926.0	–306.3	–1,863.4
	July–Dec.	36.8	–13.3	–437.2	–63.7	–263.1	–727.2
2000	Jan.–June	15.5	–40.8	–380.0	–344.9	–223.6	–933.0
	July–Dec.	–249.7	–60.2	–1,140.9	–836.0	–241.2	–2,467.8
01	Jan.–June	–363.9	–113.8	–36.9	–1,657.7	–297.7	–2,356.2
	July–Dec.	–588.4	–148.7	–823.5	–480.1	–410.3	–2,302.3
02	Jan.–June	–502.8	–156.7	–681.1	–648.9	–528.3	–2,361.1
	July–Dec.	–521.7	–170.3	–270.2	–580.3	–314.3	–1,686.5
03	Jan.–June	–304.0	–154.0	–395.1	–456.1	–322.4	–1,477.6
	July–Dec.	–271.6	–303.9	–849.3	–476.7	–263.7	–1,861.3
04	Jan.–June	–499.5	–314.1	–470.7	–252.8	–213.9	–1,436.9
	July–Dec. <sup>2</sup>	n.a.	n.a.	n.a.	n.a.	n.a.	–1,908.0



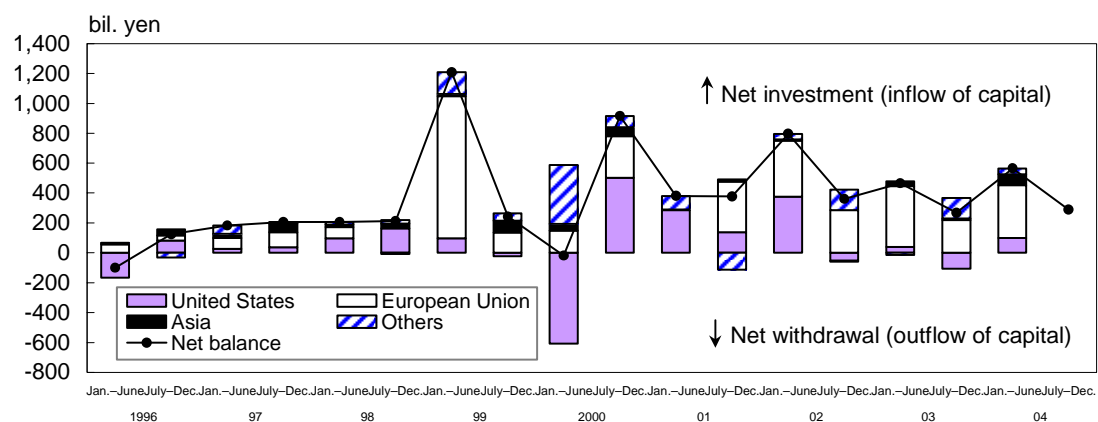
Notes: 1. Negative figures show a net outflow of capital.

2. A breakdown of figures for the second half of 2004 is scheduled to be released in June 2005.

Chart 52: Inward Direct Investment (By Region)<sup>1</sup>

bil. yen

		United States	European Union	Asia	Others	Overall inward direct investment
1996	Jan.–June	–165.7	56.2	7.8	2.3	–99.4
	July–Dec.	80.7	34.9	40.4	–31.7	124.3
97	Jan.–June	25.9	73.6	28.6	55.2	183.3
	July–Dec.	37.5	100.0	58.5	10.8	206.8
98	Jan.–June	98.1	73.0	19.1	15.4	205.6
	July–Dec.	164.9	–7.3	31.4	23.3	212.3
99	Jan.–June	96.7	950.3	16.2	145.4	1,208.6
	July–Dec.	–21.9	136.5	79.3	48.8	242.7
2000	Jan.–June	–607.5	147.8	44.6	396.6	–18.5
	July–Dec.	502.3	277.7	61.7	73.7	915.4
01	Jan.–June	286.6	–0.3	2.8	91.5	380.6
	July–Dec.	138.0	339.9	13.0	–113.0	377.9
02	Jan.–June	374.9	374.1	8.4	39.8	797.2
	July–Dec.	–53.6	286.4	–6.9	135.4	361.3
03	Jan.–June	39.5	405.4	34.3	–13.2	466.0
	July–Dec.	–107.0	220.1	9.6	144.4	267.1
04	Jan.–June	99.1	352.6	73.0	40.8	565.5
	July–Dec. <sup>2</sup>	n.a.	n.a.	n.a.	n.a.	290.0

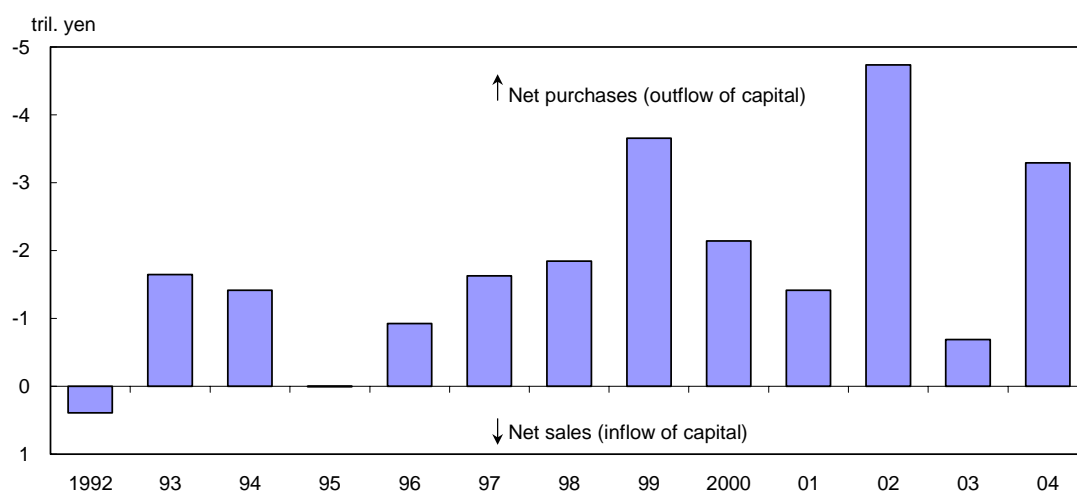


Notes: 1. Negative figures show a net outflow of capital.

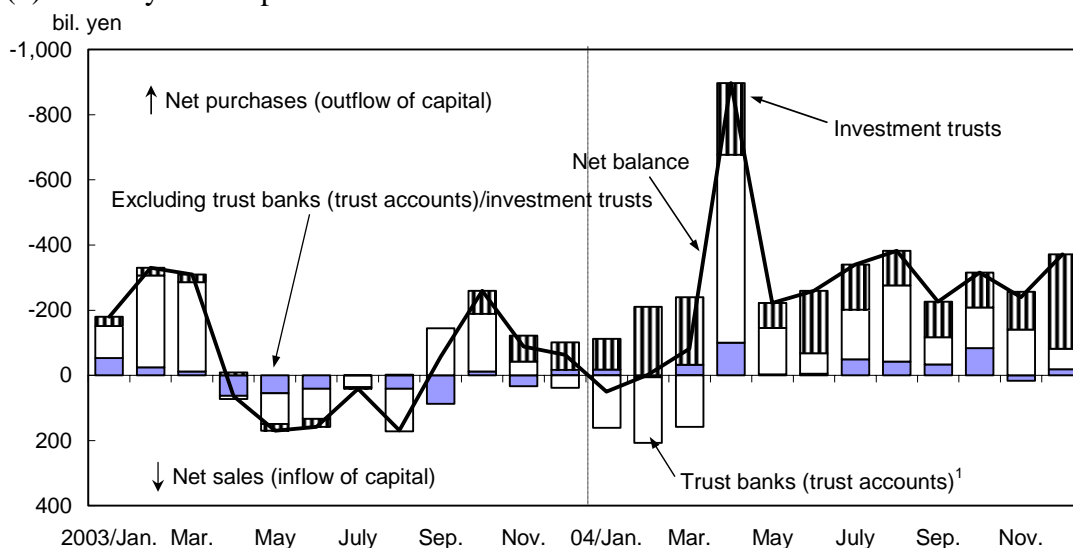
2. A breakdown of figures for the second half of 2004 is scheduled to be released in June 2005.

Chart 53: Outward Investment in Equities

(1) Annual Development



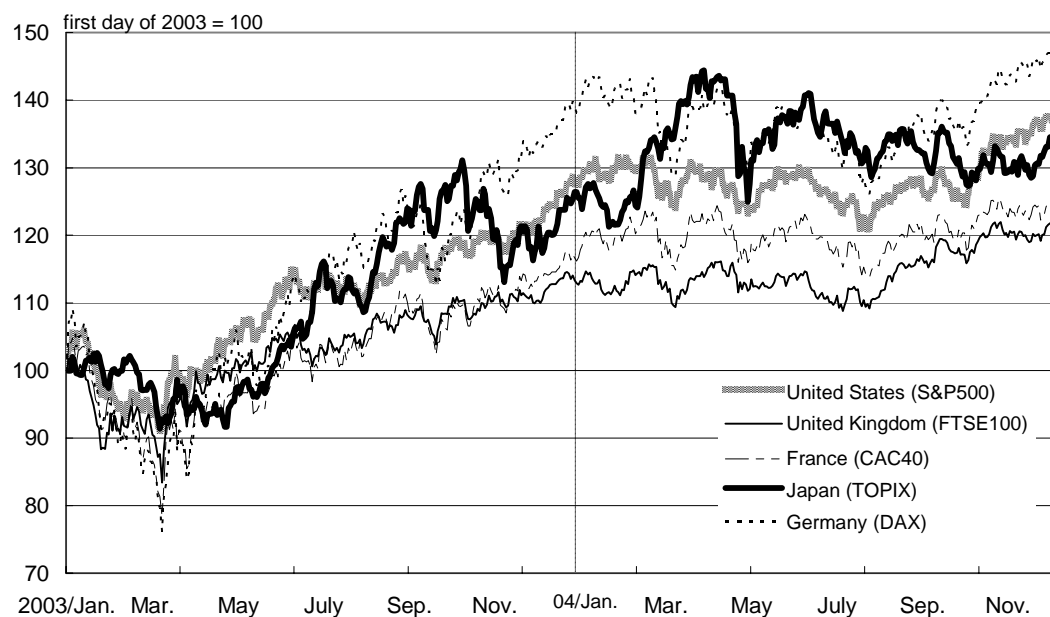
(2) Monthly Development



Note: 1. Figures for trust banks (trust accounts) and investment trusts are based on “Securities Investment at Home and Abroad (compiled based on the value of transactions settled, hereafter settlement base),” released by the Ministry of Finance.



Chart 54: Stock Prices in Major Markets



Source: Bloomberg.

Chart 55: Outward Investment in Equities (By Sector) <sup>1</sup>

bil. yen	2001	02	03	04
Life insurance companies	519.8	397.2	309.5	18.1
Trust banks	-1,369.1	-4,862.3	-619.1	-1,060.2
Investment trusts	-374.0	-391.1	-269.7	-1,865.3
Banks	37.3	140.4	-61.7	-138.5
Others	-295.2	218.2	-39.5	-110.0

Notes: 1. Negative figures show net purchase (outflow of capital).

2. The category "banks" includes domestic banks, foreign banks, financial institutions for small businesses (*shinkin* banks), financial institutions for agriculture, forestry, and fisheries (agricultural cooperatives), and bank accounts of trust banks. "Others" includes securities companies, individuals, and nonfinancial corporations. "Trust banks" includes trust accounts of banks and trust banks.

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

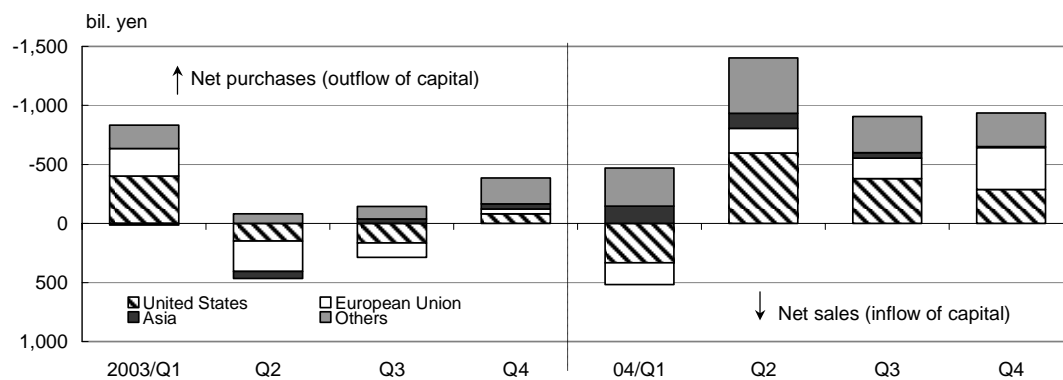
[Reference] Comparison of the Definitions in the Balance of Payments Statistics and Securities Investment at Home and Abroad<sup>1</sup>

	<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 of resident 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.

*Securities Investment at Home and Abroad* was integrated into *Balance of Payments* beginning with figures for January 2005. For details, see the announcement made in September 2004 concerning "Revision of Balance of Payments Related Statistics."

Chart 56: Outward Investment in Equities (By Region)<sup>1</sup>



bil. yen	2001	02	03	04	IIP <sup>4</sup> (end of 2003)
United States	-1,499.8	-3,051.8	-169	-933.1	15,293.7
EU countries <sup>2</sup>	329.4	-737.3	107.0	-551.4	8,570.1
Of which Germany	174.8	-58.3	-54.3	4.1	933.1
France	-228.8	-55.3	4.8	26.7	1,271.4
United Kingdom	-131.8	-441.1	82.3	-47.4	3,521.8
Asia <sup>3</sup>	29.4	-92.5	-8.8	-328.3	885.8
Cayman Islands	-250.5	-411.5	-324.0	-742.5	1,687.3

Notes: 1. Negative figures show net purchase (outflow of capital).

2. Figures through April 2004 are based on 15-country membership (the same applies to IIP). Figures for May 2004 and thereafter are based on expanded 25-country membership.

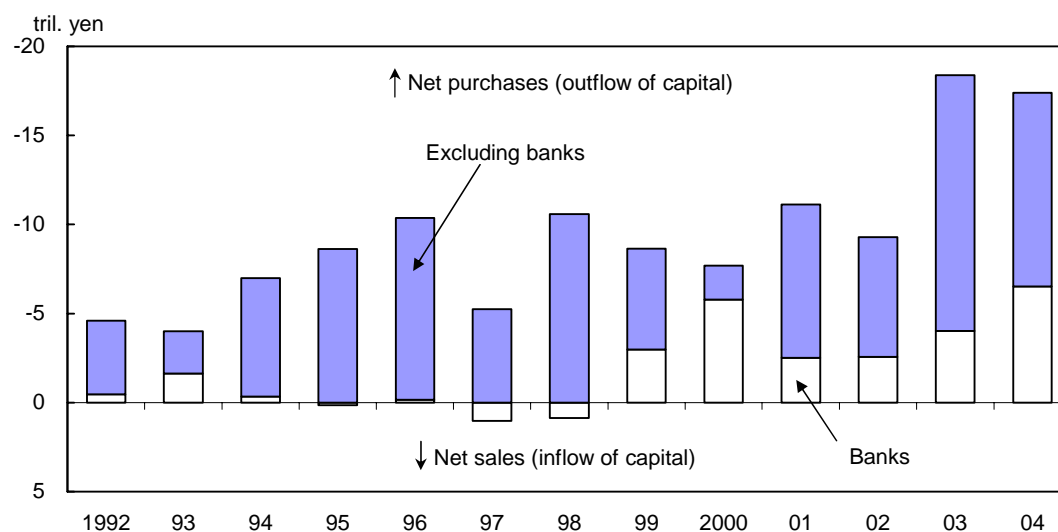
3. Figures are total for Hong Kong, South Korea, Thailand, Malaysia, and Singapore (the same applies to IIP).

4. International investment position.

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

Chart 57: Outward Investment in Bonds and Notes

(1) Annual Development<sup>1</sup>



(2) By Sector<sup>2</sup>

bil. yen

	2001	02	03	04	IIP (end of 2003) <sup>3</sup>
Investment in foreign bonds and notes	-11,130.0	-9,291.2	-18,392.7	-17,404.4	150,708.0
Public sector	1,509.2	1,807.1	776.4	321.3	1,926.0
Banks	-2,519.6	-2,568.2	-4,018.0	-6,536.5	45,298.0
Other sectors	-10,119.6	-8,530.0	-15,151.1	-11,189.3	103,485.0

Notes: 1. Negative figures show net purchase (outflow of capital.)

2. Definitions of sectors in Japan's BOP statistics conform to the International Monetary Fund's BPM5. Investors are categorized into three sectors: "public sector," "banks," and "other sectors." "Public sector" includes general government, monetary authorities, and government financial institutions. "Banks" includes banks and other depository corporations, such as cooperative-type financial institutions. "Other sectors" includes trust accounts of trust banks, life and nonlife insurance companies, securities companies, nonfinancial corporations, and households.

3. Includes issuance and redemption of yen-denominated foreign bonds and notes (bonds and notes issued in Japan by nonresidents). International investment position (IIP) is based on "International Investment Position of Japan."

### (3) Monthly Development

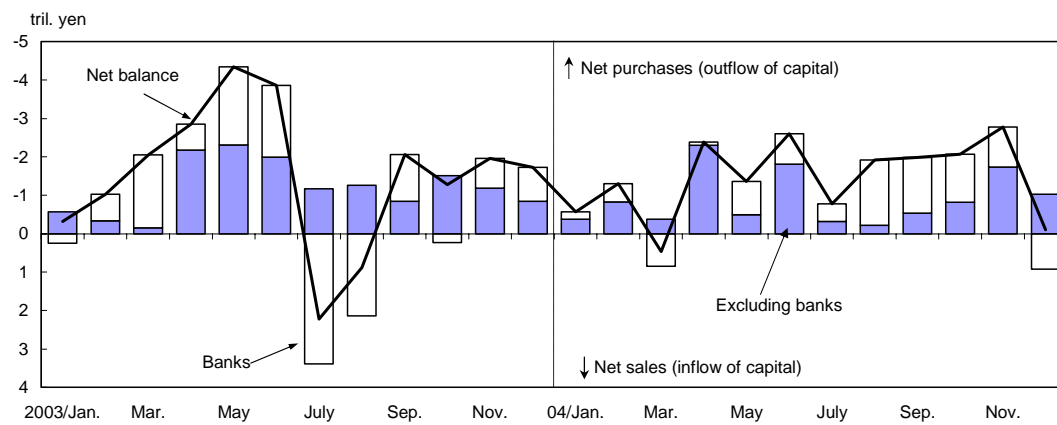


Chart 58: Issuance and Redemption of Bonds and Notes Issued in Japan by Nonresidents (Annual Development)

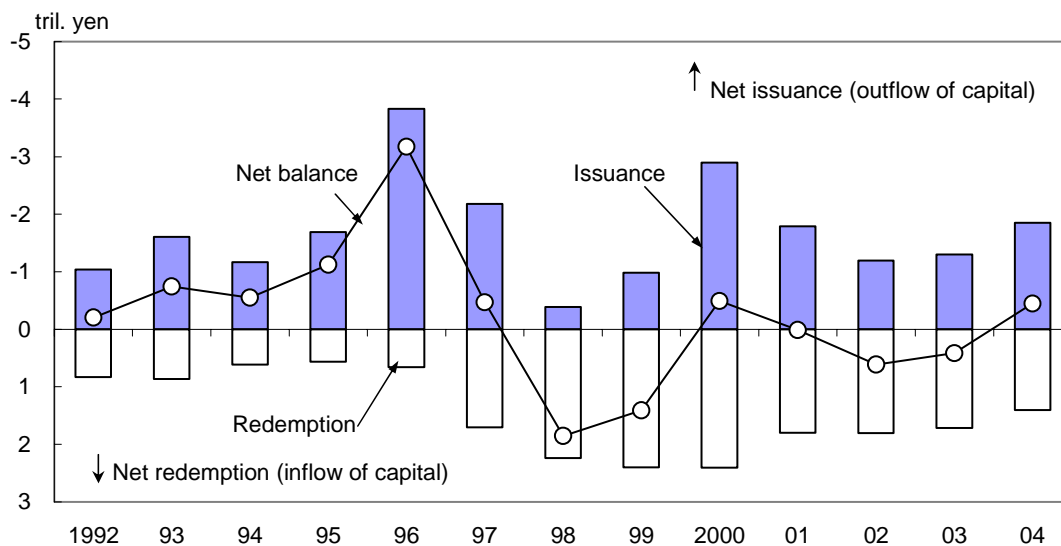


Chart 59: Outward Investment in Bonds and Notes (By Sector)<sup>1</sup>

bil. yen

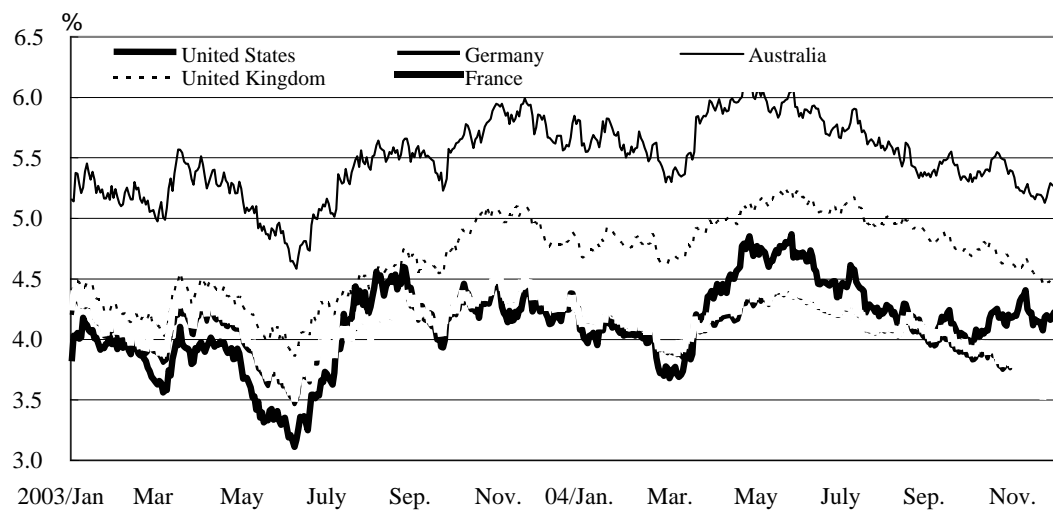
	2001	2002	2003	2004
Life insurance companies	-4,579.2	-1,082.8	-5,541.7	-2,949.7
Trust banks	-550.4	-1,167.9	34.7	-639.3
Investment trusts	-4,568.6	-4,152.1	-5,101.0	-6,989.4
Banks	-1,340.6	-763.3	-3,195.5	-3,387.7
Public sector	—	1,983.9	887.6	275.1
Others	-568.9	-3,824.4	-4,702.9	-1,701.8

Notes: 1. Negative figures show net purchase (outflow of capital).

2. The category “banks” includes domestic banks, foreign banks, financial institutions for small businesses (*shinkin* banks), financial institutions for agriculture, forestry, and fisheries (agricultural cooperatives), and bank accounts of trust banks. “Others” includes securities companies, individuals, and nonfinancial corporations. “Trust banks” includes trust accounts of banks and trust banks.

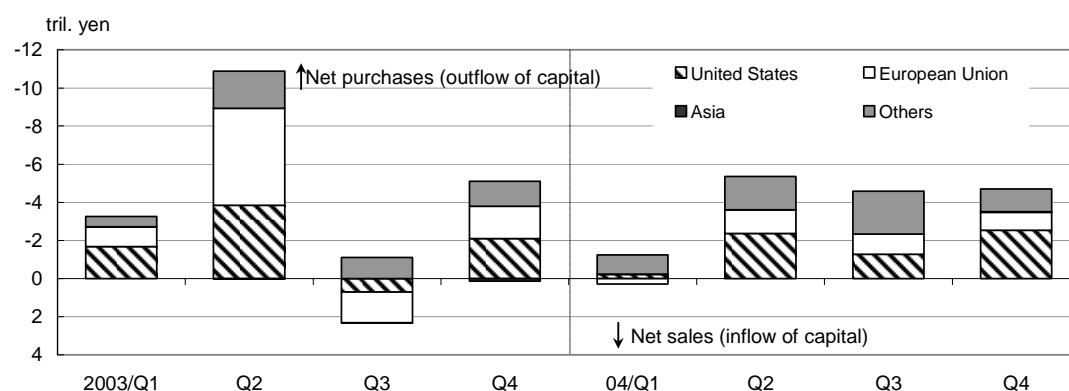
Source: Ministry of Finance, “Securities Investment at Home and Abroad (settlement base).”

Chart 60: Long-Term Interest Rates in Major Markets (10-Year Government Bonds)



Source: Bloomberg.

Chart 61: Outward Investment in Bonds and Notes (By Region)



bil. yen

	2001	02	03	04	IIP (end of 2003) <sup>4</sup>
United States	-4,395.3	-3,690.3	-6,901.8	-6,388.1	49,624.8
EU countries <sup>2</sup>	-2,358.1	-1,588.8	-6,189.1	-2,971.8	58,911.6
Of which Germany	-122.7	1,295.9	-1,882.7	650.4	15,532.9
France	-1,363.6	-518.4	-897.2	-1,055.1	8,290.9
United Kingdom	162.1	645.6	-576.7	-1,063.5	6,556.6
Asia <sup>3</sup>	62.8	106.6	128.7	-38.5	974.5
Cayman Islands	-2,177.0	-2,385.8	-2,005.4	-5,505.4	19,071.3

Notes: 1. Negative figures show net purchase (outflow of capital).

2. Figures through April 2004 are based on 15-country membership (the same applies to IIP). Figures for May 2004 and thereafter are based on expanded 25-country membership.

3. Figures are total for Hong Kong, South Korea, Thailand, Malaysia, and Singapore (the same applies to IIP).

4. The international investment position (IIP) is based on "International Investment Position of Japan." (IIP includes figures for issuance and redemption of yen-denominated bonds and notes issued in Japan by nonresidents).

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

Chart 62: Outward Investment in Money Market Instruments (Monthly Developments)

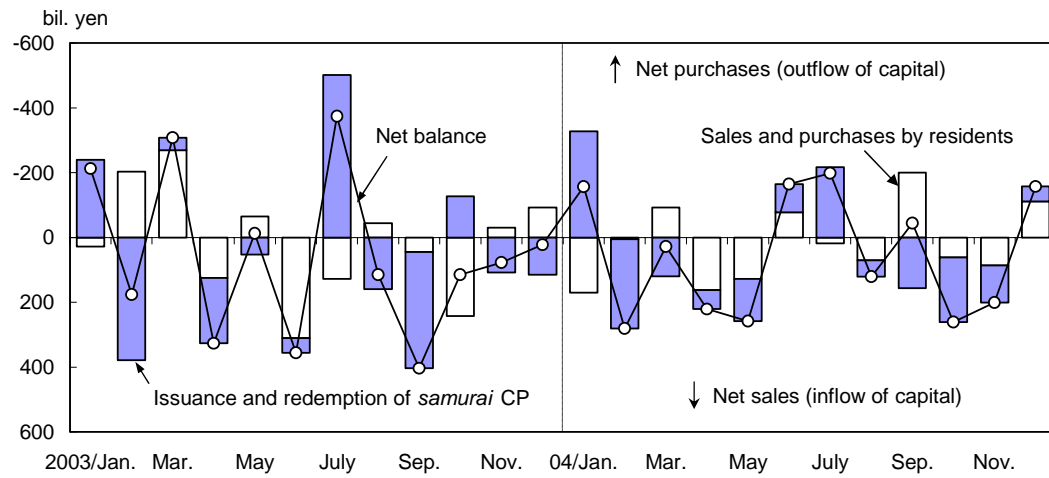
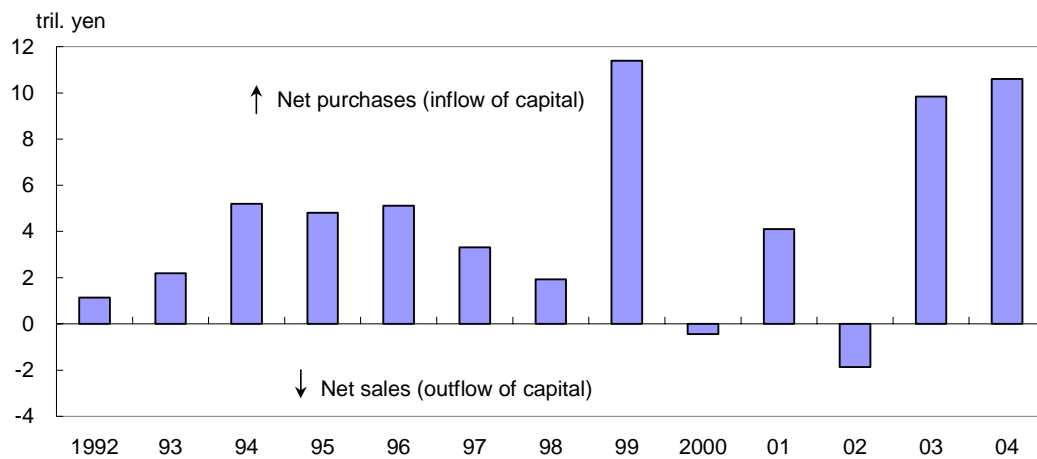


Chart 63: Inward Investment in Equities

(1) Annual Development





## (2) Monthly Development

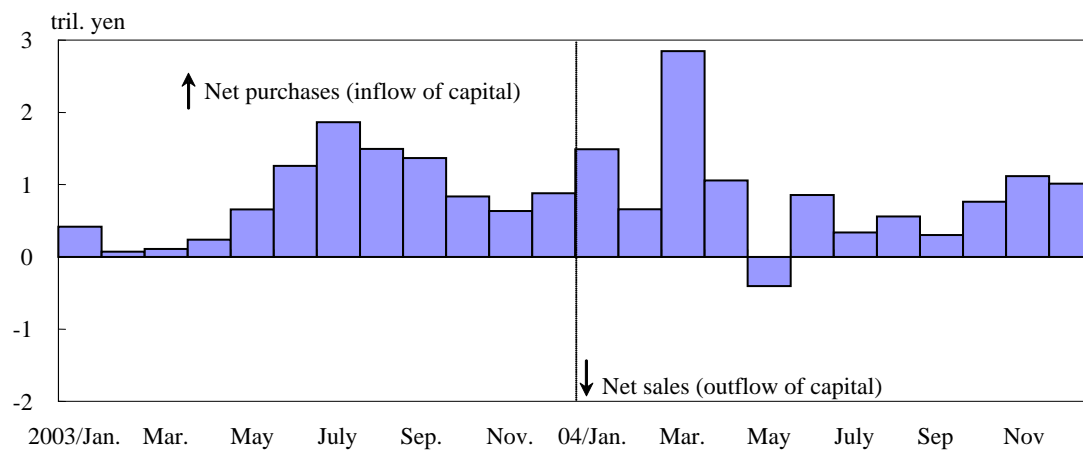
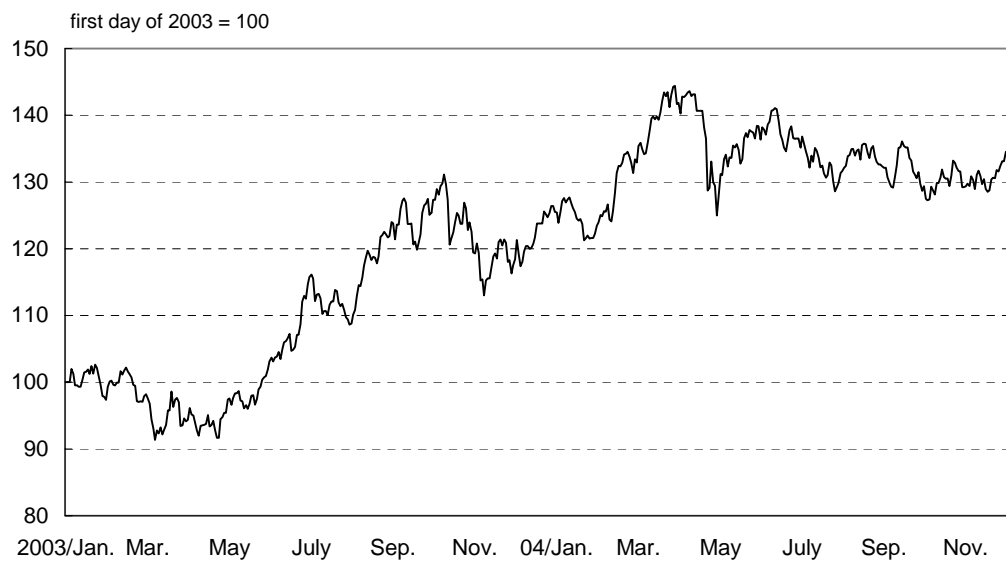
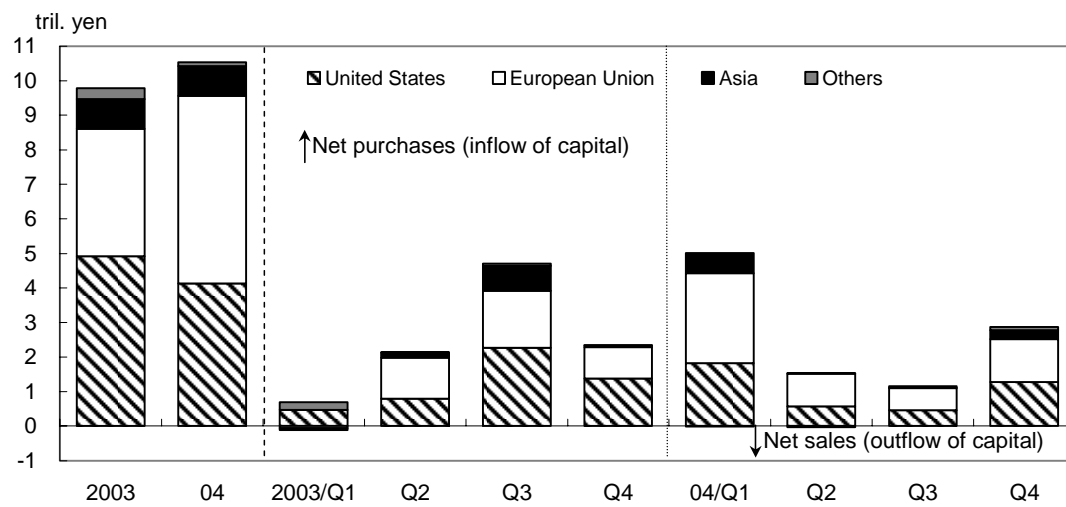


Chart 64: TOPIX (U.S. Dollar Basis)<sup>1</sup>



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

Chart 65: Inward Investment in Equities (By Region)



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

Chart 66: Inward Investment in Equities (By Industry)

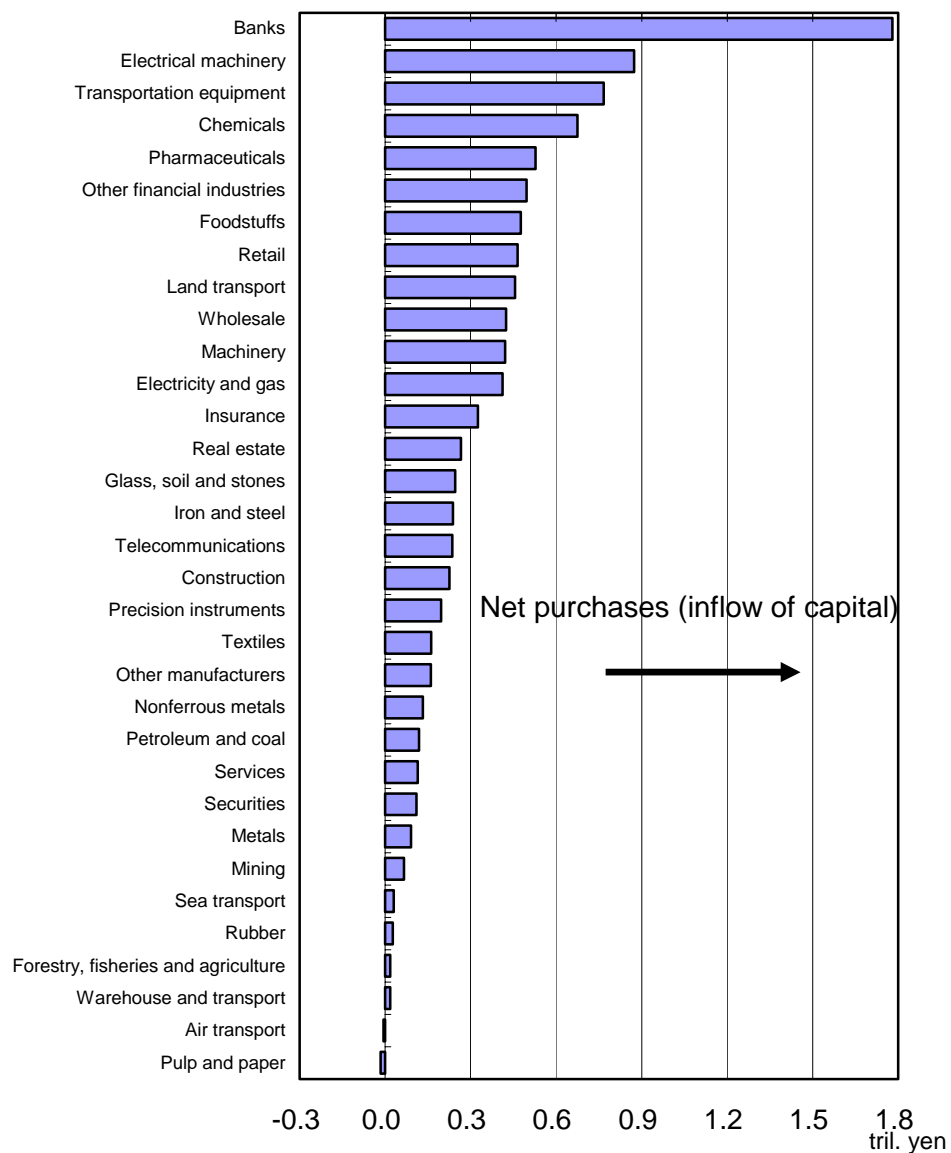
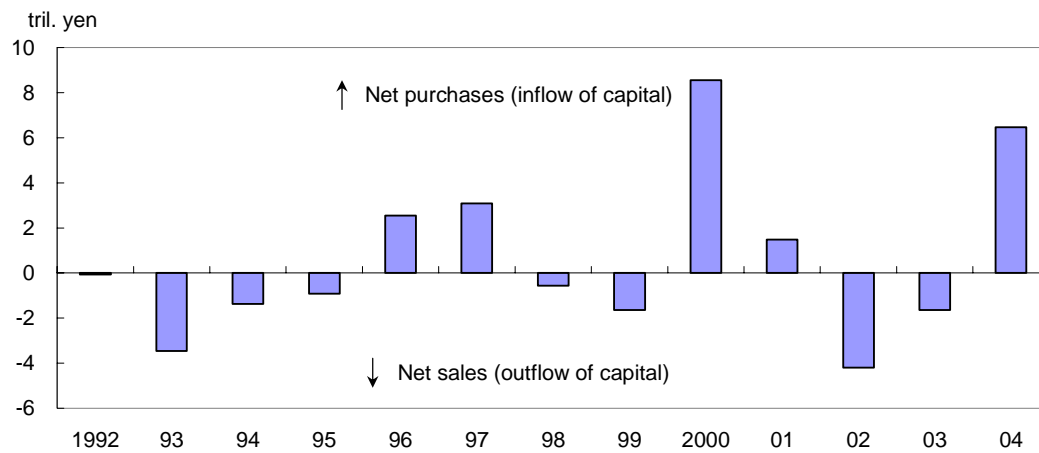


Chart 67: Inward Investment in Bonds and Notes

(1) Annual Development



(2) Monthly Development

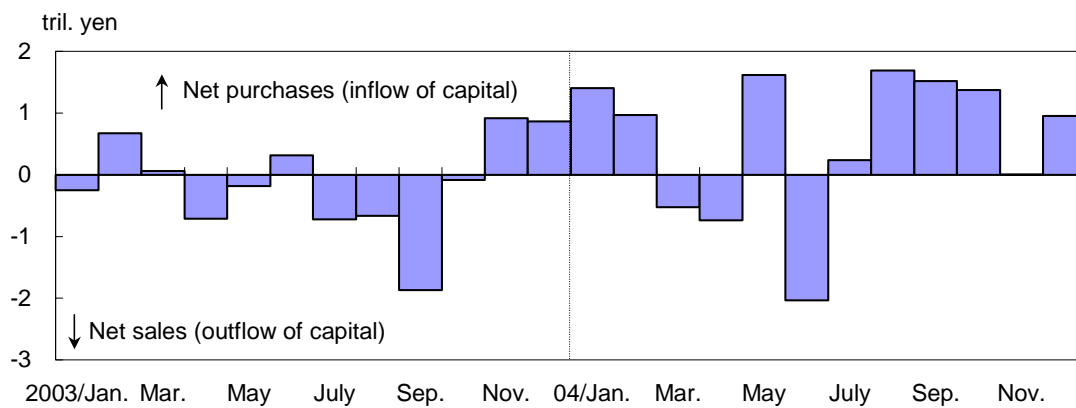
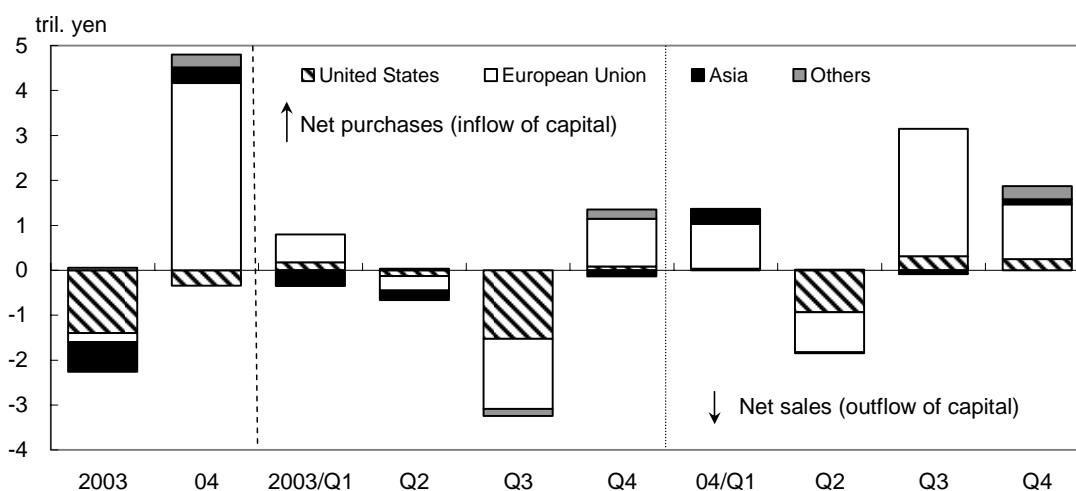


Chart 68: Inward Investment in Bonds and Notes (By Region)



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

Chart 69: Inward Investment in Money Market Instruments (Monthly Development)

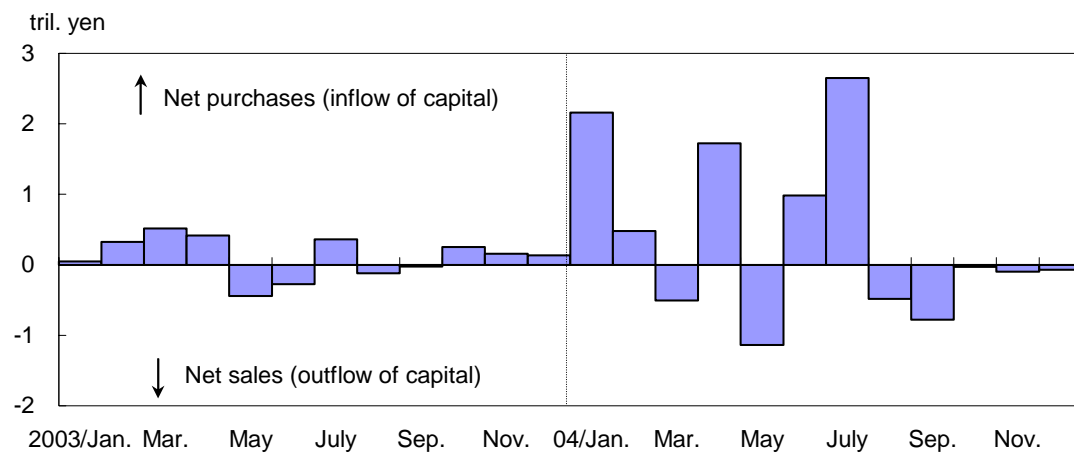


Chart 70: Financial Derivatives (Monthly Development)

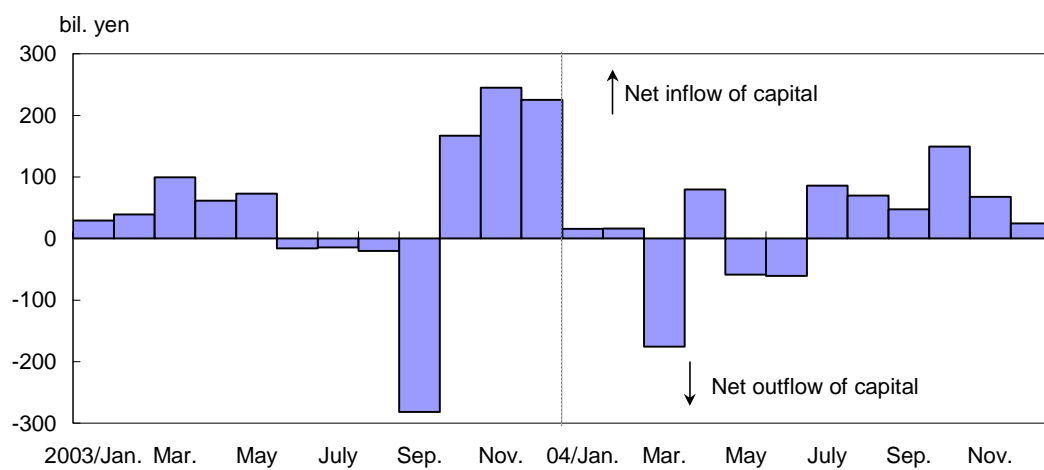


Chart 71: Other Investment (By Investor, Monthly Development)

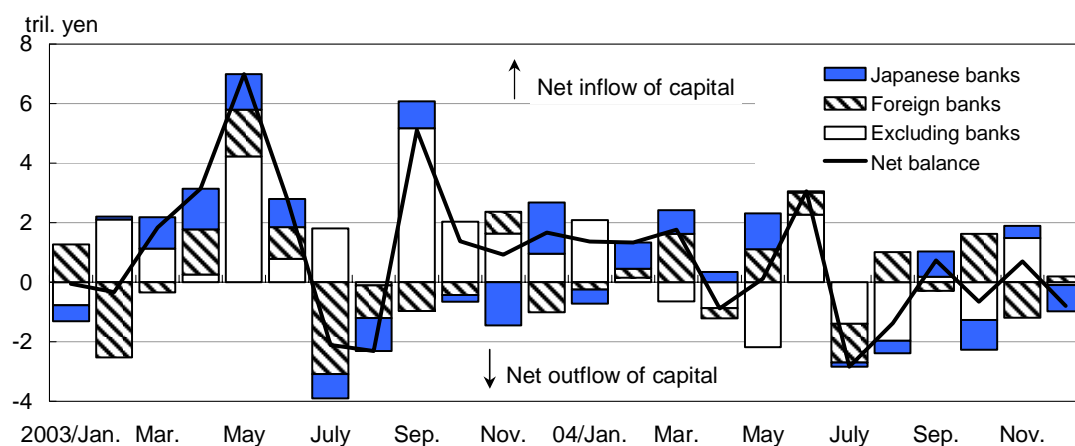


Chart 72: Other Investment (By Item, Annual Development)

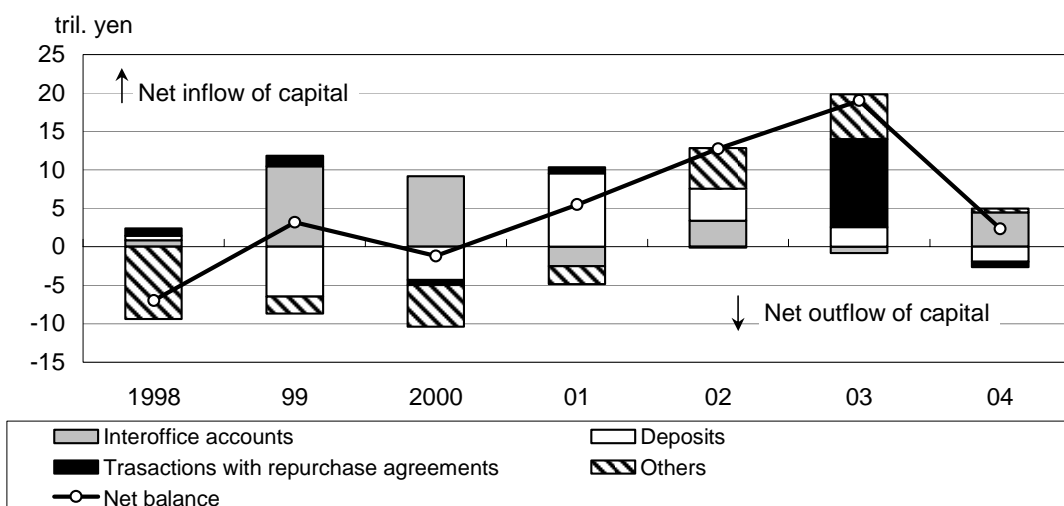


Chart 1 for Box 1: Patterns of BOP by Stage of Development

		Current account	Goods and services	Income	Capital and financial account
I	Immature debtor countries	-	-	-	+
II	Mature debtor countries	-	+	- -	+
III	Debt repayment countries	+	++	-	-
IV	Immature creditor countries	++	+	+	- -
V	Mature creditor countries	+	-	++	-
VI	Credit disposing countries	-	- -	+	+

Chart 2 for Box 1: “Development Stage” of Major Countries<sup>1</sup>

(1) 1996–2000

		ratio to nominal GDP, %				
Development level/ country		Current account	Goods and services	Income	Capital and financial account	[Reference] Current transfers
I	Cambodia	-5.3	-12.7	-2.4	5.9	9.8
I	Mongolia	-2.6	-8.8	-0.6	5.5	6.8
I	India	-1.1	-3.2	-0.9	1.2	2.9
I	Brazil	-3.9	-1.8	-2.4	4.1	0.3
II	Germany	-0.8	0.8	-0.2	0.6	-1.4
III	Canada	0.3	3.5	-3.3	-0.5	0.1
III	China	2.5	3.5	-1.5	-0.7	0.5
III	South Korea	1.9	2.4	-0.7	-1.3	0.3
IV	France	2.0	2.4	0.5	-2.4	-0.8
IV	Japan	2.3	1.3	1.3	-2.7	-0.2
IV	Switzerland	9.7	5.1	6.3	-11.1	-1.7
VI	United Kingdom	-1.4	-1.1	0.5	1.2	-0.8
VI	United States	-2.7	-2.3	0.2	2.6	-0.5

(2) 2001 Onward

		ratio to nominal GDP, %				
Development level/ country		Current account	Goods and services	Income	Capital and financial account	[Reference] Current transfers
I	Mongolia	-7.9	-20.3	-0.3	8.7	12.7
I	Cambodia	-2.2	-9.2	-4.1	2.8	11.1
I	India	0.6	-1.5	-0.7	-0.6	2.8
I→II	Brazil	-1.8	1.6	-3.9	1.9	0.5
II→III	Germany	1.6	3.6	-0.6	-2.7	-1.3
III	Canada	2.1	4.6	-2.6	-1.4	0.1
III	China	2.6	2.6	-1.1	-3.1	1.0
III→IV	South Korea	1.6	1.9	-0.0	-1.8	-0.3
IV	France	1.0	1.5	0.6	-1.3	-1.1
IV	Japan	2.9	1.4	1.7	-2.7	-0.2
IV	Switzerland	10.6	6.4	6.1	-11.5	-1.9
VI	United Kingdom	-1.9	-2.9	1.8	1.8	-0.8
VI	United States	-4.4	-4.1	0.2	4.8	-0.5

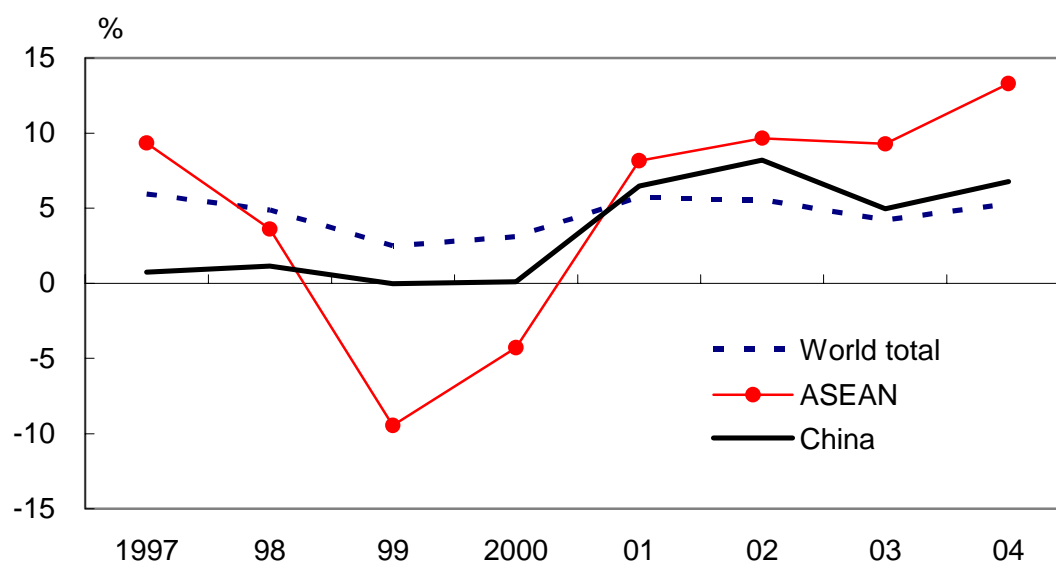
Note: 1. Figures for Japan are for the four years ending in 2004. Figures for all other countries are for the three years ending in 2003.

Chart 3 for Box 1: Development Stage Theory of Japan's BOP

	Development level	Current account	Goods and services	Income	Capital and financial account
1986-90	IV	2.8	2.3	0.7	-2.1
1991-95	IV	2.6	1.9	0.9	-2.5
1996-2000	IV	2.3	1.3	1.3	-2.7
2001-04	IV	2.9	1.4	1.7	-2.7
2001	IV	2.1	0.6	1.7	-2.2
02	IV	2.8	1.3	1.7	-2.8
03	IV	3.2	1.7	1.7	-2.8
04	IV	3.7	2.0	1.8	-3.1

ratio to nominal GDP, %

Chart 1 for Box 2: Profit Rate of Foreign Direct Investment<sup>1</sup>

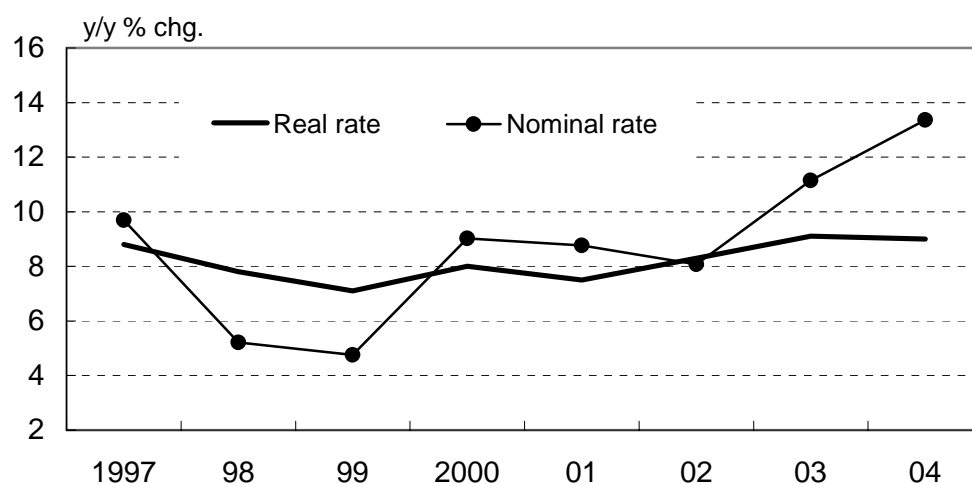


Foreign direct investment (FDI) profit rate =  $\text{FDI profit} / (\text{FDI stock at current year-end} + \text{FDI stock at previous year-end}) / 2$ .

Note: 1. Figures for 2004 are estimated by the Bank of Japan. FDI profit was computed by multiplying the annual figure for 2003 by the year-on-year change for the first half of 2004. FDI stock is based on estimate for the third quarter of 2004.



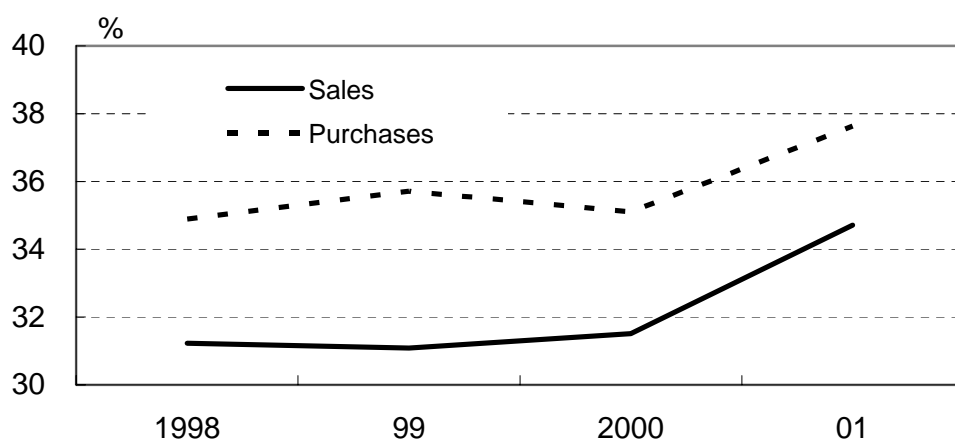
Chart 2 for Box 2: China's Rate of Economic Growth<sup>1</sup>



Note: 1. Figures for 2004 are estimated by the IMF.

Source: International Monetary Fund (IMF), *World Economic Outlook*.

Chart 3 for Box 2: Weight of Japan in Sales and Procurements of Japanese-Affiliated Direct Investment Enterprises in China



Source: Ministry of Economy, Trade and Industry, "Basic (Trend) Survey of Overseas Business Activities."

Chart 4 for Box 2: Japan's Trade with China

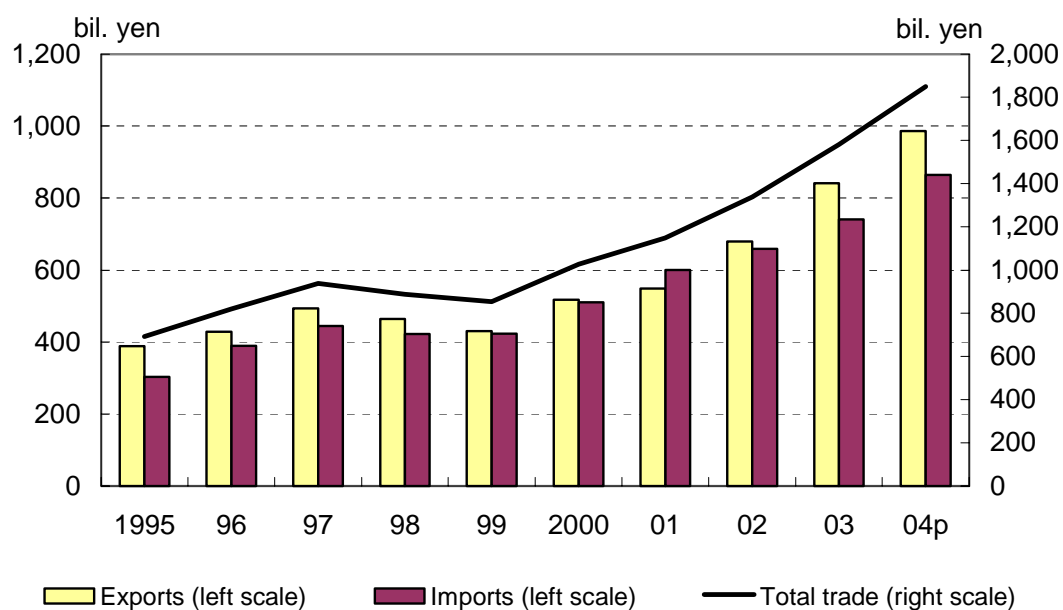


Chart 5 for Box 2: Ratio of Recurring Profits to Revenues of Japanese-Affiliated Direct Investment Enterprises in China

All industry %				
	World total	North America	ASEAN	China
1998	1.4	1.7	1.0	0.4
99	2.0	2.3	2.2	2.0
2000	2.9	3.1	4.5	3.1
01	2.0	1.7	4.0	2.9
02	2.8	2.7	5.1	3.5

Merchandizing sector %				
	World total	North America	ASEAN	China
1998	1.1	1.5	0.3	0.4
99	1.2	1.7	1.1	0.5
2000	1.3	1.9	2.7	1.1
01	1.4	2.2	2.2	1.1
02	1.3	1.9	2.2	1.5

Manufacturing sector %				
	World total	North America	ASEAN	China
1998	1.6	1.4	1.2	0.2
99	2.6	2.6	2.6	3.9
2000	3.7	3.6	3.2	5.3
01	2.2	1.0	4.3	4.5
02	4.1	3.7	5.8	5.1

Services sector %				
	World total	North America	ASEAN	China
1998	1.7	4.5	1.6	0.4
99	1.2	4.6	1.8	-1.3
2000	2.6	4.4	1.4	1.6
01	14.2	21.8	9.4	6.9
02	4.6	1.5	10.1	1.8

Source: Ministry of Economy, Trade and Industry, "Basic (Trend) Survey of Overseas Business Activities."

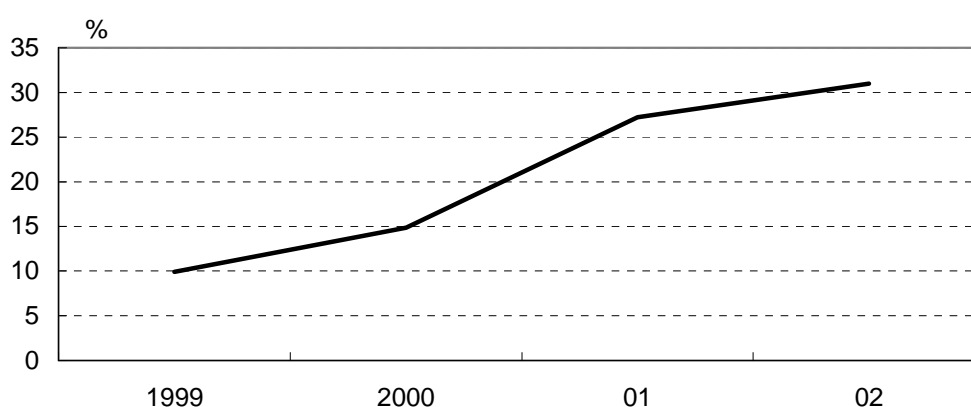
Chart 6 for Box 2: Ratio of Recurring Profits to Revenues of Japanese-Affiliated Direct Investment Enterprises (Manufacturing) in China<sup>1</sup>

	1998	99	2000	01	02
1	Transport equipment	Chemicals	Petroleum and coal	Foodstuffs	Transport equipment
2	Precision instruments	Electrical machinery	Other manufacturers	Transport equipment	Chemicals
3	Petroleum and coal	Transport equipment	Transport equipment	Wood, paper and pulp	Foodstuffs
4	Wood, paper and pulp	Foodstuffs	Chemicals	Nonferrous metals	Nonferrous metals
5	Electrical machinery	General machinery	Foodstuffs	Electrical machinery	Other manufacturers
6	Chemicals	Precision instruments	General machinery	Iron and steel	Electrical machinery
7	Textiles	Wood, paper and pulp	Electrical machinery	Other manufacturers	General machinery
8	General machinery	Textiles	Textiles	Textiles	Iron and steel
9	Other manufacturers	Other manufacturers	Nonferrous metals	Petroleum and coal	Precision instruments
10	Iron and steel	Nonferrous metals	Precision instruments	Precision instruments	Telecommunications

Note: 1. Among Japanese companies directly investing in China, the top ten manufacturing categories with respect to ratio of current profit to sales, by fiscal year.

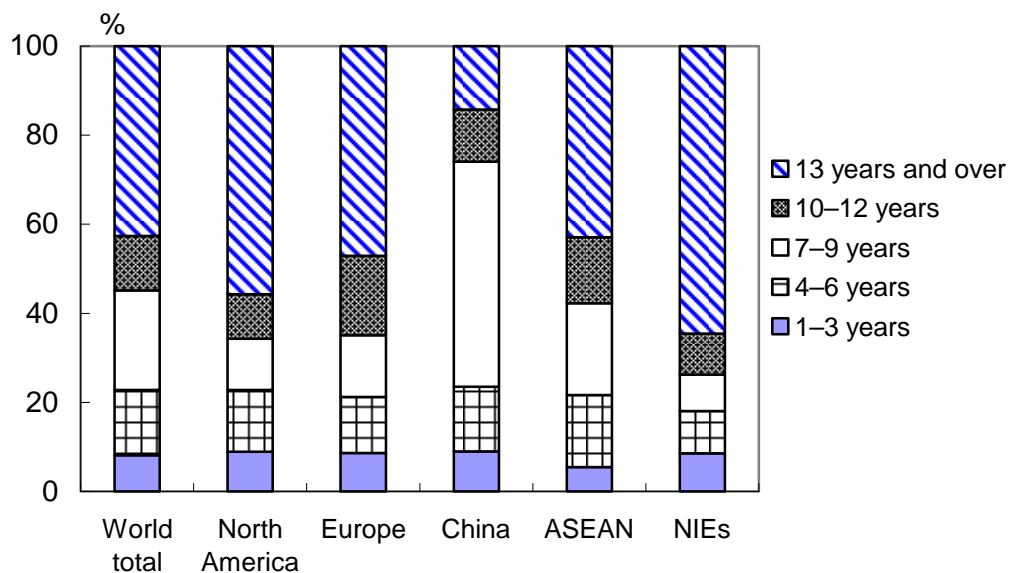
Source: Ministry of Economy, Trade and Industry, “Basic (Trend) Survey of Overseas Business Activities.”

Chart 7 for Box 2: Share of Transport Equipment in Total Recurring Profits of Manufacturing Industries in China



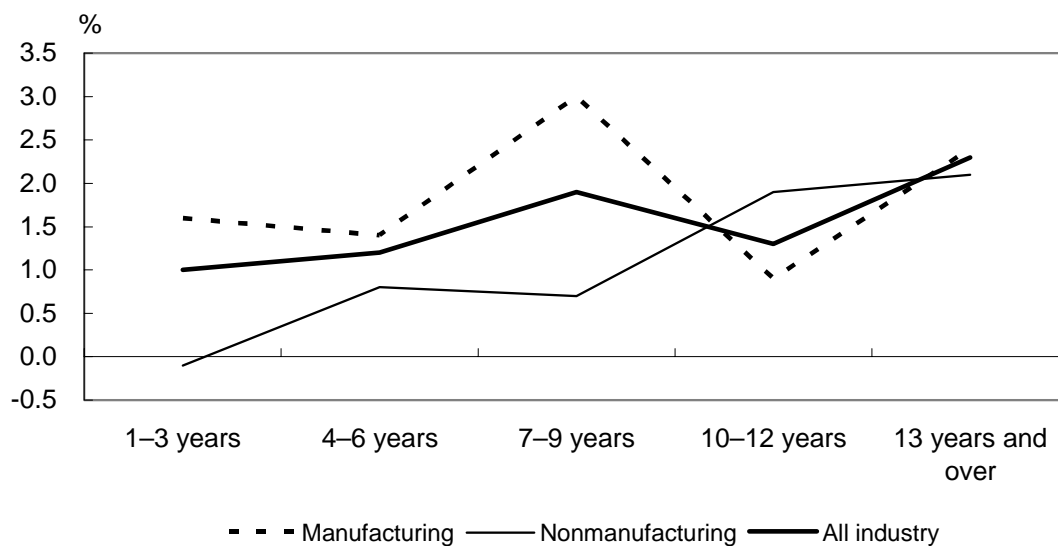
Source: Ministry of Economy, Trade and Industry, “Basic (Trend) Survey of Overseas Business Activities.”

Chart 8 for Box 2: Age Distribution of Japanese-Affiliated Direct Investment Enterprises (Manufacturing)



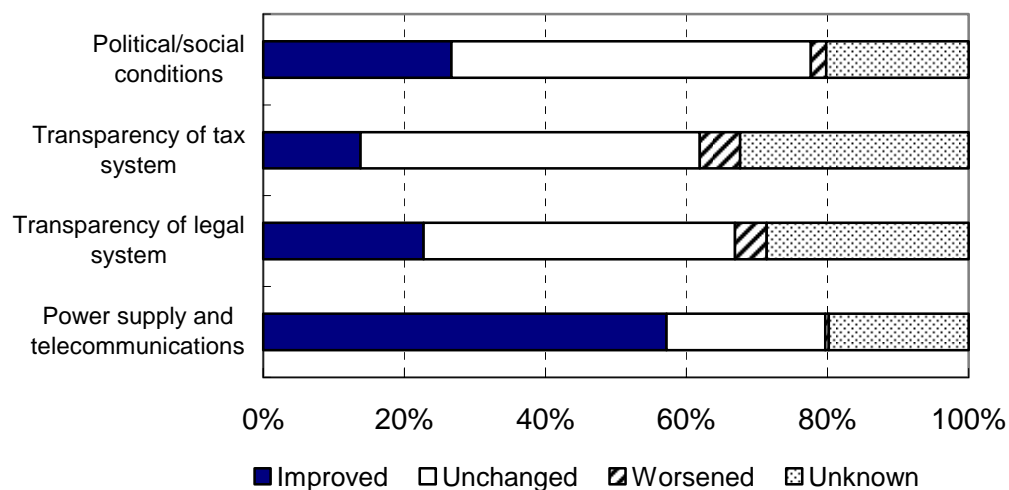
Source: Ministry of Economy, Trade and Industry, “Basic (Trend) Survey of Overseas Business Activities for Fiscal 2002.”

Chart 9 for Box 2: Profit Ratio by Age of Business



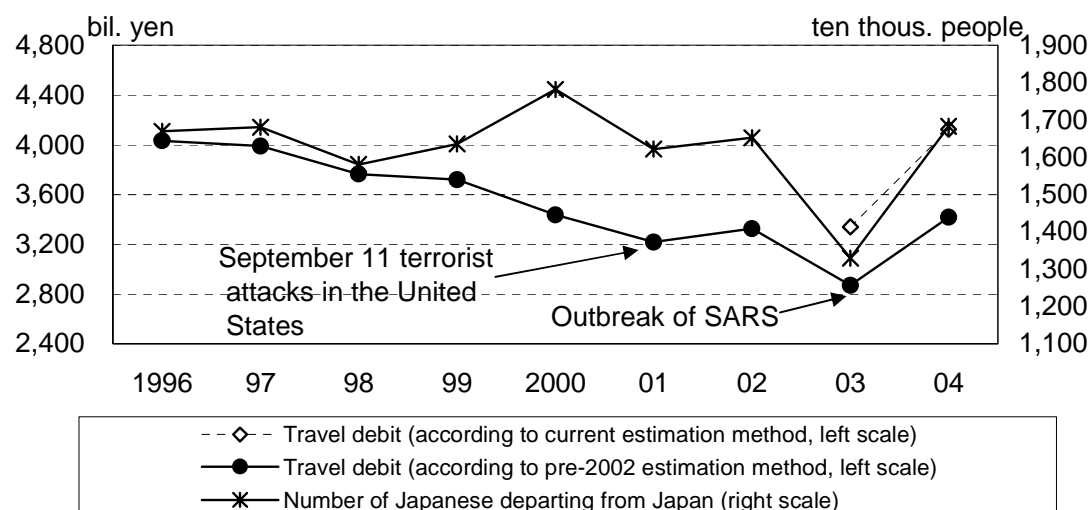
Source: Ministry of Economy, Trade and Industry, “Basic (Trend) Survey of Overseas Business Activities for Fiscal 2002.”

Chart 10 for Box 2: China's Infrastructure from the Perspective of Japanese-Affiliated Direct Investment Enterprises in China



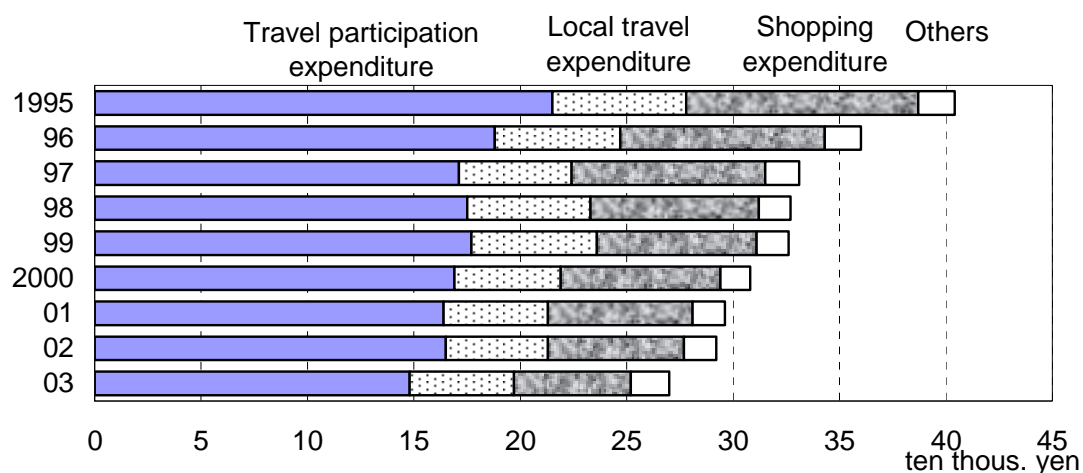
Source: Japan Bank for International Cooperation, "Fiscal 2001 Questionnaire of Foreign Direct Investment Enterprises."

Chart 1 for Box 3: Debit in Travel and Number of Japanese Overseas Travelers



Source: Japan National Tourist Organization (JNTO), "Visitor Arrivals and Japanese Overseas Travelers."

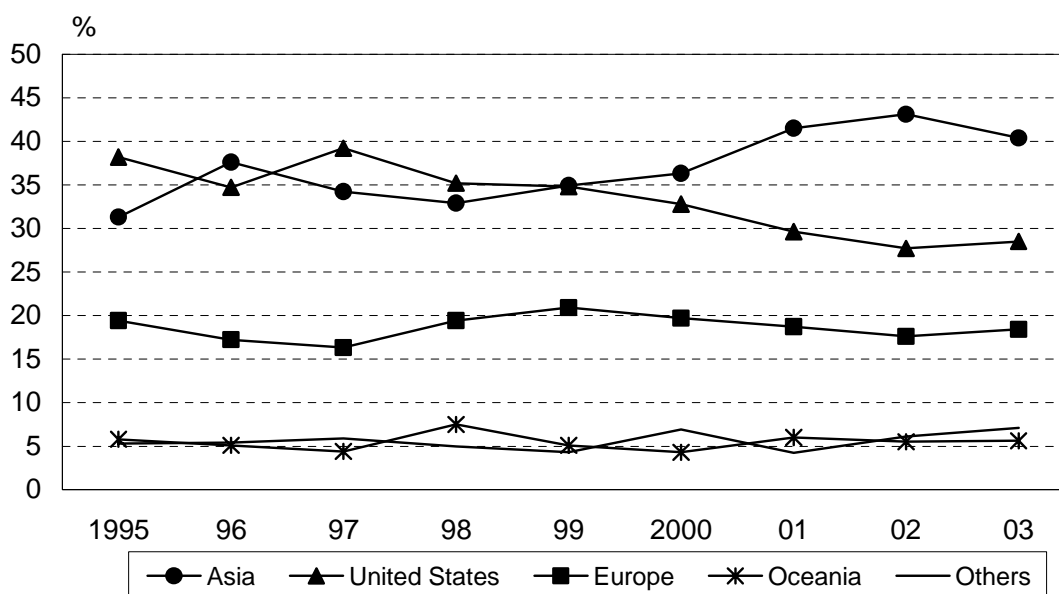
Chart 2 for Box 3: Trends in Travel Expenditure Per Capita<sup>1</sup>



Note: 1. “Travel participation expenditure” includes air and sea transport fares categorized under transportation in the BOP statistics. Therefore, strictly speaking, these figures do not fully correspond to travel expenditure per capita (debit in travel/number of Japanese overseas travelers) computed from the BOP statistics (the same applies to Chart 7 for Box 3).

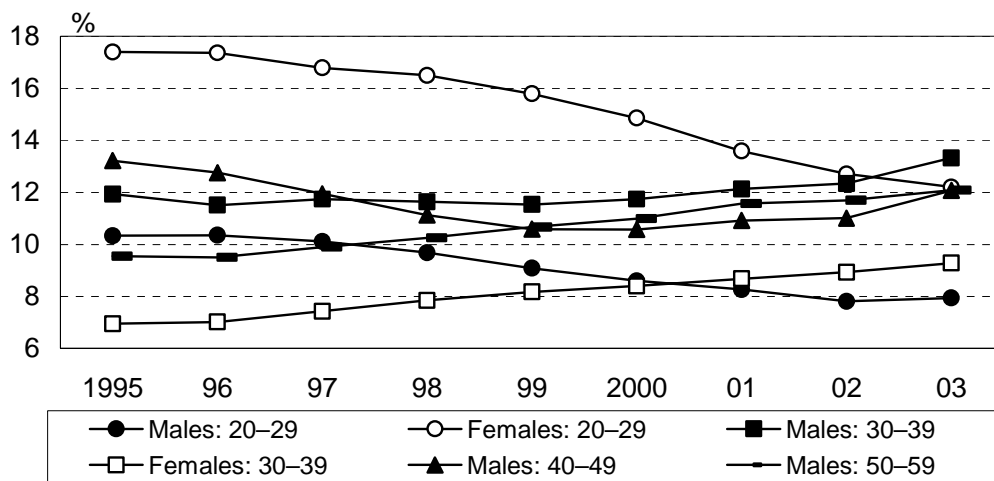
Source: Japan Tourism Marketing Co. (JTM), based on various editions of “JTB Report: Japanese Overseas Travelers.” JTM summarizes developments in Japan’s overseas travel market based on sampling surveys. Data for 2000 and before and portions of data for 2001 are from surveys conducted by the Japan Tourist Bureau (JTB).

Chart 3 for Box 3: Breakdown of Destinations of Japanese Overseas Travelers



Source: Japan Tourism Marketing Co. (JTM).

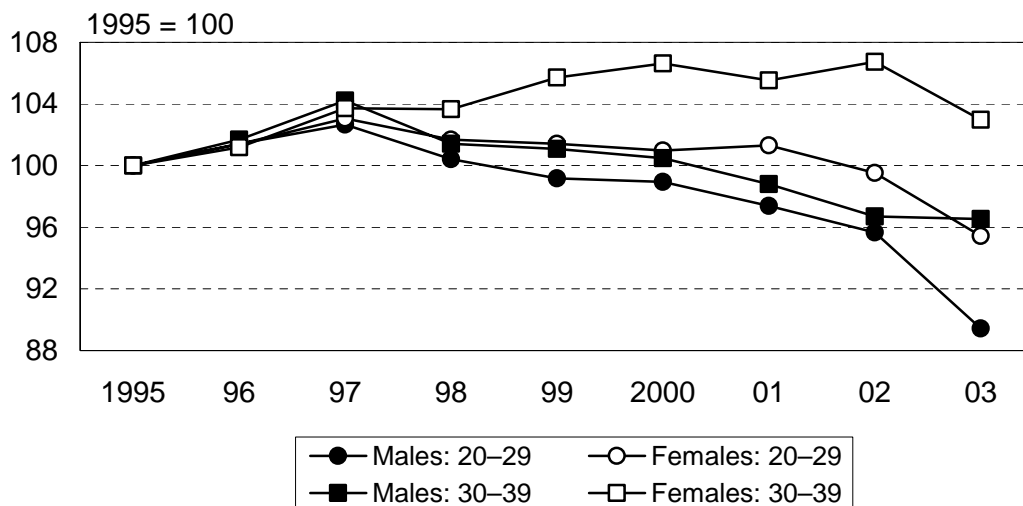
Chart 4 for Box 3: Breakdown of Japanese Overseas Travelers by Sex and Age Group<sup>1</sup>



Note: 1. The chart depicts selected sex and age groups registering significant changes in shares since 1995. Among all groups not included in the chart, men in their 60s or older had the largest impact and registered a 1.9 percentage point increase in share between 1995 (6.7 percent) and 2002 (8.6 percent).

Source: Ministry of Justice, "Immigration Control Statistics Annual."

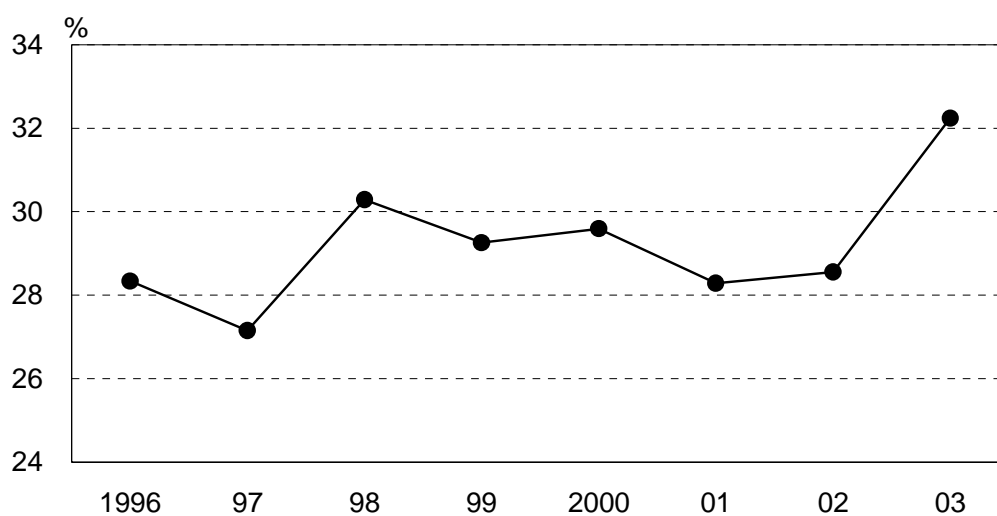
Chart 5 for Box 3: Average Income by Age Group<sup>1</sup>



Note: 1. Figures for 2003 represent a simple average of the first and second halves of the year for individual age groups.

Source: National Tax Agency.

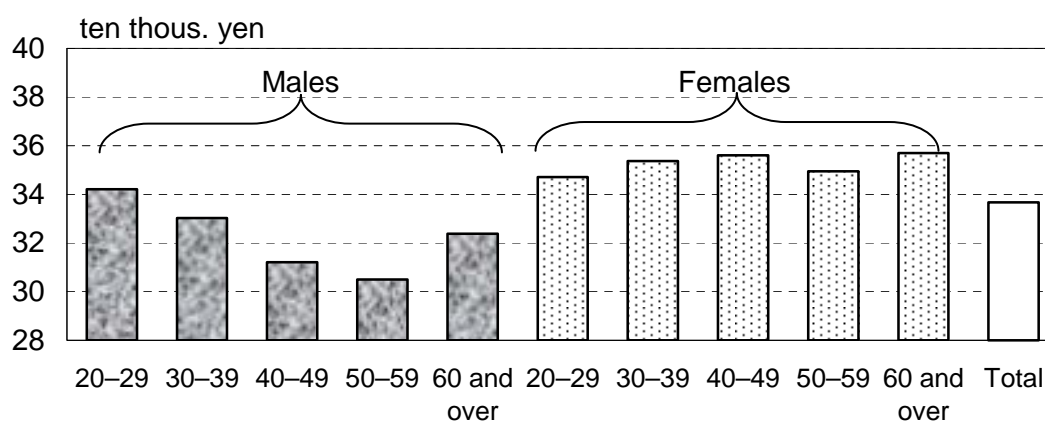
Chart 6 for Box 3: Share of Male Travelers (Excluding Students and Seniors)<sup>1</sup>



Note: 1. Total for unmarried, married, and middle-aged men.

Source: Japan Tourism Marketing Co. (JTM).

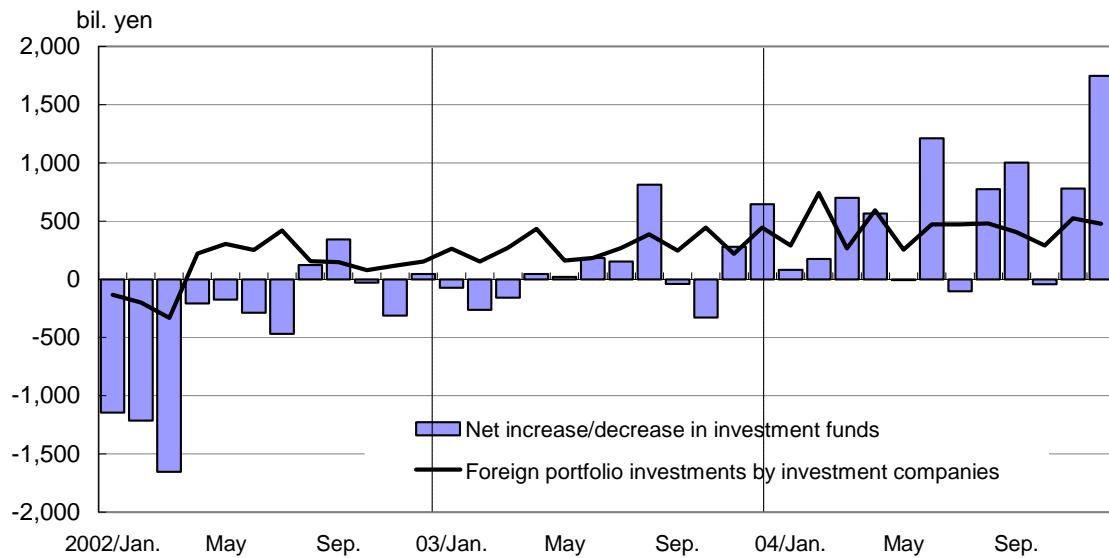
Chart 7 for Box 3: Travel Expenditure Per Capita by Sex and Age Group<sup>1</sup>



Note: 1. Figures are calculations by the International Department, Bank of Japan, and are based on statistical materials of Japan Tourism Marketing Co. (JTM), the Ministry of Justice, and the Ministry of Land, Infrastructure and Transport. Data for 2002 from each of the series were used in the calculations.



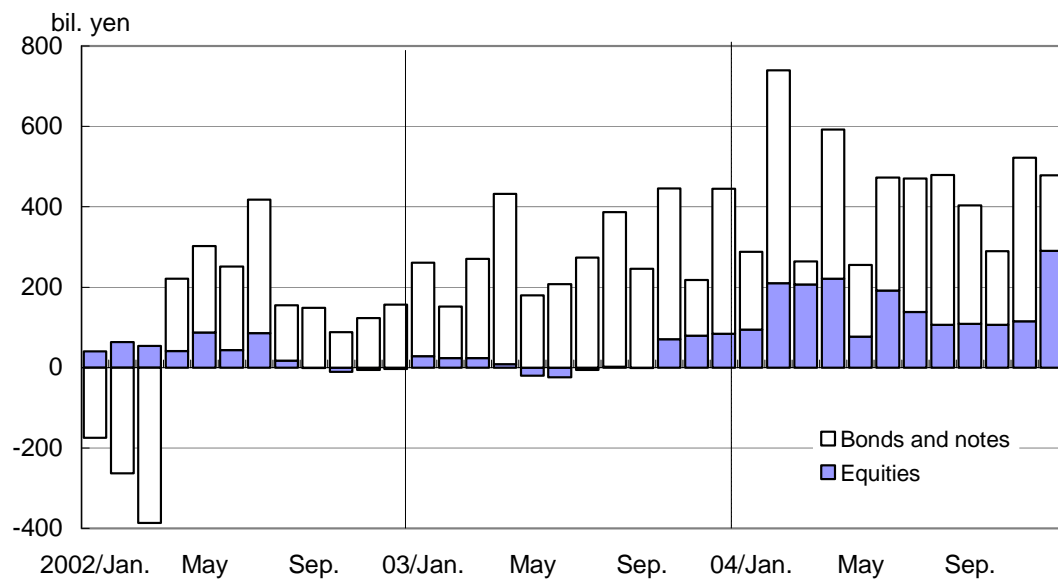
Chart 1 for Box 4: Net Increase/Decrease in Investment Trusts and Overseas Portfolio Investment by Investment Trust Companies<sup>1</sup>



Note: 1. Net flow of investment trusts = sales – repurchases – redemption.

Sources: The Investment Trusts Association, Japan; Ministry of Finance, “Securities Investment at Home and Abroad (settlement base).”

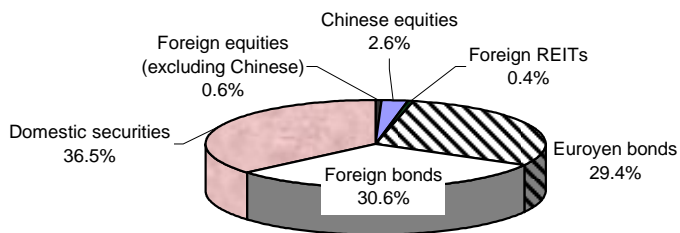
Chart 2 for Box 4: Outward Portfolio Investment by Investment Trusts



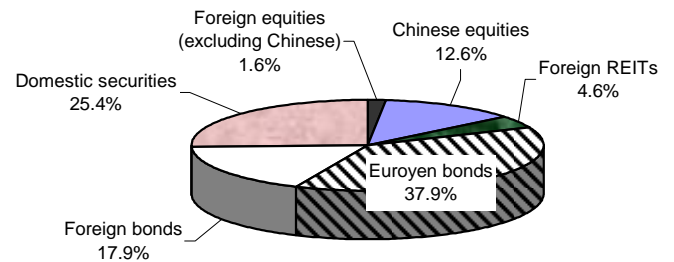
Source: Ministry of Finance, “Securities Investment at Home and Abroad (settlement base).”

Chart 3 for Box 4: Classification of Investment Funds Sold by Type of Investment Fund Portfolio<sup>1</sup>

2003 (New funds sold: 1.6 tril. yen)



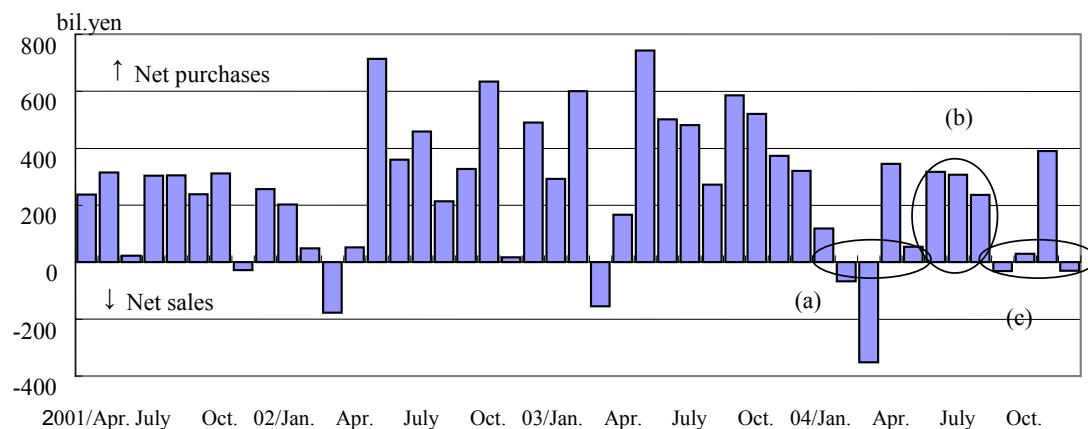
2004 (New funds sold: 2.0 tril. yen)



Note: 1. The figures show the proportion of new funds sold during the year, categorized by investment fund portfolio. Figures do not include additional increase of open-end-type funds; fund decrease by repurchases and redemption are also not reflected in the figures. Figures are calculated by the International Department, Bank of Japan and are based on data of the Investment Trusts Association, Japan and the prospectuses of investment trust companies.

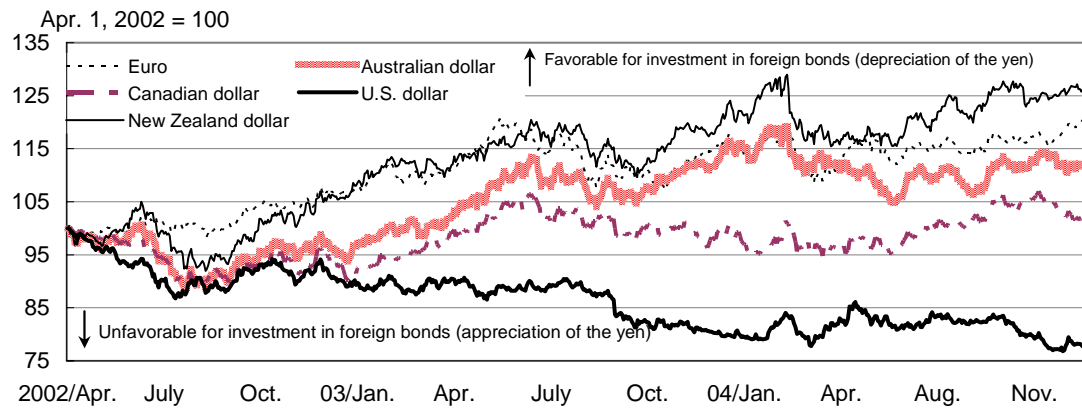
Sources: The Investment Trusts Association, Japan and the prospectuses of investment trust companies.

Chart 1 for Box 5: Investment in Foreign Bonds and Notes by “Other Sectors”<sup>1</sup>



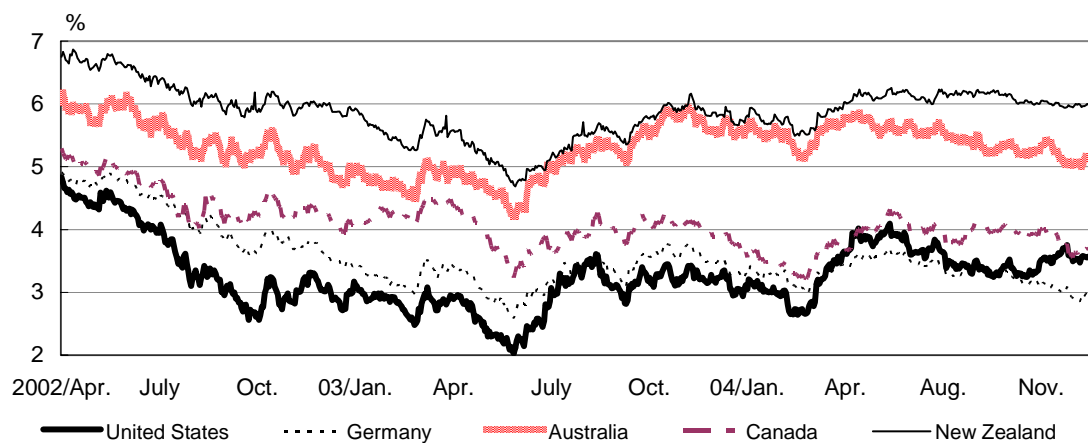
Note: 1. Investment in foreign bonds is derived from “other sectors” (total for individuals, nonfinancial companies, and securities companies (own-account investments) in the Ministry of Finance’s “Securities Investment at Home and Abroad (settlement base).”

Chart 2 for Box 5: Exchange Rates of Major Currencies against the Yen



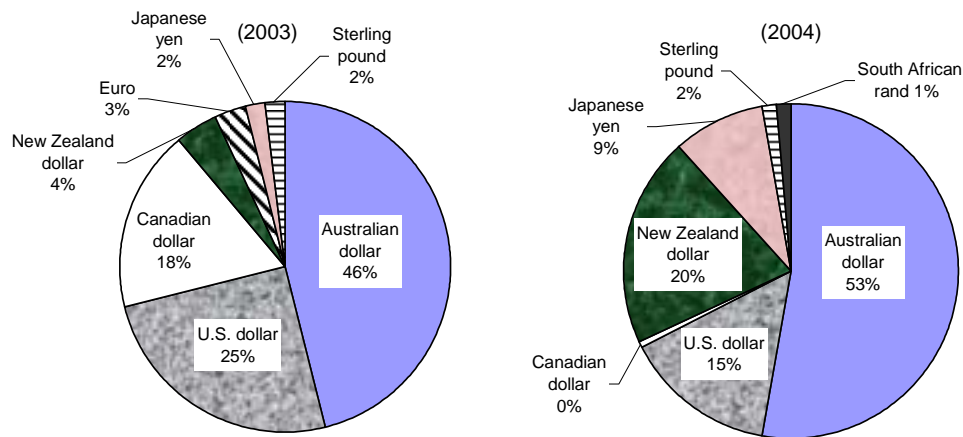
Source: Bloomberg.

Chart 3 for Box 5: Interest Rates in Leading Countries (5 years government bond)



Source: Bloomberg.

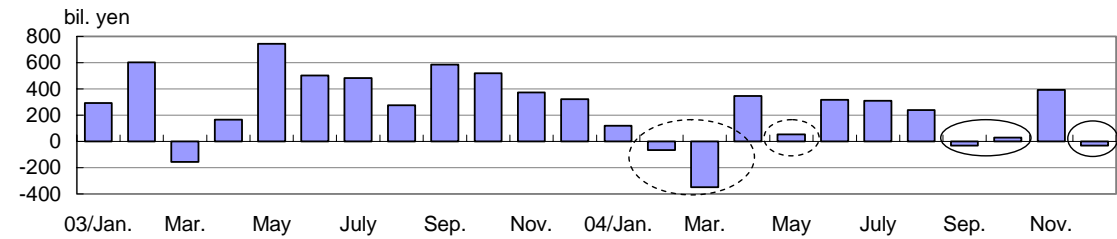
Chart 4 for Box 5: Foreign Bonds Underwritten for Retail Sales by Currency<sup>1</sup>



Note: 1. Figures are the sum of major foreign bonds underwritten by securities companies for retail sales (as they are on a contract basis, negative flows of redemptions are not taken into account). Figures do not include foreign investment trusts underwritten for retail sales.

Chart 5 for Box 5: Underwriting of Foreign Bonds by “Other Sectors” and Issuance of JGBs for Individual Investors

(1) Underwriting of Foreign Bonds by “Other Sectors”



(2) Issuance of JGBs for Individual Investors

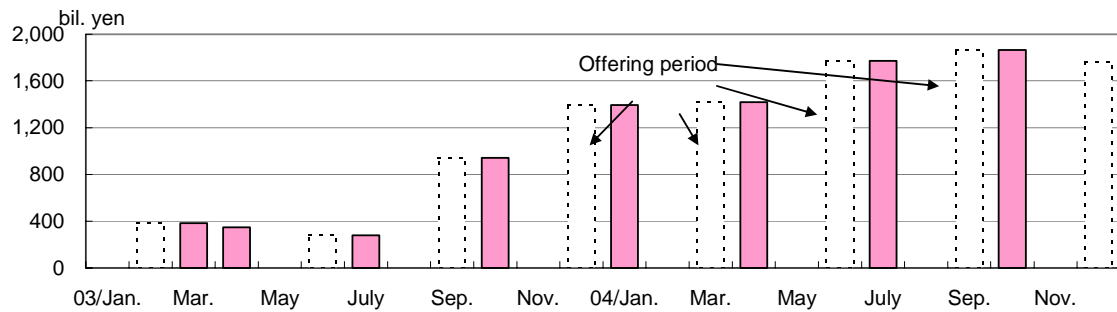


Chart 1 for Box 6: Inward Investment in Bonds and Notes

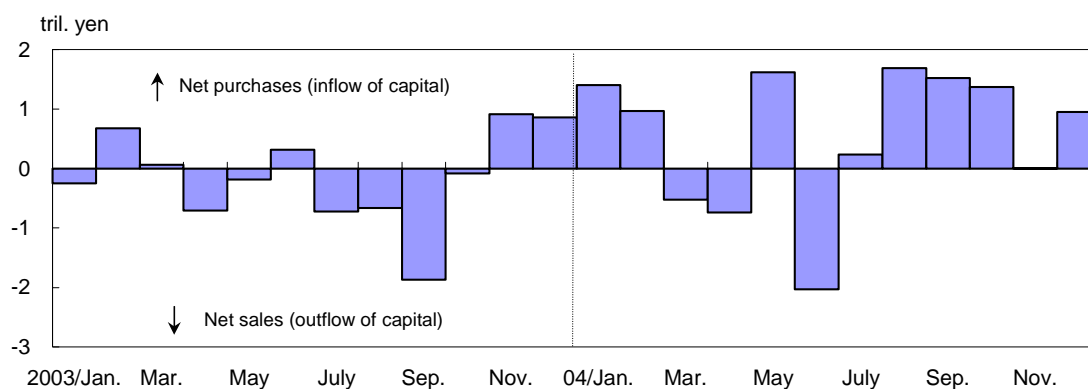
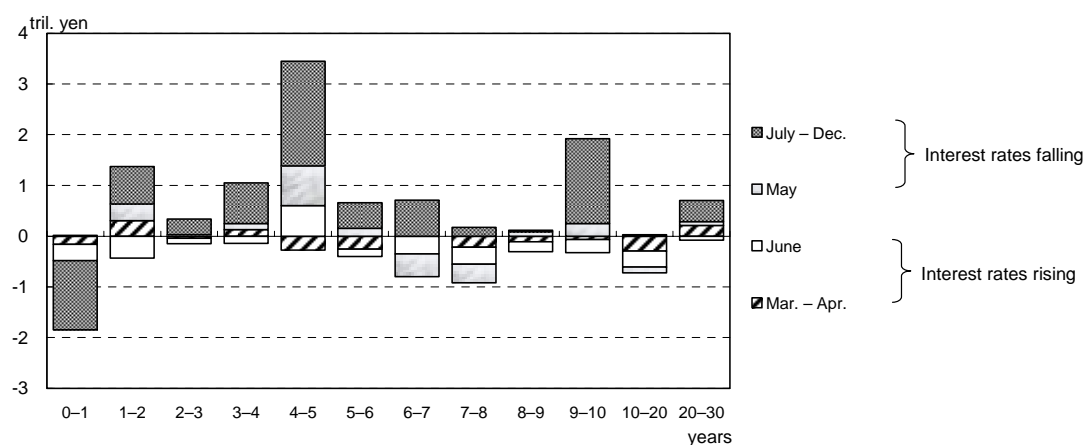


Chart 2 for Box 6: Purchase of JGBs by Nonresidents by Length of Residual Maturity<sup>1</sup>



Note: 1. Figures are calculations by the International Department, Bank of Japan and are derived by aggregating large transactions (exceeding 1 billion yen) included in reports submitted by counterparties as designated under the Foreign Exchange and Foreign Trade Law.

Chart 3 for Box 6: Long-Term Interest Rates and Five-Year, Seven-Year, and Ten-Year Butterfly Spreads in 2004<sup>1</sup>



Note: 1. Butterfly spread = interest on seven-year bond x 2 – (interest on five-year bond + interest on ten-year bond).

Chart 4 for Box 6: Swap Spreads (Five-Year)

