

Issues surrounding Japan's balance of payments and the impact on the yen foreign exchange rate

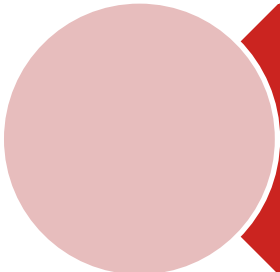
Takashi MIWA
Executive Economist,
The Nomura Securities, Co. Ltd.
+81 3 3275 2761
takashi.miwa@nomura.com

October 31, 2024

The points we focus on in this talk



**Introducing the Report on Japan's
balance of payments by MOF**



**Clarifying the issues identified in the
Report and how they relate to the
changes in the balance of payments
structure**



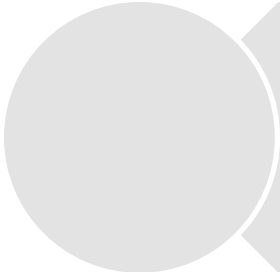
**Checking whether those issues or those
changes in BOP caused the recent JPY
weakness**



**Introducing the Report on Japan's
balance of payments by MOF**



**Clarifying the issues raised in the
Report and how they relate to the
changes in balance of payments
structure**

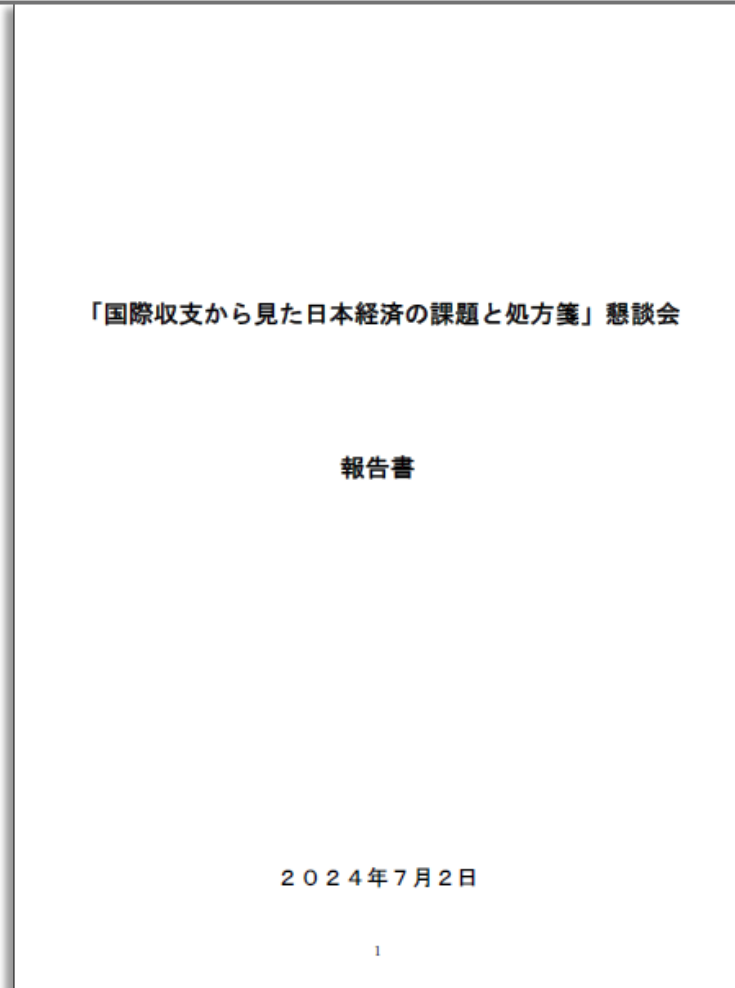


**Checking whether those issues or those
changes in BOP cause the recent JPY
weakness**

What is the Report?

- An advisory council under the Ministry of Finance Japan published the Report on issues regarding Japan's balance of payments

The cover page of the Report



Source: Ministry of Finance

The background of the Report

- The Report was published by a council that Masato Kanda, a former Vice-Minister of Finance for International Affairs, initiated and chaired

The focuses of the Report ?

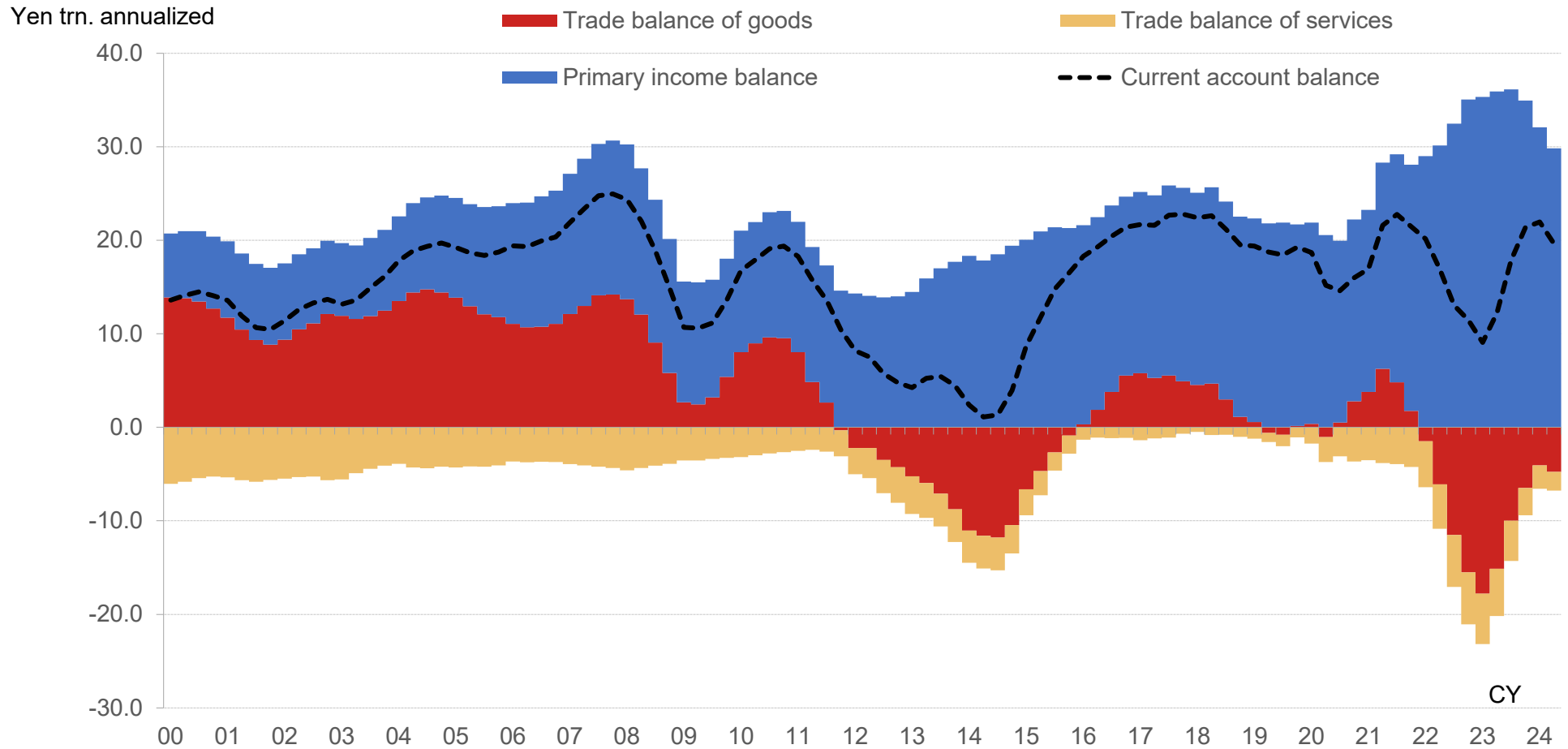
The points and issues the Report is aware of

- ✓ **The structural loss of competitiveness and growth potential of Japan's macroeconomy reflected in various aspects of changes occurring in the balance of payments**
- ✓ **A strong sense of crisis regarding the sustainability of Japan's fiscal and public debt management, if Japan loses underlying power to earn surplus in trade and current account balances**
- ✓ **(and implicitly...) underlying changes hidden behind the recent depreciation of JPY exchange rates**

Japan's external balance surplus still looks large enough

Where does the sense of crisis in the Report really come from?

Decomposition of Japan's current account balance



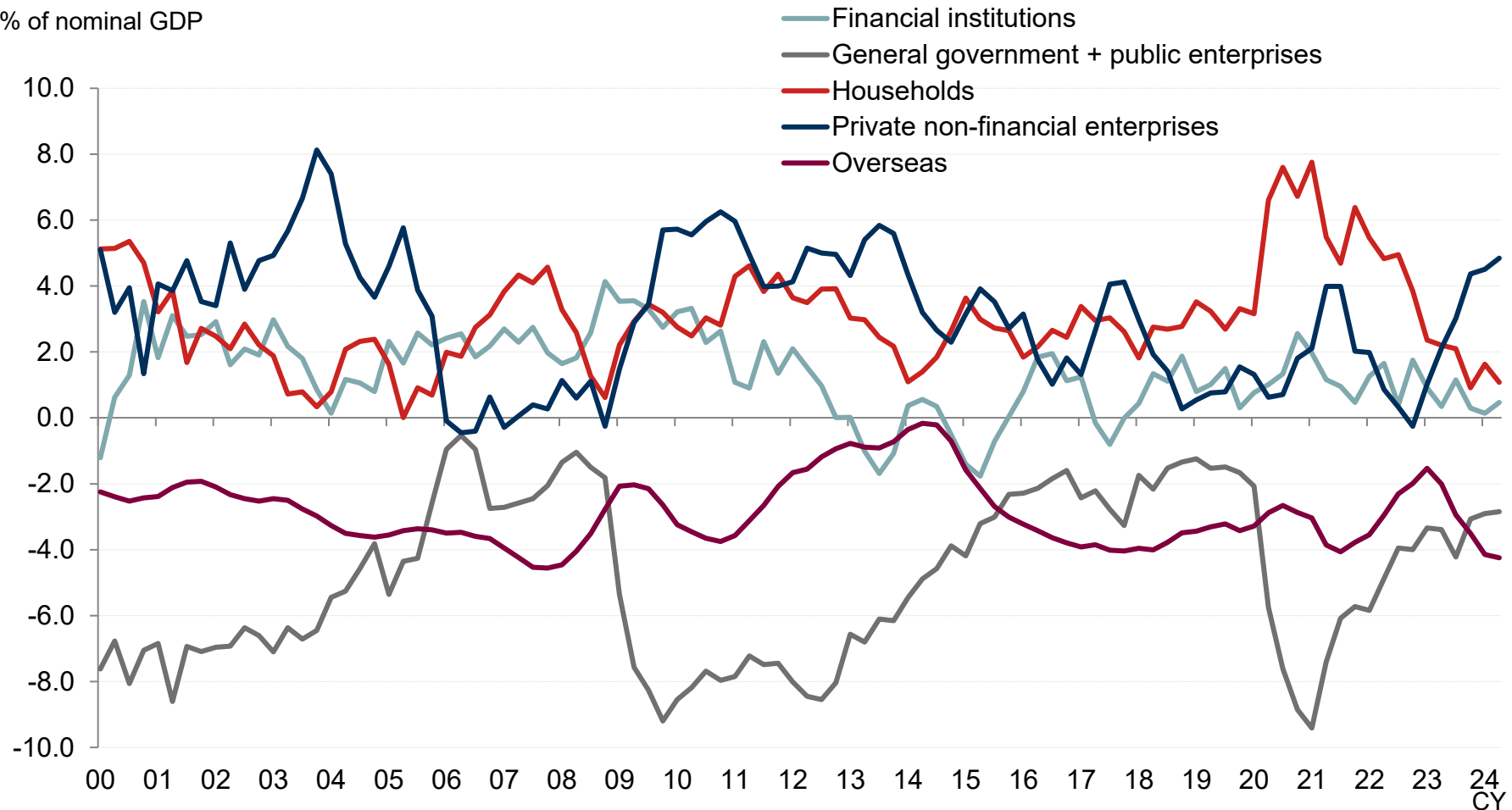
Source: Nomura based on Ministry of Finance data

The origin of the sense of crisis over the fiscal and public debt

Japan is subject to shrinkage of private sector net savings as its population ages

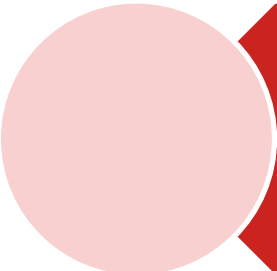
Saving-investment balance by sectors

as % of nominal GDP





**Introducing the Report on
Japan's balance of payments by
MOF**



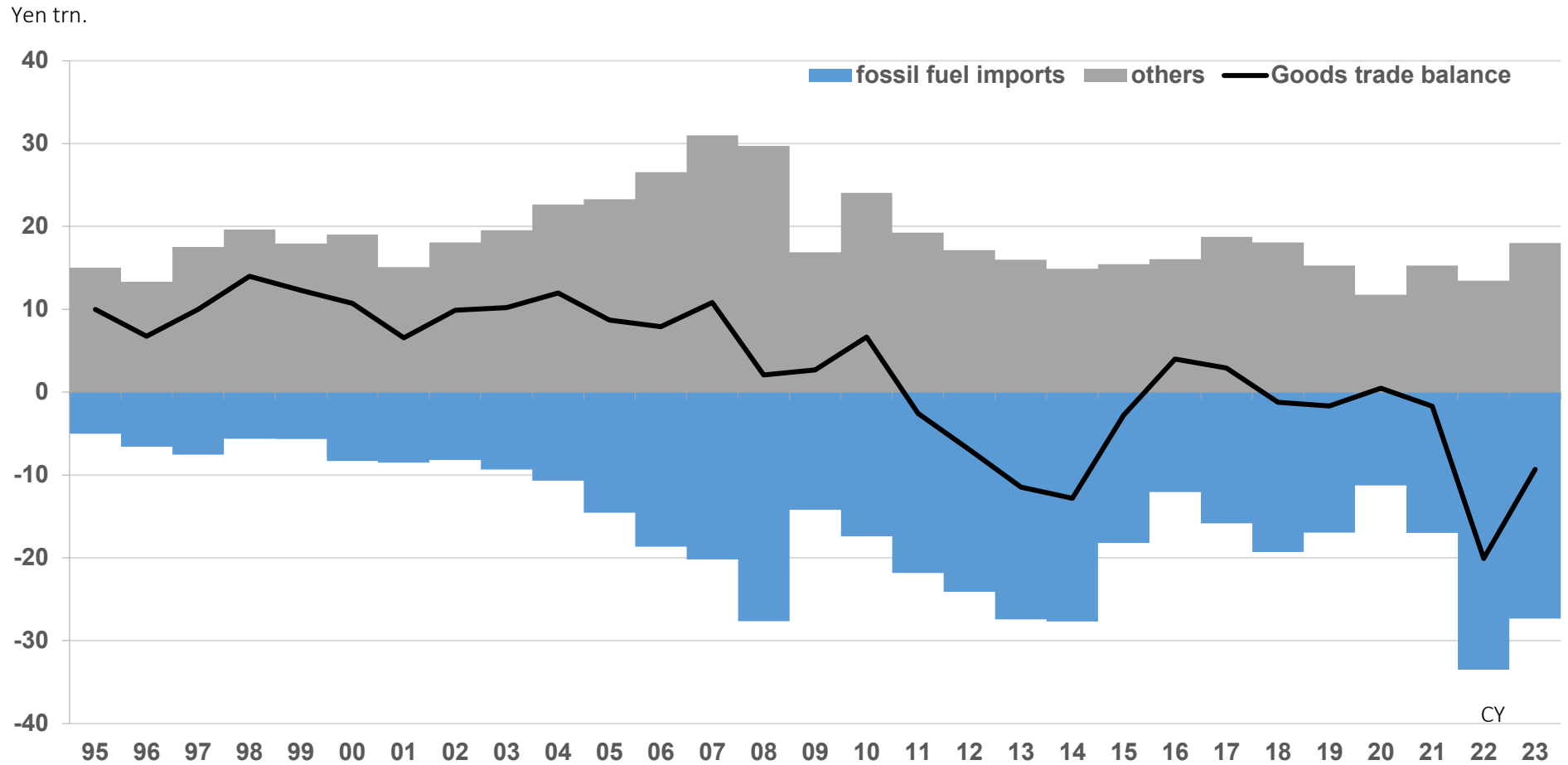
**Clarifying the issues identified in the
Report and how they relate to the
changes in the balance of payments
structure**



**Checking whether those issues
or those changes in BOP cause
the recent JPY weakness**

A structural deterioration of goods trade balance (1)

Impact of increasing fossil fuel imports on Japan's goods trade balance

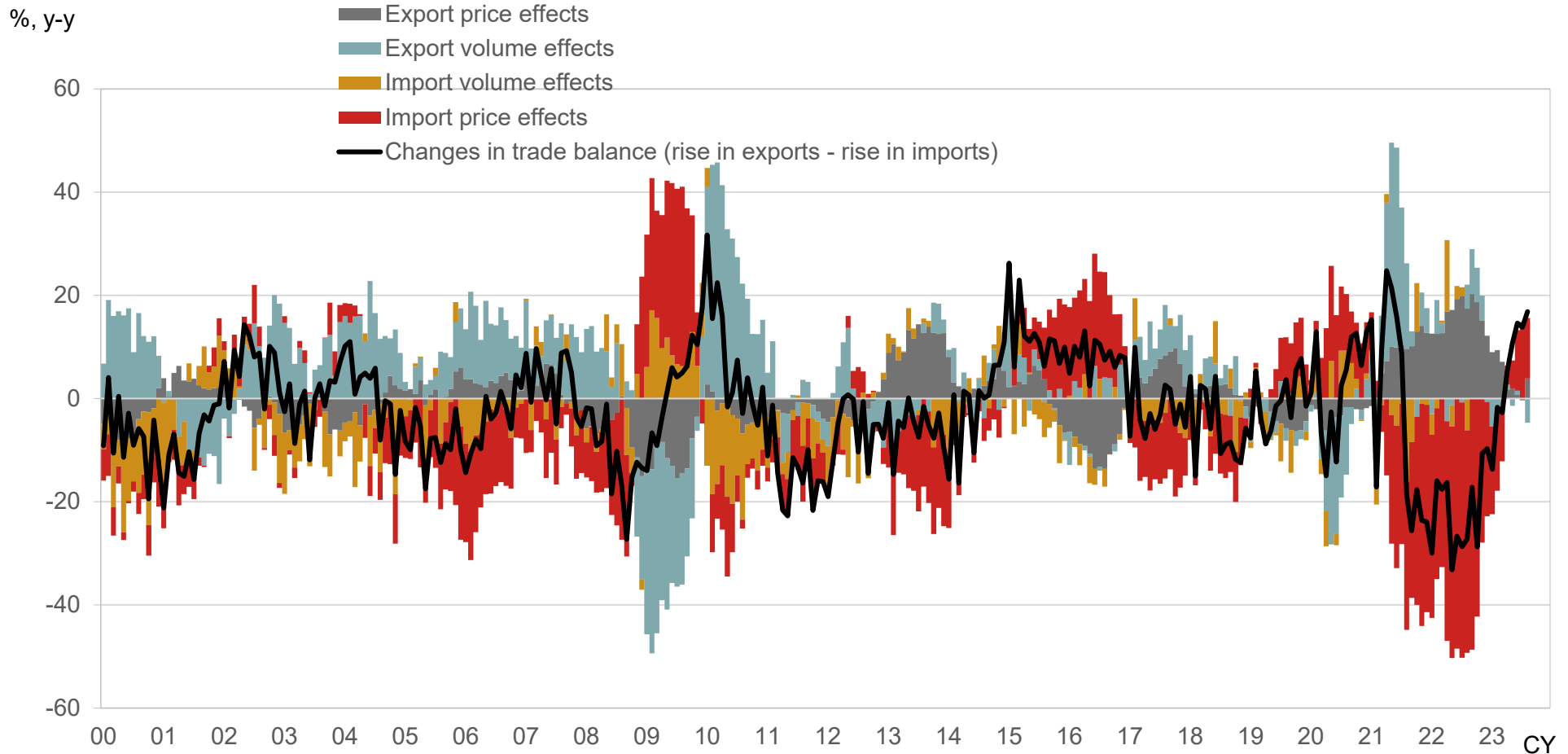


Source: Nomura based on Ministry of Finance data

A structural deterioration of goods trade balance (2)

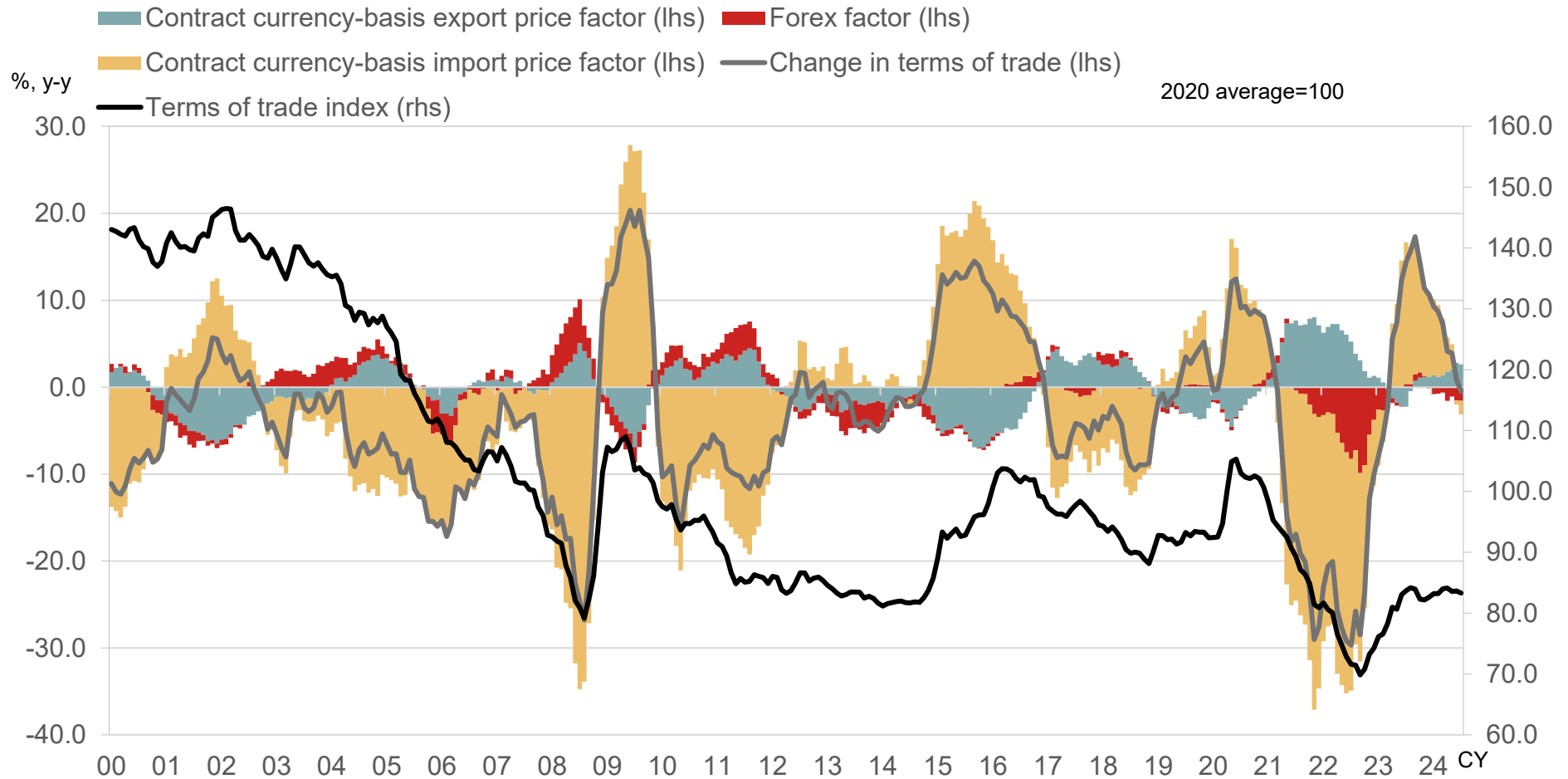
Goods exports are less elastic against export price as well as JPY exchange rate movement, reflecting outsourcing of Japanese enterprises' production capacity abroad

Factor decomposition of Japan's goods trade balance



A structural deterioration of goods trade balance (3)

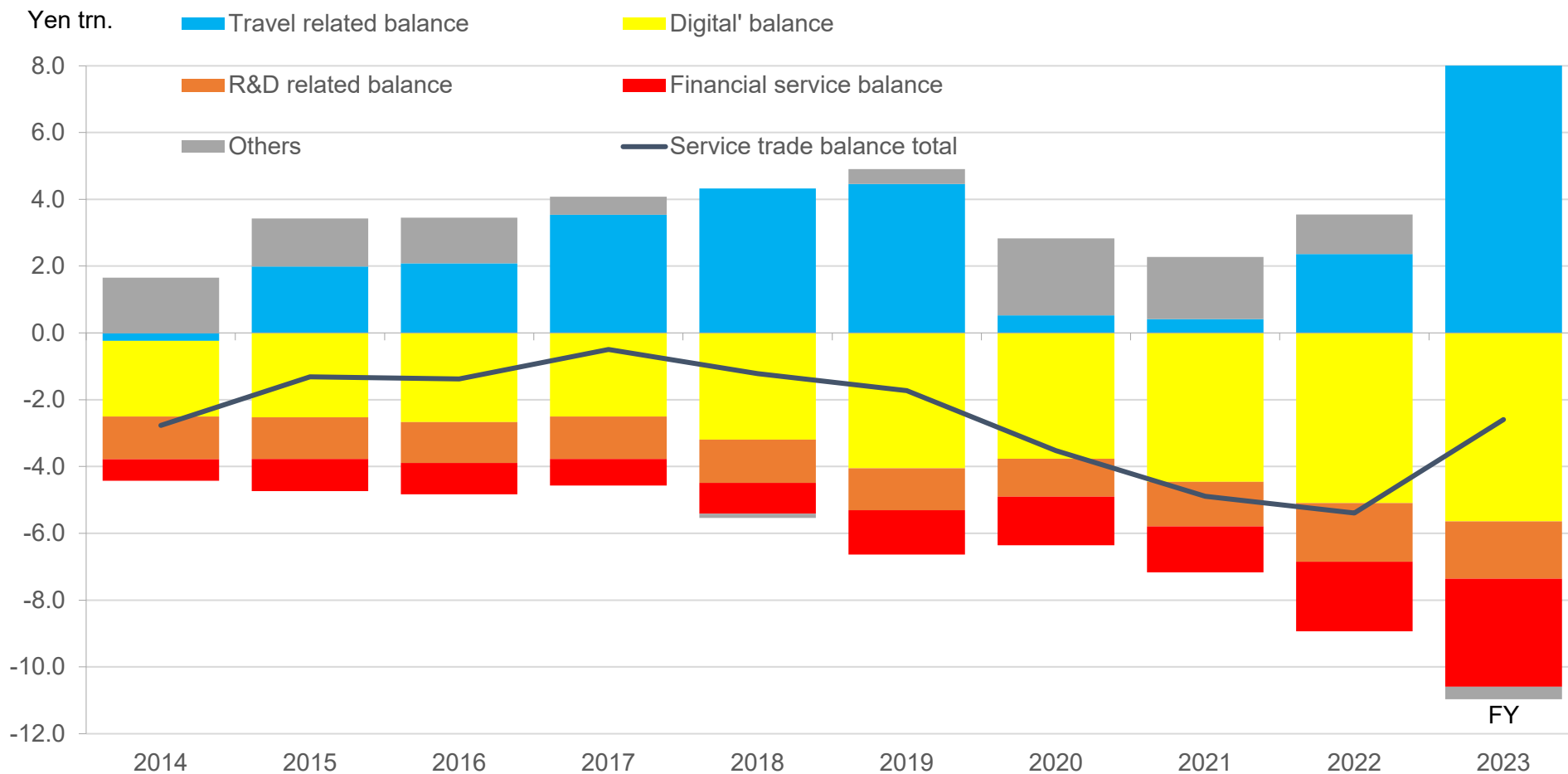
Changes in terms of trade and decomposition



A structural deterioration of service trade balance

Increasing 'digital' related service payments and financial service charges are to be blamed

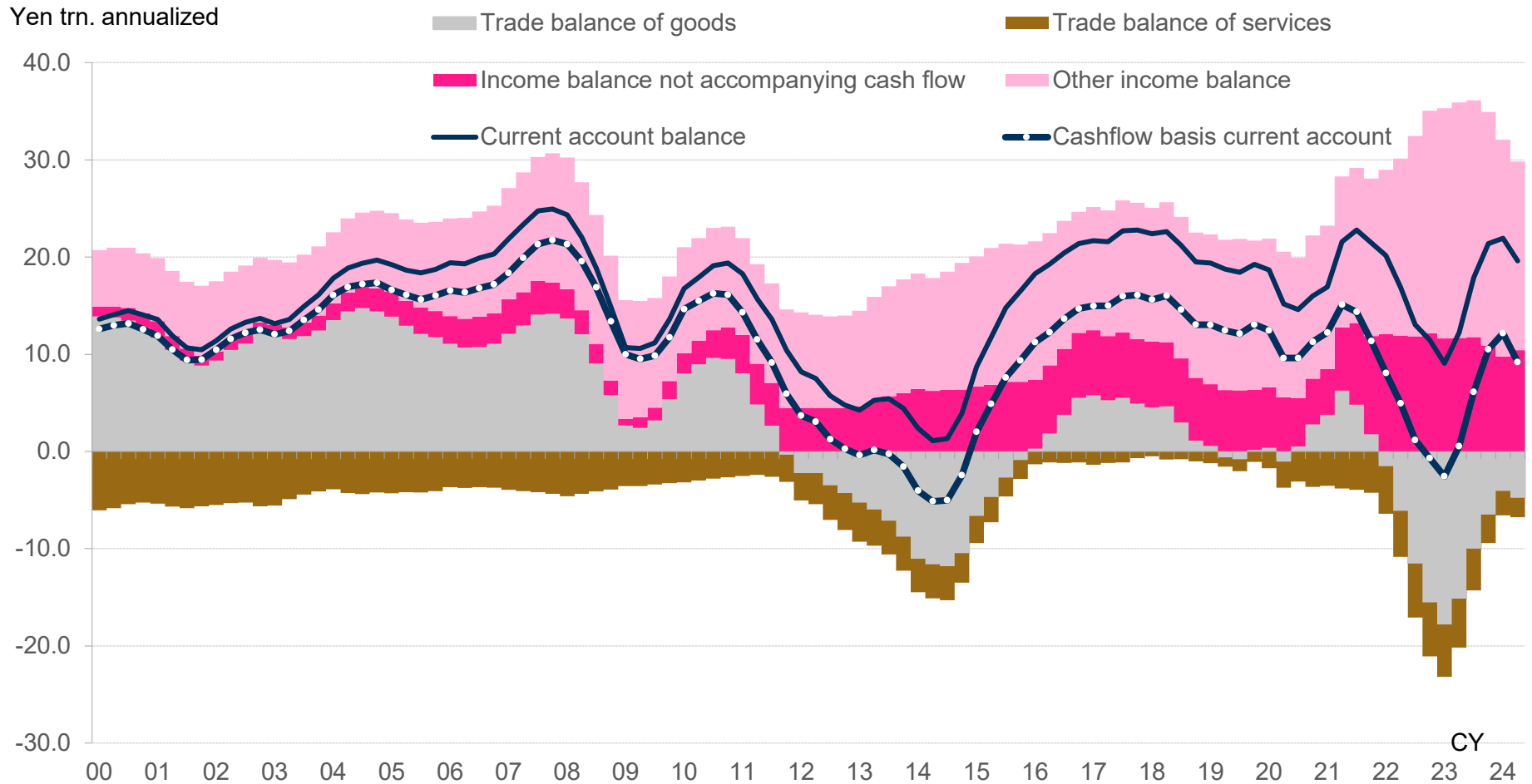
Factor decomposition of Japan's service trade balance



A majority of primary income surplus not repatriated...

Japan's current account surplus, if measured by actual cash inflow, is not that large

Cashflow basis primary income balance in Japan's current account



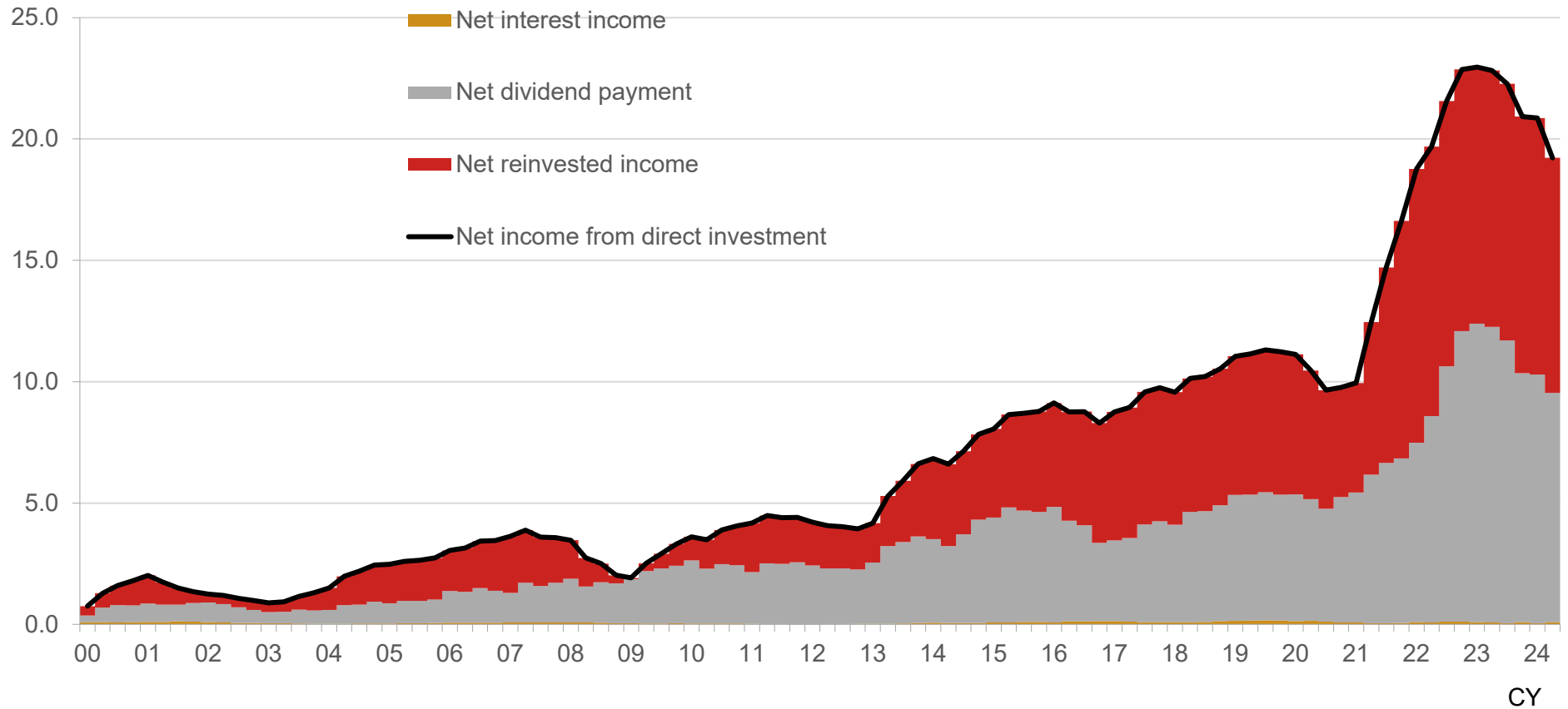
Source: Nomura based on Ministry of Finance data

... as overseas affiliates of Japanese enterprises retain earnings where earned

A significant portion of income from direct investment is reinvested overseas

Decomposition of Japan's net income from foreign direct investment

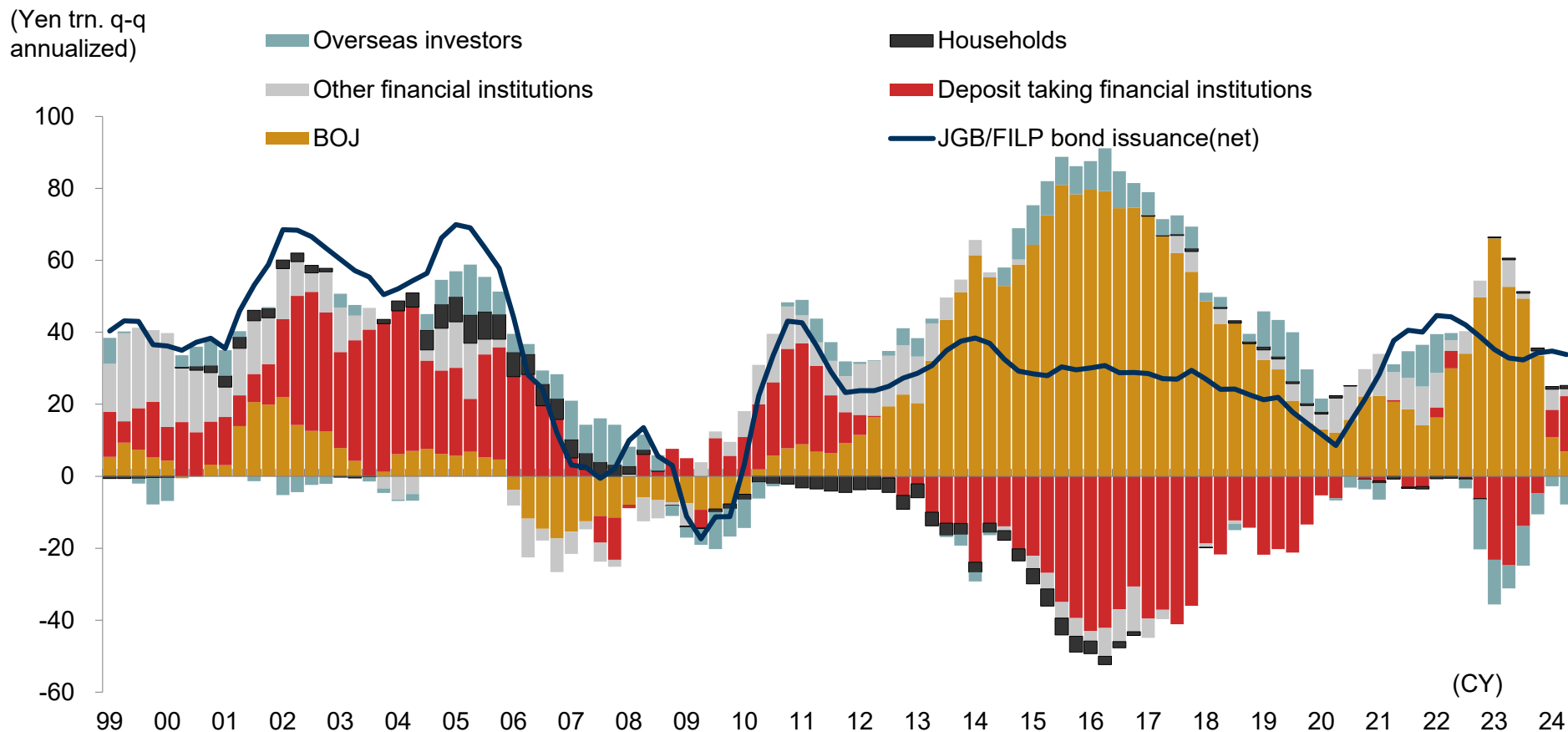
Yen trn. annualized



An increasing presence of foreign holders in JGB market...

...despite still large current account surplus that implies little need for inward foreign investment

Net changes in Japan's government debt securities and its decomposition by holder





Introducing the Report on Japan's
balance of payments by MOF

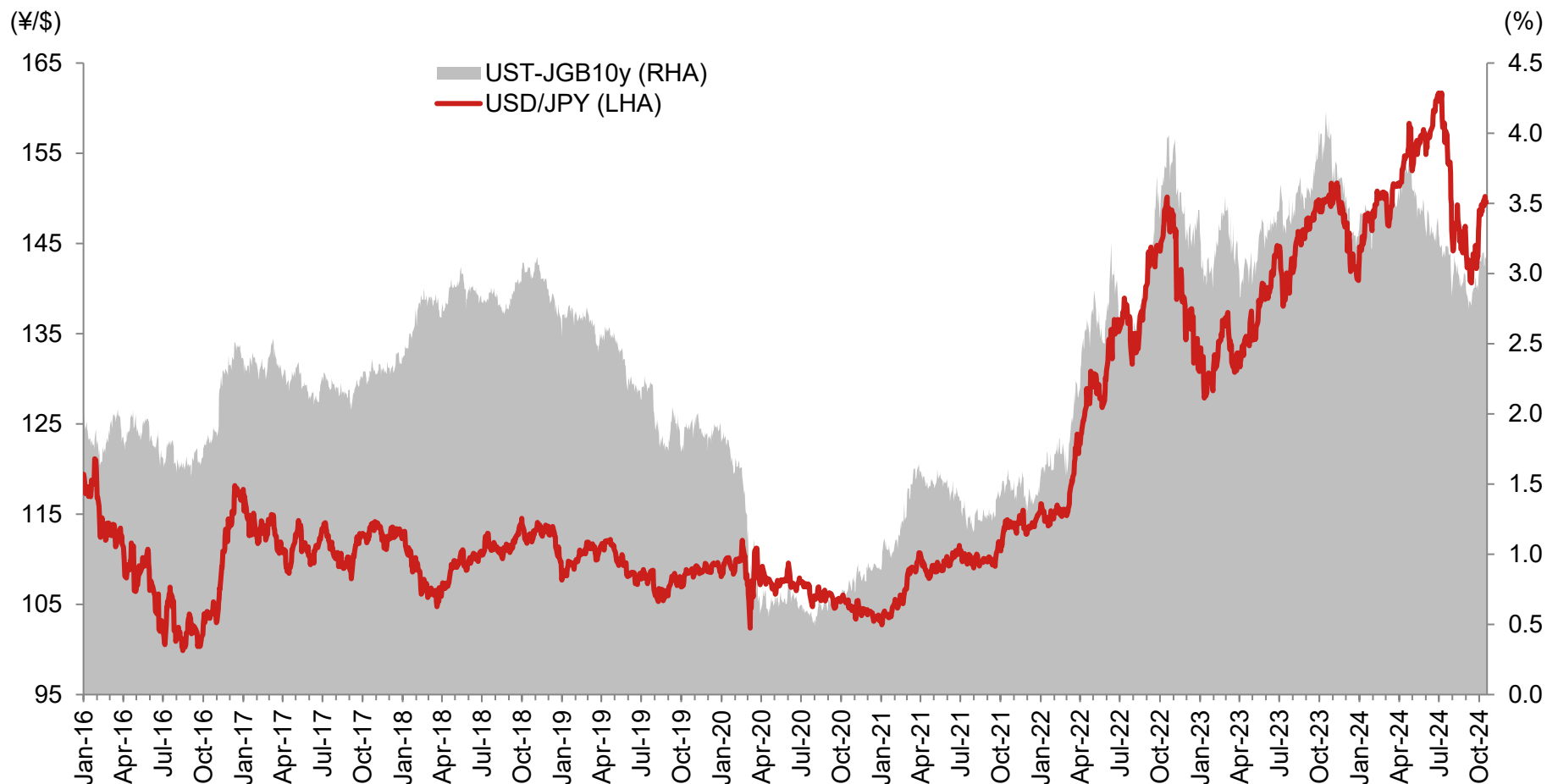
Clarifying the issues raised in the
Report and how they relate to the
changes in balance of payments
structure

**Checking whether those issues or those
changes in BoP caused the recent JPY
weakness**

Interest rate parity explains a major part of the recent JPY weakness

The reversal of USD/JPY since August implies the start of US rate cutting phases can lead to JPY appreciation ahead

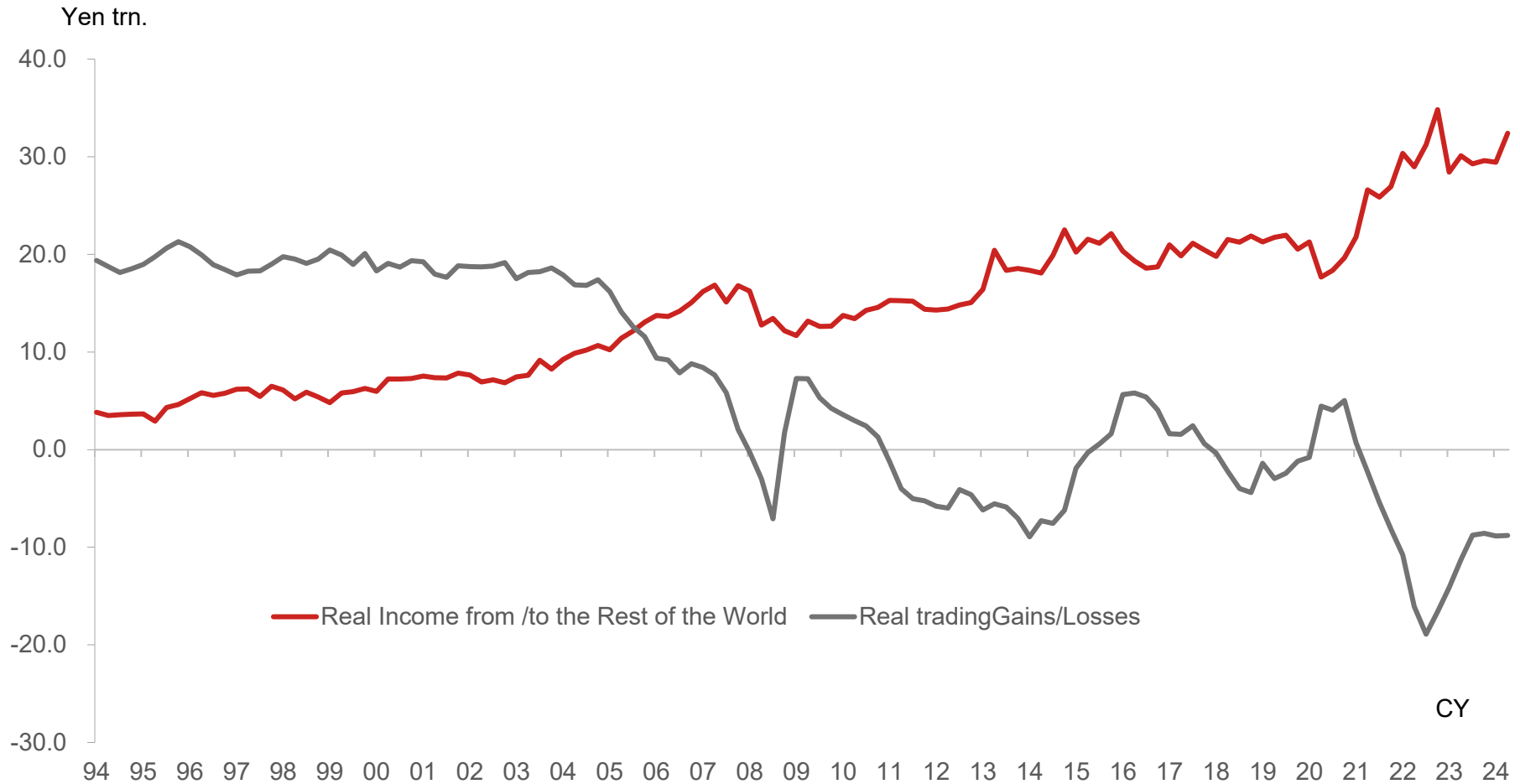
USD/JPY exchange rate and US-Japan rate differential



JPY exchange rate's autocorrective power for Japan's external balance still survives...

...despite smaller elasticity of Japan's export volume against JPY exchange rates

Net primary income receipts and net trading gains in Japan's national accounts



Conclusion

- ✓ **As the Report points out, the changes in Japan's international balance of payments partly reflect important challenges facing the Japanese economy in the medium to long term.**
- ✓ **It is not fair to link the recent weakness of JPY foreign exchange rate solely and directly to changes in the balance of payments. We can attribute the weakening JPY exchange rate more to widening interest rate differentials against JPY and to accumulation of JPY short positions by speculative investors.**
- ✓ **The fact that the structural changes in Japan's balance of payments reflect the effect of the demographic shift on Japan's economic competitiveness does not really mean that Japan must stick to the past level of current account surplus and efforts to maintain it. There should be multiple styles and models of balance of payments structure that Japan can live with while maintaining, or even enhancing, its growth potential under an aging demography.**

Thank you very much for your attention!