

# Overview of Methodologies by Item

## 1 Current Account

The current account shows transactions in goods and services, payments/receipts of income, and current transfers. It is broadly divided into the following four categories: "goods," "services," "primary income," and "secondary income," the first two of which are collectively referred to as "goods and services." Each category is further broken down into detailed items according to the type of transaction.

### 1.A Goods and Services

This category shows transactions in items that are the outcome of production activities and is divided into "goods" and "services."

#### 1.A.a Goods

This item shows transactions in goods, that is, exports and imports of goods. It is divided into "general merchandise on a balance of payments basis," "net exports of goods under merchanting (credit)," and "nonmonetary gold."

##### 1.A.a.1 General merchandise on a balance of payments basis

This item covers goods whose economic ownership changes between a resident and a nonresident and that are included in neither "net exports of goods under merchanting (credit)" nor "nonmonetary gold."<sup>1</sup>

The main data source for this item is the *Trade Statistics of Japan* (the *Trade Statistics*). However, the definitions of exports and imports of goods differ between the *Trade Statistics* and the *Balance of Payments (BOP)*. Therefore, data are compiled adjusting the valuation, coverage, and time of recording as shown in Table 1.

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<sup>1</sup> Some transactions in goods are recorded as "services" under items such as "travel." For details, see each item under "services."

**Table 1: Differences in Definitions and Adjustment Factors**

	<i>Trade Statistics</i>	General merchandise on a balance of payments basis in the <i>BOP</i>	Adjustments
Valuation	Exports: FOB <sup>1</sup> Imports: CIF <sup>2</sup>	Both exports and imports: FOB	Insurance premiums and freight charges are deducted from imports.
Coverage	Goods that have crossed Japan's customs frontier regardless of changes in ownership	Goods whose ownership has changed between residents and nonresidents	Certain additions and deductions are made to/from exports and imports in the <i>Trade Statistics</i> depending on changes in ownership. <sup>3</sup>
Time of recording	Exports: When the ship or aircraft carrying the goods leaves the port Imports: When import of the goods is permitted	Both exports and imports: When ownership changes	

Notes: 1. Stands for "free on board." The price of goods at the frontier of the exporting country is recorded. Excludes insurance premiums and freight charges incurred after the goods have been loaded on board.

2. Stands for "cost, insurance, and freight." Includes insurance premiums and freight charges in addition to the price of goods.

3. Examples of goods included in "general merchandise on a balance of payments basis" in the *BOP* but excluded from the *Trade Statistics* are (1) payments/receipts due to price adjustments and (2) goods for resale through transactions between resident merchants.<sup>2</sup>

### **1.A.a.2 Net exports of goods under merchanting (credit)**

This item shows the value of transactions in goods under merchanting.

In the balance of payments (BOP) statistics, merchanting is defined as the purchase of goods by a resident from a nonresident combined with the subsequent resale of the same goods to another nonresident without the goods crossing the border.

The purchase of goods by a resident from a nonresident is recorded as a negative export, while the subsequent resale to another nonresident is recorded as a positive export. Merchanting entries are valued at transaction prices as agreed by the parties, unlike general merchandise entries which are valued on an FOB basis.

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<sup>2</sup> In cases where a resident purchases goods from a nonresident and resells them to another resident and this resident resells the goods to another nonresident, without them ever passing Japanese customs in the course of the trade, the first and the last transaction involving a nonresident are recorded as imports and exports, respectively.

### **1.A.a.3 Nonmonetary gold**

This item covers transactions in gold bullion other than monetary gold.<sup>3</sup> It covers not only physical deliveries of gold bullion but also deliveries through allocated accounts (accounts in which the stored metals are identifiable by number, brand, weight, etc.) held at overseas banks or other institutions.

### **1.A.b Services**

This item shows service transactions and is divided into "transport," "travel," and "other services."

#### **1.A.b.1 Transport**

This item covers passenger and freight services as well as services auxiliary to transport. The charter of vessels or aircraft with crew is also included.

"Transport" contains the sub-items "sea transport" and "air transport," classified according to the mode of transport, each of which is further divided according to the nature of the service into "passenger," "freight," and "other."

#### **(Passenger)**

This item covers all services provided in the international transport of nonresidents by resident carriers (credit) -- such as vessels and aircraft -- and of residents by nonresident carriers (debit). It includes fares and charges for items purchased on board carriers.

#### **(Freight)**

This item covers transport related to the export/import of goods and the transport of goods between foreign countries. Freight costs for exports/imports are recorded under the principle that all freight costs beyond the customs frontier of the exporting country are incurred by the importer.<sup>4</sup> Therefore, for Japan's imports, transport services provided by nonresident transport providers beyond the customs frontier of the exporting countries are recorded as debit, while for Japan's exports, transport services provided by resident transport providers beyond Japan's customs frontier are recorded as credit.

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<sup>3</sup> Monetary gold is gold held by monetary authorities as a reserve asset.

<sup>4</sup> The same principle applies for insurance services for exported/imported goods.

## **(Other)**

This item covers service transactions that are auxiliary to transport and includes, for example, cargo handling charges, storage and warehousing charges, towing charges, and agents' fees.

### **1.A.b.2 Travel**

This item covers goods and services for own use or to give away acquired from a country by nonresidents (that is, travelers) during visits to that country. It includes, for example, accommodation, food, recreation, local transport, and souvenirs.<sup>5</sup>

"Travel" is broadly classified into "business" and "personal," the latter of which is further divided into "education-related" and "other."

#### **1.A.b.2.1 Business**

This item covers goods and services acquired for non-business purposes by persons whose primary purpose of travel is for business. (Business transactions are recorded elsewhere under the relevant category.) Included among such travelers are (1) carrier crews stopping off or laying over, (2) government employees on official travel, (3) employees traveling on behalf of their employer, and (4) self-employed persons traveling for business purposes.

#### **1.A.b.2.2 Personal**

This item covers goods and services acquired by persons whose purpose of travel is other than business, such as persons going abroad for vacation or to participate in recreational and cultural activities, as well as students and patients.<sup>6</sup>

#### **1.A.b.3 Other services**

"Other services" is a category added in Japan's BOP statistics and includes all service transactions other than "transport" and "travel."

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<sup>5</sup> While the international fares are recorded under "transport," the sum of figures for "travel" and passenger transport are disseminated as "tourism-related services in travel and passenger transport."

<sup>6</sup> In the BOP statistics, students and patients are treated as residents of their country of origin, regardless of the length of their stay. The tuition and other expenditures of students, as well as the medical and hospital expenditures of patients, are recorded under "travel."

While the main data source for this category is the reports on payments and receipts, a large portion of this category consists of small-value transactions under the reporting threshold. Therefore, data for such small-value transactions are supplemented through estimation.

#### **1.A.b.3.1 Manufacturing services on physical inputs owned by others**

This item covers the fees charged by a processor when the owner of the goods commissions the processor to process or assemble the goods. Examples of processes include oil refining, liquefaction of natural gas, and assembly of clothing and electronics.

#### **1.A.b.3.2 Maintenance and repair services n.i.e.**

This item covers maintenance and repair work by residents on goods that are owned by nonresidents (and vice versa). Examples include repairs and maintenance of movable property such as vessels and aircraft as well as after-sales services incurred by the seller under the sales contract, such as repairs and maintenance during the warranty period.

#### **1.A.b.3.3 Construction**

This item covers construction and installation work abroad undertaken by residents and such work undertaken by nonresidents in Japan. Also included are (1) expenditures for materials acquired from the location of the construction work or third countries; (2) payments for construction work to subcontractors; and (3) operating costs incurred at the local construction site, including payrolls, electricity and heating bills, and costs of consumable supplies. For example, when a resident undertakes construction work abroad, payments such as for materials, payrolls, and equipment incurred at the local construction site are recorded as debits and receipts from the client as payment for the construction work are recorded as credits.

#### **1.A.b.3.4 Insurance and pension services**

This item covers services of providing various types of insurance and pensions as well as auxiliary services to insurance and pension schemes.

In overview, charges for insurance services correspond to the margin between the premiums payable by policyholders to insurance companies and the claims payable by insurance companies to policyholders. However, since the amount of payments/receipts of claims tends to fluctuate considerably, insurance services in Japan's BOP statistics

are estimated by multiplying gross premiums by the ratio of service charges to premiums.

In the BOP statistics, net premiums after subtracting insurance service charges, as well as claims are recorded depending on the insurance category. For nonlife insurance, transactions between policyholders and insurance companies are deemed as transfers, because the right to pursue claims corresponding to the premiums is contingent; therefore, net premiums and claims are recorded under "other current transfers" under "financial corporations, nonfinancial corporations, households, and NPISHs<sup>7</sup>" under "secondary income." By contrast, for life insurance, net premiums and claims are treated as financial assets managed by the insurance companies for policyholders; therefore, they are recorded under "insurance and pension reserves" under "other investment" in the "financial account."

#### **1.A.b.3.5 Financial services**

This item covers financial intermediary and auxiliary services. Examples are (1) fees related to banking activities such as the opening of letters of credit, the setting up of lines of credit, guarantees, and foreign exchange transactions; and (2) fees related to transactions in securities or financial derivatives and for asset management. Also included are late or early repayment fees or penalties.

In addition, fees indirectly charged as margins on interest rates on loans and deposits as well as on transactions in financial instruments are recorded as financial services. The fees are recorded as follows.

##### **(a) Financial intermediation services indirectly measured (FISIM)**

While banks and other financial corporations provide intermediation services through their lending and deposit operations, fees for such services are usually indirectly charged as part of the margins in interest rates on loans and deposits.

In Japan' BOP statistics, FISIM are estimated for loans from "deposit-taking corporations, except the central bank" to nonresidents and deposits by nonfinancial corporations, etc. at nonresident financial corporations.

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<sup>7</sup> NPISHs stands for nonprofit institutions serving households.

## **(b) Financial dealers' margins**

Service charges for transactions in financial instruments include explicit charges as well as implicit charges through the spread between buying and selling prices (referred to as "financial dealers' margins" hereafter).

In Japan's BOP statistics, financial dealers' margins are estimated by multiplying the turnover in debt securities by the relevant average spread. Consequently, transaction prices excluding financial dealers' margins are recorded under "portfolio investment" in the "financial account."

### **1.A.b.3.6 Charges for the use of intellectual property n.i.e.**

This item covers (1) charges for the use of proprietary rights arising from research and development as well as from marketing, (2) charges for licenses to reproduce or distribute copyrighted works, and (3) charges for screening and broadcasting rights. In Japan's BOP statistics, this item is further divided into "charges for the use of industrial property n.i.e." and "charges for the use of copyrights n.i.e."

#### **1.A.b.3.6.1 Charges for the use of industrial property n.i.e.**

This item covers (1) charges for the use of industrial property rights such as patents, utility model rights, design rights, and trademarks; (2) charges for the use of know-how or technical information; (3) various expenses related to franchising; and (4) payments/receipts for grants of distribution rights. Also included are technical assistance or management fees related to such rights.

#### **1.A.b.3.6.2 Charges for the use of copyrights n.i.e.**

This item covers (1) charges for licenses to reproduce or distribute computer software, music, video recordings, etc.; (2) charges for the use of copyrighted works such as literature, art, music, video, and characters; (3) charges for screening and broadcasting rights; (4) charges for the distribution right to films; and (5) charges for the right to release films on video.

### **1.A.b.3.7 Telecommunications, computer, and information services**

This item covers services related to information technology. It is further broken down into "telecommunications services," "computer services," and "information services."

#### **1.A.b.3.7.1 Telecommunications services**

This item covers charges for using communication devices such as telephones, telex, satellites, and the Internet. Charges for Internet backbone services are also included.

#### **1.A.b.3.7.2 Computer services**

This item covers (1) computerized data-processing services, (2) the development of customized software such as operating systems and applications, (3) web page design and development, (4) hardware consultancy and maintenance and repairs, and (5) hardware and software installation.

#### **1.A.b.3.7.3 Information services**

This item covers the provision of news by the media and online services that provide content other than audio, video, and computer software. Also included are database services, search engine services, and library and archive services.

#### **1.A.b.3.8 Other business services**

This item covers various services for businesses that are not included in the above services categories. It is further broken down into "research and development services," "professional and management consulting services," and "technical, trade-related, and other business services."

##### **1.A.b.3.8.1 Research and development services**

This item covers services that are associated with research and development such as basic research, applied research, and the development of new products. Also included are outright sales of the industrial property rights obtained as a result of research and development (such as represented in patents, utility model rights, and design rights).

##### **1.A.b.3.8.2 Professional and management consulting services**

This item covers legal services, accounting and management consulting services, public relations services, and advertising and market research services.

##### **1.A.b.3.8.3 Technical, trade-related, and other business services**

This item covers (1) architectural, engineering, and other technical services; (2) agricultural and mining services; (3) operating leasing services; (4) trade-related services; and (5) other professional business services.



### **1.A.b.3.9 Personal, cultural, and recreational services**

This item covers services for individuals as well as services related to cultural and recreational activities. It is further broken down into "audiovisual and related services" and "other personal, cultural, and recreational services."

#### **1.A.b.3.9.1 Audiovisual and related services**

This item covers services related to the production of motion pictures, radio and television programs, and musical recordings. Also included are services related to theatrical and musical productions, sporting events, circuses, and other similar events, such as expenditures on venues and advertising as well as compensation for performers, directors, and producers involved in such events.

#### **1.A.b.3.9.2 Other personal, cultural, and recreational services**

This item covers (1) services related to education, such as correspondence courses and education via television or the Internet; (2) services associated with museums and other cultural activities; and (3) expenditures related to sporting competitions such as rewards, prizes, and fees for athletes.

### **1.A.b.3.10 Government goods and services n.i.e.**

This item covers the expenditures of embassies, consulates, and military bases<sup>8</sup> as well as service transactions of governments or international organizations that are not included in other categories. This includes, for example, the overseas support activities by the Japan Self-Defense Forces.

## **1.B Primary Income**

This category shows income associated with the production process and income on assets. It is broken down into "compensation of employees," "investment income," and "other primary income."

### **1.B.1 Compensation of employees**

This item covers remuneration in return for the labor input provided by an individual in an employer-employee relationship with the enterprise. If such a relationship does not

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<sup>8</sup> All goods and services, except for those related to construction, purchased by embassies, consulates, and military bases are recorded under this item. This includes not only official expenditures but also the personal expenditures of staff and their dependents.

exist, payment of remuneration is treated as a service provided by a self-employed individual.

Major examples of "compensation of employees" in Japan's BOP statistics are (1) compensation paid by Japanese embassies or consulates overseas to local staff and compensation received by residents from foreign embassies or consulates in Japan, and (2) compensation paid to nonresident crew members working on vessels or aircraft operated by residents and compensation received by resident crew members working on vessels or aircraft operated by nonresidents.

## **1.B.2 Investment income**

This item covers dividends, interest, etc., which is the return for the provision of financial assets. It is broken down into income on "direct investment," "portfolio investment," and "other investment."

### **1.B.2.1 Direct investment**

This item covers income on direct investment assets/liabilities. For the definition of direct investment, see "direct investment" in the "financial account."

It is divided into "income on equity and investment fund shares" and "interest" depending on the form of direct investment from which the income accrues. The former is further broken down into "dividends and withdrawals from income of quasi-corporations" and "reinvested earnings."

#### **1.B.2.1.1 Income on equity and investment fund shares**

##### **1.B.2.1.1.1 Dividends and withdrawals from income of quasi-corporations**

This item covers the dividends paid out of earnings<sup>9</sup> that are distributed to the direct investor (DI) from the direct investment enterprise (DIE) as well as branch profits remitted to the head office.

##### **1.B.2.1.1.2 Reinvested earnings**

In the BOP statistics, reinvested earnings are the DIEs' shares of earnings that are not distributed as dividends to investors but accumulated as retained earnings. Such shares

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<sup>9</sup> Other dividends such as liquidating dividends and those made out of capital are treated as withdrawals of equity and recorded under "equity other than reinvestment of earnings" under "direct investment" in the "financial account."

are recorded under this item as if they were distributed as dividends, and the same amount is recorded under "reinvestment of earnings" under "direct investment" in the "financial account," as if this amount was reinvested in the DIE.

#### **1.B.2.1.2 Interest**

This item covers interest payments on loans and debt securities between the DI and the DIE, including indirectly held enterprises, and between fellow enterprises.

#### **1.B.2.2 Portfolio investment**

This item covers dividends and interest on debt securities that do not fall under "direct investment" under "investment income."

It comprises (1) "investment income on equity and investment fund shares," which is further broken down into "dividends on equity excluding investment fund shares" and "investment income attributable to investment fund shareholders"; and (2) "interest," which is further broken down into interest on "long-term" and "short-term" debt securities. This breakdown corresponds to that under "portfolio investment" in the "financial account."

##### **1.B.2.2.1 Investment income on equity and investment fund shares**

###### **1.B.2.2.1.1 Dividends on equity excluding investment fund shares**

This item covers dividends on equity securities made out of earnings that do not fall under "direct investment" under "investment income."

###### **1.B.2.2.1.2 Investment income attributable to investment fund shareholders**

This item covers the distribution of income by investment trusts (both corporate- and contract-type) that does not fall under "direct investment" under "investment income."

###### **1.B.2.2.2 Interest**

This item covers interest on debt securities that does not fall under "direct investment" under "investment income" and is divided into interest on "long-term" or "short-term" debt securities. For discounted debt securities, the amount of interest accrual is estimated because there is no actual cash flow during the period in which the interest accrual should be recorded. A corresponding entry is made under "portfolio investment" in the "financial account."

### **1.B.2.3 Other investment**

This item covers all investment income that does not fall under "direct investment" or "portfolio investment" under "investment income."

It comprises "withdrawals from income of quasi-corporations" and "interest." In Japan's BOP statistics, "interest" is further divided into "interest on trade credit and advances," "interest on loans," "interest on deposit," and "other interest." This breakdown corresponds to that under "other investment" in the "financial account."

#### **1.B.2.3.1 Withdrawals from income of quasi-corporations**

This item covers the distributed income on investments in equity in quasi-corporations such as partnerships and other institutions.

#### **1.B.2.3.2 Interest**

##### **1.B.2.3.2.1 Interest on trade credit and advances**

This item covers interest on trade credit.

##### **1.B.2.3.2.2 Interest on loans**

This item covers interest on "loans" that does not fall under "direct investment" under "investment income." It also includes the part of lease payments in financial leases that corresponds to interest payments.

##### **1.B.2.3.2.3 Interest on deposit**

This item covers interest on deposits.

##### **1.B.2.3.2.4 Other interest**

This item covers all investment income that is not included in the above investment income categories. It also includes fees on securities lending.

### **1.B.3 Other primary income**

This item covers rent for natural resources (such as charges for the use of mining rights) and taxes and subsidies on products and production (including taxes levied based on aspects such as the volume and price of oil, natural gas, etc. that is extracted). Refunds of such taxes are also included.

**Table 2: Treatment of Taxes**

		Levied on nonresidents by the Japanese government	Levied on residents by foreign governments
Current taxes on income, etc.	"Secondary income"	"General government"	"Financial corporations, nonfinancial corporations, households, and NPISHs"
Taxes on capital transfers such as inheritance taxes and gift taxes	"Capital transfers" under the "capital account"		
Taxes on products and production	"Other primary income" under "primary income"		

## 1.C Secondary Income

This category shows the redistribution of income through current transfers. Transfers are transactions that differ from exchanges in that they involve a provision of an economic value (that is, goods, services, financial assets, or nonproduced nonfinancial assets) by one party without the receipt of a corresponding item of economic value. The BOP statistics apply the double-entry system, so when something of economic value is provided without a corresponding return of an item of economic value, the corresponding entry is made as a transfer.<sup>10</sup>

"Secondary income" is divided into current transfers to/from "general government" and those to/from "financial corporations, nonfinancial corporations, households, and NPISHs" depending on the sector of the residents involved.

### 1.C.1 General government

This item covers current transfers involving the Japanese government, including the central government, local governments, and social security funds. In Japan' BOP statistics, this item contains the sub-items "grant aid" and "contributions to international organizations."

Also included are receipts of social contributions and payments of social benefits under social insurance schemes, receipts of current taxes on nonresidents' income, etc. levied by the Japanese government, and payments for the refund of such taxes.

<sup>10</sup> Transfers are classified as "current transfers" or "capital transfers" depending on the nature and use of the items provided. See 2.A below for more details on "capital transfers."

### **1.C.2 Financial corporations, nonfinancial corporations, households, and NPISHs**

This item is divided into "personal transfers (current transfers between resident and nonresident households)" and "other current transfers."

"Personal transfers" cover, for example, workers' remittances in cases where persons employed in a host country and treated as residents send remittances of earnings gained in that country to family members in their country of origin.

"Other current transfers" cover (1) gifts and compensation for damage other than those between persons; (2) unofficial disaster relief; (3) payments of salaries by a head office to employees of overseas branches; (4) payments/receipts of nonlife insurance premiums/claims; and (5) regular contributions to charities and religious, scientific or cultural institutions. Payments of current taxes on residents' income, etc. levied by foreign governments and receipts for the refund of such taxes are also included.

## **2 Capital Account**

The capital account shows "capital transfers" and "gross acquisitions (DR.)/disposals (CR.) of nonproduced nonfinancial assets."

### **2.A Capital Transfers**

This item covers transfers (1) in which the ownership of an asset (other than cash or inventories) changes; (2) which oblige one or both parties to acquire or dispose of an asset (other than cash or inventories), such as investment grants; or (3) where a liability is forgiven by the creditor.

"Capital transfers" are divided into those to/from "general government" and those to/from "financial corporations, nonfinancial corporations, households, and NPISHs" depending on the sector of the residents involved.

#### **2.A.1 General government**

This item covers capital transfers involving the Japanese government. It is broken down according to the nature of the transaction into "debt forgiveness" and "other capital transfers." In Japan's BOP statistics, "grant aid" is separated from "other capital transfers" and is provided as another item.

Debt forgiveness is the voluntary cancellation of all or part of a debt obligation within a contractual agreement between a creditor and a debtor. Specifically, when a resident cancels a loan to a nonresident, the decrease in the asset is recorded under the relevant items in the "financial account" and the same amount is recorded as a debit under "debt forgiveness."

"Grant aid" covers funding to support facility improvements in developing countries.

"Other capital transfers" cover (1) taxes on capital transfers such as inheritance taxes and gift taxes, and (2) contributions to the funds of international organizations that engage in lending activities.

## **2.A.2 Financial corporations, nonfinancial corporations, households, and NPISHs**

This item is divided into "debt forgiveness" and "other capital transfers."

The definitions and treatment of "debt forgiveness" are the same as those for the corresponding item under "general government."

"Other capital transfers" include investment grants by the private sector, transfers of assets involving inheritances or testamentary gifts, and payments of inheritance taxes and gift taxes to foreign governments.

## **2.B Gross Acquisitions (DR.)/Disposals (CR.) of Nonproduced Nonfinancial Assets**

This item covers transactions in (1) natural resources such as mineral rights and land; (2) contracts, leases, and licenses that are recognized as economic assets such as emissions permits and transfer fees; and (3) marketing assets such as trademarks.

For transactions involving mineral rights and trademarks, only the outright sales of rights are included in this item.

## **3 Financial Account**

The financial account shows transactions involving external financial assets and liabilities. It is broken down into the following functional categories: "direct investment," "portfolio investment," "financial derivatives (other than reserves)," "other investment," and "reserve assets." These categories are built on the classification of

financial instruments, with an additional dimension that takes into account aspects such as the relationship between the parties. Each category consists of "assets" (that is, claims on nonresidents) and "liabilities" (that is, obligations to nonresidents). "Reserve assets" by their nature consist only of "assets."

For "portfolio investment," "financial derivatives (other than reserves)," and "other investment," figures are classified in terms of the following institutional sectors that residents (creditors in the case of assets and debtors in the case of liabilities) belong to: "central bank," "deposit-taking corporations, except the central bank," "general government," and "other sectors." "Other sectors" is further broken down into "other financial corporations" and "nonfinancial corporations, households, and NPISHs."<sup>11</sup>

In addition, debt instruments under "portfolio investment" and "other investment" are classified into long-term and short-term instruments according to their original maturity.<sup>12</sup>

The "financial account" does not cover increases/decreases in holdings of assets/liabilities that do not involve transactions. Thus, the financial account excludes (1) changes in the valuation of assets resulting from fluctuations in exchange rates or other market prices and (2) the reclassification of existing assets, such as from "portfolio investment" to "direct investment" due to an investor making additional investments in the equity of a foreign enterprise. These increases/decreases not involving transactions are recorded as "exchange rate changes" or "other changes" in the *International Investment Position of Japan*. By contrast in cases where, for example, the sector of the resident debtor changes as a result of the government assuming the debt of a private sector entity, or where the terms of a loan agreement change from short-term to long-term, the extinction of the existing debt and the creation of the new debt are reflected in the statistics as a transaction under the mutual agreement of the parties.

Only actual claims/obligations that legally exist should be recorded as financial assets and liabilities in the statistics. For example, arrangements of credit lines are not reflected in the statistics.

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<sup>11</sup> With regard to the classification of the institutional sector that residents belong to, it should be noted that in Japan, public financial corporations that do not engage in deposit operations or exchange transactions are classified under "general government."

<sup>12</sup> Long-term instruments are those with a maturity of more than one year or with no stated maturity (other than on demand), while short-term instruments are those that are payable on demand or have a maturity of one year or less.



In contrast to the "current account," the "financial account" shows net changes in assets, that is, the difference between acquisitions and disposals of assets during a certain period. For example, transactions in Japanese government bonds by nonresidents are recorded as follows: if net changes are positive (net purchases), figures are recorded as an increase in liabilities; and if net changes are negative (net sales), figures are recorded as a decrease in liabilities.

### **3.A Direct Investment**

The sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)* defines direct investment as "a category of cross-border investment associated with a resident (DI) in one economy having control or a significant degree of influence on the management of an enterprise (DIE) that is resident in another economy."<sup>13</sup>

In Japan's BOP statistics, not only corporations and partnerships in which an investor owns 10 percent or more of the voting power but also branches are treated as DIEs. Investments in/from indirectly held enterprises and between fellow enterprises are also included in direct investment. In addition, acquisitions/disposals of overseas real estate by residents and acquisitions/disposals of domestic real estate by nonresidents are recorded under direct investment.

"Direct investment" covers not only the initial transaction that establishes a direct investment relationship but also all subsequent transactions between the parties in the relationship. These transactions are classified as "equity other than reinvestment of earnings," "reinvestment of earnings," or "debt instruments," according to the form of investment.

#### **3.A.1 Equity other than reinvestment of earnings**

This item covers share capital of DIEs, branch capital, and other capital contributions including capital reserves. It also covers cases when a subsidiary acquires equity in its parent which account for less than 10 percent of the voting power of the parent.

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<sup>13</sup> Specifically, a direct investment relationship is defined to "arise when a direct investor directly owns equity that entitles it to 10 percent or more of the voting power in the direct investment enterprise." *BPM6* further states that a direct investor "is able to exercise indirect control or influence through a chain of direct investment relationships" and that "there are also direct investment relationships between two enterprises that do not control or influence each other, but that are both under the control or influence of the same investor (i.e., fellow enterprises[...])."

In addition, sales of overseas real estate by residents and sales of domestic real estate by nonresidents are recorded in this item.

### **3.A.2 Reinvestment of earnings**

This item covers DIES' shares of earnings that are not distributed as dividends to investors, which are recorded in proportion to each DI's ownership. Because such shares are recorded as if they were distributed as dividends to the DIs and then reinvested by the DIs, the same amount recorded under this item is recorded as "reinvested earnings" under "direct investment" under "investment income."

### **3.A.3 Debt instruments**

This item covers transactions in loans and debt securities between parties in a direct investment relationship.<sup>14</sup> Not only transactions with parties in an immediate direct investment relationship, but also those with indirectly held or fellow enterprises are included.

## **3.B Portfolio Investment**

This category shows transactions in equity and debt securities that do not fall under "direct investment" or "reserve assets."

The asset side of "portfolio investment" shows transactions in securities issued by nonresidents and the liability side shows transactions in securities issued by residents. "Assets" and "liabilities" are each broken down into "equity and investment fund shares" and "debt securities" according to the type of securities involved. The former is further divided into "equity securities other than investment fund shares" and "investment fund shares or unit" and the latter is further divided into "long-term" and "short-term" debt securities. In addition, each of these categories is classified by sector: "assets" are classified according to the sector of the holder (that is, the resident transactor) while "liabilities" are classified according to the sector of the issuer.

### **3.B.1 Equity and investment fund shares**

#### **3.B.1.1 Equity securities other than investment fund shares**

This item covers transactions in both listed and unlisted equity securities.

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<sup>14</sup> In Japan, transactions in deposits as well as trade credit and advances are recorded under "other investment."

### **3.B.1.2 Investment fund shares or unit**

This item covers transactions in shares or units of investment trusts (both corporate- and contract-type trusts); however, an investment in a corporate-type investment trust that entitles the investor to 10 percent or more of the voting power in the trust is recorded as "equity other than reinvestment of earnings" under "direct investment."

### **3.B.2 Debt securities**

#### **3.B.2.1 Long-term**

This item covers transactions in securities with an original maturity (that is, the period from the issue date to the maturity date) of more than one year. In Japan's BOP statistics, this item is further broken down into "buying and selling" and "issues."

"Buying and selling" covers not only ordinary sales and redemptions but also the estimated amount of accrued interest on discounted debt securities as a corresponding entry to the amount recorded under "portfolio investment" under "primary income." Also included as sales of securities are conversions of convertible bonds into stock and substitute payments through the exercise of warrants.

#### **3.B.2.2 Short-term**

This item covers transactions in securities with an original maturity of one year or less. Examples of such securities are treasury bills, commercial paper, negotiable certificates of deposit (NCDs) issued abroad, and trade bills. As in the case of long-term debt securities, this item covers transactions involving ordinary sales, issues, and redemptions as well as the estimated amount of accrued interest on discounted debt securities.

### **3.C Financial Derivatives (Other than Reserves)**

Financial derivatives are financial instruments that are linked to other specific financial instruments or indicators or commodities and through which specific financial risks (such as interest rate risk, foreign exchange risk, equity and commodity price risks, and credit risk) are traded in financial markets.

Specifically, this category covers (1) option premiums as well as option trading gains and losses; (2) share options; (3) forward and futures trading gains and losses; (4) notional exchange gains and losses on currency swaps; and (5) interest payments, dividends, and capital gains, etc. accruing from swap transactions.

### **3.D Other Investment**

This category shows all financial transactions that do not fall under "direct investment," "portfolio investment," "financial derivatives (other than reserves)," or "reserve assets." As in the other functional categories, claims by residents are recorded as "assets," and obligations to nonresidents are recorded as "liabilities." "Other investment" is broken down into "other equity," "currency and deposits," "loans," "insurance and pension reserves," "trade credit and advances," "other accounts receivable/payable," and "special drawing rights (net incurrence of liabilities)." "Loans," "trade credit and advances," and "other accounts receivable/payable" are further broken down into "long-term" (more than one year) and "short-term" (one year or less), respectively, according to the original maturity.

#### **3.D.1 Other equity**

This item covers transactions in equity that is not in the form of securities and that do not fall under either "direct investment" or "reserve assets." In Japan's BOP statistics, this item contains the sub-item "subscriptions to international organizations."

Investments in equity in partnerships and withdrawals of equity from partnerships are also included. Such partnerships under Japanese laws include investment limited partnerships, limited liability partnerships, partnerships under the Civil Code, and anonymous partnerships. In addition, partnerships under foreign laws which are similar to the above partnerships, such as limited partnerships, are included.

#### **3.D.2 Currency and deposits**

This item covers currency in circulation used as a general means of payment. Transactions in commemorative coins or notes that are not in circulation are recorded under "goods."

Deposits cover transactions in all claims that are represented by certificates of deposit that are not negotiable, including deposits payable on demand with a settlement function. Also included are payments/receipts of cash collateral and margins in transactions in financial derivatives. Transactions in gold, platinum, and other metals through unallocated accounts (that is, accounts in which the stored metals are not identifiable by number, brand, weight, etc.) held at overseas banks or other institutions are treated as deposit transactions.<sup>15</sup> Meanwhile, NCDs issued in Japan are recorded under "currency

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<sup>15</sup> Unallocated accounts do not provide ownership of specific pieces of metal but represent a claim for the

and deposits" and not under "portfolio investment," because they are nominative and nonnegotiable.

### **3.D.3 Loans**

This item covers financial assets that are created when a creditor lends funds directly to a debtor and that are evidenced by documents that are not negotiable. "Assets" show loans to nonresidents provided by residents while "liabilities" show loans to residents provided by nonresidents. Included are (1) ordinary loans of funds involving financial and nonfinancial corporations;<sup>16</sup> (2) loans to finance trade made by banks and other institutions other than the exporter, such as buyers' credits; and (3) yen loans to foreign governments provided by public financial corporations.

### **3.D.4 Insurance and pension reserves**

Nonlife insurance premiums are usually paid before the period covered by the policy begins, while claims are paid only after the insured event happens. Insurance companies designate a certain amount of their reserves to account for these prepayments of premiums and claims incurred but not yet paid. *BPM6* recommends treating these reserves as liabilities of insurance companies (assets of policyholders) and recording changes in such reserves as financial transactions. Similarly, for life insurance and pension schemes, *BPM6* recommends recording as financial transactions the changes in reserves corresponding to the estimated obligations to beneficiaries and policyholders that accrued during the period.

In Japan's BOP statistics, prepayments of nonlife insurance premiums and changes in reserves for life insurance and pension schemes are estimated and recorded in this manner.

### **3.D.5 Trade credit and advances**

This item covers the creation/extinction of claims/obligations related to (1) credit extended directly by exporters to their counterparties and (2) advances and prepayments.

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delivery of metal of the same quality and amount as that deposited. Therefore, such accounts are treated as financial assets in the BOP statistics.

<sup>16</sup> Loans of funds between enterprises in a direct investment relationship are included in this item only when both parties are financial corporations.

### **3.D.6 Other accounts receivable/payable**

This item covers accounts receivable or payable other than those included in "trade credit and advances" or other instruments. Examples are accounts receivable or payable arising from difference in the timing of when contracts are entered and securities transactions that are recorded on a contract basis are settled. Also included is the right to indemnification arising from payments of insurance claims or payments by guarantors.

### **3.D.7 Special drawing rights (Net incurrence of liabilities)**

The Special Drawing Right (SDR) is an international reserve asset created by the International Monetary Fund (IMF). For details, see "reserve assets" below.

When SDRs are allocated to member countries, they record an increase in assets under "special drawing rights" under "reserve assets" and at the same time an incurrence of liabilities under this item. The allocation of SDRs is treated as the incurrence of liabilities because of the requirement to repay the allocation in certain circumstances, and also because interest accrues.

## **3.E Reserve Assets**

This category shows those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs and for intervention in foreign exchange markets. In Japan's BOP statistics, changes in assets that are held as reserve assets by the Foreign Exchange Fund Special Account and the Bank of Japan are recorded.

### **3.E.1 Monetary gold**

This item covers transactions in gold held by the monetary authorities as reserve assets.

### **3.E.2 Special drawing rights**

SDRs are international reserve assets created by the IMF to supplement gold and foreign currencies. SDRs are systematically allocated to the members of the SDR Department of the IMF in proportion to their IMF quota. Member countries may not only obtain foreign currencies from other countries in return for SDRs when their balance of payments deteriorates but also use SDRs directly for transactions and settlements. Changes in SDRs due to payments to/receipts from other countries as well as allocations by the IMF are recorded in the BOP statistics.

### **3.E.3 Reserve position in the IMF**

This item covers the reserve tranche that may be drawn by IMF member countries and loans to the IMF under loan agreements that the IMF repays on demand. The reserve tranche is the part of the quota assigned to member countries that comprises currencies other than the domestic currency. Member countries may draw foreign currencies up to the amount of the reserve tranche. Because the reserve tranche may be drawn by member countries at their discretion and does not involve fees or obligations to repay the funds, the reserve tranche is included in reserve assets as "reserve assets that are readily available to the monetary authorities."

### **3.E.4 Other reserve assets**

This item covers transactions in securities, deposits, etc.