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Japan's Balance of Payments for 2008

August 2009
International Department
Bank of Japan

This is an English translation of the Japanese original released on March 24, 2009

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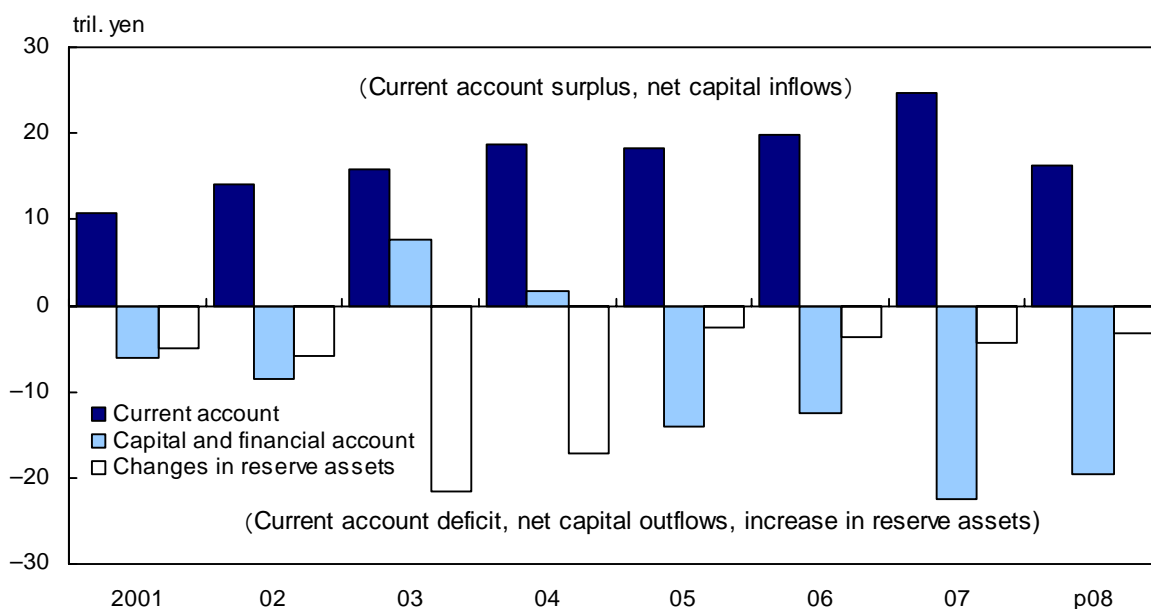
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I. Summary

Japan's current account surplus decreased to 16.3 trillion yen in 2008, down from 24.8 trillion yen in 2007, mainly due to a decrease in the trade surplus. The decrease in the current account surplus is the first in three years. The capital and financial account deficit (net outflow) decreased to 19.6 trillion yen in 2008, down from 22.5 trillion yen in 2007. Reserve assets continued to increase, rising by 3.2 trillion yen in 2008 compared to an increase of 4.3 trillion yen in 2007. Balance of payments data for the whole of 2008 and the fourth quarter of 2008 in this report are preliminary unless otherwise stated.

In balance of payments statistics, the following relationship holds true at all times: Current account + capital and financial account + changes in reserve assets + errors and omissions = 0. Japan's balance of payments for 2008 shows that the current account surplus earned is mirrored by reverse flows abroad in the form of a capital and financial account deficit (outflows) and an increase in reserve assets.

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

	2006	2007	p2008	Change from the previous year	Highlights
Current account	19,848.8	24,793.8	16,280.3	-8,513.6	The surplus decreased for the first time in three years, mainly due to a decrease in the trade surplus.
Goods and services	7,346.0	9,825.3	1,797.3	-8,028.0	The surplus decreased significantly, due to a decrease in the trade surplus.
Goods	9,464.3	12,322.3	4,033.8	-8,288.5	The surplus decreased sharply due to a decrease in exports and an increase in imports.
Exports	71,630.9	79,725.3	77,352.2	-2,373.1	Exports decreased, reflecting the deterioration in overseas economic conditions.
Imports	62,166.5	67,403.0	73,318.4	+5,915.4	Imports increased, reflecting the surge in prices of natural resources.
Services	-2,118.3	-2,497.1	-2,236.5	+260.6	The deficit decreased, mainly due to the decline in deficit in the balance of travel.
Income	13,745.7	16,326.7	15,832.4	-494.3	The surplus decreased for the first time in six years, but it still remained high.
Current transfers	-1,242.9	-1,358.1	-1,349.4	+8.7	The deficit remained due to the payment of taxes and contributions.
Capital and financial account	-12,466.5	-22,538.3	-19,556.0	+2,982.3	The outflow of funds decreased as "other investment" turned to a net inflow from a net outflow in the previous year.
Of which:					
Outward direct investment	-5,845.9	-8,660.7	-13,168.6	-4,507.9	The outward investment amount registered a record high.
Inward direct investment	-756.6	2,655.2	1,968.0	-687.2	The inward investment amount remained high.
Outward portfolio investment	-9,689.0	-12,929.8	-14,165.1	-1,235.3	
Equity securities	-3,055.0	-2,957.6	-6,661.9	-3,704.3	Net purchases (outflows) increased as purchases (outflows) of equity securities registered a record high.
Bonds and notes	-7,725.5	-10,247.8	-7,271.0	+2,976.8	
Money market instruments	1,091.4	275.6	-232.3	-507.9	
Inward portfolio investment	22,198.5	24,922.6	-10,341.4	-35,263.9	
Equity securities	9,855.4	5,444.2	-7,463.6	-12,907.8	Net sales (outflows) registered a record high as net sales (outflows) of equity securities and bonds and notes registered a record high.
Bonds and notes	8,459.9	10,496.7	-4,417.3	-14,914.0	
Money market instruments	3,883.2	8,981.7	1,539.6	-7,442.1	
Financial derivatives	283.5	324.9	2,457.6	+2,132.7	Net receipts (inflows) of funds increased.
Other investment	-18,108.1	-28,413.1	14,015.8	+42,428.9	Net outflows of fund turned to net inflows for the first time in four years.
Changes in reserve assets	-3,719.6	-4,297.4	-3,200.1	+1,097.3	Reserve assets continued to increase.
Errors and omissions	-3,662.7	2,041.9	6,475.8	+4,434.0	
Ratio of current account to nominal GDP (%)	3.9	4.8	3.2		

Notes:

1. Negative figures represent capital outflows. Negative figures in "changes in reserves assets" represent an increase in reserve assets.
2. Figures for portfolio investment and other investment exclude securities lending transactions.

II. Current Account

A. Summary

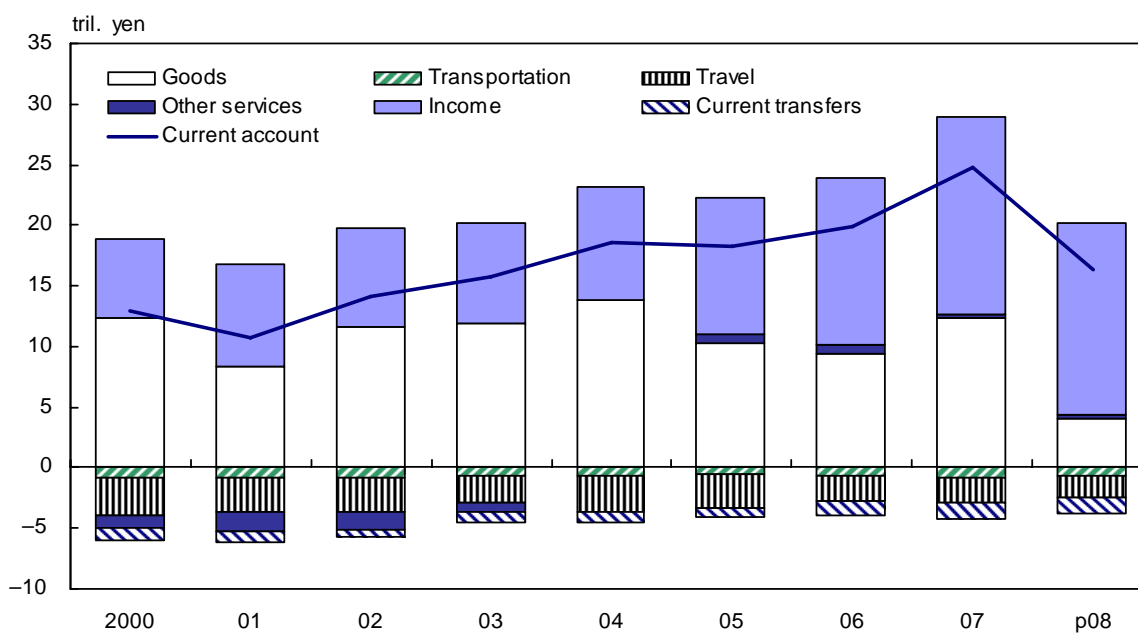
The current account surplus decreased for the first time in three years, mainly due to a decrease in the trade surplus. The trade surplus decreased sharply to the lowest level since 1980 when it stood at 0.3 trillion yen. The deficit in the balance of trade in services decreased. The surplus in the balance of income decreased for the first time in six years, but it still remained at a high level.

Table 2: Current Account

bil. yen

	2007	p2008	Change from the previous year
Current account	24,793.8	16,280.3	-8,513.6
Goods and services	9,825.3	1,797.3	-8,028.0
Goods	12,322.3	4,033.8	-8,288.5
Exports	79,725.3	77,352.2	-2,373.1
Imports	67,403.0	73,318.4	+5,915.4
Services	-2,497.1	-2,236.5	+260.6
Transportation	-826.4	-729.0	+97.5
Travel	-2,019.9	-1,773.8	+246.1
Other services	349.3	266.3	-83.0
Income	16,326.7	15,832.4	-494.3
Current transfers	-1,358.1	-1,349.4	+8.7

Figure 2: Current Account



B. Developments in the Main Components

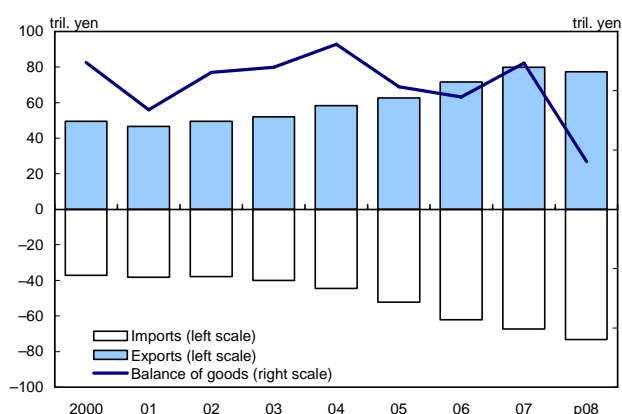
1. Goods

The balance of trade in goods in 2008 registered a surplus of 4.0 trillion yen, down from 12.3 trillion yen in 2007. The surplus in the balance of goods decreased sharply, due to a decrease in exports and an increase in imports. Exports decreased for the first time in seven years, while imports increased for the sixth consecutive year.

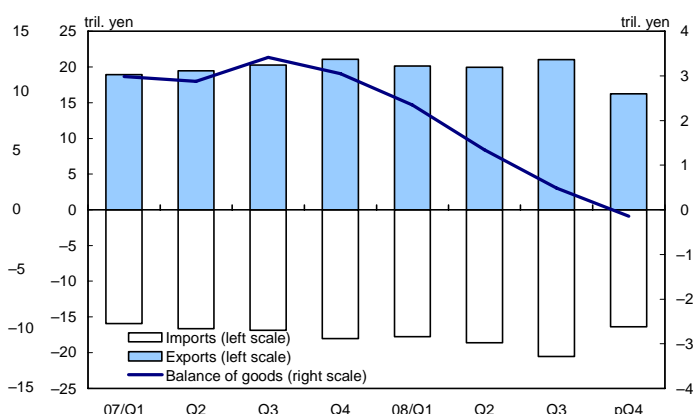
By quarter, the surplus of trade in goods decreased from the first quarter to the third quarter as the moderate increase in exports was outpaced by the increase in imports reflecting the surge in mineral fuel prices. In the fourth quarter, imports decreased due to the fall in crude oil prices, but this was more than offset by the significant drop in exports reflecting the deterioration in world economic conditions. As a result, the balance of trade in goods turned negative for the first time since 1985, when the current method for the compilation of statistics was introduced.

In this report, figures by region and type of goods are based on the "Trade Statistics of Japan."¹

Figure 3: Exports and Imports
(By year)



(By quarter)



¹ 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. The 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 aircraft carrying the goods leaves the port Imports: When imported goods are officially recognized	When ownership is transferred

Note: FOB stands for "free on board" and CIF stands 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 decreased for the first time in seven years to 77.4 trillion yen, down from 79.7 trillion yen in 2007, reflecting the deterioration in overseas economic conditions. By region and by item, exports of motor vehicles and related goods and electrical machinery to the United States and the European Union dropped sharply, while exports of IT-related goods and materials to Asia also decreased.

In the fourth quarter, exports to Asia, the United States, and the European Union contracted substantially as world economic conditions deteriorated. Exports to other emerging economies also decreased. By item, exports of almost all goods, in particular motor vehicles and related goods, dropped substantially.

Figure 4: Contribution to Overall Export Growth by Region

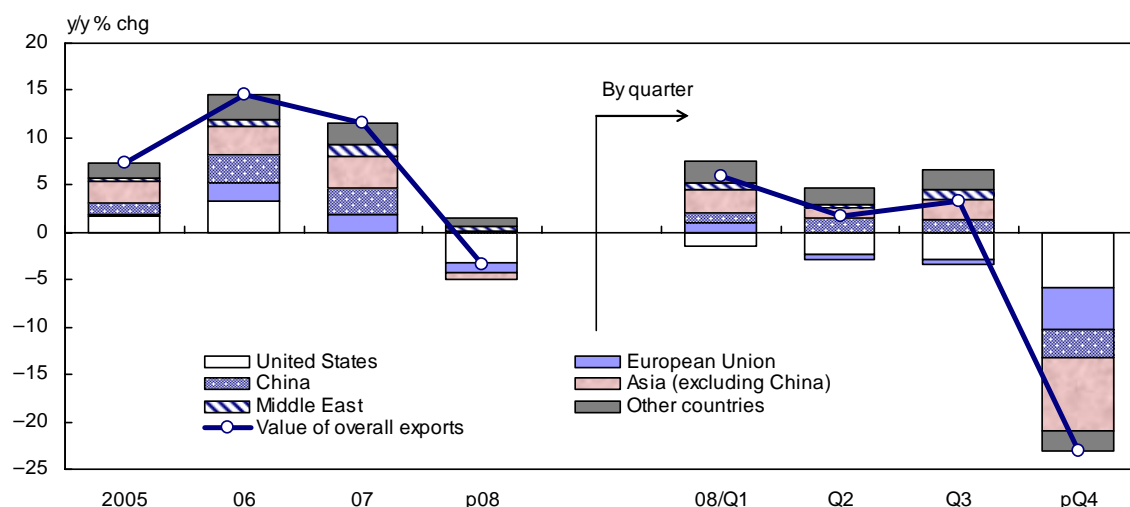
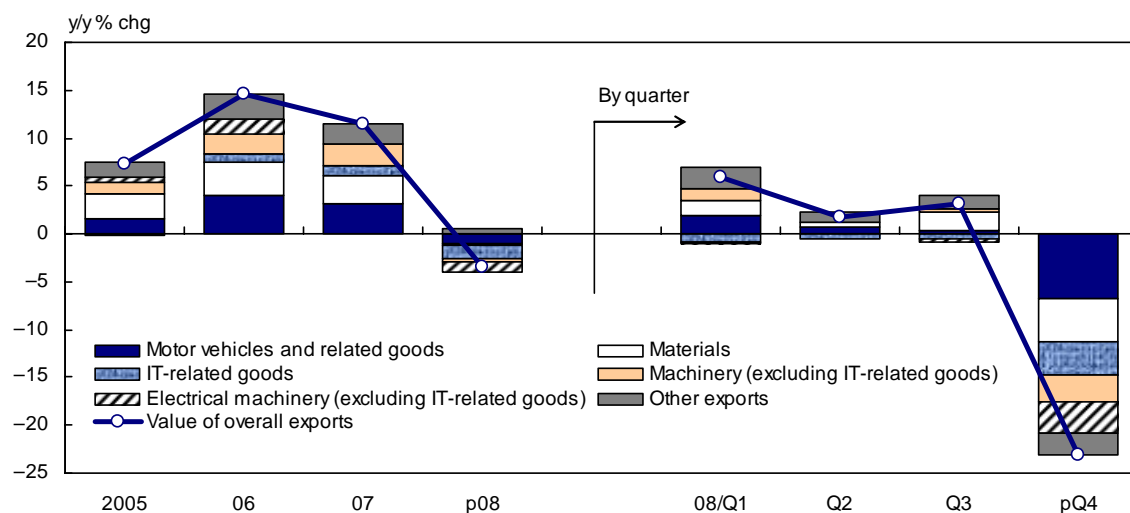


Figure 5: Contribution to Overall Export Growth by Item



Note: Figures for the European Union are compiled retroactively based on the increase in membership in 2007 to 27 countries. Figures for motor vehicles and related goods represent the sum of figures for motor vehicles and motor-vehicle parts. Figures for materials represent the sum of figures for raw materials, chemicals, and manufactured goods. Figures for IT-related goods represent the sum of figures for semiconductors and other electronic parts, computers and peripherals, computer parts, telecommunications apparatus, and scientific and optical instruments.

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

Table 3: Exports by Region

%

	Overall exports	Of which: United States	European Union	Asia	Of which: China	Middle East	Russia	Central and South America	Oceania	Africa
Year-on-year change	-3.4	-15.8	-7.8	-1.0	+0.9	+14.0	+35.5	+2.8	+4.7	+1.8
(Contribution to overall export growth)	-	(-3.2)	(-1.2)	(-0.5)	(+0.1)	(+0.5)	(+0.5)	(+0.1)	(+0.1)	(+0.0)

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

Table 4: Exports by Item

%

Exports Total	y/y change -3.4	Contribution to overall export growth	Major factors
Of which: IT-related goods	-10.3	(-1.4)	Exports of semiconductors and other electronic parts mainly to Asia decreased due to a price fall and a fall in production of IT goods from autumn 2008.
Electrical machinery (excluding IT-related goods)	-8.1	(-1.0)	Exports of audio and visual apparatus decreased mainly due to a price fall.
Motor vehicles and related goods	-4.9	(-1.0)	Exports to the United States and the European Union decreased due to a sales slump.
Machinery (excluding IT-related goods)	-2.5	(-0.4)	Exports of housing construction machinery to the United States and the European Union decreased.
Materials (chemicals, iron and steel products, etc.)	-0.9	(-0.2)	Exports decreased as both demand for and price of a wide range of materials fell from the autumn 2008.
Mineral fuels	+82.2	(+1.0)	Exports of gas oil and jet fuel increased due to increased demand in Asia and the surge in prices.

Note: Figures for IT-related goods represent the sum of figures for semiconductors and other electronic parts, computers and peripherals, computer parts, telecommunications apparatus, and scientific and optical instruments. Figures for motor vehicles and related goods represent the sum of figures for motor vehicles and motor-vehicle parts. Figures for materials represent the sum of figures for raw materials, chemicals, and manufactured goods.

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

b. Imports

Imports increased for the sixth consecutive year to 73.3 trillion yen, up from 67.4 trillion yen in 2007, reflecting the surge in prices of natural resources. By type of goods, a large contribution to the total increase was made by crude oil, liquefied natural gas, and coal, whose prices had risen significantly during the first half of the year.

In the fourth quarter, however, imports of a wide range of goods decreased, and total imports dropped for the first time in five years. This was because crude oil imports dropped due to the fall in crude oil prices and imports of materials (non-ferrous metals), IT-related goods, and machinery decreased.

Figure 6: Contribution to Overall Import Growth by Region

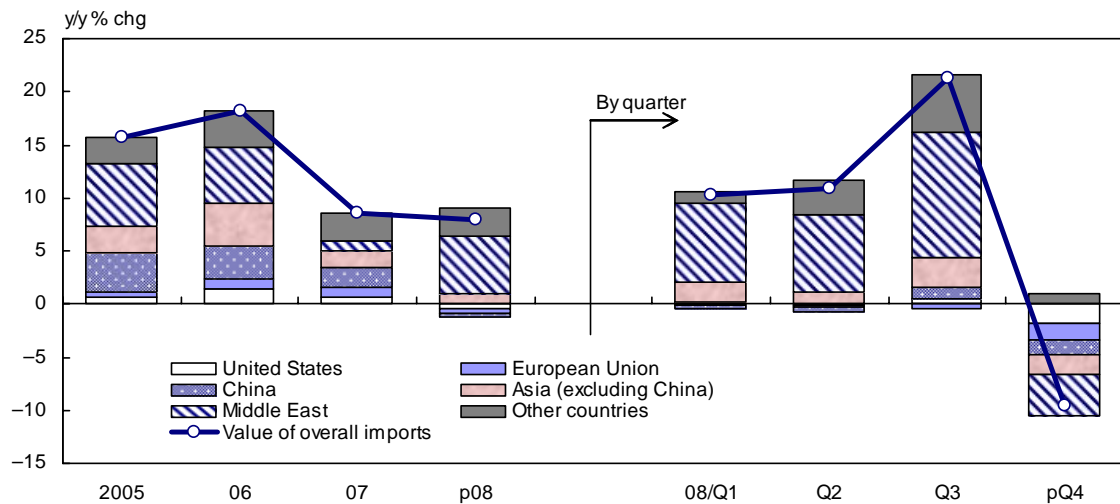
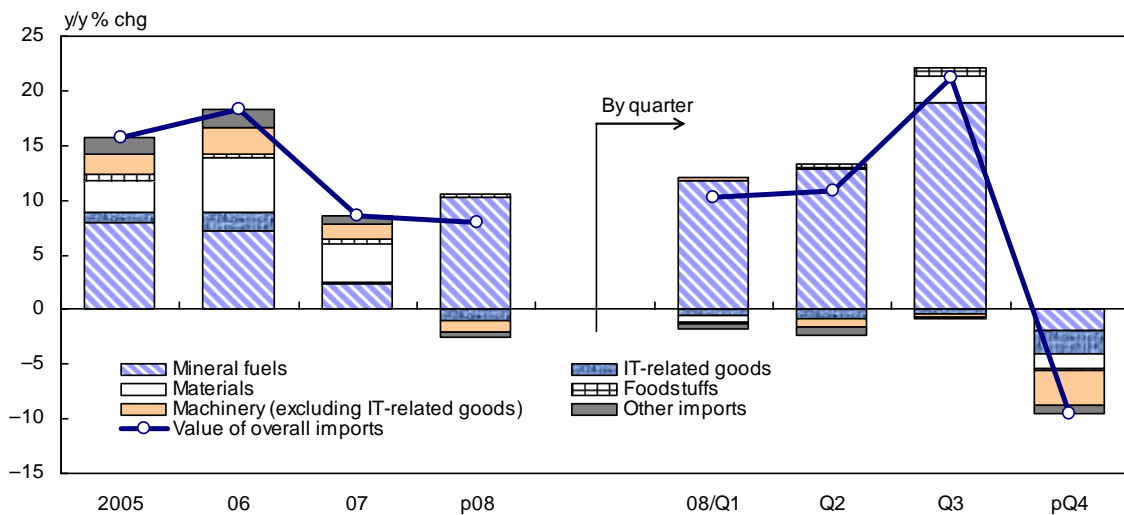


Figure 7: Contribution to Overall Import Growth by Item



Note: Figures for the European Union are compiled retroactively based on the increase in membership in 2007 to 27 countries. Figures for IT-related goods represent the sum of figures for semiconductors and other electronic parts, computers and peripherals, computer parts, telecommunications apparatus, and scientific and optical instruments. Figures for materials represent the sum of figures for raw materials, chemicals, and manufactured goods (excluding textile yarn and fabrics). Machinery (excluding IT-related goods) includes transport equipment, electrical machinery (excluding IT-related goods), and general machinery (excluding IT-related goods).

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

Table 5: Imports by Region

	Overall imports	Of which: United States	European Union	Asia	Of which: China	Middle East	Russia	Central and South America	Oceania	Africa
Year-on-year change	+7.9	-3.7	-4.9	+1.6	-1.4	+29.8	+11.5	-0.7	+27.5	+25.1
(Contribution to overall import growth)	-	(-0.4)	(-0.5)	(+0.7)	(-0.3)	(+5.4)	(+0.2)	(-0.0)	(+1.6)	(+0.6)

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

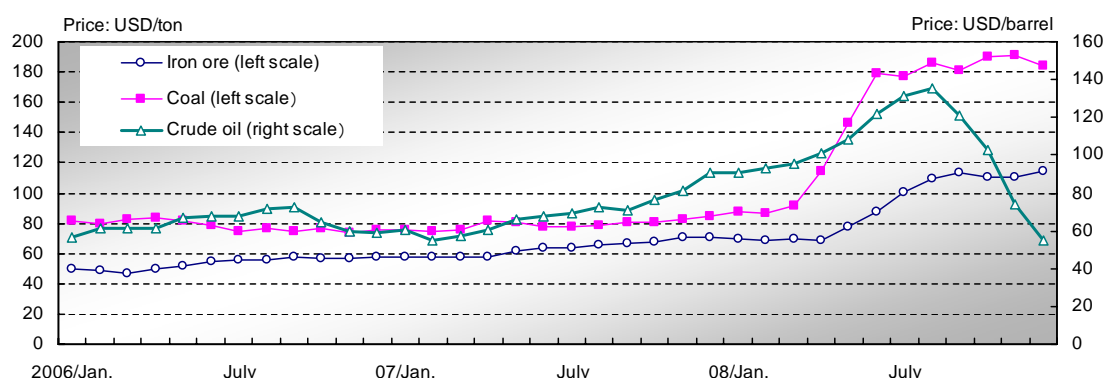
Table 6: Imports by Item

Imports Total	y/y change + 7.9	Contribution to overall import growth	Major factors
Of which:			
Mineral fuels	+36.9	(+10.2)	Imports of the crude oil increased due to the surge in prices until summer 2008. Liquefied natural gas and coal also increased due to the rise in prices.
Foodstuffs	+2.8	(+0.2)	Imports of corn and wheat increased due to the rise in prices.
Machinery (excluding IT-related goods)	-6.3	(-1.0)	
Transport equipment	-8.6	(-0.3)	Imports of motor vehicles decreased due to a slump in sales. Imports of aircraft also decreased due to a delay in delivery.
Electrical machinery (excluding IT-related goods)	-4.8	(-0.4)	Imports of audio and visual apparatus decreased, mainly due to the fall in prices.
IT-related goods	-9.1	(-1.0)	Imports of semiconductors and other electronic parts decreased due to the fall in the price of PC memory chips.

Note: Figures for IT-related goods represent the sum of figures for semiconductors and other electronic parts, computers and peripherals, computer parts, telecommunications apparatus, and scientific and optical instruments.

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

Figure 8: Import Prices of Crude Oil and Natural Resources



Note: Import prices are obtained by dividing the value of imports by the volume as recorded at the time of import.

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

(Reference) Developments in Foreign Exchange Rates in 2008

The average foreign exchange rates applied to the calculation of customs values² for 2008 were 104.23 yen per dollar (an 11.6 percent yen appreciation from 2007) and 153.86 yen per euro (a 4.4 percent yen appreciation from 2007).³ This appreciation of the yen contributed to the decrease in yen-dominated values of exports and imports.

Figure 1 for Reference: Foreign Exchange Rates Used for the Calculation of Customs Values (Annual Average Rates)

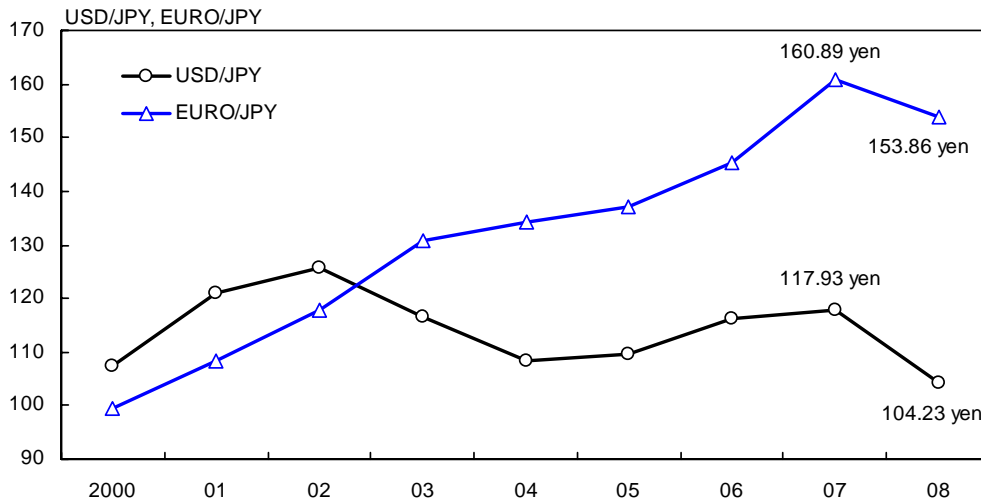
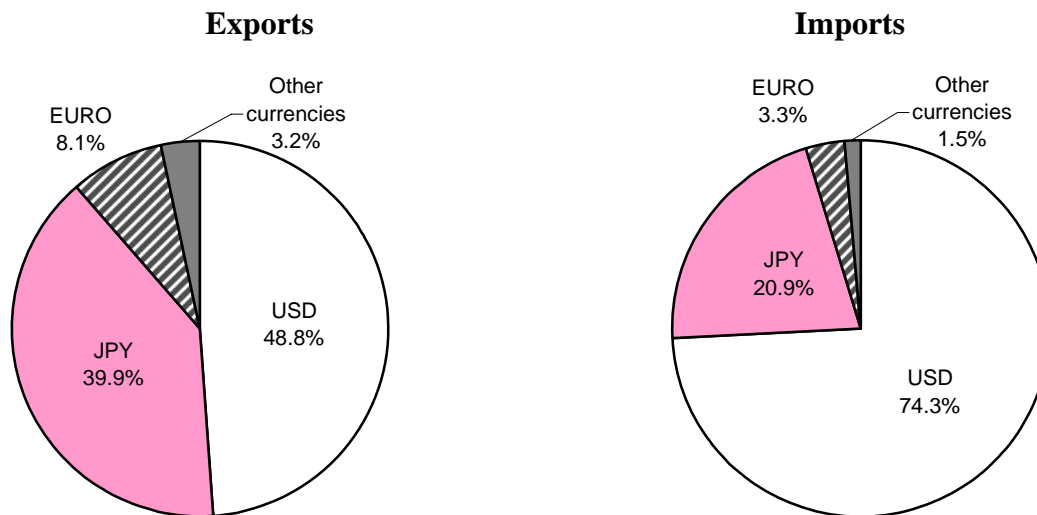


Figure 2 for Reference: Exports and Imports by Settlement Currency



Source: Ministry of Finance.

² The foreign exchange rates used for the calculation of customs values, which are released by customs pursuant to Article 4-7 of the Customs Act, are the weekly average inter-bank rates (central spot rates) on the Tokyo Foreign Exchange Market from two weeks earlier, and are posted weekly.

³ These average annual values were obtained by weighting the weekly posted rates by the number of days applicable.

2. Services

The deficit in the balance of trade in services decreased to 2.2 trillion yen from 2.5 trillion yen in 2007, mainly due to the decrease in deficit in the balance of travel reflecting the decline in the number of Japanese traveling abroad.

Figure 9: Services

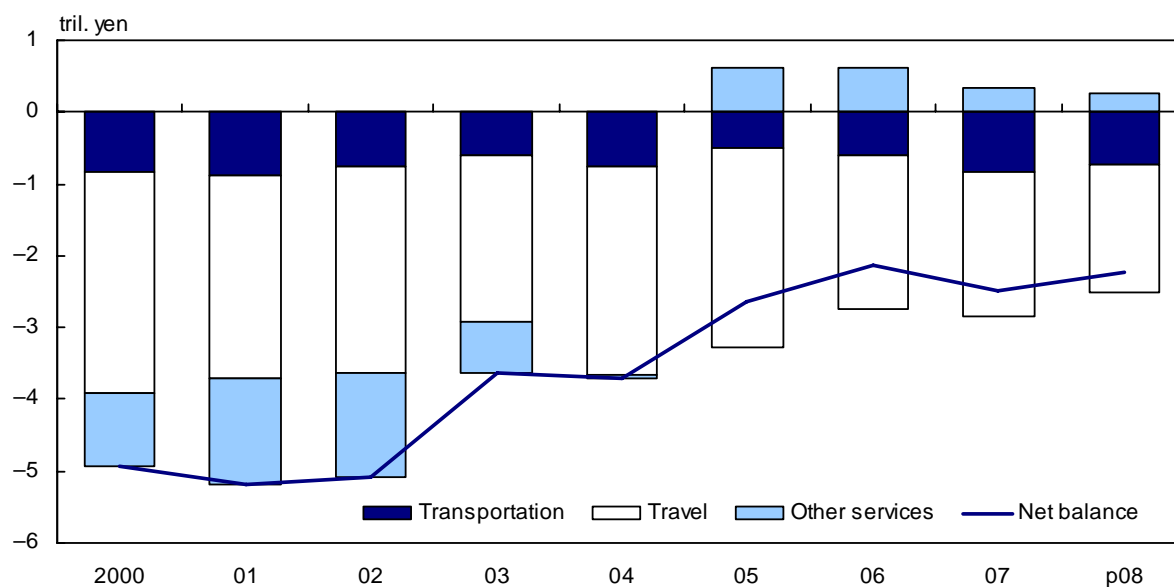


Table 7: Balance of Trade in Services

bil. yen

	2007	p2008	Change from the previous year	Major factors
Services	-2,497.1	-2,236.5	+260.6	
Transportation	-826.4	-729.0	+97.5	The deficit decreased as a whole due to an increase in the surplus in sea freight reflecting a surge in freight rates until the middle of the year and also due to a decrease in the deficit in air passenger transport reflecting the decrease in the number of Japanese traveling abroad.
Travel	-2,019.9	-1,773.8	+246.1	The deficit decreased due to a decline in the number of Japanese traveling abroad.
Other services	349.3	266.3	-83.0	The surplus remained due to the continued surplus in merchandising and other trade-related services as well as royalties and license fees.

a. Transportation

The deficit in the balance of transportation decreased for the first time in three years to 0.7 trillion yen, down from 0.8 trillion yen in 2007, reflecting an increase in sea freight receipts and a decrease in air passenger payments.

Both receipts and payments of sea freight increased reflecting high sea freight rates until the middle of the year. From the beginning of autumn, however, sea freight and charterage receipts decreased significantly, reflecting a softening in sea freight rates and a decline in cargo movement due to the deterioration in world economic conditions.

Regarding passenger air transport, passenger payments to foreign airlines decreased, reflecting a decrease in the number of Japanese traveling abroad.

Figure 10: Transportation

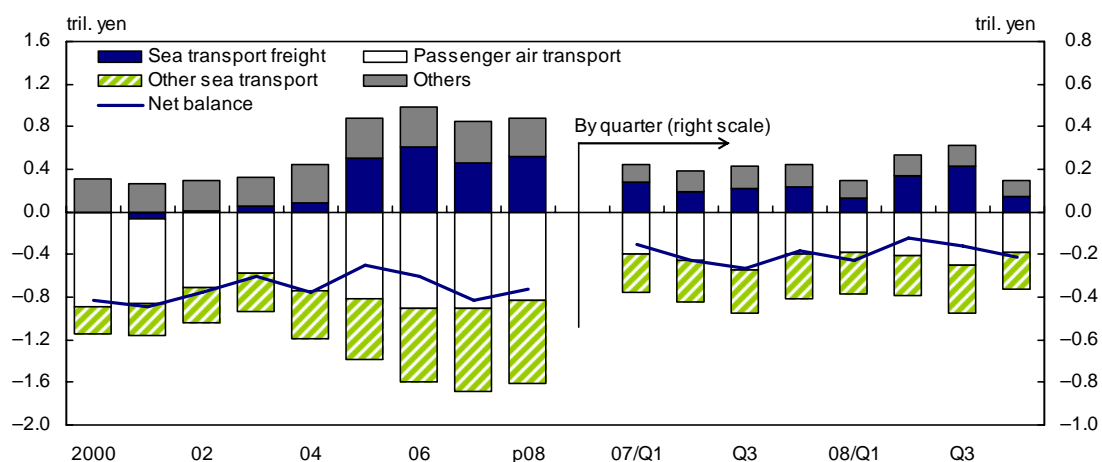


Table 8: Balance of Transportation

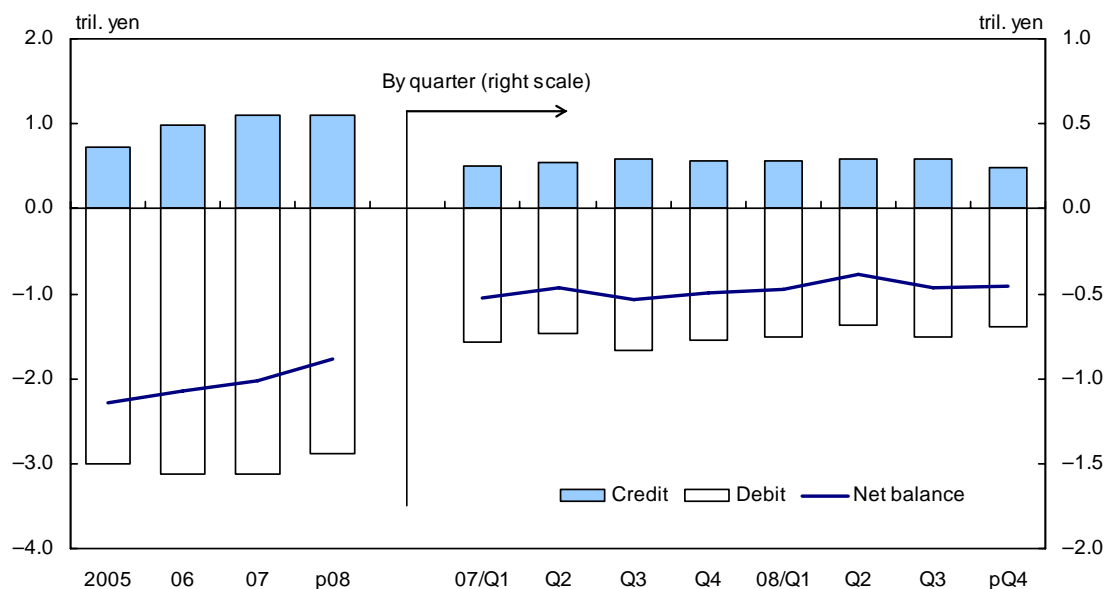
bil. yen

	2007	p2008	Change from the previous year	Major factors
Transportation	-826.4	-729.0	+97.5	
Of which:				
Sea transport	-322.8	-261.7	+61.1	
Of which:				
Freight	460.4	523.4	+63.0	Both credits (including cross trade freight) and debits increased due to high ocean freight rates until the middle of the year.
Credit	3,433.0	3,568.6	+135.6	
Debit	2,972.5	3,045.2	+72.7	
Other sea transport	-779.0	-780.8	-1.8	Both credits and debits decreased as terminal charges paid to shipping companies at ports decreased reflecting slowdown in movement of cargo.
Credit	317.9	256.7	-61.2	
Debit	1,096.9	1,037.4	-59.5	
Air transport	-487.2	-455.3	+31.9	
Passenger	-899.1	-830.1	+69.0	Passenger payments for air transport to foreign airlines decreased, reflecting a decrease in the number of Japanese traveling abroad.
Credit	360.2	305.1	-55.1	
Debit	1,259.3	1,135.2	-124.1	
Freight	91.4	100.4	+9.0	Both credits and debits decreased due to the decrease in air cargo.
Credit	386.9	336.4	-50.5	
Debit	295.5	236.1	-59.4	
Other air transport	320.5	274.4	-46.1	Receipts of agency fees from foreign airlines decreased due to the decrease in the number of Japanese traveling abroad.
Credit	439.9	382.2	-57.7	
Debit	119.4	107.7	-11.6	

b. Travel

The deficit in the balance of travel decreased to 1.8 trillion yen, down from 2.0 trillion yen in 2007. The deficit decreased for the fourth consecutive year mainly due to a decrease in the number of Japanese traveling abroad.

Figure 11: Travel



Note: The compilation method for the travel balance was changed beginning with the figures for January 2006. Under the new method, figures are estimated by multiplying foreign and Japanese travelers' per capita expenditures by the number of travelers. Travelers' per capita expenditures are based on the results of a survey concerning travel expenditures conducted in fiscal 2005. The figures for 2005 are estimated retrospectively by using the current compilation method and provided for reference.

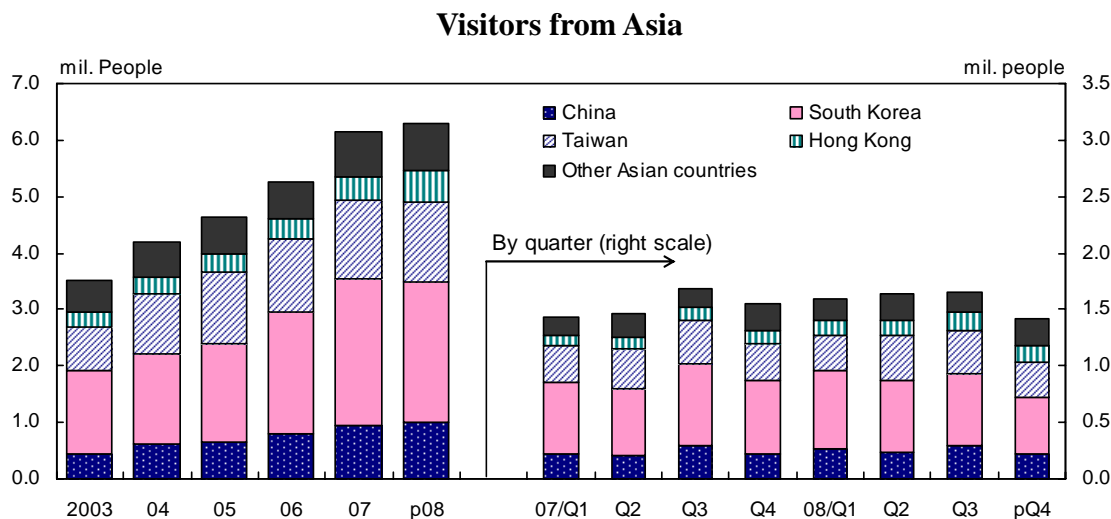
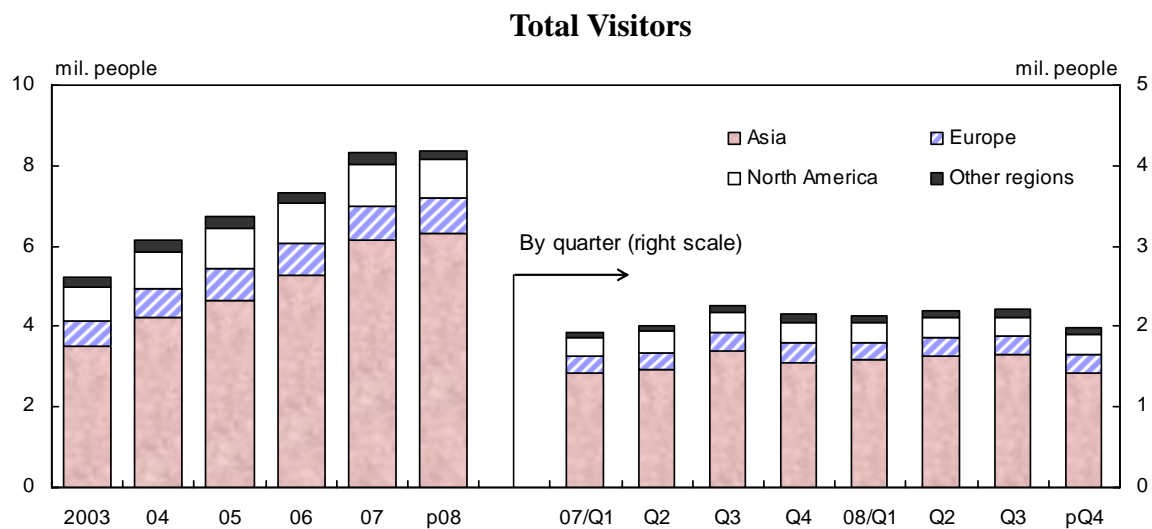
Table 9: Balance of Travel

bil. yen			
	2007	p2008	Change from the previous year
Travel	-2,019.9	-1,773.8	+246.1
Credit	1,099.0	1,110.0	+11.0
Debit	3,118.9	2,883.9	-235.0

The number of Japanese traveling abroad decreased due to the rise in airfares caused by the increase in fuel surcharges and reluctance to travel abroad reflecting deteriorating economic conditions.

The number of foreign visitors, mainly those from Asia, continued to show an increasing trend in the first half of the year. In the second half of the year, the number of visitors from Korea, who make up about 30 percent of all foreign visitors, decreased sharply due to the depreciation of the won against the yen. The number of visitors from the United States also decreased. For the year as a whole, the number of foreign visitors increased only slightly.

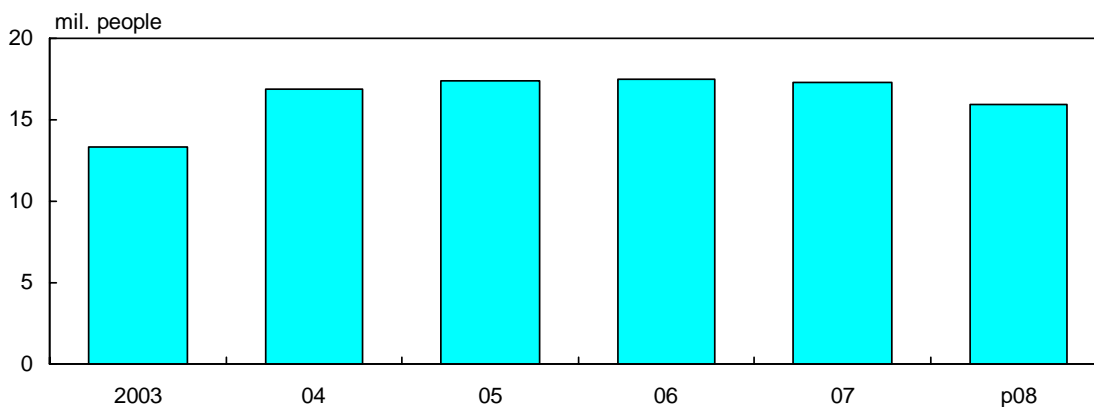
Figure 12: Number of Foreign Visitors to Japan



Note: Figures for 2008 are estimated by the International Department of the Bank of Japan using the actual figures for January through November 2008.

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

Figure 13: Number of Japanese Traveling Abroad



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

c. Other services

The balance of trade in other services recorded a surplus of 0.3 trillion yen in 2008, almost unchanged from the previous year, reflecting the continued surpluses in merchanding and other trade-related services as well as in royalties and license fees.⁴

Figure 14: Other Services

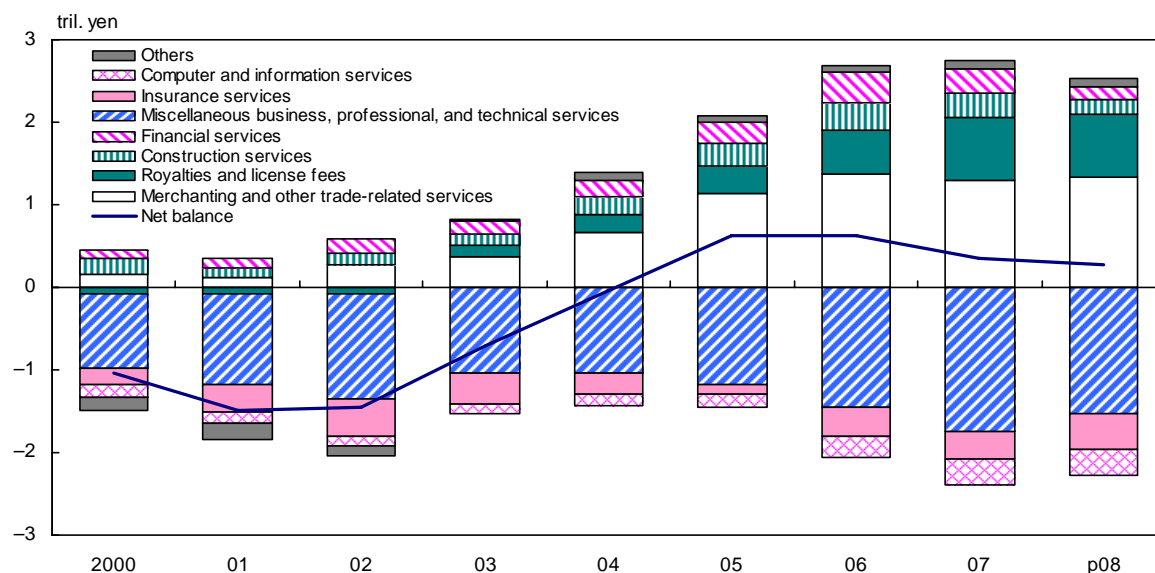


Table 10: Balance of Other Services

		bil. yen			Major factors
		2007	p2008	Change from the previous year	
Other services		349.3	266.3	-83.0	
Credit		9,154.0	9,117.4	-36.6	
Debit		8,804.8	8,851.1	+46.3	
Of which:					
Merchandising and other trade-related services		1,289.7	1,333.3	+43.6	The surplus in merchanding remained.
Credit		2,326.4	2,482.0	+155.6	
Debit		1,036.7	1,148.6	+112.0	
Royalties and license fees		772.9	760.0	-12.9	Credits decreased due to a decrease in royalties from overseas subsidiaries of Japanese motor vehicle manufacturers reflecting a fall in production. Debits also decreased, particularly in the electrical machinery sector, reflecting a decline in domestic mobile phone sales.
Credit		2,734.7	2,644.7	-90.0	
Debit		1,961.8	1,884.7	-77.2	
Construction services		281.1	180.2	-100.9	Credits remained at a high level reflecting the outstanding contracts of overseas plant construction projects by Japanese engineering and construction companies. Debits increased due to higher costs of construction materials, machinery, and labor.
Credit		1,214.7	1,172.4	-42.3	
Debit		933.6	992.2	+58.6	
Financial services		306.2	150.7	-155.5	Credits decreased due to a decrease in receipts of (trading) fees reflecting a fall in foreign investors' trading volume.
Credit		731.2	562.0	-169.3	
Debit		425.1	411.3	-13.8	
Insurance services		-326.8	-429.4	-102.6	The deficit continued due to payments of reinsurance premiums to foreign insurance companies.
Credit		159.1	97.3	-61.8	
Debit		485.9	526.7	+40.8	
Miscellaneous business, professional, and technical services		-1,753.4	-1,530.4	+223.0	The deficit continued due to payments regarding R&D and marketing expenditures by Japanese pharmaceutical and motor vehicle companies, and payments regarding oil exploration expenditures.
Credit		1,276.7	1,446.5	+169.8	
Debit		3,030.1	2,976.9	-53.2	

⁴ For details, see Box 1, "Features of Merchanding in 2008."

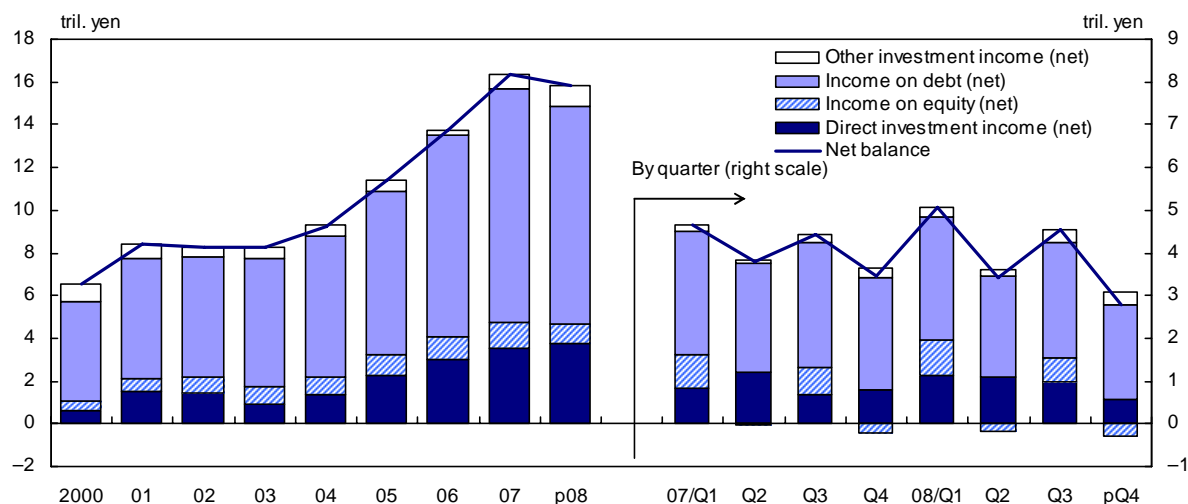
3. Income

The surplus in the balance of income decreased slightly to 15.8 trillion yen in 2008, from 16.3 trillion yen in 2007, but still remained at a high level.

The surplus decreased for the first time in six years.

The surplus in the balance of income increased steadily during the first half of the year, but registered a decrease in the fourth quarter.

Figure 15: Income



The surplus in the balance of portfolio investment income, which accounted for the largest share in investment income, decreased due to the decline in receipts of interest on debt reflecting the appreciation of the yen and lower interest rates. Both credits and debits in direct investment income decreased due to the worldwide deterioration in economic conditions.⁵

Table 11: Balance of Income

	Credit		Debit		Net balance	
		Change from the previous year		Change from the previous year		Change from the previous year
Investment income	21,974.6	-1,512.3	6,142.2	-1,018.0	15,832.4	-494.3
Of which:						
Direct investment income	5,026.1	-283.2	1,221.8	-521.8	3,804.2	+238.6
Portfolio investment income	14,245.3	-975.6	3,201.6	+92.0	11,043.7	-1,067.5
Income on debt	11,229.2	-768.2	1,073.6	-4.3	10,155.6	-764.0
Income on equity	3,016.1	-207.3	2,128.0	+96.2	888.2	-303.6
Other investment income	2,685.5	-256.6	1,698.1	-587.2	987.5	+330.5

⁵ For details, see Box 2, "Features of the Income from Outward Direct Investment by Region in 2008."

Table 12: Long-Term Interest Rates (10-Year Government Bonds, Annual Average)

%

	2006	2007	2008	08/Q4
United States	4.78	4.62	3.64	3.20
Year-on-year change	+0.51	-0.16	-0.99	-1.05
Germany	3.78	4.23	4.00	3.51
Year-on-year change	+0.40	+0.45	-0.23	-0.71
United Kingdom	4.50	5.01	4.49	3.96
Year-on-year change	+0.09	+0.50	-0.52	-0.81
Australia	5.59	5.99	5.82	4.78
Year-on-year change	+0.25	+0.40	-0.18	-1.35

Source: Bloomberg.

Table 13: Currency Exchange Rates (Annual Average)

yen, %

	2006	2007	2008	08/Q4
USD/JPY	116.67	118.75	106.33	105.67
Year-on-year change	+8.2	+1.8	-10.5	-8.9
EUR/JPY	144.14	159.50	159.22	150.64
Year-on-year change	+5.6	+10.7	-0.2	-6.6
GBP/JPY	211.02	235.52	206.61	189.77
Year-on-year change	+6.1	+11.6	-12.3	-19.1
AUD/JPY	87.14	97.54	94.60	84.35
Year-on-year change	+5.3	+11.9	-3.0	-15.4

Note: The exchange rates shown are the rates determined by Article 35, paragraph 2 of the Ministerial Ordinance Concerning Reports on Foreign Exchange Transactions, etc.

4. Current transfers

The deficit in the balance of current transfers amounted to 1.3 trillion yen in 2008, more or less unchanged from 1.4 trillion yen in 2007. This reflects the payment of taxes to foreign governments, contributions to international organizations, and foreign workers' remittances to their home countries.

Figure 16: Current Transfers

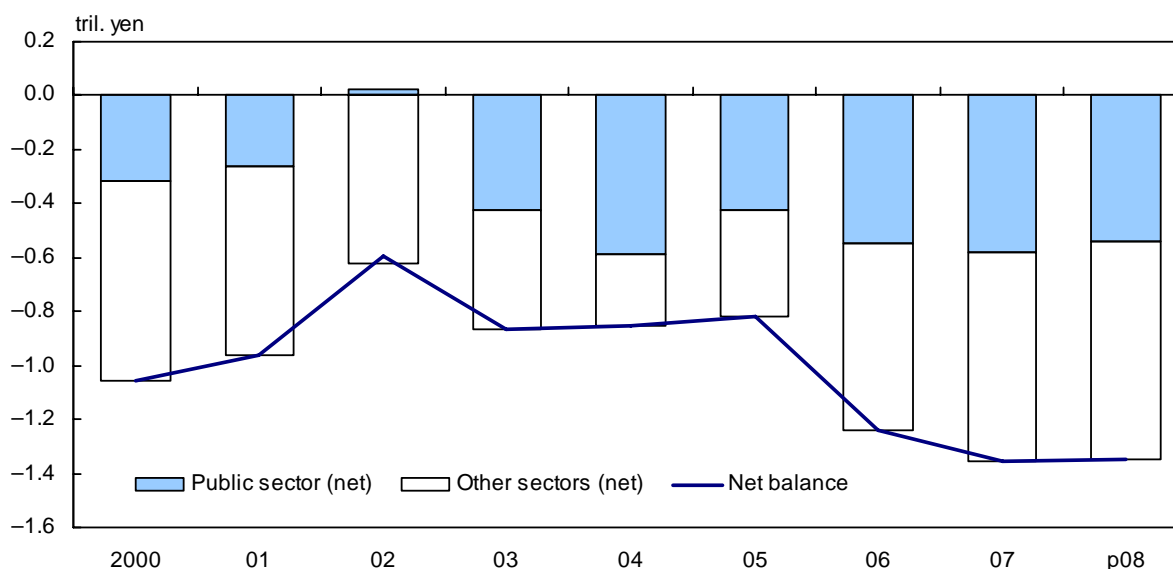


Table 14: Balance of Current Transfers

bil. yen				
	2007	p2008	Change from the previous year	Major factors
Current transfers	-1,358.1	-1,349.4	+8.7	
Public sector	-580.2	-537.9	+42.3	The deficit continued due to the contributions to international organizations.
Credit	27.0	31.1	+4.1	
Debit	607.2	569.0	-38.2	
Other sectors	-777.9	-811.5	-33.6	The deficit in workers' remittances and "other transfers" remained at approximately the same level as in 2007.
Credit	769.0	909.6	+140.6	
Debit	1,546.9	1,721.1	+174.2	
Workers' remittances	-257.9	-285.6	-27.8	Both credits and debits increased through the course of the year.
Credit	148.7	160.4	+11.7	
Debit	406.6	446.0	+39.4	
Other transfers	-520.0	-525.8	-5.8	Debits increased due to an increase in tax payments to oil-producing countries reflecting the rise in crude oil prices. Credits also increased due to receipts of sales incentive from foreign alliance partners.
Credit	620.3	749.2	+128.9	
Debit	1,140.3	1,275.0	+134.7	

III. Capital and Financial Account

A. Summary

The capital and financial account recorded a net outflow of 19.6 trillion yen in 2008, down from 22.5 trillion yen in 2007.

The net outflows of direct investment and portfolio investment reached record highs.⁶

"Other investment" turned from a large net outflow to a large net inflow.

Table 15: Capital and Financial Account

bil. yen

	2007			p2008		
		Assets (outward investment)	Liabilities (inward investment)		Assets (outward investment)	Liabilities (inward investment)
Current account	24,793.8			16,280.3		
Capital and financial account	-22,538.3			-19,556.0		
Financial account	-22,100.9			-19,233.8		
Direct investment	-6,005.4	-8,660.7	2,655.2	-11,200.6	-13,168.6	1,968.0
Portfolio investment	11,992.8	-12,929.8	24,922.6	-24,506.5	-14,165.1	-10,341.4
Equity securities	2,486.6	-2,957.6	5,444.2	-14,125.5	-6,661.9	-7,463.6
Bonds and notes	248.9	-10,247.8	10,496.7	-11,688.3	-7,271.0	-4,417.3
Money market instruments	9,257.3	275.6	8,981.7	1,307.3	-232.3	1,539.6
Financial derivatives	324.9	22,140.0	-21,815.1	2,457.6	27,922.7	-25,465.1
Other investment	-28,413.1	-29,046.3	633.2	14,015.8	174.8	13,841.0
Of which:						
Interoffice account transactions of banks	-13,882.8	-9,527.3	-4,355.6	-5,743.4	-6,672.4	929.0
Capital account	-473.1			-554.0		
Changes in reserve assets	-4,297.4			-3,200.1		
Errors and omissions	2,041.9			6,475.8		

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 collections of 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 would therefore make it difficult to grasp trends in securities transactions and loans.

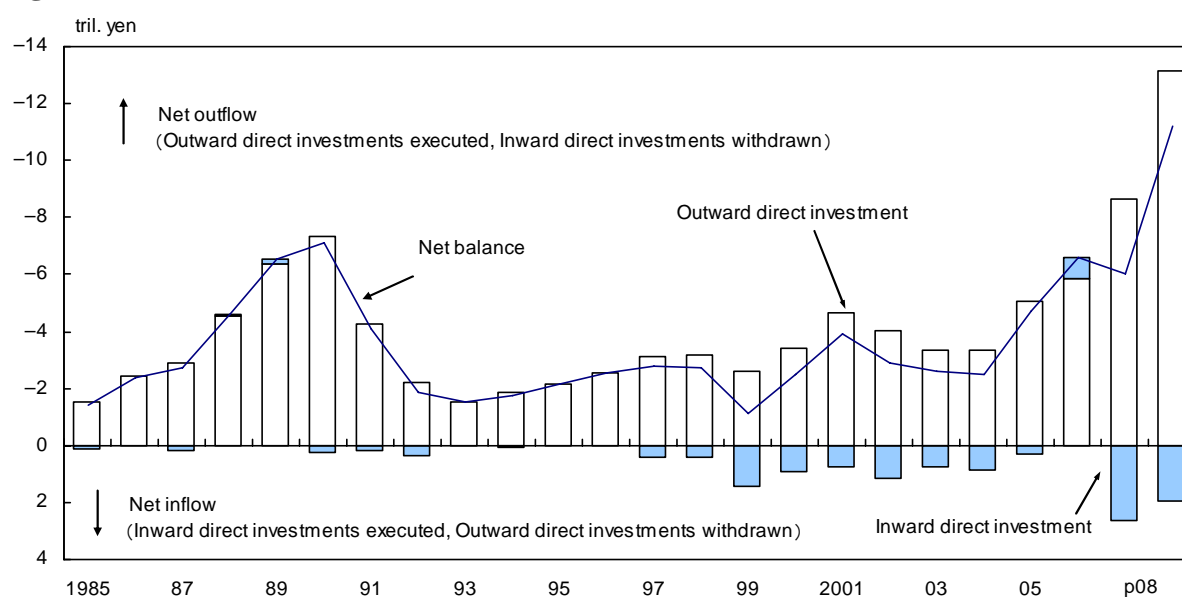
⁶ These are record highs since statistics started to be compiled on the current basis in 1996. The same qualification applies to similar comparisons hereafter.

B. Developments in the Main Components

1. Direct investment⁷

Outward direct investment by residents⁸ increased significantly, registering a net outflow of 13.2 trillion yen and substantially exceeding the previous record high set in 2007 (8.7 trillion yen). The surge in outward direct investment was mainly due to acquisitions aimed at expanding overseas business. Reflecting large-scale investments in the finance and insurance sector, inward direct investment by nonresidents⁹ recorded a high level of 2.0 trillion yen, down slightly from 2.7 trillion yen in the previous year, which was a record high.

Figure 17: Outward and Inward Direct Investment



a. Outward direct investment (assets)

Outward direct investment increased significantly and registered a record high, underpinned by (1) large-scale acquisitions and capital participations with the aim of expanding overseas business, and (2) investments in indirect capital increases¹⁰ to inject capital into Japanese financial institutions.

⁷ See Box 3, "Classification of Direct Investment by Type of Investment."

⁸ 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.

⁹ 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.

¹⁰ This refers to participation certificates issued by overseas special purpose companies (SPCs) that are subsidiaries of Japanese financial institutions and underwritten by Japanese securities companies. In most cases, the participation certificates underwritten by Japanese securities companies are recorded under securities companies' direct investment in SPCs. Often, these participation certificates are sold to domestic financial institutions immediately after underwriting. Capital raised through the issuance of participation certificates is often used to make subordinated loans to, or to purchase subordinated bonds from, parent financial institutions. Those subordinated loans are recorded under "other investment," and subordinated bonds are recorded under "portfolio investment."

(1) Breakdown by region

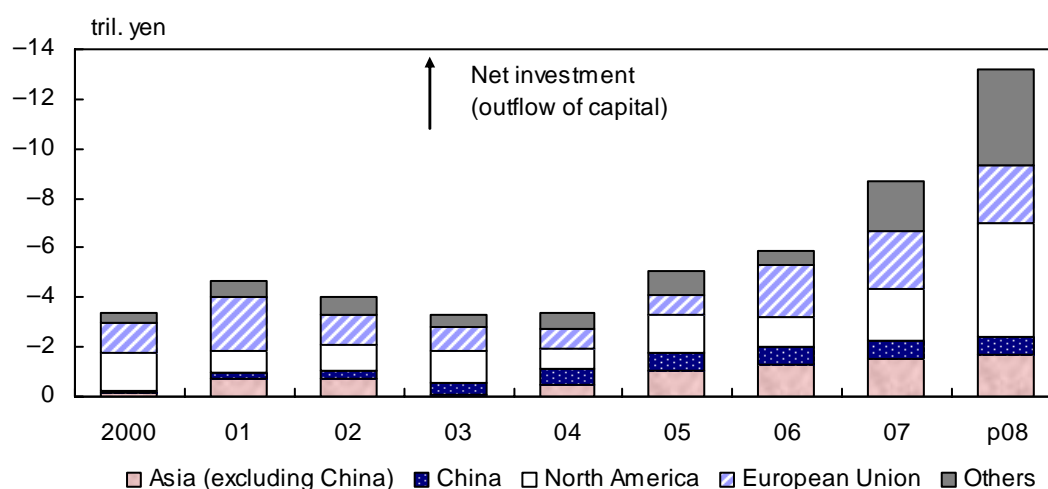
Net outflows to Asia (including China) in 2008 at 2.4 trillion yen were up slightly from 2.3 trillion yen in 2007. Contributing factors include a large-scale acquisition aimed at business expansion by a pharmaceutical company and capital injections to overseas branches by financial companies.

Net outflows to North America amounted to 4.6 trillion yen in 2008, up significantly from 2.0 trillion yen in 2007. Contributing factors include large-scale capital participations in the financial sector and investments aimed at expanding overseas business by electric machinery and pharmaceutical companies.

Net outflows to the European Union in 2008 at 2.3 trillion yen were down slightly from 2.4 trillion yen in 2007. Major investments include those for capital increases in subsidiaries in the financial sector, and acquisitions to expand overseas business in the precision machinery, electric machinery, and food industries.

Net outflows to other regions amounted to 3.9 trillion yen in 2008, up from 2.0 trillion yen in 2007. This was due to the acquisitions of participation certificates issued by special purpose companies (SPCs) in Central and South America set up by Japanese financial institutions for the purpose of strengthening their capital base. Also, mining companies invested in Central and South America as well as Oceania for natural resource exploration.

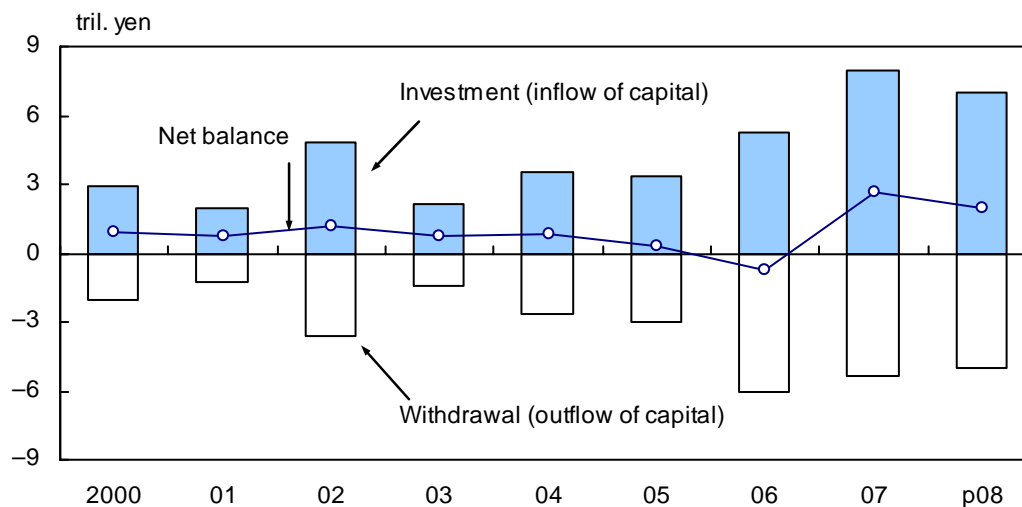
Figure 18: Outward Direct Investment (By Region)



b. Inward direct investment (liabilities)

Inward direct investment remained at a high level, registering the second highest level on record next to the previous year. This reflects large-scale investments in the finance and insurance sector, investments aimed at business expansion, and real estate-related investments.

Figure 19: Inward Direct Investment



(1) Breakdown by region

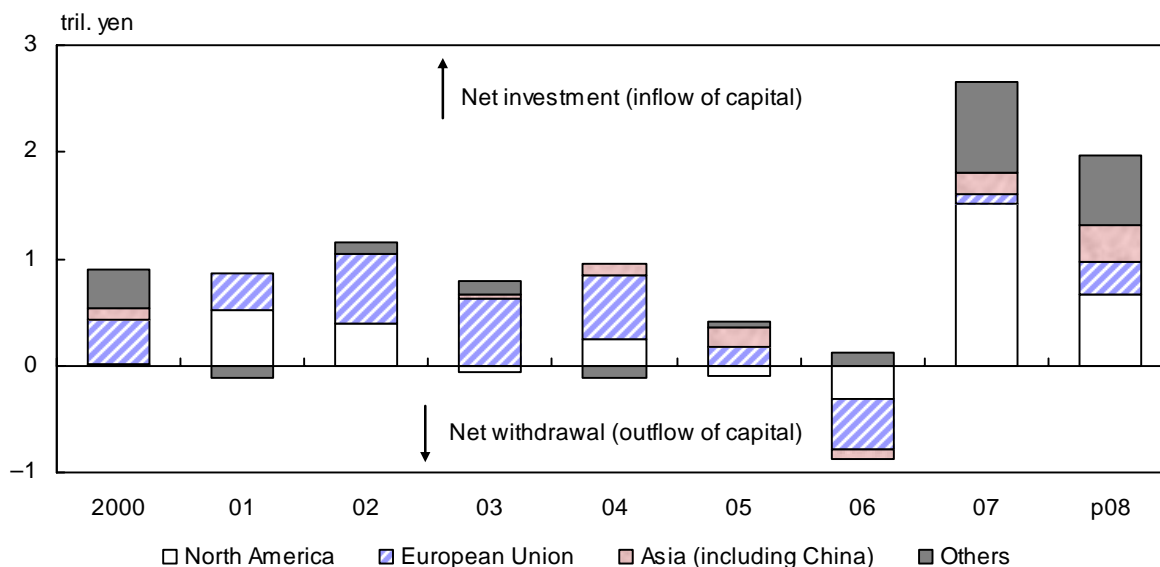
Investment from North America decreased to 0.7 trillion yen in 2008, down from 1.5 trillion yen in 2007. Although there were continued investments for capital increases in the finance and insurance sector, the total amount was below that for 2007, when large-scale investments took place.

Investment from the European Union increased to 0.3 trillion yen in 2008, up from 0.1 trillion yen in 2007. Contributing factors include the capital injection by a foreign pharmaceutical company in a Japanese pharmaceutical company, and large-scale lending by a foreign transportation equipment company to a Japanese subsidiary to buy out a motor vehicle manufacturer with the aim of business expansion.

Investment from Asia (including China) increased to 0.4 trillion yen, up from 0.2 trillion yen in 2007, because investment companies residing in the region increased their purchases of Japanese real estate.

Investment from other regions decreased to 0.6 trillion yen in 2008, down from 0.9 trillion yen in 2007. Despite capital participation in financial institutions as well as large-scale lending to a wholesale and retail company, the total amount was below that for 2007, when a foreign parent company acquired the stock of a wholesale and retail subsidiary in order to operate it as a wholly-owned subsidiary.

Figure 20: Inward Direct Investment (By Region)

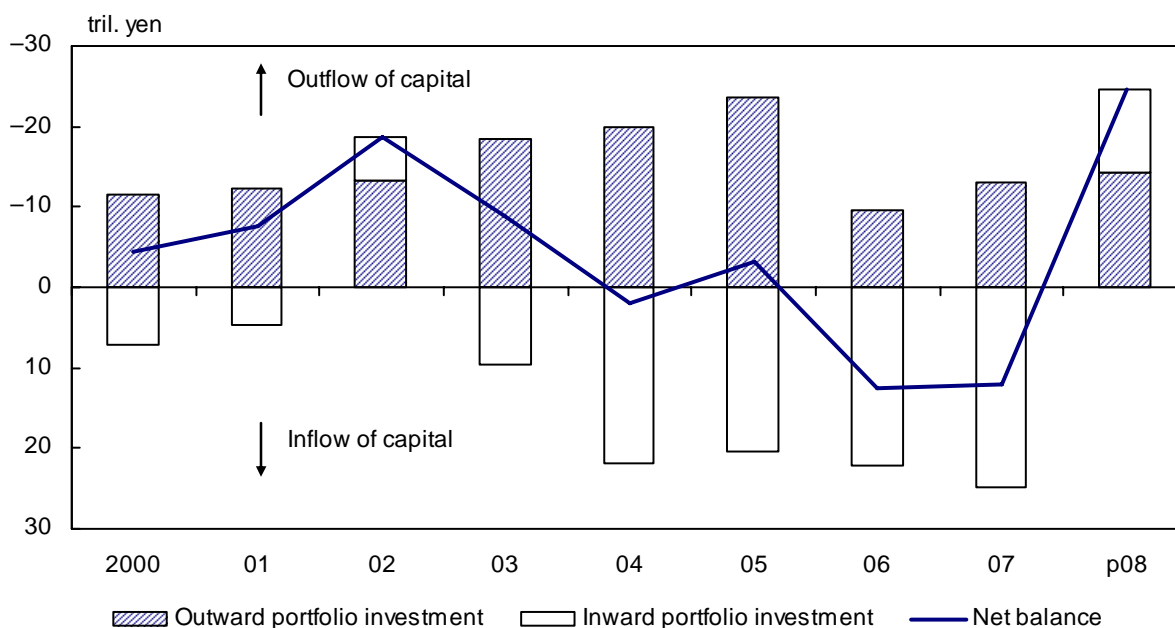


2. Portfolio investment (excluding securities lending)

Outward portfolio investment recorded large net purchases (outflows), increasing to 14.2 trillion yen in 2008 from 12.9 trillion yen in 2007. Inward portfolio investment turned negative for the first time in six years, from net purchases of 24.9 trillion yen in 2007 to net sales of 10.3 trillion yen in 2008, with outflows in 2008 marking a record high.

As a result, there was a large net outflow of portfolio investment amounting to 24.5 trillion yen, which was also a record high and a reversal from the net inflow in the previous year of 12.0 trillion yen.

Figure 21: Portfolio Investment

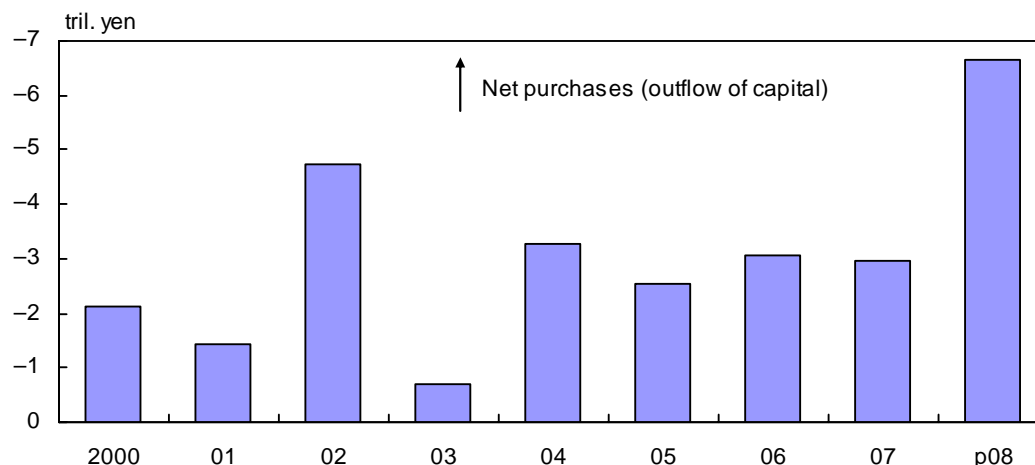


a. Outward portfolio investment (assets)

(1) Outward investment in equity securities (assets)

Net purchases (outflows) of equity securities registered a record high amounting to 6.7 trillion yen in 2008, up sharply from 3.0 trillion yen in 2007. This was mainly due to the significant increase in purchases of foreign equity securities by public and private pension funds through banks' trust accounts. On the other hand, purchases by individual investors through investment trusts decreased.

Figure 22: Outward Investment in Equity Securities



(a) Developments by investor category

Net purchases (outflows) by investment trusts decreased significantly to 0.7 trillion yen in 2008, down from 6.1 trillion yen in 2007, due to the decrease in investment in foreign equity securities by individual investors through investment trusts.

Net purchases (outflows) through banks' trust accounts¹¹ amounted to 5.4 trillion yen, a record high and a reversal from the net sales (inflows) of 3.0 trillion yen in 2007. The reversal was mainly due to large purchases by pension funds as they rebalanced¹² their portfolios in light of appraisal losses on foreign equity securities caused by the drop in U.S. and European equity prices and the appreciation of the yen.¹³

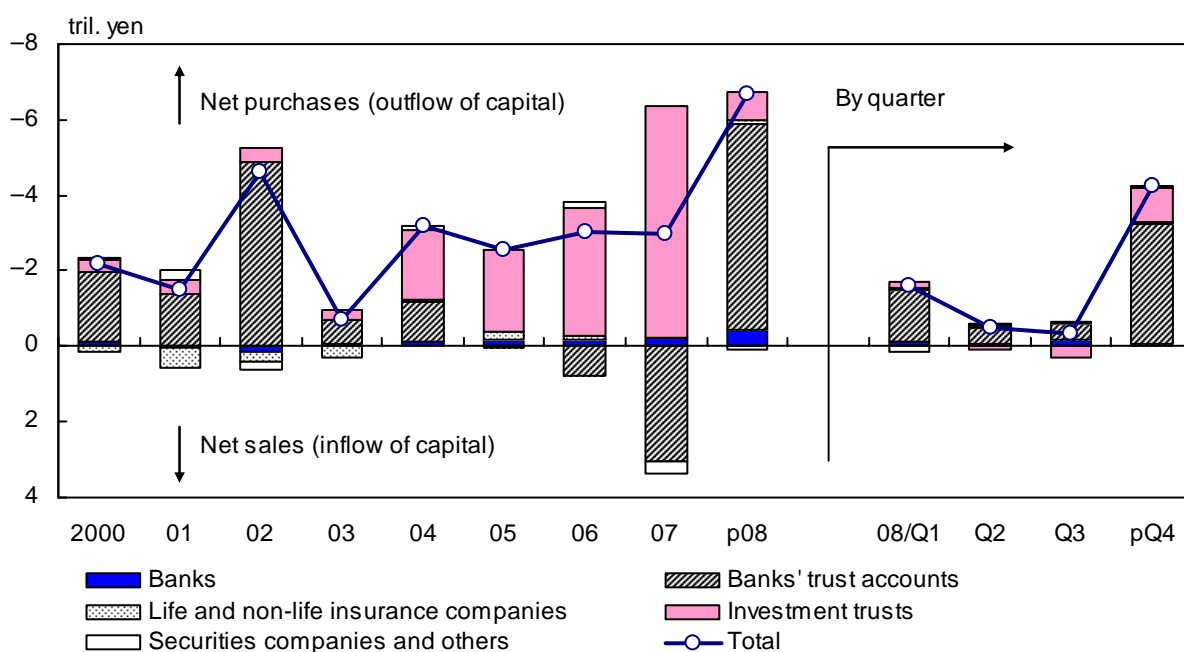
Net purchases (outflows) by banks increased to 0.5 trillion yen in 2008 from 0.2 trillion yen in 2007 as Japanese financial institutions provided capital to U.S. and European financial institutions.

¹¹ As pension funds often invest through banks' trust accounts, this item tends to reflect investments by pension funds.

¹² Public and private pension funds usually decide the weight of assets such as foreign equities and bonds and domestic equities and bonds in total assets prior to investment. To rebalance their 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.

¹³ For details, see Box 4, "Outward Investment in Equity Securities by Type of Investor in 2008."

Figure 23: 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" is the sum of the banking accounts of banks and trust banks, while "banks' trust accounts" is the sum of the trust accounts of banks and trust banks.

(b) Breakdown by region

Net purchases of Asian equities turned negative due to large sales of emerging market equities by individual investors through investment trusts. Net purchases of U.S. and EU equities increased as pension funds, whose holdings tend to include a large share of developed country equities with a large market capitalization, rebalanced their portfolios.

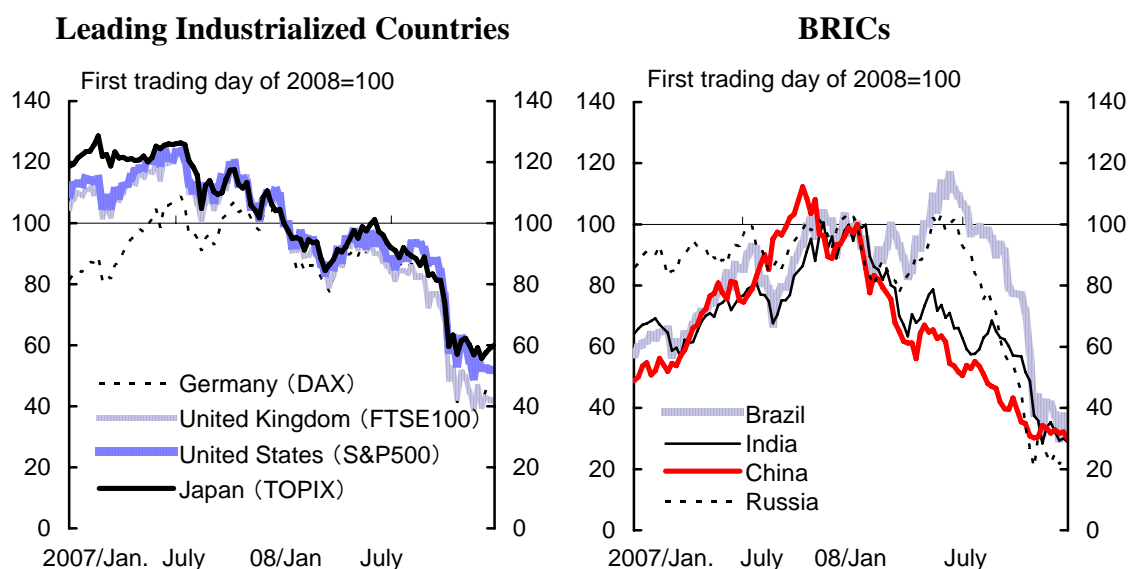
Table 16: Outward Investment in Equity Securities (By Region)

bil. yen

	2006	2007	p2008	IIP (end of 2007)
United States	-946.2	-161.7	-3,569.4	25,295.5
European Union	-221.7	-1,286.7	-1,806.5	19,773.1
Of which:				
United Kingdom	-68.3	-451.3	-924.5	6,026.7
France	-151.6	-208.8	-407.7	3,112.9
Germany	-35.0	-264.0	-151.3	2,611.7
Asia	-661.8	-454.1	350.6	6,581.0
Of which:				
India	59.6	38.0	-32.0	685.0
China	-230.5	91.0	152.8	1,714.9
Central and South America	-619.4	-498.0	-490.2	6,109.6
Of which:				
Cayman Islands	-489.9	-138.7	-181.7	4,377.3
Brazil	-142.4	-224.8	-95.0	680.0
Others	-605.9	-557.1	-1,146.3	7,616.3
Of which:				
Russia	-65.8	-85.0	-2.5	438.7
Total	-3,055.0	-2,957.6	-6,661.9	65,375.5

Note: IIP stands for international investment position.

Figure 24: Equity Price Indices in Major Markets (Yen Basis)



Source: Bloomberg.

(2) Outward investment in bonds and notes (assets)

Net purchases (outflows) of foreign bonds and notes decreased to 7.3 trillion yen in 2008, down from 10.2 trillion yen in 2007. This mainly reflects a decrease in individual investors' investment in foreign bonds and notes through investment trusts.

Figure 25: Outward Investment in Bonds and Notes

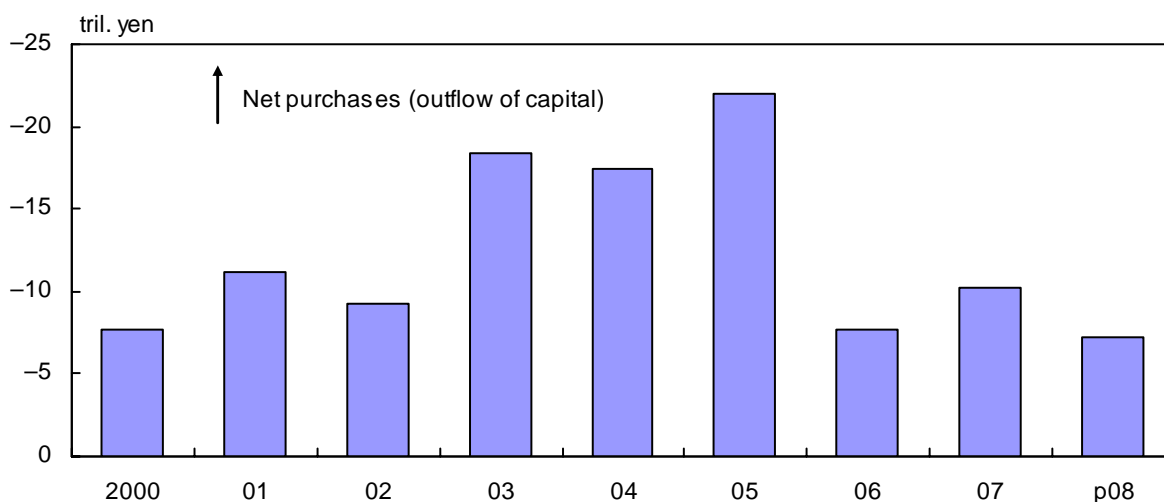
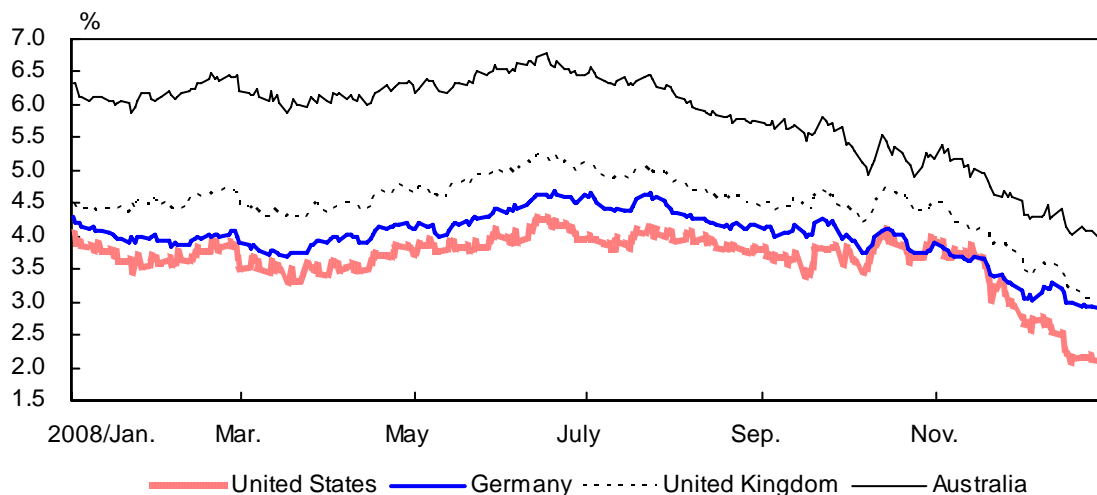


Figure 26: Long-Term Interest Rates in Major Markets (10-Year Government Bonds)



Source: Bloomberg.

(a) Developments by investor category

Outward investment in bonds and notes by banks was slightly positive in 2008, with net purchases (outflows) declining to 0.2 trillion yen from 0.8 trillion yen in 2007.

In the first quarter, banks purchased U.S. Treasuries and other bonds and notes in the expectation of a decline in interest rates due to concerns about the deceleration in U.S. economic growth. In the second quarter, profit-taking sales of bonds and notes expanded as interest rates rose due to rising inflation expectations.

In the third quarter, banks sold U.S. Treasuries to take profits as interest rates declined moderately when crude oil prices reversed and started falling.

From the autumn, as interest rates declined due to significant policy rate cuts by central banks and the flight to quality, banks actively sold and purchased bonds and notes, particularly U.S. Treasuries and German government bonds, in order to take profits and take up new positions.

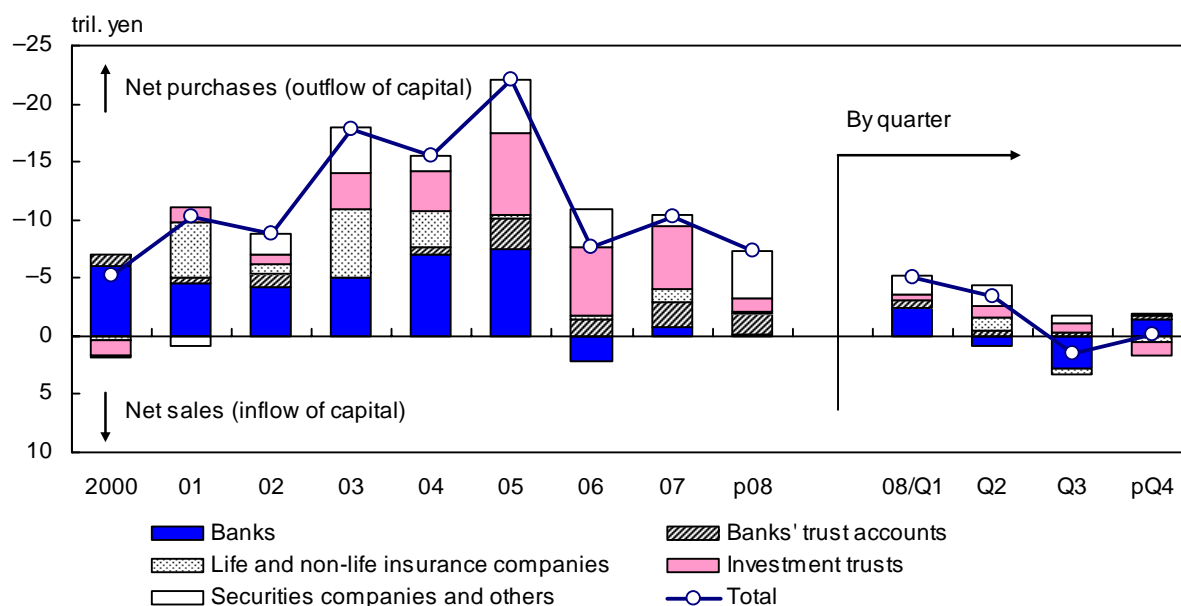
Outward investment in bonds and notes through banks' trust accounts continued to show net purchases (outflows), reflecting continued purchases by pension funds, and the net purchases amounted to 1.8 trillion yen in 2008, down only slightly from 2.1 trillion yen in 2007.

Net purchases (outflows) of bonds and notes by investment trusts significantly decreased to 1.1 trillion yen in 2008, from 5.4 trillion yen in 2007, due to a decrease in individual investors' investment in foreign bonds and notes through investment trusts mainly reflecting the appreciation of the yen.

Outward investment in bonds and notes by life and non-life insurance companies remained slightly positive in 2008, declining to 0.1 trillion yen from 0.8 trillion yen in 2007. When currency hedging costs declined reflecting the decrease in U.S. and European short-term interest rates, life and non-life insurance companies purchased foreign bonds and notes with currency hedging. When the yen sharply appreciated, some of them sold non-hedged foreign bonds and notes.

Net purchases (outflows) of bonds and notes by securities companies and others increased to 4.1 trillion yen in 2008, up from 1.1 trillion yen in 2007. Securities companies continued to purchase foreign bonds and notes to sell them to individuals, business enterprises, and institutional investors, while sales of foreign bonds and notes by institutional investors and redemptions decreased.

Figure 27: 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" is the sum of the banking accounts of banks and trust banks, while "banks' trust accounts" is the sum of the trust accounts of banks and trust banks.

(b) Breakdown by region

Net purchases of U.S. bonds and notes increased, while net purchases of EU and Central and South American bonds and notes decreased.

Table 17: Outward Investment in Bonds and Notes (By Region)

bil. yen

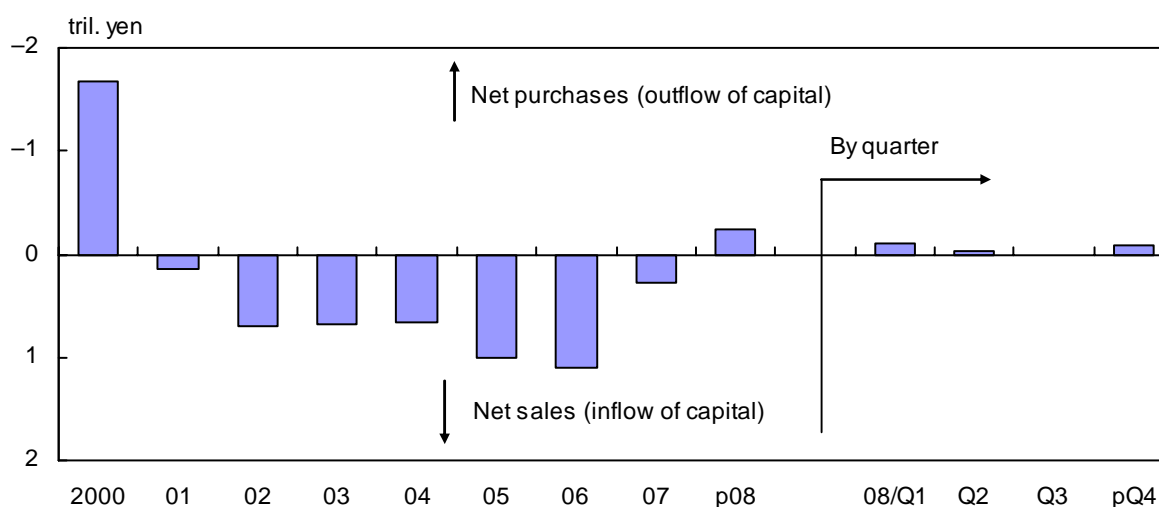
	2006	2007	p2008	IIP (end of 2007)
United States	-2,413.2	-372.4	-2,074.0	66,155.6
European Union	-3,677.2	-3,889.8	-1,520.7	84,884.3
Of which:				
United Kingdom	-1,721.0	-2,101.1	-1,731.4	12,222.6
Germany	-148.5	216.2	-901.9	17,925.1
Luxembourg	-187.4	-415.3	-278.8	9,250.9
France	-288.4	-95.3	986.9	13,495.7
Asia	-88.5	-579.0	-221.1	2,119.6
Central and South America	-340.9	-3,584.1	-119.7	38,946.2
Of which:				
Cayman Islands	-294.9	-3,235.3	639.2	35,614.0
Others	-1,205.7	-1,822.5	-3,335.5	27,324.8
Total	-7,725.5	-10,247.8	-7,271.0	219,430.5

Note: IIP stands for international investment position.

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

Net purchases (outflows) of money market instruments amounted to 0.2 trillion yen in 2008, a reversal from the net sales (inflows) of 0.3 trillion yen in 2007. The reversal reflects continued purchases not only by securities companies for sales to individuals, business enterprises, and institutional investors but also by banks, and decreased sales particularly by business enterprises and redemptions.

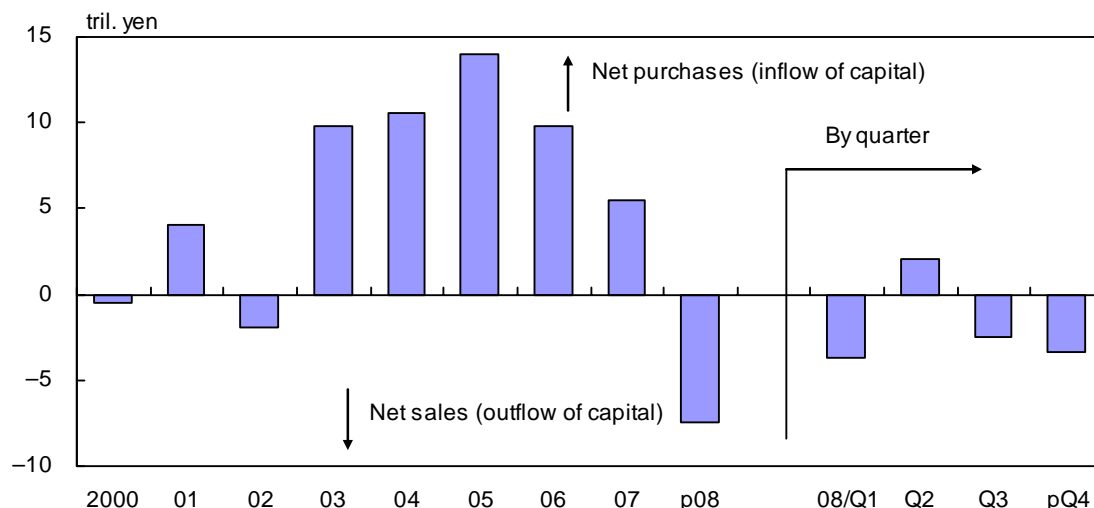
Figure 28: Outward Investment in Money Market Instruments



b. Inward portfolio investment (liabilities)
(1) Inward investment in equity securities (liabilities)

Inward investment in equity securities turned negative for the first time in six years in 2008, registering outflows of 7.5 trillion yen after inflows of 5.4 trillion yen in 2007. Net sales of Japanese equities reached a record high as business outlook for Japanese companies worsened reflecting the deterioration in world economic conditions and the appreciation of the yen.

Figure 29: Inward Investment in Equity Securities

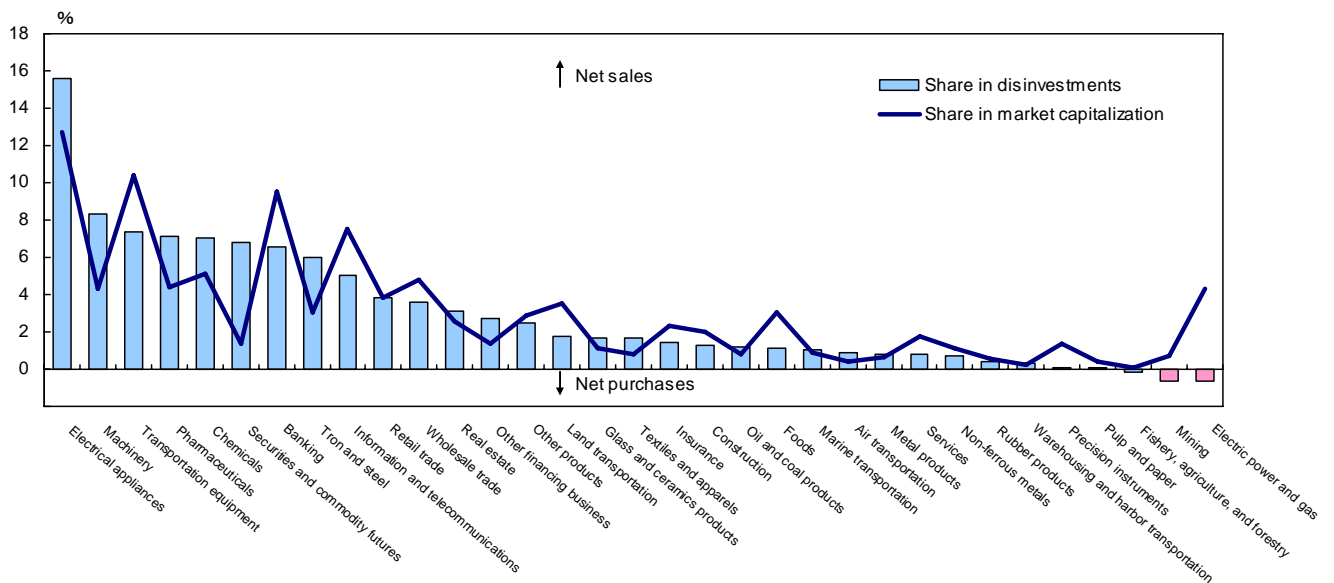


By industry, in the second quarter, equities of firms from the electrical appliances, transportation equipment, wholesale (trading companies), and banking industries were purchased due to expectations of a recovery of the U.S. economy.

From the third quarter, however, selling of equities of firms from the electrical appliances, machinery, and wholesale (trading companies) industries intensified.

Toward the end of the calendar year, selling extended to a wide range of industries as foreign investors were forced to close their positions.

Figure 30: Inward Investment in Equity Securities: Disinvestment by Industry (Share in Percent)



Note: The share in market capitalization is calculated using the average for the year of the end-of-month market capitalization of each industry on the First Section of the Tokyo Stock Exchange. The share in disinvestments is calculated using the amount of net purchases and sales by foreign investors. Net purchases are shown in pink.

Figure 31: TOPIX (U.S. Dollar Basis)



Source: Bloomberg.

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

Inward investment in bonds and notes turned negative for the first time in five years in 2008, with outflows registering a record high of 4.4 trillion yen after registering net inflows of 10.5 trillion yen in 2007.

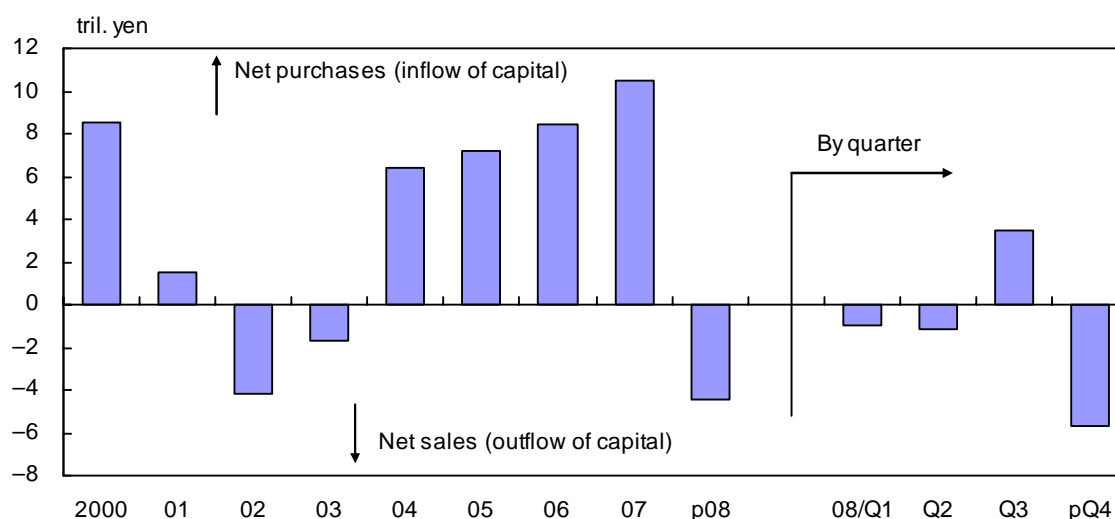
Major developments during 2008 shaping inward investment in bonds and notes can be summarized as follows.

During the first quarter, when the market was facing growing instability due to the collapse of a U.S. securities company, foreign investors closed their long-term Japanese government bond (JGB) asset swap positions.

In the second quarter, foreign investors mainly sold medium-term JGBs, while in the third quarter, against the background of the deterioration in world economic conditions, they actively established new long positions in medium-term JGBs and positions in which cash bond purchases of long-term JGBs are combined with shorting of overvalued JGB futures.

In the fourth quarter, when yen funding conditions for foreign investors tightened, they were forced to close these asset swap positions as well as their positions in inflation-indexed bonds and floating rate bonds.

Figure 32: Inward Investment in Bonds and Notes



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

Net purchases (inflows) decreased to 1.5 trillion yen in 2008, down from 9.0 trillion yen in 2007. Foreign public entities were major active buyers in the second quarter, but became sellers toward the end of the calendar year.

Figure 33: Inward Investment in Money Market Instruments

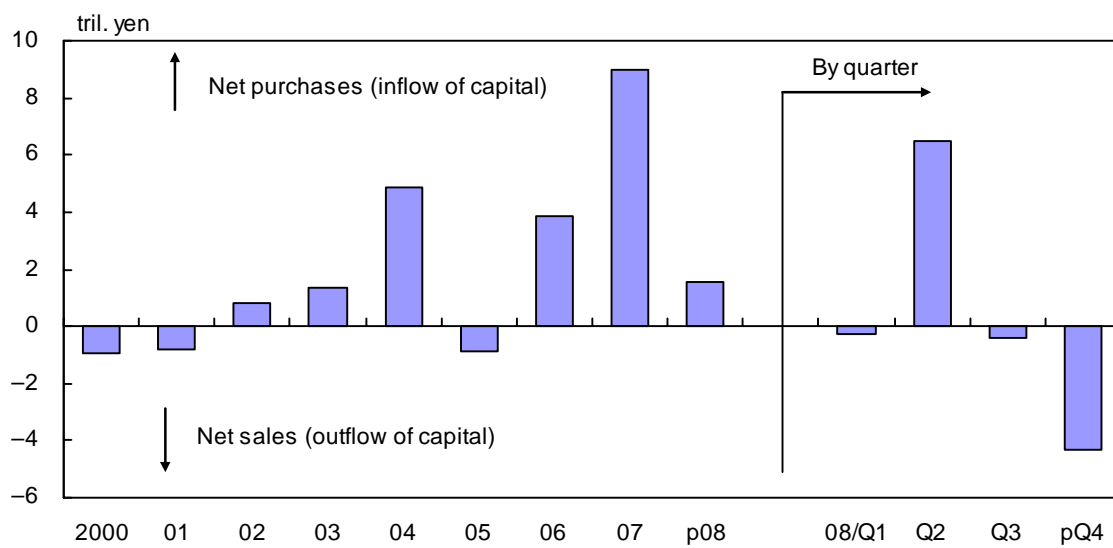
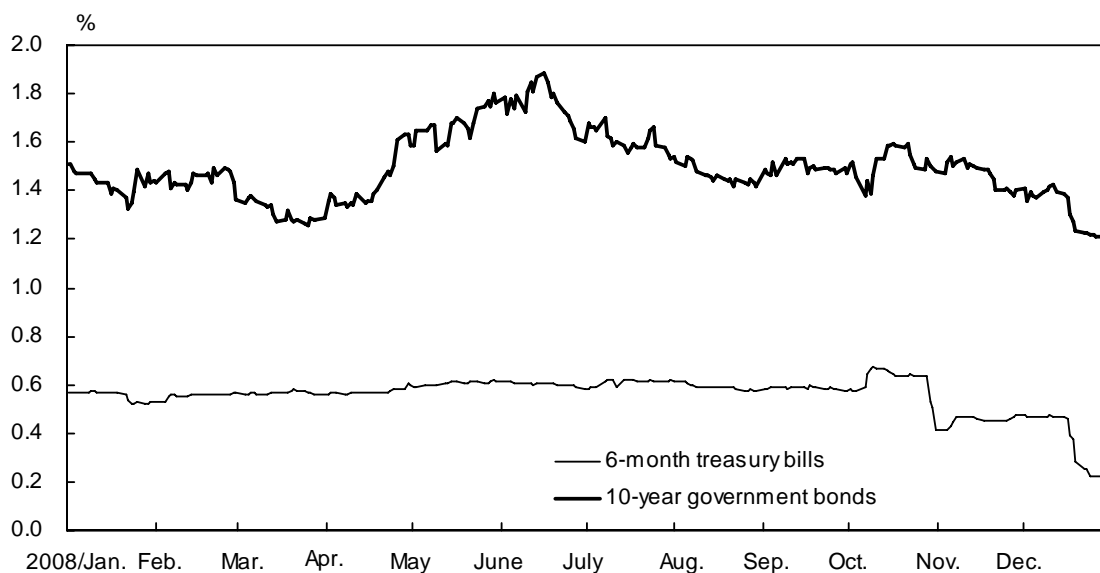


Figure 34: Principal Interest Rates in Japan

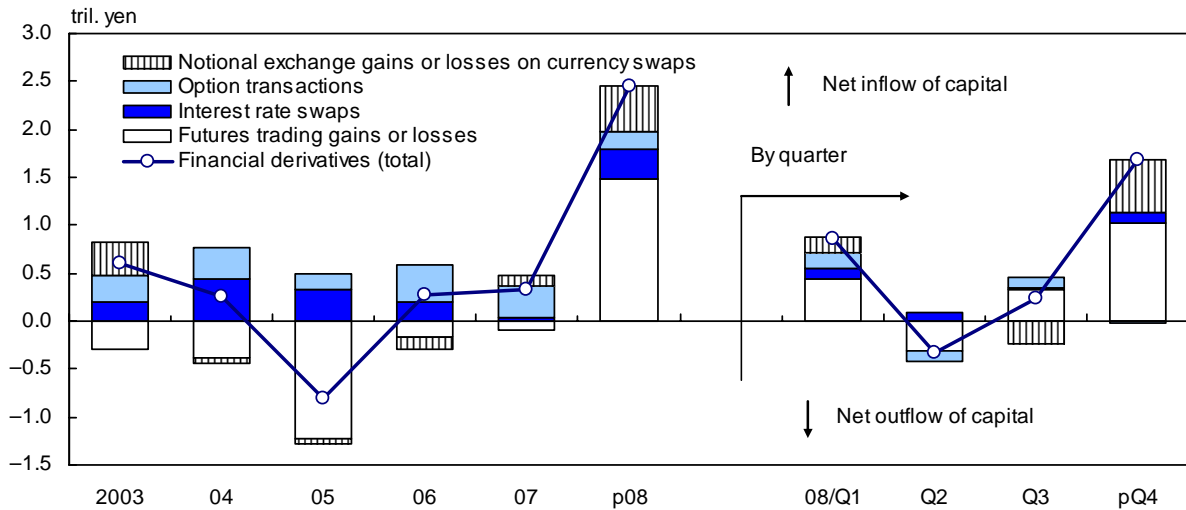


Source: Bloomberg.

3. Financial derivatives

Financial derivatives transactions accounted for a net inflow of 2.5 trillion yen in 2008, significantly up from 0.3 trillion yen in 2007. Foreign investors with long positions in Japanese stock index futures paid trading losses to domestic securities companies, reflecting the sharp fall in Japan's equity prices after the summer. Net inflows of foreign exchange gains on currency swaps also increased reflecting the appreciation of the yen.

Figure 35: Financial Derivatives

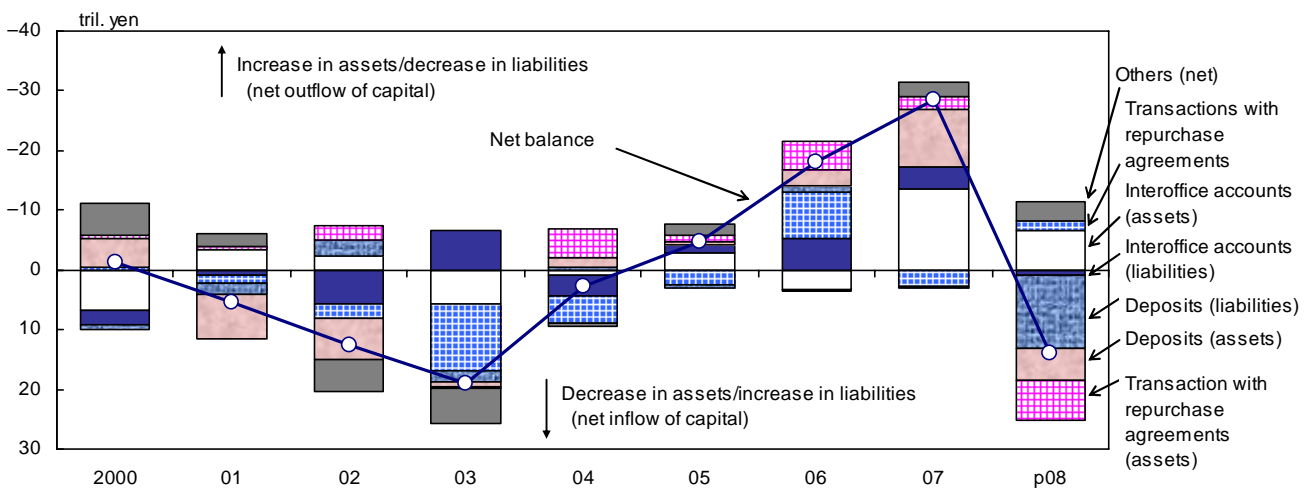


Note: "Financial derivatives (total)" includes transactions other than those listed and therefore does not equal the sum of the individual categories of financial derivatives.

4. Other investment (excluding securities lending)

Other investment registered a net inflow of 14.0 trillion yen in 2008, a reversal from the net outflow of 28.4 trillion yen in 2007. This represents the first net inflow in four years.

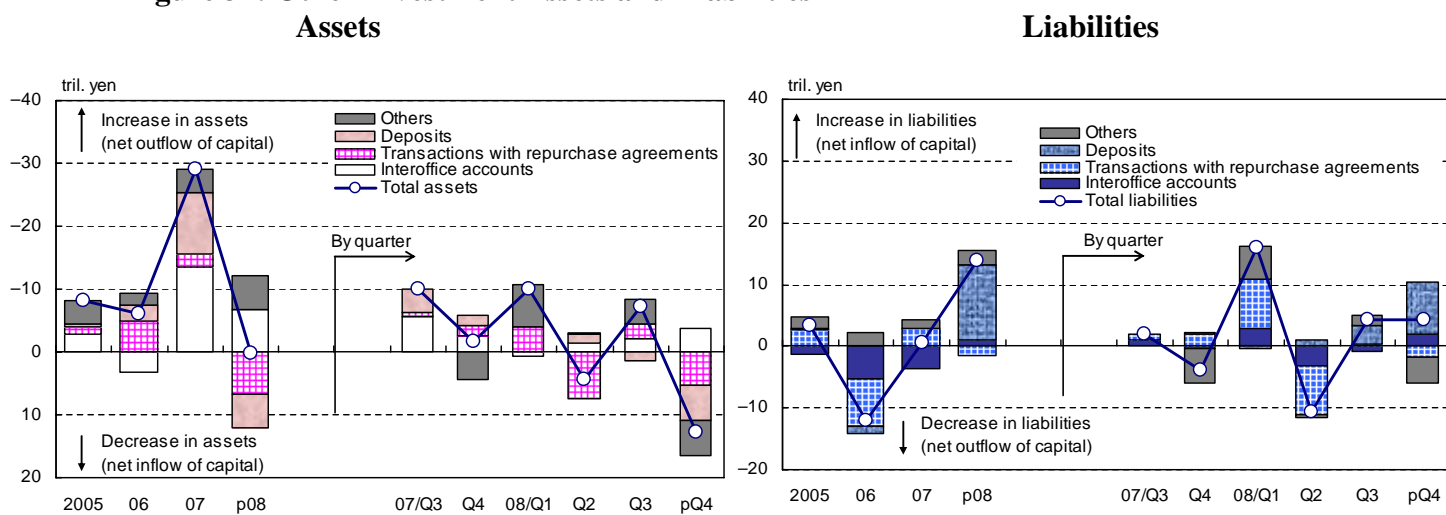
Figure 36: Other Investment



On the asset side, as uncertainty in global financial markets increased, banks withdrew their funds invested in foreign interbank markets (recorded as an inflow of "deposits" on the asset side). Foreign investors actively repaid the funds that they had raised for investments in JGBs (recorded as "transaction with repurchase agreements" on the asset side). On the other hand, interoffice accounts continued to register a net outflow.

On the liability side, deposits increased significantly due to the execution of currency swap transactions between the Bank of Japan and the Federal Reserve Bank of New York aimed at raising dollar funds for the Bank of Japan's U.S. dollar funds-supplying operations.¹⁴

Figure 37: Other Investment Assets and Liabilities



¹⁴ For details, see Box 5, "Cross-Border Flows of Funds in 2008."

Box 1. Features of Merchanting in 2008

"Merchanting" in the balance of payments is defined as the purchase of goods by a resident from a nonresident and the subsequent resale of the goods to another nonresident; during the process, the goods do not enter or leave Japan. The difference between the value of goods when acquired (payments) and the value when sold (receipts) is recorded as merchanting under "other services" in the balance of payments.

Focusing on merchanting in 2008, the value of goods purchased and sold as well as the surplus in the merchanting balance all increased. This stands in contrast with the decrease in the surplus of trade in goods.

The increased volume of merchanting reflects the further development of the overseas production and sales networks of Japanese companies whereby goods produced in overseas production units are purchased by head offices located in Japan for reselling to consuming countries.

Table for Box 1: Transactions in Merchanting

tril. yen, %

	2006	2007	Change from the previous year	p2008	Change from the previous year
Merchanting (net)	1.4	1.6	+0.2	1.8	+0.1
Receipts	21.9	25.4	+3.5	26.6	+1.2
Payments	20.5	23.8	+3.3	24.8	+1.0

Note: Figures are calculated by summing up the value of purchases and sales of goods related to "merchanting and other trade-related services," under "other services," excluding trade-related fees.

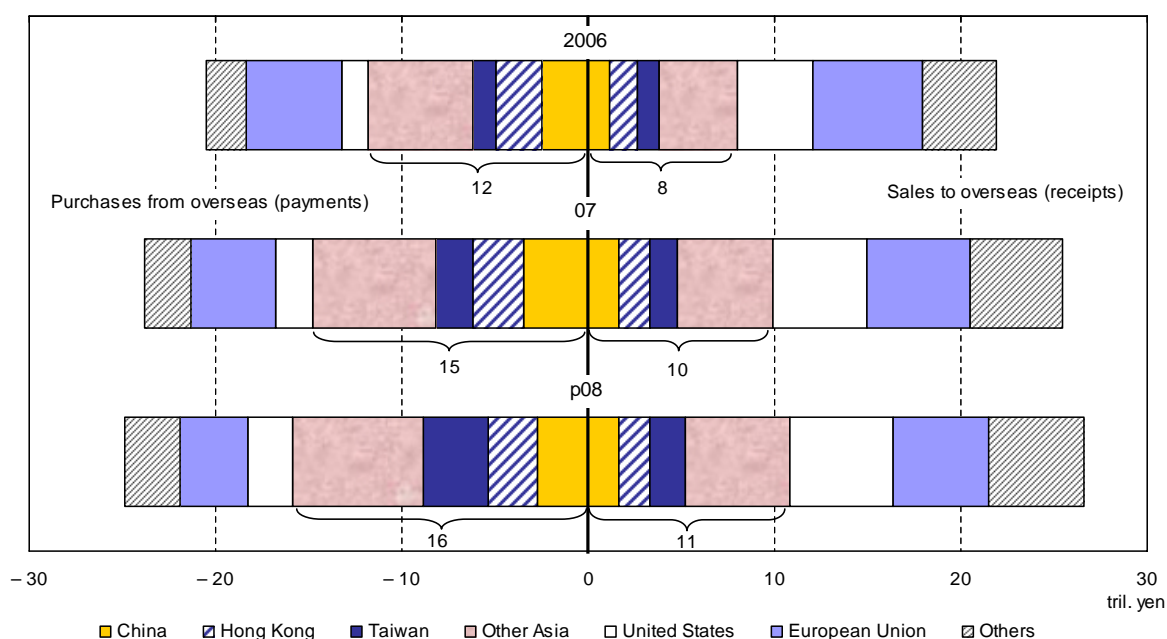
Breakdown by region¹⁵

By region, payments to Taiwan increased significantly in 2008. This indicates the growing position of Taiwan as a supplier of materials and producer of goods for Japanese companies. Japanese electric machinery companies are actively outsourcing the production of their brand products, such as digital home appliances (personal computers, game consoles, and flat-panel televisions) and electronic parts, to Taiwanese companies to reduce production costs and increase production. This increase in outsourced production can be regarded as one of the factors contributing to increased payments to Taiwan.

Turning to merchanting sales by destination country, the share of Asian countries, including Taiwan and China, is increasing, which implies that Japanese companies are expanding their cross-border production and sales in Asia.

¹⁵ Figures for 2008 by region are estimated by the International Department of the Bank of Japan based on the actual figures for January through September 2008.

Figure for Box 1: Developments in Merchenting by Region



Treatment of Merchenting in the *Balance of Payments and International Investment Position Manual, Sixth Edition (BPM6)*¹⁶

An examination of merchenting transactions makes it possible to obtain a more comprehensive picture of the overseas economic activities of Japanese firms with regard to the overseas production and sales of goods that do not appear in the trade balance.

In the BPM6, which was published by the IMF in December 2008, the treatment of merchenting was revised from the previous manual (BPM5). According to the BPM5, the difference between sales and purchases of goods for merchenting was recorded under trade in services. However, according to the BPM6, in which the "change of ownership principle" is more strictly applied than in the BPM5, the difference is treated as "net exports of goods under merchenting,"¹⁷ a subcomponent of trade in "goods." This revision is based on the notion that it is more appropriate to regard the activities of manufacturers in the context of the construction of international operation networks as trade in "goods" rather than the provision of merchenting "services."

¹⁶ For details about the IMF's BPM6, see Box 6, "Revision of the IMF's *Balance of Payments Manual*."

¹⁷ In the IMF's *Balance of Payments Manual, Fifth Edition* (issued in 1993), merchenting was considered to be an exception to the "change of ownership principle." The net balance of merchenting was recorded in the balance of services.

Box 2. Features of the Income from Outward Direct Investment¹⁸ by Region in 2008

Focusing on direct investment income by region,¹⁹ income received from the European Union decreased in 2008 due to the deterioration in the financial and economic environment in Europe. Income received from North America and Asia also decreased in the fourth quarter due to the economic deterioration in these regions.

Figure 1 for Box 2: Direct Investment Income Receipts (By Region)

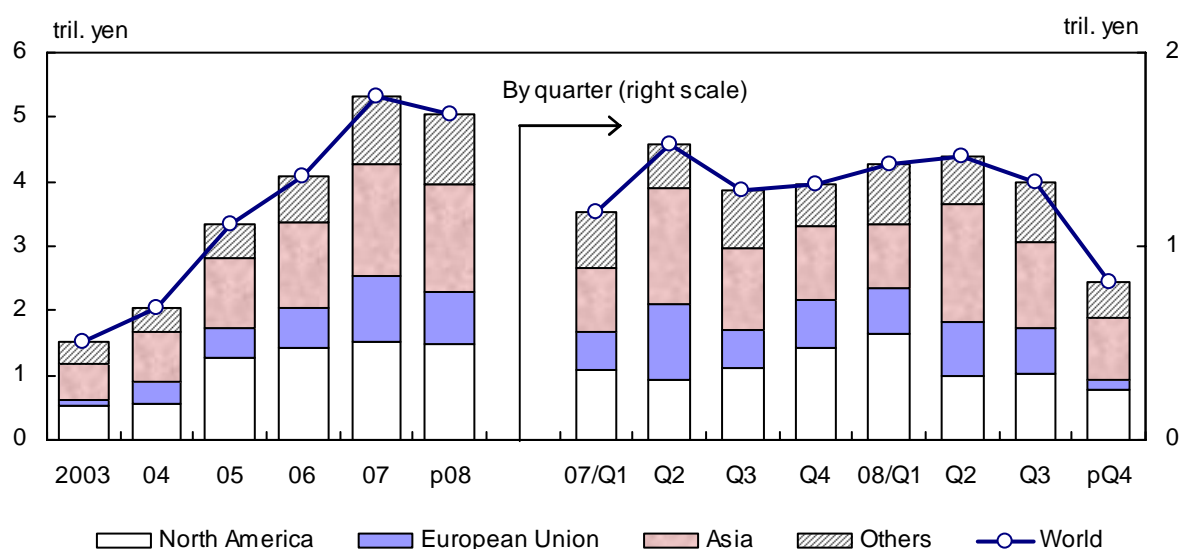


Table 1 for Box 2: Annual Figures for Direct Investment Income Receipts (By Region)

bil. yen

	2007	p2008	Change from the previous year	Fourth quarter (change from the same quarter of the previous year)
Direct Investment Income Receipts (Total)	5,309.3	5,026.1	-283.2	-509.7
Of which:				
European Union	1,035.3	802.5	-232.8	-193.6
North America	1,513.4	1,482.0	-31.4	-210.1
Asia	1,719.5	1,685.3	-34.2	-72.3

¹⁸ Direct investment income includes dividend receipts from subsidiaries, interest receipts/payments derived from loan contracts between parent companies and their subsidiaries, and reinvested earnings. Reinvested earnings are direct investors' shares of earnings that subsidiaries do not distribute as dividends but accumulate as internal reserves. In the balance of payments, reinvested earnings are recorded under the income account in the current account, and an offsetting entry with opposite sign is made under direct investment in the capital and financial account. This is based on the assumption that the internal reserves are to be paid out to direct investors as dividends and reinvested in subsidiaries by them.

¹⁹ Figures for 2008 by region are estimated by the International Department of the Bank of Japan based on the actual figures for January through September 2008.

Direct investment income from subsidiaries in the European Union

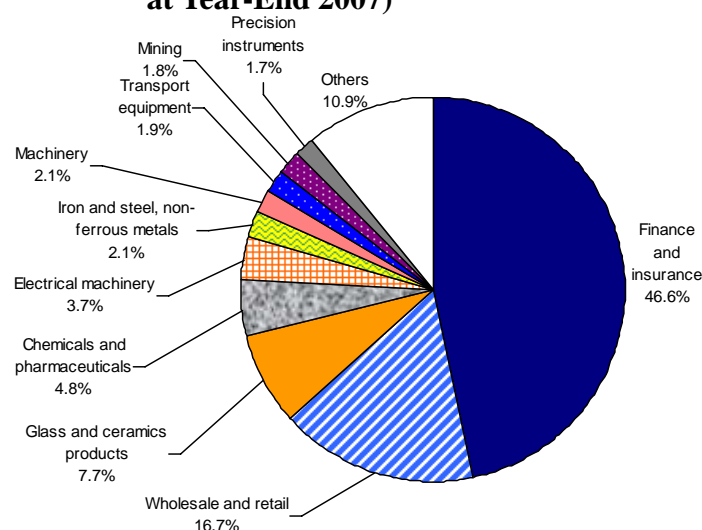
Direct investment income from subsidiaries in the European Union decreased sharply. This reflected the decrease in receipts from financial and insurance subsidiaries due to the turmoil in global financial markets and the deterioration in corporate earnings. Furthermore, the decrease from the previous year was substantial, as large income receipts were recorded in 2007 reflecting the extraordinary profit due to a sale of natural resources-related subsidiaries. Receipts from electrical machinery and transport equipment subsidiaries also decreased due to the deterioration in the European economy.

By country, direct investment income from the United Kingdom, where the finance and insurance sector accounts for almost fifty percent of Japan's direct investment, seems to have decreased substantially.

Table 2 for Box 2:
Direct Investment Income Receipts from Subsidiaries in the European Union (By Country)

	bil. yen		
	2007	p2008	Change from the previous year
European Union	1,035.3	802.5	-232.8
Of which:			
Netherlands	325.5	361.8	+36.3
Belgium	138.1	129.0	-9.1
Germany	63.7	97.3	+33.6
Sweden	83.5	73.3	-10.2
United Kingdom	355.1	50.9	-304.2
France	61.8	55.6	-6.2

Figure 2 for Box 2:
Amount Outstanding of Direct Investment in the United Kingdom (By Industry, at Year-End 2007)

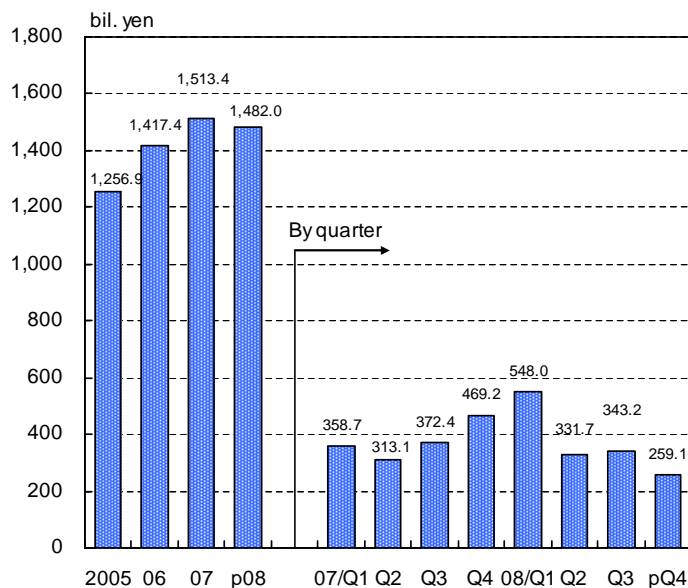


Notes: Japan's direct investment in the U.S. and European wholesale and retail sectors includes substantial amounts of direct investment in the sales subsidiaries of Japanese (transport equipment and electrical machinery) manufacturers.

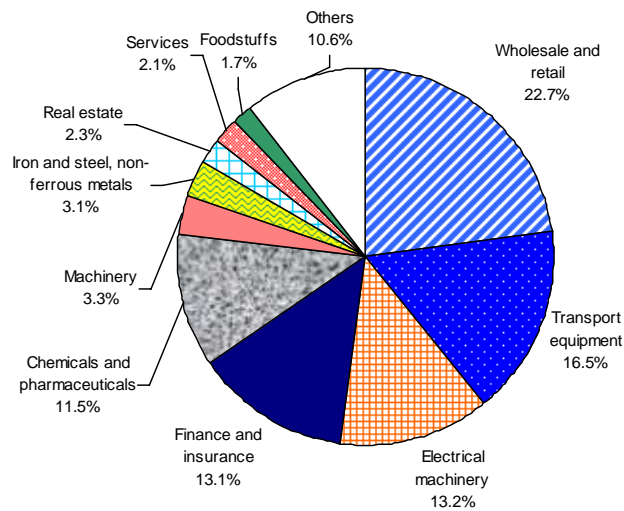
Direct investment income from subsidiaries in North America

Direct investment income from North America also seems to have decreased, especially in the fourth quarter, reflecting the deterioration in the real economy and financial markets. By industry, receipts from subsidiaries in the transport equipment and machinery sectors, and also in the wholesale and retail sectors, many firms in which are sales subsidiaries (mainly car dealerships), decreased due to the fall in sales of motor vehicles and machinery. Direct investment income receipts from financial and insurance companies decreased as well.

**Figure 3 for Box 2:
Direct Investment Income
Receipts from Subsidiaries in
North America**



**Figure 4 for Box 2:
Amount Outstanding of
Direct Investment in
North America (By Industry,
at Year-End 2007)**



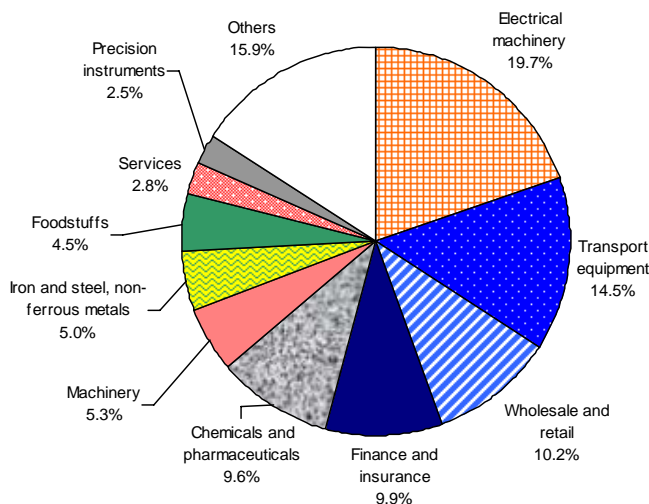
Direct investment income from subsidiaries in Asia

Direct investment income from many countries in Asia also decreased, with China being an exception. The decrease is due to a deterioration in corporate earnings particularly of subsidiaries that are highly dependent on foreign demand, such as those in the electrical machinery (semiconductor, electrical machinery, and electronic parts) and transport equipment sectors.

**Table 3 for Box 2:
Direct Investment Income
Receipts from Subsidiaries in
Asia (By Country)**

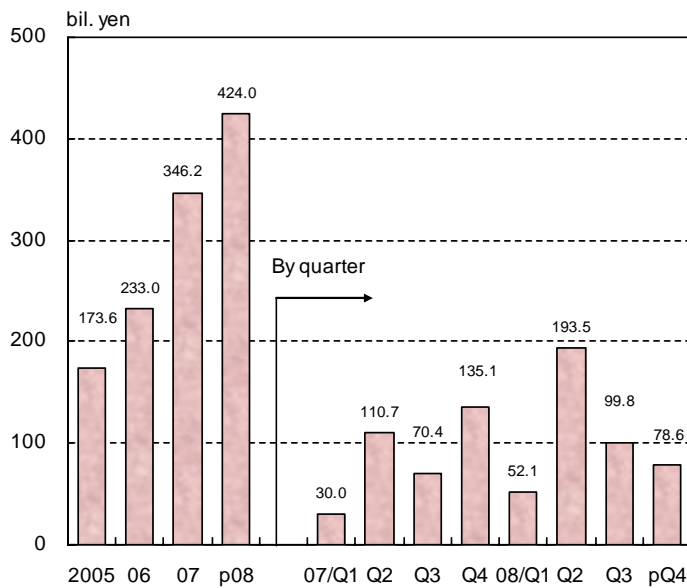
	bil. yen		
	2007	p2008	Change from the previous year
Asia	1,719.5	1,685.3	-34.2
Of which:			
China	346.2	424.0	+77.8
Thailand	317.4	296.6	-20.8
Singapore	285.7	222.3	-63.4
Hong Kong	181.8	161.4	-20.4
Korea	163.4	146.0	-17.4
Indonesia	126.8	94.2	-32.6

**Figure 5 for Box 2:
Amount Outstanding of
Direct Investment in Asia
(By Industry, at Year-End
2007)**

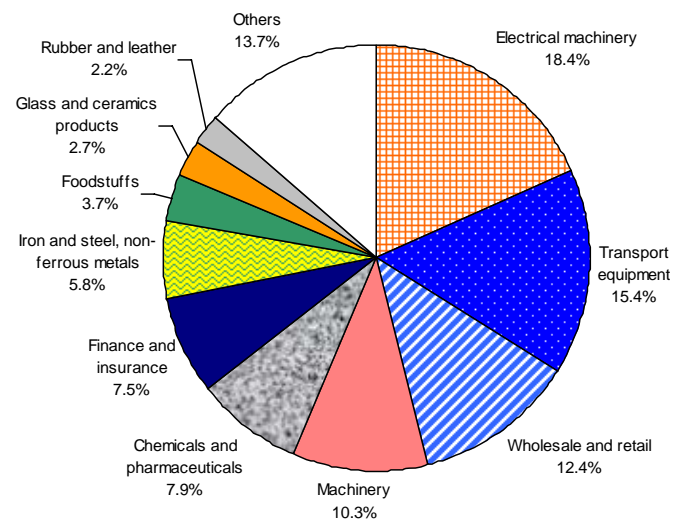


Direct investment income from China increased in 2008 overall. On a quarterly basis, direct investment income increased significantly in the second quarter, but its growth decelerated in the third quarter, and then it turned to decrease in the fourth quarter, mainly from the transport equipment and electrical machinery sectors with large amounts of investment stock.

**Figure 6 for Box 2:
Direct Investment Income
Receipts from Subsidiaries in China**



**Figure 7 for Box 2:
Amount Outstanding of
Direct Investment in China
(By Industry, at Year-End
2007)**



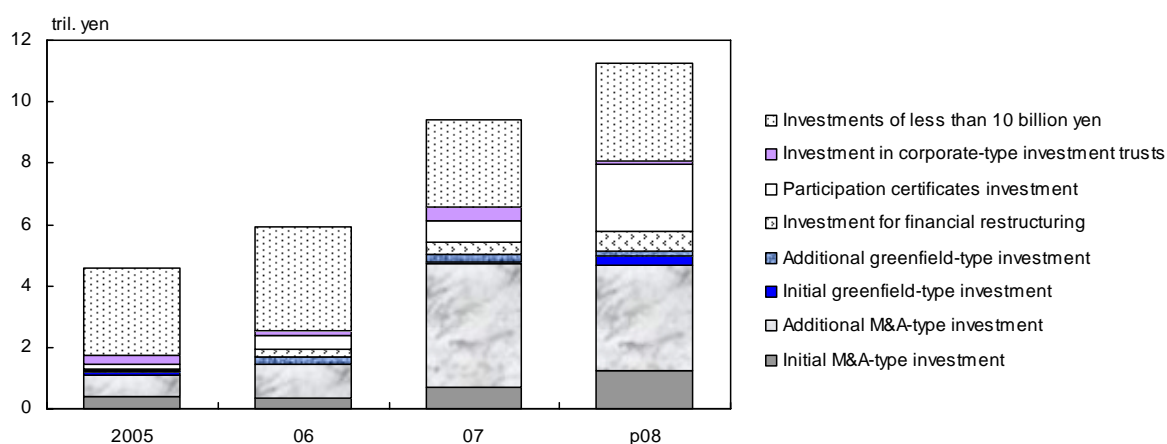
Box 3. Classification of Direct Investment by Type of Investment

One possible approach to classifying different types of direct investment 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 is used to repay debt can be defined as "investment for financial restructuring." Such a classification makes it possible to examine the impact on a host country's economy (e.g., job creation) by the type of investment.

Features of Outward Direct Investment in 2008

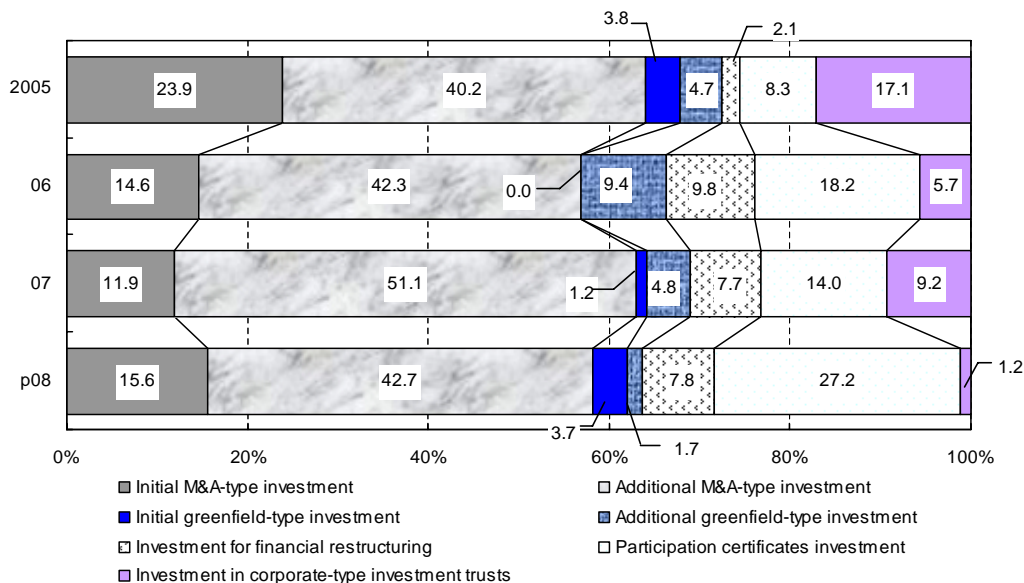
- (1) Large-scale investments increased compared to the previous year. The amount of outward direct investment reached a record high in 2008, and the share of initial investment increased for both "M&A-type" and "greenfield-type" investments. This reflects acquisitions made by a non-life insurance company and a pharmaceutical company, and investments made in the mining industry by trading companies.
- (2) As in the previous year, expansion of overseas business was the main motive for "additional M&A-type investments."
- (3) "Investment in corporate-type investment trusts" decreased due to the increasing uncertainty in financial markets. In contrast, purchases of participation certificates issued by overseas SPCs for the purpose of injecting capital into Japanese financial institutions increased.

Figure 1 for Box 3: Outward Direct Investment by Type of Investment (On a Transaction Value Basis)^{20,21}



²⁰ For details of the definitions of types of investment, see "Japan's Balance of Payments for 2005" released on August 18, 2006, on the Bank of Japan's web site (<http://www.boj.or.jp/en/index.htm>).

²¹ It should be noted that because the analysis in this Box focuses on investments of at least 10 billion yen in equity capital, results should be interpreted allowing for a margin error. Investments in corporate-type investment trusts and participation certificates are included in direct investment.

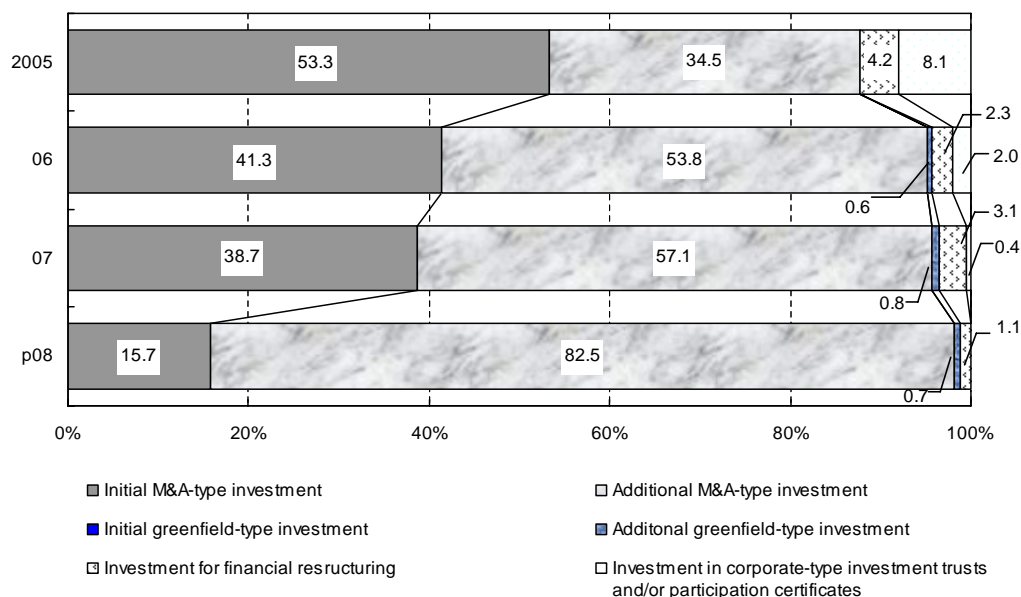


Note: Investments of 10 billion yen or more accounted for 37.9 percent (on a transaction value basis) of total outward direct investment in 2005, 42.5 percent in 2006, 52.5 percent in 2007, and 71.7 percent in 2008.

Features of Inward Direct Investment in 2008

While the share of initial investment decreased, the share of additional M&A-type investment increased. Additional M&A-type investment includes investment aimed at expanding business in Japan and investment aimed at injecting capital into subsidiaries.

Figure 2 for Box 3: Inward Direct Investment by Type of Investment (On a Transaction Value Basis)

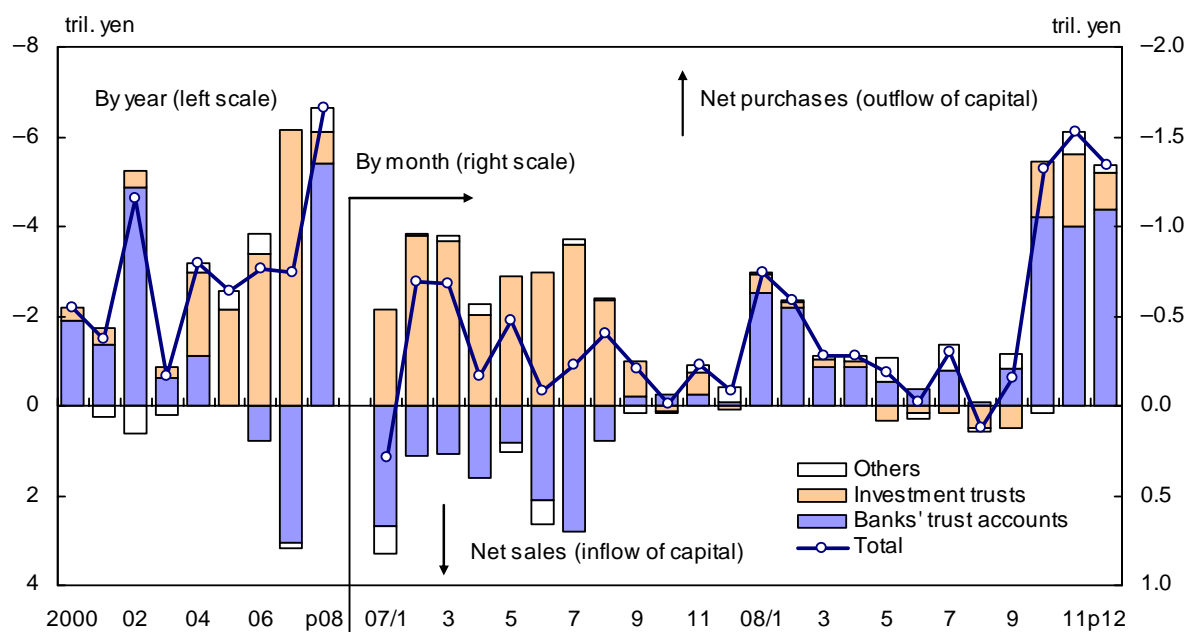


Note: Investments of 10 billion yen or more accounted for 39.0 percent (on a transaction value basis) of total inward direct investment in 2005, 57.1 percent in 2006, 68.0 percent in 2007, and 37.8 percent in 2008.

Box 4. Outward Investment in Equity Securities by Type of Investor in 2008

Outward investment in equity securities registered a record high in 2008. Looking at investments by type of investor, some changes from the previous year can be observed. Purchases (outflows) by investment trusts, which had accounted for the largest share for several years until 2007, decreased significantly. On the other hand, transactions through banks' trust accounts, which had been responsible for net sales of foreign equity securities in recent years, reversed and accounted for the largest share of outward investment in equity securities.

Figure 1 for Box 4: Outward Portfolio Investment in Equity Securities by Type of Investor



1. Investment Trusts

Investment in foreign equities by investment trusts had been high for several years, reflecting the keen preference of individual investors for investment trusts investing in foreign securities. Since summer 2007, however, when the subprime mortgage problem triggered turmoil in the financial markets, purchases of foreign equities by investment trusts have dropped significantly. When foreign equity prices fell and the yen appreciated further against most major currencies in 2008, individual investors became more risk averse and investment trusts in mid-2008 consequently became net sellers of foreign equities. As a result, the amount of foreign equity purchases by investment trusts dropped to the lowest level in five years.

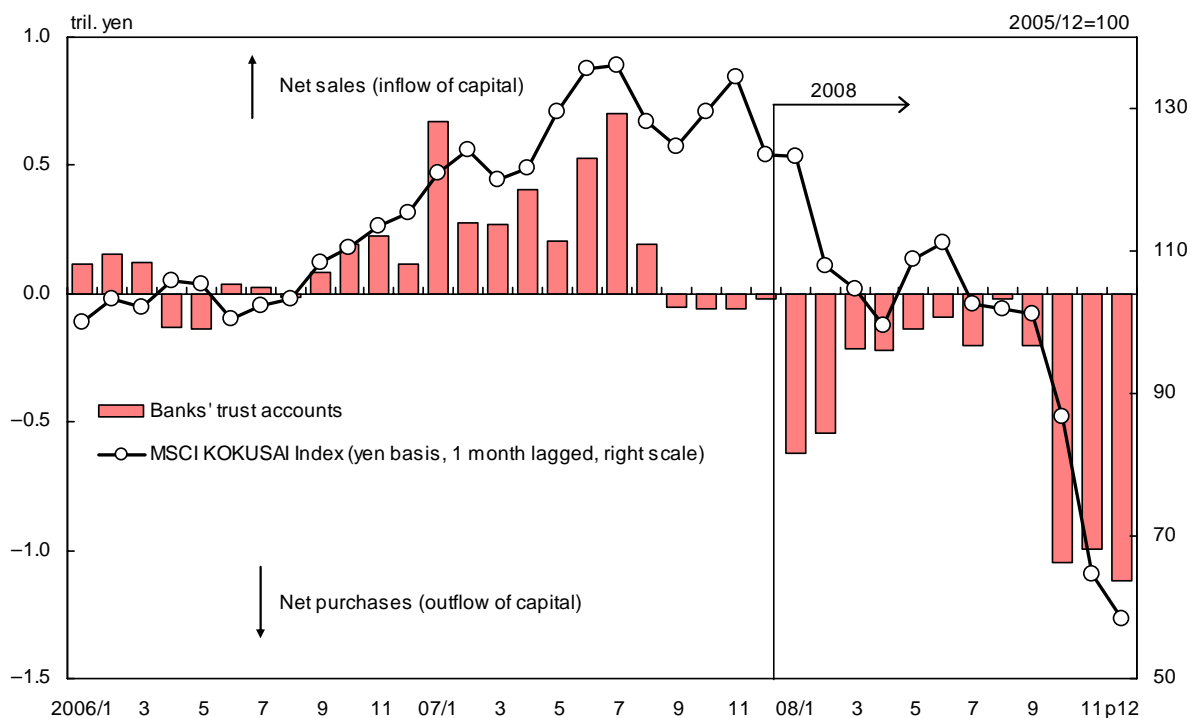
In the fourth quarter, investment trusts became net buyers again. However, these purchases reflect the rebalancing transactions of balanced investment funds and balanced variable annuities that invest in foreign equities through investment trusts. Individual investors' cautious investment stance, on the other hand, remained unchanged.

2. Banks' Trust Accounts

Pension funds are one of the largest institutional investors in foreign equities. Looking at their investments as reflected in the figures for banks' trust accounts reveals that, in 2007, they sold foreign equities on a large scale for rebalancing purposes reflecting the yen's depreciation and the rise in foreign equity prices during the first half of the year. However, in 2008, pension funds turned from net sellers into net buyers reflecting the fall in foreign equity prices and the appreciation of the yen, and as a consequence, net purchases through banks' trust accounts registered a record high of 5.4 trillion yen.

One of the most commonly used benchmarks to measure the performance of outward investment in equities by pension funds is the MSCI KOKUSAI Index. Comparing the amount of outward investment in equities through banks' trust accounts and the movement in the index suggests that, beginning in 2008, as the performance of foreign equities deteriorated and their weight in pension funds' portfolios declined, there were large-scale purchases of foreign equities for rebalancing purposes. Purchases were particularly large from October onward, when the turmoil in global financial markets led to a fall in foreign equity prices and a rapid appreciation of the yen.

Figure 2 for Box 4: Outward Portfolio Investment in Equity Securities through Banks' Trust Accounts and the Performance of Foreign Equities

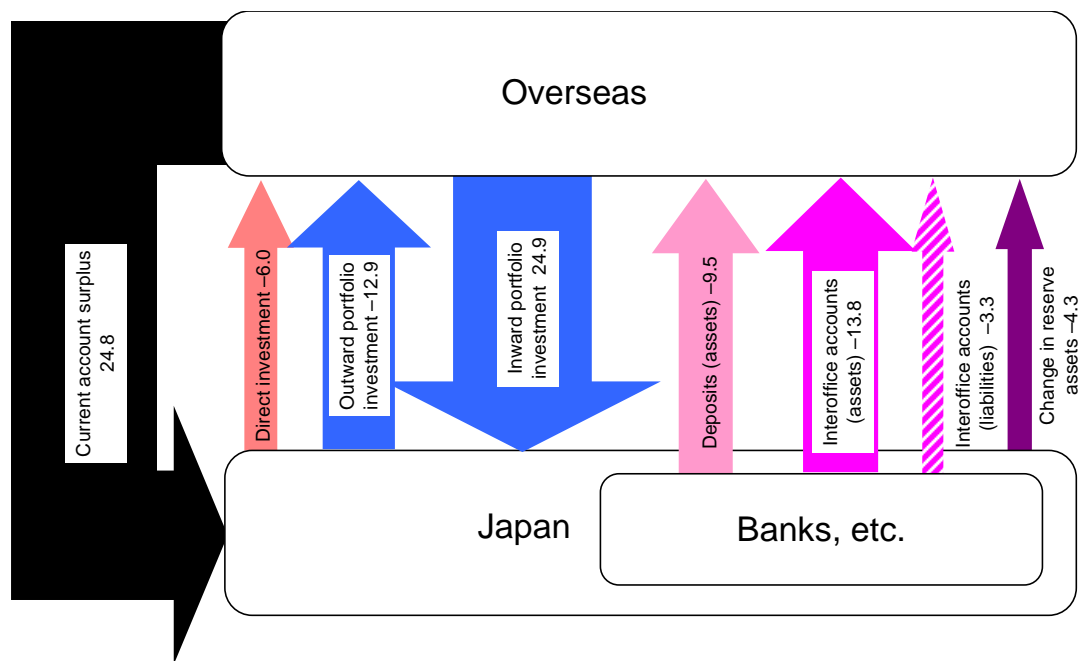


Box 5. Cross-Border Flows of Funds in 2008

The balance of payments is an ex-post identity in which the inflow (outflow) of funds through the current account surplus (deficit) is offset by outflows (inflows) in the capital and financial account and changes in reserve assets (Current account + capital and financial account + changes in reserve assets + errors and omissions = 0). A characteristic of Japan's balance of payments is that the current account surplus is mirrored by reverse flows abroad in the form of a capital and financial account deficit (outflows).

Looking at the developments in the main components of the balance of payments shows that, in 2007, Japan recorded an inflow of funds through its current account surplus and inward portfolio investment. These funds were then channeled overseas through outward portfolio investment, direct investment, other investment, and changes in reserve assets.

Figure 1 for Box 5: Cross-Border Flows of Funds in 2007



Notes: 1. Unit: trillion yen.

2. The direction of the arrows indicates the net flow of funds (inflow/outflow). The striped arrow indicates a net reduction in liabilities.

During the first eight months of 2008, this pattern in the flows of funds, with inflows through the current account surplus and outflows through the capital and financial account, remained largely unchanged. Until the summer, the inflow of funds through the current account surplus was mirrored by reverse outflows mainly through outward portfolio investment and direct investment.

However, from September to December, foreign investors sold Japanese securities in large quantities (outflow), while domestic financial institutions closed their reverse repurchase agreements and deposit positions (inflow). At the same time, there was an inflow of funds through U.S. dollar-yen swap transactions between the Federal Reserve Bank of New York (FRBNY) and the Bank of Japan (BOJ) that funded the Bank of Japan's U.S. dollar funds-supplying operations as well as an outflow of funds through banks' interoffice accounts.

Figure 2 for Box 5: Cross-Border Flows of Funds during Jan.-Aug. 2008

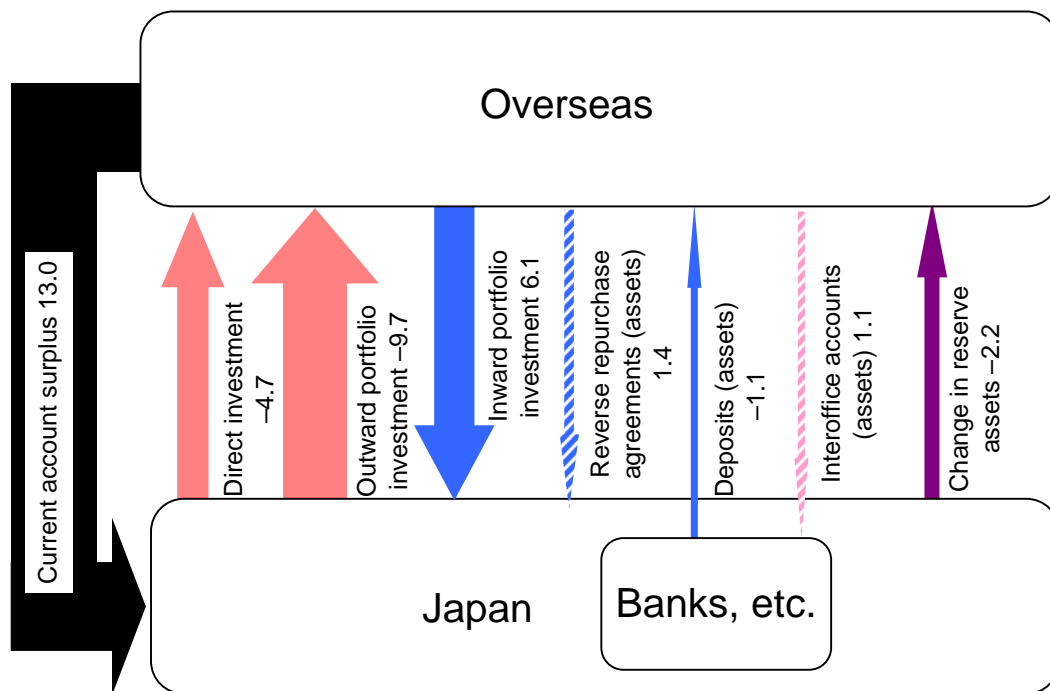
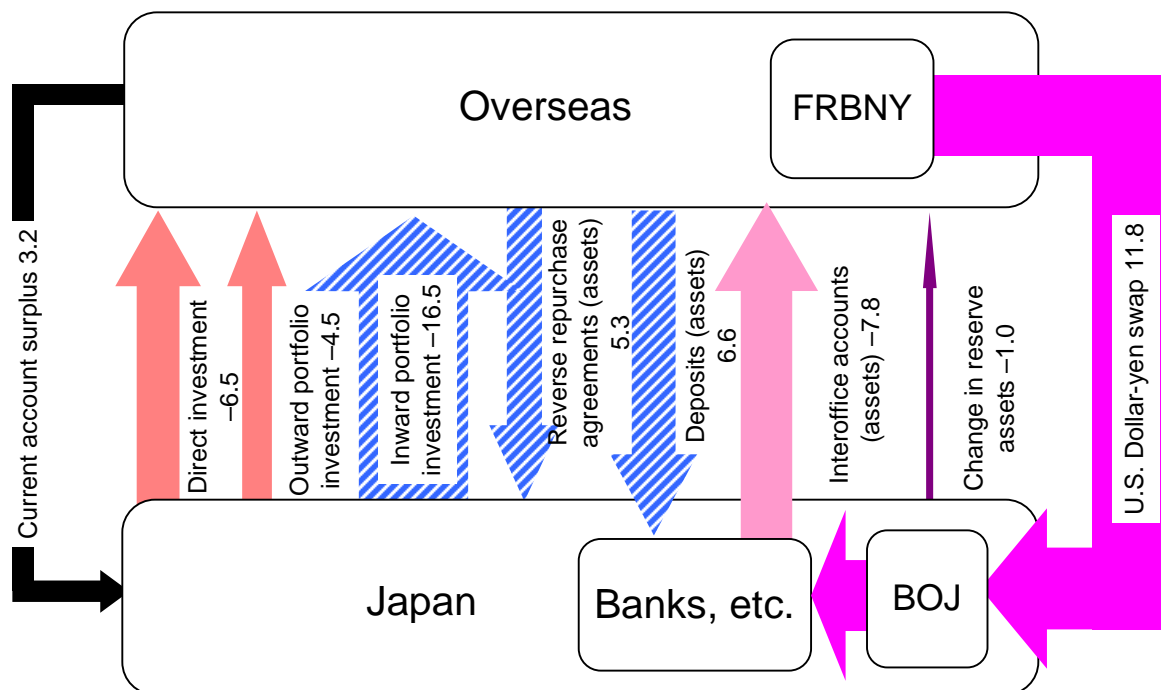


Figure 3 for Box 5: Cross-Border Flows of Funds during Sep.-Dec. 2008



Notes: 1. Unit: trillion yen.

2. The direction of the arrows indicates net cash flows (inflow/outflow). Striped arrows indicate net reductions in assets/liabilities.

Box 6. Revision of the IMF's *Balance of Payments Manual*

Japan's balance of payments (BOP) statistics are compiled based on the IMF's *Balance of Payments Manual*. The IMF had been working on updating the manual and released the new manual, the *Balance of Payments and International Investment Position Manual, Sixth Edition* (BPM6), in late December 2008. National compilers of the BOP statistics will take steps in order to bring their statistics into line with the new manual.

The following is a brief outline of issues related to the BPM6, consisting of a description of (1) the IMF's *Balance of Payments Manual*, (2) features of the BPM6, and (3) tasks related to the revision of the BOP statistics in line with the new manual.

(1) The IMF's *Balance of Payments Manual*

The IMF's *Balance of Payments Manual* is an international guideline for the compilation of the BOP statistics, which includes definitions, classifications, and accounting principles. Each IMF member country compiles its BOP statistics in accordance with this manual.²²

Currently, the BOP statistics of major countries including Japan are based on the fifth edition published by the IMF in 1993. Japan's BOP statistics for 1996 and after are based on the fifth edition.

Table for Box 6: Revisions of the IMF's *Balance of Payments Manual*

	1 st edition	2 nd edition	3 rd edition	4 th edition	5 th edition	6 th edition
Year of publication	1948	1950	1961	1977	1993	2008

The latest revision of the *Balance of Payments Manual* (i.e., the update from the BPM5 to the BPM6²³) had been under continuing discussion by the IMF Committee on Balance of Payments Statistics, of which Japan is a member, since 2000, and the BPM6 was adopted by the Committee in November 2008 and released in late December. Against this background, the IMF and national compilers have begun to work on the revision of the BOP statistics in accordance with the BPM6.

(2) Features of the BPM6

The update of the manual was conducted in order to reflect changes in the economic and financial environment since the previous manual was released. Key features of the revision include the following points.

²² The IMF obliges member countries to compile and report their balance of payment statistics to the IMF as stipulated under Article VIII (General Obligations of Members) of the Articles of Agreement of the International Monetary Fund.

²³ The full text is available on the IMF's web site (<http://www.imf.org/external/pubs/ft/bop/2007/bopman6.htm>).

a. Increasing emphasis on position data

The BPM6 shifts the emphasis of the structure of the accounts from focusing on flow data to a more comprehensive structure that also includes position data. Along with this, it also aims to enhance the preparation and analytical usefulness of data in order to increase, for example, the international comparability of data on external financial assets and liabilities. Reflecting this basic idea, the title of the manual was changed from the *Balance of Payments Manual* to the *Balance of Payments and International Investment Position Manual*.

b. Harmonizing the concepts with those in the System of National Accounts (SNA)²⁴

The concepts of the BPM6, such as sectoral classifications, the structure of the accounts, and recording rules are harmonized with those in the SNA, and the BOP statistics based on the BPM6 can be more easily compared or aggregated with other datasets.

c. Taking into account globalization and economic developments

In order to reflect advances in globalization and to gain a more accurate grasp of economic developments, some recording rules have been changed and new items have been introduced.

Examples are the extension of the coverage of financial services and R&D services as well as modifications to the treatment of telecommunication, computer, and information services.

(3) Tasks related to the revision of the BOP statistics

The IMF is now preparing a "compilation guide" to help member countries compile the BOP statistics based on the new manual. The Bank of Japan is actively taking part in the international initiatives including those to establish the "compilation guide." The Bank is also making preparations for the revision of the BOP statistics in Japan in accordance with the BPM6.

The Bank is planning to undertake, in close cooperation with concerned government agencies such as the Ministry of Finance, various steps in this direction, beginning with an examination of what revisions are necessary to compile the BOP statistics in accordance with the BPM6. Moreover, to promote a better understanding of the revision of the statistics and to reflect the various needs of statistics users, the revision process will involve consultations with reporting parties and statistics users.

²⁴ The SNA is an accounting system for recording a nation's economic activity and was created by the United Nations (UN) Statistical Commission. Japan's GDP and other data are currently based on the 1993 SNA adopted by the UN Statistical Commission in 1993. Most recently, a revised version of the 1993 SNA (2008 SNA) was adopted in 2009.