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# **Japan's Balance of Payments for 2006**

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**International Department**  
**Bank of Japan**

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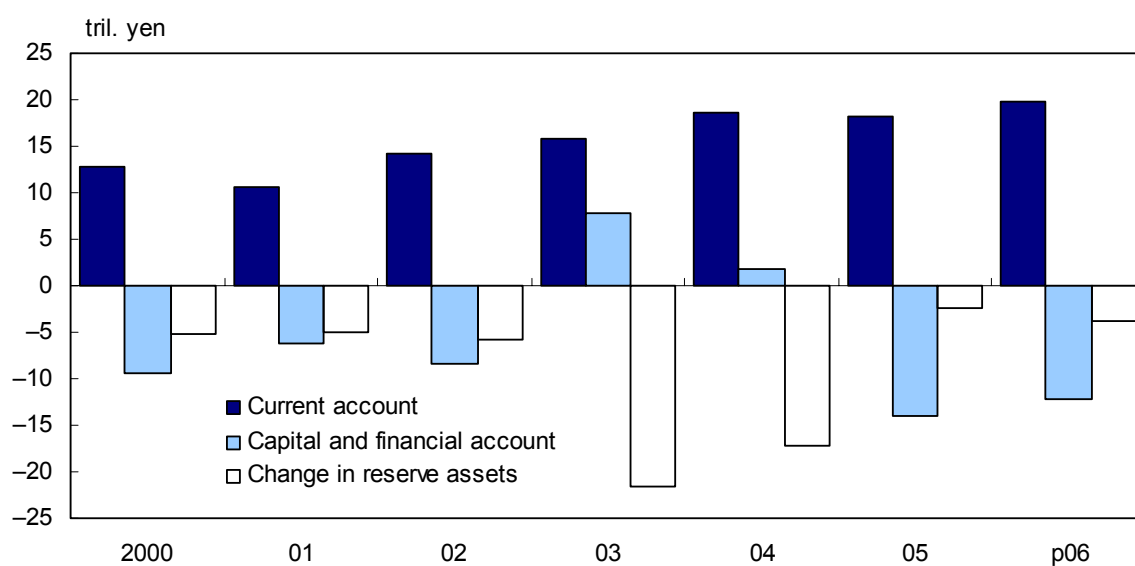
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## I. Summary

Japan's current account surplus increased to 19.8 trillion yen in 2006, up from 18.3 trillion yen in 2005, while the capital and financial account deficit (net outflow) decreased to 12.3 trillion yen in 2006, down from 14.0 trillion yen in 2005. Reserve assets increased by 3.7 trillion in 2006, which was a larger increase than the one recorded in 2005 (2.5 trillion yen). Developments in each account reflect worldwide economic growth, a rise in foreign interest rates, and the globalization of Japanese companies. Balance of payments data for the whole of 2006, the second half of 2006, and the fourth quarter of 2006 in this report are preliminary unless otherwise stated.

**Figure 1: Balance of Payments**



Note: "p" denotes preliminary data. The same applies to the remainder of the report.

**Table 1: Japan's Balance of Payments**

bil. yen

	2004	2005	p2006	Change from the previous year	Highlights
Current account	18,618.4	18,259.1	19,839.0	+1,579.9	Surplus increased, mainly due to increased income surplus.
Goods and services	10,196.1	7,693.0	7,333.8	-359.2	Surplus decreased, mainly due to increased imports.
Goods	13,902.2	10,334.8	9,459.6	-875.2	Surplus decreased, reflecting increased imports of mineral fuel due to higher crude oil prices.
Exports	58,295.1	62,631.9	71,617.8	+8,985.9	
Imports	44,392.8	52,297.1	62,158.2	+9,861.1	
Services	-3,706.1	-2,641.8	-2,125.8	+516.0	Deficit decreased due to an increased number of foreign visitors to Japan.
Income	9,273.1	11,381.7	13,744.9	+2,363.1	Surplus increased in portfolio investment income and direct investment income.
Current transfers	-850.9	-815.7	-1,239.6	-424.0	Deficit increased due to increased workers' remittances debit.
Capital and financial account	1,737.0	-14,006.8	-12,295.8	+1,711.0	
Of which:					
Outward direct investment	-3,348.7	-5,045.9	-5,860.7	-814.8	Large-scale investments continued.
Inward direct investment	845.6	305.9	-735.5	-1,041.4	A large-scale withdrawal in the communications company led to net outflows.
Outward portfolio investment	-20,020.1	-23,567.4	-9,209.3	+14,358.1	Net purchases decreased significantly. Net purchases of equities slightly increased, mainly due to the strength of purchases by individual investors. On the other hand, net purchases of bonds and notes decreased significantly as banks became net sellers.
Equity securities	-3,290.3	-2,540.6	-3,009.2	-468.6	
Bonds and notes	-17,399.0	-22,024.6	-7,291.5	+14,733.1	
Money market instruments	669.2	997.8	1,091.4	+93.6	
Inward portfolio investment	21,899.3	20,346.1	22,085.9	+1,739.7	Net purchases of equities decreased, but net purchases of bonds and notes increased. Net purchases of money market instruments turned positive.
Equity securities	10,595.8	13,978.6	9,855.6	-4,122.9	
Bonds and notes	6,409.0	7,232.1	8,352.3	+1,120.1	
Money market instruments	4,894.4	-864.6	3,878.0	+4,742.5	
Financial derivatives	259.0	-802.3	227.5	+1,029.8	Payments related to margin trading in stock futures decreased.
Other investment	2,649.3	-4,701.9	-18,261.7	-13,559.8	Banks repaid foreign currency-denominated funds raised for foreign securities investment.
Changes in reserve assets	-17,267.5	-2,456.2	-3,719.6	-1,263.3	Investment income from reserve assets increased.
Errors and omissions	-3,087.9	-1,796.0	-3,823.6	-2,027.6	
Ratio of current account to nominal GDP (%)	3.7	3.6	3.9		

Notes: 1. Negative figures represent capital outflows. Negative figures in "Changes in reserve assets" represent an increase in reserve assets.

2. Figures for portfolio investment and other investment exclude securities lending transactions.

## II. Current Account

### A. Summary

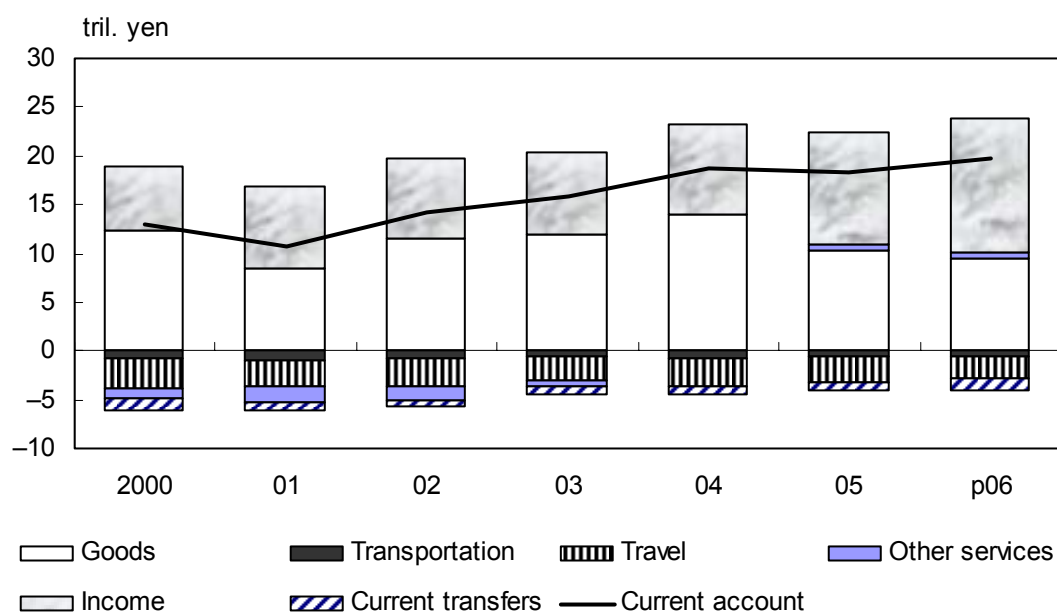
The current account surplus marked a record high due to an increase in the surplus in the balance of income for the fourth consecutive year.

**Table 2: Current Account**

bil. yen

	2005	p2006	Change from the previous year
Current account	18,259.1	19,839.0	+1,579.9
Goods and services	7,693.0	7,333.8	-359.2
Goods	10,334.8	9,459.6	-875.2
Exports	62,631.9	71,617.8	+8,985.9
Imports	52,297.1	62,158.2	+9,861.1
Services	-2,641.8	-2,125.8	+516.0
Transportation	-502.1	-599.3	-97.2
Travel	-2,765.9	-2,151.5	+614.4
Other services	626.2	624.9	-1.2
Income	11,381.7	13,744.9	+2,363.1
Current transfers	-815.7	-1,239.6	-424.0

**Figure 2: Current Account**



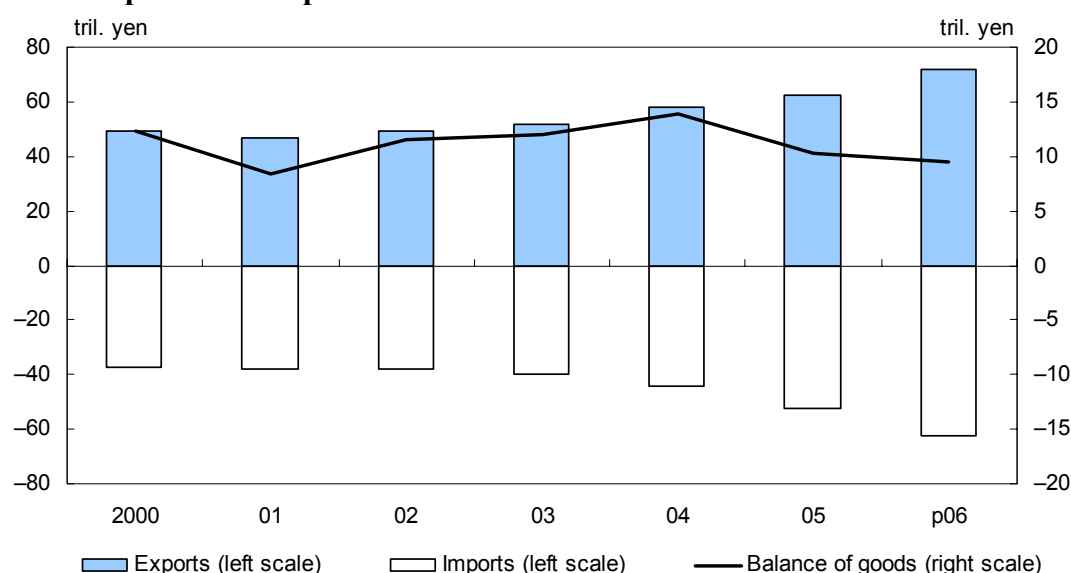
## B. Developments in the Main Components

### 1. Goods

The balance of goods in 2006 registered a surplus of 9,459.6 billion yen, a decrease of 875.2 billion yen or 8.5 percent from the previous year.

While both exports and imports increased in 2006, the increase in imports exceeded the increase in exports. As a result, the surplus of trade in goods decreased for the second consecutive year. Figures by region and type of goods are based on the "Trade Statistics of Japan."<sup>1</sup>

**Figure 3: Exports and Imports**



<sup>1</sup> Figures for exports and imports are based on the "Trade Statistics of Japan" (customs-clearance basis). The definitions of exports and imports in the balance of payments statistics differ from those of the merchandise trade statistics in the "Trade Statistics of Japan." Balance of payments statistics are based on the transfer of ownership principle, while merchandise trade statistics are recorded on a customs-clearance basis. Therefore, certain adjustments are made to compile the balance of payments statistics. Major differences between the merchandise trade statistics and the balance of payments statistics are as follows.

	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 (in principle)
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

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.



## a. Exports

Exports increased for the fifth consecutive year. By region, a large contribution to the total increase was made by exports to Asia and the United States. The increase in exports to Asia was mainly concentrated in chemicals and other raw materials, general machinery, electrical machinery, and IT-related goods. Motor vehicle-related goods accounted for much of the increase in exports to the United States.

**Table 3: Contribution to Overall Export Growth by Region**

y/y % chg.

	Overall exports	United States	European Union	Asia	China	South Korea	Taiwan	Middle East
2005	+7.3	+1.8	+0.1	+3.5	+1.4	+0.6	+0.4	+0.4
p2006	+14.6	+3.2	+1.9	+6.1	+3.0	+1.1	+0.5	+0.6

Source: Ministry of Finance, "Trade Statistics of Japan."

**Table 4: Contribution to Overall Export Growth by Item**

y/y % chg.

	2005	p2006	Major factors
Value of overall exports	+7.3	+14.6	
Motor vehicle-related goods	+1.6	+4.0	
Motor vehicles	+1.2	+3.6	Exports increased mainly to the United States, where Japanese vehicle sales were strong.
Parts of motor vehicles	+0.4	+0.3	Exports mainly to Central and South America and Asia increased due to increased overseas production in those regions.
Transport equipment (excluding motor vehicles)	+0.2	+0.6	Exports of ships and other equipment mainly to Central and South America increased.
Raw materials	+2.6	+3.7	
Of which:			
Chemicals	+1.0	+1.4	Exports to Asia of high-value-added plastics and other products for producing motor vehicles and IT-related goods increased.
Iron and steel products	+0.8	+0.7	Exports mainly to Asia and the Middle East increased.
Non-ferrous metals	+0.2	+0.7	Exports to Asia increased.
IT-related goods	-0.4	+0.9	
Of which:			
Semiconductors and other electronic parts	+0.0	+0.7	Exports to Asia (especially China) increased, reflecting a rise in the production of electronic devices there.
Office machines	-0.2	+0.2	Exports to the United States increased.
Electrical machinery (excluding IT-related goods)	+0.4	+1.7	
Of which:			
Parts of audio and visual apparatus	+0.1	+0.4	Exports of LCD-TV parts mainly to Central and South America and Asia increased.
Electrical apparatus	+0.1	+0.4	Exports to Asia increased.
Machinery (excluding IT-related goods)	+1.2	+2.0	
Of which:			
Construction, mining machines	+0.2	+0.4	Exports to the European Union and the United States increased.
Metal working machines	+0.3	+0.2	Exports mainly to Asia increased.
Mineral fuels	+0.4	+0.3	Exports of petroleum products to Asia and the United States increased.
Foodstuffs	+0.1	+0.1	Exports of fish and shellfish to Asia increased.
Other imports	+1.1	+1.4	

Note: Figures for raw materials represent the sum of figures for minerals, chemicals, and manufactured products classified chiefly by material. Figures for IT-related goods represent the sum of figures for semiconductors and other electronic parts, telecommunications apparatus, and office machines (computers and computer-related parts).

Source: Ministry of Finance, "Trade Statistics of Japan."

## b. Imports

Imports increased for the fourth consecutive year, and the increase in imports exceeded that in exports for the second consecutive year. By region, imports from the Middle East and Asia made a large contribution to the total increase. Imports from the Middle East consisted mainly of mineral fuels, while those from Asia consisted mainly of IT-related goods, mineral fuels, and non-ferrous metals and other raw materials.

**Table 5: Contribution to Overall Import Growth by Region**

y/y % chg.

	Overall imports	United States	European Union	Asia	China	South Korea	Taiwan	Middle East
2005	+15.7	+0.6	+0.4	+6.2	+3.6	+0.6	+0.4	+5.9
p2006	+17.9	+1.5	+0.8	+7.1	+3.2	+0.8	+0.6	+5.3

Source: Ministry of Finance, "Trade Statistics of Japan."

**Table 6: Contribution to Overall Import Growth by Item**

y/y % chg.

	2005	p2006	Major factors
Value of overall imports	+15.7	+17.9	
Mineral fuels	+7.9	+7.2	
Of which:			
Crude oil and partly refined oil	+5.6	+4.8	Imports from the Middle East increased due to a rise in crude oil prices.
Liquefied natural gas	+0.7	+1.2	Imports from the Middle East, Asia, and Australia increased partly due to a rise in prices.
Raw materials	+3.2	+4.8	
Of which:			
Chemicals	+1.0	+1.0	Imports from Asia increased.
Non-ferrous metals	+0.3	+1.2	Imports from Africa, Asia, and other regions increased partly due to a surge in market prices.
Ore of nonferrous metals	+0.5	+1.0	Imports from Central and South America and Asia increased partly due to a surge in market prices.
IT-related goods	+0.4	+1.2	
Of which:			
Semiconductors and other electronic parts	+0.1	+1.0	Imports of DRAMs, MPUs, and other products from Asia and the United States increased.
Electrical machinery (excluding IT-related goods)	+0.9	+1.1	
Of which:			
Electrical power machinery	+0.0	+0.2	Imports of generators and other equipment from Asia, the European Union, and other regions increased.
Electrical measuring and controlling instruments	-0.0	+0.2	Imports from the United States, Asia, and other regions increased.
Machinery (excluding IT-related goods)	+1.3	+1.6	
Of which:			
Power generating machinery	+0.2	+0.3	Imports of internal combustion engines from the United States, Asia, and other regions increased.
Scientific and optical instruments	+0.5	+0.6	Imports from Asia increased.
Textiles	+0.4	+0.6	Imports of clothing and other fabrics from China increased.
Transport equipment	+0.3	+0.3	Imports of motor-vehicle parts and other equipment from Asia increased.
Foodstuffs	+0.5	+0.3	Imports of grain and other foodstuffs from the United States, and vegetables and other foodstuffs from Asia increased.
Other imports	+0.9	+0.9	

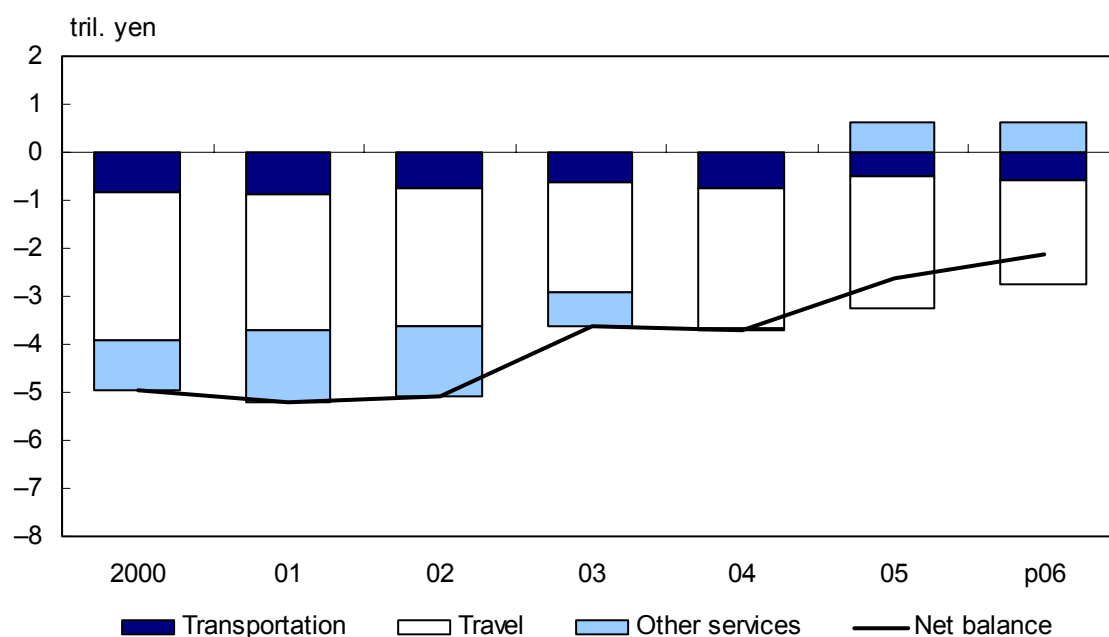
Note: Figures for raw materials represent the sum of figures for minerals, chemicals, and manufactured products classified chiefly by material (excluding textile yarn and fabrics). Figures for IT-related goods represent the sum of figures for semiconductors and other electronic parts, telecommunications apparatus, computers, and computer-related parts. Figures for textiles represent the sum of figures for textile yarn and fabrics, and clothing and accessories.

Source: Ministry of Finance, "Trade Statistics of Japan."

## 2. Services

The deficit in the balance of trade in services for 2006 decreased to 2,125.8 billion yen, a decline of 516.0 billion yen or 19.5 percent from 2005. The balance of trade in services continued to record a deficit in the 2-3 trillion yen range mainly due to outlays made by Japanese travelers abroad, such as consumption overseas and airfare payments to foreign airlines. The balance of trade in other services posted a surplus for the second consecutive year due to the surpluses in "merchandising and other trade-related services" and "royalties and license fees."

**Figure 4: Services**



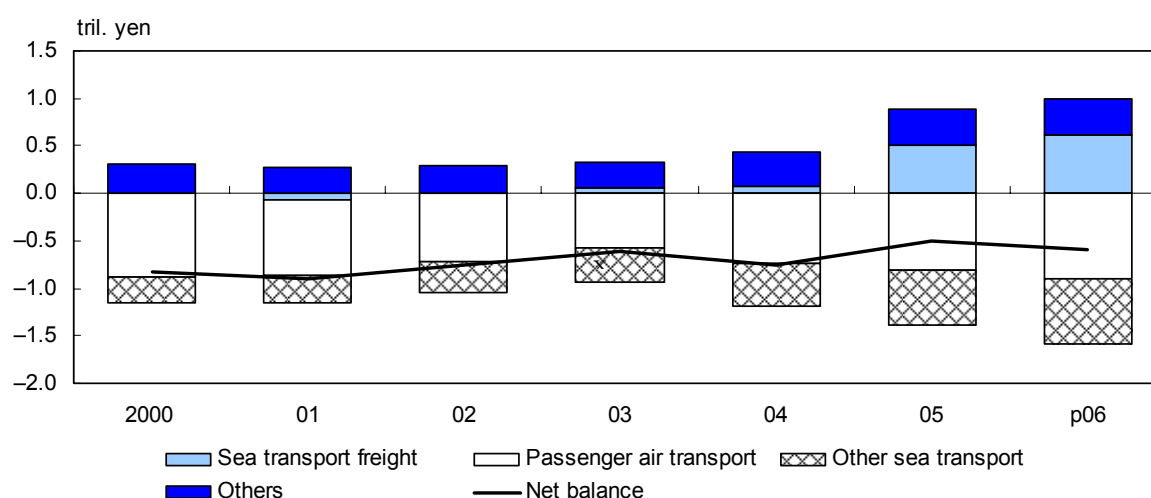
**Table 7: Balance of Trade in Services**

	2005	p2006	Change from the previous year	Major factors
Services	-2,641.8	-2,125.8	+516.0	
Transportation	-502.1	-599.3	-97.2	Deficit rose as air transport debit increased mainly due to the upward adjustment in fuel surcharges.
Travel	-2,765.9	-2,151.5	+614.4	Deficit decreased due to increase in foreign visitors to Japan.
Other services	626.2	624.9	-1.2	Surplus continued mainly due to ongoing surpluses in merchandising and other trade-related services and royalties and license fees.

### a. Transportation

The deficit in the balance of transportation rose to 599.3 billion yen, an increase of 97.2 billion yen or 19.4 percent from 2005. The deficit increased primarily due to the increase in the deficits in passenger air transport and other sea transport. Airfare payments to foreign airlines increased resulting from the upward adjustment in fuel surcharges following the rise in crude oil prices, while payments of terminal charges to overseas ports by Japanese shipping companies also increased. Driven by global economic growth, sea freight credit from cross trade increased for the fourth consecutive year. The credit increased to 1.5 trillion yen in 2006 from 0.8 trillion yen in 2002.

**Figure 5: Transportation**



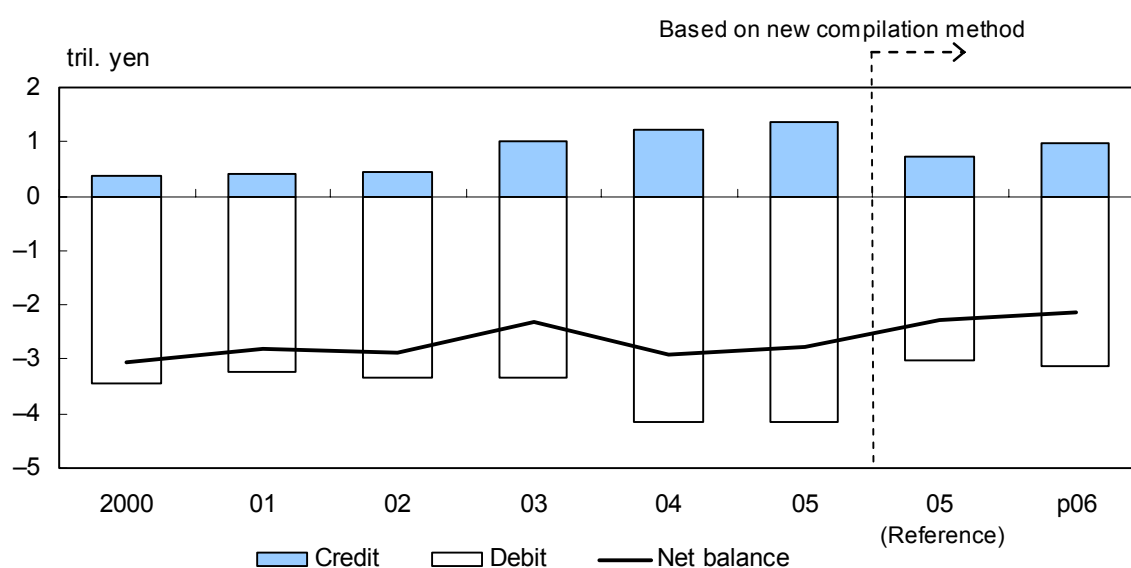
**Table 8: Balance of Transportation**

	2005	p2006	Change from the previous year	Major factors
Transportation	-502.1	-599.3	-97.2	
Of which: Sea transport	-55.2	-80.7	-25.5	
Of which: Freight	510.4	615.9	+105.4	Sea freight credit from cross trade increased due to strong movement of cargo from Asia to Europe and the United States. Both credit and debit in sea freight increased due to strong movement of cargo.
Credit	2,496.5	2,913.8	+417.3	
Debit	1,986.1	2,298.0	+311.8	
Of which: Other sea transport	-565.7	-692.6	-126.8	Terminal charges paid by Japanese shipping companies in overseas ports increased.
Credit	316.0	299.6	-16.4	
Debit	881.7	992.2	+110.5	
Of which: Air transport	-441.2	-510.2	-69.1	
Passenger	-817.1	-896.8	-79.7	Debit increased due to the upward adjustment in the fuel surcharges following the rise in crude oil prices.
Credit	342.2	349.5	+7.3	
Debit	1,159.3	1,246.3	+87.0	
Freight	44.2	50.2	+6.1	Both credit and debit increased due to the upward adjustment in the fuel surcharges following the rise in crude oil prices.
Credit	331.7	353.1	+21.4	
Debit	287.5	302.9	+15.3	
Other air transport	331.8	336.4	+4.5	Surplus remained at approximately the same level as 2005 supported by ongoing net receipts of agency fees.
Credit	455.8	457.5	+1.7	
Debit	124.0	121.1	-2.9	

## b. Travel

The deficit in the balance of travel decreased to 2,151.5 billion yen, a decline of 614.4 billion yen or 22.2 percent from 2005. The deficit decreased for the second consecutive year due to an increase in the number of foreign visitors. A new compilation method for the travel balance, which uses some new source data, has been introduced beginning with the January 2006 figures. Figures are estimated by multiplying foreign and Japanese travelers' per capita expenditures and the number of travelers. Travelers' per capita expenditures are based on the results of a survey concerning travel expenditures conducted in fiscal 2005.

**Figure 6: Travel**



**Table 9: Balance of Travel**

bil. yen					
	2005		p2006	Change from the previous year	
Travel	-2,765.9	(-2,279.3)	-2,151.5	+614.4	(+127.8)
Credit	1,371.0	(730.8)	974.2	-396.9	(+243.4)
Debit	4,136.9	(3,010.1)	3,125.6	-1,011.3	(+115.5)

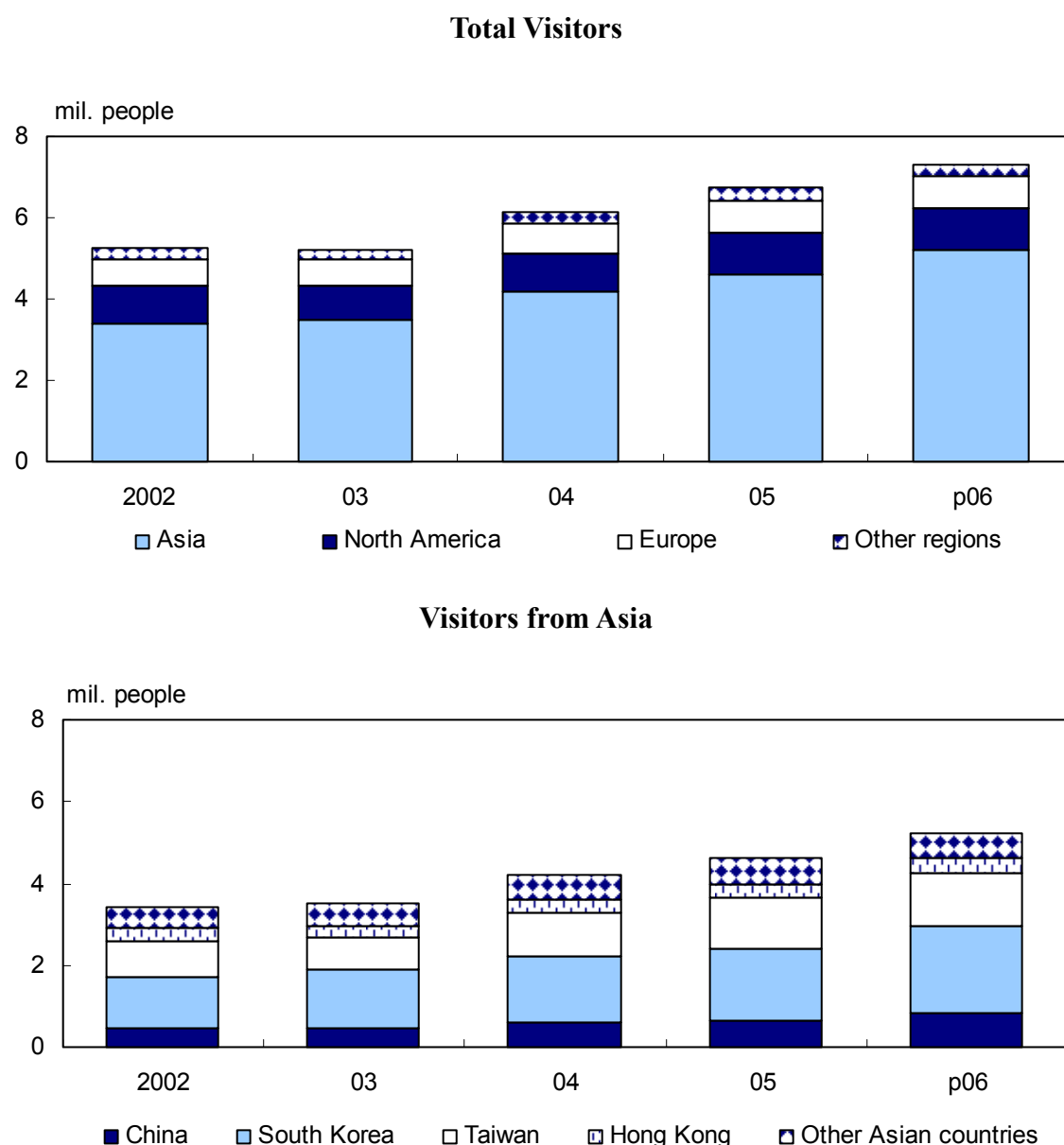
Note: Figures in parentheses are estimated figures using the new compilation method.

The number of foreign visitors from East Asia increased, led by those from South Korea and China. Factors contributing to the increase include (1) the effect of visa exemptions and the deregulation of visa acquisition for foreign visitors from certain areas<sup>2</sup> and (2) the positive

<sup>2</sup> Starting from March 1, 2005, short-stay visitors (up to 90 days) from South Korea have been visa exempted. Starting from July 25, 2005, eligibility for the issuance of group tourist visas for visitors from China was expanded from five provinces and three cities (Guangdong, Jiangsu, Zhejiang, Shandong, Liaoning, Beijing, Shanghai, and Tianjin) to the whole of China.

impact of the Visit Japan Campaign.<sup>3</sup> As for the number of Japanese traveling abroad, while the number of those visiting Asia, especially China, continued to rise, the number of travelers to destinations in the Pacific region such as Hawaii and Guam declined due to (1) a reduction in aircraft seating capacity to the region and (2) a rise in airfares due to the upward adjustment in the fuel surcharge.

**Figure 7: Number of Foreign Visitors to Japan**

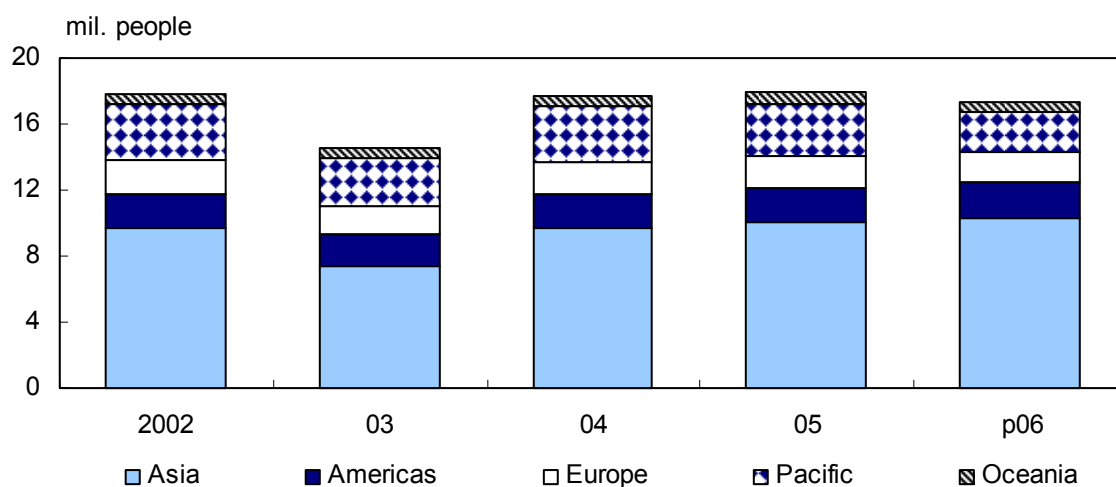


Note: Figures for 2006 are estimates by the International Department of the Bank of Japan using the year-on-year change for January through September 2006.

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

<sup>3</sup> The Visit Japan Campaign is part of the "Strategy to Promote Inbound Tourism," which aims to attract foreign visitors to Japan. This is one of the strategies enumerated in the "Inbound Tourism Initiative of Japan," which was announced at a cabinet meeting on December 2002. The goal of the campaign is to increase the number of foreign visitors to 10 million by 2010.

**Figure 8: Number of Japanese Overseas Travelers**



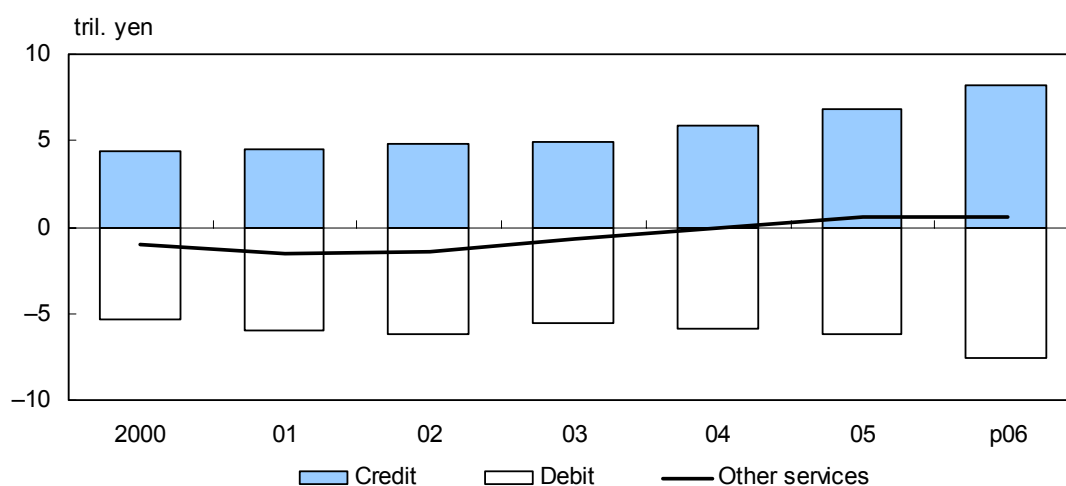
Note: Figures for 2006 are estimates by the International Department of the Bank of Japan using the year-on-year change for January through September 2006.

Source: Ministry of Land, Infrastructure and Transport, "Provisional Statistical Report on Air Transport."

### c. Other services

The surplus in the balance of trade in other services decreased to 624.9 billion yen, a marginal decline of 1.2 billion yen or 0.2 percent from 2005. By item, increased surpluses were registered in "merchandise and other trade-related services" and "royalties and license fees," while increased deficits were recorded for "miscellaneous business, professional, and technical services" and "insurance services." The surplus in "royalties and license fees" increased mainly due to an increase in royalty and license fee receipts for industrial processes and franchises, reflecting the advancing globalizing of Japanese companies.<sup>4</sup>

**Figure 9: Balance of Other Services**



<sup>4</sup> See Box 2, "Developments in Fees for Industrial Property Rights."

**Table 10: Balance of Other Services**

bil. yen

	2005	p2006	Change from the previous year	Major factors
Other services	626.2	624.9	-1.2	
Credit	6,841.6	8,160.9	+1,319.2	
Debit	6,215.4	7,535.9	+1,320.5	
Components contributing to increase in surplus				
Other business services				
Merchanting and other trade-related services	1,142.9	1,366.4	+223.5	Merchanting continued to increase.
Credit	1,847.5	2,249.0	+401.4	
Debit	704.6	882.5	+177.9	
Royalties and license fees	328.9	547.1	+218.2	Credit increased due to rise in royalties mainly from foreign subsidiaries of Japanese motor vehicle manufacturers.
Credit	1,941.9	2,329.5	+387.6	
Debit	1,612.9	1,782.4	+169.4	
Financial services	260.8	365.1	+104.2	Credit increased due to active trading of Japanese equities by nonresidents and the growing derivatives market.
Credit	558.9	711.4	+152.4	
Debit	298.1	346.3	+48.2	
Construction services	270.0	322.4	+52.4	Credit increased as Japanese engineering and construction companies received large construction orders from the Middle East.
Credit	796.7	959.8	+163.2	
Debit	526.6	637.4	+110.8	
Components contributing to decrease in surplus				
Other business services				
Miscellaneous business, professional, and technical services	-1,181.4	-1,454.6	-273.2	Debit increased mainly due to increase in payments to overseas subsidiaries for advertising, research and development, and oil exploration expenditures.
Credit	1,012.8	1,074.9	+62.2	
Debit	2,194.1	2,529.5	+335.4	
Insurance services	-117.0	-351.8	-234.8	In 2005, deficit decreased mainly due to receipt of reinsurance payments for typhoon damage sustained in the previous year. In 2006, in the absence of this factor, the deficit increased.
Credit	95.7	182.8	+87.1	
Debit	212.7	534.6	+321.9	

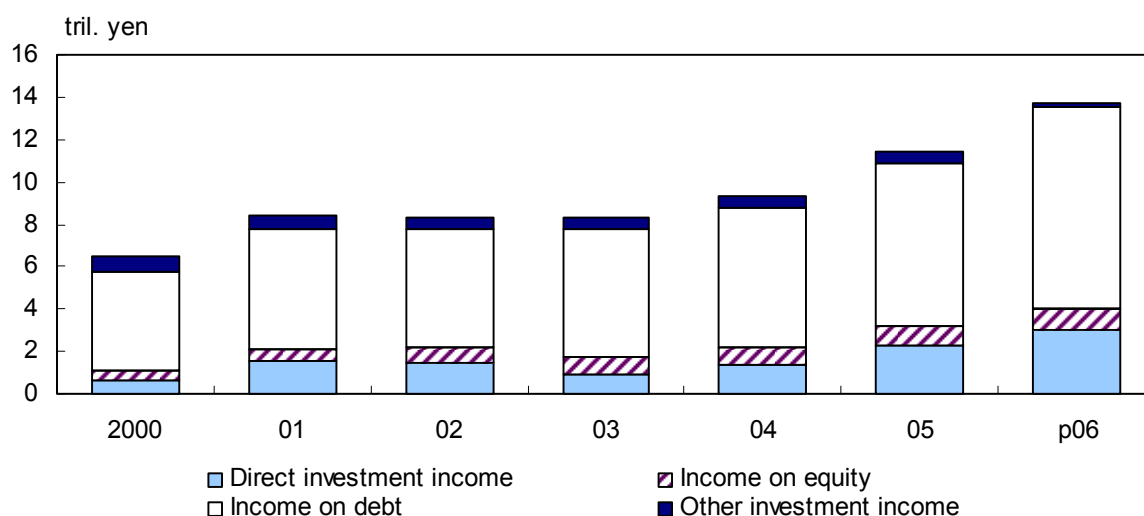
### 3. Income

The surplus in the balance of income rose to 13,744.9 billion yen, an increase of 2,363.1 billion yen or 20.8 percent from 2005. This marked a new record high for the third consecutive year and was a result of the following trends. First, portfolio investment income rose due to a substantial increase in credit from interest on bonds and notes springing from the accumulation of outward portfolio investment and the rise in foreign interest rates. Second, direct investment income climbed reflecting the strong performance of foreign subsidiaries of Japanese companies that are actively involved in overseas business.<sup>5</sup>

<sup>5</sup> See Box 1, "Features of the Balance of Income in 2006."



**Figure 10: Income**



**Table 11: Balance of Income**

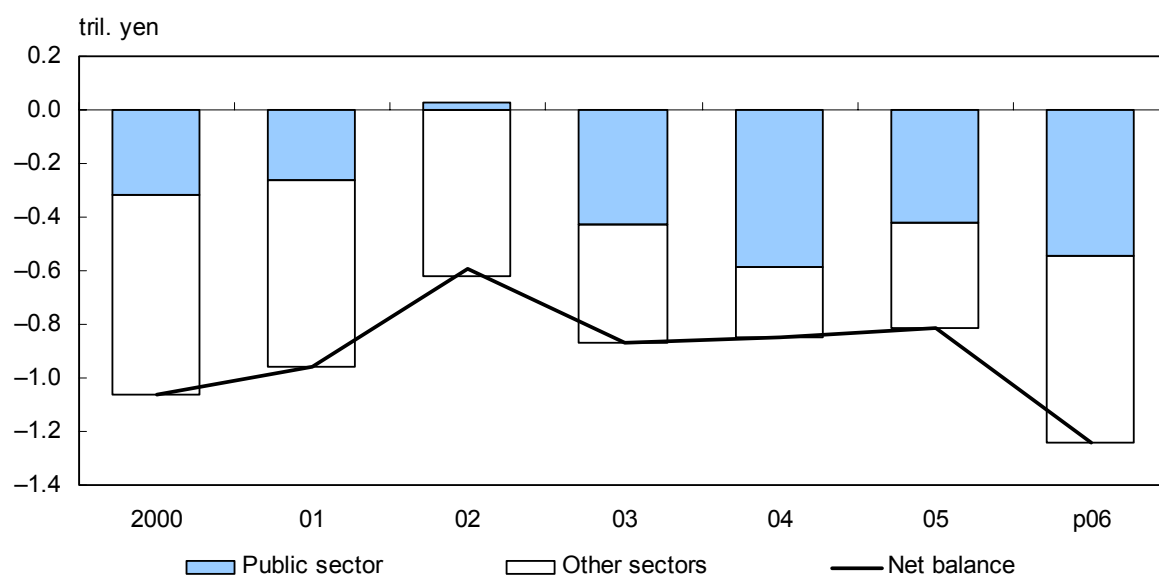
bil. yen					Major factors
	2005	p2006	Change from the previous year		
Investment income	11,381.7	13,744.9	+2,363.1		
Of which: Direct investment income	2,306.3	3,027.2	+720.9		
Of which: Dividends and distributed branch profits	971.0	1,315.2	+344.1		
Credit	1,798.3	2,071.1	+272.8		Credit increased due to the strong performance of Japanese companies' foreign subsidiaries.
Debit	827.3	755.9	-71.3		
Of which: Reinvested earnings	1,278.0	1,638.2	+360.2		
Credit	1,464.3	1,900.2	+435.9		
Debit	186.3	262.0	+75.7		
Of which: Portfolio investment income	8,609.7	10,496.4	+1,886.6		
Income on equity	937.1	1,033.6	+96.5		
Credit	2,042.0	2,640.4	+598.4		Interest income on bonds and notes increased due to the accumulation of outward portfolio investment, a rise in foreign interest rates, and yen depreciation.
Debit	1,104.9	1,606.8	+501.9		
Income on debt	7,672.6	9,462.8	+1,790.1		
Credit	8,441.9	10,303.4	+1,861.5		
Debit	769.2	840.6	+71.4		
Of which: Other investment income	479.8	224.7	-255.1		
Credit	1,687.1	2,237.9	+550.8		Interest payments increased due to the rise in short-term interest rates.
Debit	1,207.3	2,013.2	+805.9		

#### 4. Current transfers

The deficit in the balance of current transfers rose to 1,239.6 billion yen, an increase of 424.0 billion yen or 52.0 percent from 2005.

Two main factors contributed to the increase in deficit in the balance of current transfers. The first was a sharp increase in debit of workers' remittances resulting from an increase in the amount recorded due to expanded data coverage, and the second was a rise in tax payments to oil-producing countries.

**Figure 11: Current Transfers**



**Table 12: Balance of Current Transfers**

bil. yen

	2005	p2006	Change from the previous year	Major factors
Current transfers	-815.7	-1,239.6	-424.0	
Public sector	-423.0	-544.4	-121.5	The public sector continued to be in deficit due to contributions to international organizations.
Credit	140.4	15.7	-124.7	
Debit	563.3	560.1	-3.2	
Other sectors	-392.7	-695.2	-302.5	Deficit increased mainly as a result of the expanded data coverage of workers' remittances and increased tax payments to oil-producing countries along with the rise in oil prices.
Credit	933.3	701.9	-231.5	
Debit	1,326.0	1,397.1	+71.0	
Workers' remittances	-13.2	-245.7	-232.6	The amount recorded in the statistics increased due to the expansion of data sources.
Credit	80.7	119.1	+38.4	
Debit	93.9	364.8	+271.0	
Other transfers	-379.5	-449.5	-69.9	Payments of taxes on rights and interests to oil-producing countries increased due to the rise in oil prices, while both receipts and payments related to reinsurance decreased.
Credit	852.6	582.7	-269.9	
Debit	1,232.1	1,032.2	-199.9	

### III. Capital and Financial Account

#### A. Summary

The capital and financial account recorded a net outflow of 12.3 trillion yen in 2006, which was slightly lower than the 14.0 trillion yen in 2005. The slight decrease owes mainly to the fact that portfolio investment in 2006 turned to a net inflow from a net outflow in 2005, while the net outflow of other investment increased.

**Table 13: Capital and Financial Account**

bil. yen

	2005			p2006		
Current account	18,259.1			19,839.0		
Capital and financial account	-14,006.8	Assets (outward investment)	Liabilities (inward investment)	-12,295.8	Assets (outward investment)	Liabilities (inward investment)
Financial account	-13,457.9			-11,749.5		
Direct investment	-4,740.0	-5,045.9	305.9	-6,596.2	-5,860.7	-735.5
Portfolio investment	-3,221.3	-23,567.4	20,346.1	12,876.6	-9,209.3	22,085.9
Equity securities	11,438.0	-2,540.6	13,978.6	6,846.4	-3,009.2	9,855.6
Bonds and notes	-14,792.5	-22,024.6	7,232.1	1,060.8	-7,291.5	8,352.3
Money market instruments	133.3	997.8	-864.6	4,969.3	1,091.4	3,878.0
Financial derivatives	-802.3	25,452.7	-26,254.9	227.5	16,657.3	-16,429.8
Other investment	-4,701.9	-8,025.5	3,323.5	-18,261.7	-6,257.6	-12,004.1
Of which:						
Interoffice account transactions of banks	-4,121.7	-2,738.5	-1,383.3	-1,997.1	3,279.2	-5,276.3
Capital account	-549.0			-546.4		
Changes in reserve assets	-2,456.2			-3,719.6		
Errors and omissions	-1,796.0			-3,823.6		

Notes: 1. Negative figures represent capital outflows. Capital outflows are registered in the case of outward investment and loans by residents, withdrawals of inward investment and loans by nonresidents, and an increase in reserve assets.

2. Figures in this table exclude securities lending transactions. Figures for securities lending transactions are not included in the analysis in this report unless otherwise noted. The reason is that such transactions are large and volatile, and including them in portfolio investment or other investment in the capital and financial account therefore could prevent an accurate understanding of securities transactions and loans.

#### B. Developments in the Main Components

##### 1. Direct investment<sup>6</sup>

Outward direct investment by residents<sup>7</sup> increased, registering a net outflow of 5.9 trillion yen, the highest level since 1990 (7.4 trillion yen), mainly due to acquisitions with the aim of

<sup>6</sup> See Box 3, "Classification of Direct Investment by Type of Investment."

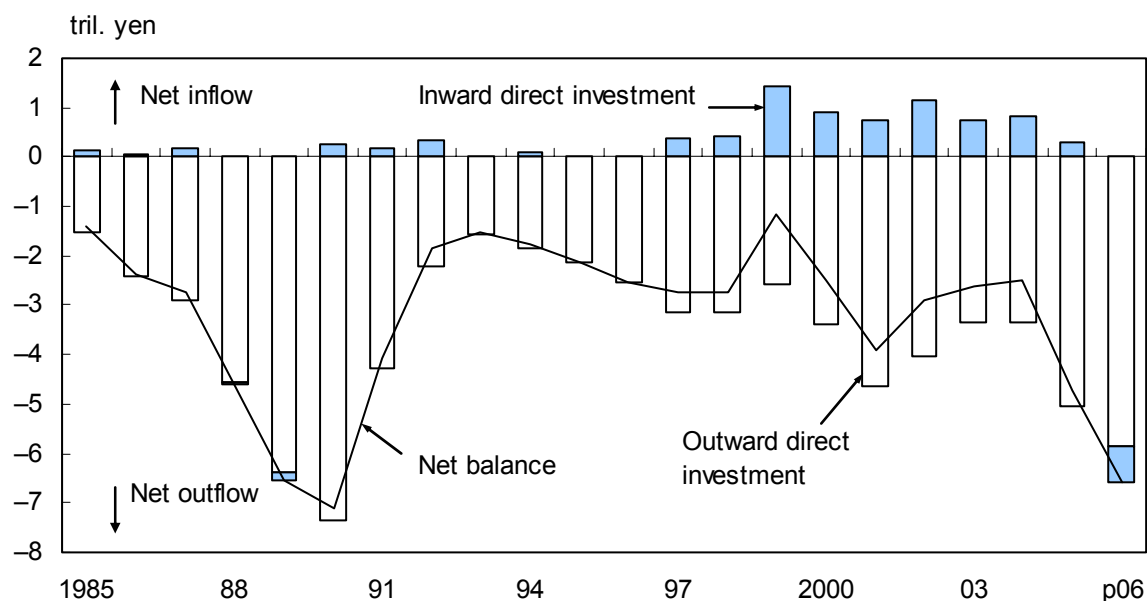
<sup>7</sup> Outward direct investment refers to direct investments by Japanese investors in foreign corporations (with at least 10 percent ownership), such as initial capitalizations, capital increases, loan capital (excluding loans between financial companies), and reinvested earnings.

expanding overseas business. Inward direct investment by nonresidents<sup>8</sup> turned negative, registering a net outflow of 0.7 trillion yen, the first such outflow since 1989, as a result of large-scale withdrawal.

**Table 14: Outward and Inward Direct Investment**

	2004		2005		p2006		2006 Jan.- June		p2006 July-Dec.	
	Value (bil. yen)	Percentage change from a year earlier	Value (bil. yen)	Percentage change from a year earlier	Value (bil. yen)	Percentage change from a year earlier	Value (bil. yen)	Percentage change from a year earlier	Value (bil. yen)	Percentage change from a year earlier
Outward direct investment	-3,348.7	+0.3	-5,045.9	+50.7	-5,860.7	+16.1	-2,305.5	+19.4	-3,555.2	+14.2
Inward direct investment	845.6	+15.3	305.9	-63.8	-735.5	Turned to net outflow	-1,288.1	Turned to net outflow	552.6	Turned to net inflow

**Figure 12: Outward and Inward Direct Investment**



<sup>8</sup> Inward direct investment refers to direct investments by foreign investors in Japanese corporations (with at least 10 percent ownership), such as initial capitalizations, capital increases, loan capital (excluding loans between financial companies), and reinvested earnings.

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

The following three types of investment were dominant in outward direct investment: (1) acquisitions and capital participations with the aim of entering foreign markets (major sectors were glass and ceramics products, electric power business, and electrical machinery); (2) investment for developing oil, natural gas, and other resources; and (3) investment in indirect capital increases to inject capital into foreign subsidiaries of Japanese companies.<sup>9</sup>

As for withdrawals by Japanese companies (negative outward direct investment), companies in, for example, the electrical machinery industry sold their foreign subsidiaries due to changes in their overseas business strategies.

#### **(1) Breakdown by region**

Net outflows to Asia (including China) increased to 2.0 trillion yen in 2006, up from 1.8 trillion yen in 2005, as (1) transportation equipment companies sought to establish new production facilities and expand existing ones and (2) an electrical machinery company made a large acquisition to expand overseas business operations.

Net outflows to the European Union (EU) increased to 1.7 trillion yen in 2006, up from 0.9 trillion yen in 2005. This was due to an acquisition by a glass and ceramics products company to expand overseas business operations and also to the purchase of additional equities by trading companies to increase the capital of holding companies involved in the development of oil and natural gas.

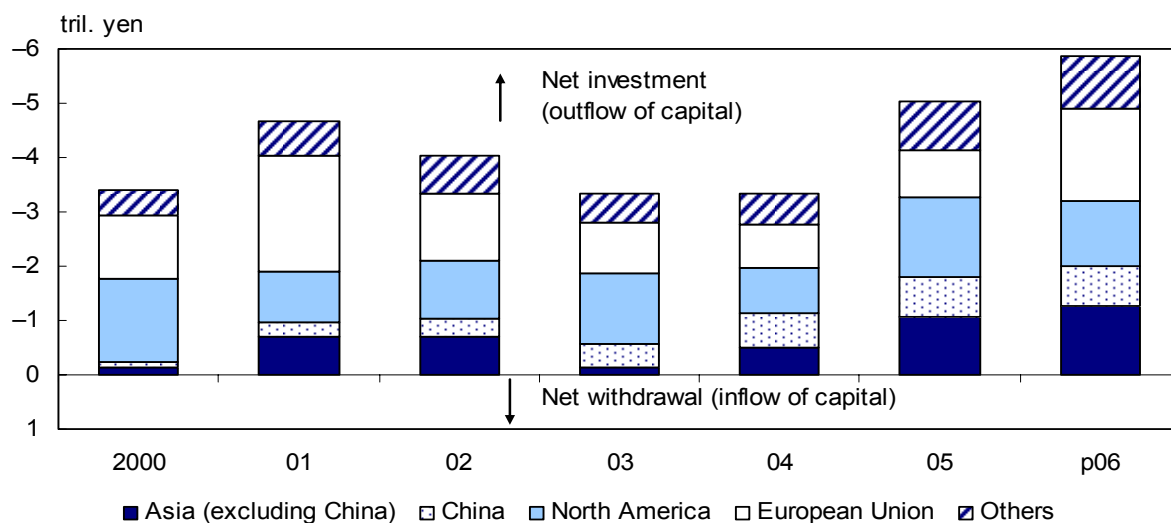
Net outflows to North America decreased to 1.2 trillion yen in 2006, down from 1.5 trillion in 2005. An electrical machinery company made a large investment in the electric power business, and reinvested earnings rose in response to the strong earnings of transportation equipment companies. The increase in outflows, however, was largely offset by large-scale withdrawal by an electrical machinery company in the movie and entertainment production business.

Net outflows to other regions remained largely unchanged, registering only a slight increase from 0.9 trillion yen in 2005 to 1.0 trillion yen in 2006, which was due to the acquisition of participation certificates issued by special purpose companies (SPCs) established in the Cayman Islands by the finance and iron and steel companies.

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<sup>9</sup> This refers to participation certificates issued by overseas special purpose companies (SPCs) that are subsidiaries of Japanese companies and underwritten by Japanese securities companies. Capital raised through the issuance of participation certificates is used to make subordinated loans to, or to purchase subordinated bonds from, parent companies.

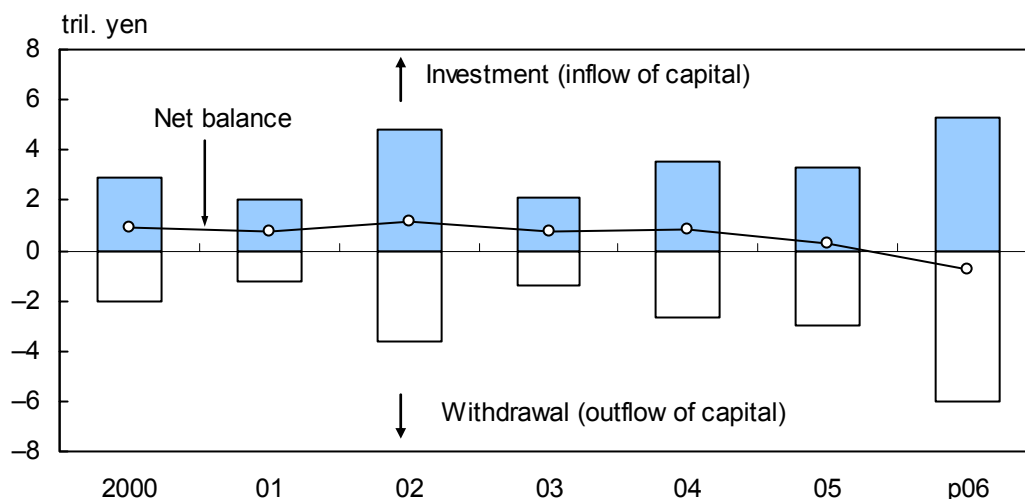
**Figure 13: Outward Direct Investment (By Region)**



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

Inward direct investment registered net withdrawals (net outflows) for the first time since 1989. On a gross basis, both investment into Japan (5.3 trillion yen) and withdrawals from Japan (6.0 trillion yen) recorded the highest level since 1996, when the current method for the compilation of statistics was introduced. The fact that both investments into and withdrawals from Japan registered record highs was due to the following factors: (1) a withdrawal due to unfavorable business results in the communications sector; (2) the strengthening and dissolution of capital tie-ups driven by global business realignment in the transportation equipment industry; and (3) acquisitions by foreign companies of non-core business lines demerged from Japanese companies such as a chemicals pharmaceuticals company.

**Figure 14: Inward Direct Investment (Gross)**



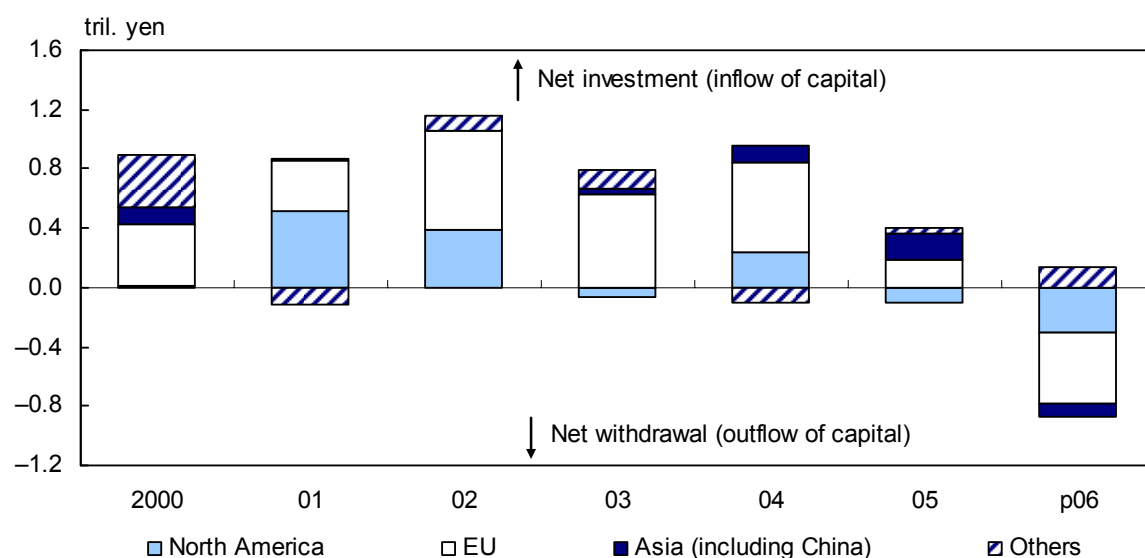
### (1) Breakdown by region

Investment from the EU turned from a net inflow of 0.2 trillion yen in 2005 to a net outflow of 0.5 trillion yen in 2006. This was because large inflows, through, for example, capital participations in the transportation equipment industry, were offset by large-scale withdrawal in a Japanese communications company.

The net outflow in direct investment from North America increased from 0.1 trillion yen in 2005 to 0.3 trillion yen in 2006. This was because a parent company withdrew from its investments, selling shares of a transportation equipment company in order to reduce the ownership percentage as part of a wider restructuring program and companies in the financial sector withdrew capital from a subsidiary in order to utilize its funds more efficiently.

Investment from Asia (including China) also turned from a net inflow in 2005, of 0.2 trillion yen, to a net outflow of 0.1 trillion yen in 2006, as foreign securities companies withdrew capital from local branches in Japan in line with the incorporation of those branches.

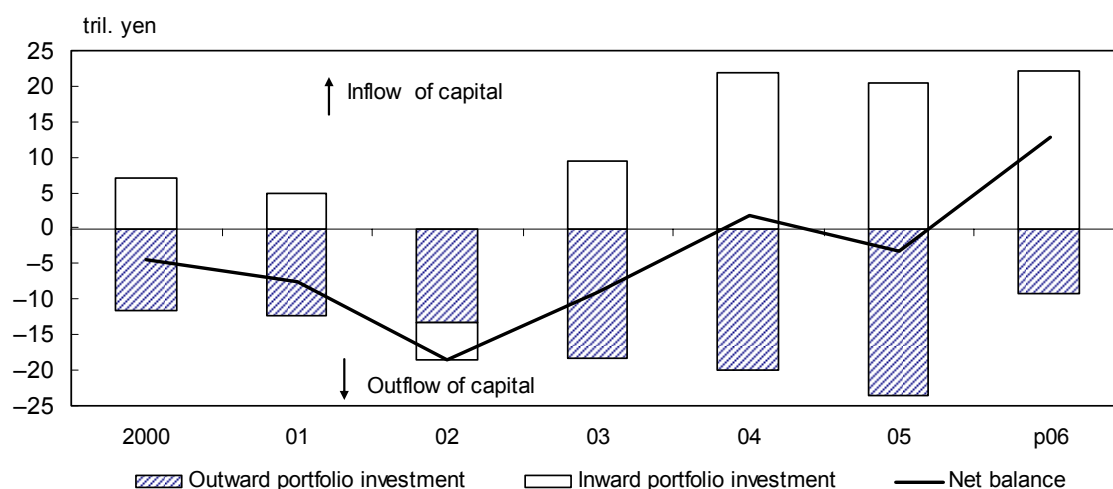
**Figure 15: Inward Direct Investment (By Region)**



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

Portfolio investment turned to a large net inflow of 12.9 trillion yen from a net outflow of 3.2 trillion yen in 2005. While inward portfolio investment continued to record large net purchases (inflows), increasing to 22.1 trillion yen in 2006 from 20.3 trillion yen in 2005, net outward portfolio investment decreased substantially, particularly in bonds and notes, falling to 9.2 trillion yen in 2006 from 23.6 trillion yen in 2005.

**Figure 16: Portfolio Investment**

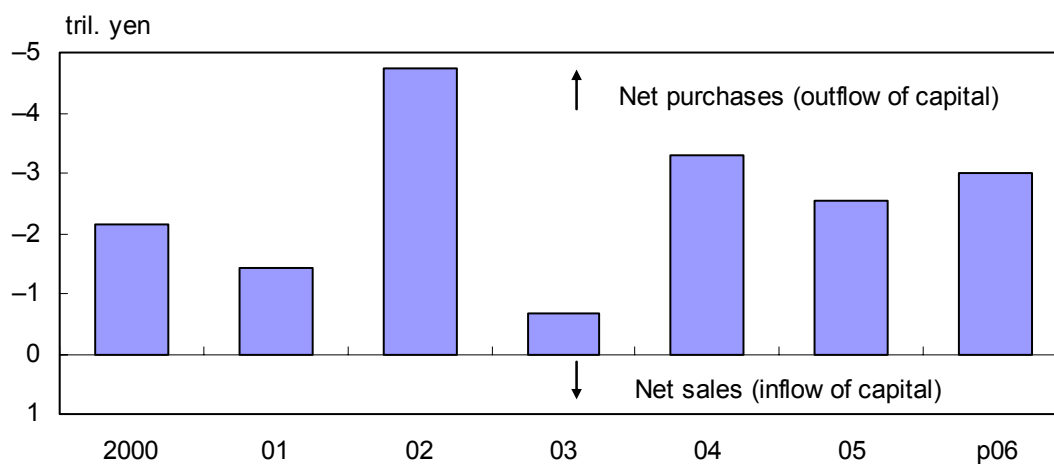


**a. Outward portfolio investment (assets)**

**(1) Outward investment in equity securities (assets)<sup>10</sup>**

Net purchases (outflow) of outward investment in foreign equity securities increased to 3.0 trillion yen in 2006 from 2.5 trillion yen in 2005, reflecting active investment through investment trusts in equities in emerging markets, particularly in Asia, and in overseas REITs.

**Figure 17: Outward Investment in Equity Securities**



**(a) Developments by investor category**

Net purchases of foreign equities by banks were around the same level as in the previous year and recorded a net outflow of 0.2 trillion yen in 2006, reflecting investments in corporate-type investment trusts and overseas financial institutions.

<sup>10</sup> See Box 4, "Outward Portfolio Investment by Retail Investors in 2006."



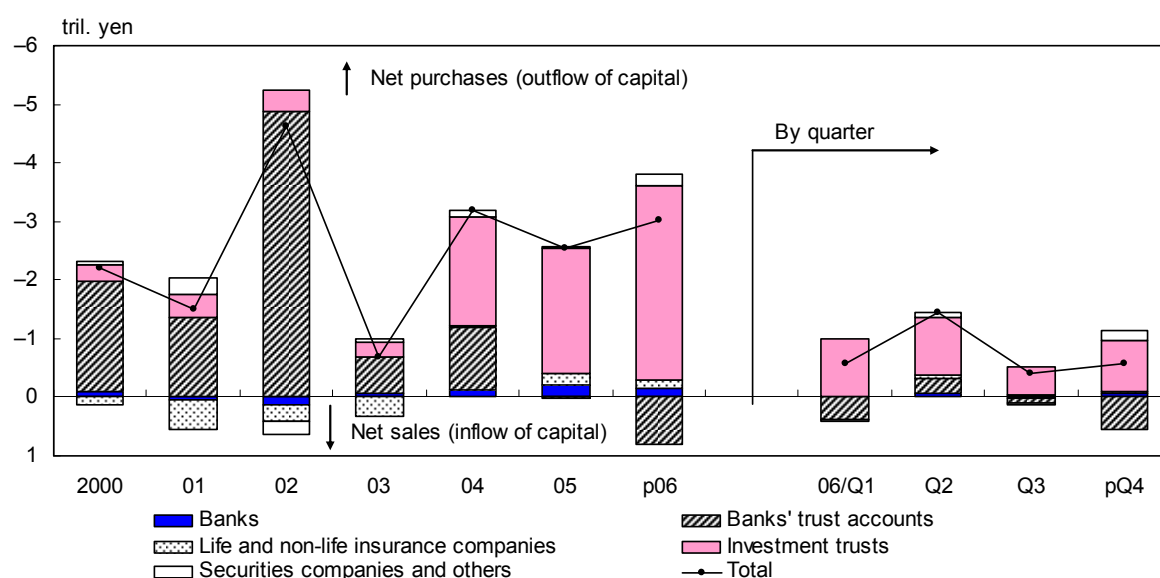
Net sales by banks' trust accounts increased significantly to 0.8 trillion yen in 2006 from 16.5 billion yen in 2005, as pension funds rebalanced<sup>11</sup> their portfolios in light of the rise in global equity prices.

Net purchases by life and non-life insurance companies decreased to 0.1 trillion yen in 2006 from 0.2 trillion yen in 2005, reflecting a rebalancing of portfolios in response to the rise in equity prices and a reduction of the weight of foreign equities in their assets.

Investment trusts increased their purchases of the following assets due to active investment in investment trusts by individual investors: Asian and other emerging market equities; U.S. and Australian REITs as well as those of other countries; and European and U.S. corporate equities. Overall, net purchases increased to 3.3 trillion yen in 2006 from 2.1 trillion yen in 2005.

Other institutions, including securities companies, increased their net purchases to 0.2 trillion yen in 2006 from 11.4 billion yen in 2005, reflecting investments such as purchases of equities through initial public offerings (IPOs) of newly listed Chinese financial institutions and Indian IT companies.

**Figure 18: Outward Investment in Equity Securities (By Sector)**



Note: Figures for years through 2004 are from "Securities Investment at Home and Abroad (Settlement Basis)." Figures for 2005 and after are based on balance of payments statistics. "Banks" comprises the sum of the banking accounts of banks and trust banks, while "banks' trust accounts" comprises the sum of the trust accounts of banks and trust banks.

<sup>11</sup> Public and corporate pension funds usually decide the weight of each asset in total assets prior to investment. To rebalance portfolios in order to maintain the desired weighting, they purchase/sell those assets whose weight in total assets has declined/increased due to changes in asset prices or exchange rates.

**(b) Breakdown by region**

Investment in U.S. and EU equities declined slightly, while investment in Asian equities increased significantly. As for BRICs equities, there was an increase in sales of Indian and Russian equities due to profit-taking, while there was an increase in purchases of Chinese and Brazilian equities reflecting large-scale IPOs.

**Table 15: Outward Investment in Equity Securities (By Region)<sup>1</sup>**

bil. yen

	2003	2004	2005	p2006	IIP <sup>4</sup> (end of 2005)
United States	-169.0	-933.1	-959.3	-945.8	22,721.5
EU countries <sup>2</sup>	107.0	-551.4	-696.0	-186.1	13,729.6
Of which:					
Germany	-54.3	4.1	-55.5	-35.0	1,365.9
France	4.8	26.7	-73.0	-151.6	1,973.8
United Kingdom	82.3	-47.4	78.6	-68.6	4,665.1
Luxembourg	48.3	-111.4	-283.8	33.4	1,064.9
Asia <sup>3</sup>	-65.3	-350.3	-99.0	-661.2	2,451.4
Cayman Islands	-324.0	-742.5	-355.5	-491.7	3,508.1
Others	-227.3	-617.6	-430.8	-724.5	5,789.0
Total	-678.6	-3,194.9	-2,540.6	-3,009.2	48,199.6

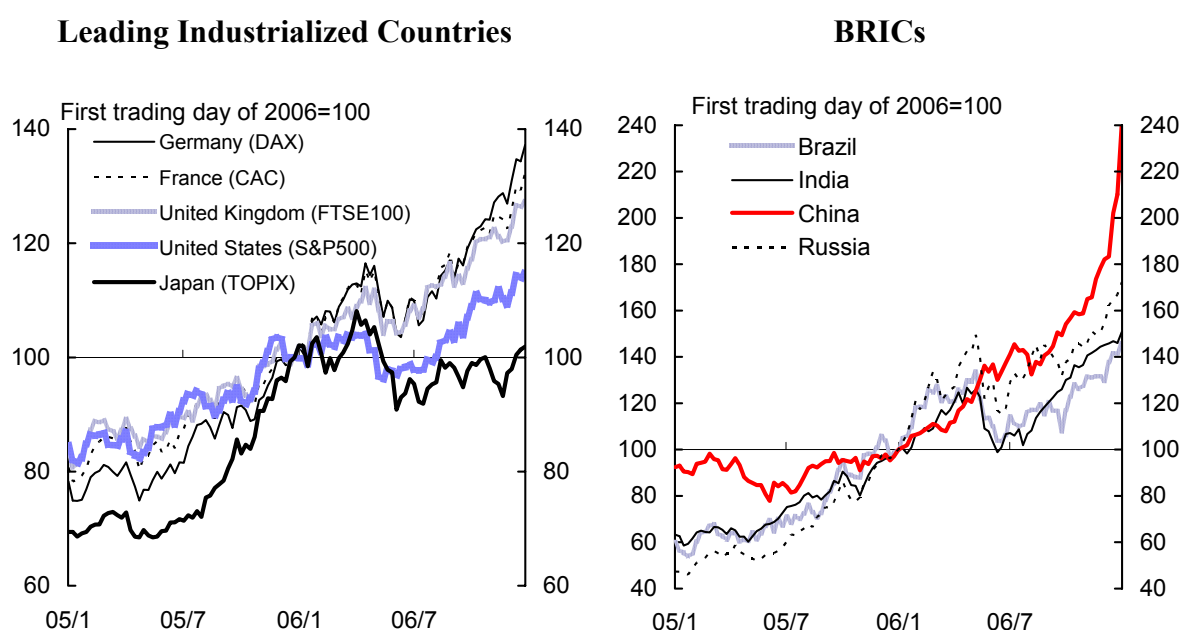
Notes: 1. Figures for years through 2004 are from "Securities Investment at Home and Abroad (Settlement Basis)," while figures for 2005 and after are based on balance of payments statistics.

2. Figures for months through April 2004 are based on 15-country membership before the enlargement of the EU, while figures thereafter are based on 25-country membership following the enlargement.

3. Flow figures for years through 2004 are the sums of figures for Hong Kong, South Korea, Taiwan, Thailand, Malaysia, and Singapore. Thereafter, India, China, and other countries are included in the figures. Thus, there is a discontinuity in the data between 2005 and preceding years.

4. IIP stands for international investment position. Figures include those of India, China, and other countries.

**Figure 19: Equity Price Indices in Major Markets (By Country)**



Note: Calculated on a yen basis (conversion to yen basis by Bloomberg).

Source: Bloomberg.

**Table 16: Investment in BRICs Equity Securities**

	Equity investment (bil. yen)		<Reference> Rate of change in stock prices (%)	
	2005	2006	2005	2006
Brazil	-27.0	-142.4	67	46
Russia	-71.8	-65.8	111	72
India	-232.3	59.6	58	51
China	29.1	-230.3	8	140

Note: Negative figures indicate net purchases. Calculated on a yen basis (conversion to yen basis by Bloomberg).

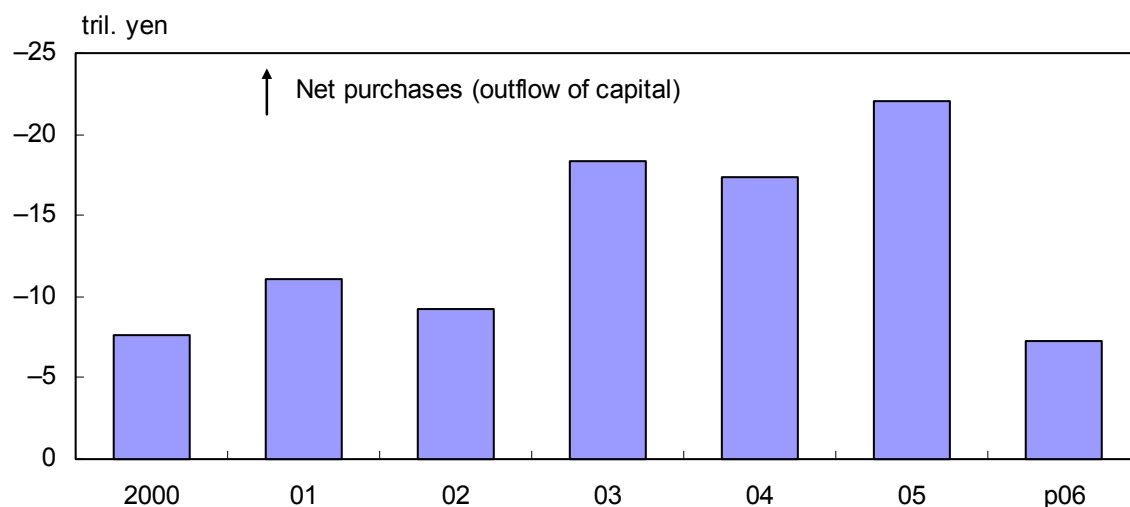
Source: Bloomberg.

## (2) Outward investment in bonds and notes (assets)<sup>12</sup>

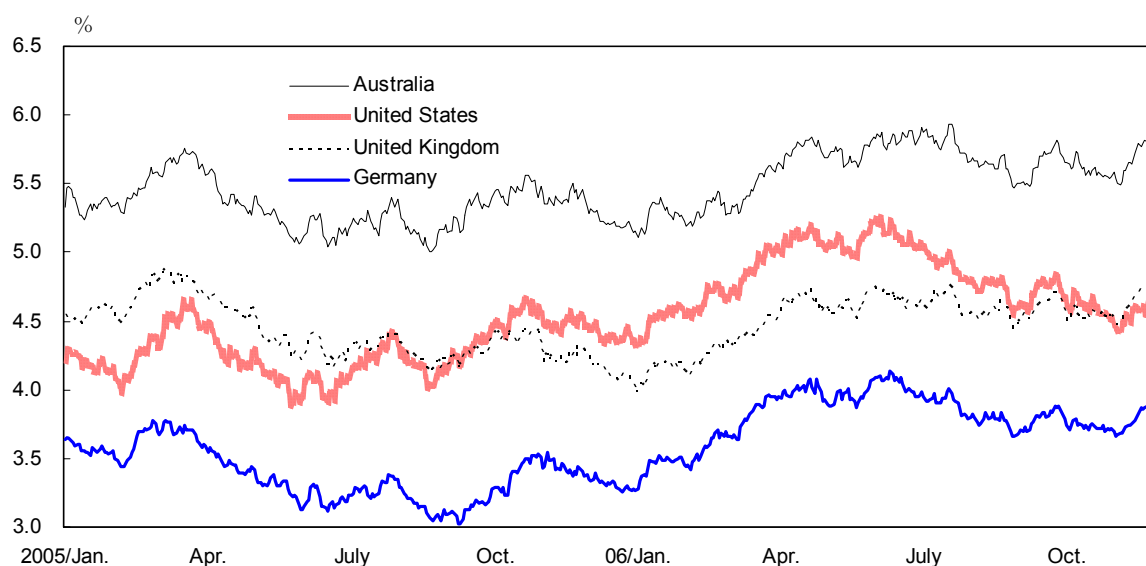
Net purchases (outflows) of foreign bonds and notes declined to 7.3 trillion yen in 2006 from 22.0 trillion yen in 2005. The decline reflects sales of bonds and notes by banks in the first half of 2006 against the background of rising interest rates in Europe and the United States.

<sup>12</sup> Investment in foreign bonds and notes by residents (assets) is the sum of sales and purchases by residents and the issuance and redemption of bonds and notes issued in Japan by nonresidents.

**Figure 20: Outward Investment in Bonds and Notes**



**Figure 21: Long-Term Interest Rates in Major Markets (10-Year Government Bonds)**



Source: Bloomberg.

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

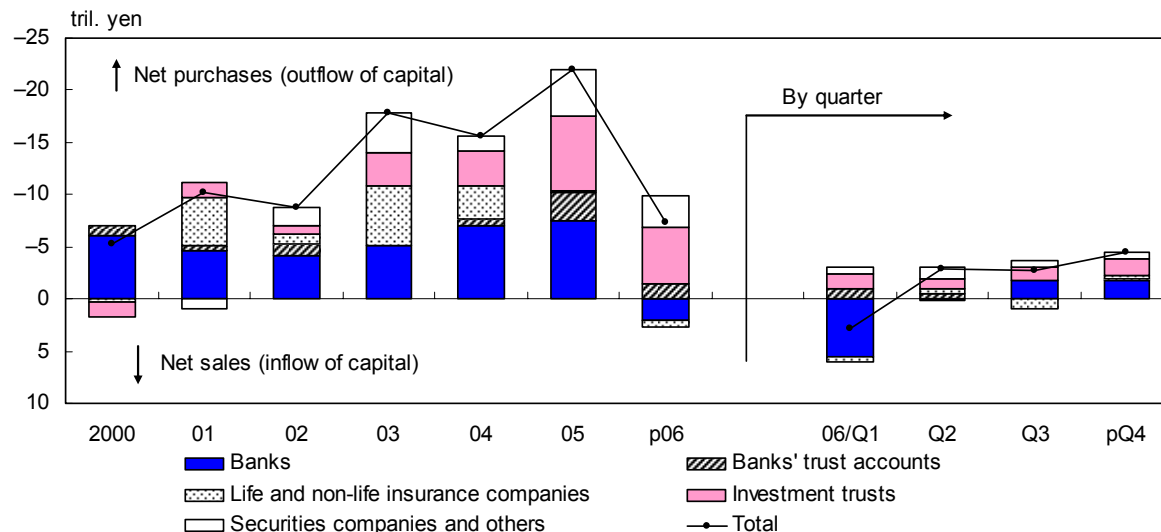
Banks accounted for net sales (inflows) of bonds and notes worth 2.1 trillion yen in 2006 following net purchases worth 7.6 trillion in 2005. This reversal is mainly due to the following two developments. First, banks significantly reduced their foreign bonds and notes positions, selling in particular government bonds and U.S. government-sponsored enterprise (GSE) bonds against the background of rising interest rates in Europe and the United States during the first half of 2006. And second, in order to reduce risks, banks sold investment funds established in the Cayman Islands.

Investment trusts continued to account for large net purchases (outflows) of foreign bonds and notes. Underlying this trend is the massive flow of household funds into monthly-distribution-income type investment funds that mainly invest in foreign bonds. However, the depreciation of the yen during the second half of the year led to a considerable amount of selling for profit-taking, decreasing net purchases slightly to 5.3 trillion yen in 2006 from 7.1 trillion yen in 2005.

Life and non-life insurance companies accounted for net sales (inflows) of 0.5 trillion yen in 2006, following net purchases (outflows) of 0.3 trillion yen in 2005, as several insurance companies sold exchange-rate-risk-hedged foreign bonds and notes and instead bought domestic bonds and notes mainly due to (1) concerns about the rise in European and U.S. interest rates; (2) the rise in costs to hedge exchange rate risks; and (3) the rise in domestic interest rates.

Net purchase (outflows) accounted for by securities companies decreased to 3.1 trillion yen in 2006 from 4.5 trillion yen in 2005. Active purchasing of foreign bonds and notes by individual investors continued, but the amount of redemptions was also large.

**Figure 22: Outward Investment in Bonds and Notes (By Sector)**



Note: Figures for years through 2004 are from "Securities Investment at Home and Abroad (Settlement Basis)." Figures for 2005 and after are based on balance of payments statistics. "Banks" comprises the sum of the banking accounts of banks and trust banks, and "banks' trust accounts" comprises the sum of the trust accounts of banks and trust banks.

### (3) Outward investment in money market instruments (assets)

Outward investment in money market instruments continued to record net sales (inflows), registering net sales of 1.1 trillion yen in 2006, up from 1.0 trillion yen in 2005, due to the large amount of redemptions of CP issued by nonresidents.

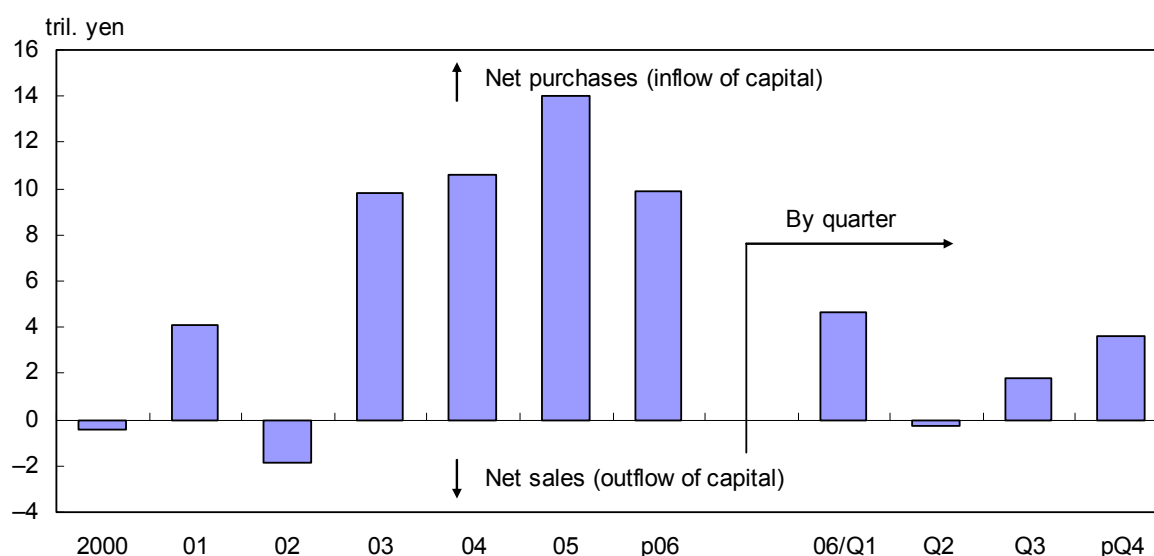
## **b. Inward portfolio investment (liabilities)**

### **(1) Inward investment in equity securities (liabilities)<sup>13</sup>**

Since foreign investors' purchases of Japanese equities were restrained as global equity prices declined in May and June 2006, net purchases decreased to 9.9 trillion yen in 2006 from 14.0 trillion yen in 2005.

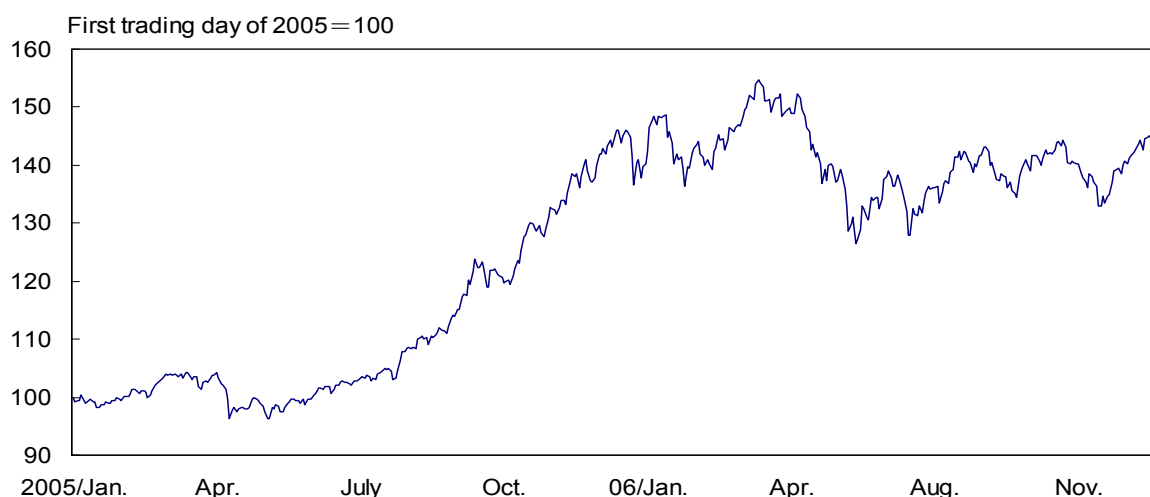
Inward investment in equities showed the following developments during 2006. Between January and March, net purchases continued, based on continuing expectations of an economic recovery in Japan and the high performance of Japanese companies. In May and June, net inward investment in equities turned negative due to increased concerns about an economic slowdown in the United States and a decline in global equity prices. In the second half of the year, net investment in Japanese equities turned positive again and remained so from July onward. This was due to a rise in U.S. equity prices and expectations that the depreciation of the yen would lead to better-than-projected business results for Japanese companies, in addition to the continuing expectations of the economic recovery in Japan.

**Figure 23: Inward Investment in Equities**



<sup>13</sup> See Box 5, "Inward Investment in Equities by Foreign Investors by Industry in 2006."

**Figure 24: TOPIX (U.S. Dollar Basis)**



Note: Converted to a U.S. dollar basis by Bloomberg.

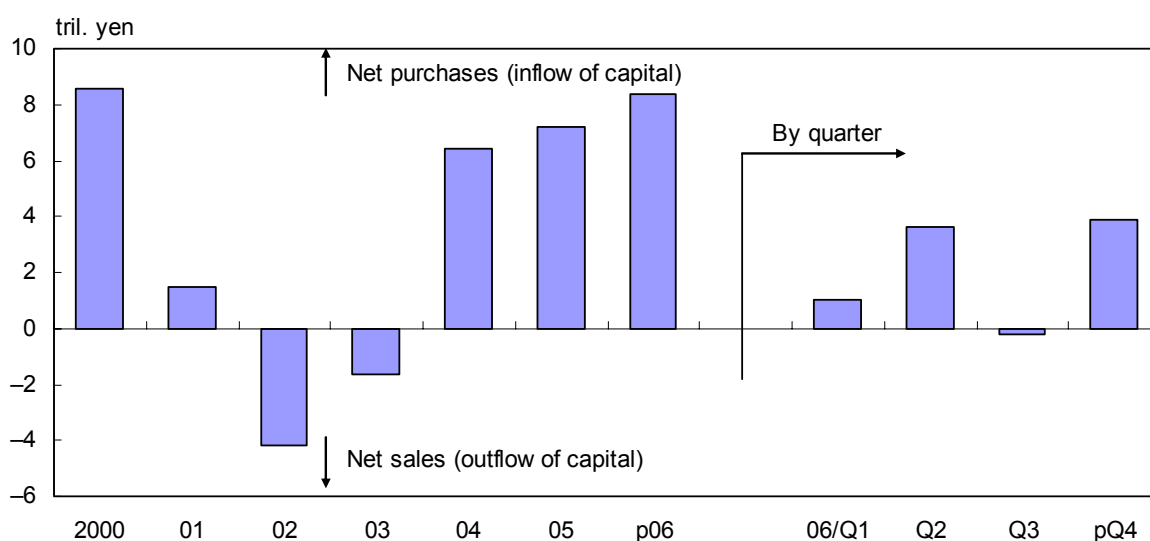
Source: Bloomberg.

## **(2) Inward investment in bonds and notes (liabilities)**

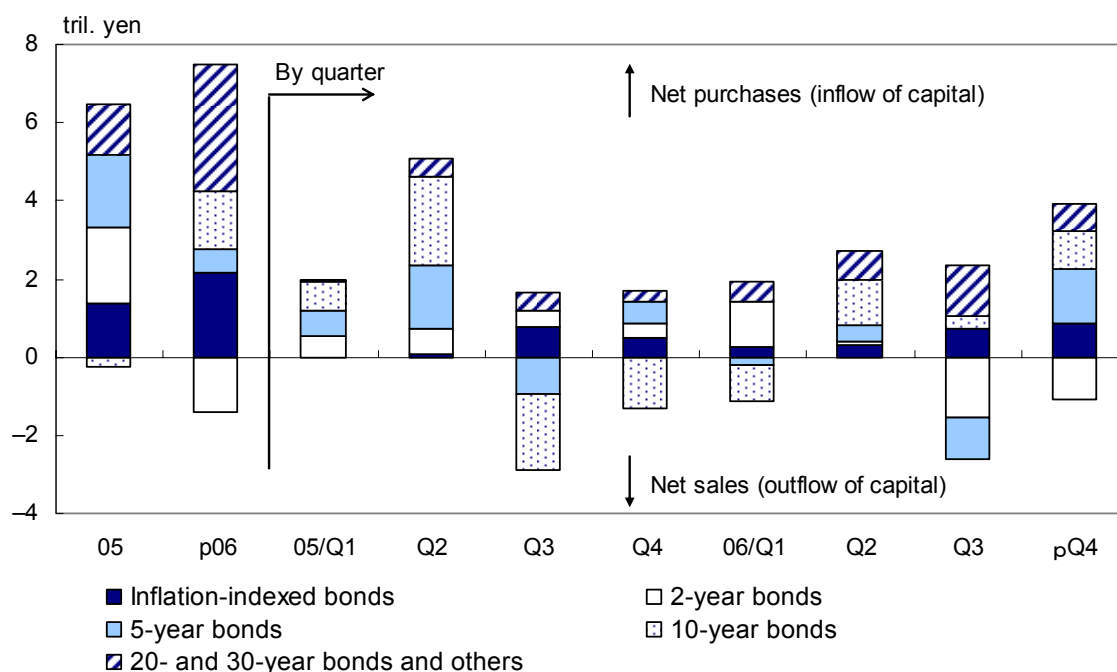
Inward investment in bonds and notes continued to register sizeable net purchases (inflows), increasing to 8.4 trillion yen in 2006 from 7.2 trillion yen in 2005.

Inward investment in bonds and notes showed the following developments during 2006. In January and May, when swap spreads narrowed, hedge funds and foreign banks took on new arbitrage positions combining cash bond purchases with yen-yen interest rate swaps with fixed rate payments. These arbitrage positions were partially closed when swap spreads widened in July. In the second half of the year, European and U.S. pension funds and foreign monetary authorities purchased inflation-indexed bonds.

**Figure 25: Inward investment in Bonds and Notes**



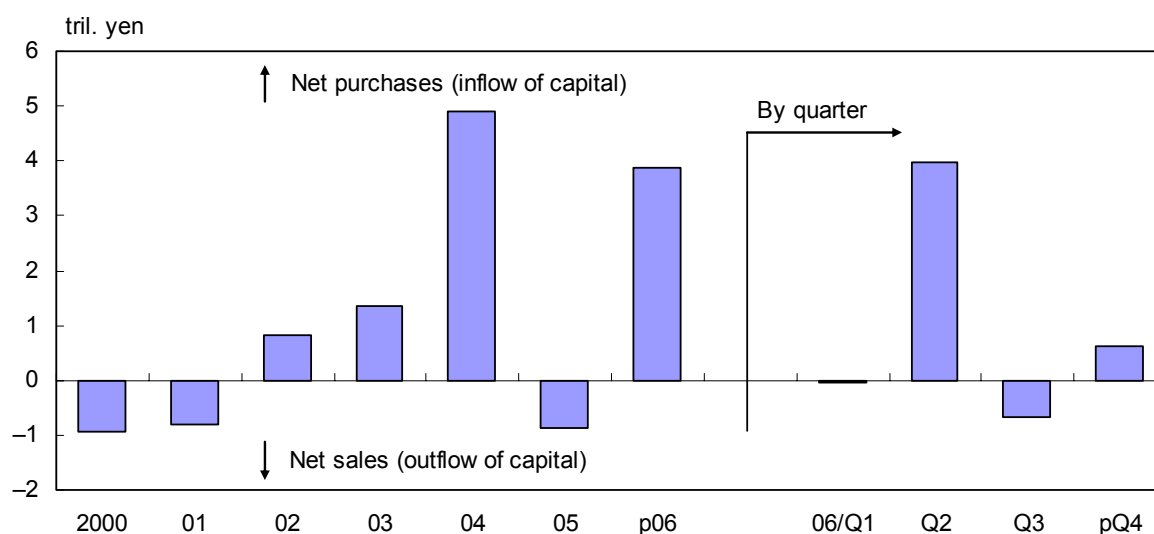
**Figure 26: Purchases and Sales of Bonds and Notes (By Type)**



### (3) Inward investment in money market instruments (liabilities)

Inward investment in money market instruments registered net purchases (inflows) of 3.9 trillion yen in 2006 following net sales (outflows) of 0.9 trillion yen in 2005. Foreign banks and foreign monetary authorities actively purchased money market instruments as short-term interest rates rose during the April-June quarter.

**Figure 27: Inward Investment in Money Market Instruments**

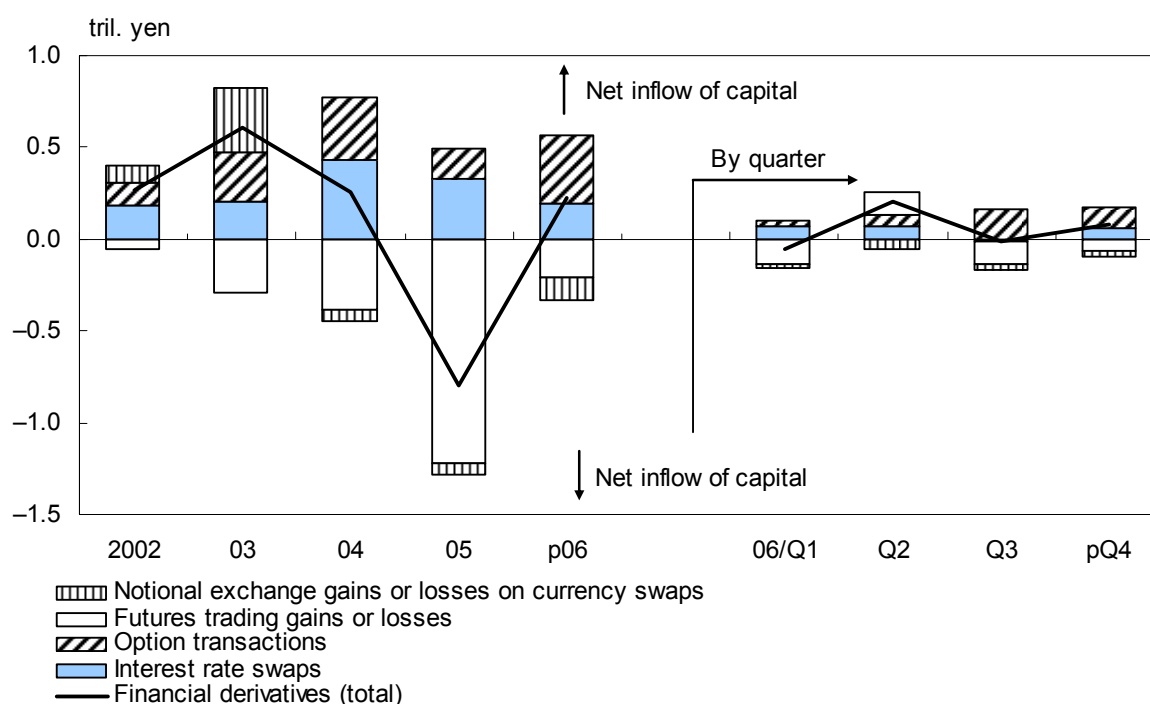




### 3. Financial derivatives

Financial derivatives transactions recorded a net inflow of 0.2 trillion yen in 2006 following a net outflow of 0.8 trillion yen in 2005. Contributing factors were, first, that in 2005 Japanese securities companies had made large payments to nonresident investors who realized capital gains from long positions in Nikkei 225 futures and TOPIX futures, but there were no longer such payments in 2006. And second, nonresident investors who bought call options with the expectation of higher Japanese equity prices paid option premiums to residents.

**Figure 28: Financial Derivatives**

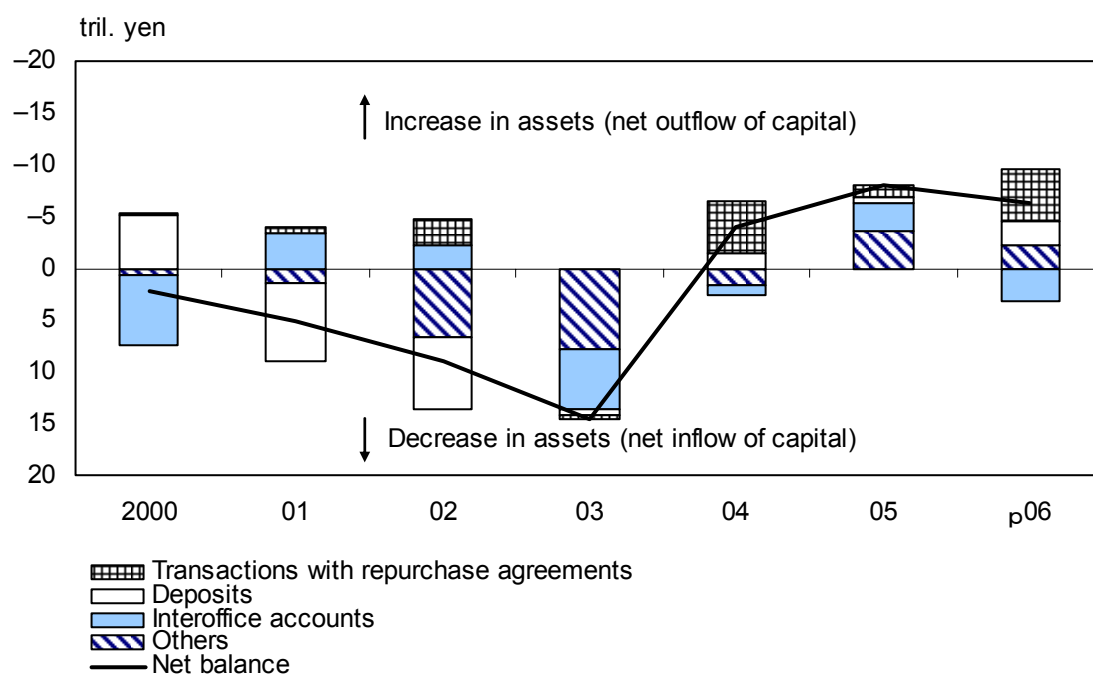


Note: "Financial derivatives (total)" includes investments other than those listed, and therefore does not equal to the sum of individual categories of financial derivatives.

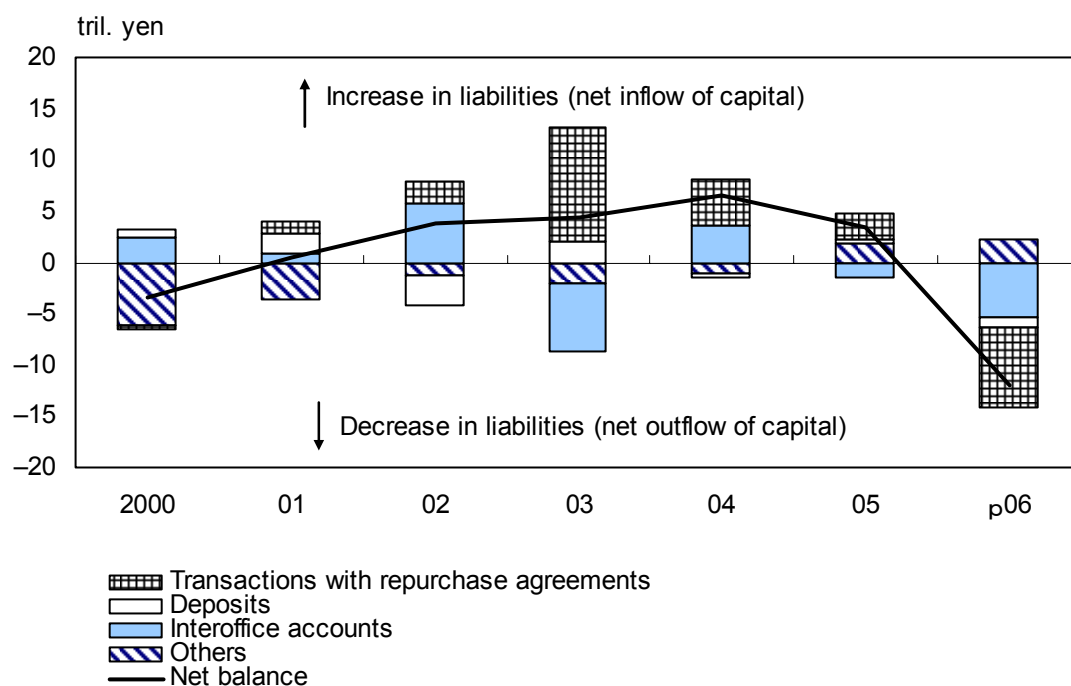
### 4. Other investment (excluding securities lending)

In 2006, the net outflow for other investment increased to 18.3 trillion yen from 4.7 trillion yen in 2005. On the asset side, the increase in the net outflow was about the same as that of the previous year. On the liability side, however, other investment shifted to a large net outflow as banks repaid foreign currency-denominated funds that had been raised for foreign securities investment through repurchase agreements and interoffice accounts.

**Figure 29: Other Investment (Assets)**



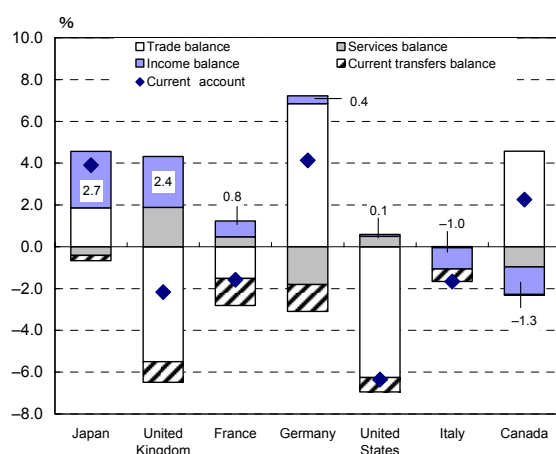
**Figure 30: Other Investment (Liabilities)**



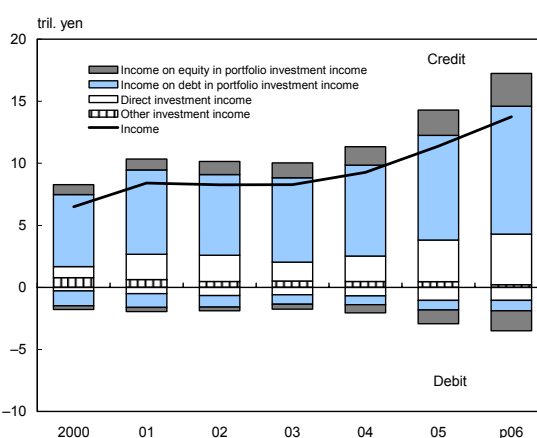
## Box 1. Features of the Balance of Income in 2006

Japan's income account surplus in 2006 was equivalent to 2.7 percent of nominal GDP, the highest among the G-7 nations, followed by the United Kingdom (2.4 percent) (Figure 1 for Box 1). Japan's surplus increased due to the increase in direct and portfolio investment income receipts (Figure 2 for Box 1).

**Figure 1 for Box 1:**  
**Current Account Components as a Ratio of Nominal GDP of the G-7 Nations**



**Figure 2 for Box 1:**  
**Income Account, Credit and Debit**

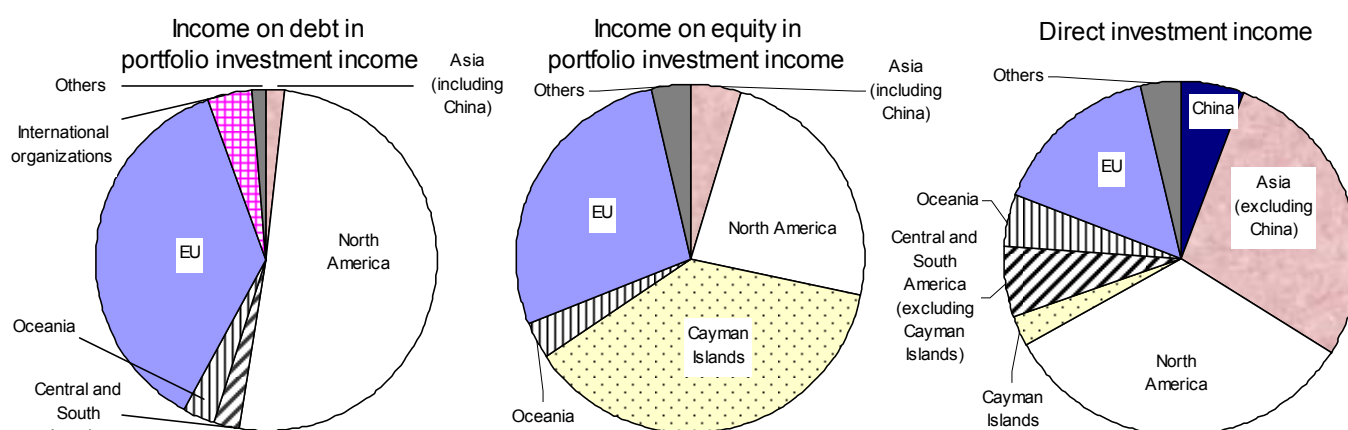


Note: Figures for Japan are for 2006. Figures for the other countries are for 2005.

Source: International Monetary Fund, "International Financial Statistics."

Focusing on portfolio investment income receipts by region, North America and the EU accounted for the largest shares in income on debt, while the Cayman Islands recorded the largest share (37 percent) in income on equity. Equity income receipts from the Cayman Islands mainly derived from investment funds established in this region. As for direct investment income receipts, Asia, including China, accounted for the largest share (34 percent) as many Japanese companies have established subsidiaries in the region, particularly in China.

**Figure 3 for Box 1: Income Receipts (By Region)**

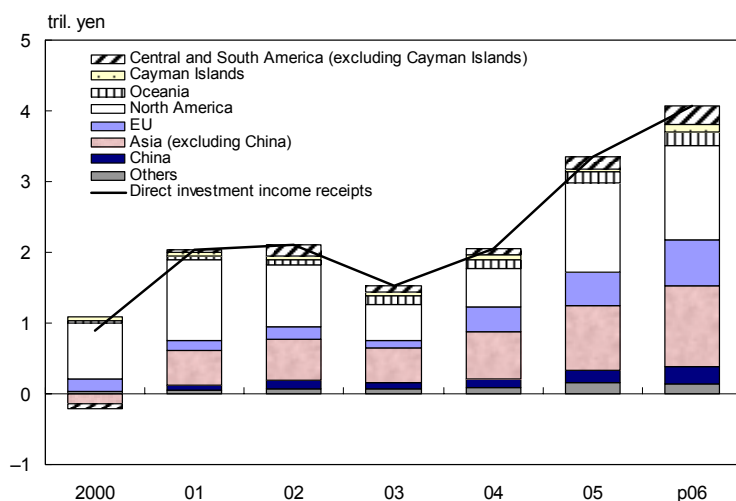


Notes: 1. Regional data for 2006 are based on figures for January through September 2006.

2. "Income on equity in portfolio investment income" includes distributed profits of investment trusts.

Direct investment income from Asia (including China) increased markedly to 1.4 trillion yen in 2006 from 1.1 trillion in 2005. As a result, Asia became the largest source of direct investment income, overtaking the United States, which both in 2005 and 2006 accounted for receipts of 1.2 trillion yen. Among Asian countries, the large increase was registered in direct investment income from China, which accounted for the second-largest share in the region.

**Figure 4 for Box 1: Direct Investment Income Receipts (By Region)**



Note: Figures for 2006 are estimated using the year-on-year rate of change for January through September 2006.

**(Reference) Direct Investment Income from Asian Countries**

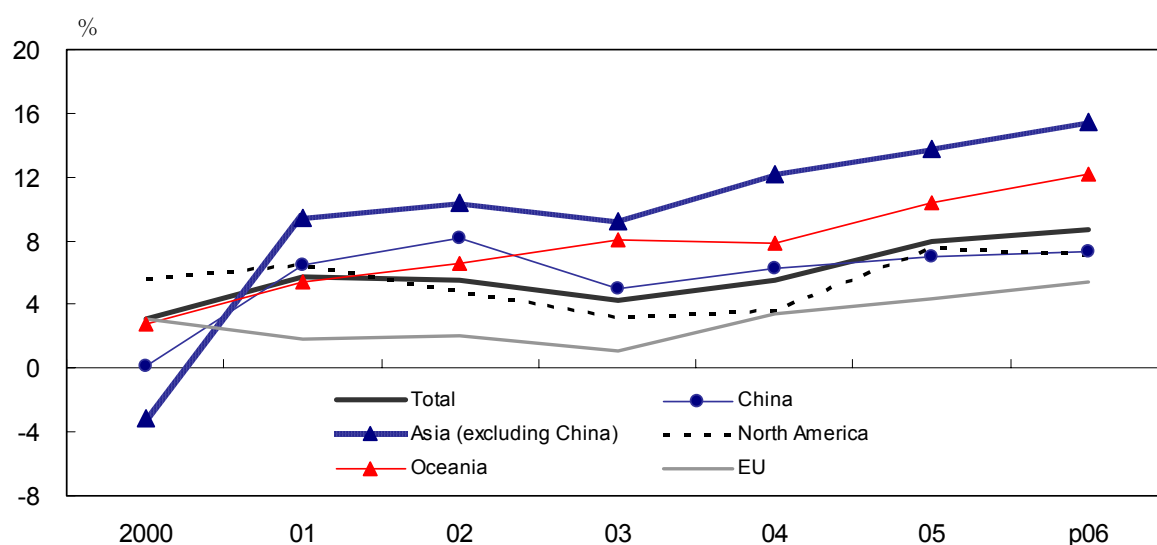
	2005	p2006	Change from the previous year
Thailand	201.1	249.3	+48.2
China	173.6	237.2	+63.6
Singapore	204.3	230.0	+25.7
Hong Kong	116.8	141.0	+24.2
Taiwan	77.1	121.0	+43.9
South Korea	60.3	112.7	+52.4
Malaysia	73.2	96.2	+23.0

Note: Figures for 2006 are estimated using the year-on-year rate of change for January through September 2006.

With regard to rates of return (ROR) on direct investment, the region with the highest rate was Asia (excluding China). The ROR on direct investment in China was below the world average, but, as mentioned above, in terms of absolute size, income was large. The low ROR reflects the large amount outstanding of direct investment to China.<sup>1</sup>

By industry, motor vehicle and energy-related industries recorded sharp increases in direct investment income. Receipts increased by 84 percent from the previous year in the transport equipment industry and by 41 percent in the mining industry.<sup>2</sup>

**Figure 5 for Box 1: Rate of Return in Outward Direct Investment (By Region)**



Note: The ROR on outward direct investment is calculated by dividing direct investment income receipts in 2006 by the average of the outward direct investment amounts outstanding as of the end of 2005 and 2006. The amount outstanding of direct investment by region as of the end of 2006 is estimated by adding annual flow figures for 2006 to the amount outstanding as of the end of 2005.

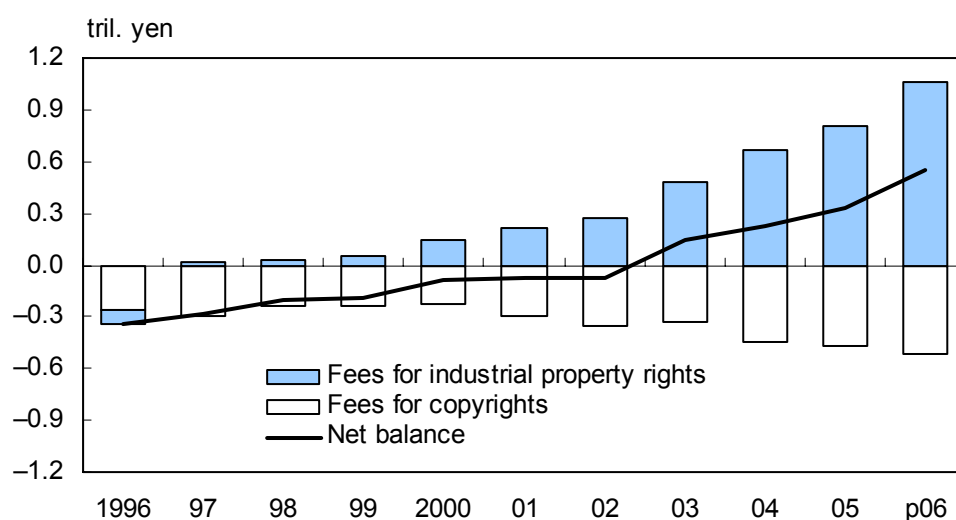
<sup>1</sup> As of the end of 2005, the amount outstanding of outward direct investment in China was 2.9 trillion yen, which was the largest among all Asian countries. This figure is more than twice as large as the amounts invested in Singapore (1.4 trillion yen) and Thailand (1.4 trillion yen), the second and third most important destinations in Asia in terms of the outward direct investment amount outstanding.

<sup>2</sup> The data are estimated using those for large dividend receipts (of 1 billion yen or more), a component of direct investment income. Large dividend receipts accounted for 38 percent of direct investment income in 2005 and 37 percent in 2006. The industry classification is made by the International Department of the Bank of Japan based on the industries under which overseas subsidiaries are primarily classified.

## Box 2. Developments in Fees for Industrial Property Rights

Payments for patents or other industrial property rights (royalties) received by Japanese companies have been increasing in recent years. In the balance of payments statistics, royalties are recorded under "industrial processes, franchises, etc." (hereafter "fees for industrial property rights") of "royalties and license fees," a component of "other services." The steady increase in the net receipts of royalties is the main reason for the growing surplus in "royalties and license fees."

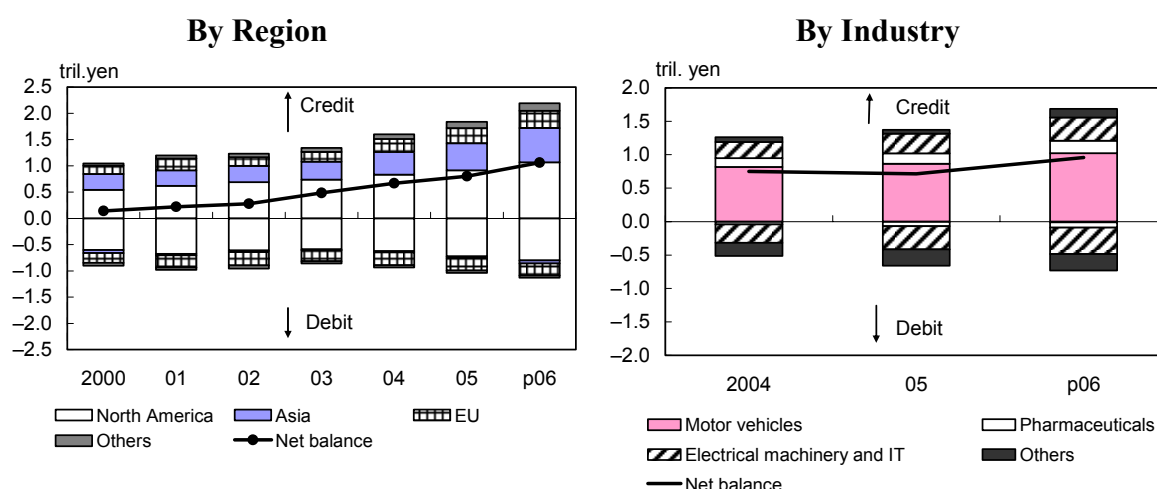
Figure 1 for Box 2: Net Royalties and License Fees



"Fees for industrial property rights," of which royalties make up a major part in Japan's balance of payments, displays the following geographical patterns. Fee receipts from Asia, where Japanese manufacturers have production facilities, have been increasing considerably. With regard to the United States, net receipts of "fees for industrial property rights" are only half of the amount received from Asia, although receipts and payments on a gross basis are large.

By industry, royalties received by motor vehicle companies accounted for a large amount, influencing the overall developments in "fees for industrial property rights."

**Figure 2 for Box 2: Fees for Industrial Property Rights**



Notes: 1. Regional figures for 2006 are estimated by the International Department of the Bank of Japan based on the year-on-year rate of change for January through September 2006.

2. Figures by industry are estimated by the International Department of the Bank of Japan. Totals do not match figures for the corresponding balance of payments components.

One of the reasons for the large receipts of motor vehicle-related royalties is the industry's high overseas production ratio. A comparison of overseas production ratios among manufacturing industries shows that the ratio of the transport equipment industry, at 36.0 percent (in fiscal 2004) is more than twice as high as the average for all manufacturing industries (16.2 percent in fiscal 2004). The electrical machinery and IT-related industries also have high overseas production ratios, and these industries have also received large amounts of royalties, which place them second only to the transport equipment industry. However, the amount of royalty payments is also large. This seems to be mainly because there are many cases where Japanese companies use technologies owned by companies of the United States and other countries.

In 2006, the increase in motor vehicle sales in the United States and other countries<sup>3</sup> contributed to the increase in motor vehicle-related royalty receipts. Japanese motor vehicle manufacturers are expecting to increase overseas production in fiscal 2007, and it is very likely that the surplus in "fees for industrial property rights" will continue to grow.

<sup>3</sup> According to the Japan Automobile Manufacturers Association, overseas production by Japanese motor vehicle manufacturers in the January-September period of 2006, at 8.12 million units, was 3.9 percent higher than in the same period a year earlier, when 7.82 million units were produced.

**Table 1 for Box 2: Overseas Production Ratios (By Industry)**

%

	FY 2002	FY 2003	FY 2004	FY 2005 (estimates)
Manufacturing	14.6	15.6	16.2	17.0
Of which:				
Electrical machinery	21.0	23.4	21.3	n.a.
Transport equipment	32.2	32.6	36.0	n.a.
North America	6.1	6.1	5.8	6.2
Asia	5.0	5.7	6.4	6.8
Europe	2.6	3.0	3.1	3.1
Others	0.9	0.8	0.9	0.9

Notes: 1. Overseas production ratio of all Japanese companies = Sales of overseas subsidiaries (manufacturing industries) / (sales of overseas subsidiaries [manufacturing industries] + Domestic sales [manufacturing industries] x 100)

2. "Electrical machinery" includes information and telecommunications apparatus.

3. "n.a." denotes "not available."

Source: Ministry of Economy, Trade and Industry, "Survey of Overseas Business Activities" (fiscal 2004 actual results/July 1, 2005 survey).



## (Reference) Industrial Property Rights and Copyrights (By Region)

**Table 2 for Box 2: Fees for Industrial Property Rights by Region**

bil. yen

	Total			Asia			North America			EU		
	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
1996	677.6	760.9	-83.3	292.8	16.4	276.5	257.2	549.3	-292.1	97.5	165.7	-68.2
1997	790.9	771.0	19.9	303.0	23.2	279.7	343.2	553.0	-209.8	110.3	164.3	-54.0
1998	871.4	839.3	32.1	266.8	82.2	184.6	409.7	568.0	-158.3	151.8	157.9	-6.2
1999	871.1	821.4	49.6	232.4	99.1	133.3	471.4	534.1	-62.6	131.0	153.8	-22.7
2000	1,043.0	900.8	142.2	299.3	59.9	239.5	543.8	605.1	-61.3	159.4	184.1	-24.7
2001	1,198.3	979.6	218.7	298.0	27.6	270.4	617.0	676.4	-59.4	224.8	231.9	-7.1
2002	1,232.0	955.1	276.9	309.2	30.0	279.2	689.0	614.2	74.8	167.7	253.5	-85.7
2003	1,342.1	859.0	483.1	340.3	19.5	320.8	737.1	590.9	146.2	187.7	209.2	-21.5
2004	1,599.2	933.1	666.2	427.8	23.9	404.0	831.6	626.1	205.5	252.3	243.9	8.4
2005	1,840.5	1,038.7	801.8	514.6	34.4	480.3	915.1	726.9	188.2	286.9	234.1	52.9
p2006	2,190.0	1,130.7	1,059.3	650.0	58.8	591.2	1,065.7	800.6	265.1	332.0	229.1	102.9

**Table 3 for Box 2: Fees for Copyright by Region**

bil. yen

	Total			Asia			North America			EU		
	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net	Credit	Debit	Net
1996	48.2	307.6	-259.4	22.5	2.8	19.7	13.4	232.9	-219.5	10.4	63.3	-52.9
1997	93.1	392.4	-299.3	26.2	4.1	22.1	39.5	303.0	-263.4	23.3	75.2	-51.9
1998	94.4	331.3	-236.8	17.8	2.2	15.6	53.3	255.1	-201.8	22.0	61.5	-39.4
1999	60.0	299.9	-239.9	12.4	2.0	10.3	29.7	240.2	-210.5	17.4	50.3	-32.9
2000	59.4	285.5	-226.1	10.6	50.7	-40.1	41.4	179.4	-138.0	7.1	48.1	-40.9
2001	70.6	369.4	-298.8	15.1	72.7	-57.6	44.6	229.3	-184.7	9.7	57.4	-47.7
2002	74.5	424.6	-350.2	14.4	76.7	-62.3	46.5	270.0	-223.5	12.3	61.1	-48.8
2003	80.9	414.8	-333.9	13.9	74.2	-60.3	41.9	255.8	-213.9	22.6	68.2	-45.6
2004	98.3	541.3	-443.1	11.5	91.9	-80.4	56.9	359.1	-302.2	29.1	81.4	-52.2
2005	101.4	574.2	-472.9	14.3	105.7	-91.4	54.8	385.6	-330.9	30.2	76.9	-46.7
p2006	139.4	651.6	-512.2	17.7	121.3	-103.6	68.4	449.2	-380.8	50.8	73.0	-22.2

Note: Figures for 2006 by region are estimated by the International Department of the Bank of Japan based on the year-on-year rate of change for January through September 2006.

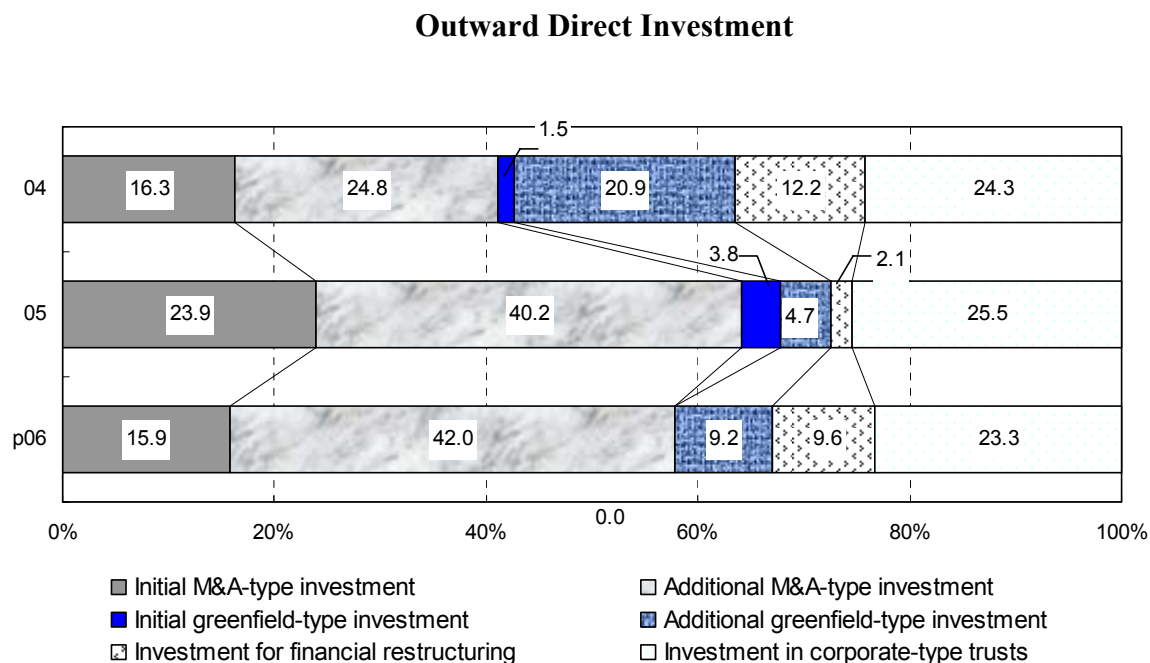
### **Box 3. Classification of Direct Investment by Type of Investment**

One possible approach to classifying different types of direct investments is to distinguish them by how the invested capital is used by the ultimate investee enterprise. This method allows for the following classification. Investment that increases tangible fixed assets such as factories and other facilities can be defined as "greenfield-type investment." Investment that does not increase tangible fixed assets, such as the acquisition of shares, can be defined as "M&A-type investment." Lastly, investment that does not increase the total asset base of the ultimate investee enterprise can be defined as "investment for financial restructuring." Such a classification makes it possible to examine the rates of return on foreign direct investment and of the impact on a host country's economy (e.g., job creation) by the type of investment. It should be noted that because the following analysis focuses on investments of at least 10 billion yen in equity capital, results should be interpreted allowing for a margin of error.

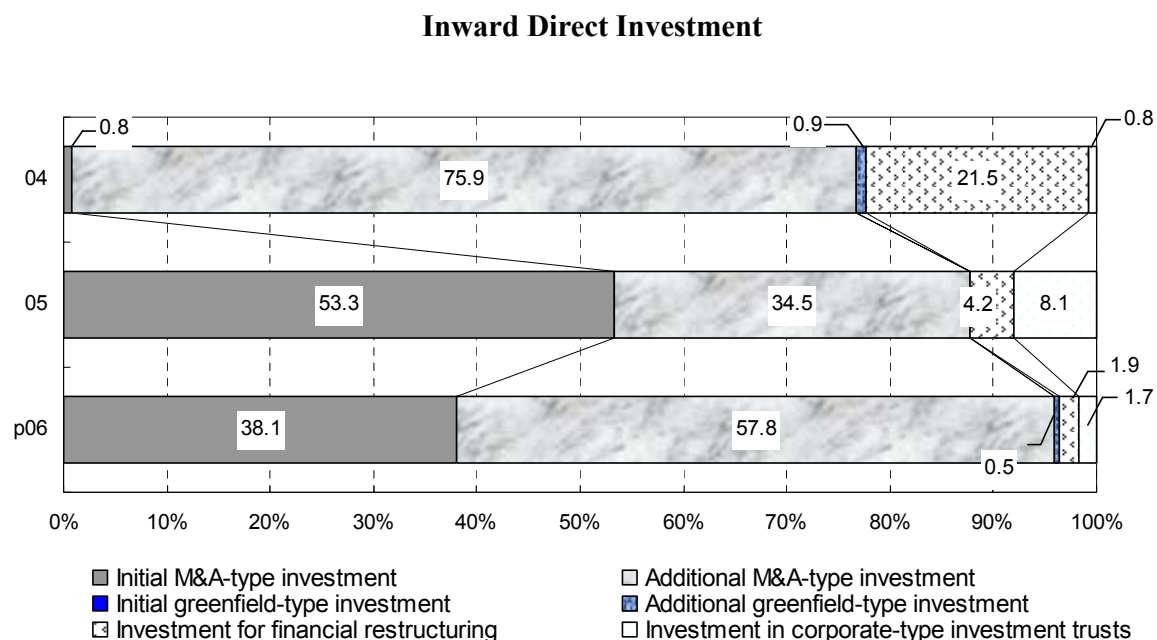
#### **Features Distinguishing Direct Investment in 2006**

- (1) M&A-type investment continued to account for a large share of both outward and inward direct investment. In 2006, the share of additional M&A-type inward direct investment increased, owing to capital injections by overseas securities companies aiming to incorporate Japanese subsidiaries.
- (2) Greenfield-type investment accounted for only a very small proportion of inward direct investment, but made up about 10-20 percent of outward direct investment. The major part of this type of outward direct investment was for developing oil, natural gas, and other resources.

**Figure 1 for Box 3: Foreign Direct Investment by Type of Investment (On a Transaction Value Basis)**



Note: Investments of 10 billion yen or more accounted for 28.8 percent (on a transaction value basis) of total outward direct investment in 2004, 37.9 percent in 2005, and 47.2 percent in 2006.



Note: Investments of 10 billion yen or more accounted for 63.9 percent (on a transaction value basis) of total inward direct investment in 2004, 39.0 percent in 2005, and 68.2 percent in 2006.

**Figure 2 for Box 3: Definitions for the Classification of Foreign Direct Investment  
(By Investment Type)**

Type	Definition	
(a) Initial M&A-type investment	It is a first-time investment by a direct investor in a direct investment enterprise, and . . .	. . . the invested capital is used for the acquisition of shares issued by an existing enterprise.
(b) Initial greenfield-type investment		. . . the invested capital is used for the acquisition of shares issued by a newly established enterprise.
(c) Additional M&A-type investment	It is not a first-time investment by a direct investor in a direct investment enterprise, and . . .	. . . the invested capital is not used for the acquisition of tangible fixed assets of an enterprise (or, it is used for the acquisition of shares already issued by an existing enterprise).
(d) Additional greenfield-type investment		. . . the invested capital is used for the acquisition of tangible fixed assets of an enterprise.
(e) Investment for financial restructuring		. . . the invested capital does not increase the asset base of the enterprise and is used for debt repayment.

Note: These definitions assume that the target enterprise is the ultimate investee enterprise.

Classifications of foreign direct investment are defined in Figure 2 for Box 3. In the figure, categories (a) and (c) can be grouped into M&A-type investment, while categories (b) and (d) can be grouped into greenfield-type investment; and categories (a) and (b) can be grouped into initial investment, while categories (c) and (d) can be grouped into additional investment.

In addition to the above categories, investment in corporate-type investment trusts and the acquisition of nonvoting shares issued by SPCs, (i.e., participation certificates) are included in direct investment.

#### **Box 4. Outward Portfolio Investment by Retail Investors<sup>4</sup> in 2006**

Over the past several years, individual investors have come to play a greater role in outward portfolio investment as they continued to invest in foreign equities and bonds in search of higher returns. In 2006, investment by retail investors was characterized by an increased preference for equities, especially those in emerging markets, and for foreign REITs.

In addition to low domestic interest rates, outward portfolio investment by individuals expanded for the following reasons: (1) an increase in individuals' risk-taking capacity against the background of improved economic conditions; (2) an increase in investments by retirees; (3) an increased preference for investing abroad driven by the strong performance of overseas markets; (4) greater marketing efforts by banks at their branches; and (5) the enhancement of products tailored to customer needs and offered by investment trusts and securities companies.

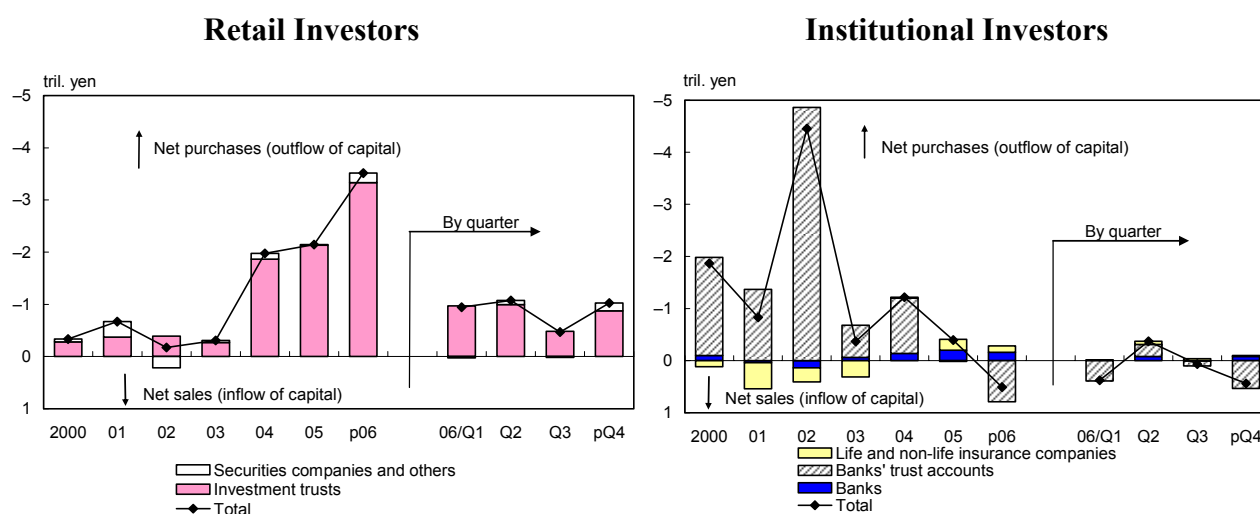
##### **1. Outward Portfolio Investment in Equities**

Looking at outward portfolio investment in equities by type of investor, institutional investors accounted for net sales of 0.5 trillion yen in 2006 compared with net purchases of 0.4 trillion yen in 2005; the reversal was due to an increase in sales by banks' trust accounts to rebalance their portfolios in the wake of equity price rises. In contrast, net purchases by retail investors through investment trusts increased significantly to 3.5 trillion yen in 2006, up from 2.1 trillion yen in 2005.

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<sup>4</sup> Investments by "retail investors" are the sum of investments by investment trusts and securities companies, which, among the investor classifications used in balance of payments statistics, are regarded as serving mainly individual investors and non-financial business investors.

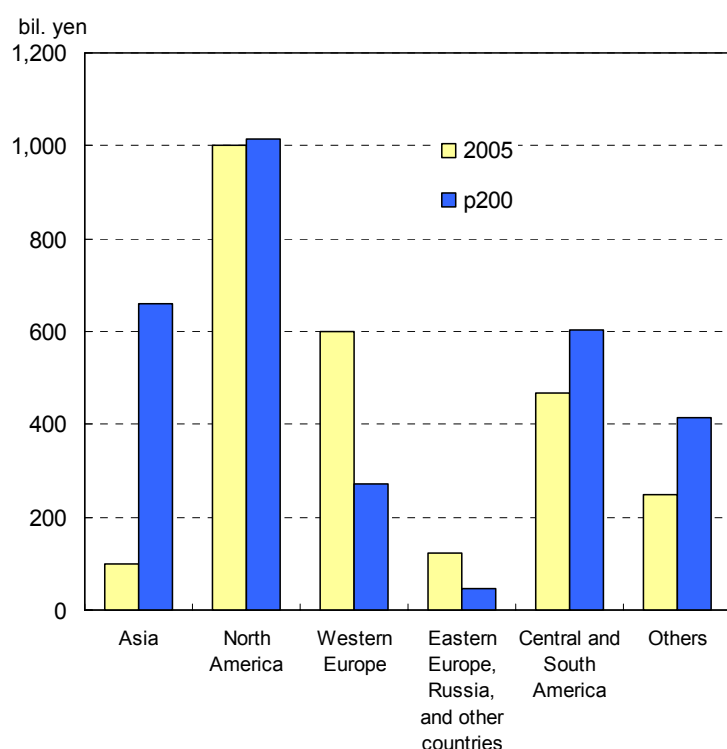
**Figure 1 for Box 4: Outward Portfolio Investment in Equities (By Investor Category)**



By region, purchases of equities in developed countries were either unchanged or declined due to pension funds' rebalancing of portfolios, while purchases of emerging market equities in Asia and other regions increased greatly, mainly due to purchases made by households through investment trusts. Growth in purchases of Asian equities was driven by the establishment of Asian equity investment trusts and by major IPOs in China. Purchases of BRICs equities were active until recently as prices rose rapidly, but profit taking resulted in net sales of Indian and Russian equities in 2006.

The market in REITs, which are often classified as equities, is expanding throughout the world. Investments in U.S. and Australian REITs increased through investment trusts that invest in foreign REITs and those that diversify their investment in domestic and foreign equities, bonds, and REITs.

**Figure 2 for Box 4: Outward Portfolio Investment in Equities (By Region)**



	2005	p2006	Change from the previous year
Asia	99.0	661.2	+562.2
China	-29.1	230.3	+259.4
Hong Kong	-154.5	112.7	+267.2
Taiwan	33.1	123.7	+90.6
South Korea	29.9	104.9	+75.1
Singapore	7.1	101.8	+94.8
Thailand	-5.0	13.1	+18.1
Indonesia	-0.1	18.4	+18.5
Malaysia	0.9	25.9	+25.0
Philippines	-14.5	-11.1	+3.4
India	232.3	-59.6	-291.9

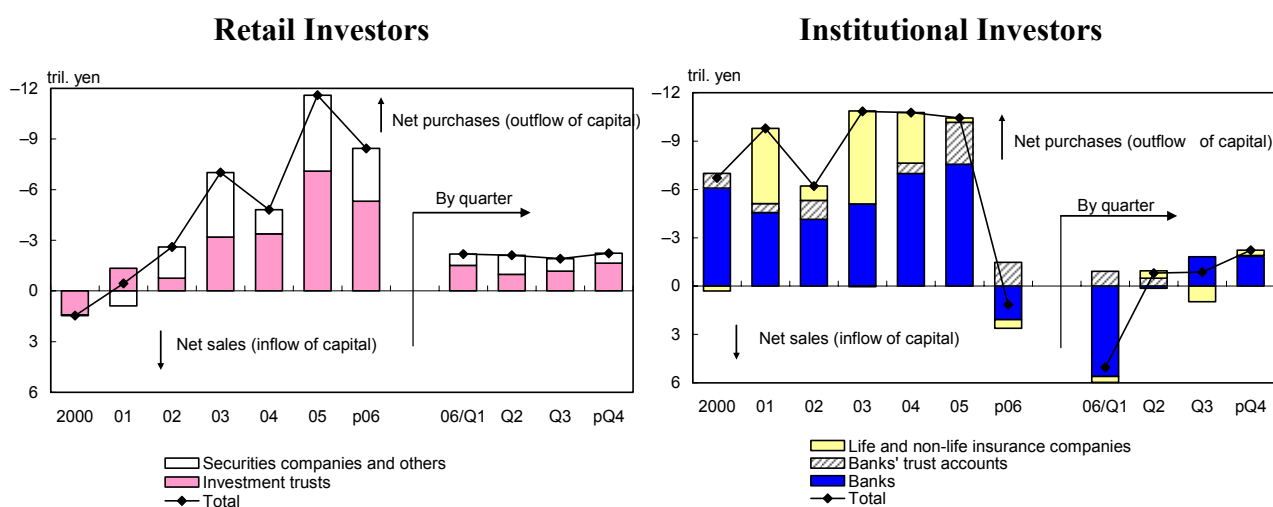
Note: Negative figures indicate net sales (inflow of capital)

Note: Figures indicate net purchases by Japanese investors. Most investments in Asian equities are made through investment trusts.

## 2. Outward investment in bonds and notes

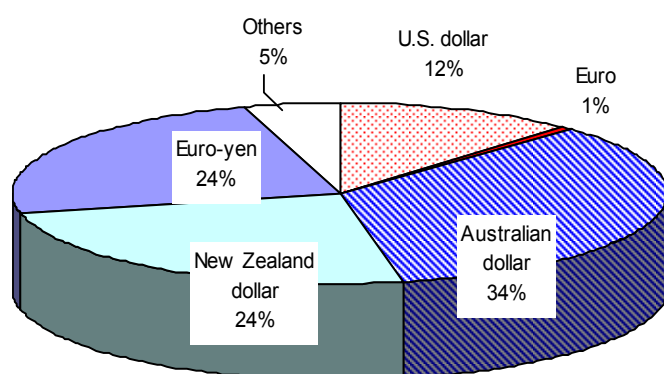
By investor category, institutional investors (mainly banks) became net sellers of foreign bonds and notes, accounting for net sales of 1.2 trillion yen in 2006, after having been net buyers in 2005 accounting for net purchases of 10.4 trillion yen, amid interest rate rises in Europe and the United States. In contrast, retail investors remained major purchasers of bonds and notes through investment trusts that invested in foreign bonds and notes. Their net purchases were 8.5 trillion yen in 2006 compared with 11.6 trillion yen in 2005. This meant that retail investors, in place of institutional investors, became the leading purchasers of foreign bonds and notes in 2006. In the second half of 2006, individual investors seem to have cancelled contracts with the above-mentioned investment trusts, which invest in foreign bonds and notes, to take profits as the depreciation of the yen progressed. As a result, inflows of capital into these investment trusts seem to have leveled off.

**Figure 3 for Box 4: Outward Investment in Bonds and Notes (By Investor Category)**



Bonds purchased by securities companies for retail sale increased slightly to 2.4 trillion yen in 2006 from 2.1 trillion yen in 2005. The currency denomination of these bonds shows that bonds issued in high-interest-rate currencies such as Australian and New Zealand dollars accounted for more than half of the purchases. Purchases of Nikkei-equity-indexed bonds with early redemption terms and Euro-yen denominated structured bonds with high interest rates were also notable.

**Figure 4 for Box 4: Shares of Currencies in Which Bonds Purchased by Securities Companies for Retail Sales Were Denominated (2006)**



**(Reference) Yield on 5-Year Bond**

	Average interest rate in 2006
New Zealand	6.0%
Australia	5.7%
United States	4.7%
Germany	3.6%

Note: Figures are based on gross purchases, compiled by the Bank of Japan.

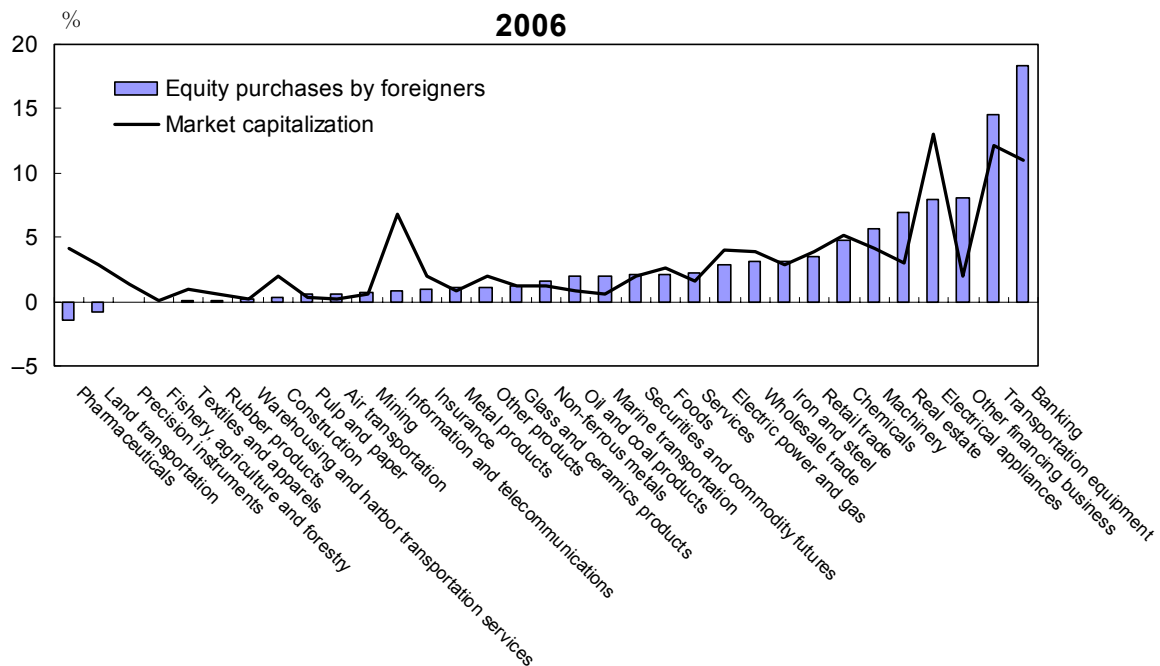


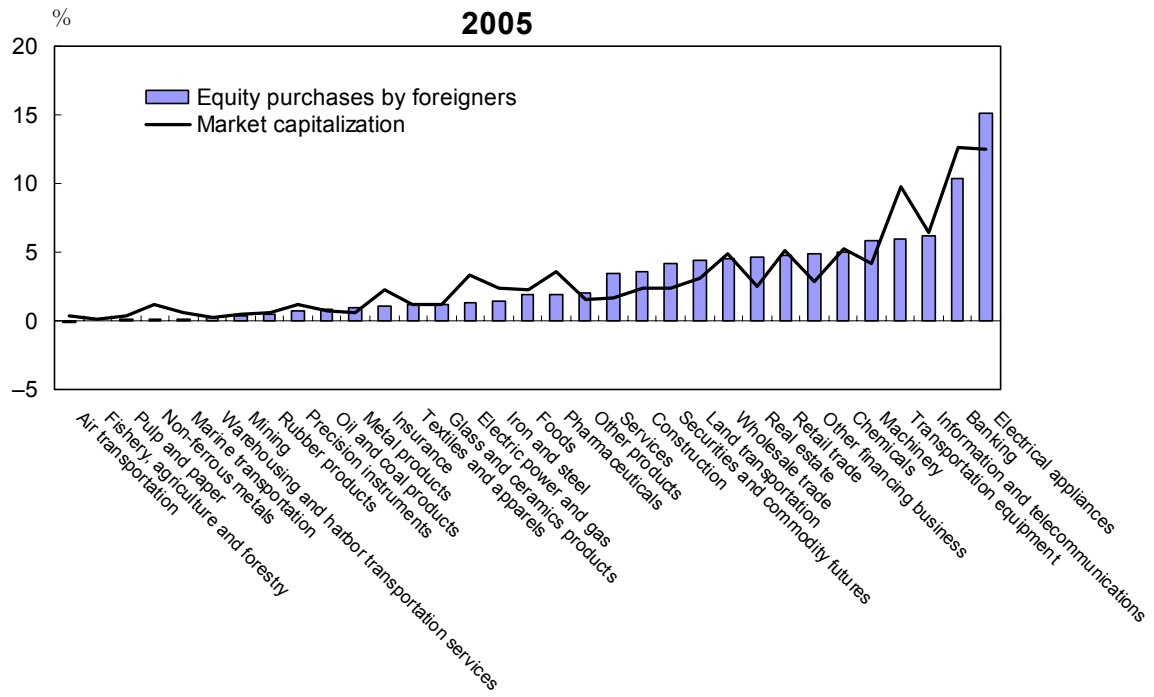
### Box 5. Inward Investment in Equities by Foreign Investors by Industry in 2006

Looking at investment in Japanese equities by foreign investors during 2006, compared with 2005, investors became much more selective about which industries to invest in.

A comparison of the industry distribution of inward investment in equities in 2005 with that of market capitalization on the First Section of the Tokyo Stock Exchange (TSE) shows that both were roughly the same and thus it could be said that, in 2005, foreigners were "buying into Japan." In contrast, in 2006, equity purchases in industries such as banking and transportation equipment exceeded these industries' weight in market capitalization on the First Section of the TSE, while equity purchases in industries such as electrical appliances and information and telecommunications fell below these sectors' TSE First Section market capitalization weight.

**Figure for Box 5: Distribution of Equity Purchases and Market Capitalization by Industry**





## Reference: Revisions to the Methods for Compiling the Balance of Payments Statistics in 2006<sup>5</sup>

In compiling statistics, it is necessary to constantly search for better data sources and revise compilation methods in order to more accurately capture changes in the economic situation. From this point of view, statisticians in Japan constantly review, and if necessary revise, the method for compiling Japan's balance of payments statistics, cooperating with the International Monetary Fund (IMF)<sup>6</sup> and related parties in other major countries. Revisions implemented in 2006 are listed below.

Revisions	Category within the balance of payments	First released figures using the revised methods
1. Improvement in the compilation method for the travel balance	Travel	Revised figures for January 2006
2. Expansion of data sources for workers' remittances	Current transfers	Preliminary figures for January 2006
3. Expansion of released items of outward/inward direct investment	Direct investment	Preliminary figures for February 2006 (historical time-series data from January 1996 onward are provided)

### 1. Improvement in the compilation method for the travel balance<sup>7</sup>

While the Japanese government continued campaigns to attract foreign visitors, the Bank reviewed the source data and compilation method for the travel balance.

The Bank conducted a survey covering travelers at major airports regarding travel expenditures. The results of this survey are used in the new compilation method to directly estimate the amounts spent by travelers to pay for goods and services. In contrast, the prior estimation method required combining several types of data, such as data on cross-border payments by credit card and data on Japanese and foreign currency used by travelers.

<sup>5</sup> For details, refer to "Notices of Changes" under "Balance of Payments" on the Bank of Japan's web site: (<http://www.boj.or.jp/en/theme/research/stat/bop/bop/index.htm>).

<sup>6</sup> The IMF formulates the *Balance of Payments Manual* (BPM5), an international guideline for compiling balance of payments statistics, with the aim of improving international comparability and increasing the accuracy of the statistics. The IMF Committee on Balance of Payments Statistics holds regular meetings, at which the IMF, other international organizations, and representatives from major countries discuss various institutional issues related to the balance of payments statistics.

<sup>7</sup> See "Change in the Method for Compiling 'Travel' in the Balance of Payments Statistics" (July 4, 2006) on the Bank's web site.

## **2. Expansion of data sources for workers' remittances<sup>8</sup>**

The importance of cross-border workers' remittances for the economic development of developing countries was pointed out at the Sea Island Summit in June 2004. With an action plan to improve statistics on workers' remittances laid out at the Summit, the Bank expanded the coverage of financial institutions that are to report and the contents of the reports. The Bank also started to release data by region.

## **3. Expansion of released items of outward/inward direct investment<sup>9</sup>**

In addition to net figures, the Bank started to release gross figures on components of outward/inward direct investment in response to user requests. Gross figures include "inflow" and "outflow" of equity capital, reinvested earnings, and other capital in outward/inward direct investment, to allow users to better capture the movement of direct investment funds.

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<sup>8</sup> See "Expansion of Data Sources for 'Workers' Remittances'" (March 13, 2006) and "Release of Regional Breakdown Data for 'Workers' Remittances' in the Balance of Payments Statistics" (August 10, 2006) on the Bank's web site.

<sup>9</sup> See "Expansion of Released Items of Outward/Inward Direct Investment" (April 12, 2006) on the Bank's web site.