Nomura Securities Co., Ltd., Tokyo
Economic Research

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Japanese Retail Investment in Overseas Securities and FX Margin Trades

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Introduction

Reserve Bank of New Zealand reports...

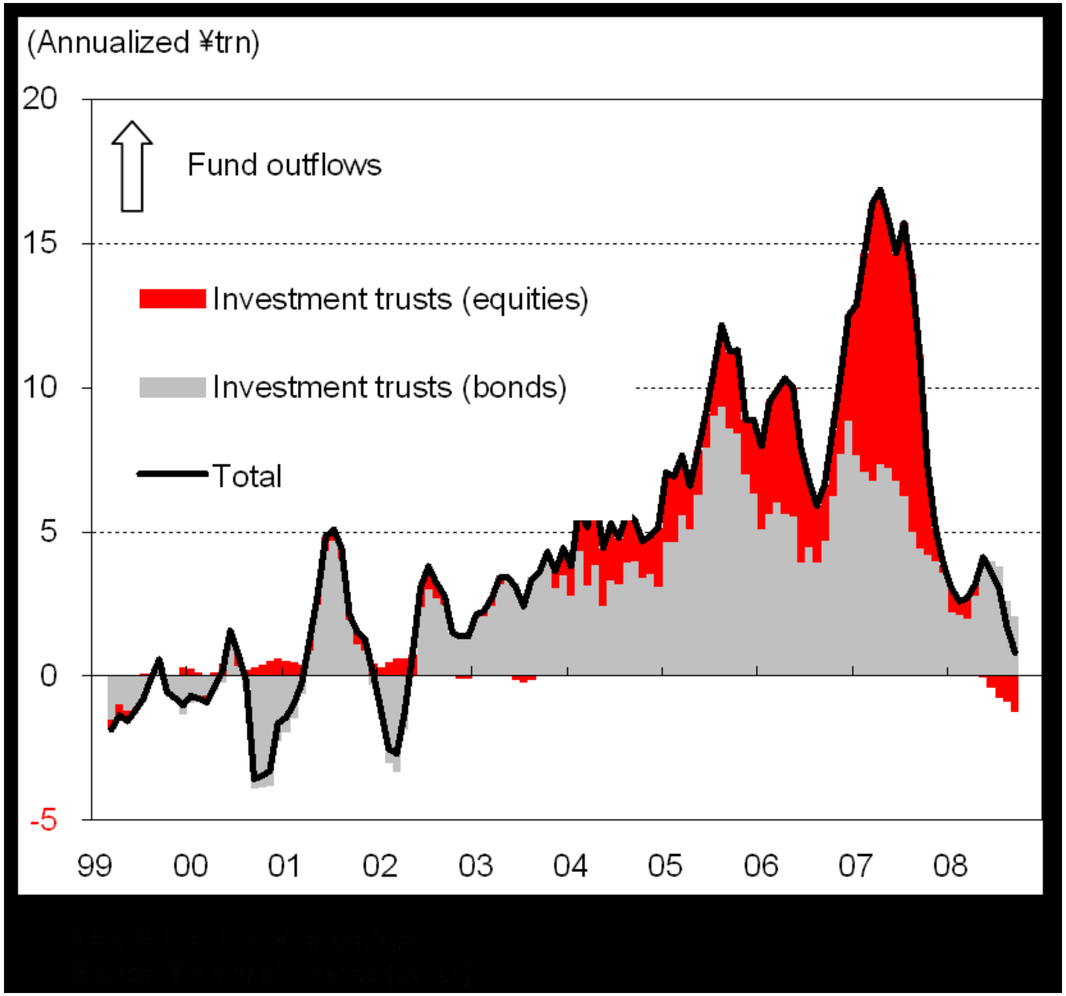
“Although the NZD has weakened against the yen as global risk appetite has fallen, other factors suggest continued demand for the NZD from Japanese investors. Issuance of Uridashi bonds (bonds denominated in foreign currencies sold to **Japanese households**) has rebounded since the middle of last year, with market contacts suggesting Japanese investors are substituting away from volatile equities and towards bonds. Uridashi bonds denominated in NZD have accounted for around half of all new Uridashi issuance since the beginning of this year. This rebound in issuance has helped support liquidity in New Zealand interest rate swap markets. In addition to Uridashi issuance, there has been some recovery in the level of net long positions of NZD held by **Japanese households** through margin trading accounts.”

Source: RBNZ “Financial Stability Report” (May 2008)

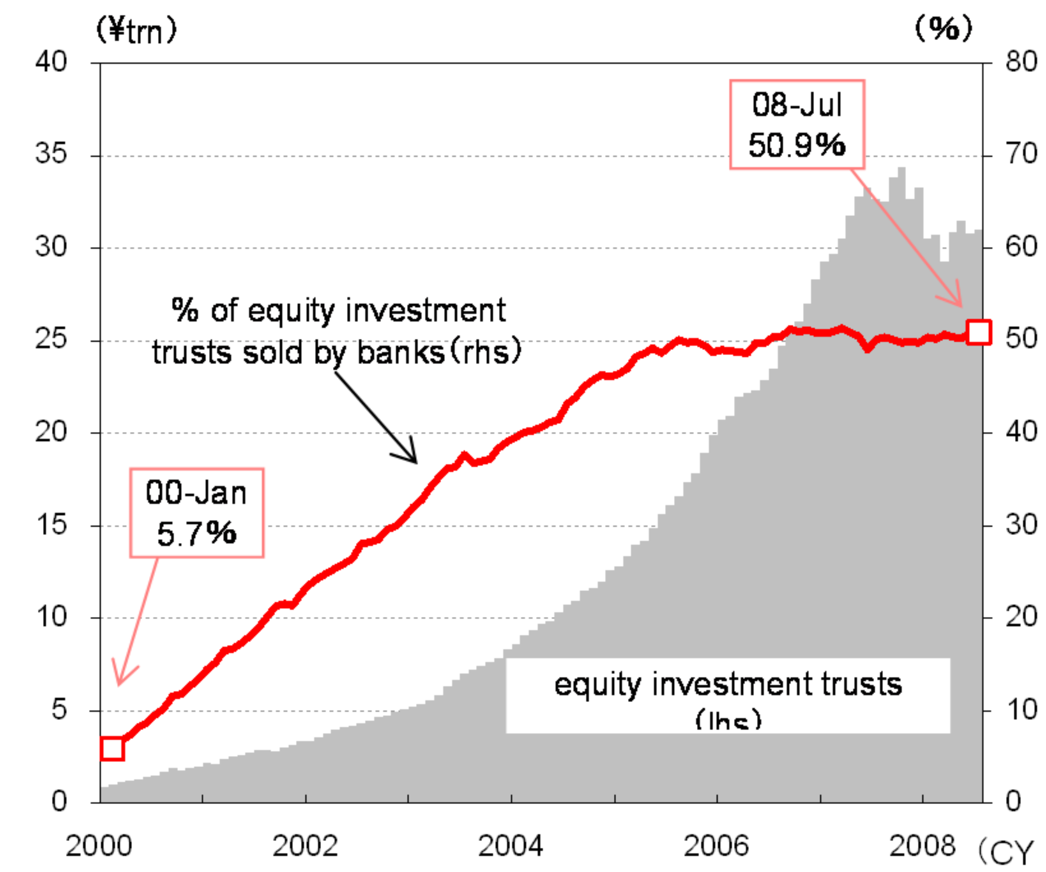
Summary

- In 2005-07, Japanese households aggressively raised their exposure to foreign currency risks by investing in investment trusts or taking positions in so-called FX margin trades, contributing to the yen's weakness
- We found three factors behind such a trend:
  (1) Expansion of sales channels of those investment vehicles
  (2) Persistently wide spread between overseas and domestic interest rates
  (3) Japanese economic expansion and the improvement in employment conditions, which allowed households to take more risks
- We also found that FX margin positions in each currency can be explained by
  (i) Levels of short-term interest rates
  (ii) Upward/downward divergence from historical trends
  (iii) The degree of a currency's liquidity
- We see some signs that Japanese households have modified their foreign currency investment attitude in the current financial turmoil.

Ex.1: Japanese investment trust investment in overseas securities

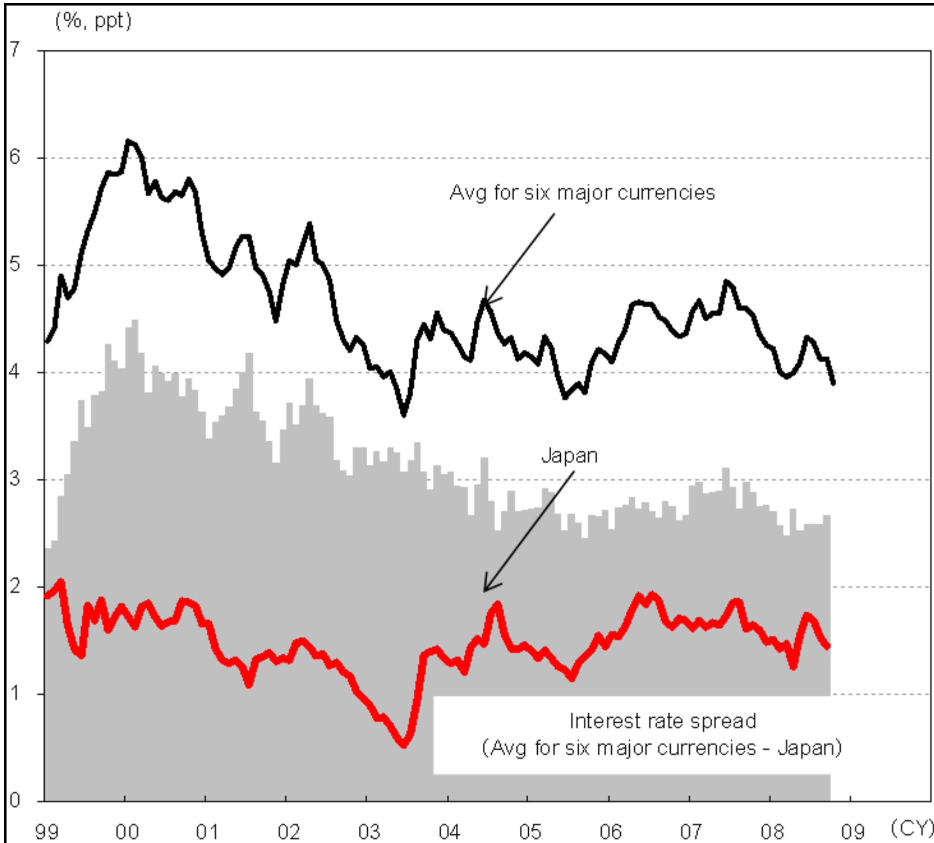


Ex.2: Percentage of equity investment trusts sold by banks



Source: Nomura,based on the Investment Trusts Association Japan data

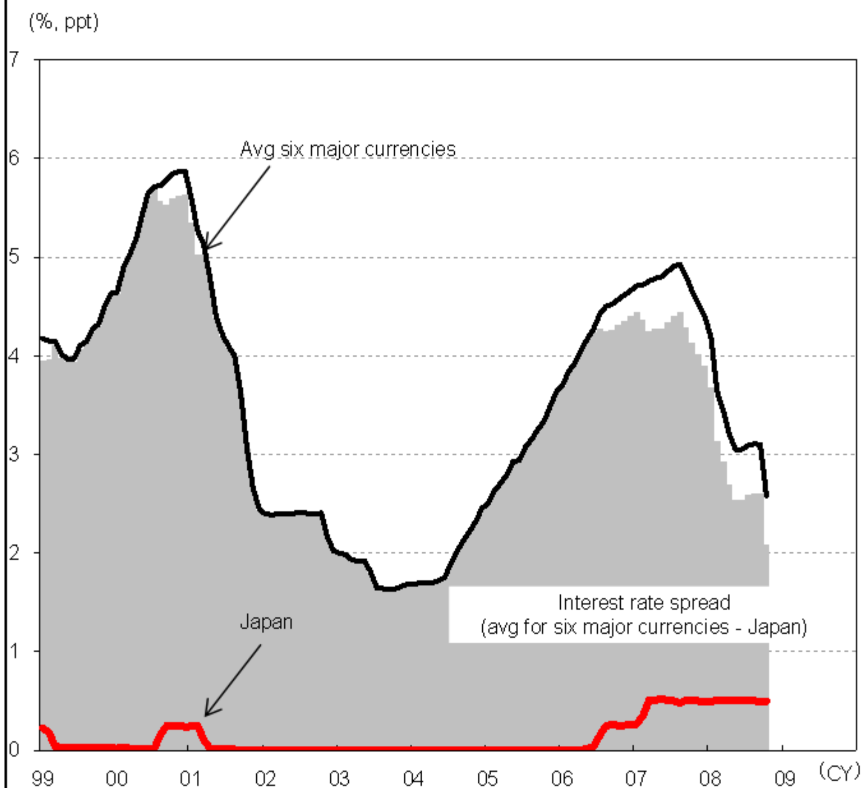
Ex.3: Average long-term interest rate (and vis-à-vis Japan) of six countries with major currencies



Note: (1) the average long-term interest rate is the average 10-year government bond yields of the US,the Eurozone (Germany), the UK, Switzerland, Australia, and Canada weighted by the relative transaction volume of their respective currencies as published by the BIS. (2)the market estimates of Japanese long term interest rates are as according to the ESP Forecast.

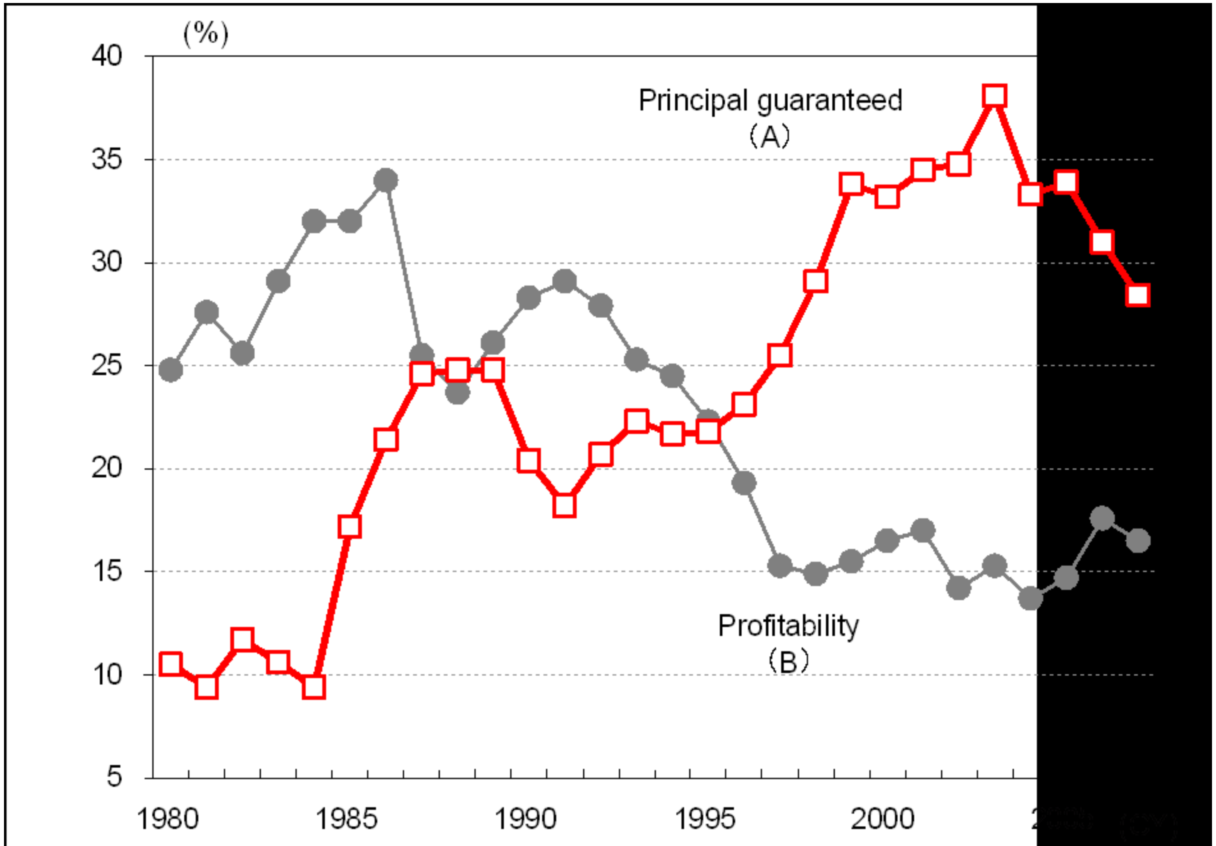
Source:Nomura, based on BIS, Economic Planning Association data

Ex.4: Average policy interest rate (and spread vis-à-vis Japan) of six countries with major currencies



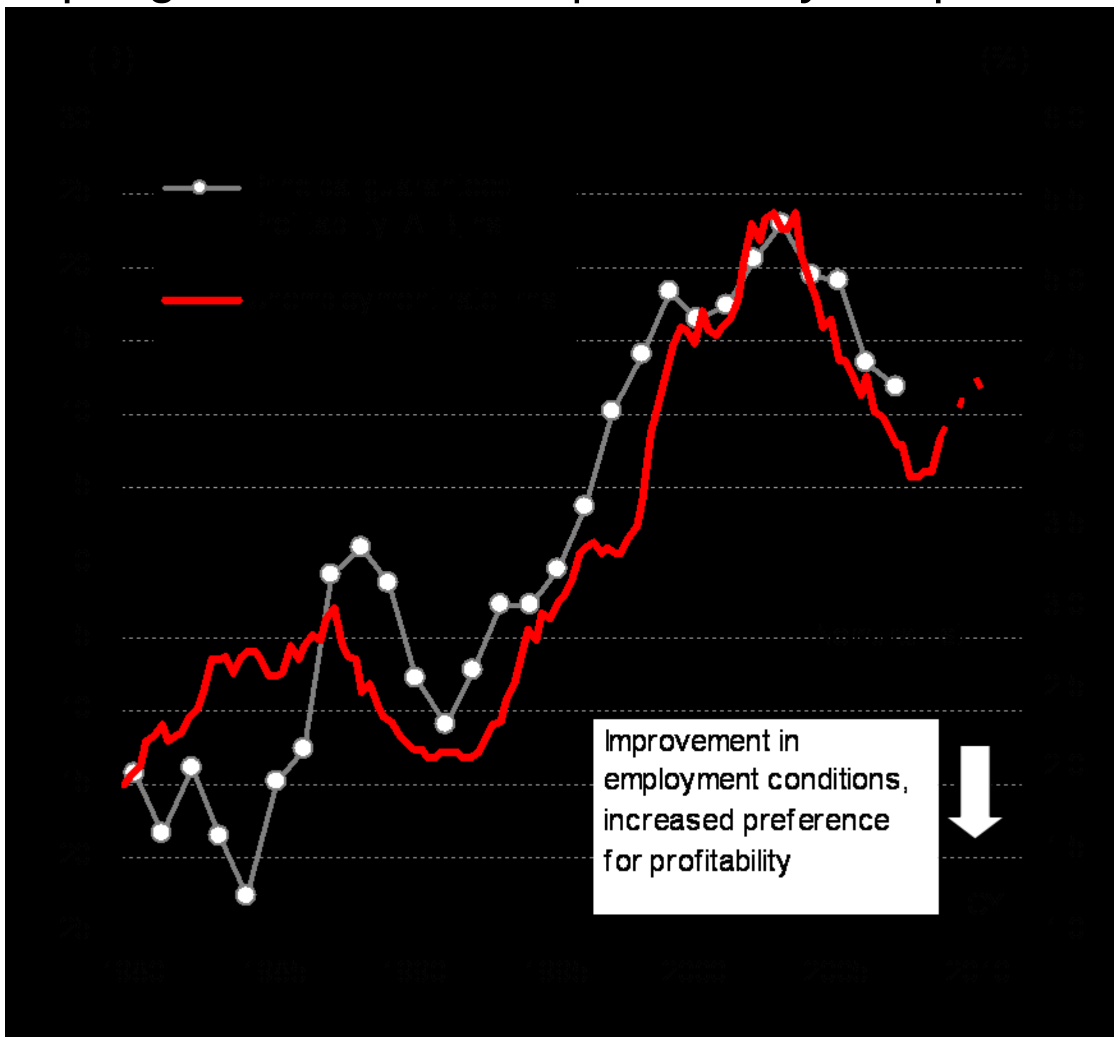
Note:(1)the average policy interest rate is that of the US,the Eurozone (Germany),the UK,Swizerland,Australia,and Canada weighted by the relative transaction volume of their respective currencies as published by the BIS.(2)the market estimates of Japan's policy interest rates are as according to the ESP Forecast.
Source:Nomura,based on BIS,Economic Planning Association data

Ex.5: Important criteria in the selection of financial products

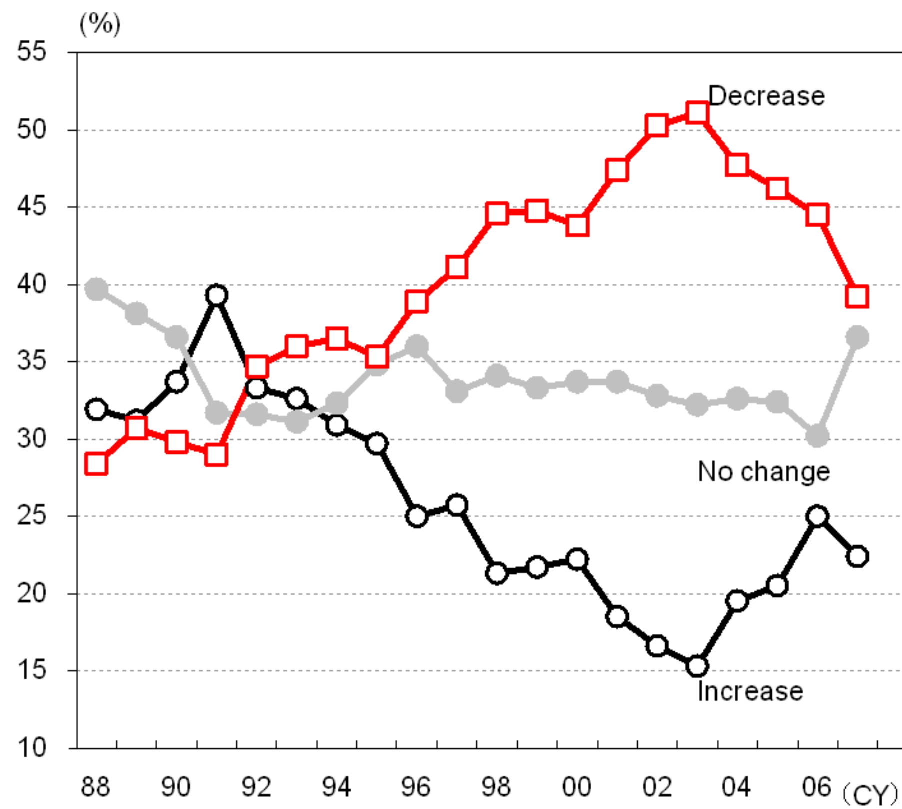


Note: % of survey responses
Source: Nomura, based on the Central Council for Financial Services Infor[redacted]

Ex.6: Unemployment rate and difference between “principal guaranteed” and “profitability” response rates

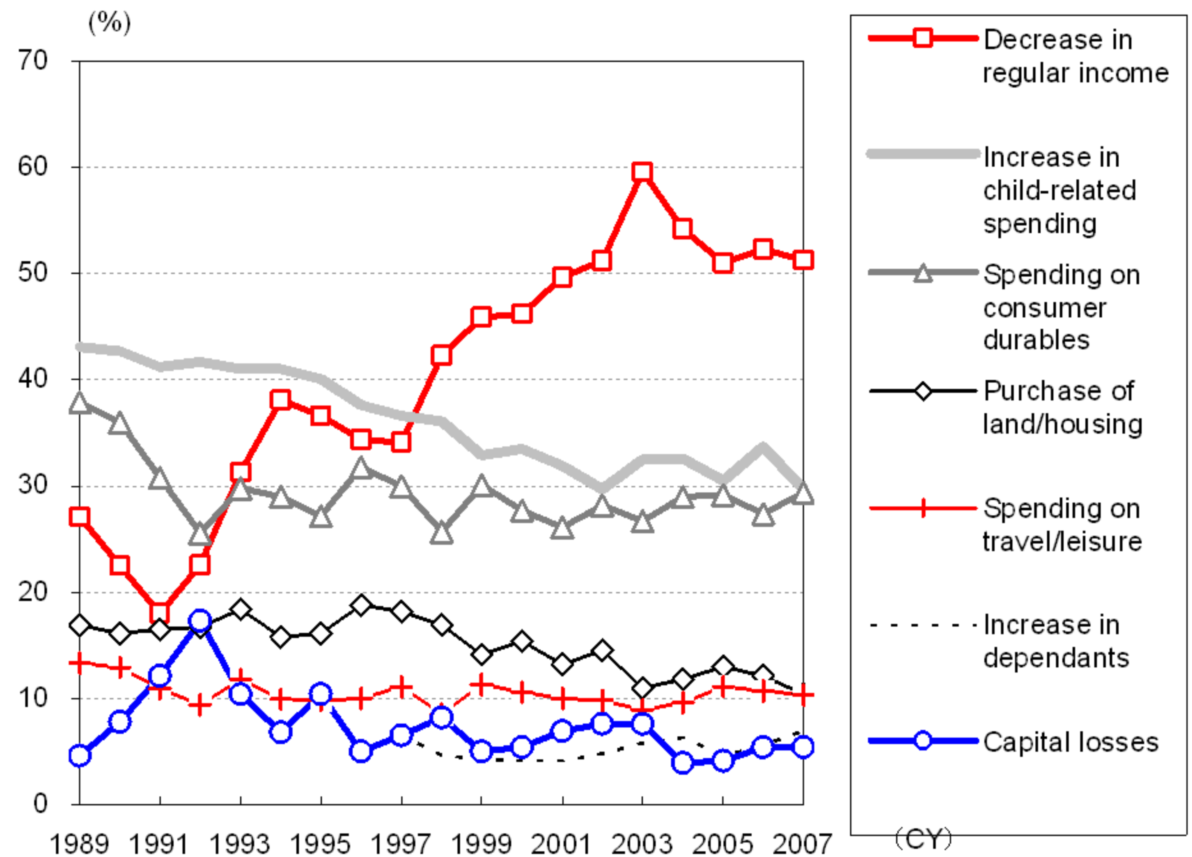


Ex.7: Change in outstanding amount of financial assets



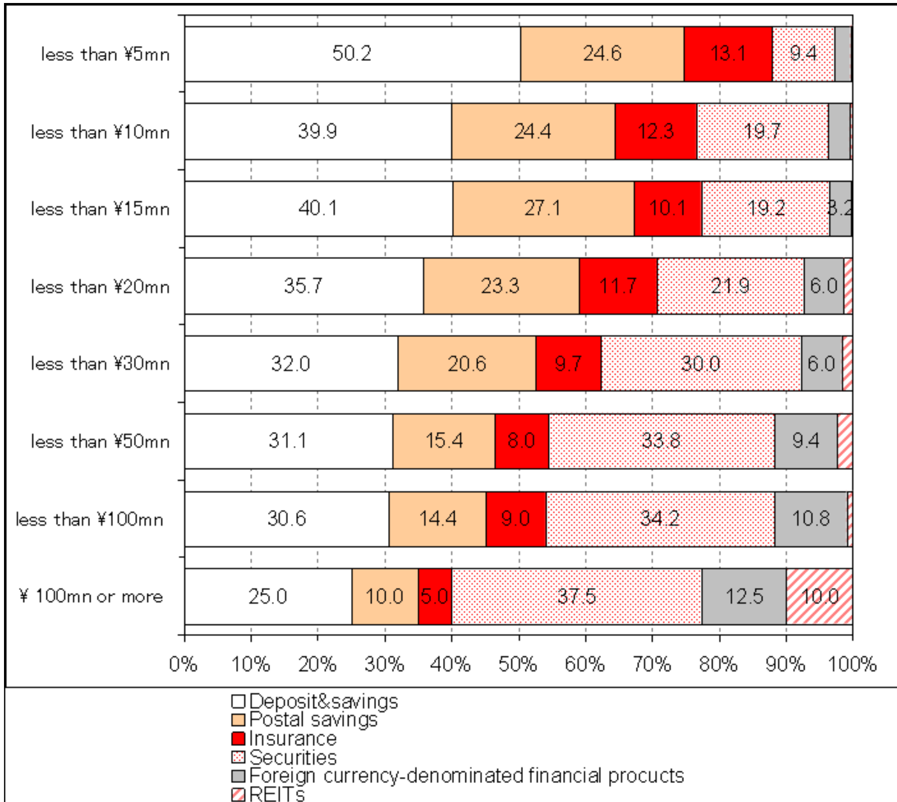
Note: Percentage of responses saying increased, decreased, and no change.
Source: Nomura, based on Central Council for Financial Services Information

Ex.8: Reasons for decrease in outstanding amount of financial assets



Note:Totals do not add up to 100% as multiple responses were allowed.
Source:Nomura, based on Central Council for Financial Services Information data

Ex.9: Financial products of which households intend to hold or acquire a large amount, by size of outstanding financial assets



Note: (1) Actual response figure do not total 100% because of multiple response,but we have adjusted the figures to total 100%. (2) Securities is the total of investment trusts, government and municipal bonds, bonds other than government and municipal bonds,equities, equity real estate investment trusts, and government and municipal bond investment trusts. insurance is the total of savings-type insurance products and

"The Kimono Traders"

A yen for trade: Ritsuko's day

7am: Ritsuko decides on two currency bets. She has 100,000 yen (£417) in her online trading account and the brokerage will lend her ten times that.

8am: She studies the Nikkei and Bloomberg and reckons the euro will rise

8.15am: She borrows 500,000 yen. (cheaply: the overnight interest rate is just 0.5 per cent), goes on to the spot foreign exchange market and buys euros at one euro per 160 yen.

8.30am: A medium-term bet: she borrows another 500,000 yen and buys New Zealand dollars, which will earn 8.25 per cent interest.

12 noon: Lunch and shopping (there are sales at Furla and Max Mara).

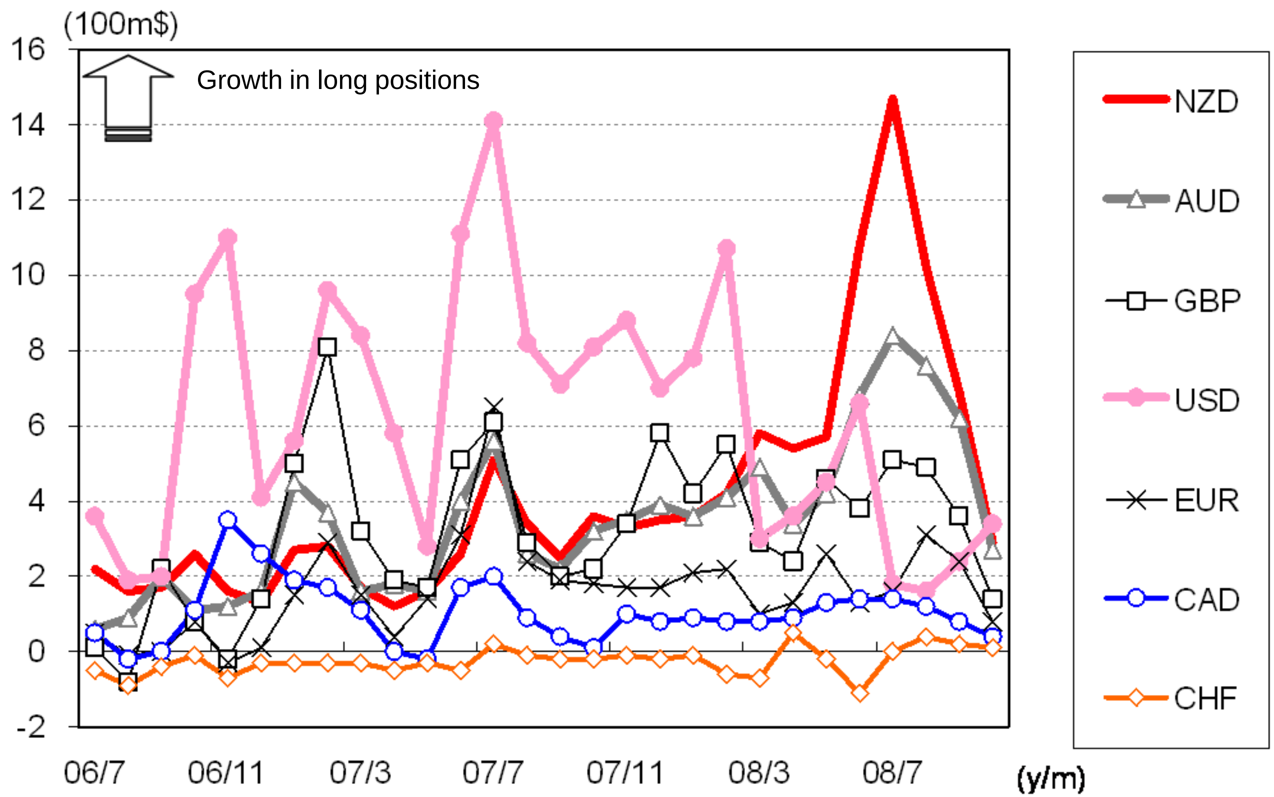
5.31pm: She was right: the euro is up 1 per cent. She buys back her yen, this time getting 176 yen per euro. After brokerage fees, her profit is around 5,000 yen – which about pays for her lunch.

2 months later: Ritsuko believes the Icelandic krone will be more lucrative than her New Zealand dollars. She exits her position with one sixth (two months out of 12) of the 8.25 per cent annual interest on the NZ dollars, pocketing around 6,100 yen – which she immediately churns into her next trade.

Source: The Times (August 3, 2007)

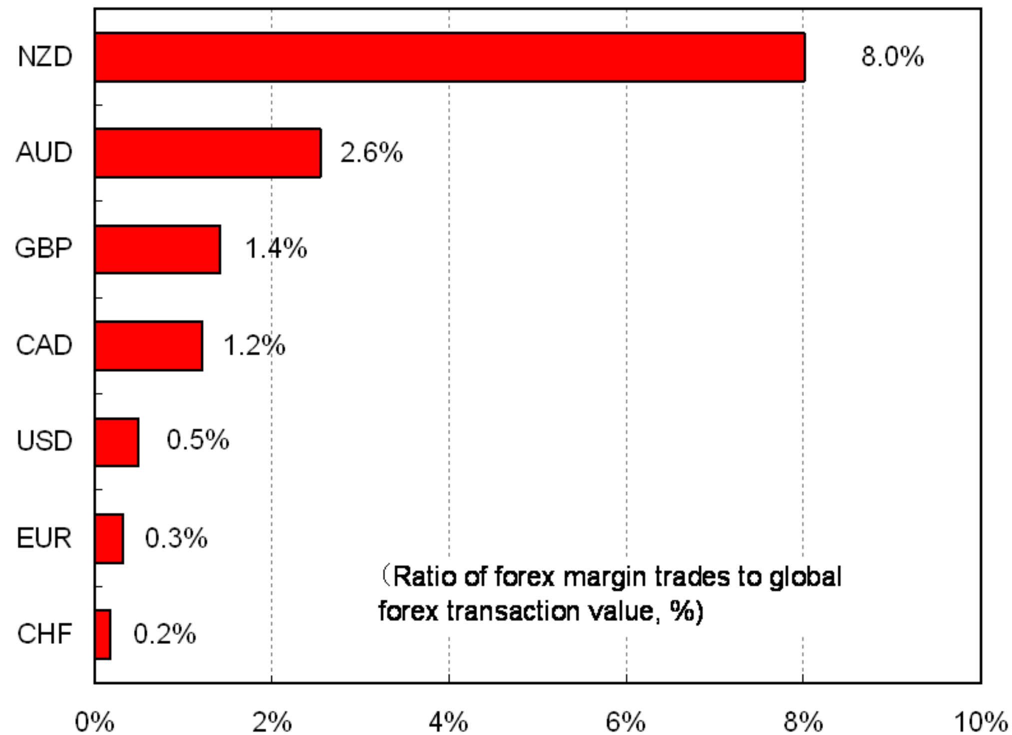
Did she buy Icelandic krone then ??

Ex.10: Forex margin positions in Japan by currency



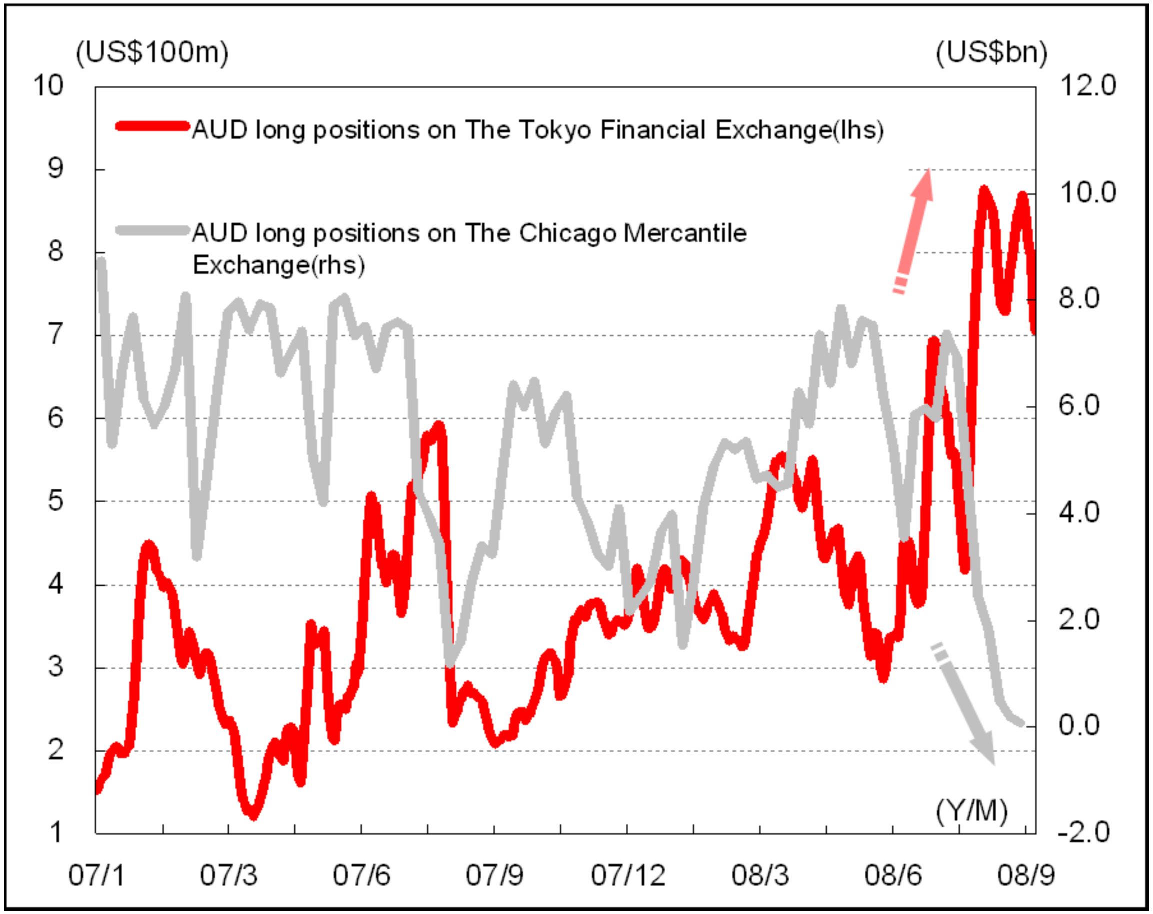
Note: (1) Daily trading data released by Tokyo Financial Exchange converted to monthly basis, using data through 17.October. (2) Net positions for each currency are at end-month (converted to dollar basis using USD/JPY at the given time point).
Source: Nomura, based on Tokyo Financial Exchange

Ex.11: Ratio of FX margin positions in Japan relative to overall global forex transaction value, by currency



Note: Position in each currency is divided by global daily transaction value for each currency (as of April 2007).
Source: Nomura, based on Bank for International Settlements(BIS) and Tokyo Financial Exchange data.

Ex.12-1: Comparison of Tokyo Financial Exchange and Chicago Mercantile Exchange (Australian Dollar)



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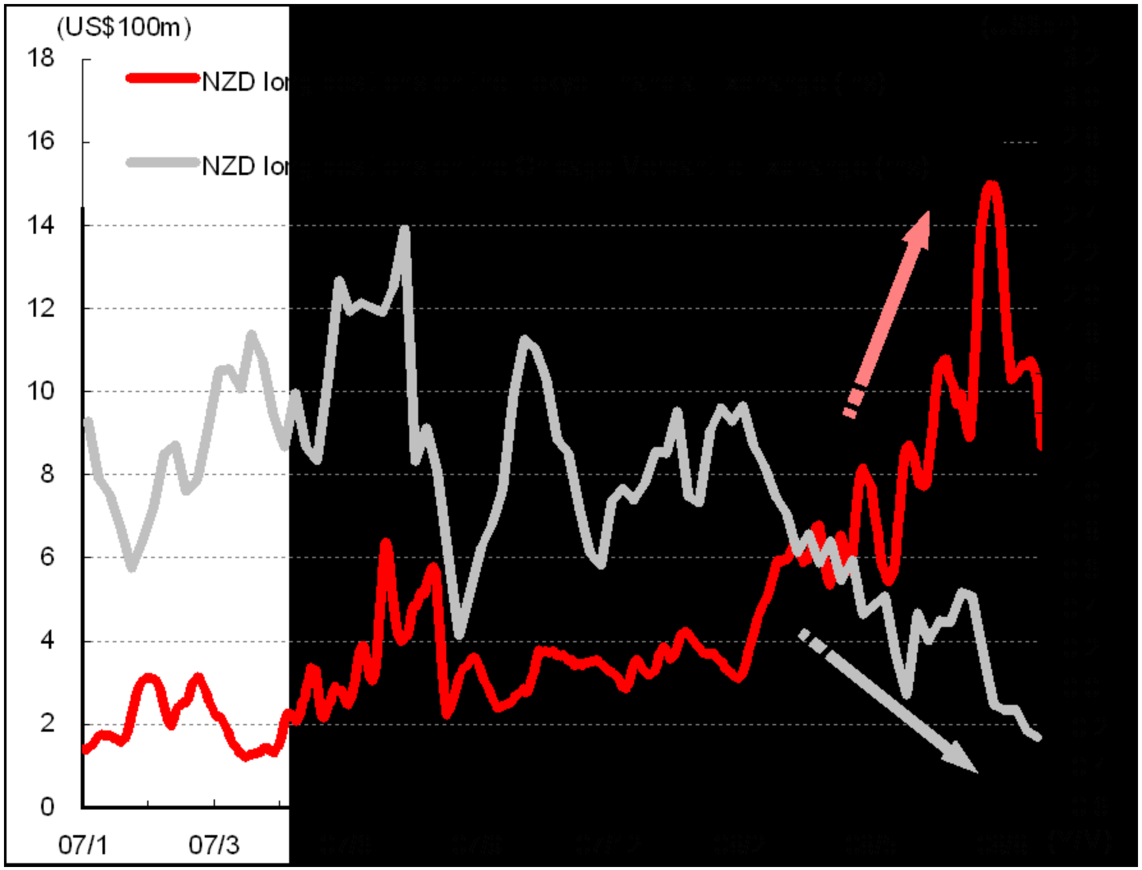
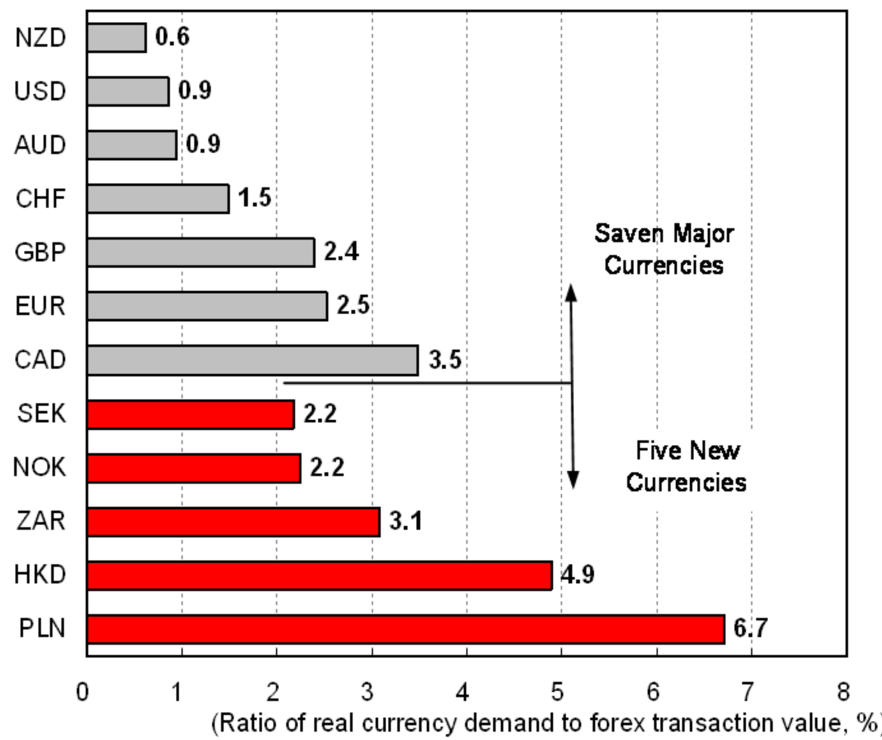
Ex.12-2: Comparison of Tokyo Financial Exchange and Chicago Mercantile Exchange (New Zealand Dollar)



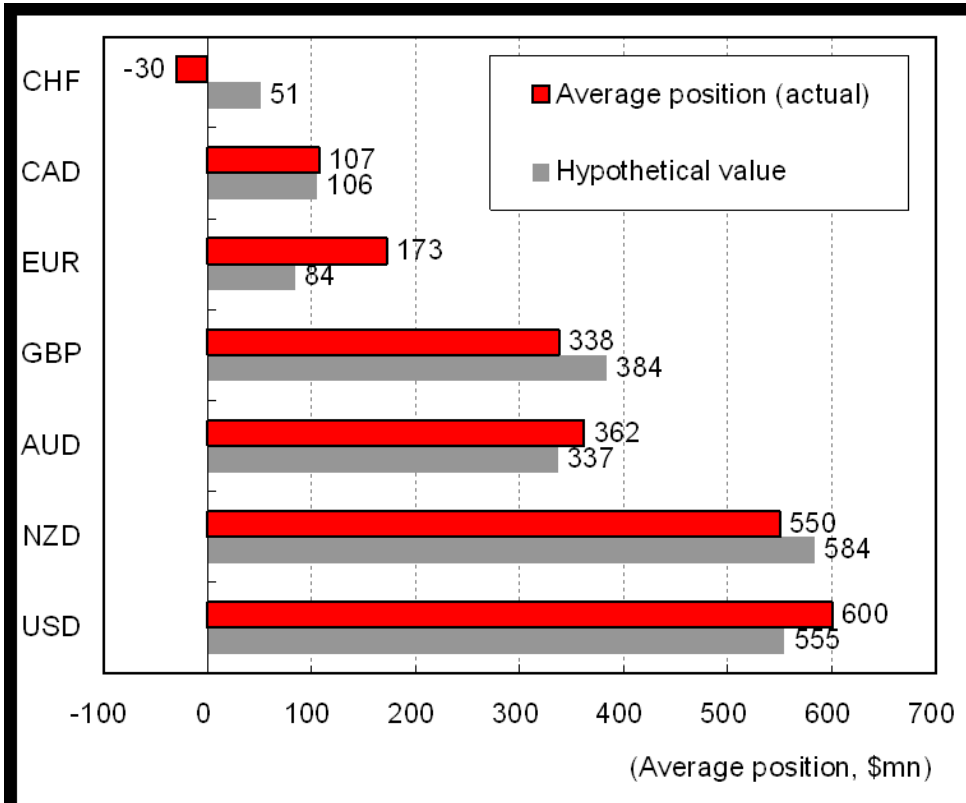
Ex.13: Liquidity gauge by currency
(Ratio of real currency demand to total forex transaction value)



Note: (1) Figures are based on each country's real transaction value divided by annual transaction value for each currency (1year = 240 trading days) based on the BIS report.
(2) Real transaction value=goods/services trade transactions + income transactions + current transactions.

Source: Nomura, based on BIS and Tokyo Financial Exchange data.

Ex.14: Estimates of currency positions



Note: Based on results of estimates using the average position for each currency as a dependent variable and (α) the average policy rate, (β) deviation from the lagged three-month moving average, and (γ) ratio of real currency demand to forex transaction value as three explanatory variables.
α = 0.78, β = -0.47, γ = -0.03, and adjusted R-square = 0.93, based on estimation period between July 2006 and September 2008.
Source: Nomura, based on Tokyo Financial Exchange data